



2010 Consultant Search Forecast

Annual Survey

February 2010

- **Investment consultants expect North American institutional investors to award nearly \$430 billion in mandates to asset managers during 2010, a 13% increase over 2009 levels.**
- **Inflation protection and liability-driven investing are core themes.** More than 80% of US respondents predict a high or moderate focus on inflation-protected strategies during 2010.
- **Institutional interest in hedge funds and funds of hedge funds will revive,** with 80% of US consultants predicting strong or moderate search activity. Only half of the US respondents anticipate equal interest in real estate or private equity.
- **Funds of funds for both hedge funds and private equity increased in popularity,** with nearly 70% of investment consultants preferring assembled products to direct investments.
- **International and global equity managers will remain the most sought-after firms in 2010.** Conversely, US respondents believe domestic equity will fall from second to sixth place in expected search activity, and core and core-plus bonds from third to fourth.
- **Manager replacement will characterize search activity in traditional asset classes,** with a majority of consultants expecting turnover to fuel most searches in long-only equities and bonds.
- **The style box is less influential.** Only one out of five respondents favored value stocks, with the remainder indicating no preference; opinions regarding large-cap portfolios were similar.
- **Consultants continue to avoid quantitative and long-extension strategies,** with no respondents expressing a preference for either portfolio construction approach.
- **Canadian consultants expect increased demand for domestic equity and property, and have fewer concerns about inflation,** although their other responses mirrored those of US counterparts.

Introduction: Expected Search Activity in 2010

Casey Quirk and eVestment Alliance have worked together to produce their fourth annual survey of investment consultants in the United States and Canada. Conducted in December 2009, the poll asks investment consultants to provide their opinions about the expectations of institutional investors and other professional buyers in North America, profiling potential demand for various investment strategies during 2010.

This year, 70 North American investment consultants, representing nearly \$7 trillion in assets under advisement participated in the poll. During 2009, the respondents conducted more than 4,000 manager searches, and placed a total of \$378 billion in mandates, well exceeding their expectations in the prior year's survey. Nearly 90% of US investment consultants said they expect search activity to keep increasing during 2010, with nearly 20% of respondents predicting a 25% or greater increase in the number of searches. North American respondents expect clients to tender \$426 billion of assets in 2010 searches, a 13% rise over last year.

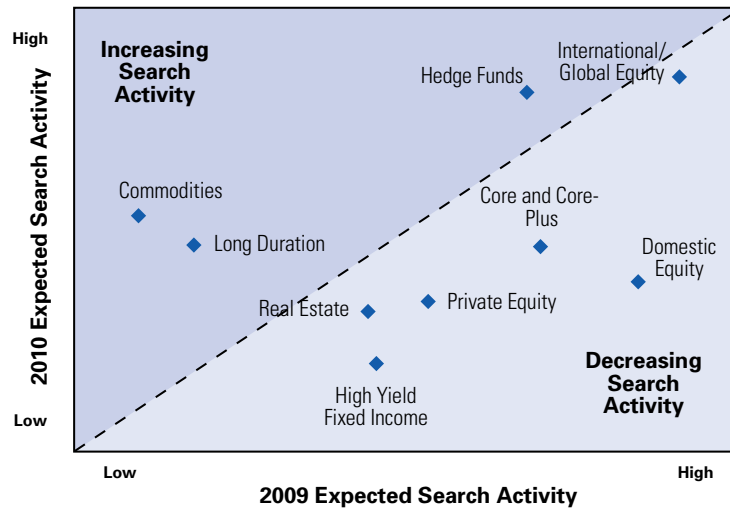
This year's survey results reflect a post-crisis thaw in strategy-driven search activity, shifting from a crisis-response mode to a more thoughtful look at investment policy. The asset management firms successful in winning mandates during 2010 will offer product lines and client servicing strategies that meet four key, and growing, concerns of institutional investors:

1. Fears about inflation, which are raising interest in new asset classes.
2. Concerns about pension liabilities, which are refocusing attention on liability-driven investment strategies.
3. A need to shore up funding gaps, which has revived an appetite for hedge funds.
4. Demand for non-US securities, which continues to rise.

