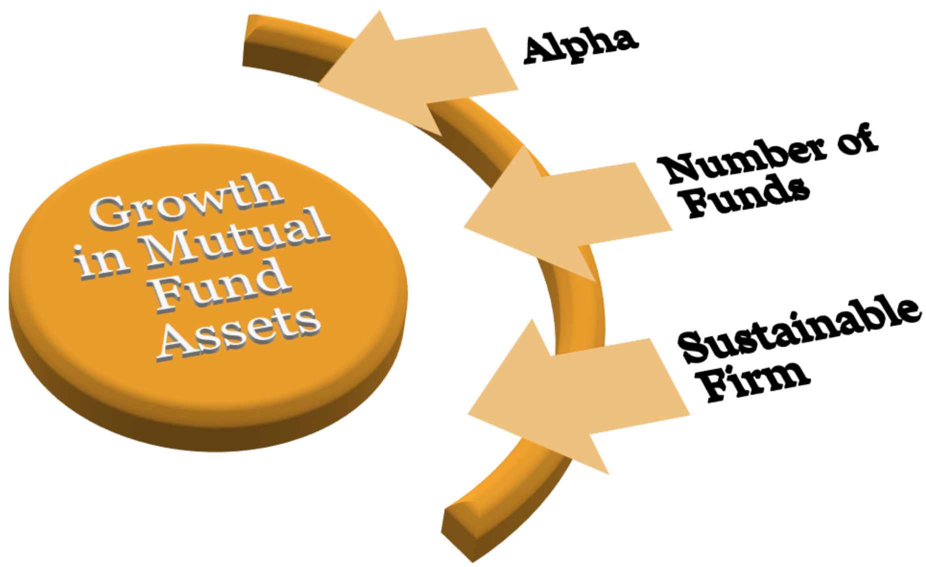

What Do Winning Mutual Fund Families Do Differently

"More & Less Than You Think"

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Your Second Opinion, LLC

Executive Summary

Industry wisdom suggests that mid – sized mutual fund investment management firms are struggling for survival and will soon disappear.

This wisdom isn't so wise. Some are doing better than people think.

I am dedicated to helping the rest of the fund families in the middle get unstuck.

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I reviewed 32 U.S. mutual fund families that manage between $10 and $100 billion in AUM. In the last 5 years, 10 of these fund families have at least doubled their assets.

While rising asset prices have helped industry growth overall, the fastest growers are also doing something differently. If we can identify those differences, then maybe more md – sized mutual fund families can also grow faster.

Growth in AUM is a function of 4 main drivers:

1. Alpha (consistent annual investment performance above benchmark)
2. A limited set of products (fewer than 20 funds)
3. A sound organization likely to outperform in the future (based on medals awarded by Morningstar for their funds based on investment process, investment performance, people, parent and price)
4. Satisfied employees (based on the fund family's ranking on anonymous continuous surveys compiled by Glassdoor.com)

Here are the fastest growing fund families that also score well on these four drivers.

- *Baird*
- *Diamond Hill*
- *Guggenheim*
- *Harding Loevner*
- *Parnassus*
- *Primecap Odyssey*
- *Robeco*

This report concludes with advice on how to emulate the success of these firms.

Introduction

Over the last 5 years, 10 mid – sized U.S. mutual fund families (of 32 considered), have grown at least 100% in AUM.

Why have these fund families experienced superior growth? There may be many reasons. But there must be a simple – and repeatable explanation for other mutual fund families to follow.

"Plurality is not to be posited without necessity" Pythagoras
(Keep it simple!)

1. Is the firm consistently generating alpha?
2. Does the firm have the right number of funds?
3. Is the firm organized to succeed?
4. Do people like working there?

Of the 32 fund families considered in this analysis, 6 fund families actually shrunk in AUM over the last five years. The median 5 year growth of the 32 fund families considered was 28%, which makes the doubling (and more) of the AUM of the top 10 fund families all that more remarkable. Here are the top 10:

- Robeco
- Primecap Odyssey
- Baird
- AQR
- Guggenheim
- Henderson Global
- Parnassus
- Diamond Hill
- SunAmerica
- Harding Loevner

1. The Big Drivers

A. Persistent Alpha

Morningstar reports weighted average performance for each fund family based on a custom weighted benchmark. I considered looking at cumulative alpha over the most recent 5 years, but chose to focus on the consistency of alpha each year over the last 5 years. While long – term alpha is the Holy Grail, clearly investors and their advisers make decisions based on short – term performance.

