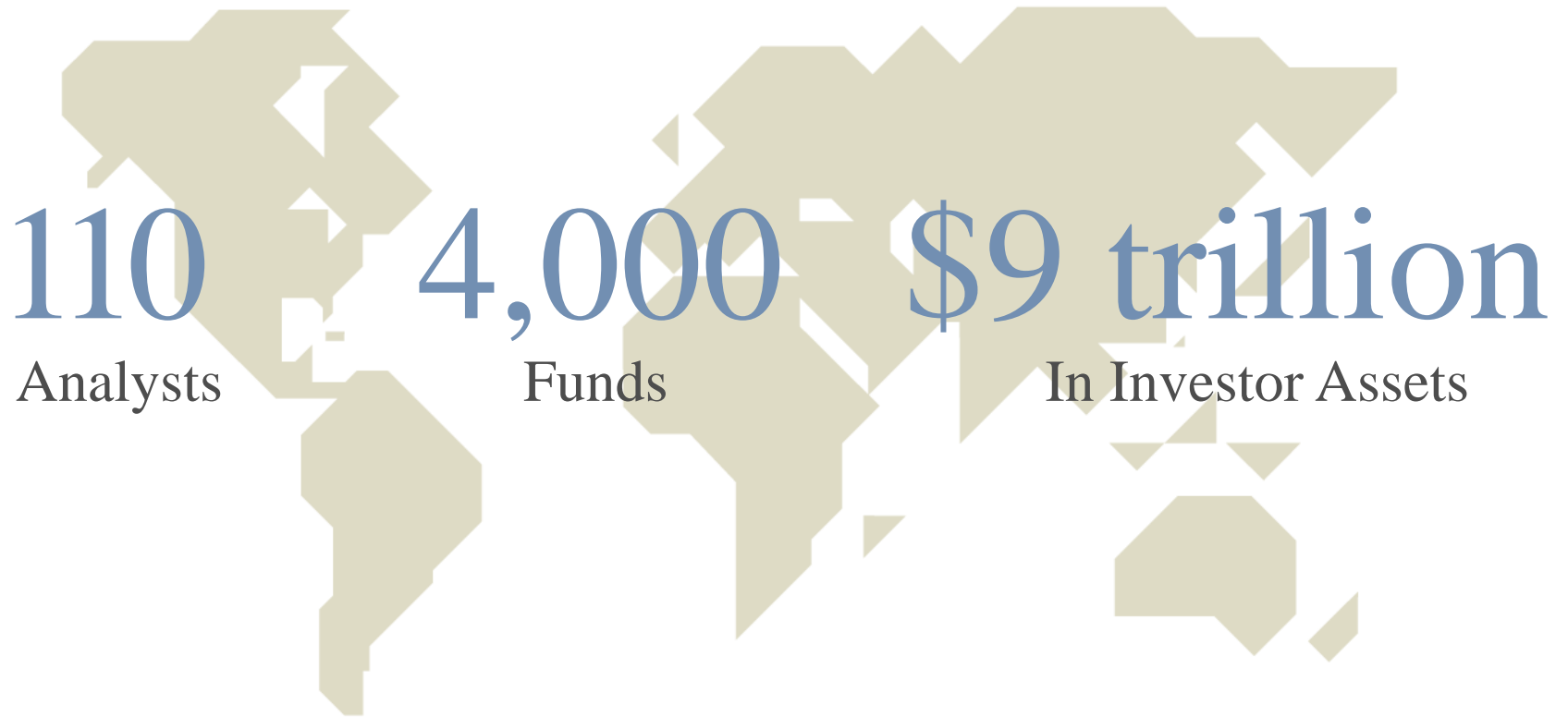

Reflections on Fund Management in the US: Lessons for Asia?

▶ **Arne Hilke**

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Global Scope, Local Expertise



What do These Companies Have in Common?