2010 Product Opportunity Map

Our product opportunity map for 2010 compares the demand consultants anticipate for the coming year with expected demand reported in the previous year in key asset classes. Last year, polled in the midst of the unfolding financial crisis, consultants predicted rising demand for traditional asset classes—particularly core and core-plus bonds, as well as specialty fixed income—and receding interest in hedge funds and other alternative investments. For 2010, however, their opinions have changed again.

2010 Product Opportunity Map



Note: US respondents only.

Sources: Casey Quirk, eInvestment Alliance

Changing trends in demand fall into three broad categories:

- 1. Traditional asset classes:** Consultants believe demand for international and global equity will remain strong in 2010, reflecting secular shifts toward global benchmarks among US and Canadian institutional investors, as well as a growing belief that short-term investment opportunities may be more plentiful in emerging markets. The cyclical demand for core and core-plus bonds apparently has faded, and demand for US equities has dropped considerably.
- 2. Alternatives:** Respondents predict resuscitating interest in hedge funds. More pension funds of all sizes realize non-correlated alpha will represent one of the few methods through which they can shore up funding gaps that collapsing equity markets re-opened in 2008-2009. Consultants expected slightly less search activity in real estate and private equity, likely due to liquidity needs. Canadian respondents were more interested in real estate than their US counterparts, ranking it third overall by expected search activity, compared to eighth in the US.
- 3. Specialty fixed income and commodities:** Last year, investment consultants predicted the deleveraging crisis would create a wide number of opportunities within credit markets. Interest in shifting to core-satellite fixed income portfolios also boosted expectations regarding high-yield products. But this year their interest apparently has cooled, as well-priced investments become less obvious and default concerns resurface. Respondents, however, predict interest in long-duration bonds and commodities will rise significantly.

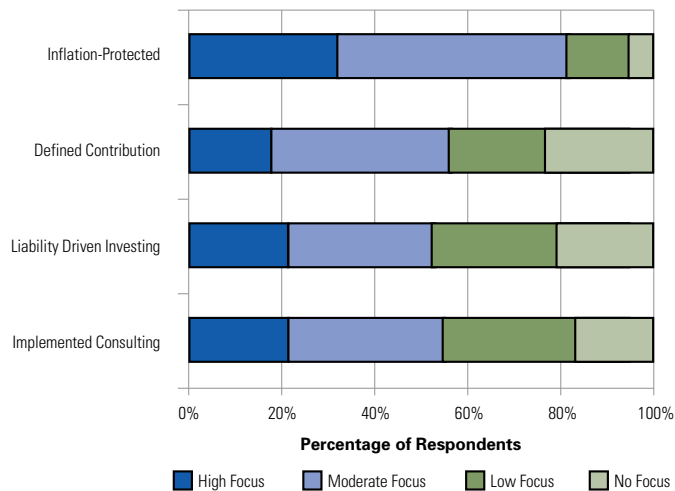
The lattermost trend is one of the most interesting. This year's survey specifically polled respondents about key themes driving search activity. Protecting portfolios from inflation led the list, with more

than 80% of polled US consultants indicating they expected their clients to have at least a moderate or high focus on inflation. Many institutional investors believe the wave of policy-driven liquidity created by stimulus packages and quantitative easing will boost prices, and there are fears that governments worldwide will be slow to ratchet up interest rates in response. Canadian consultants, conversely, were more sanguine about inflation, with the wide majority of respondents expecting their clients will place a low focus on inflation-protected instruments in 2010.

Respondents also believe liability-driven investing will remain a key theme in 2010. The financial crisis slashed funding ratios among many defined benefit pension plans, but it also emphasized the long-term business risk of carrying significant pension obligations into the future. Many corporate pension plans are redoubling efforts to immunize liabilities as a result.

Exhibit 2

Key Themes Driving Manager Search Activity, 2010



Note: US respondents only.

