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**Trends** in the US fund industry and **developments** in asset management in Europe are discussed in this issue. A **guest column** suggests **ways to reach the Ultra High Net Worth investor**, and provides **insights valuable to every financial advisor**. A number of **enhancements to SI's technologies** are touched on in the **Tools Time** section. And many **fund trustees might agree with our conclusion that it is no longer necessary to implement additional redemption fee rules under 22c-2**.

If your associates are **interested in direct access to Windows, including past issues of importance** (e.g., last month we focused on **subadvisory relationships** and opportunities) have them **log on to [www.sionline.com](http://www.sionline.com) and register**; access is generally free within organizations already subscribing to SI's research.

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# Perspectives



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20 years ago, when Joel Rosenthal and I founded Strategic Insight, stock and bond fund assets totaled about \$250 billion. American Funds and Vanguard each ran just over \$10 billion of these assets. This past month, US-based funds just crossed the \$10 trillion mark.

This issue of *Windows* discusses changes in investment demand, distribution to the affluent and ultra wealthy, international expansion opportunities, and some analysis helpful for fund trustees, among others. You may consider sharing these insightful articles broadly within your organization, as well as with your distribution partners and independent trustees.

## Following the Ideas Trail... Excerpts from This *Windows* Issue

- Diversified US funds: **the rotation from value to growth** style investing continues.
- Non-US funds: its not just investors that find **international diversification** attractive. The portfolio **managers of many US-centered funds at times have high allocations to non-U.S. stocks**. On average (asset weighted), non-US stocks accounted for 9% of all active diversified US equity fund assets as of late. Among \$10 billion-plus funds, a few have a much higher non-US stock allocation.
- New fund innovation: each of the planned funds we highlight in the New Fund Filings section either uses **non-market correlated strategies or invests (to varying extent) in derivatives**.
- The data shows that **variability of pre-expense total returns** as measured by the standard deviation of such returns **remains extraordinarily high**, even among the more “commodity-like” large cap equity sectors. For example, Large Cap Growth fund **pre-expense returns** over the trailing three year period had a **standard deviation of nearly 17%**.
- Different methodologies of performance calculations result in large differences in average returns for a particular category (survivorship bias-free, ‘portfolio’ vs. ‘class’ etc.). ...**For certain categories with a large number of liquidated and merged funds, we calculated a variance (for 2000 average returns, for illustration purposes) of 2% (Europe Stocks) and more than 4% (Pacific Funds excluding Japan)**.
- Proposed SEC new rule 22c-2—the **data shows virtual disappearance of any major abusive market timing activity among international equity funds...22c-2 cost of eliminating ‘the last of the abusive market timers’ and its other disruptions to the mutual fund business is just too high**.
- Looking at the **global fund business: funds domiciled in Luxembourg and Dublin (which constitute the major expansion vehicle for US fund managers) captured over €200 billion in flows for the full year 2005**, and accounted for **more than half the total net flows to funds in Europe**. ‘BRIC’ funds were **among the highest cash flow products in Europe** during the first two months of 2006.
- We include in this issue data and highlights of SI’s just published detailed study on developments in the **variable annuity / life** business.
- Many Ultra High Net Worth (UHNW) individuals and families **grew up middle- or lower-class... many still consider themselves “middle class at heart”**. Our guest columnists Andrea Trachtenberg and Evelyn Ehrlich underscore the importance of understanding the nuances that distinguish the attitudes and behaviors of UHNW individuals at different stages of the “wealth maturation cycle.” Most financial advisors, if they segment the HNW market at all, do so by assets. But asset size doesn’t reveal as much about these individuals as does another measure—**how long they have been wealthy**.
- To assist the many and **diverse users of Simfund 4.0** with their distinctive data intelligence needs, and to help each maximize the benefits of the database, Strategic Insight is planning to offer a **new training program: Simfund Certified Analyst**.
- **Fund Filing 4.0**, our newest upgrade to the Fund Filing website, will be launched by the summer.
- **Strategic Insight’s five Internet libraries of proprietary research: we summarize what you can find in each**.

# US Fund FlowWatch

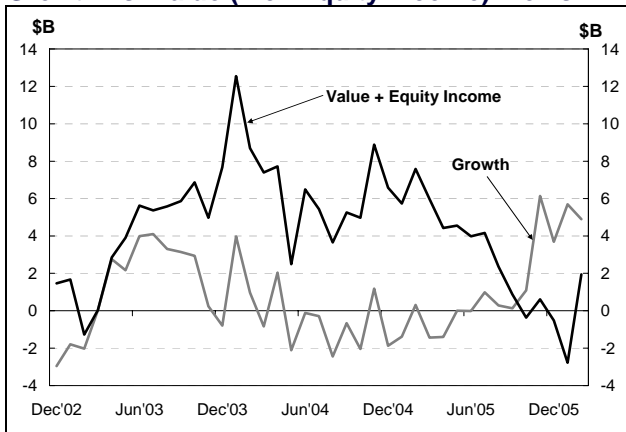


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## Flows: Is the Growth Style Back?

A rotation towards growth style funds and away from value started to become evident in late 2005.

### Diversified U.S. Lipper Classifications Growth vs. Value (Incl. Equity Income) Flows



Source: Strategic Insight Simfund MF, Lipper Inc. (Class.)

The growth style's gains were more pronounced in Multicap and Mid/Small-Cap funds, and were experienced less in the Large-Cap Growth fund category. Interestingly, each of the pure Large-Cap Categories, in aggregate, sustained net redemptions lately, while Multi-cap as well as Mid / Small-cap core or value funds showed positive and rising flows.

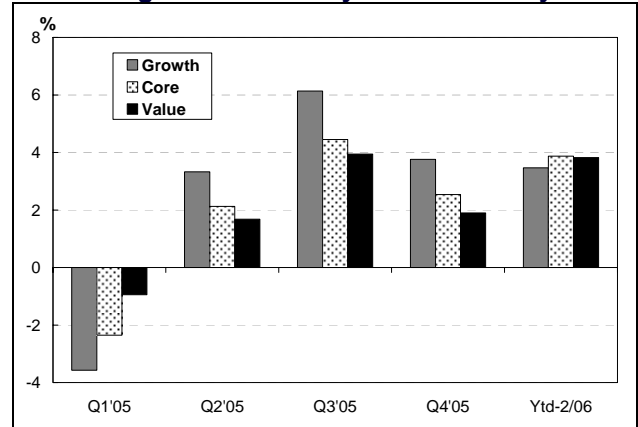
### Diversified U.S. Equity Fund Flows

	Flows \$MM		
	Q3'05	Q4'05	1-2/06
Multi-Cap Growth	5,477	9,974	10,866
Mid-Cap Growth	-74	1,423	1,526
Small-Cap Growth	211	576	718
Large-Cap Growth	-4,222	-1,056	-2,515
<b>Growth Funds</b>	<b>1,392</b>	<b>10,918</b>	<b>10,595</b>
Small-Cap Core	1,987	2,132	4,644
Multi-Cap Core	973	2,944	3,654
Mid-Cap Core	3,044	2,458	3,615
Large-Cap Core	-12,799	-12,246	-9,096
<b>Core Funds</b>	<b>-6,795</b>	<b>-4,712</b>	<b>-2,817</b>
Multi-Cap Value	4,709	2,224	3,984
Small-Cap Value	529	-442	305
Mid-Cap Value	3,486	-360	-13
Large-Cap Value	-2,774	-2,621	-3,011
<b>Value Funds</b>	<b>5,951</b>	<b>-1,199</b>	<b>1,265</b>

Source: Strategic Insight Simfund MF, Lipper Inc. (Class.)

The shift to the growth style can be partially attributed to its better returns over the past year (even though in 1Q06 most value styles slightly outperformed growth). For the one year period ended March, returns of growth style funds exceeded those of value-style funds by 3-6%, depending on capitalization sector.

### Asset-weighted Returns by Investment Style



Source: Strategic Insight Simfund MF; Lipper Inc. (Classifications), Standard & Poor's

The largest beneficiaries of flows into growth funds were **Growth Fund of America, Fidelity Contrafund, and Fidelity Advisor New Insights fund, taking in over \$9 billion** in net flows combined in January and February (the two Fidelity funds, as well as Fidelity Growth, just announced closure to new investors by April-end; in the list below the Rainier fund also just closed).

### Best Selling Growth Style Funds

Portfolio Name	Lipper Class.	2/06	Ytd-2/06 Flows	
		Assets \$B	\$MM	Growth Rate %
Growth Fund of America	MulGr	137.1	5,864	5%
Fidelity Contrafund	MulGr	63.8	2,249	4
Fidelity Adv New Insights	MulGr	5.5	1,159	27
Price Growth Stock	Lrg Gr	13.9	770	6
Calamos Growth	MulGr	19.3	573	3
Fidelity Growth Company	MulGr	29.2	515	2
Rainier Small/Mid Cap	Mid Gr	2.8	463	22
Fairholme Fund	Mid Gr	2.0	383	24
Munder Mid Cap Core Gr	Mid Gr	1.6	371	32
Legg Mason Opportunity	MulGr	5.6	355	7

\*Ytd-2/06 Flows as % of 12/05 assets; Source: Strategic Insight Simfund MF, Lipper Inc. (Classifications)

Closure of leading funds, and persistent allocation to the large cap growth style by many strategists, will continue to offer opportunities for other growth funds. Demand for more growth funds, if realized, should be the evidence that a structural transition to the growth style (and not just opportunistic buying of high-returning growth funds) is underway.

## New Fund Filings



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### Notable New Funds

Among noteworthy products currently on the drawing boards of fund complexes, we **highlight below one fund or series in each of these categories: funds-of-funds; lifecycle funds; diversified US equity; diversified global equity; and global bond.** Each of the funds below either uses **non-market correlated strategies or invests (to varying extent) in derivatives.**

**John Hancock's** proposed [Absolute Return Portfolio](#) will seek "maximum real return, consistent with preservation of real capital and prudent investment management" through its investments in other John Hancock equity or fixed income funds. This FoF's **subadviser, MFC Global** (a John Hancock affiliate), **will try to achieve an average annual total return for the portfolio that's greater than or equal to the Consumer Price Index (All Urban Consumers) plus 5% (net of advisory fees)** "over a long-term time horizon while attempting to maintain a low probability of negative returns in any 12-month time period."

