

What Consultants Really Want:

Understanding and Trust

September 2017

IN THIS ARTICLE

Our research reveals that trust and understanding are the most important drivers of consultant decisions to recommend asset managers. Consultants remain major gatekeepers to institutional investors so meeting their needs is a must for the success of any asset manager.

Trust and understanding drive consultants' asset manager hiring decisions, as detailed in the chart below. **Strong investment performance is not a driving factor.**

Asset managers must invest in a world-class investor communications effort to gain consultants' understanding and trust. Asset allocations will follow. Our report details key elements of manager communications most highly valued by consultants.

For managers struggling to establish consultant relationships, we outline tactics consultants themselves recommend as detailed on page 4.

“Good communication and smart people. That’s all we need.”
- Investment Consultant

“Communication is always the most important variable”
- Investment Consultant

Top Five Factors Driving the Decision to Hire an Asset Manager

% of respondents rank as important

- | | | |
|----------|---|------------|
| 1 | Direct Meeting with Senior PMs | 87% |
| 2 | Clear Performance Discussion and Analysis | 83% |
| 3 | Strong Intellectual Capital | 78% |
| 4 | Regular Updates on Firm Developments | 65% |
| 5 | Clear, Understandable Marketing Materials | 43% |

Consultants Play a Critical Role in Large Investors' Allocation Decisions

We recently asked over 120 institutional investors and consultants for their insights on what consultants are looking for and how allocators are using them. What we learned is that trust and communication are the key factors in building long-term relationships with consultants - and by extension, their clients.

Still Major Gatekeepers for Largest Plans

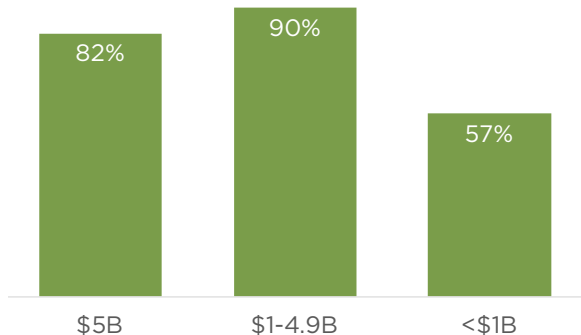
Use of consultants is skewed toward larger investors, as seen in the chart below. Among our respondents, 82% of allocators with over \$5 billion in assets use consultants, and 90% for those in the \$1-4.9 billion range. Corporate and government plans are by far the heaviest users of consultants. Corporate plan sponsors appear to lean more on the research capabilities of consultants.

before making any investment decisions. Thus, it is imperative that asset managers cultivate strong relationships with the consultant community.

“We are required by regulation to have the recommendation of an independent fiduciary. We have to get the rubber stamp of a consultant”

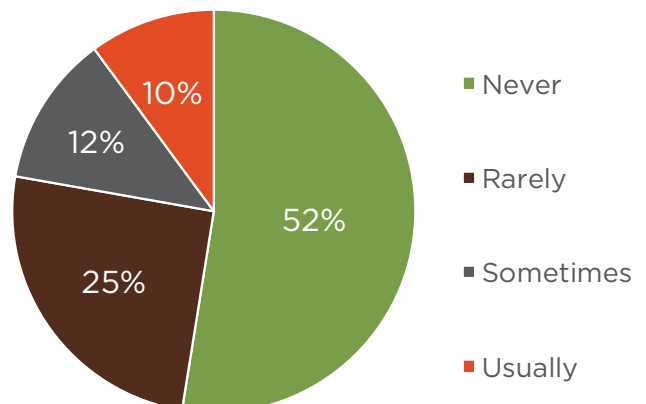
- Government Plan

Size of Institutional Investors Using Consultants



Many any of our asset manager clients tell us how difficult it can be to even get a meeting with a consultant, much less build a close relationship. Our research identifies effective tactics to overcome these hurdles (detailed on page 4).

