

Distribution Dynamics: *INVESTMENT SELECTION*

Distribution Dynamics is a periodic report series offered by Rep. Think Tank, a consulting alliance for the financial services industry. Recognizing that the financial services industry continues to evolve at a rapid pace, the members of Rep. Think Tank developed this report series to identify and dissect trends in the distribution of financial products and services, and translate them into useful guidance for asset managers.

The *Distribution Dynamics* series goes right to the source—financial advisors in each of the primary distribution channels—to ask timely questions about their business models. Their responses are then analyzed to identify current and future trends that impact how asset managers distribute their products and services through each channel. Finally, the reports offer action-oriented guidance on how asset managers can customize their approaches to each channel.

Each report addresses a unique topic and is designed so that readers can easily access information by distribution channel and quickly compare and contrast findings across channels. Understanding that consolidation within the industry has begun to blur channel distinctions, *Distribution Dynamics* also looks at trends that transcend channel lines to influence distribution strategies across the industry.

The inaugural issue of *Distribution Dynamics* addresses Investment Selection, and explores the following topics:

- What products financial advisors currently utilize, and how they expect to change their product usage in the short term
- How financial advisors allocate assets across broad objectives and specific asset classes, how and why they adjusted their asset allocations since the start of the financial crisis, and which asset classes they expect to make changes to in the months to come
- Which tools financial advisors utilize to construct client portfolios, such as home-office models or third-party resources, and which selection criteria they screen against to select investments and asset managers, including fees and expenses, relative and absolute performance, and asset manager reputation

KEY DATA & ANALYSIS

Distribution Dynamics: Investment Selection is based on survey results of more than 1,000 advisors representing the primary distribution channels—national wirehouses, regional broker/dealers, independent broker/dealers, bank broker/dealers, insurance companies, and registered investment advisor firms (RIAs). Each channel section starts with a high-level summary of recent events and trends shaping the channel. This is followed by a presentation of channel-specific survey results, drawing particular attention to findings that are unique to the channel. Together, these analyses provide the foundation for guidance that asset managers can employ to customize their approaches to each channel.

Channel Summary – Brief synopsis of broad trends impacting the channel (e.g., consolidation, advisor migration, movement toward fee-based business, etc.), which lays the groundwork for understanding the specific trends related to investment selection.

Channel Snapshot – Survey results that explain the attributes of each channel and how it is structured. This section provides context for examining the investment selection decisions made by advisors in the channel.

- Percentage of dually registered advisors
- Proportion of advisors working as solo practitioners versus team members
- Revenue derived from fee-based business
- Assets under management
- Number of clients serviced
- Average advisor experience

Product Usage – Survey results that examine the types of products utilized in the channel, expected changes in product usage, and how advisors divide their assets between actively and passively managed investments.

- Types of products utilized
- Expected changes in product usage
- Division between actively and passively managed investments
- Uses for passive investments

Asset Allocation – Survey results that look at asset allocations by broad objective and specific asset class, how asset allocations have changed in the recent past and how they can be expected to change in the short-term future.

- Average asset allocation by broad objective and specific asset class
- Reasons for making asset allocation changes since the start of the financial crisis
- Expected changes to asset allocations over the next year
- Preferred asset managers by asset class

Portfolio Construction Tools – Survey results that evaluate the tools advisors use to make investment decisions and construct client asset allocations, and the criteria they screen against to select investment products and asset managers.

- Tools used to construct a portfolio (i.e., home-office models, portfolio optimization systems, third-party resources, etc.)
- Uses and opinions of home-office models
- Most-used investment selection screening criteria (i.e., fees and expenses, relative and absolute performance, manager reputation, etc.)

Guidance for Approaching the Channel – Action-oriented guidance that translates research results into customized approaches that address the specific needs of advisors in the channel.

USING THE REPORT

To show how asset management firms can use this report, below is an example of how the research findings for a particular channel can lead to the identification of long-term strategic and short-term tactical opportunities.

Channel Attribute:

In the national wirehouse channel, an advisor's proportion of fee-based revenue was directly correlated to his years in the business; those advisors with fewer than five years in the business derived an average of 53% of revenue from fee-based business in 2009, a figure that gradually declined to 31% for those advisors in the business 30 years or longer.

