



Relationship and Asset Retention: Selected Themes



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SI OnLine.com

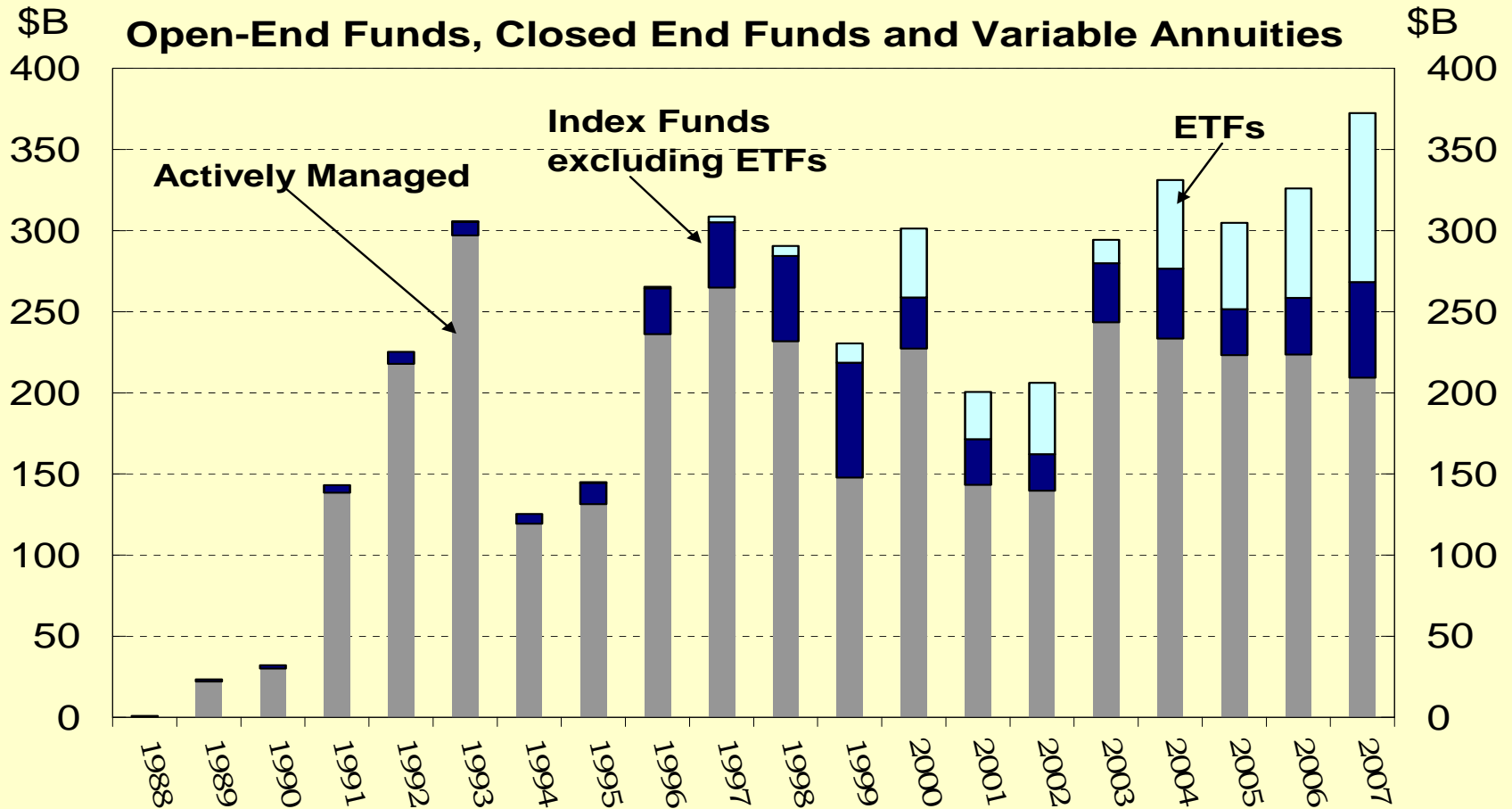
Simfund 5.0 Databases

Strategic Insight Global.com Annuity Insight.com SimfundFiling.com

15(c) Advisory Contract Renewal

US: Strong Demand for Active Funds Persists

Stock / Bond Fund Inflows \$B

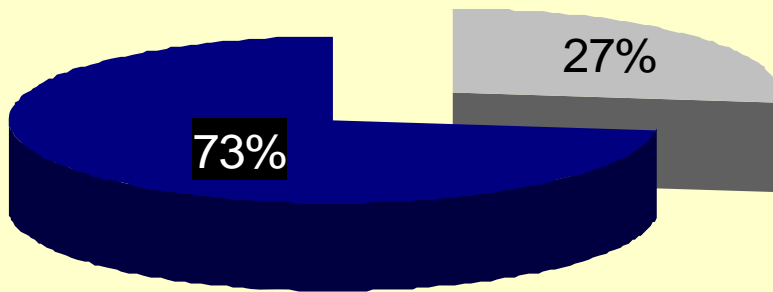


Source: Strategic Insight Simfund MF, Simfund VA

Equity Funds: Increasing Importance for Retirement Investing

U.S. Equity Fund Flows
1997 -2006 (\$1.6T)

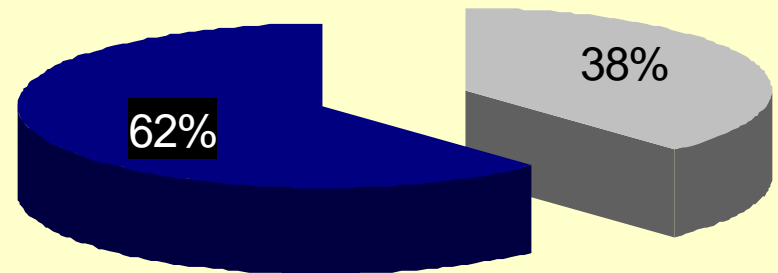
Taxable Accounts



Retirement Accounts

U.S. Equity Fund Assets
12/06 (\$6.6T)

Taxable Accounts



Retirement Accounts

Mutual Funds: Foundation of Retirement Investments

- ❖ DC investments in mutual funds: \$2.3 trillion; mutual funds oversee half of all DC assets
- ❖ Past decade: fund investors net purchased \$700 billion within their DC accounts; in addition, they earned about \$1 trillion due to appreciation
- ❖ IRAs: almost all net flows past decade seeded by DC rollovers; and IRAs invested through mutual funds also earned about \$1 trillion past 10 years
- ❖ **Majority of mutual fund shareholders are introduced to mutual funds via their DC plan.** Subsequently, many expand their investment portfolios, for both retirement savings and other purposes, using mutual funds.