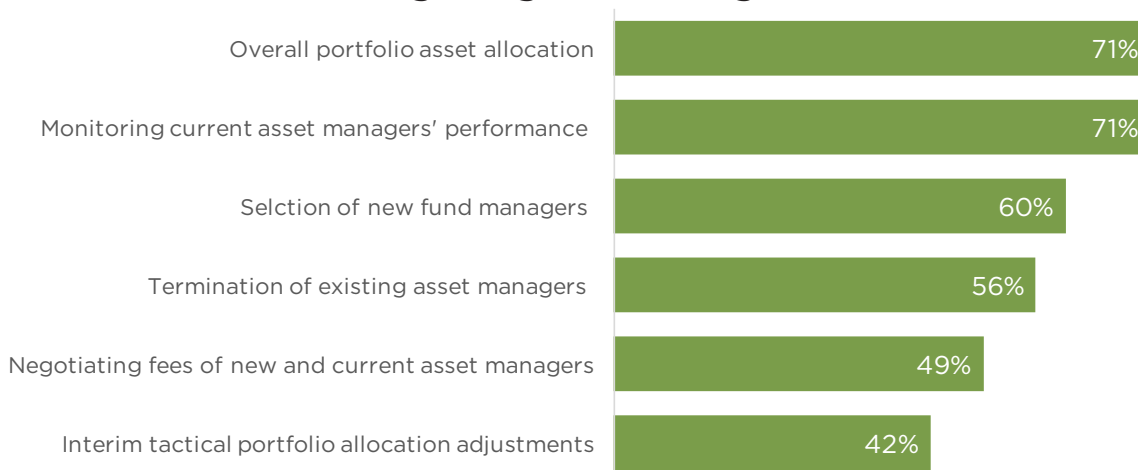
Sponsors Making Asset Manager Decisions Without Consulting Approval



As one corporate CIO noted, “We use consultants to get validation, verification and analysis. They have the tools to thoroughly vet [asset managers]. They have more resources than we do.” Foundations and endowments are far less likely to use consultants - use among our respondents was only 54%.

However, our research shows over 75% of allocators speak with their consultant

Consultants' Influence on Key Allocator Decisions Regarding Asset Managers



Consultants Most Involved in Monitoring Portfolio Performance

Consultants play a significant role in their clients' investment decision process. Over 70% of institutional investor respondents say consultants hold important sway in monitoring the current performance of asset managers and in recommending the overall capital allocation to individual managers.

Three in five investors with consultants say the consultants are influential in their selection of new managers, and 56% involve their consultants in the decision to terminate existing asset managers. The two areas where consultants are somewhat less influential are negotiating fees (49%) and interim tactical portfolio asset allocation adjustments (42%).

Consultants are Still Largely the "Gatekeepers" for Hiring New Asset Managers,

Significantly, 77% of investors report that they either never or rarely hire a new asset manager that has not met with their consultant. Most of the 22% of institutional investors surveyed who sometimes

or usually hire new managers without conferring with their consultant are in the smaller endowment/foundation sectors. The one exception is family offices, who don't tend to use consultants.

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Consultants Want Strong and Consistent Communication from Asset Managers

Our previous research has shown that investor trust is a key driver of any asset manager's success in retaining and attracting capital (see side box on page 5). In our latest survey, we asked investment consultants to rank the factors that help build their trust and understanding with asset managers (details on cover page). Their overwhelming response was that they want strong and consistent communication.

On the following page we provide recommended tactics on how to get a meeting with a consultant.

Recommended Tactics on How to Get a Meeting with a Consultant

Ask What They are Looking For, Be Persistent but Not Annoying, and Bring a PM for a Visit

We asked consultants to think of an asset manager they don't currently recommend or know very well, and then tell us what that manager could possibly do - aside from outstanding investment performance - to secure a meeting with them. Based on our findings we recommend the following tactics:

1. Do your research

It is critical to research the consultant before beginning your pitch. The feedback from consultants is consistent- reach out and ask what they are looking for. This will help you avoid wasting your and the consultants' time.

2. Educate them

Consultants are always looking to learn. Several consultants noted educational meetings as high value. As one consultant told us, "If someone called and said we've been investing in infrastructure for a really long time and we think it's a great place to be for the next 5-7 years, I might take a meeting to begin educating myself in a new asset class."