Sources: Casey Quirk, eVestment Alliance

Search Activity Characteristics

Surveyed US and Canadian consultants still believe they will conduct more searches for international and global equity managers than they will for any other asset class in 2010, similar to their expectations in 2009. Domestic equity is a different story, with US stocks falling to sixth place in a ranking of asset classes by expected search activity. Canadian respondents, however, ranked domestic equity second among the asset classes in which they expected to see the most search activity.

Exhibit 3

Historical Ranking of Asset Classes by Expected Search Activity, 2010

	2008	2009	2010
1	Hedge Funds/Funds of Hedge Funds	International/Global Equity	International/Global Equity
2	International/Global Equity	Domestic Equity	Hedge Funds/Funds of Hedge Funds
3	Domestic Equity	Core/Core-Plus Fixed Income	Emerging Market Equity*
4	Real Estate	Hedge Funds/Funds of Hedge Funds	Core/Core-Plus Fixed Income
5	Private Equity	Real Estate	Commodities
6	Core/Core-Plus Fixed Income	High-Yield Fixed Income	Domestic Equity
7	LDI/Long Duration Fixed Income	Private Equity	Long Duration
8	Commodities	LDI/Long Duration Fixed Income	Real Estate

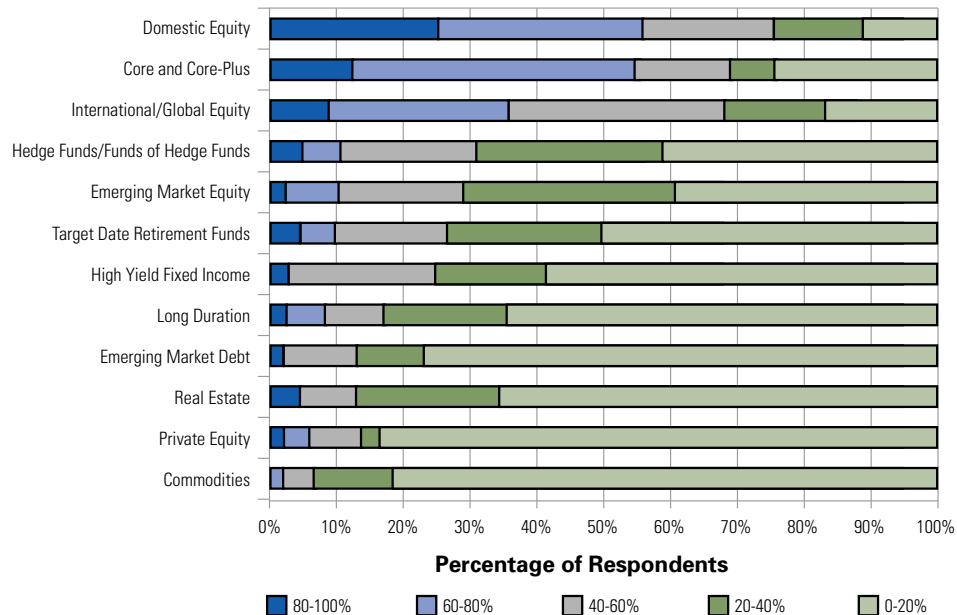
Note: US respondents only. *New asset class for 2010.

Sources: Casey Quirk, eInvestment Alliance

Perhaps more importantly, searches for domestic equity managers will center more on replacing underperforming managers than supporting new allocations, representing a take-away game. This year's survey included a new question designed to separate search activity between manager turnover and new commitments to an asset class. Roughly 25% of respondents expected between 80% and 100% of their US equity searches would involve replacing managers—the highest such turnover predicted for any disciplines. Investment consultants believe turnover will drive most of the search activity in not only US equities, but also the other traditional asset classes. Canadian respondents expect similarly high turnover among core products.

Exhibit 4

Expected Proportion of Search Activity From Manager Replacement by Asset Class, 2010



Note: US respondents only.

Sources: Casey Quirk, eInvestment Alliance

Conversely, consultants expected the wide majority of their searches for long duration bonds and commodities—again, asset classes perceived as inflation-fighting—will represent new mandates, rather than the overhaul of an existing manager roster.