MF Retention and New Business: It's (Mostly) About Retirement Investing

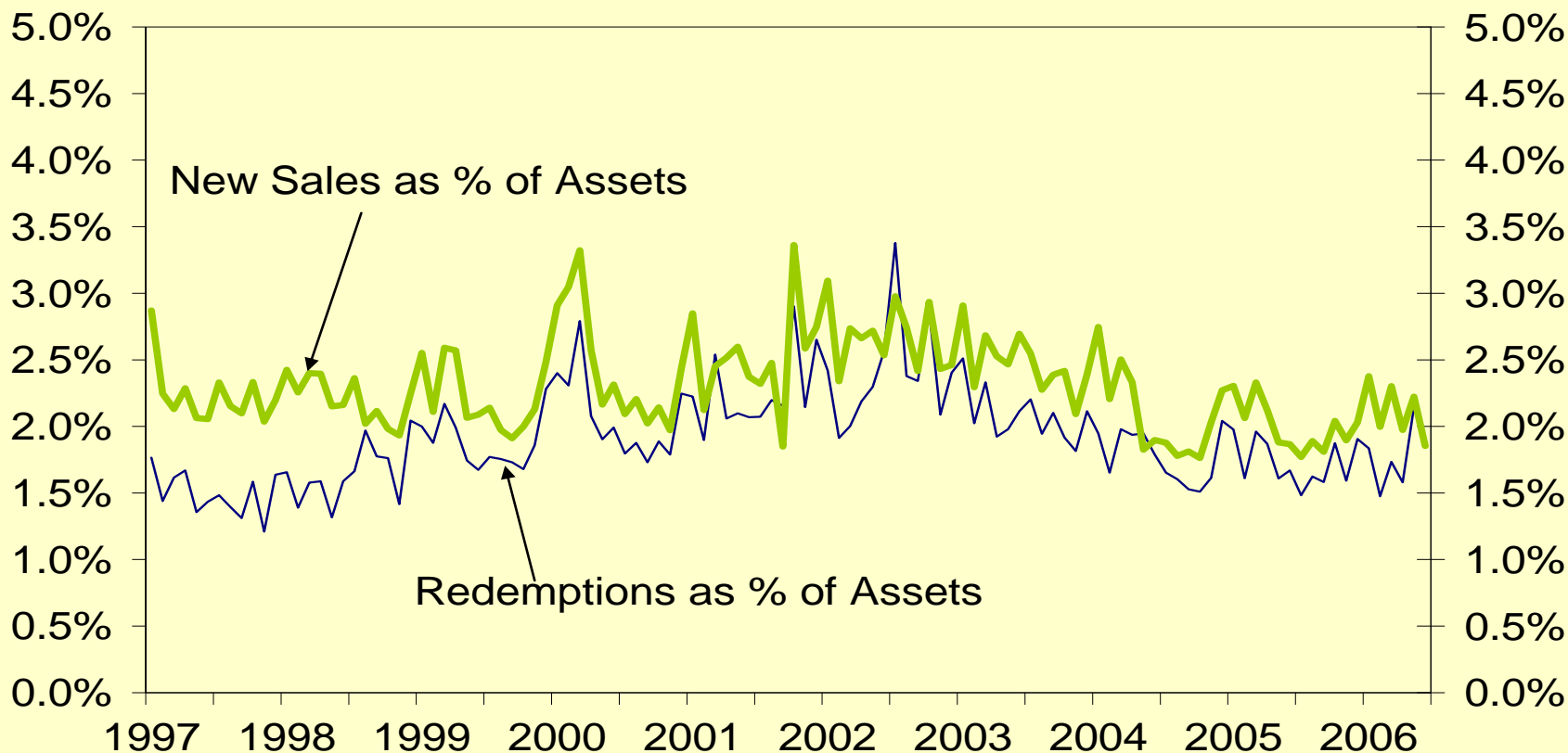
- ❖ Retirement intended investments (DC,IRA,VA, and also in taxable accounts) account for **70-80% of equity fund assets and majority of inflows**; ('01-02 such investments provided more than 100% of equity fund net inflows, in '03-06, 70% of inflows);
- ❖ As such, retirement investments **stabilize and strengthen the industry**;
- ❖ **This is why most U.S. fund investors buy and hold for the long term; and maintain their “strategic” asset allocation**
- ❖ New investment rules and PPA seed more growth.

Redemptions: Some Basics

- ❖ For each investor, a **personal “planning time horizon”** which **shrinks fast with “perceived personal risks”** but only slow with age
- ❖ Most fund investors inactive
- ❖ Redemption rise in up market, fall down market
- ❖ Redemptions = sum of \$ redemption out of a pool of assets. **Redemption Rates imply, misleadingly, homogenous withdrawals activity; thus such rates means little, especially not “Avg. Holding Period”** (blaming the many for sins of few)
- ❖ In your control: targeted focus.

Asset Movements Goes Up and Down in Parallel to S&P Index

Stock and Bond Fund New Sales and Redemptions as % of Assets, 1997 - June 2006

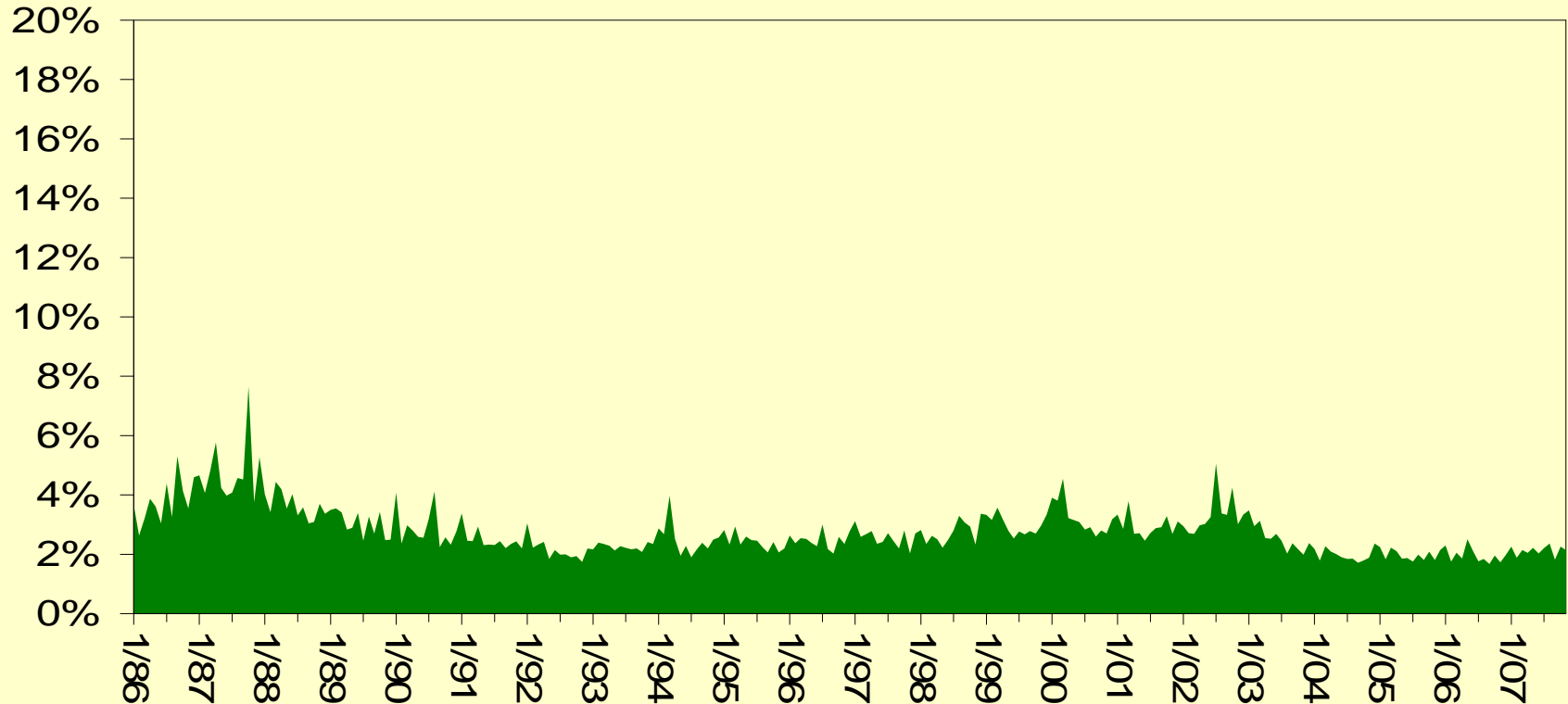


Source: Strategic Insight Simfund / ICI Trends

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Down Market Redemption Spikes Short Lived, and Equity Fund Overall Redemptions are Trending Down