4. Provide access to key decision makers

This is very important to consultants and can be a good way to get a first meeting. One consultant said, "If a Portfolio Manager is in the area we want to be notified of that and given access to that individual. That is the most relevant reason to get together with a group."

5. Ask for a referral from the Plan Sponsor

The great majority (74%) of plan sponsors we surveyed will recommend new managers to their consultants after meeting them first. Consultants are obligated to respond to their clients' requests.

6. Bring a unique idea to the table

Articulating a compelling strategy or idea is the best way to get recommended to a consultant, according to 44% of our allocator respondents. One investor said they will refer a manager to a consultant "if the manager has something unique or a distinctive quality that makes me want to get them on my consultant's radar."

Consultants cited **direct meetings with senior portfolio managers** as a key factor driving their understanding and trust. As one noted, “Access to members of the portfolio team are key whether it be particular portfolio holdings or changes to the portfolio - but that level of conversation is very important to our process.”

Several consultants add that portfolio specialists provide a critical role in communication. As one respondent noted, “We know PMs go out on the road less and less so having very strong portfolio specialists who know the strategy inside out and can really communicate it clearly is key.” Another consultant put it this way: “We do not need direct exposure to PMs, but it’s very important to have good portfolio specialists.”

The second most important factor for consultants is **clear performance discussions and analysis.** As one consultant said, “it depends on the type of attribution they are providing. Just performance updates are not critical. If they are having difficulty and they can really describe what the basis of the underperformance is and attribute it to their process, that’s extremely helpful.”

Nearly as many consultants find **strong intellectual capital** very helpful in strengthening their understanding of an asset manager. One consultant told us: “It’s incredibly important for the investment thesis to be executed by bright people.” Most consultants say they also want **regular updates on firm developments**, as “this is the most important, making sure there is good communication.”

Interestingly, only 17% of the consultants

The ROI of Investor Education Is Substantial

Trusted Asset Managers:

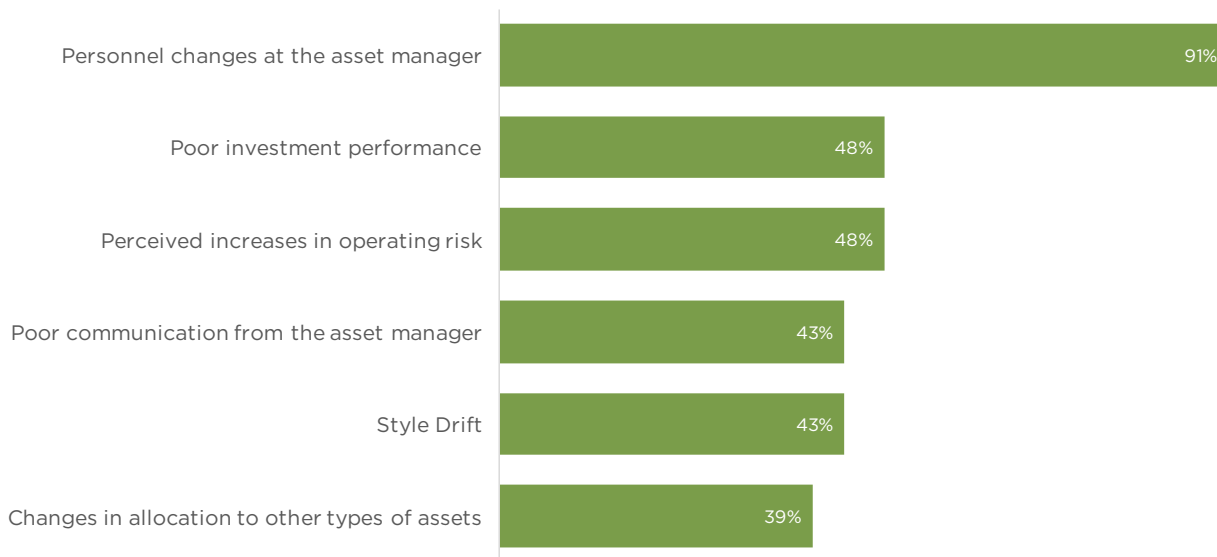
- *Raise over 4X more capital than top investment performers*
- *Are hired 3-12 months more quickly than the average asset manager*
- *Are retained 3-12 months longer*
- *Have clients that are easier to cross-sell new products*
- *Have clients that are more likely to reinvest additional capital in existing products*

