



Institutional Market
Global Trends
2nd Quarter 2011

Stephen Tully
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Sources:

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- Pension & Investments Magazine
- InterSec Research
- Casey Quirk
- Standards & Poor
- NMS September 2010 Conference
- Institute of International Finance
- Empirical Partners
- Commonfund
- Pyramis Global Advisors, “Solutions for a New Decade”
- Greenwich Associates
- Eager, Davis and Holmes
- Russell Investments
- Wilshire Investments
- Mercer
- NEPC
- Towers Watson
- Callan
- Hymans Robertson
- AIMSE
- SEI Investments
- Barclays
- Money Management Letter
- Hedge Fund Research

Institutional Industry Trends

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- Globalization continues (particularly in Public Funds)
- Pockets of opportunities: EM stocks, bonds, commodities, currencies, “illiquids”
- Active strategies – more meaningful in lower return environment (93% of 232 equity hires in 2010)
- Risk management – continued focus
- Moderate search activity across all asset classes in Q1 with increase in allocation to Alternatives.
- Inflation protection strategies in high demand (TIPS, Commodities, Leveraged Loans) (in DC too)
- Small Cap Equity in demand
- Due diligence process is taking longer
- Ipads – increasingly being used in investor meetings
- Pension Investment Advisors face “lobbyist” label in CA and NYC
- Longest period of low-quality stock performance in a long-time; reversion to high quality stock outperformance in 2011?



Consultants

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Consultants: Trends

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- 2011 Consultant Benchmark Survey – MML
 - 91% of consultants say foundations and endowments is the sector in which their firm is pursuing business growth or plans to pursue growth.
 - 96% of consultants say the scope of services demanded by clients is widening.
 - Top (2) investment strategies firms say they expect to emphasize: Alternatives / Risk-centric
 - 88% expect to see more consolidation
- Moving their clients to less quarterly meetings
- Outsourced CIO model – continuing to grow / “Fiduciary Fatigue”
 - *Casey Quirk predicts that by 2012 this market will grow to \$510 billion, representing 13% of institutional assets and 25% of institutional investors.*
- Discussions on fiduciary responsibility continue
- Top 25 consultants placed 68% of institutional assets in 2010

Consultants: Firm Updates

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- NEPC:

- 2011 general actions for clients: maintain asset allocation discipline, examine portfolio structure, illiquidity premium remains attractive, hedge developed market currency to reduce uncompensated risk
- 1st quarter commentary:
 - Raised \$42.3B in 93 funds during 1st Quarter 2011
 - one source of risk jumps out: currency
 - Does not believe the USD will continue secular decline vs. major developed currencies
 - EM currencies, attractive opportunity relative to USD
 - Event-driven strategies success continued into 2011
 - Fundraising for private equity – remains challenging
 - Stability in commercial real estate
- 659 searches in 2010; \$23.7B (27% of searches were for non-traditional managers and strategies)
- Callan: 2010 search activity; 140 searches, 43 in domestic equities, 38 in non-US equities (2 global), 19 fixed income, 21 real estate.
- Cambridge: Recent research: “The Case for Diversified Emerging Markets Exposure”

Consultants: Firm Updates

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- Russell:

- “Square root sign recovery”; emerging markets, above average expectations with near-term risks

- Survey

- Less Bullish: emerging markets equities, 20% less than December 2010

- More Bullish: US Large Cap Growth; tech sector

- Bearish: US Treasuries, Cash, Corporate Bonds

- 72 managers (all-time high) believe market is fairly valued

- Investors are showing a preference for large-cap, high quality, globally focused companies

- REITs, attractive given lower inventories

- Towers Watson: equity mandates worldwide up over 30% from 2009; hedge fund mandates grew by 50% (direct 60% of hedge fund searches); bond mandates fell by 30%; private markets mandates grew 73%; passive mandates continue to grow.

- Rogerscasey

- “Three adjectives – cautious, selective and patient – capture the essence of our advice to our clients for 2011 and beyond.”