Monthly Equity Fund Outflow Rates
1986 - December 2007



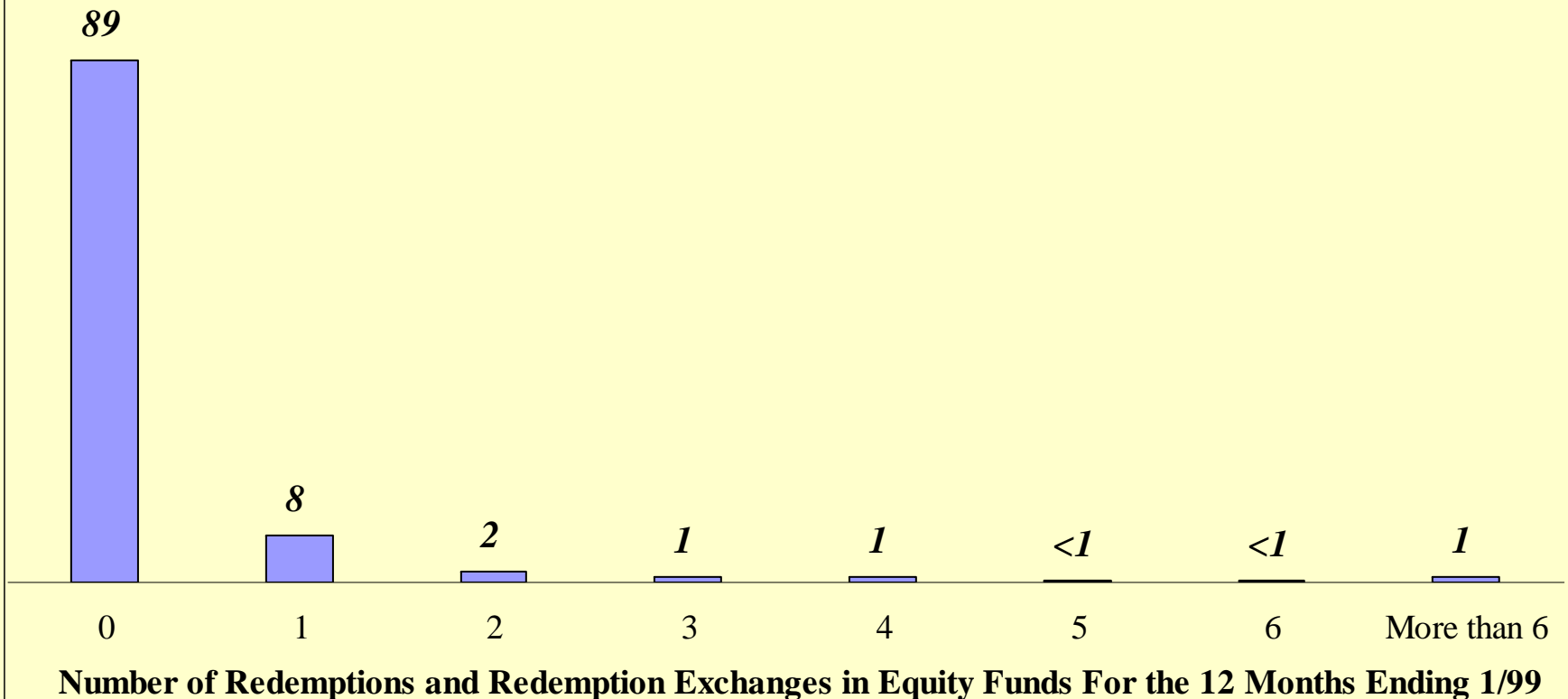
Source: Strategic Insight Simfund MF / ICI Trends

Remember, Average Redemption Rate Can Be Very Misleading

- ❖ Check the example:
- ❖ Icarus Growth fund, IPO 1991: 100,000 shareholders: 25% buy-and-hold for 20 years; 25% B&H 10 yrs; 25% B&H 5 yrs; 25% trade once-each-year.
- ❖ Each month 3% of assets redeemed; Avg. annualized redemption rate = 34%; Is expected holding period 3 years?

Blaming the Many for Sins of Few: DC Plans

Percentage of Equity Fund Shareholders by Redemption Activity in Defined Contribution Plans* in 1998



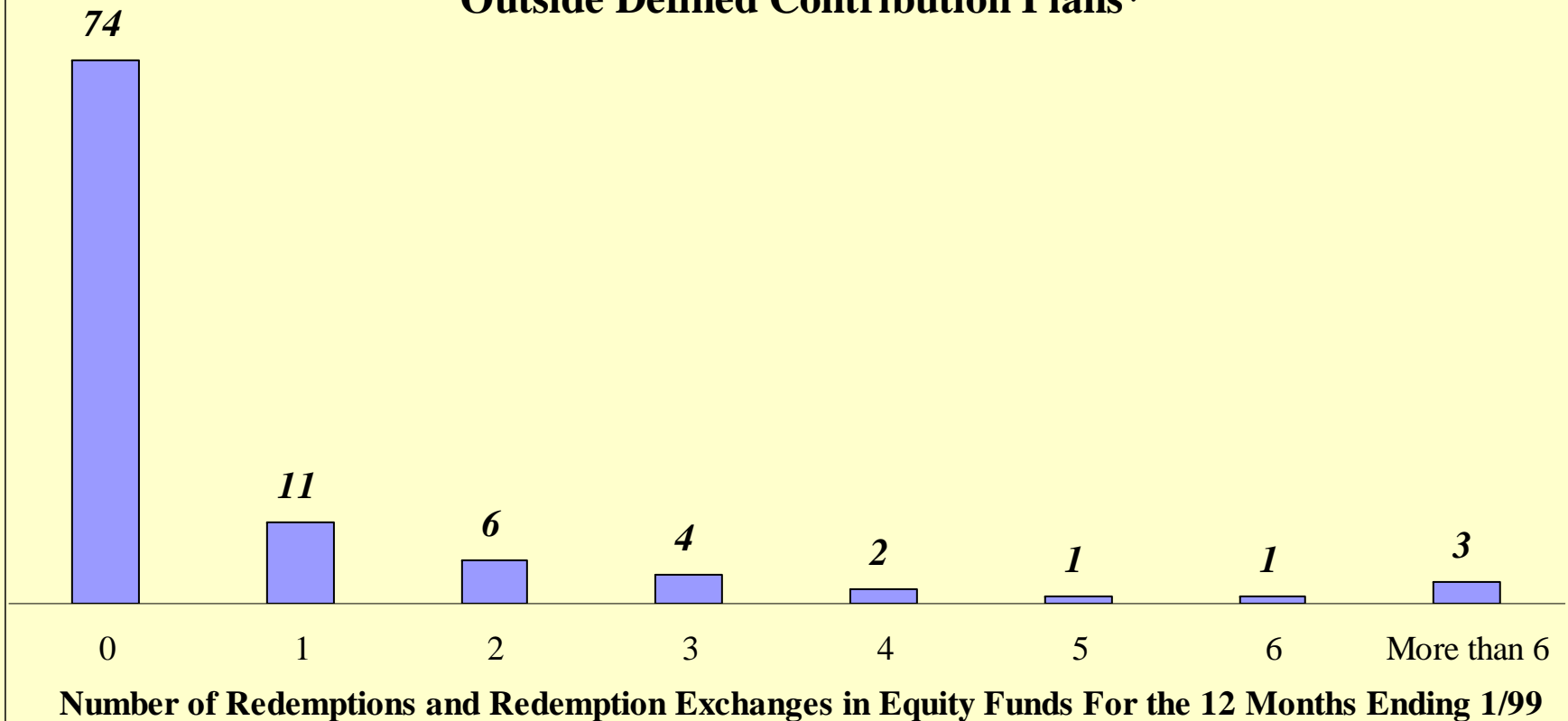
* The shareholder base excludes respondents not owning equity funds in defined contribution plans.