- ▶ Abbott Laboratories
- ▶ Circuit City
- ▶ Fannie Mae
- ▶ Gillette
- ▶ Kimberly-Clark
- ▶ The Kroger Co
- ▶ Nucor
- ▶ Philip Morris
- ▶ Pitney Bowes
- ▶ Walgreens
- ▶ Wells Fargo

Agenda

- ▶ 1) Leadership is Not Permanent
- ▶ 2) Predictions Often Miss the Mark
- ▶ 3) Change is Not Random
- ▶ 4) Investor Experience is Paramount
- ▶ 5) We are in the Behavior Modification Business

Leadership is Not Permanent

Biggest U.S. Fund Firms 1986

1. Merrill Lynch

2. Fidelity

3. Federated

4. Dreyfus

5. Franklin

6. Dean Witter

7. Kemper

8. Putnam

9. Pru-Bache

10. EF Hutton

11. Shearson

12. IDS

Biggest U.S. Fund Firms 2011

1. Vanguard

2. Fidelity

3. American Funds

4. BlackRock/iShares

5. PIMCO

6. JP Morgan

7. Franklin Templeton

8. Federated

9. T. Rowe Price

10. State Street Global Advisors

11. Dreyfus

12. Columbia

Long Gone

- ▶ Merrill Lynch
- ▶ Dean Witter
- ▶ Kemper
- ▶ Pru-Bache
- ▶ EF Hutton
- ▶ Shearson
- ▶ IDS

New Entrants

- ▶ Vanguard
- ▶ American Funds
- ▶ BlackRock/iShares
- ▶ PIMCO
- ▶ JP Morgan
- ▶ T. Rowe Price
- ▶ State Street Global Advisors
- ▶ Columbia

Reinvented or Surviving on Money Market Assets

- ▶ Fidelity
- ▶ Franklin Templeton
- ▶ Federated
- ▶ Dreyfus

Predictions Often Miss the Mark

1986 Predictions

- ▶ Banks will join brokerages and dominate industry because they control distribution
- ▶ No-load funds will win from disintermediation theme
- ▶ Passive funds will trump active as academic evidence supports indexing
- ▶ Active Funds will trump passive as indexing is un-American

2011 Reality

- ▶ Both banks and brokerages blew it. Owning distribution didn't lead to success
- ▶ No-load shops like Vanguard and T. Rowe Price did win, but so did load shops like Franklin, American Funds, and JP Morgan. Many like Fidelity simply offered both load and no-load funds
- ▶ Passive shops like Vanguard, I-Shares, and State Street Global Advisors did win, but so did active shops like Fidelity, PIMCO, American Funds

Predictions Generally Misguided

- ▶ The way the debate was framed was perhaps wrong or beside the point
- ▶ Smartest people in the industry focused on this
- ▶ Lots of wasted effort?
- ▶ Remember past debates and be humble in future predictions

Change is Not Random

General Traits of Winners and Losers

Losers

Closed architecture

Higher cost

Hot concepts

Short-term sales focus

“Funds are sold”

Winners

Open architecture

Lower cost

Investment merit

Long-term investor focus

“Funds are bought”

Salesmanship vs. Stewardship

Salesmanship

Merrill Lynch

Dean Witter

Pru-Bache

EF Hutton

Shearson

Stewardship

Vanguard

American Funds

JP Morgan

T. Rowe Price

PIMCO

Investor Experience is Paramount

Asset Managers Often Focus on the Wrong Things

What Firms Focus on

- ▶ Near-term investment performance
- ▶ Fund category ranking
- ▶ Finding hot fund, asset class

What Matters

- ▶ Long-term investor experience
- ▶ Retaining clients
- ▶ Curbing investor instincts
- ▶ Clients achieving goals

