CHESTNUT ADVISORY GROUP
Grow Your Edge With Investors

Taking Investors' Temperature

Market Insights For Asset Managers

FEBRUARY 2016

Chestnut Advisory Group is a consulting firm working exclusively with asset managers to maximize the return on their sales and marketing efforts, enabling them to raise assets more quickly and retain them longer.

Upcoming Appearances

Alpha Hedge East Annual Conference
Feb 29-Mar 1, 2016
Palm Beach Gardens, FL

Chestnut CEO Amanda Tepper is moderating a panel titled "*Capital Raising in a Tough Environment*"

Pimco Strongly Outperforms Peers, Suffers Capital Outflows Anyway. Another Example of Why Your Performance Doesn't Really Matter.

Pimco's Total Return Fund has suffered continuous outflows since the sudden departure of Bill Gross in September 2014 despite strong performance. Previously, Pimco overall had strong net capital flows at the firm despite historically poor performance at its flagship fund (as we discussed in our January 2015 *Investors' Temperature*).

Pimco's experience during both these periods illustrates Chestnut's bedrock belief, backed by our market research: ***investor trust, not manager performance, is the primary driver of net asset flows.*** The good news is that asset managers have strong control over building and maintaining that trust. The bad news is that when that trust is lost, investors punish the now-distrusted asset manager severely. Article begins on page 2

Pimco Has Large Outflows Despite Outperformance. It Appears Investor Trust Has Been Lost

Pimco's Total Return Fund has suffered continuous outflows since the sudden departure of PM Bill Gross in September 2014 despite strong performance in 2015 and the beginning of 2016.

According to Todd Rosenbluth, head of exchange-traded fund and mutual fund research at S&P Capital IQ, the Pimco Total Return Fund was up 0.72% in 2015 versus a decline of 0.81% for the Lipper Core Plus Bond peers and the broader taxable bond universe that fell 1.87% in 2015. In January 2016, the Total Return fund gained 1.02% versus 0.40% for the peers and negative 0.03% for the broader bond universe.

Despite that strong investment performance, the fund suffered another $1.1B in outflows in January 2016. The Total Return fund hit a peak AUM of $293 billion in April 2013, and now sits below $90 billion at the end of January 2016.

The reasons for these outflows are likely wide and varied. Some are probably associated with a secular shift away from actively-managed bond funds to passive, as well as a general rotation out of fixed income in a rising rate environment. Nonetheless, we believe the loss of close to 70% of Total Return's assets in less than three years represents some loss of trust with investors. We will not speculate about the drivers of the loss of trust in this particular case; our primary goal is simply to use this example to illustrate how valuable investor trust is to any asset manager's success, and why asset managers should make every possible effort to grow and maintain this trust.

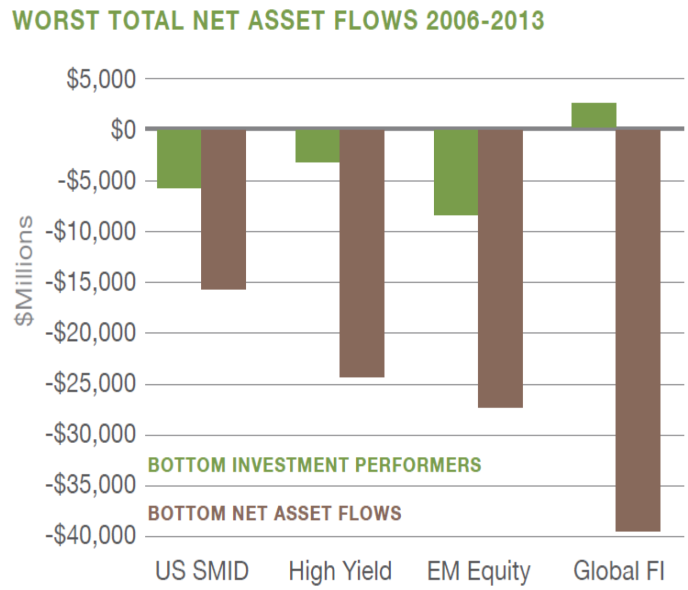
Pimco Was Ranked the #1 Most Trusted Asset Manager Just Two Years Ago

Chestnut conducted a investor survey in the Spring of 2014, after the resignation of PIMCO's co-CIO and CEO Mohamed El-Erian in January of that year but before Gross' exit. At that time, US institutional investors named Pimco as the #1 most-trusted asset manager. This was an unaided-recall question where respondents could name any firm they thought of, so this ranking is truly heartfelt.

We asked investors why they trusted Pimco so much. It was clear by their responses that these investors had ongoing conversations with PIMCO post-El-Erian's departure, and felt they truly understood what was happening at the firm. As one investor put it, "Despite their turnover at the top, I would choose PIMCO... because of the depth of their professional organization. It doesn't matter that Mohamed El-Erian left because they have a deep bench."

Loss of Trust Can Lead to Significant Outflows

Chestnut's proprietary research has quantified the low correlation between investment performance and asset flows. Our research has shown that **trust-losing asset managers lose seven times more capital than their worst-performing peers.** We also found that "trusted" asset managers raise 4 times more assets than the best performing asset managers.



Source: Chestnut Advisory Group. Average quarterly net asset flows of the bottom quintile investment performers and of the bottom quintile net asset gatherers, over the period 2006-2013.

The chart above illustrates our research findings that during the investment period of 2006-2013 the bottom quintile of funds ranked by net flows experienced over 7 times more net outflows than the bottom quintile of investment performers. This capital outflow occurred despite the fact that the firms with the worst outflows actually *outperformed* the worst performers by 81bps annually on average.

Pimco, as Most Trusted Manager, Had a Lot of Trust to Lose

Pimco built its strong brand and high investor trust over several decades of outstanding investor education efforts. We wrote about Pimco's industry-leading IR efforts in our January 2015 issue of this very newsletter. The only downsize of achieving such high levels of trust is the punishment investors will dole out if and when they start to lose that trust.

Our research demonstrates that performance alone does drive capital inflows or outflows, but a "loss of trust" is the biggest contributor of net capital outflows. We believe this may reflect what has happened at Pimco over the last 18 months.

(See our white paper, *Your Performance Doesn't Really Matter,* for details.)