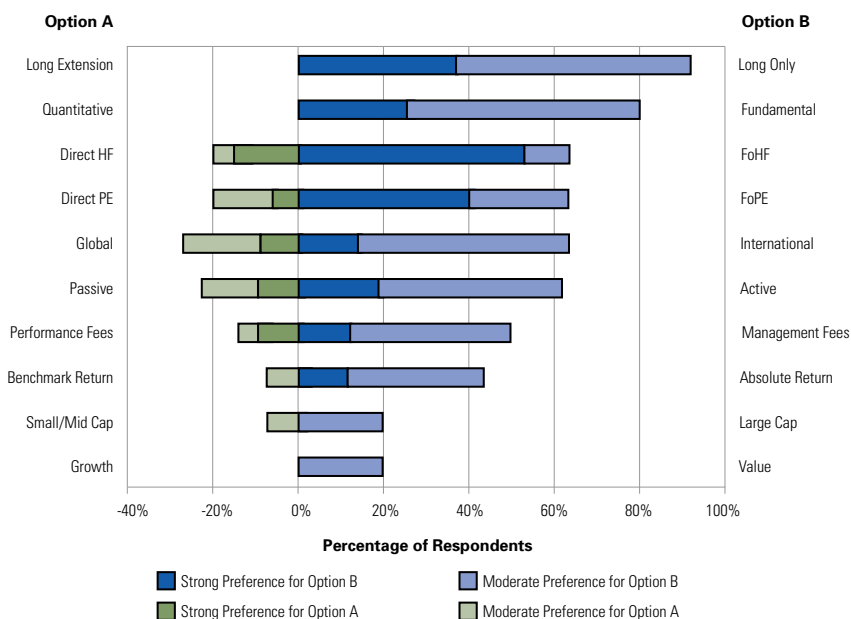
Answers to questions that aimed to provide greater granularity regarding the characteristics of search activity reinforced respondents' opinions from surveys in prior years:

- As a whole, investment consultants continue to avoid long-extension and quantitative strategies, absent strong three-year performance numbers from these categories.
- They also increasingly show little preference for growth or value portfolios among equities, underscoring the waning influence of the style box.
- Assembled approaches to alternatives—funds of hedge funds, funds of private equity funds—are rising in favor as mid-sized pensions, too small to make impactful direct investments, boost their non-traditional allocations.
- Interest in absolute-return strategies has surged as institutional investors become more outcome-oriented in their investment policies and asset allocations.

More than 60% of consultants expressed a preference for international (*i.e.*, excluding US) mandates over global (*i.e.*, including US) assignments, higher than in previous years. But the proportion of consultants favoring global managers remains roughly the same as 2009. The proportion of respondents expressing no preference has dropped dramatically, indicating that fund managers increasingly will need to explain and defend their approach to foreign equity portfolios.

Exhibit 5

Expected Investor Preferences, 2010



Sources: Casey Quirk, eVestment Alliance

Conclusion

Fund managers seeking to gather assets from North American institutional investors in 2010 have both tactical and strategic opportunities. Expected high turnover among managers in traditional asset classes highlights dissatisfaction with incumbents. That will increase pressure on investment management firms to identify and fix their weakness, both regarding product performance and client servicing. Additionally, this year's findings underscore longer-term implications for fund managers:

- Asset managers increasingly must define their value not in terms of benchmarks, but in terms of outcomes.
- Product development will be a critical differentiator, as searches in traditional asset classes devolve into take-away games and the influence of the style box wanes.
- Resurgent demand for hedge funds reflects a growing appetite for non-correlated alpha, a trend that likely will favor managers able to field long-short as well as long-only products.
- Globalization remains a secular trend in portfolio management, favoring firms able to handle domestic and foreign securities with equal skills.
- Incentive alignment will remain a critical differentiator, as asset owners and their consultants favor fund managers with long-term compensation and ownership structures that motivate and retain talent.

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