Source: Chestnut Advisory Group’s proprietary survey of US institutional investors, *Your Performance Doesn’t Really Matter*

that we surveyed believe that **highly capable marketing representatives** are helpful in building trust in an asset manager. As one consultant explained, a strong marketer is “... very useful in the initial getting to know the firm. Its less important once the firm has been hired.”

Not surprisingly, none of the consultants in our survey say regular updates and insights on capital markets play a key role in building trust. Several consultants noted that they get regular capital markets updates from many firms and that while “... it’s interesting to know about capital markets, we really want to know what the impact is on their portfolio, so making that connection for us is critical.”

Key Factors Driving Consultants' Recommendations to Terminate Asset Manager Mandates



We recommend that any written updates focus on the asset manager’s particular strategy or investment universe.

Consultants Don't Want Surprises, Especially Negative Ones

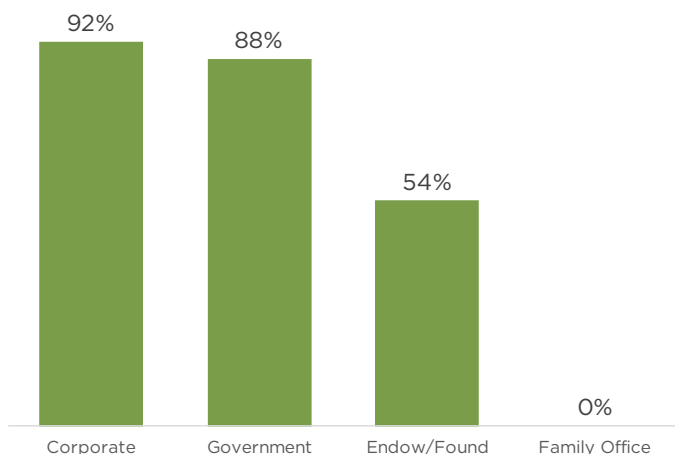
In order to help clarify what investment consultants DON'T want, we asked them to rank factors that have been important in their recommendation to terminate a manager. Overwhelmingly, 91% of

respondents say **personnel changes at the asset manager** are an extremely important factor in terminating a relationship, although there is a distinction made between communicating the departure of “material or senior personnel - we understand that lower level employees come and go.”

As our research has consistently shown (see Chestnut Advisory Group’s whitepaper, *Your Performance Doesn't Really Matter*), **poor investment performance is NOT the top reason for firing a manager**. In this survey poor performance ties with perceived increases in operating risk for a distant second place (48% of consultants each) as reason for a termination recommendation.

As several consultants noted, “Investment performance plays a part but that’s not going to necessarily drive my decision to get rid of a manager - other factors like change in investment philosophy, change in personnel and a lot of other things get me concerned. I don’t mind underperformance, its part of the game.” As another consultant

Types of Institutional Investors Using Consultants

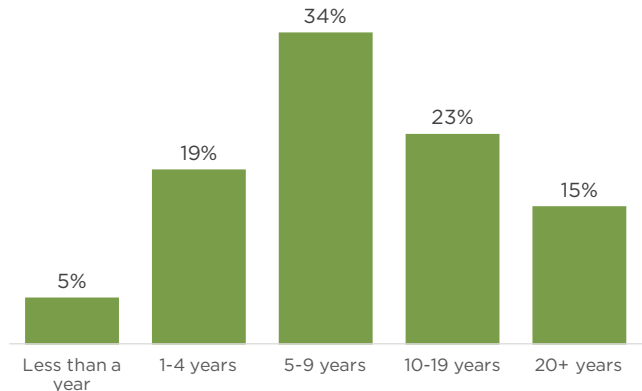


put it, “We expect everyone to have poor performance at some point in the cycle. We are aware of it but [performance] is not generally the prime criteria of retention.”