- Three new themes they are watching in 2011: Low interest rate environment, emerging markets, and municipal bonds

Consultants: Firm Updates

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- Hewitt EnnisKnupp

- Emerging markets weakness has further to run
- Believe clients should maintain exposure to emerging market equity equivalent to its size within universe, currently 15% of world market capitalization

- PCA:

- Expanding passive management while not giving up on active management. Near-term favors active.
- June 2011: New white paper, *"Hedge Funds in an Institutional Portfolio"*, John Linder, CFA, CPA; Neil Rue, CFA; Allan Emkin

Casey Quirk: “2011 Consultant Search Forecast”

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- **Consultants servicing North American institutional investors will continue to favor asset managers with the following 5 characteristics:**
 1. a focus on non-correlated investments that add excess return to portfolios
 2. the ability to offer both traditional and alternative investments
 3. innovative product development
 4. fully globalized portfolios
 5. competitive long-term incentive schemes
- **3 Core shifts in Institutional Portfolio Construction:**
 1. Greater emphasis on Outcomes
 2. Increasingly central role for alternative investments
 3. Wider use of global benchmarks
- **Managing inflation and longevity risk have become critical policy concerns, especially among corporate defined benefit plans**
 - Inflation fears driving demand for illiquid investments
- **Hedge Funds – appetite continue to rise**
 - Consultants expect most search activity to center on hedge funds in 2011
 - Growing number of large investors will turn to more direct mandates, using fund of funds for specialist portfolios

Source: “Old Wind in New Bottles: 2011 Consultant Search Forecast – April 2011”, Casey Quirk

Casey Quirk: “2011 Consultant Search Forecast”

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- Institutional Investors will continue to look outside the US, with more than 80% of consultants expecting their clients to increase their non-US equity exposures in 2011.
- Traditional asset classes – expected to experience material manager replacement
 - More than 50% of consultants expect more than half of US equity, US fixed income and EAFE equity search activity to involve manager replacements.
- 3 Noticeable Shifts in Search Activity During 2011:
 1. More demand for unlisted investments, driven by rising inflation and longevity fears among North American institutional investors.
 2. Increasing specialist demand for emerging markets equity and debt; more than 1/3 of consultants expecting EME to see most search activity in 2011. Less interest in EAFE mandates
 3. Reduced interest in core and core-plus fixed income
- Inflation is most influential factor driving institutional investors to separate portfolios into return-seeking and risk-mitigation allocations, rather than simple splits between stocks and bonds.
 - Inflation risk drove increased search activity for commodities managers in 2010, as investors sought real assets.
 - Expected to broaden in 2011, embrace a wider array of illiquid, longer-dated asset classes, such as private equity, which are more immune to inflating currencies.
- Pension consultants – over 80% prefer absolute returns vs. benchmark returns
- Endowment/Foundation consultants – 100% prefer absolute returns vs. benchmark returns

Source: “Old Wind in New Bottles: 2011 Consultant Search Forecast – April 2011”, Casey Quirk

Casey Quirk: “2011 Consultant Search Forecast”

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- **Defined Contribution**
 - Continued focus on target-date solutions
 - TD funds will attract more than 80% of the new inflows into DC plans between now and 2020
 - Consultants expect further search activity regarding customized target-date vehicles
 - “lifetime income options” – very popular
- **“Investment Solutions Spectrum”:**
 1. Investment product
 2. Investment solutions
 3. Customized investment solutions and strategic partnerships
 4. Portfolio outsourcing

Source: “Old Wind in New Bottles: 2011 Consultant Search Forecast – April 2011”, Casey Quirk



Investor Updates

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Institutional Industry Trends: Endowments

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- Risk has changed significantly ; focus on risk of permanent loss of capital (Case Western case study – Institutional Investor Magazine, April 2011)
- Many hiring Chief Risk Officers
- Option-based strategies – “controlling investment outcomes”
- More like a pension fund, managing assets and liabilities (operating budget)
- Average cash holdings up significantly (5 years ago 1-2%; now as high as 7-9%)
- Less interest in peer rankings, more focus on liquidity
- Commonfund: Foundations held 36%, 35%, and 38% of assets in alternatives during and after the crisis in 2008, 2009, and 2010 respectively. >\$1B, allocated 6% more in each of these years.
- 15 prominent US universities chose to raise \$7.25B via the bond market in 2009 to supplement their endowments’ uncertain future distributions.