**ABN AMRO** is preparing to launch four structured target-date funds. According to the preliminary prospectus of the **Target Horizon 2011, Target Horizon 2013, Target Horizon 2016** and **Target Horizon 2021** funds, each of them will seek long-term capital appreciation, and, for shares held until the fund's Horizon date, offer shareholders a "**protected value**" which is the greater of (i) the fund's NAV at inception and (ii) the highest month-end NAV achieved by the fund prior to the Horizon Date (as adjusted for dividends and distributions paid). Each Target Horizon fund's portfolio will comprise of an equity component, a fixed-income component and cash equivalents. The **equity component** will seek capital appreciation by investing chiefly in derivatives based on US equity indexes (mainly futures and options on the S&P 500 Index). The

**fixed-income component** will try to preserve each fund's "protected value" by investing mainly in zero coupon US Treasury securities. **Cash equivalents** will be held to "maintain liquidity, provide reserves for future Fund expenses, provide coverage for certain derivatives transactions, and facilitate rebalancing of its portfolio." Per the filing: "Assets are allocated among the various components based on several factors, including the portion of the portfolio needed to achieve the Protected Value, the remaining time to the Horizon Date, and market conditions."

**Morgan Stanley** filed the [Equities Plus Portfolio](#), which will invest in a portfolio mainly composed of equity index derivatives to gain exposure to the S&P 500 Index, backed by investment grade dollar denominated fixed income securities, especially US government, corporate and mortgage securities. The fund's adviser plans to actively manage the fixed income securities held with the objective of seeking incremental return; with respect to this fixed income component, the portfolio will normally aim to maintain an average duration between zero and one year. The fund may invest up to 20% of its assets in securities of foreign issuers, including those in emerging markets (this percentage restriction, however, will not apply to securities of foreign companies that are listed in the U.S. on a national exchange); and up to 20% of its assets in high yield bonds.

**Dreyfus** registered the [Premier Global Tactical Advantage](#) fund, which will seek total return through investments in instruments providing exposure to global equity, bond and currency markets, mainly via long and short positions in futures, options or, in the case of currencies, forward contracts. The fund will focus its investments among the major developed capital markets of the world. Its portfolio managers will seek to deliver "alpha" by "applying a systematic, quantitative investment approach designed to identify and exploit relative mis-valuations across and within global capital markets."

**SEI** is planning to start a **short duration global bond fund** that will seek to provide "an enhanced return above typical short-term funds." The proposed [SEI Institutional Enhanced Income](#) fund will allocate assets among multiple subadvisers (**Highland Capital Management, Record Currency Management** and **Wellington**) and aim for a total return greater than that of the 3-month LIBOR. The sub-advisers will try to boost the fund's return by actively managing its foreign currency exposure using various derivative products. The fund may also invest a portion of its assets in bank loans.

# International Funds



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For the first two months of 2006, U.S.-based international/global fund net flows outpaced domestic equity fund flows, continuing the 2005 trend.

## U.S. Based Equity Mutual Funds\*

	Assets		Net New Flows \$B		% Share
	\$T		Ytd-2/06	Equity Flows	Ytd-2/06
	2/06	2004	2005	2/06	
Domestic Equity	5.0	215	102	21	29%
Int'l Equity	1.3	106	155	52	71%
<b>Total above</b>	<b>6.3</b>	<b>321</b>	<b>257</b>	<b>72</b>	

\*Equity and balanced funds, open-end, closed-end, ETFs, VA.  
Source: Strategic Insight Simfund MF, VA

Gains among international funds were evidenced among active and passive funds, ETFs, and VA underlying funds.

## US Based Int'l/Global Equity Mutual Funds

	Assets		Net New Flows \$B			
	\$B		2003	2004	2005	Ytd-2/06
	2/06					
Open-End Active	974	27.0	70.9	103.9	39.4	
Open-End Index	48	2.2	5.7	8.9	1.8	
ETF	77	5.7	15.3	23.0	6.9	
Closed-End	27	0.3	4.4	6.7	0.0	
VA	125	4.8	9.4	12.3	3.5	
<b>Total above</b>	<b>1251</b>	<b>40.0</b>	<b>105.6</b>	<b>154.9</b>	<b>51.7</b>	

\*Equity and Balanced Funds, Open-end, Closed-end, ETFs, VA.  
Source: Strategic Insight Simfund MF, VA

Latin American funds continued to lead all equity styles in terms of performance through February 2006, ranking first among styles for trailing 1- and 3-year annualized total returns, and second for trailing 5-year annualized returns (for the year ending March they gained 76%! ). Overall, seven of the top ten performing styles (in terms of trailing 1-year returns) were international or global in nature.

## Top Performing Open-End Equity Styles in terms of Trailing 1-Year Returns (as of 2/06)

	1 Yr	Rank	3 Yr	Rank	5 Yr	Rank
Latin American	62.23	1	63.36	1	24.59	2
Gold-Oriented	41.59	2	29.99	14	31.38	1
Emerging Markets	34.48	3	42.41	2	20.92	3
Japanese	32.12	4	28.21	16	5.67	30
Pacific Region	29.20	5	31.79	9	11.24	12
Natural Resources	28.24	6	36.45	5	17.36	5
Real Estate	28.01	7	30.45	11	20.82	4
Int'l Sml/MidCap Gro	27.14	8	39.28	3	12.46	10
Pacific Ex Japan	26.06	9	33.55	7	15.89	7
Gbl Sml/MidCap Gro	22.36	10	33.16	8	9.04	18
S&P 500 Index	7.84	51	16.47	47	1.79	49

Source: Strategic Insight Simfund MF, Lipper Inc.

## US Centered Funds and their Allocation of Non-U.S. Stocks

Its not just investors that find international diversification attractive. The portfolio managers of many US centered funds at times allocate a high percentage of assets to non-U.S. stocks. As of late, non-US stocks accounted, on average (asset-weighted), for 9% of assets in active diversified US equity funds. Among \$10 billion-plus funds, a few have a much higher allocation, according to Morningstar data: Fidelity Contrafund, Magellan, and Low Priced Stock, each devote more than 20% of assets to non-US stocks; similarly American Funds' Fundamental Investors, Franklin's Mutual Shares, and The Hartford's Capital Appreciation have recently assigned more than a quarter of their assets to non-US stocks. The following table highlights other US centered funds with a high international stock allocation lately.

## Domestic Equity Funds with High Non-US Allocations

Fund	Style	Asset Alloc %		Assets \$MM
		Non-US Stock	2/06	
Pearl Aggressive Growth	MultiCore	62	9	40
Huntington Rotating Markets	MultiCore	50	9	34
FundX Upgrader	MultiCore	46	9	465
Mutual Qualified	MultiCore	44	9	5,015
Janus Contrarian Fund	MultiCore	42	9	3,443
J Hancock LgCp IntrinsicValue	MultiCore	38	9	4
PMFM Mgd Portfolio Trust	MultiCore	36	9	70
American Century Newton	SmlCore	35	5	6
Birmiwal Oasis	SmlCore	34	5	15
Third Avenue Value	MidCore	34	8	7,763
CGM Focus	MidGrth	34	7	1,991
Kinetics Paradigm	MidValue	32	10	643
AdvisorOne Amerigo	MultiGrth	32	13	554
J Hancock Large Cap Equity	LrgCore	32	8	525
Mutual Shares	MultiValue	32	12	16,576
Pioneer Cullen Value	LrgValue	31	9	684
Wells Fargo Avg GrowthEqty	MultiCore	31	9	594
Mutual Beacon	MultiCore	31	9	6,123

Source: Strategic Insight Simfund MF, Lipper Inc.

# High Demand for Mutual Fund Wraps / Advisory Programs



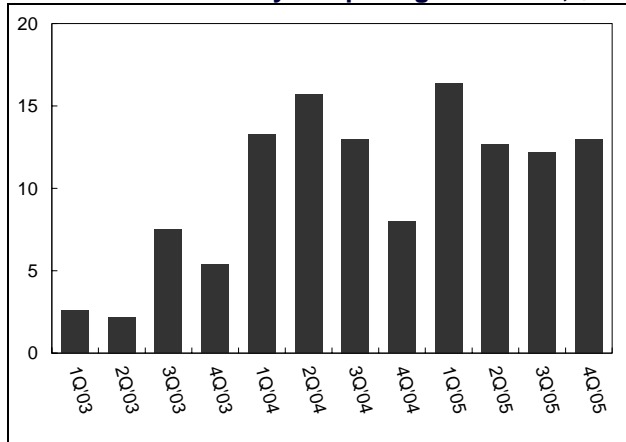
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Continuing their rapid growth pattern which began in early 2004, mutual fund wrap programs captured more than \$50 billion in net inflows in 2005. **For a number of distributors, the fund wrap segment is among the fastest growing parts of their business.**

In parallel with gains experienced by other kinds of asset allocation fund programs, such as lifecycle funds and global asset allocation funds-of-funds, demand for fund wraps has been influenced by **converging forces: greater attention to prudent asset allocation; compliance concerns associated with point-of-sales compensation; and a desire among financial advisors and their brokerage firms for fee-based relationships.** In view of the ongoing impact of these forces, **rapid growth of fund wraps will persist.**

Financial advisory systems benefiting from large inflows lately within mutual funds wraps include **Ameriprise** (which sponsors the largest mutual fund wrap program), **Wachovia, UBS, and Fidelity**; each of these gained by our estimate \$1-1.5 billion quarterly in net flows. But **most national and regional B/Ds and financial planning firms show strong growth too.**

## Mutual Fund Advisory/Wrap Program Flows, \$B



Source: Cerulli Associates, Strategic Insight estimate

## Mutual Fund Wrap: a Quick Primer

Mutual fund wrap programs are structured to:

- **Evaluate investors’ risk profile and objectives**
- **Set asset allocation goals**
- **Select funds, diversify within each style**
- **Rebalance.**

Most fund wraps are non-discretionary, but exceptions exist. A Cerulli Associates past survey estimated that **sources of investment** into fund wraps are:

- **51% IRA Rollovers**
- 21% conversions of funds
- 10% conversion from stocks
- 18% new cash.