Consultants make clear that **strong asset manager communication is the key to successful retention** in a client’s portfolio. As one consultant put it, “Communication is always the most important variable.” Another consultant said, “If the performance is poor and we understand why in the context of the market environment, that’s fine with us, we will ride that out. If it’s poor and it doesn’t make sense or the manager is doing things differently, that’s where we have more concern.”

Style drift and **poor communication** are cited by 43% of consultants as factors to consider for termination. Some view style drift as “more critical than performance - if they’re doing stuff different than what we hired them for, that’s a problem.”

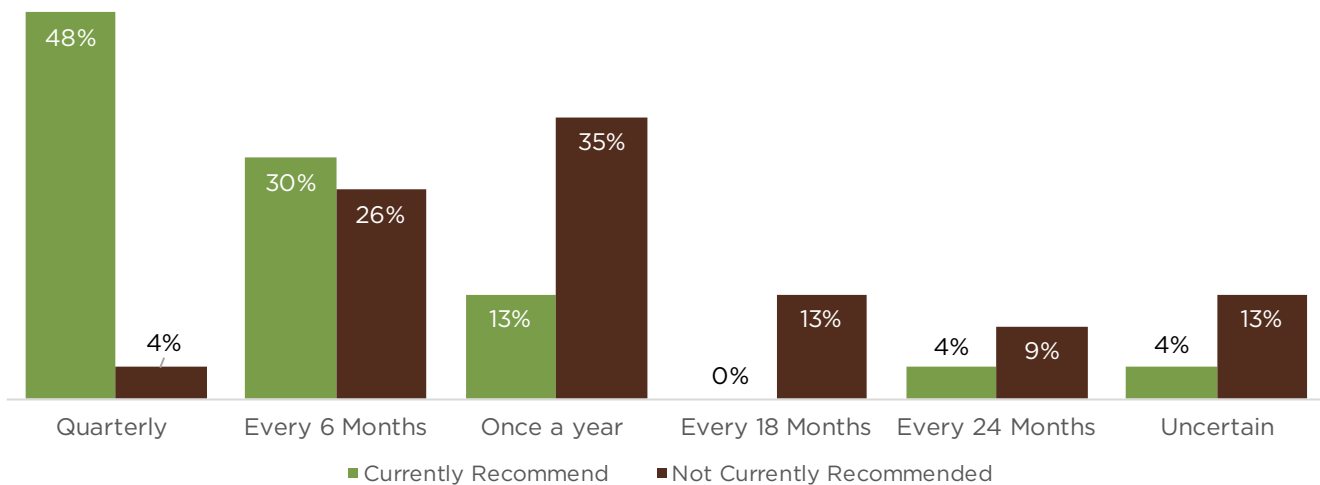
Length of Allocator / Consultant Relationship



Respect the Consultant/Allocator Relationship

It is important that asset managers understand the long-term relationship many investors and consultants have built. Plan sponsors we surveyed have worked with their consulting firms for 10.5 years on average. Fifteen percent of allocators’ consultant relationships go back 20 years or more. It’s a true partnership. As one consultant noted, “Understanding the relationship between the consultant and

How Often Consultants Want to Meet with Asset Managers that are Currently Recommended/Not Recommended in Their Clients Funds



the client is important and sometimes that is not understood. You can be the best performing manager but you can really hurt your relationship with our firm and also the client if you don't understand the nuances of that relationship.”

Consultants Want Open Lines of Communication

Since direct communication is a key factor for trust and understanding, we asked consultants how often they want to meet with asset managers that are widely held by their clients. Almost half (48%) of respondents would like quarterly meetings and another 30% would prefer meetings at least every six months. A common response was, “Quarterly update calls and an annual on-site visit.”

For asset managers that the consultants don't currently recommend, several consultants noted “It depends on our interest in the asset class and whether or not we want exposure.” Overall, 35% of consultants would like to either have a phone update or meeting once a year with new asset managers, and another 26% said every six months.