Institutional Industry Trends: Endowments

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- Liquidated \$285bn in hedge fund holdings during 2008-2009, investors added just \$55bn in new capital in 2010. First quarter of 2011 brought in fresh capital of \$32bn, at an annualized rate second only to 2007.
- Private equity investment has been weak.
- E&F board committees focused more on refining investment process and less on adjusting their portfolio. Not looking for a “new new thing”.
- Many E&F’s not as different from Pension funds given commitments to support programs annually.
- Like pension funds, splitting portfolios into protection and return-seeking components. Rather than investing the entire portfolio for maximum risk-adjusted return.
- Cambridge, David Shukis - endowments recognize the threat of inflation, and have been building up their real asset investments.
- Albourne, Richard Quigley, “the next chapter seems to be a move to smaller managers, or managers with a higher volatility profile, and the role that alternatives might have in inflation hedging, whether that’s infrastructure through private equity or commodity-based hedge funds.”

Institutional Industry Trends: Pensions

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Corporate Plans:

- Top 3 concerns over next 5 years: Cash flow, Income Statement, and Balance Sheet
- Most “reducing risk” more than “seeking higher returns”
- Funded Ratios increased in 1st Quarter 2011

Public Plans:

- Pew Study (2011):
 - On average state pension plans had 75% of the assets needed to cover the long-term benefits owed to government workers
 - NY was 101% funded, the only state with a pension surplus in fiscal 2009
 - Illinois was 51% funded, the least funded
 - In 2010, at least 19 states passed legislation to reduce pension benefits
 - Asset values at state and local pension funds increased 35% from March 31, 2009
 - States made 36% of the \$47 B of recommended contributions suggested by their actuaries



Investments

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Global Equity Investing

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- Global fundings on the rise
- Most of the leaders are fundamental, bottom-up managers
- Increase in fundings to products that do not have a global analyst pool
- Consultants have placed greater emphasis upon independent firms
- “Small teams” (less than 10 members) accounted for nearly a quarter of global products invested with US tax-exempt clients
- “Small teams” have provided more favorable results in 3-year period ending September 30, 2010.
- Global benchmark-agnostic products have grown in AUM over last 3-years, also have better performance. Some are diversifying investments in global by “benchmark sensitivity”

Emerging Markets Investing

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- Contributing 40% of Global GDP
- Not just equities (Equity, Debt, and Currency)
- Not used just for returns, being used for diversification
- On the rise:
 - “Multi-Asset” Emerging Markets portfolios
 - Russia (but risks)
 - Africa
- Risk: management of inflation; dependent on individual countries
- Implementation strategies: specialist vs. broad portfolios

Alternatives

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- Hedge Funds

- +\$18B in activity in 1st Quarter 2011. Up 38% from same quarter in 2010; back to pre-2008 levels
- Fund-of-funds have matched corporate bond returns since 2010 with lesser volatility
- Macro funds – net inflows of \$6.5B in 4th Quarter 2010, most popular standard hedge fund strategy (according to Hedge Fund Research) Performance has lagged demand thus far.
- 54% of US institutional investors said they plan to increase allocation to hedge funds in next 12 months.
- Performance potential of emerging hedge fund managers is getting attention
- Hedge funds returns have become more correlated with those of pension funds (their assets outgrew that of their customers)
- Institutional investors accounted for an average of 61% of hedge fund managers' assets under management

- Commodities

- Increasingly more active investments; 2005 – mostly all investment were passive; 2010 – enhanced index and long-short vehicles claimed \$55B of \$376B
- Consultants generally believe active commodities strategies will become even more popular

- Bank Loans – increasing interest

- Could grow if interest rates rise
- Attractive to tax-exempt investors
- Yields on the loans held reset every quarter
- Flows up 50% in 1st quarter relative to 2010