## Asset Allocation as a Process, Not an Event

- **Fund wraps help address two compliance concerns:** preventing investors from putting too much money into the “hot” style, and justification of fees based on initial and on-going services for these fee-based accounts. Thus, the **alignment** of fund wraps **with a due diligence process should continue to support their fast expansion.**
- Looking back at the early adoption of fund wraps in the late 1990s, one of the lessons learned was to limit FA flexibility, especially if such flexibility allowed just the recommending of contemporary “hot” funds. Beyond structural makeup, factors facilitating the acceptance of fund wraps include service quality and dynamic rebalancing.
- Within a fund wrap, financial advisor discretion to choose among the many good funds screened and offered within each style still exists. But in a few cases, a very short list of screened and recommended funds at times accounts for a rising share, a quarter to a third of all wrap program flows.
- Tax sensitive tools, **tax-efficient funds not yet sufficiently used** within fund wraps.
- An important consideration for investment managers is how **to manage acquisition, retention costs** within fund wraps, especially when holding periods are uncertain.

# Investment Offerings among B/Ds and Financial Planners



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The past year witnessed significant activity among investment management organizations residing inside large financial institutions. Merrill Lynch Investment Management, Citigroup Asset Management, and RiverSource are just a few examples. Asset management units within commercial banks have also been actively repositioning themselves, some articulating more resourcefully their quality and independence (e.g. BOA's Columbia, Wachovia's Evergreen, JP Morgan Asset Management), while a few smaller fund units within smaller banks deciding instead to leave the fund management business altogether.

This increasing focus on investment management and the successful articulation of quality and independence have resulted in **growing acceptance of many of the funds offered by asset management units** that were previously too embedded within a larger firm and historically dependent on proprietary distribution ties. Often such acceptance is still limited, however, to the affiliated B/D, but in some cases increasing external distribution is evident.

Exemplifying this trend are funds identified in the following table, all of which have an attractive performance ranking and rising inflows. Many of these funds have benefited from increasing resources and a portfolio management personnel change in recent years that contributed to a dramatic improvement in returns.

Asset allocation funds and asset allocation programs (such as funds-of-funds at times used in DC plans), international funds benefiting from the global reach of many of these managers, and import of ideas from institutional or international units (e.g., at UBS), are common in the list. For example, one investment manager suggested that three-quarters of their sales (funds and SMAs) now occur within

integrated/diversified (allocation) solutions, and nearly 9 in 10 of their (affiliated) FAs now sell their products, reflecting a deepening acceptance by these advisors and renewed recognition of the quality of these funds.

## Selected High Flow Funds among Fund Managers with Proprietary Distribution Legacy

	Assets 2/06	Trailing 12-Mth Flows
RVS Diversified Equity Income	6,085	916
RVS Mid Cap Value	1,457	549
RVS Intl Select Value	1,723	270
Ivy Global Natural Resources	3,157	1,369
W&R Advisors Asset Strategy	1,296	369
Ivy Cundill Global Value	884	328
Ivy Asset Strategy	467	317
UBS Dynamic Alpha	1,945	1,449
UBS Global Allocation	3,695	624
UBS Absolute Return Bond	391	385
UBS US Large Cap Equity	507	333
Merrill Lynch Global Allocation	13,717	1,675
Merrill Lynch Large Cap Value	2,030	827
Merrill Lynch Large Cap Core	3,009	643
Jennison Natural Resources	1,444	448
Jennison Health Sciences	1,073	407
Jennison 20/20 Focus	1,050	213
Dryden International Equity	316	170
Evergreen Asset Allocation	8,492	2,903
Evergreen IL Enhanced Income	649	645
Evergreen International Bond	995	304
Evergreen International Equity	2,940	148
LM Inst'l Western Core + Bond	7,238	2,522
Legg Mason Value Trust	19,972	1,647
LM Inst'l Western Core Bond	4,618	1,247
Legg Mason Opportunity	5,611	693

### Funds-of-Funds

Princor	4,137	1,788
RiverSource	2,381	1,037
Gartmore Mutual	3,634	972
Thrivent Financial	537	517
State Farm	1,611	512

Source: Strategic Insight Simfund MF

## Inside FundFiling.Com: Share Class Pricing Evolution



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**New Share Class for Mutual Fund Wraps:** With rapidly expanding mutual fund wrap programs, B/Ds offering such an asset allocation solution are increasingly seeking lower fee share classes for inclusion. Generally an “A” share class offered at NAV is the preferred choice (with such funds’ 0.25% 12b-1 service fees used to facilitate distribution). Sometimes, an Institutional share class (without 12b-1 fees) is also used. **The latest approach to wrap fund revenue sharing is exemplified by a new “W” share class, launched by MFS Value fund.** Registered in February 2006, the fund **is structured with a 0.10% 12b-1 fee.**

**Fine-tuning “B” and “C” Share Class Maximum Allowed Investments:** Many fund managers have limited “B” share maximums to \$50,000 or \$100,000 in recent years, and some have set limits to “C” shares. In a recent filing, John Hancock set “B” shares’ maximum at \$100,000 and “C” shares’ maximum at \$1 million for a number of its bond funds, which previously did not set maximum allowable investments.

**NAV Purchase:** AIM introduced new rules for NAV purchases, and will permit certain categories of persons to purchase Class A shares of AIM funds without paying an initial sales charge. Interestingly, AIM stipulated that, *“It is the purchaser’s responsibility to notify AIM Distributors or its designee of any qualifying relationship at the time of purchase,”* possibly a clarification to get the distributor to help in the management of point-of-sales discount. Henderson

Global initiated its plan to offer Class A shares at NAV in some instances.

**NAV Purchase Qualifications due to Changing Affiliations (M&As):** As a result of Citigroup’s sale of substantially all of its worldwide asset management business to Legg Mason, NAV purchases of Class A shares are now available to employees of Legg Mason and its subsidiaries. Inversely, sales to employees of Citigroup and its subsidiaries will no longer qualify for a Class “A” sales charge waiver.

**Managing Capacity by Raising Minimums:** Some fast growing funds opt to increase minimum investments instead of a “soft” or “hard” close when they near capacity. Such was the case with Oppenheimer International Small Company and Oppenheimer Developing Markets funds, which have raised minimums to \$50,000 (Classes A, B, C, and N). Existing shareholder and wrap-fee platforms can continue to buy shares at lower increments.

**Fine-Tuning 12b-1:** MFS Research and MFS Total Return funds added the following text to their 12b-1 plan regarding any left-over portion of the distribution fee, *“To the extent the Class A service fees paid under the distribution plan do not exceed 0.25% annually, the fund may pay the remaining amount of service fees available under the plan for distribution-related expenses.”*

**Share Closings:** MFS stopped selling B shares of a number of its shorter duration bond funds. Farm Bureau terminated Class B for the Equitrust Series. Allegiant funds discontinued B shares, and further re-organized their Class R shares into A shares. Effective in June, Dreyfus is closing Class B of Premier funds (\$2.1 billion in assets), except in connection with dividend reinvestment and permitted exchanges.

**New Share Classes:** JP Morgan registered new inst’l Class R (shareholder service fee of 0.05%, minimum \$5 million, for DC plans.) Mainstay introduced Class R3 (0.50% 12b-1 fee). Phoenix Foreign Opportunities fund filed the new Class X, which will not impose sales charges or distribution fees and with an initial minimum investment of \$500, the shares are available to institutional investors, investment advisors, endowments, foundations and corporations.

# Fees & Expenses



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## The Large Variability in Pre-Expense Total Returns

Low advisory fees and total expense ratios, lower turnover and resultant low transaction costs, and an organizational culture focusing on investors' long-term experiences beyond total returns are areas of increasing focus and scrutiny.

Yet, it is valuable to recognize that excellence in portfolio management and securities selection is a far bigger differentiator than just lower expenses.

To illustrate this point, the following table compares pre-expense return variability (measured by standard deviation).

*Methodology: Only a single share class (SI's Primary Share Class) for each portfolio is selected, to eliminate the bias of including many share classes of the same investment portfolio. Pre-expense returns were estimated by adding, to post-expense returns, the share class's expense ratios; because total expense ratios are available only for fiscal year periods, which vary by fund and are not available for the exact time period of three years ending 1/06, some error in estimating pre-expense total returns is unavoidable. SI believes this error is quiet small, however. Morningstar Category as of period end is used to calculate the average below.*

The data shows that total return variability—before accounting for fund expenses—remains extraordinarily high, even among the more “commodity-like” large cap equity sectors.

For example, the wide variability of **Large Cap Growth fund pre-expense returns over the past three years, with a standard deviation of nearly 17%**—as shown below—implies that the 0.1% or 0.2% differences in advisory fee ratios could only be a small contributor to realized total return excellence.

### Estimated Pre-Expense Total Return % Trailing 3-Years to 1-06

Morningstar Category	Standard Deviation %	Average Return %
US Large Cap Growth	16.6	62
US Large Cap Value	13.5	67
US Small Cap Growth	24.8	99
US Small Cap Value	22.4	108
Int'l Large Cap Growth	17.3	107
Int'l Large Cap Value	16.7	115
Int'l MidSml Cap Gro	38.1	174
Int'l MidSml Cap Value	28.0	150
Corp. High Yield	9.3	43
Muni High Yield	6.3	26
Intermediate US Gov't	3.5	11
Intrmd Corp. Bond	3.6	14

Source: Strategic Insight Simfund, SI research.  
All data as of 1/06. See methodology above.

Naturally, **smaller cap styles**, both in the US and internationally, **experienced even bigger return variability**. Meantime, **bond fund variability was much smaller**, especially for lower duration funds.