Source: *Equity Ownership in America*, Investment Company Institute and Securities Industry Association, 1999

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Redemption Heterogeneity outside DC Plans

Percentage of Mutual Fund Shareholders by Redemption Activity Outside Defined Contribution Plans*

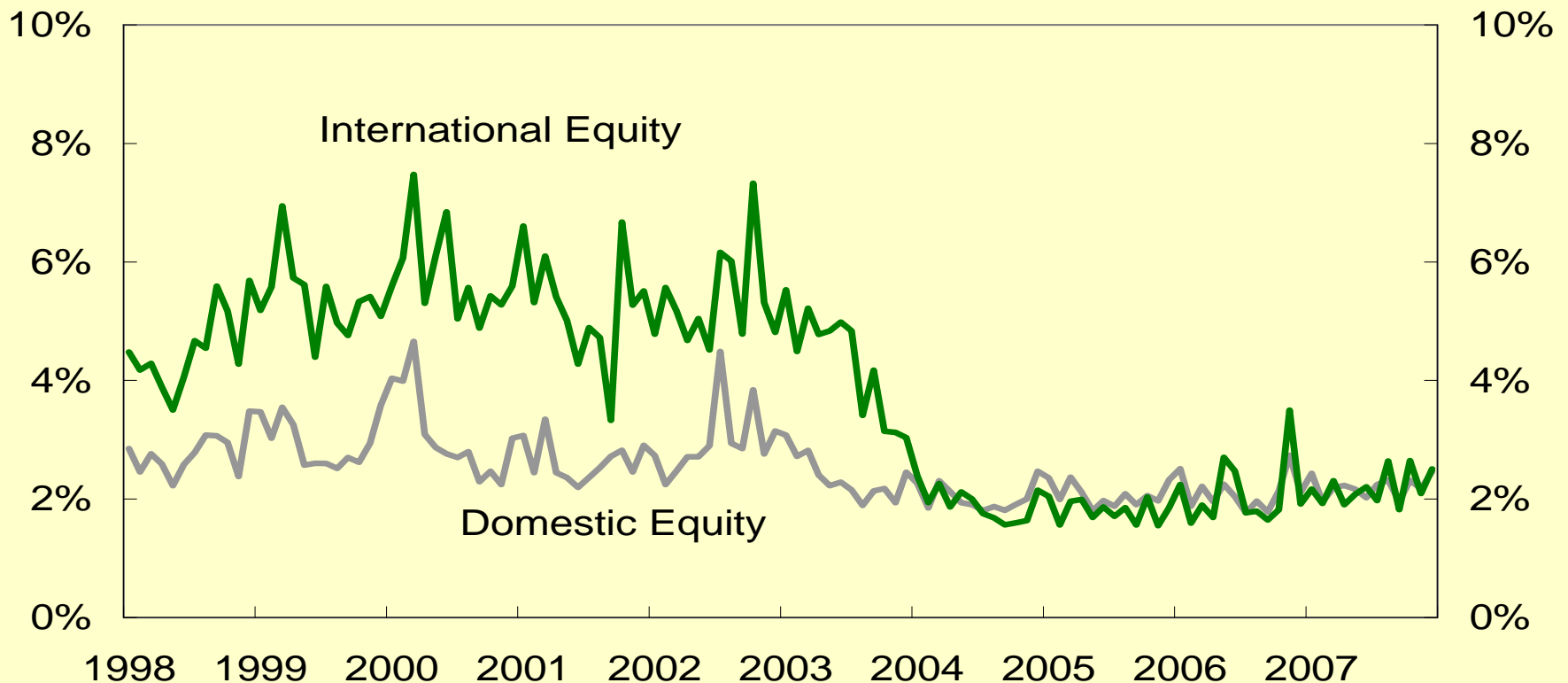


* The shareholder base excludes respondents not owning funds in defined contribution plans.

Source: "Mutual Fund Shareholders' Use of the Internet",
Fundamentals, Investment Company Institute, July 2000

Why 22c-2? Abusive Arbitrage Trading in Int'l Funds Largely Gone

Monthly Equity Fund Outflow Rates (excluding VAs)
1998 - December 2007



Source: Strategic Insight Simfund / ICI Trends

Retention Strategies: Focus, Action Plan, and Leadership

- ❖ It's in the **nature of the customer**: stock vs. bond; retirement vs. short-term; **by distributor, by FAs**
- ❖ **Identify which 10% of relationships to focus on (high \$\$\$, low engagements past 12-18 months);** technology system commitment needed
- ❖ Once identify, stimulate proactive engagements
- ❖ One more to do: **enrich, in non-performance ways, the new relationships (at risk) during bonding period**
- ❖ **A respected leader in firm must lead effort.**

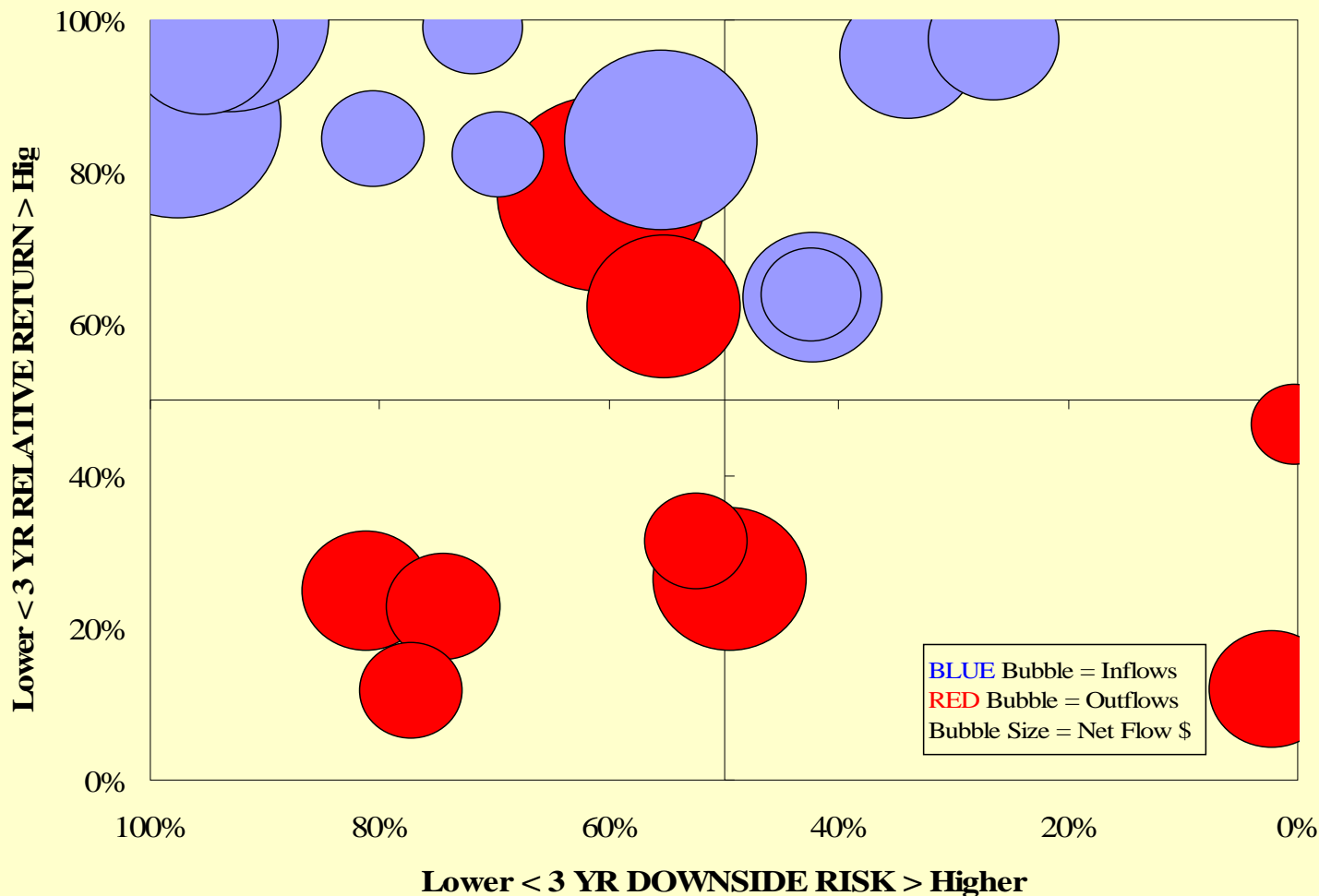
Retention and Performance

- ❖ Q: which trigger: relationship vs. performance? A: 80% (relationships) : 20% (performance disappointments)
- ❖ Naturally, shining Morningstar(s) faster sales, dimming stars faster redemptions;
- ❖ Importance of societal shift to **satisfying life needs** (“need centric”), not just “great funds”; with need (outcome)-based approach and more asset-allocation sales, less focus on performance.