Managers

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Managers: Trends

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- Continued convergence of traditional and alternatives managers is growing
- International equities – concentrated market, 10 largest managers controlling between 35% and 50% of the assets.
- Hedge funds survived, US institutions planning to increase exposures.
- Unique business models developing, i.e., “boutiques” developed by large asset managers
- Joint ventures with sovereign wealth funds
- Most of the leaders are fundamental, bottom-up managers
- Multi-boutique Asset Management firms



Reading

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Book List (2011)

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Investing /Finance:

- *"What Works on Wall Street: A Guide to the Best-Performing Investment Strategies of All Time"*, James P. O'Shaughnessy
- *"The Intelligent Investor"*, Benjamin Graham
- *"The Little Book That Beats the Market"*, Joel Greenblatt
- *"Pioneering Portfolio Management"*, David Swensen

Management:

- *"The Halo Effect...and the Eight Other Business Delusions That Deceive Managers"*, Phil Rosenzweig
- *"Built to Last / Good to Great"*, Jim Collins

Marketing:

- *"Differentiate or Die: Survival in our Era of Killer Competition"*, Jack Trout

Development:

- *Dale Carnegie books*
- *"Wins, Losses, and Lessons"*, Lou Holtz
- *"How to Make People Like You in 90 Seconds"*, Nicholas Boothman
- *"The Magic of Thinking Big"*, Dr. David Schwartz
- *"Never Eat Alone"*, Keith Ferrazzi
- *"Who's Got Your Back: The Breakthrough Program to Build Deep, Trusting Relationships That Create Success--and Won't Let You Fail"*, Keith Ferrazzi
- *"The Trusted Advisor"*, David Maister
- *"The Seven Habits of Highly Effective People"*, Stephen Covey
- *"7 Powers of Questions"*, Dorothy Leeds

Book List (2011)

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Sales/Networking:

- *"The Little Black Book of Connections: 6.5 Assets for Networking Your Way to Rich Relationships", Jeffrey Gitomer*
- *"The Little Red Book of Selling", Jeffrey Gitomer*

White Papers of Interest (2010-2011)

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- *“How Active is Your Fund Manager? A New Measure That Predicts Performance”*, Yale
- *“Side-by-Side Management of Hedge Funds and Mutual Funds”* – Tom Nohel, Z. Jay Wang, Lu Zheng
- *“Growth Opportunities in Global Markets”* – Rodger Smith, October 2009 – Greenwich Associates
- *“Implementing Global Equity”* – InterSec Research, December 15, 2010
- *“The Elephant in the Room: Accounting and Sponsor Risks in Corporate Pensions Plans”*



Client Service

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Client Service: New Things I'm Doing

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- *Ask clients, “How do we fit in your overall portfolio?”*
- *Always seek feedback, when you win and when you lose and keep track*
- *Be proactive, pick up the phone, the “3 point meeting”: 1) Collect Information, 2) Deliver Information, 3) Reason for next meeting/call*
- *Best advice I received in last few months: “Talk to as many smart people as you can and figure out 5 ‘next trends’. Then try to find a way to be a part of it. It’s about the question.”*



Sales / Networking

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Sales / Network Ideas

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- *Always seek feedback, when you win and when you lose and keep track*
- *New voicemail tips I received:*
 - *Be somewhat cryptic: Name, Co. Name, phone # slowly and 3rd party reference, i.e. , calling in reference to “Coke” when calling Pepsi.*
 - *10 seconds long*
 - *Not concise*
 - *Leave them at 7pm so they get next morning*
 - *Be patient, more than 6-7 touch points, get a methodology*
 - *Call Monday/Call Wednesday/Email Friday*
 - *Climb their “to do” list*



Misc. Stuff

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Trends I See...And Want to Know More About

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- *Insurance dedicated vehicles*
- *More discussion on currency management strategies*
- *Almost nobody investing today has lived through a secular rise in interest rates. (What are the implications for the next 10 -20 years?)*
- *Shifting demographics, where are the young populations, are they the most innovative? Do they experience the best forward looking growth?*
- *Resources running out?*
- *Declining American educational standards relative to the rest of the World*
- *The only thing that matters in investing, the bubbles and the busts?*
- *Social media's role in investment communication going forward?*