## Averages Fee Paid by Investors, vs. Average Expense Ratios

The experience of the “average investors” is reflected by “asset weighted” averages, to give higher weight to larger funds owned by most investors, and low weight to the many tiny funds that hardly anyone owns. In that context, latest **asset-weighted average total expense ratio for actively-managed equity funds is 0.99%**, whereas the **simple average expense ratio is 1.61%**, **63% higher than the truer “cost ratio”**.

Look at it another way: the lower-fee \$1 billion-plus funds in the table below control 74% of the entire segment's assets; the smaller, much more expensive funds (less than \$100 million) control under 4%.

### Expense Ratios\*: Actively-Managed Open-End Equity Funds

Size of Fund Class 1/06	Average Expense Ratio*	Assets \$B 1/06	Number of Fund Classes
Over \$1 Billion	0.88%	3,415	793
\$0-100 Million	1.65%	167	7,654

Source: Strategic Insight Simfund, SI research  
\*All expense ratios are asset-weighted; data as of latest fiscal year as captured by SI.

# 15(c)



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## Understanding Biases in Performance Benchmarking

**Measuring your investment process only once for each fund:** most performance measurement systems account for each pricing share class as a unique fund, and generally include all share classes in the presentation of any category statistics, such as category average returns. Illustrating this point, American Funds offers only 16 equity portfolios, yet such funds are counted 211 times due to the 211 share classes offered by these unique portfolios.

**Survivorship bias:** most performance measurement systems drop “dead” funds from their systems, as they are structured mostly to assist investors choose and monitor “live” funds to buy today. But once “dead” funds are dropped, any historical computation—like trailing three-and five-years— or recalculating annual returns of past years—will not include performance data of “dead” funds. In categories where fund liquidations or mergers were relatively few (vs. the total sample size), such recalculations of historical performance statistics result only in minor changes. However, some categories (especially narrow sector of regional foreign funds) experience at time large number of liquidations, creating a significant survivorship bias.

Since many (but not all) of dead funds have below-average returns, removing them from the recalculated averages actually increases such averages, making relative returns of the surviving funds lower, an important theme in the 15(c) process.

The following table, run for only actively-managed funds, exemplifies the two biases mentioned above: we calculated historical averages (in this case, for 2000, using Morningstar Categories as existed on 12/00) for:

- All surviving funds, using one class per each portfolio (SI’s defined “Primary Class”, generally “A” or no-load share class)
- All surviving share class, a parallel approach most common in the industry
- All funds in existence for all of 2000 (some of which have been liquidated since), using only the “Primary Class”
- All share classes, including dead ones.

### Different Methodology, Different Benchmarking

Morningstar Category 12-00	2000 Average Total Return %			
	Live Funds Only		Survivorship-Bias-Free	
	Primary Class	All Classes	Primary Class	All Classes
Large Value	7.46	6.87	5.51	5.56
Large Growth	-12.28	-13.20	-13.26	-14.16
Small Value	16.69	17.89	15.87	17.50
Small Growth	-2.89	-3.54	-4.66	-4.98
Technology	-30.89	-31.18	-33.11	-33.24
Europe	-6.99	-4.74	-6.50	-6.12
Pac/Asia ex-Japan	-24.53	-23.89	-27.95	-28.36
Latin America	-14.89	-15.58	-16.22	-15.52

Source: Strategic Insight Simfund MF

The data above captures large return spreads based on methodology. For Large Cap Value, for example, the spread between the “Primary Class” survivorship bias-free average and the live funds’ “All Classes” average is 1.36%. For certain categories with a large number of liquidated and merged funds since 2000, the gap is much wider—almost 2% for Europe funds, and more than 4% for Pacific Funds excluding Japan.

Another source of benchmarking bias is the ongoing reclassifications of funds, from one category to another. Once reclassified, historical relative returns, as well as category averages, may be recalculated using the current classification of many funds that were actually invested differently in the past. For example, over the past three years, nearly 21% of funds (18% of assets) in the Morningstar Category Small Value have migrated into other categories.

### Morningstar Category Migration: 2002 to 2005

Morningstar Category	Same Category		New Category		Liquidated	
	# of Portf.	Assets	# of Portf.	Assets	# of Portf.	Assets
Large Value	73%	93%	11%	5%	16%	2%
Large Blend	66%	86%	12%	11%	22%	3%
Large Gro	70%	95%	7%	2%	23%	3%
Small Value	67%	78%	21%	18%	12%	4%
Small Blend	75%	90%	12%	9%	13%	1%
Small Gro	75%	85%	9%	8%	16%	6%

Source: Strategic Insight Simfund MF

# Board Talk: Why Implement Redemption Fees?



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## Are Expensive, Cumbersome New Redemption Fee Rules Necessary If Disruptive Redemption Activity Is Largely Yesterday's Problem?

The SEC's revisions to its proposed 22c-2 redemption fee rules and a possible October 16<sup>th</sup> compliance date may result in a very expensive, cumbersome, and, by some measures, unnecessary rule. Estimates of the industrywide cost of the implementation of **rule 22c-2**, regarding harmful market timing activity, range from **\$2 billion** (SEC estimate) to **as high as \$6 billion**, according to some other estimates recently quoted. **Beyond its direct high cost, this rule might become very disruptive for management company and distributor relationships.**

**If this rule is adopted, each fund board will have to "Determine that imposition of a redemption fee is either not necessary or appropriate."** Such fees may be approved, "in an amount (but not more than two percent...) to recoup for the fund the cost it may incur as a result of those redemptions or to otherwise eliminate or reduce so far as practicable a dilution of the value of the outstanding securities issued by the fund..."

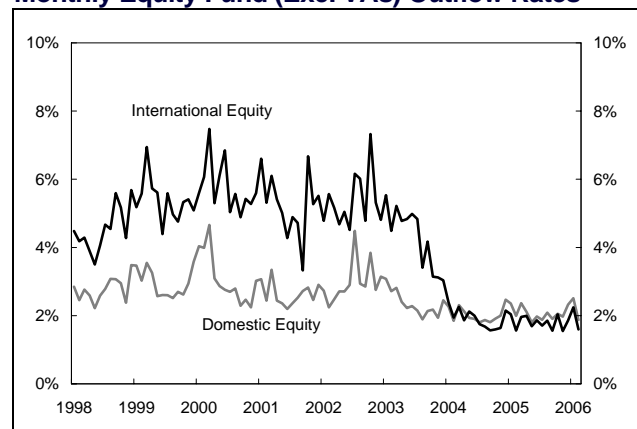
Yet, one could argue that collaborative efforts (including fair value pricing and systems already in place to deter abusive redemptions) have resulted in the **virtual elimination of any major abusive market timing activity among international funds.** This reality has largely deemed rule 22c-2 unnecessary. Isolated pockets of such activity within one's international funds (or among other funds where "stale" pricing is not yet matched by "fair value pricing" methodology) may still occur. But **the cost of eliminating 'the last of the abusive market timers' and other disruptions to the mutual fund business is just too high.**

**Data sets are easily available to monitor abusive timers: at the industry level** (as captured and discussed below), **at the fund level for its board to review each month** if desired (each fund's redemption rate activity benchmarked to a peer group, adjusted for normal redemption and appropriate rebalancing activity), and **for the public and regulators** (SEC publicly available data filed in the N-SAR semi-annual filing, also accessible in Simfund). **These data sources are more than sufficient to allow ongoing monitoring of instances when an individual fund and its distributors fail to deter abusive market timing.**

When such instances are identified by the management company and its board, corrective actions can be taken. Why impose collective punishment in costs and inconvenience for the very rare (today) instance of abuse?

The following chart illustrates the reality of the virtual elimination of wide scale abusive market timing among international equity funds (SI has presented this data many times even before September 2003...). The data, based on ICI's monthly tracking of the industry's redemption activity, shows average outflow rates ('redemptions out of the fund and its family' plus redemptions through exchanges to another fund within same family', as a percentage of fund's assets) for US equity funds, and separately for international equity funds.

### Monthly Equity Fund (Exc. VAs) Outflow Rates



Source: Strategic Insight Simfund / ICI Trends

**Abusive time-zone arbitrage market timing activity by the very few caused the aggregate outflow rate within international equity funds to be much higher than that of domestic funds until 2003. But the irrefutable data depicted above also shows that such activity is no longer common. Actually, outflow activity among international funds is a tad lower today than among domestic funds.**

# Global FlowWatch



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## Growing in Luxembourg and Dublin

Luxembourg and Dublin as offshore roundtrip and cross-border fund centers play an important role for the European mutual fund industry.

Luxembourg has become Europe's largest fund center. **Since 1999, assets under management in Luxembourg have more than doubled, from €735 billion to now over €1.5 trillion.** In Dublin, assets under management increased from €250 billion in 2002 to €600 billion in 2005.

**Funds domiciled in Luxembourg and Dublin garnered combined flows in excess of €200 billion in 2005, accounting for more than half of total net flows to funds in Europe, according to Strategic Insight estimates. Luxembourg captured close to €170 billion, while Dublin funds raised €45 billion, with the majority of flows going to equity and bond funds.**

## Highest Cash Flow Funds

### Highest Cash Flow Long-Term Funds in 2005 Luxembourg and Dublin Funds Excludes Money Market Funds

Fund Name	Category**	Est. Flows (€billion)	
		2005	Assets 12/05
dit-Euro Bond Total Return *	Europe/Euro Bnd	3.4	8.1
Activest TotalReturn *	Global Bond	2.7	6.5
Pioneer Funds Euro Bond	Europe/Euro Bnd	2.5	15.4
AXA Rosenberg Japan Eqty Alpha	Asia Pacific Eqty	2.2	3.3
Fidelity Funds - India Focus	Emerg. Mkts Eqty	2.1	2.8
Dexia Total Return Bond *	Global Bond	2.0	3.2
JPMF Europe Equity	Europe Equity	2.0	5.6
MLIIF World Energy	Sector Equity	1.9	3.0
Focused Sicav-HighGradeBnd EUR	Europe/Euro Bnd	1.9	1.9
Fidelity Fund-European Growth	Europe Equity	1.9	22.4
<b>Total Above</b>		<b>20.7</b>	<b>72.2</b>

\*Primarily a round-trip fund; \*\*Category based on Lipper Classification.  
Sources: Strategic Insight; Lipper. Data includes all share classes of a fund.