Buying or Redeeming Individual Funds: Look Back Style-Based Excellence

- ❖ **A compelling reason to buy, and a compelling reason to redeem; funds are **not commodities....****
- ❖ **Style-adherent risk-adjusted past return excellence – a magnet for inflows; winners grow, losers shrink**
- ❖ **Take your pick: Morningstar Stars, Lipper Leaders, or just 3-year simple look back – any such measure correlates well to flows.**

Buying / Redeeming on Past Performance: Flows vs. Relative Risk-Return Excellence – (Trailing 3-Years; Mid Cap Blend)

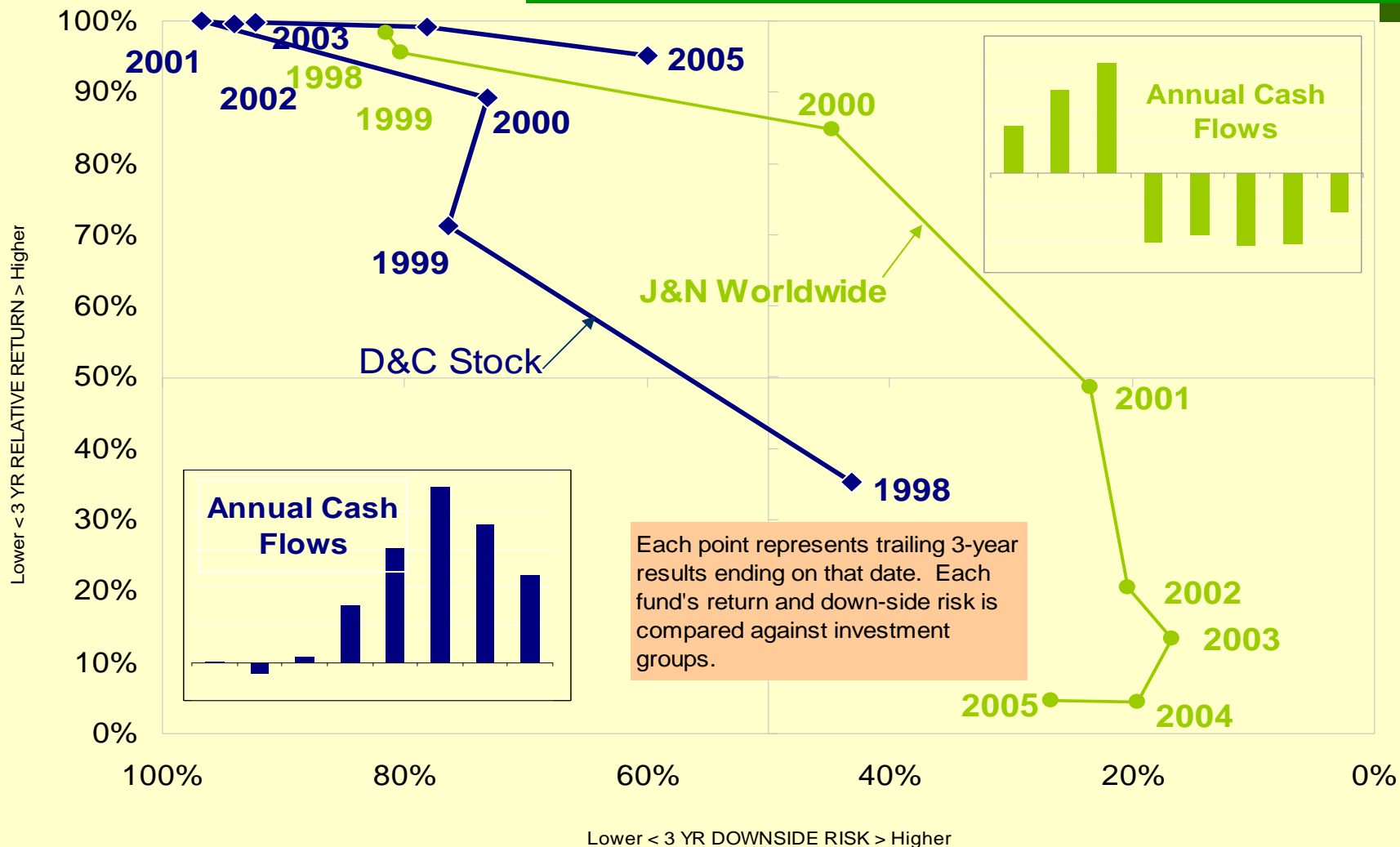


Sour

* Funds with trailing 3Mth-1/07 inflows over \$100M, or outflows over \$100M (1/07)

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Risk/Return Excellence Over Time, and Resultant Flows: Look-Back, Rolling 3-Year Periods



Source: Strategic Insight Simfund MF

Key Investment Selection Question Unanswered

- ❖ “Seattle” vs. “Miami” positioning: which to buy for “**win probability**” for **next 3-5-10 years?** not just looking back, and “investing as consumers”
- ❖ “Stars” predictability, or lack thereof
- ❖ **Dynamic rebalancing away from “hot” style;** toward an investment process, asset-allocation, not just look-back ranking.

Beyond Yesterday Stars: Increasing Comfort Zone Investing

- ❖ Dramatic accelerating of Fund-of-Funds, mutual fund wraps, and dynamic rebalancing; next, maybe, Liability-Driven choices
- ❖ Satisfying life needs (“need centric”), not just offering great products (“product centric”); “income-at-retirement”, “educational savings”, “wealth protection”, “charitable giving”..., not XYZ 5-★★★★★ fund or just one-time 60:40 Asset Allocation...;
- ❖ How to teach people to **invest “not as consumers.”**

“Investing as Consumers:” Understanding Our Biases

- ❖ Making choices in our lives based on “past experiences” is common, if not innate
- ❖ Buying another Lexus, Godiva, or Jimmy Choo makes sense
- ❖ Buying the “hottest” (stock, fund, style) generally does not
- ❖ The US financial industry is transitioning towards offering more selections featuring “asset allocation by default”.

Asset Allocation by Default

- ❖ **“Investing as Consumers” dilemma**, the Herculean task of investor education, and other drivers of the explosive growth of **“Assembled Advice”** and asset allocation processes
- ❖ **Because of fiduciary concerns, “Assembled Advice” will increasingly dominate** financial advisors’ / DC plan recommendations
- ❖ For example, a prudent **higher allocation to int’l equity funds** (currently 29% of equity fund overall assets); more to come (a move away from “home-bias” in Europe, Canada, Japan ...)
- ❖ Or, adding to bond fund exposure during flat yield-curve periods.