Useful Websites

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- www.abnormalreturns.com
- www.dawaldschmidt.com
- www.sethgodin.com
- [The Billion Prices Project @ MIT:](#)
 - <http://bpp.mit.edu/>
- www.pionline.com
- www.fearless-selling.com

Quotes of the Quarter

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“Never tell anyone your problems, 20% don’t care, the other 80% are glad you have them.” Lou Holtz

“Remember, when there is no wind, start rowing the boat.” Lou Holtz

“Is this a private fight, or can anyone get in?” (Unknown, Irish origins)



My White Paper Notes

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White Paper Notes: *"Identifying Predictive Factors in Manager Selection"*

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- Key Findings:
 - "Small is beautiful" - larger managers underperformed their smaller counterparts
 - Compact teams make better decisions
 - Owner occupier is best
 - Personnel turnover = poor performance
 - Experience counts for nothing

Source: "Identifying Predictive Factors in Manager Selection?", by Steve Birch, Partner, Hymans Robertson

White Paper Notes: *Pension Plans – Managing Liabilities*

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- **Funding Volatility – 2 components**
 1. **Equity Risk**
 2. **Interest-Rate Risk**
 - Stems from duration mismatch between assets and liabilities
 - Present value of liabilities calculated using yield on long dated bonds
 - Duration extension strategies – aim to reduce/eliminate mismatch
- **Competing objectives of pension investment strategies**
 - **Objective:**
 - Long-term: cover pension liability
 - Short-term: minimize swings in funded status
 - **Risks:**
 - Long-term: running out of assets/actuarial risks
 - Short-term: Financial statement volatility/contributions
 - **Strategy:**
 - Long-term: increase total return
 - Short-term: reduce equity beta exposure/match liabilities

Source: "Pension Plan Duration Strategy, Which Solution Makes Sense?", by Gabriella Barschdorff

White Paper Notes: *Pension Plans – Managing Liabilities*

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- Target Hedge Ratio
 - \$ duration of assets / \$ duration of liabilities
 - What is the maximum amount of additional contributions we could afford to make under adverse market conditions.
- 3 Options:
 1. Increase Fixed Income Allocation
 - Increase must be substantial to reduce funding volatility materially
 2. Increase Duration of Fixed Income Assets
 - Easy to implement
 - Shifting from intermediate to long bonds likely to only reduce funding volatility by 2-3% for plan with 40% fixed income allocation
 - Investment universe for long-term fixed income is quite narrow and concentrated
 3. Duration Overlay
 - Valuable for plans that don't want to increase fixed income
 - Possible to eliminate almost all interest-rate risk, but likely no necessary
 - Will control interest-rate risk, doesn't necessarily lower overall funding volatility, the risk that really matters.
 - Doesn't work when long bonds and equities are highly correlated, i.e., 1970's, overlay increased funding volatility

Source: "Pension Plan Duration Strategy, Which Solution Makes Sense?", by Gabriella Barschdorff

White Paper Notes: Pension Plans – Managing Liabilities

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- **Risks / Considerations**
 - **Measuring the right risk – reducing funding volatility**
 - **Consider gains/losses holistically**
 - **Timing of losses and cash flows**
 - **Basis risk**
 - **Flexibility in execution**
 - **Yield curve risk**
 - **Actuarial risk**
 - **Inflation risk**

Source: "Pension Plan Duration Strategy, Which Solution Makes Sense?", by Gabriella Barschdorff

White Paper Notes: *“Managing Developed Country Currency Risk – A Proactive Approach” (NEPC)*

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- US institutional investors traditionally ignored currency volatility
- Volatile exposure, adding risk without any increase in return expectations
- Investors should understand how much explicit non-dollar exposure exists in their portfolios and the risk impact of maintaining long exposure to foreign currency by leaving positions unhedged.
- Emerging currencies - desirable risk premia
- Feel that investors should maintain unhedged exposure to emerging markets currencies because of the positive expected return over long-term
- Transactions costs have improved in emerging markets, but still meaningful higher
- Believe that the expected return for bearing currency risk is zero
- Currency exposure is additive to risk, and not diversifying; over and above 100% of invested capital
- Hedging a portion of the foreign-currency exposure can reduce the total volatility of foreign asset classes.
- Longer term - existing US dollar based system is unlikely to stay in place forever

Source: "Managing Developed Country Risk – A Proactive Approach", NEPC 2011

Biography

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· **Stephen L. Tully, Jr.**

Director, Client Services

Cantillon Capital Management LLC

· **At Cantillon Capital Management**

Mr. Tully is Director, Client Services and lead's the firm's Institutional Business in North America. He is responsible for client service, business development, and consultant relations focused on corporate and public pension plans, endowments and foundations, and other institutional clients. Mr. Tully joined Cantillon in 2009.