**Net flows to the ten highest cash flow long-term funds domiciled in Luxembourg and Dublin reached more than €20 billion in 2005.** With a few exceptions (round trip funds) most of the funds were sold on a cross-border basis, with themes including **fixed income total/absolute return** (dit-Euro Bond Total Return, Dexia Total Return and Activest TotalReturn), **regional/emerging markets** (Fidelity India Focus, AXA Rosenberg Japan Equity Alpha), **European equities** (JPMF Europe Equity, Fidelity Fund -European Growth Fund) and **Institutional** (Pioneer Funds Euro Bond).

## Top Selling Fund Managers

### 2005 Estimated Flows to Funds, by Manager Luxembourg and Dublin Funds Excludes Money Market Funds

	Estimated Flows (€billion)				
	Total (x MMF)	Equity	Bond	Mixed	Other
UBS	15.2	5.8	3.8	5.3	0.3
JPMorgan Chase	14.1	12.5	-0.3	2.0	-
Fidelity Int'l	10.4	8.3	1.1	1.0	0.0
Allianz/PIMCO	10.3	1.4	11.0	-1.4	-0.6
Pioneer	9.6	4.2	6.2	-0.6	-0.2
Deutsche Bank	9.2	3.0	3.1	2.7	0.3
AXA	8.6	6.8	1.0	0.5	0.3
Barclays	8.6	4.1	1.3	2.6	0.7
Dexia Group	7.4	0.7	5.3	0.8	0.5
Merrill Lynch	7.0	6.4	-0.1	0.9	-0.1
<b>Total Above</b>	<b>100.5</b>	<b>53.1</b>	<b>32.3</b>	<b>13.7</b>	<b>1.3</b>

\*Other category includes guaranteed, real estate and on-shore registered hedge funds. Source: Strategic Insight; Lipper.

**The ten management companies with the highest cash flows in Luxembourg and Dublin domiciled funds in 2005 gathered more than €100 billion (excluding money market funds) in net flows.**

UBS attracted the highest cash flows excluding money market funds with an estimated €15 billion for the full year 2005. Strong gains were recorded in many of UBS's fund lines, including the Focused Sicav, the Key Selection Sicav and other Luxembourg umbrellas. JP Morgan achieved the highest net flows into equity funds with over €12 billion, while Allianz/PIMCO gathered the most flows into bond funds with close to €1 billion, led by its **dit-Euro Bond Total Return fund** (sold primarily in Germany), which took in more than €3 billion in flows and was one of the top selling funds in 2005.

# Global Horizons



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## Europe and Asia: Of BRICs and Partnerships

Although funds investing in “BRIC” (Brazil, Russia, India, China) equities represent just a fraction of our industry, they have seen rising appeal lately in both Europe and Asia. Indeed, BRIC products from DWS, HSBC, Schroder, Templeton, and dit (Allianz) were **among the highest cash flow products in Europe** during the first two months of 2006. As a more focused theme within Emerging Markets equity, the appeal of such funds has been supported by exceptional returns; the five funds below returned 22% on average in Euro terms just in the past three months through February-end.

Selected BRIC Funds – Flows in € Million				
Fund Name	Launch Date	Jan/Feb 06 Flows	2005 Flows	Returns 3 Mths
DWS Invest BRIC Plus	Mar-05	601	1,349	24.7%
HSBC GIF BRIC Freestyle	Dec-04	428	955	21.1%
Schroder ISF BRIC	Oct-05	390	26	21.5%
Templeton BRIC	Oct-05	240	68	18.4%
dit-BRIC STARS	Sep-05	108	122	23.1%

*Returns are calculated for the primary class of each fund; Source: Strategic Insight, Lipper*

Anecdotal evidence suggests **increasing flows from Asian investors** into some of these Luxembourg-based funds, which are sold cross-border. According to a citywire statement, HSBC recently closed its GIF Indian equity fund to new investors (the fund captured more than €1 billion of flows in 2005) and is considering doing the same with the GIF BRIC Freestyle. HSBC sees **much of the demand for the BRIC and Indian funds coming from retail and institutional investors in Asia, alongside life insurance companies.**

We have also seen variations of BRIC/ Emerging Markets finding appeal in Asia through domestic

vehicles. **DWS Russian and Eastern European Equity**, a new Japan domiciled fund sold to retail investors through an exclusive distribution agreement with **Nomura Securities, gathered over €1 billion** in two weeks of marketing. According to a company statement, most of the flows came after visible promotion of the fund at Nomura’s annual Asset Management Fair in Osaka in mid-February 2006.

This is not the first time a fund manager from outside Asia found such success through a partnership. **In 2005, Fidelity gathered over €2 billion in net flows into its India Focus fund**, largely due to its distribution agreement with **Nikko Cordial** in Japan.

Also notable: **JP Morgan** launched the **JPM BRICS5** fund in Japan at the end of last year and **collected more than €400 million** by February-end; **assets reached nearly €700 million by early April**. The fund invests in BRIC countries **plus South Africa**, further reinforcing the story around **natural resources and precious metals**, which are a large part of South Africa’s economy. Of course, natural resources and metals is another “hot” investment theme today, as discussed in more detail in Strategic Insight’s Global research reports.

## A Product of Three Continents

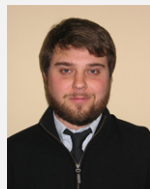
One additional item of note related to Asia/Europe/US partnerships and inter-linkages: Last year our Global research team highlighted the **UOB Kinetics Paradigm** fund, a Dublin-domiciled joint venture between UOB Global Capital, the international subsidiary of Singapore-based United Overseas Bank, and US-based Kinetics Asset Management. **In the first two months of this year, it has captured €750 million in net flows, on top of €1.5 billion in 2005.**

The fund recently gained “distributor status” in the UK, helping it to show up on screens among multi-managers in that market. Schroder’s Multi-Manager group made an allocation to the fund last year after hearing about Kinetics through Schroder’s hedge funds team, which was invested in a Kinetics hedge fund and suggested Kinetics’ long-only funds for consideration. Thus, the fund is a great example of not only **strengthening linkages between multiple firms in several markets, but also between traditional and alternative businesses.**

# VA Fund Update



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[SI just published a detailed study on developments in the variable annuity / life industry on [www.sionline.com](http://www.sionline.com); the following discussion is an excerpt from that study.]

**Total assets within VA/L underlying funds** grew by \$83 billion last year to almost \$1.1 trillion at year-end; assets in fixed accounts, however, stayed flat.

Sales of VA, at \$133 billion for all of 2005, were similar to annual sales in the prior two years. Variable Annuities/Life (VA/L) funds net flows (excluding fixed accounts) fell to \$19 billion, a 44% decrease year over year. Some industry leaders actually experienced net redemptions from their aging contracts last year.

Variable Annuities/Life: Underlying Fund Summary					
Net Flows \$B					
Fund Category	2001	2002	2003	2004	2005
Domestic Equity	5	-13	30	25	5
Int'l/ Global Equity	-3	-3	5	9	12
Hybrid/Asset Allocation	-2	-5	0	-1	-4
<b>Subtotal Equity/Hybrid</b>	<b>1</b>	<b>-21</b>	<b>34</b>	<b>33</b>	<b>13</b>
Bond	11	18	6	4	6
Money Market	10	1	-12	-4	-1
<b>Total Funds</b>	<b>22</b>	<b>-2</b>	<b>28</b>	<b>34</b>	<b>19</b>
Memo VA Fixed Accts	4	28	12	8	-9
Total Above	26	26	40	42	10

Flows to Fixed accounts for VA roughly estimated  
Source: Strategic Insight Simfund VA

VA/L domestic equity flows were lower than in 2004, reflecting a similar large decline in US fund flows elsewhere in the industry. **International/global fund flows grew last year, albeit at a slower pace than among traditional mutual funds.**

Naturally, with a bigger asset base (due to appreciated investments and net inflows), even normal redemption activity (just as a stable % of assets) necessitates similarly higher sales to support ongoing net inflows. During 2005, VA/L fund assets averaged 12% more than in 2004. Yet, year-to-year sales rose only 2.5%, thus failing to match such (likely 12%) higher natural attrition, resulting in falling net flows.

As in the previous year, respected and branded investment companies like **Capital Group, Franklin, PIMCO/Allianz, T. Rowe Price, and TIAA-CREF** were prominent in our list of leading asset managers in the variable space. Yet, there were a few new names that moved ahead in 2005. **Morgan Stanley / Van Kampen** benefited greatly from its value-oriented **Comstock** portfolio, both in its VIT form and in several sub-advisory capacities; the firm also garnered strong flows from its **Emerging Markets and Real Estate** funds. **BankAmerica** saw significant flows from several **Marsico** funds, most notably the **Capital Growth** offered through Pru-Skandia. Mellon and **OppenheimerFunds** also show large inflow gains.

## VA/L Fund Fees by Morningstar Category \*

Morningstar Category	Advisory + Admin Fee %	
	Asset Wgtd Avg.	Median
Large Value	0.559	0.742
Large Blend	0.621	0.731
Large Growth	0.630	0.759
Mid-Cap Value	0.820	0.795
Mid-Cap Blend	0.703	0.753
Mid-Cap Growth	0.718	0.808
Small Value	0.860	0.922
Small Blend	0.805	0.815
Small Growth	0.847	0.900

\*Net Advisory/Administrative fees. Asset-weighted, latest available fiscal year data from 2004 and 2005; only funds with portfolio assets > \$50 mm during latest fiscal year; exc. index funds, funds with one-all-inclusive fees; styles as of 12-05; Source: Strategic Insight Simfund

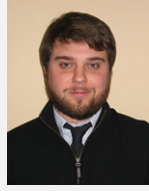
## Variable Funds of Funds

Demand for “assembled advice” rose rapidly in the VA business. In 2005, flows into VA funds-of-funds totaled \$22 billion, almost double the \$13 billion of the prior year. By February 2006, net assets in VA funds-of-funds reached nearly \$72 billion. Many living-benefit contracts mandate purchase of such FoFs, suggesting their rapid growth will continue.