Conclusion: Action Steps For Building Strong Consultant Relationships

Successful manager/consultant relationships are built on trust and understanding. Communication is key in this endeavor. We recommend a dedicated, ongoing communications effort to cultivate consultant relationships for the long-term.

Build great intellectual capital and always share it with the consultant

Seventy eight percent of consultants cited strong intellectual capital as an important factor in strengthening their trust in an asset manager. A consultant put it this way: "It's incredibly important that we know that the investment thesis is being executed by bright people."

Invest in a detailed, thoughtful performance attribution discussion

Investors and consultants tell us that rote performance reports are not helpful. They want "Consistent and timely updates" on strategy and detailed, thoughtful attribution. As one consultant noted, "It's extremely helpful if a manager is having difficulty and can really describe the basis of the underperformance and attribute it to their process."

Manage expectations well - no surprises, especially negative ones

When a manager has bad news to deliver, the earlier the better to build trust. Poor communication and perceived style drift were each cited by 43% of respondents as factors for termination. When underperforming, over-communicate. As one consultant said, "If performance is poor and we understand why in the context of the market environment, that's fine with us."

Ask first what consultants are looking for

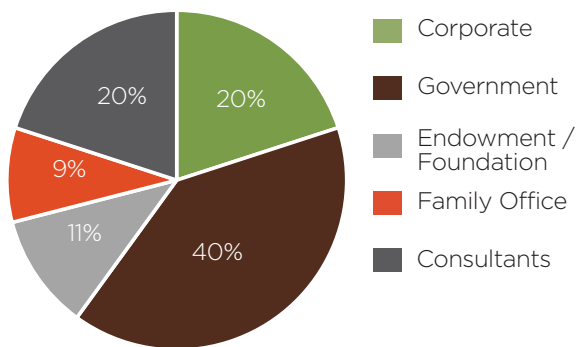
A good salesperson researches a prospective investor to ensure their interest before approaching them, and the same approach pays ample dividends with consultants. As one consultant said, "One of the things that money managers don't do is they don't ask a macro question - what kind of managers are you looking for? Because what they end up doing is telling us all about their great firm but we might not care."

Methodology

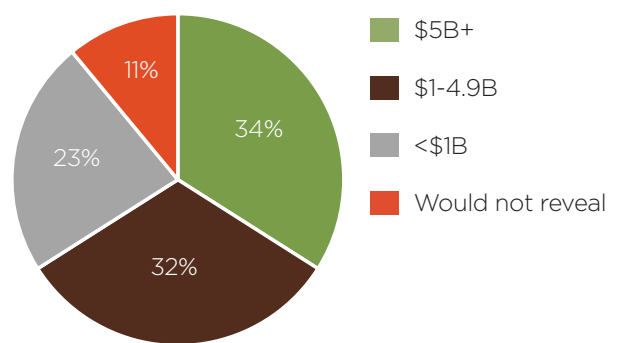
The data referenced in this article is based on a research study conducted by Chestnut Advisory Group. We conducted in-depth phone interviews among 98 institutional investors and 24 consultants.

Allocator Respondent Data

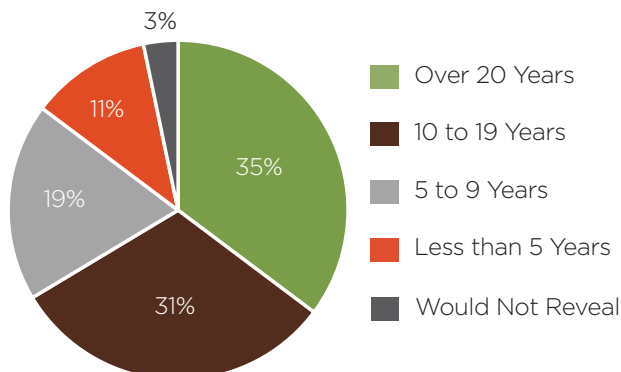
Respondent Type



Value of Funds Managed



Years Experience



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