Product Usage:

The top-three product types that wirehouse advisors expect to use more extensively over the next 12 months are mutual fund wrap accounts, ETFs, and SMAs. A larger percentage of national wirehouse advisors already use each of these products compared to the industry average.

Asset Allocation:

Over the next 12 months, national wirehouse advisors expect to slightly increase their allocations to international emerging markets, large-cap domestic equity, and international core, and decrease their allocations to government fixed income and cash.

Portfolio Construction Tools:

National wirehouse advisors are among the most likely to use home-office models as the foundation for their portfolio construction and asset allocation decisions, and most think very highly of the models provided by their firms.

Guidance for Approaching the Channel:

For asset managers that want to become more firmly entrenched in the national wirehouse channel, gaining access to the model portfolios of the national wirehouses through asset-based products, such as Morgan Stanley Smith Barney's TRAK (mutual fund wrap account) or UBS ACCESS (SMAs), will be critical to growing future assets. On the advisor level, firms can help develop stronger relationships with the potential for long-term growth by directing their efforts toward younger advisors (10-15 years in the business), who are part of a team. These advisors have gained much of their experience in a fee-based environment and their inclusion on a team means they are more likely to stay in the business as the wirehouses work to foster a team culture. In the short term, asset management specialists in areas such as emerging markets, large-cap domestic equity, and international core equity are likely to gain incremental assets as the national wirehouses transition some assets away from government fixed income and cash into equities.

SAMPLE SECTION



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EXHIBIT A.14

Preferred Asset Managers by Asset Class - National Wirehouses

DOMESTIC EQUITY		
Large-Cap	Mid/Small-Cap	Specialty
American Funds	American Funds	Ivy Funds
BlackRock	Franklin Templeton	American Funds
Davis	Royce	Fidelity
Lord Abbett		

American Funds = 11 asset classes
Franklin Templeton = 9 asset classes

INTERNATIONAL EQUITY			
Core	Mid/Small-Cap	Emerging Markets	Global
American Funds	American Funds	Franklin Templeton	American Funds
Franklin Templeton	Franklin Templeton	OppenheimerFunds	BlackRock
Thornburg	First Eagle	American Funds	Franklin Templeton

FIXED INCOME				
Corporate	Government	Muni	High Yield	Global/Intl
PIMCO	PIMCO	Franklin Templeton	Franklin Templeton	Franklin Templeton
Lord Abbett	Franklin Templeton	Nuveen	American Funds	OppenheimerFunds
American Funds	American Funds	Eaton Vance	Pioneer	American Funds
Loomis Sayles		Thornburg		

- The asset managers with the best overall positioning in the national wirehouse channel are: American Funds, Franklin Templeton, PIMCO, BlackRock, and Lord Abbett.
- Asset managers with strong asset class positioning in the national wirehouse channel include: Ivy (DE-Specialty), Thornburg (IE-Core, FI-Muni), OppenheimerFunds (IE-Emerging Markets, FI-Glob/Intl), Pioneer (FI-HY), Nuveen (FI-Muni), and Royce (DE-Mid/Small Cap).

ABOUT REP. THINK TANK

Rep. Think Tank is a consulting alliance for the financial services industry that combines the strategic expertise of its four members—*Registered Rep.* magazine, The Oechsli Institute, FUSE Research Network, and Momentum Partners LLC—to provide an integrated approach that enables asset management clients to focus their product features and benefits, differentiate from each other, and gain appropriate distribution.

With hundreds of millions spent each year trying to influence financial advisors, asset managers need to put their resources to work not only targeting the best opportunities in the industry, but identifying the best opportunities for their firm. Combining the unique skill sets of its four members, Rep. Think Tank has the ability to think strategically and act tactically to identify specific opportunities for financial services providers and help them capitalize on those opportunities with advisory services, custom research, training programs, promotional and communication activities, and more.



Registered Rep. is the most trusted magazine for the retail investment professional, serving brokers, financial advisors and financial planners with award-winning coverage of industry trends, news about firms, and the latest products and innovations.



The Oechsli Institute, founded in 1978, specializes in helping financial professionals to better attract, service and develop loyal affluent clients.



FUSE Research Network is a Boston-based research and consulting firm that employs market intelligence to deliver informed, decisive, and forward-looking guidance to the asset management industry.



Momentum Partners, LLC is a boutique advisory firm that supports financial services firms in designing strategy, differentiating brands, and developing or retooling products that advisors can and will utilize.