# VA Contract Trends



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In the past year, there were a number of notable trends in VA contract designs that centered less on the creation of new chassis types (like the L-shares and A-shares of the past), and more on subtle shifts in product emphasis.

For instance, it is becoming ever more common for distributors to have very specific preferences regarding VA contract design, riders, underlying funds and asset allocation programs. **Of particular concern to B/Ds is heading off any inappropriate sales of annuities, riders, etc., especially to seniors.** Wachovia, for one, has developed an internal system of checks and balances in an effort to prevent unsuitable practices.

Mid-way through last year, **Raymond James** went a step further by asking its insurance company partners to construct VA products with several attributes. These included no greater than a 1.00% base M&E charge, no longer than a 7-year CDSC schedule with a maximum first year charge of 6%, no more than 5% up-front first-year commission nor more than 7% “all-in” commissions (including trails) in the first seven years. Raymond James is focusing on total costs of VAs—partly to discourage sales solely based on compensation, partly to make its due diligence easier.

There were also some newer low-cost VAs introduced in 2005. **Fidelity Investments Life** rolled out two new products: **Personal Retirement Annuity, a deferred VA with contract level charges of only 0.25%**, and **Freedom Lifetime Income Annuity**, an immediate variable annuity featuring the company’s popular Freedom target-maturity funds, the contract-level charge only 0.60%.

**There remains interest in selling VA products through wrap-fee programs**, another place where low costs are appreciated. New ones filed in 2005 included the Genesis No-Load VA from **Ameritas** (featuring ProFunds exclusively), and **Jefferson National Monument Advisor** (with no contract-level charges other than a \$20 fee to request paper prospectuses).

**Longevity insurance is also becoming a buzzword in the market**, referring to annuities that do not pay income until the owner has lived beyond life expectancy. **MetLife** has come out with a **Retirement Income Insurance (RII)** version of its Personal Income Builder. **New York Life**, for its part, filed a LifeStages Longevity Benefit VA in December.

## Continuing Evolution of Living Benefit Guarantees

**The Lifetime GMWB rider, which establishes a protected base amount on which a VA contract owner may withdraw a certain percentage over his or her life, has proven quite popular and may shape up as an alternative to classic annuitization.**

The latest design modifications to Lifetime GMWB include:

- **Death Benefit Integration**—allowing for a DB paid based on any remaining GMWB amount;
- **Percentage rollups**—more along the lines of Skandia’s 5% in first 10 years;
- **Spousal Continuation (“second-to-die”)**—with spouses, if one dies after starting withdrawals under the rider, the second may continue taking guaranteed withdrawals for life as well;
- **Age bands**—increased withdrawal percentages (some as high as 8%) if one waits to take money until later;
- **RMD Friendly Status**—causes no negative adjustment if client exceeds maximum withdrawal percentage because they took Required Minimum Distributions from their qualified contracts;
- **Step-up provisions**—that may allow account value lock-in even after withdrawals are started.

For more information on recent trends in VAs, please see our latest **Strategic Insight Overview** report, “**An Update on the Variable Annuity Business: Benefits, Opportunities and Risks**”.

# Reaching the Ultra High Net Worth



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## Intermediaries and the Ultra High Net Worth (UHNW) Market

Money managers, wealth advisors, and brokerage firms are seeking to move up the wealth scale. Yet, according to a new Cerulli report, most financial advisors don't target this Ultra High Net Worth segment, or if they do, don't have the specialized knowledge to serve it. Fewer than 6% of advisors offer wealth transfer expertise and less than 2% have estate planning specialties.

How can client-facing advisors—wirehouse financial representatives, RIAs, independents and others—move up the wealth scale? And how can money management firms help them do so?

One reason financial advisors may shy away from the UHNW segment is the perception that “the rich are

different from you and me,” as F. Scott Fitzgerald wrote. Because they may regard this group as “from a different world,” some advisors may believe that their values and aspirations are too divergent.

Actually, though, many Ultra High Net Worth (UHNW) individuals and families **grew up middle or lower class**. Though they now have investable assets of \$5 million or more, many **still consider themselves “middle class at heart,”** according to “Worth-Harrison Taylor Study of The Status of Wealth in America,” published in 2005. Based on in-depth conversations with a representative sample of America’s top 0.5% of wealth, the study finds that **only 8% of today’s very wealthy had rich parents**.

The implications are numerous. In order to help intermediaries acquire the new wealthy as clients, build relationships with them, and manage their assets, these FAs need to understand the differences in the ways UHNW select their advisors, allocate their assets, and think about the future.

## Segmenting the UHNW Market by “Wealth Maturity”

In order to help intermediaries reach those with assets above \$5 million, it is important for them to understand the nuances that distinguish the attitudes and behaviors of UHNW individuals at different stages of the “wealth maturation cycle.” Most financial advisors, if they segment the HNW market at all, do so by assets. But asset size doesn't reveal as much about these individuals as does another measure—**how long they have been wealthy**.

There are three stages of wealth evolution, set off by how “seasoned” the wealth is.

Stages of Wealth Evolution			
Wealth maturation stage (% of total)	Apprentice (38%)	Journeyman (43%)	Master (19%)
Length of time wealthy	Less than 5 years	6 to 14 years	15+ years
Mean value of total assets	\$8.9 million	\$27.5 million	\$74.5 million
Average age	48	56	61

*Source: The Harrison Group, The Worth-Harrison Taylor Study of The Status of Wealth in America, © 2005. Used with permission.*

## Apprentices—Learning to be Rich

The “Apprentice” wealthy are often entrepreneurs who are experiencing their first significant liquidity event. This group, which makes up about two-fifths of the UHNW market, may be the most desirable target segment. **Since this group has not yet formed deep attachments with other wealth advisors, they may be eager for someone who can provide education.**

Yet, because they are often entrepreneurial, “Apprentices” are independent and self-directed, at times defensive about their newly achieved wealth, and suspicious of those who approach them about managing it.

The “Apprentice” wealthy are most like advisors’ other clients. Since they have not had time to “grow into” wealth, they are still building wealth and are relatively inexperienced as investors. They may be managing their own portfolios, and are still likely to be heavily concentrated in illiquid interests in their own businesses. While, from an outsiders’ perspective, they look like they have more than sufficient resources to meet their aspirations, **almost half are still worried about having “enough.”**

## Journeyman—Joining the Club

“Journeyman” have had time to grow into being rich and they have begun to leave their middle class worries behind—fewer than 30% are now worried about having “enough.” Many have now retired and are beginning to **enjoy what their wealth can bring them**—new interests, new “toys” (such as antique cars), new opportunities to support causes and ideas that are important to them. They are beginning to associate with other very wealthy people and have begun to learn what it means to be members of an elite club.

For Journeymen, a financial advisor is no longer the only source of advice about financial matters. At this stage, individuals have begun to **have different specialists for their various needs**. At the same time, financial advisors can offer advice on more than financial issues. For example, many Journeymen may be thinking about second or third homes, high-end travel or buying art. Financial advisors add value if they can provide introductions to high end realtors, travel agents, art advisors, and property and casualty insurance brokers who specialize in the unique issues facing families with multiple homes, cars, boats, artwork, jewelry and collectibles.

## Masters—Leaving a Legacy

“Masters” have had the time to develop networks with other wealthy people and their advisors. This group—those who have been wealthy the longest and have the most money—are most difficult to approach because they have many gatekeepers. They are also more interested in distributing their wealth than in managing it.

## Helping Intermediaries Approach UHNW Prospects

If your company provides Value Added tools to help intermediaries target the UHNW marketplace, the first place to begin is with the right communications.

- Advisors need to **avoid using words like “wealthy,” “rich,” or “luxury.”** This is not how the new wealthy see themselves. Fully 92% of Apprentices see themselves as middle class at heart. This percentage drops to 68% for Masters.
- **Avoid intensifiers, like “very” or “super”**, along with exaggerated **adjectives and adverbs**. Such words will raise a red flag for the prospects.
- Just because they are rich doesn’t mean they understand investing. Discussions should be kept **simple and straightforward**. Don’t attempt to impress these individuals with fancy words or complex concepts. Communicate solutions.
- **Relate to them as individuals**. Most of the super-wealthy are more like “The Millionaire Next Door” than like Donald Trump. Ask them about their **lives and their goals**. Use **examples, case studies and stories** to explain concepts and ideas.

More than money, what the ultra-wealthy are concerned about are **“value” and “values.”** Value refers to the inherent perceived quality of an object or person. The ultra-wealthy, for example, don’t like to flaunt their wealth, but they **will spend lavishly for things they perceive as having inherent value**: hand-crafted watches, fine art, wine, vintage cars. Values refers to what matters in the long run—their **legacy to their children and the world around them**. Financial advisors need to focus on the individuals’ goals and dreams for their family and legacy. They need to understand their passions and help them reach their goals, which may not be financial.

**Networking and referrals are the best way for advisors to reach out to new prospects, but they must understand the key differences in the UHNW segment.** For example, Apprentices are often entrepreneurs, so their business advisors—accountants, attorneys, business valuation specialists, commercial

real estate and insurance brokers—are good sources of referrals. Apprentices may also be looking to their financial advisors for help in understanding and making lifestyle choices.

The **established wealthy have developed networks of their own**. To meet this group, it is important to **cultivate interests and connections that match theirs**—fine wines, collecting, travel, and charitable causes. Nearly all the UHNW are charitable and they believe strongly that “money brings responsibility to help the less fortunate.” As they mature across the wealth cycle, these individuals become less apt to write a check and **more personally involved in selected causes**, often serving on a board or establishing their own charitable foundation.