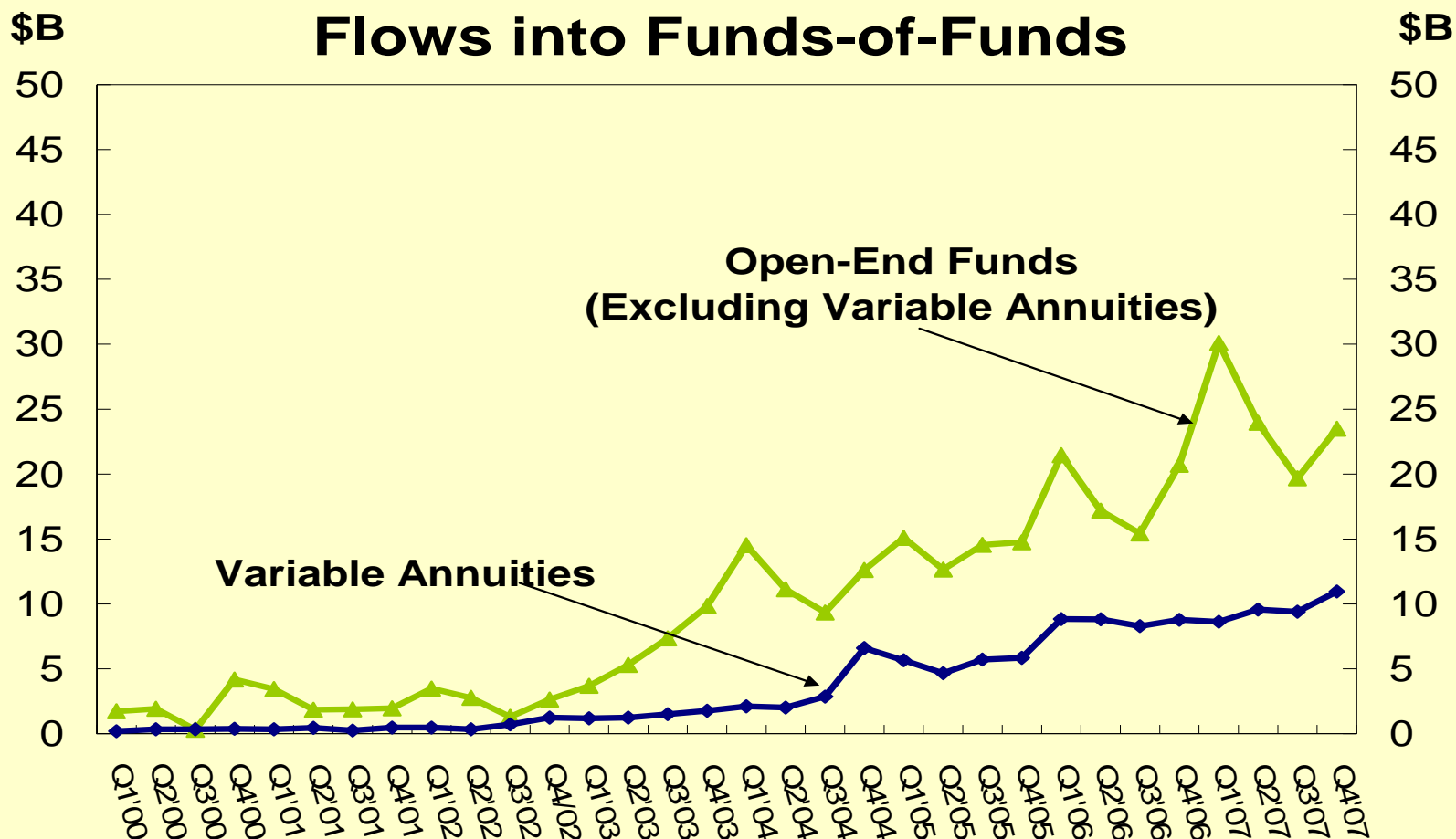
From Exuberance of “One-at-a-Time” to “Package Deals”: Inflows, Lessons

- ❖ **Funds-of-funds: 2007 flows ~\$140B; '06 \$110B; '05 \$80B**
- ❖ **Fund wrap inflows rising: \$85-90B in '07 flows, up from ~\$60B in '06**
- ❖ **Asset allocation programs' net inflows > 2/3 of all open-end stock/bond fund net inflows**
- ❖ **How can you participate in the restructuring of the wealth management process towards asset allocation, evidenced everywhere?**

Asset Allocation, “The Paradox of Choice”, The Future of Advice

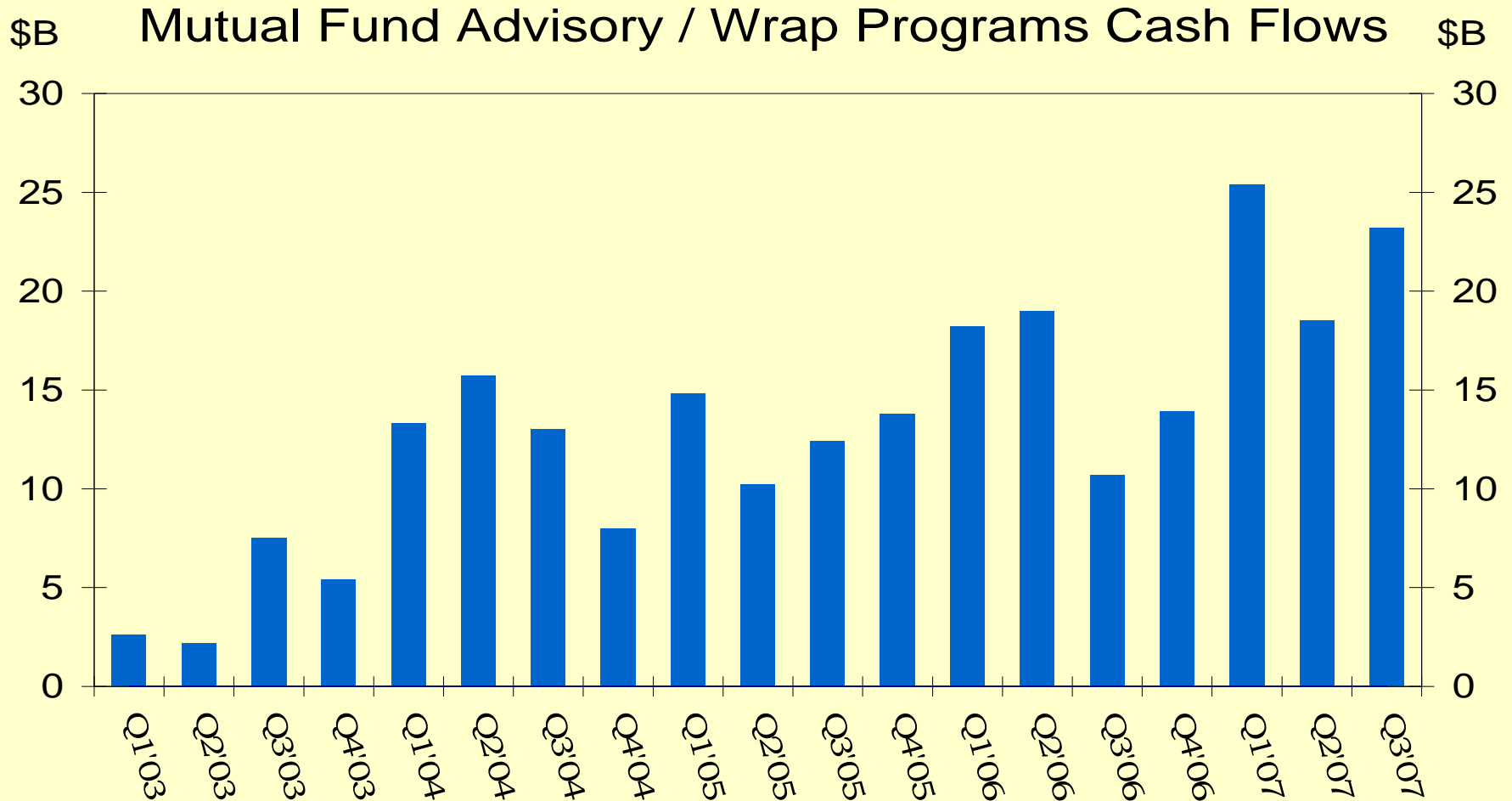
- ❖ Huge sales gains by FoFs, “Wraps”, and the like; more to come due to U.S.’s 2006 Pension Protection Act; marketplace forces a transition to “**asset allocation by default**”
- ❖ “*Choice within constraints, freedom within limits, is what enables the little fish to imagine a host of marvelous possibilities*” (Barry Schwartz, **The Paradox of Choice: Why More is Less**, Page 236 and the closing sentence)
- ❖ Using a “**total wealth**” frame of thinking, instead of zeroing in on individual investments (for which perceived risks are amplified) lead to better long-term decisions (as suggested by Daniel Kahneman, recent Nobel Prize winner); funds-of-funds or “wrapped” investments help to keep investors more in “total wealth” frame of mind...