The measure of alpha chosen was the number of years (maximum 5) that the weighted average performance of a fund family exceeded its custom benchmark.

There were only 4 fund families that exceeded their benchmark for all 5 years.

Of the ten fastest growing fund families over the last five years, 9 outperformed in each of the last 4 or 5 years.

Years Beating Benchmark (1 - 5 years)	**Top 10 Fastest Growing Fund Families**
5 years	4 families (40%)
4	5 (50%)
3	1 (10%)
2	0
1	0

As would be expected, across all of the 32 fund families, there is a more bell – shaped distribution of alpha consistency.

Years Beating Benchmark (1 - 5 years)	**All Fund Families (n=32)**
5 years	4 families (13%)
4	10 (31%)
3	8 (25%)
2	8 (25%)
1	2 (6%)

B. Fewer Funds

Fund families have different philosophies when it comes to the number of funds offered. The fewest number of funds offered by any one of the 32 fund families is 4, while the most is 43 funds. There appears to be a sweet spot between those two figures.

> *"The biggest weakness of other firms is that they lose sight of creating value for clients and they focus on just selling product"* CEO – Asset Manager

Of the ten fastest growing fund families over the last five years, 9 had 20 or fewer funds in their family.

Number of Funds in Family	**Top 10 Fastest Growing Fund Families**
More than 20 Funds	1 family (10%)
10 – 20	4 (40%)
Less than 10	5 (50%)

As is evident in the table below, most mid – sized fund families have more funds than the 10 fastest growing fund families.

Number of Funds in Family	**All Fund Families (n=32)**
More than 20 Funds	14 families (44%)
10 – 20	11 (34%)
Less than 10	7 (22%)

2. The Medium Driver

A. Quality

In recent years, Morningstar has introduced a supplementary ranking to its famous stars. They award medals to funds that they favor based on investment process, investment performance, people, parent and price. They award Gold, Silver or Bronze medals to those funds that they think "*are likely to outperform their category peer groups and appropriate benchmarks on a risk-adjusted basis over market cycles of at least five years.*"

Of the ten fastest growing fund families over the last five years, 9 have funds that have been awarded either a Gold, Silver or Bronze medal from Morningstar. One fund family has been awarded medals for 8 of their funds.

One - half of the top 10 fund families had medals awarded for more than 20% of their funds.

Funds With Morningstar Medals (Gold, Silver, Bronze) as a Percentage of Total Funds Offered Per Family	Top 10 Fastest Growing Fund Families
Over 20% of funds in family	5 (50%)
10 – 20%	2 (20%)
0 – 10%	2 (20%)
0 medals	1 (10%)

For all of the fund families, one half of them had less than 10% of their funds awarded medals. 7 fund families had not been awarded any medals.

Funds With Morningstar Medals (Gold, Silver, Bronze) as a percentage of total funds offered	All Fund Families (n=32)
Over 20% of funds in family	12 (38%)
10 – 20%	4 (13%)
0 – 10%	9 (28%)
0 medals	7 (22%)

3. The Smaller Driver

Employee Satisfaction

Glassdoor.com ranks firms based on responses to a continuous anonymous survey of employees of many firms.

Of the ten fastest growing fund families over the last five years, 3 currently score 4.0 or higher on Glassdoor.

Glassdoor Ranking of Employee Satisfaction (Scale: 1- 5 (best)	Top 10 Fastest Growing Fund Families
4.0 or higher	3 (30%)
3.0 – 4.0	3 (30%)
3.0 or less	2 (20%)
Not available	2 (20%)

Only two of the rest of the fund families scored 4.0 or more.