To meet and develop relationships, financial advisors need to serve on charitable boards with them and immerse themselves in the types of activities their prospects are likely to be interested in, such as antique shows and auctions, equestrian events, or alumni-related activities. Advisors will not gain the confidence of wealthy people unless they are “one of us,” so their interest in these activities must be real and fully committed.

Because the maturing wealthy have networks of others in the same situation, it is particularly important to offer client referral events that match the interests of this group. Organize events that offer something “behind the scenes”: an event at a museum featuring a curator talking about a collection; a cooking class in the kitchen of a fine restaurant, a conversation with a historian, artist or inventor.

Keep in touch about matters of interest—clip a magazine story about a Caribbean island they often visit or a web site for an upcoming classic car auction. Keep a record of all key information about the heads of household and their families and regularly stay in touch about matters that don’t necessarily relate to investments.

### Financial Attitudes and Behaviors

One of the biggest differences among the three maturity cycles is in their investing behavior. Apprentices, because they are often younger and less knowledgeable, will be most interested in the basics: long-range planning, tax minimization, insurance, and asset allocation.

**Do not confuse “risk capacity”** (the financial capacity to take risk) **with “risk readiness”** (the emotional ability to tolerate risk). Normally, **those in the early stages of wealth tend to be more risk-averse**, but are

**willing to increase the overall risk level in their portfolios as their experience and assets grow**. They are not looking for the newest or latest investment ideas but rather **seek to grow in measured increments**. Never discuss investment vehicles to these emergent wealthy in isolation. Rather, **present new ideas in relation to their overall portfolio goals**.

Once individuals retire or reach the Journeyman stage, they are often more interested in capital preservation than in capital growth. Because they have more assets, they may begin thinking about alternative asset classes, including real estate, collectibles, and private equity/hedge funds.

While people at this stage also begin thinking more often about intergenerational wealth transfer and estate planning, do not assume they already have an estate plan—30% of them have not yet put together a formal plan, according to The Worth-Harrison Taylor Study.

The “Masters” are the classic ultra-wealthy, concerned with distributing their wealth to future generations and to their cherished causes. A central concern is the legacy they will leave behind. Their financial advisors can help by advising them on such issues as writing an ethical will, establishing a family foundation and/or endowment, investment policy statements for their various trusts, and establishing guidelines for gifts and bequests.

	Apprentice	Journeyman	Master
<b>Primary income source</b>	Their business	Investments	Investments
<b>Primary wealth concern</b>	Accumulation	Preservation	Distribution
<b>Attitude toward wealth</b>	Defensive; live well below means; consider themselves middle class.	Growing more comfortable; begin to identify with wealthy class.	At ease with wealth, spending on family and charitable activities.
<b>Investment Advisor</b>	Self-directed	Network of advisors	Network of advisors
<b>Investment style</b>	Risk-averse; primarily equities	More aggressive; portfolio expands to include real estate, collectibles, private equity / hedge funds	Focused on future generations; foundations; family offices

# Tools Time: Simfund



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## Announcing Simfund Certified Program

Since the introduction of Simfund version 4.0 last year, we have witnessed an increasing number of analysts and executives using Simfund, now at over 200 fund managers, service companies, investment banks, and internationally.

To assist the many and diverse users with their distinctive data intelligence needs, and to help each maximize the benefits of the database, Strategic Insight is planning to offer a new training program: **Simfund Certified Analyst (SCA)** to be launched later in the year. Certification program highlights are:

- Simfund integrates data from Morningstar, Lipper, S&P, SI, and the ICI, including the ICI Confidential Sales Data (available just for Confidential Sales Report participants). The SCA program will help you **understand, compare, and contrast all data available.**
- **Hands-on step-by-step training materials** to help you create and generate advanced business intelligence reporting with great ease.
- **Web-facilitated**, more than 25 detailed **training exercises** ranging from entry level usage to advanced usage.
- Beyond the online CSA program, we will offer **one-on-one training and certification.**

As we are in the midst of advanced planning for this new and exciting Simfund Certified Analyst program, we seek your additional ideas and suggestions regarding areas to focus on in the SCA program. Please share your thoughts and questions with Hanna Bayoud at 212-944-4454 or [Hanna@sionline.com](mailto:Hanna@sionline.com).

## Dashboard Summary Report

The next two pages capture a popular Simfund report, which summarizes flows and key performance attributes for a specific fund. Some fund companies print a booklet every month of the dashboard report for their complete fund line, and share it with executives, product managers and portfolio managers.

## Service Provider Data Easily Analyzed Via Simfund

For each fund, Simfund data includes the name of, and at times, the fees collected by many of its service providers: **advisor and sub-advisor, administrator, transfer agent, custodian bank, distributor, auditor, legal counsel, and the fund manager.**

For example, *Auditor name* data is collected (using N-SAR filings and the latest available prospectus) and refreshed once a month into the new Simfund update. *Audit Fees % and Dollars* are captured through the N-SAR data (then compared to the N-CSR annual report data). This data point is updated one a year.

Note that **in the N-SAR, many funds break down their “Professional Fees” disclosed in the annual income statements into Auditor and Legal fees.**

**Service Company Market Share:** Simfund allows easy aggregating of service company relationships. For fund auditors, for example, the dominance of PricewaterhouseCooper as an auditing firm, followed by Deloitte & Touche, is easily displayed. **Through Simfund and SI’s daily updates of new filings via FundFiling.com you can also identify on a timely basis managers launching new funds and possible new business opportunities.**

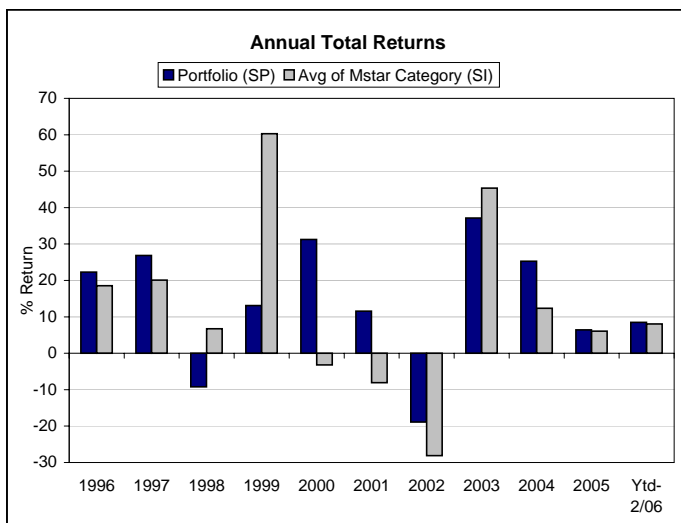
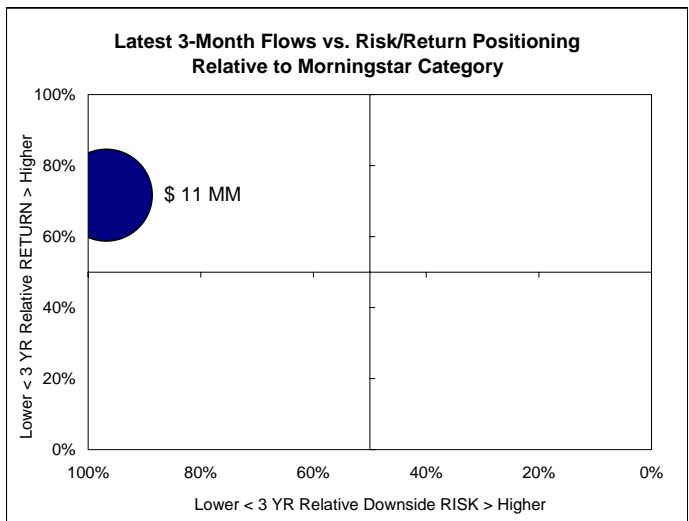
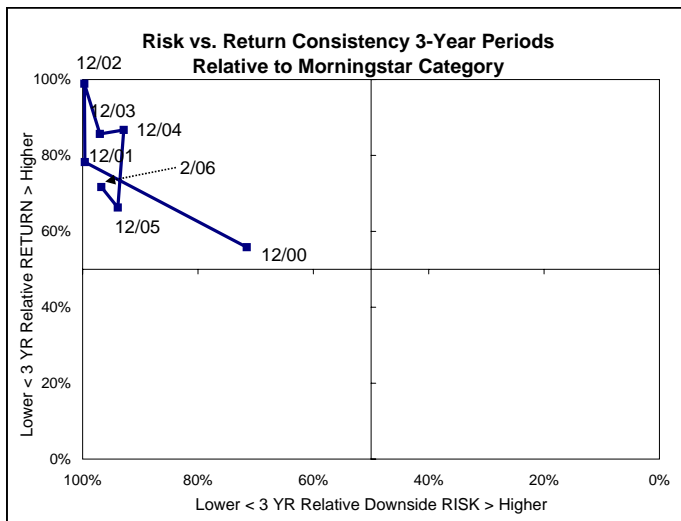
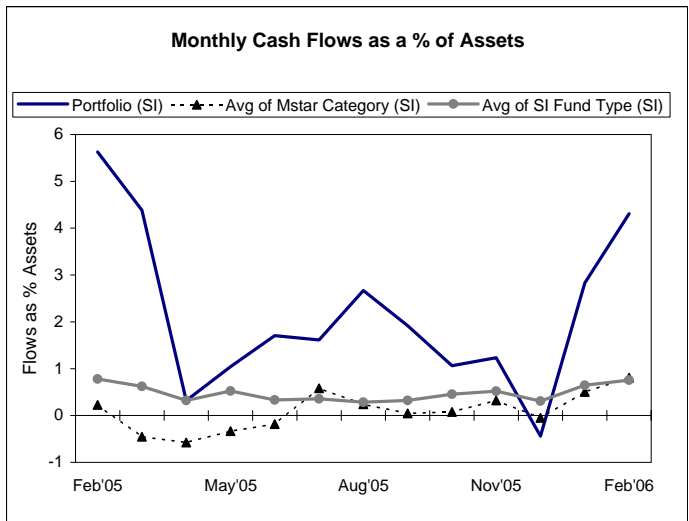
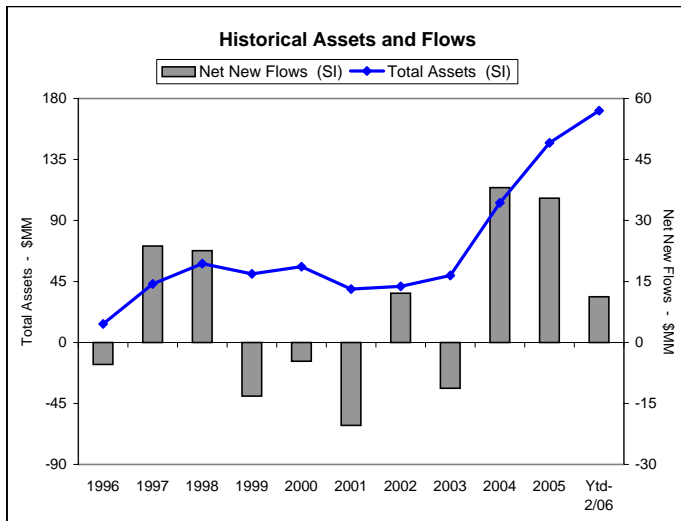
**Fees by portfolio:** Zoom into a specific auditor and study their reported audit fees by portfolio. Simfund allows you to drilldown to the portfolio level.