Pre-Assembled Advice via Funds-of-Funds: Away from “One-Great-Fund-At-a-Time”



Source: Strategic Insight Simfund MF and Simfund VA

A Unifying Solution: Mutual Fund Wraps

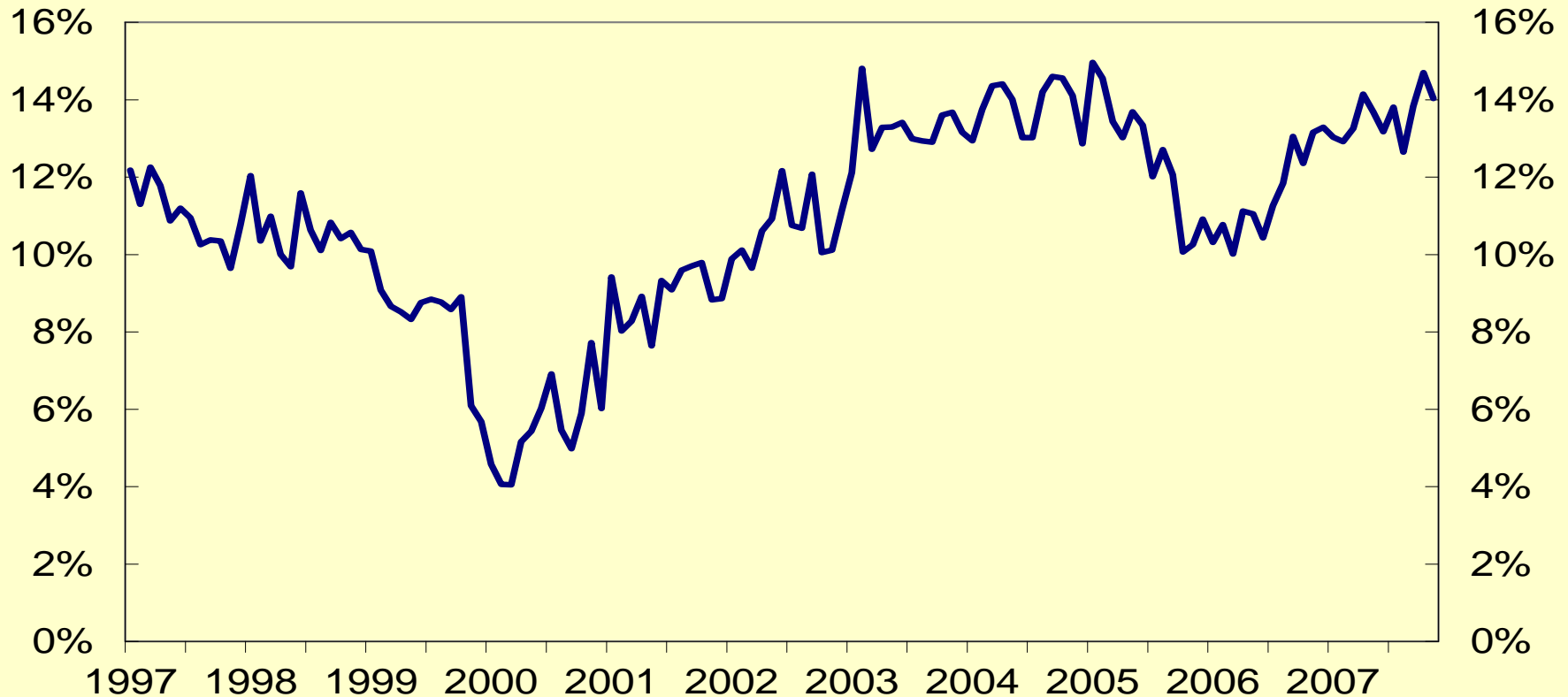


Source: Cerulli Associates

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Comfort Zone Investing: Balanced Funds' Share of Equity Fund Sales (Some Substitution by Funds-of-Funds)

Balanced/Hybrid Fund Share of U.S. Equity Fund Sales

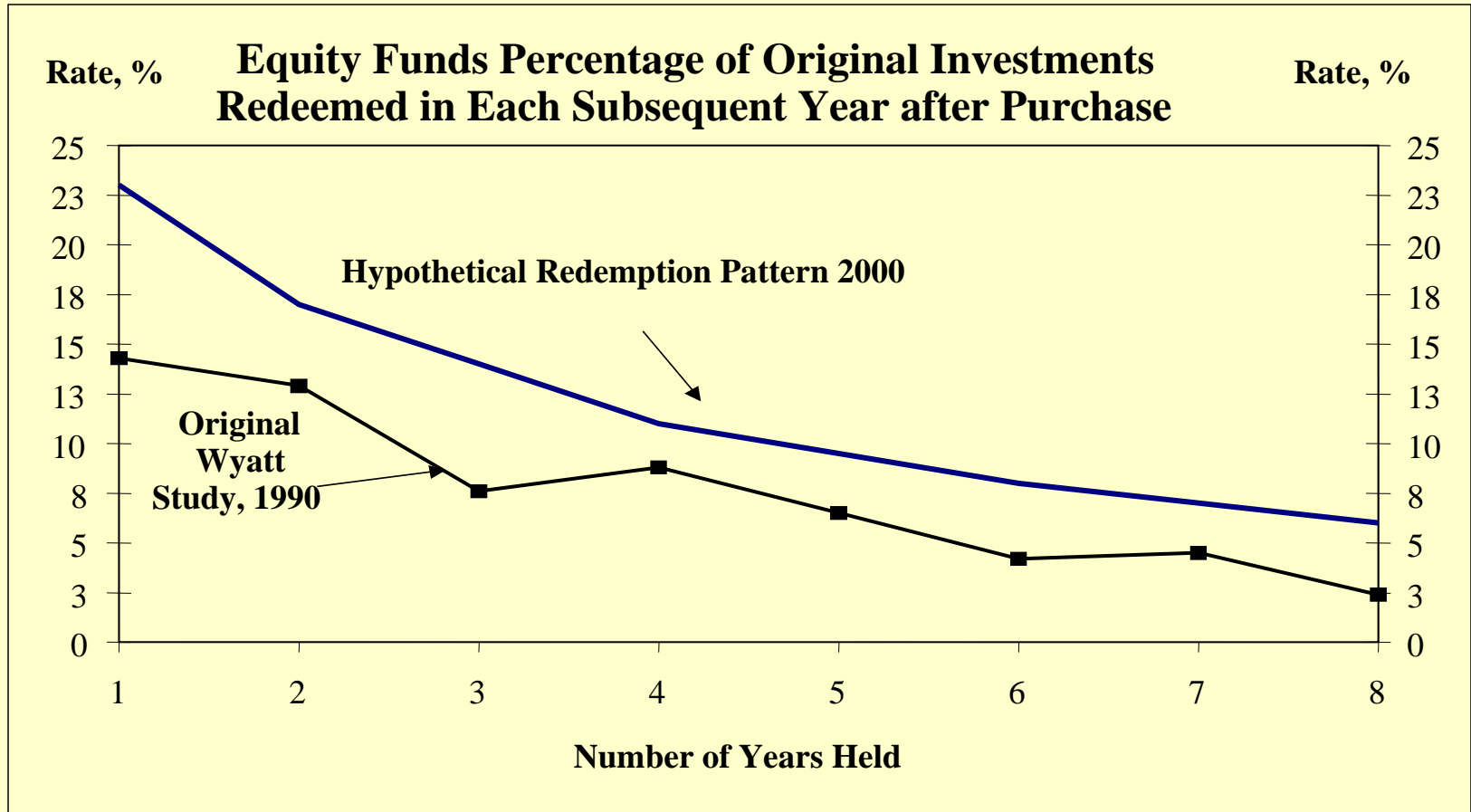


Source: Strategic Insight Simfund MF / ICI Trends

A Retention Culture: Customer Relationship Management (CRM)

- ❖ Appoint a respected leader for CRM; Set **expectations, ownership** inside your firm
- ❖ A strong leader is must, since “no one wants job” since “no way to measure success”
- ❖ Can you **increase retention by 2% of assets?**
- ❖ Plus, those that **leave unhappy do not come back and** also complain to their friends...
- ❖ To succeed in CRM, only **unrealistic expectations** of better retention get people to act...
- ❖ **Change** how a sales organization **thinks?**

Engage the New FAs: Vulnerability Highest Just After Initial Purchases



CRM: The Affluent Investor

- ❖ Product: conservative, preservation core / exploratory promises;
- ❖ Marketing: holistically to the **household, not just head**; Establish an **elegant, product-neutral platform for life-time relationship paid as long as they invest**;
- ❖ Retention: defending against **relationship failure**; remembering **HNW pride**.