The Real Test is Whether Investors Succeed

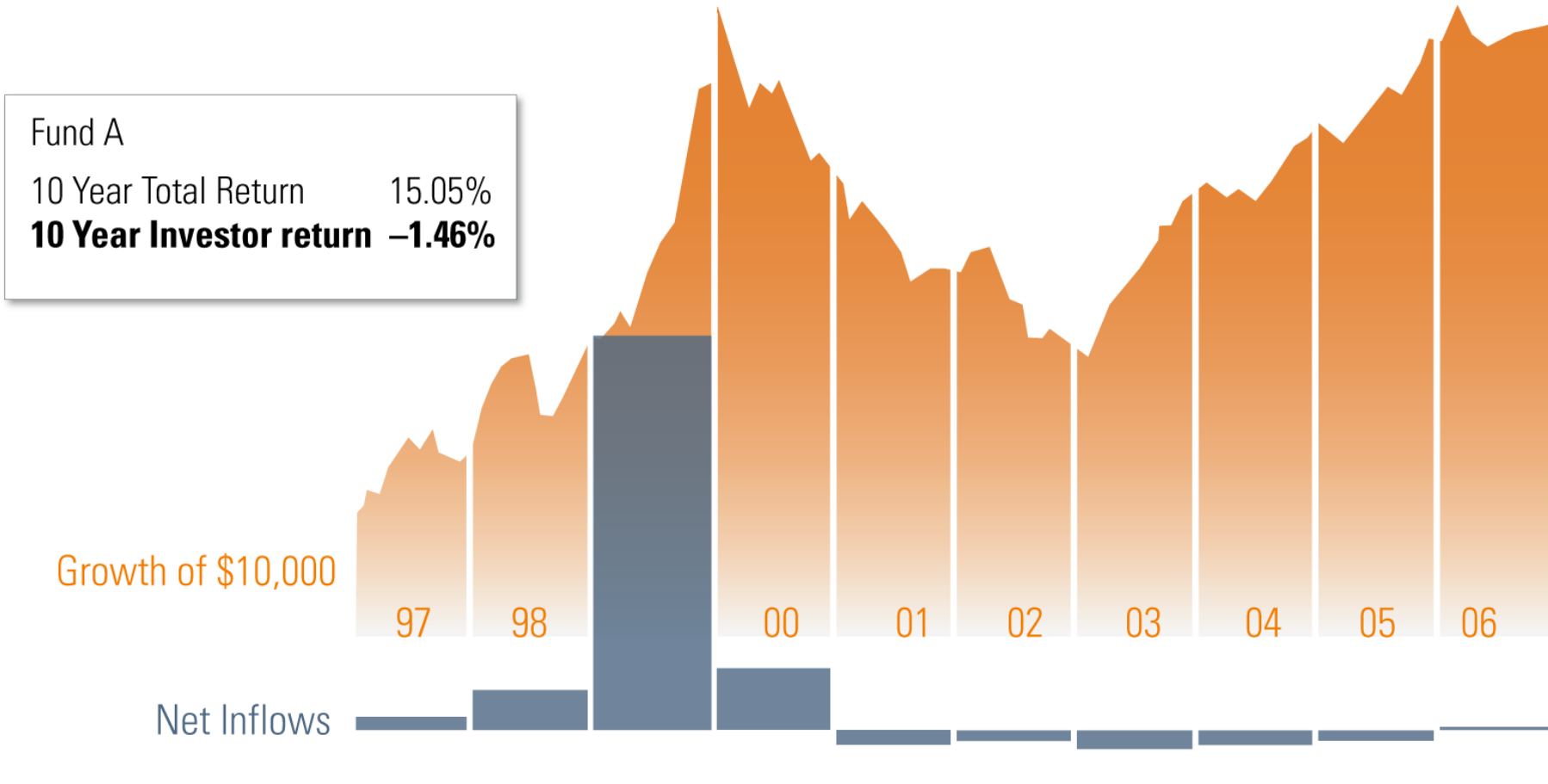
Total Return

- ▶ Time-weighted calculation
- ▶ Assumes investor buys and holds for entire period with no additional investments