Glassdoor Ranking of Employee Satisfaction (Scale: 1- 5 (best)	All Fund Families (n=32)
4.0 or higher	5 (16%)
3.0 – 4.0	14 (44%)
3.0 or less	5 (16%)
Not available	8 (25%)

4. Firms That Grew More Quickly Than Expected

AQR, Henderson Global and Sun America were ranked in the top 10 for AUM growth over the last five years. But each had a weakness that may have held back their growth.

The only weakness for AQR appears to be having more than 20 funds.

For Henderson Global, weakness in several of the supporting drivers of AUM growth was evident. No funds have been awarded a Morningstar medal, and the Glassdoor score for employee satisfaction was below the best firms.

Of the three firms that grew quickly in spite of weakness, Sun America is the biggest surprise. Only one of its funds has been awarded a Morningstar medal, alpha persistency is less strong than the best and the employee satisfaction ranking from Glassdoor is lower.

All of these fund families showed strong growth in AUM in spite of their weaknesses. So each of these fund families has a great opportunity to reinforce their recent success in growing AUM.

5. Firms That Grew More Slowly Than Expected

Interesting, there were several firms that struggled to grow AUM in spite of their strength across most drivers.

Tweedy Browne has pretty much everything going for it. While asset growth was ahead of the median fund family, this family could be growing much faster.

Cohen & Steers also scores strongly on every key driver, yet asset growth was similarly disappointing.

Matthews Asia showed only modest growth of assets in spite of strength across most of the critical drivers.

In each of these cases, there may be idiosyncratic reasons why the key drivers have not paid off in asset growth. For example, each of these firms is well known for particular investment specialties, and a combination of sales weakness or shifting client preferences may have slowed growth.

6. What Can You Change

What lessons can we learn from the experience and focus of the fastest growing mid – sized fund families?

a. Alpha Persistency

Investment performance is a linchpin of growth in the mid – sized mutual fund family space. Sustaining alpha is not a trivial issue. And there is no easy solution. For those not intimately involved in an investment process it can be very challenging to differentiate between short term performance shortfalls and broken down efforts.

Here is a list of questions to ask of investment professionals to assist in differentiating between temporary and permanent conditions:

i. Are the Necessary Resources Available to Support the Investment Process?

- Does the portfolio manager have access to the data that they need to be successful?
- Is constructing and implementing the portfolio a strength of the process?
- Is there adequate technology support?
- Does the investment team have the financial resources needed?
- Are resources sufficient to support a process that is novel, highly technical, or unusually complex?

ii. What Are the Characteristics of the People Involved?

- Do they have a passion to persistently pursue extraordinary results?
- Do they have a steady belief in what their opportunity is and how to achieve it?
- Are they humble enough to acknowledge that even past evidence doesn't guarantee future results?
- Are they aware of how and when their beliefs may fall short?
- Is there an awareness of blind spots?
- Is there a process for considering how the process will evolve - what will be considered and what will not?
- Are all of the people who are said to be involved in the process actually involved?
- Do the key contributors have a relevant and successful track record?
- Are the key contributors the same people over time?
- Are the key contributors held accountable for their efforts?

iii. Is it an Investment Team?

- Is it a team or is it a solitary contributor with supporting professionals?
- Who has decision rights on the team - who does research, offers advice, decides?

iv. What Are the Characteristics of the Portfolio?

- Can the superiority of the portfolio's characteristics be demonstrated in advance?
- How is the portfolio's superior positioning maintained over time?
- Is there evidence that these superior characteristics consistently pay off?
- How is the portfolio composition similar, different and/or superior to similar competitors?
- Is there enough exposure to opportunities that fit the investment process and is enough risk taken in the portfolio?

v. What are the Warning Signs of a Portfolio Set Up For Failure?

- A persistently bearish perspective in a long only portfolio
- An emphasis on market timing
- Excessive turnover or changes in the rate of turnover
- Excessive concentration or excessive diversification
- Risks at the extreme in relation to direct competitors
- Use of significant leverage
- Expensive execution
- Dependence on liquidity
- Investments dependent on opportunities that benefit from other's misfortunes and which carry the risk of being corrected by political or regulatory action

vi. How is the Process Sustained Through Time?