· **Before joining Cantillon Capital Management**

Mr. Tully was a Vice President and Director, Client Services at AllianceBernstein, responsible for institutional client servicing and business development in the Northeast, US. Mr. Tully joined the firm in 1999, as an associate for Sanford C. Bernstein's institutional business, working with a Senior Advisor in servicing and building institutional business with over \$25B in assets.

· **Before joining AllianceBernstein**

Mr. Tully was a graduate assistant coach for the Bryant College Football team in 1998-1999, during their inaugural year. He was responsible for coaching the quarterbacks. Mr. Tully was also Head Women's Lacrosse Coach in 1999 and oversaw their first victory in school history. He interned at Dean Witter Morgan Stanley working with the top sales team in Providence, RI.

· **Education**

Mr. Tully graduated with an MBA in Finance from the Fordham Graduate School of Business in 2006.

He graduated with a B.S. in Business Administration, Concentration Finance from Bryant College in Smithfield, RI in 1998. During his time at Bryant he was a three-year captain of the lacrosse team, two year term as Student Senator, and Director of the 1998 Rhode Island Special Olympics.

· **Other Interests**

Steve lives in Chatham, NJ with his wife and four children. In his free time, he enjoys running, golfing, surfing, coaching his children's sports teams, and spending time with his family.

Disclosure

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- *Everything in this presentation is a collection of ideas from various sources and people.*
- *Very little of the information is unique or original.*
- *The objective of the presentation is to share valuable ideas and trends that have been shared with me.*

Source or subsource or variation, may refer to: Historical document. Historical source. Source (intelligence) or subsource, typically a confidential provider of non open-source intelligence. Source (journalism), a person, publication, publishing institute or other record or document that gives information. Source document, a document in which data collected for a clinical trial is first recorded. Source text, in research (especially in the humanities), a source of information referred to by citation. Define sources. sources synonyms, sources pronunciation, sources translation, English dictionary definition of sources. n. 1. A person or thing from which something comes into being or is derived or obtained: alternative sources of energy; the source of funding for the... Sources - definition of sources by The Free Dictionary. <https://www.thefreedictionary.com/sources>. Printer Friendly. Dictionary, Encyclopedia and Thesaurus - The Free Dictionary 12,477,579,770 visitors served. source - WordReference English dictionary, questions, discussion and forums. All Free. Online Language Dictionaries. English Dictionary | source. English definition English synonyms English-Spanish English-French English-Italian Spanish-English French-English Italian-English Espa±ol-Franais Franais-Espa±ol Espa±ol-Portuguas Portuguas-Espa±ol Espa±ol: definicin Espa±ol: sinimos Espa±ol: gramtica Catal : definic3 more Source definition, any thing or place from which something comes, arises, or is obtained; origin: Which foods are sources of calcium? See more. any thing or place from which something comes, arises, or is obtained; origin: Which foods are sources of calcium? the beginning or place of origin of a stream or river. a book, statement, person, etc., supplying information. From Middle English sours, from Old French sorse (œrise, beginning, spring, source), from sors, past participle of sordre, sourdre, from Latin surg (œto rise). See surge. (General American) IPA(key): /sÉs/. (Received Pronunciation) IPA(key): /sÉs/. (rhotic, without the horseœhoarse merger) IPA(key): /so(É)s/. (non-rhotic, without the horseœhoarse merger) IPA(key): /soÉ™s/. Rhymes: -É(É)s. Homophone: sauce (non-rhotic accents with the horseœhoarse merger). source (plural sources).