Investor Return

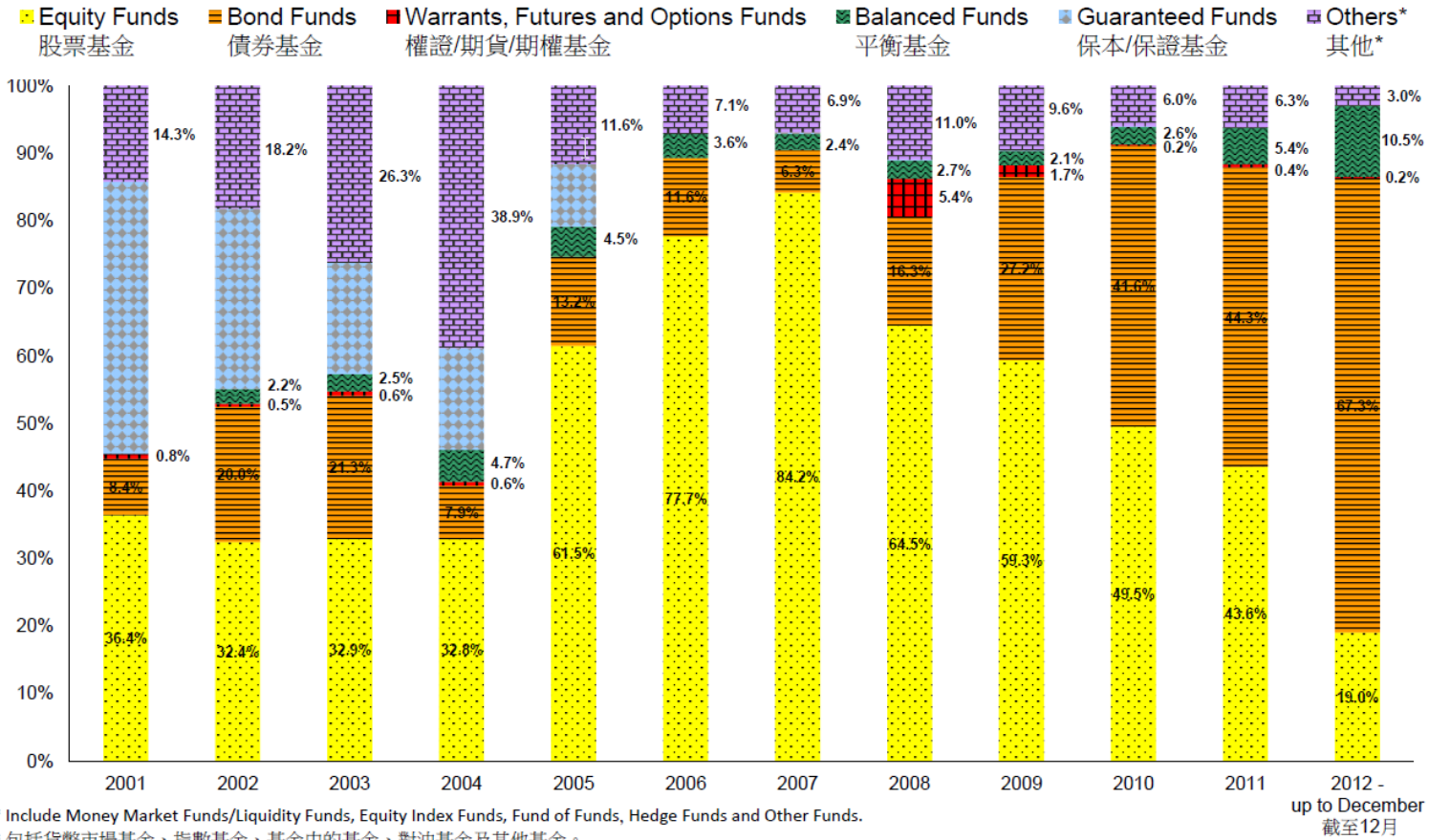
- ▶ Money-weighted calculation
- ▶ Accounts for aggregate monthly purchases and sales by all of a fund's investors