- Is the process reviewed and refined based on reflections from previous results?
- Are there enhancements under investigation regularly?
- Are there missed opportunities that the process should have captured?
- Is the process scalable as success attracts more assets?
- Is the process self - sustaining in the long - run?
- Is it able to absorb, or respond to secular changes in the capital markets?
- Are the performance results consistent with the portfolio managers expectations - do their predictions materialize as predicted?
- Do the portfolio returns move with market prices as would be expected based on portfolio characteristics?

vii. How Should Outsiders Think About the Process?

- Is the investment proposition understandable?
- Is the process communicated transparently?
- Is the process clearly and consistently represented and adequately defended?
- Is it credible to clients?
- Is the process represented accurately over time?

- Are the portfolio results consistent with the process description?
- What is the source of persistent advantage?
- How is the process distinct from others?
- Are any process changes that are communicated real, and not just pandering to clients, or inconsequential?
- Are reasons for exceptions explained before they impact results?
- What are process exceptions expected to contribute?
- Do process exceptions actually contribute?
- Is the process compelling to expert third parties like advisers, intermediaries and consultants?
- What risk is assumed and what opportunities are captured in relation to other possible portfolios?
- Does the process have a clear rationale?
- Is the process grounded in a robust theory and respected by others?

b. Keep the Number of Funds Offered Below 20

As one former CEO of a major investment management firm says, *"So many firms flit on too many flowers hoping something will happen."*

Perhaps a better approach is suggested by the CEO of another asset manager, *"stay open minded to new ideas, while staying within your core capabilities."*

Based on the funds listed by Morningstar for each fund family it appears that having fewer funds is associated with stronger growth in AUM. Fewer funds means less costs, concentrated investment capabilities and a simplified product menu for both sales people and prospective clients and intermediaries. Too few funds, on the other hand, may cut off business growth opportunities, however. Considered management of the fund family line – up with a bias towards having fewer funds rather than more, seems wise.

c. Medals/Funds

Morningstar is not the only arbiter of quality but it is an easily and publicly accessible source of an informed perspective on the quality of fund family organizations. Paying attention to the compliments and criticisms of others regarding investment process, people, and parent issues may particularly help to shape elements that are associated with growth and success.

d. Employee Satisfaction

There are several sources of independent surveys of employee satisfaction that can guide efforts to both retain and attract employees. HR departments and HR consultants offer many solutions.

However, career development opportunities and contact with senior management are two evident weaknesses of asset management firms as they grow. Even firms that score well on overall employee satisfaction currently, must maintain vigilance over these two potential weaknesses.

Authors Bio

Russell Campbell is the CEO of Your Second Opinion, LLC, a management consulting firm offering advice that makes a difference to leaders of investment management firms. He writes a weekly subscription newsletter for leaders, and also works one-on-one with leaders and teams on critical issues.

Russell has led 5 investment groups in his career. Prior to establishing his own firm, Russell was the CEO of The Marco Consulting Group, one of the largest institutional investment consulting firms, with a significant CIO outsourcing business. Previously, he was the EVP of AMCORE Bank, and led the Wealth Management Group which was one of the 60 largest bank wealth managers in the U.S. Earlier, Russell was the President and CEO of ABN AMRO Asset Management Holdings, Inc., which managed $75 billion in assets, and was the U.S. investment management affiliate of ABN AMRO Bank. Russell was promoted to this position after having been the CEO of ABN AMRO Asset Management Canada, Inc. He was previously a Vice – President and Partner of Beutel Goodman, Inc., one of Canada's largest investment counseling firms.

His first leadership position was as Vice – President, Bank of Nova Scotia, where he led the investment management of the Bank's own pension fund, and a family office portfolio.

Earlier in his career, he held positions as an institutional investment consultant, an institutional equity sales and a precious metals portfolio manager.

Russell has an MBA in Investment Finance and Marketing from York University, and he has a BA in Industrial Relations from McGill University. He also attended the Advanced Management Program at INSEAD in France.

He has earned the Chartered Financial Analyst designation, and has attended both the Financial Analyst's Seminar and the Investment Management Workshop. Russell has also acquired the Certified Financial Planner ™ certification. He previously held Series 7 and 24.

Russell has been a director of several for-profit and not for profit boards, and he is a member of numerous non-profit, civic and industry organizations.

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