CRM and the Financial Advisor

- ❖ **Biggest risk: 1 purchase, high \$\$\$, no follow up, no other active engagements with your firm**
- ❖ **Partner with distributors: update lists of fin'l advisors, offices with excessive redemptions, fine-tune “cost sharing” to retention considerations**
- ❖ **Also, focus on key brokers: those ready to retire; rollover specialists; and bond with new brokers during formative years**
- ❖ **Wholesalers incentives: strategies to increase B/D depth; adjust to unstable assets...**

CRM and the Self-Determining Investor

- ❖ Establish **non-performance** branding
- ❖ **Personify** management company
- ❖ **Engage investors** via two-way Internet, MyAccount, B/D platform, others..
- ❖ Call center **triggered response** to customers seeking redemption
- ❖ Data mining, watch list, contingency plan, local HNW seminars.

What Else Works? Especially in Times of High Anxiety!

- ❖ *“The investment process evokes many of basic psychological needs of a human being: the need to make meaning of confusing perceptions, the need for validation and affirmation of one’s self, the need for a connection with an admired other, and the need for belonging to a group of like-minded others.*
- ❖ *The highest use of financial consultants occurs among investors showing high scores in “other-oriented, high-anxiety, and high-optimism” Overall, financial consultants that are committed to an emotionally engaging and ongoing relationship with their clients, but also represent solidity and conservatism, would be most successful”. (Dr. Richard Geist).*

CRM on the WEB

- ❖ **Adult learning:** cognitive, emotional, instinctive feel; visual, linguistic, analytical communications;
- ❖ Simple, but not simplistic;
- ❖ Where do you hit the wall; **proactive follow up...**

Branding: What is YOUR Aspirational Message

- ❖ Port in the Storm?
- ❖ Experiential Investing?
- ❖ Invest with Confidence?
- ❖ Join a Winner?
- ❖ Align with the Small, Smart, Nimble?
- ❖ Be Realistic?
- ❖ The Investment Process is the Brand?
- ❖ I am Here for You!

Back to the Beginning: Retentions at Point-of-Sales

- ❖ Need-based marketing vs. product sales
- ❖ Long-term financial planning vs. short-term opportunistic purchase
- ❖ Expectation management at purchase
- ❖ Buying the process vs. buying (past) performance (non-recurring)
- ❖ Choice of performance measurement (return, risk, stars, appropriate peer group, FoFs).

Customer / FA Segmentation Post Purchase

- ❖ Engage new investors to your firm during first 1-2 (honeymoon) years
- ❖ Do they have multiple bonding points (funds, VAs, cash, etc.) vs. just one-time purchase, no follow-up engagement
- ❖ Segment investors closing accounts vs. partial redeemers.

When They Insist on Redeemptions: Manage the Separation Process

- ❖ CRM response team: overwhelm with kindness
- ❖ When failed, bridge, immediately, psychological gap of relationship discontinuity
- ❖ Re-market, seasonal needs, etc.
- ❖ Remind them that you want them back.

24/7 Engagement Party: Retention and Deeper Relationships

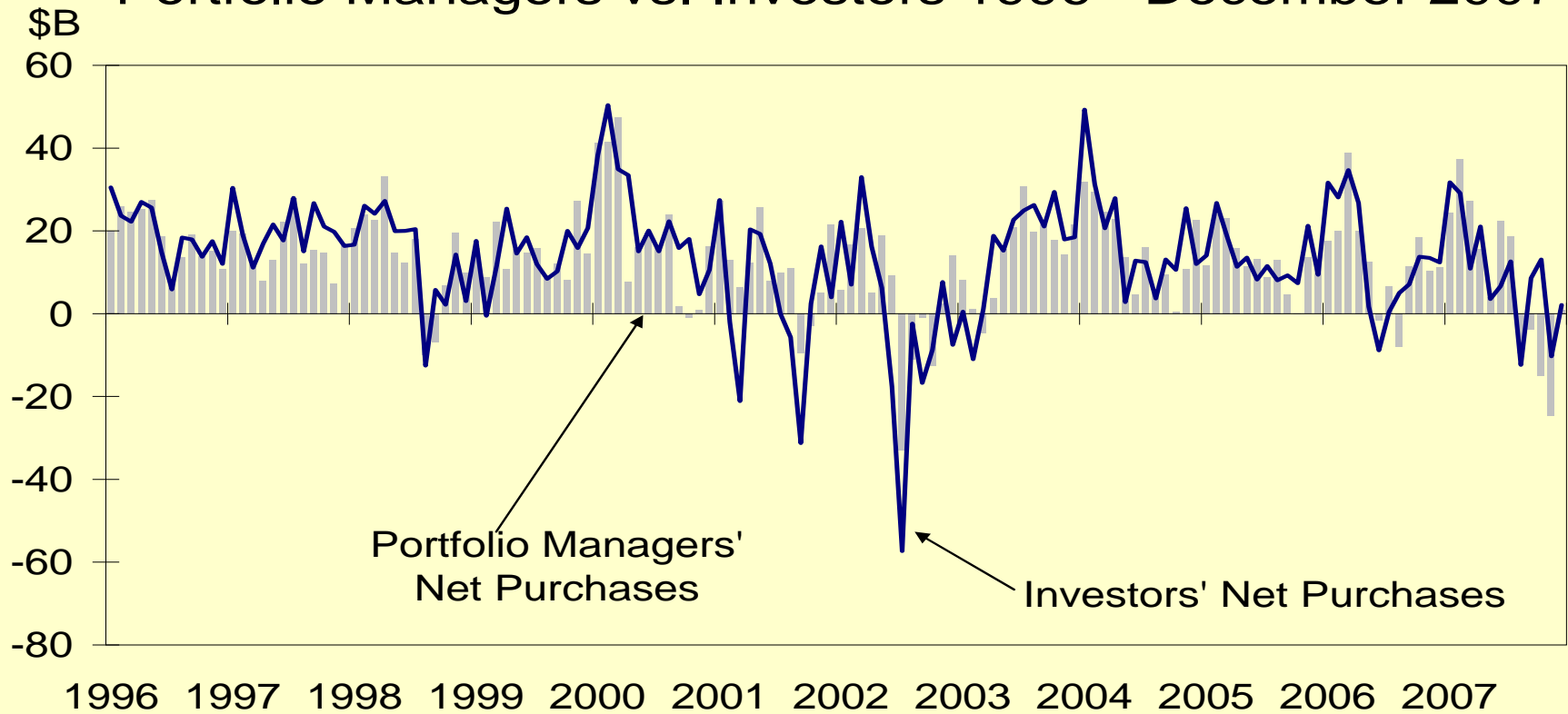
- ❖ Engaging the financial consultant: helping them build their practice
- ❖ Engaging the investor in a non-performance relationship: creating an enjoyable, repeatable experience
- ❖ Aligning Web platform to help brokers; learning / cognitive styles
- ❖ Organizational stability and coherent mission.

Communication as a Core Competency

- ❖ For managers and distributors: process and business integrity, transparency, returns and risks, fees, alternative investments and alternative pricing
- ❖ Strategic PR function
- ❖ **Relationships with investment analysts, performance tracking companies, etc.**

Equity Fund Portfolio Managers Always Buffer Investors' Fluctuating Flows

Equity Fund Net Purchases:
Portfolio Managers vs. Investors 1996 - December 2007



Source: Strategic Insight Simfund / ICI Trends

HELP! A Psychological Approach to Life and Investment Traumas

- ❖ After crisis:
 - ❖ 1. Stimulate communication; encourage talk about anxieties, perception...
 - ❖ 2. Provide perspective, framework, facilitate coping. Separate stock market chaos from your company's stability.
 - ❖ 3. Help investors restore sense of mastery; facts, alternatives, actions; back in control...
 - ❖ 4. Enhance self esteem; what can be learned.

Some Additional Resources...

- ❖ SI Book from 2000 Post-Bubble
**“Enhancing Relationship
Management and Customer
Retention”.**
- ❖ SI “Strategies for Action” Oct. 2001
- ❖ Other past studies on sionline.com.

SI Research Services Already Used by Managers of 90% of U.S. Fund Industry Assets, Increasingly Overseas

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