Investors Often Miss Benefits of Fund Ownership



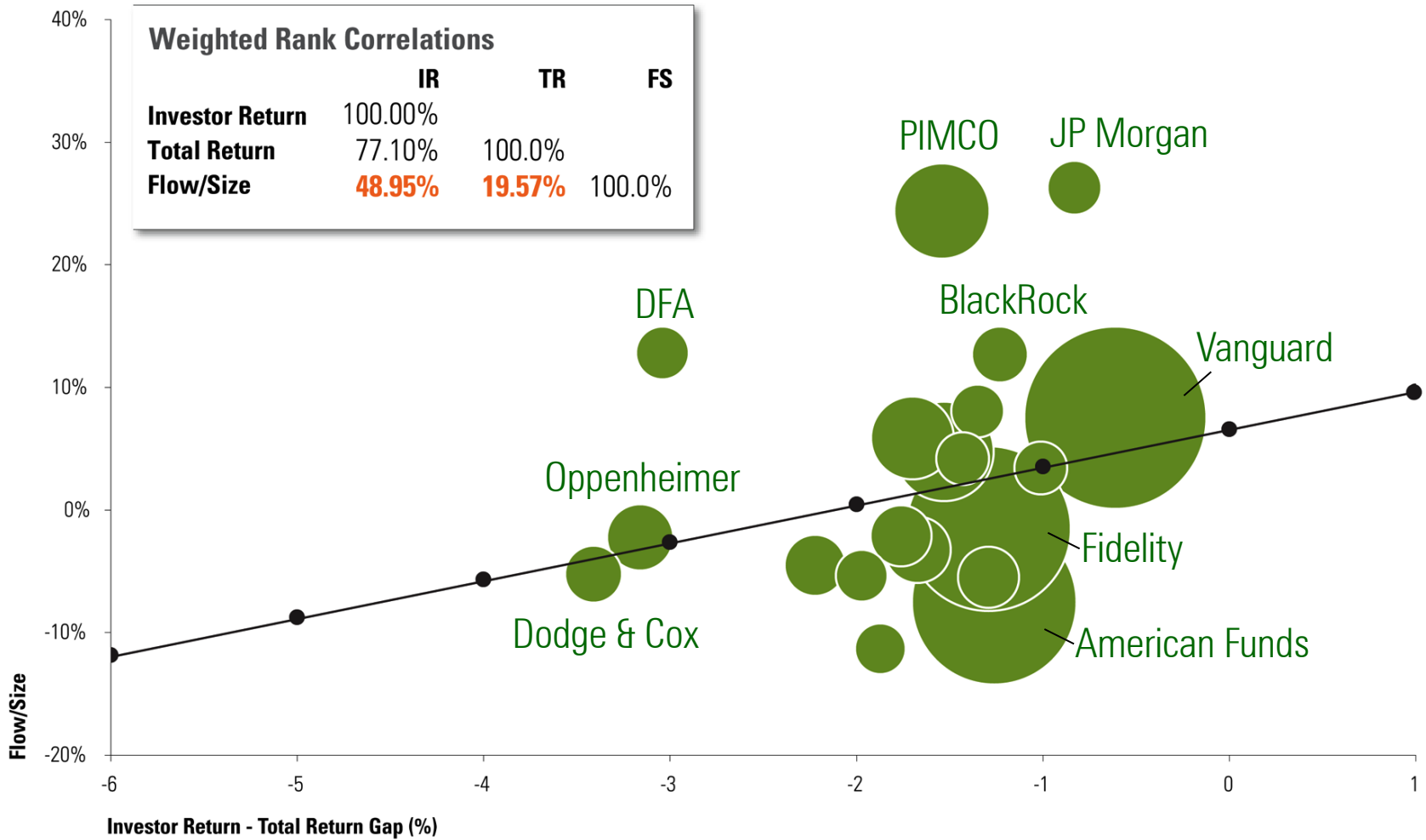
Annual Return (%)	12.7	34.9	120.1	-17.1	-27.8	-17.7	43.8	20.9	24.4	8.8
Net Assets (\$mil)	5.3	9.9	72.4	118.9	69.1	45.6	52.2	51.9	57.1	63.2

The Hong Kong Experience



Source: Hong Kong Investment Funds Association Sales & Redemptions Survey

It Pays to Mind the Gap



10-year correlation between asset flows and IR-TR gap through 8/31/11

We are in the Behavior Modification Business

We All Have Room for Improvement

- ▶ Investors are wired to buy high and sell low
- ▶ Short-term performance numbers heighten fear, greed
- ▶ Press also loses perspective
- ▶ Fund ads too often promote what investors wish they'd bought before
- ▶ Fund managers take risks they wouldn't with their own money

There Are Easy Ways to Alter Behavior

Ownership Level	% Rank Cat 5yrs	# of Funds
More than \$1,000,000	39	391
Between \$500,001 and \$999,999	42	194
Between \$100,001 and \$500,000	45	656
Between \$50,001 and \$100,000	48	273
Between \$10,001 and \$50,000	52	367
Between \$1 and \$10,000	53	144
\$0	53	1,860

Ownership data is based on the most recent SAI as of 2/28/2010

Everyone Prefers Higher Returns and Lower Risk

Star Rating	Tenure (Years)	Manager Investment
5	6.2	\$300,061
4	6.3	\$250,890
3	5.4	\$161,602
2	4.6	\$124,810
1	3.8	\$110,991

Morningstar Principia, 01/31/10

Lessons from the US

- ▶ In the long run, amplifiers lose
- ▶ In the short run, amplifiers can make lots of money
- ▶ Investor experience is paramount
- ▶ The power of aligned interests
- ▶ In time, if the investor doesn't win, we all lose

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