Portfolio	Assets		Avg. Assets Fiscal Yr
	\$MM	Auditor Fee \$K	
<b>Auditor Name (SI) "Deloitte &amp; Touche"</b>			
Growth Fund of America	137,075	88	96,618
Income Fund of America	64,346	102	52,922
American Balanced	52,594	86	48,939
Fidelity Diversified Intl	36,942	253	25,637
BlackRock Liquidity Temp	33,396	93	32,118
Fundamental Investors	30,307	79	25,328
Bond Fund of America	23,619	99	21,515
AMCAP	23,340	114	16,320

Source: Strategic Insight Simfund MF

## Schroder US Opportunities Fund - Opportunity Profile

### Relative Performance within Morningstar Category



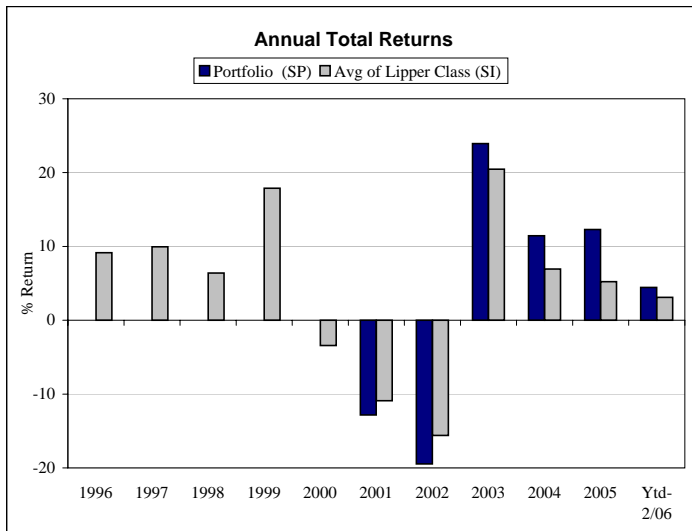
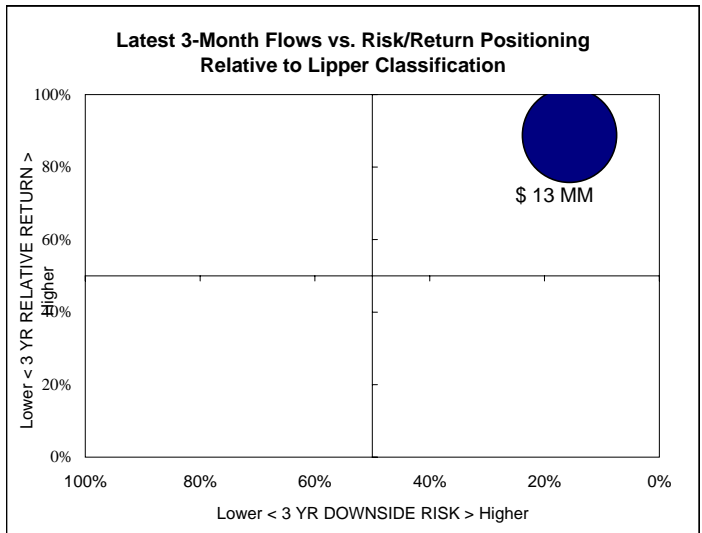
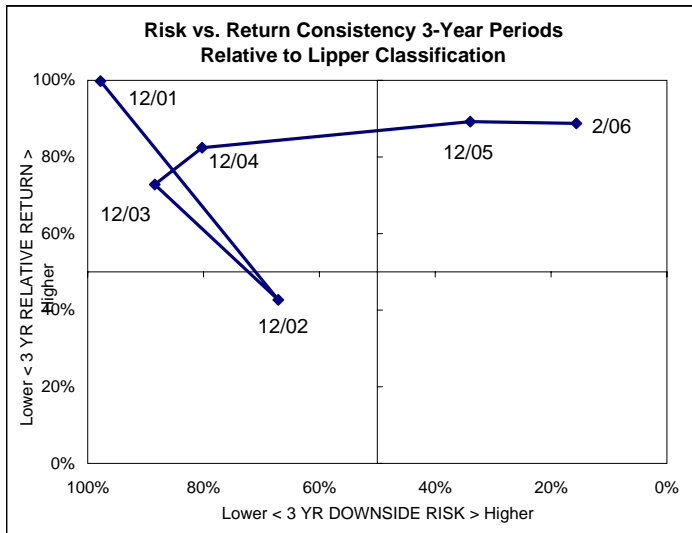
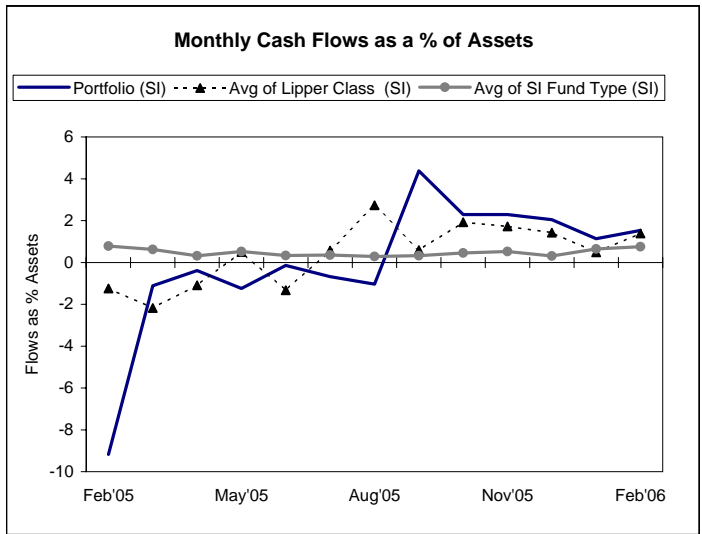
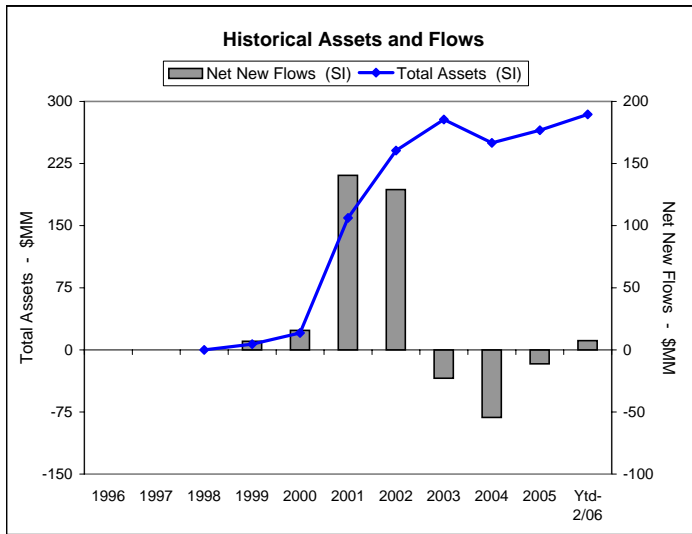
**Facts as of 2/06**

Morningstar Category	Small Growth
S&P Style	Equity Small Cap Growth
SI Objective	Small Company Equity
SI Fund Type	Equity
Total Assets	\$ 171 MM
Net New Flows - YTD	\$ 11 MM
Annualized Returns:	
1 Yr	17.03%
3 Yr	28.25%
5 Yr	12.80%
10 Yr	13.88%
S&P Star Rating	xxxx
Morningstar Rating	xxxxx
Sharpe Ratio 3Yr	0.27
Beta (S&P 500) 3 Yr	1.10

Source: Strategic Insight Simfund MF

# Janus Adviser Growth & Income Fund - Opportunity Profile

## Relative Performance within Lipper Classification



**Facts as of 2/06**

Lipper Classification	Large-Cap Core Funds
Morningstar Category	Large Growth
S&P Style	Equity Large Cap Growth
SI Objective	Growth & Income
SI Fund Type	Equity
Total Assets	\$ 284 MM
Net New Flows - YTD	\$ 7.40 MM
Annualized Returns:	
1 Yr	17.14%
3 Yr	18.72%
5 Yr	4.01%
10 Yr	n/a
S&P Star Rating	xxxxx
Morningstar Rating	xxxxx
Sharpe Ratio 3Yr	-0.30
Beta (S&P 500) 3 Yr	1.00

Source: Strategic Insight Simfund MF

# Tools Time: FundFiling.com



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**Fund Filing 4.0**, our newest upgrade to the website, will be launched this summer and bring you many exciting new features. Some of these features have already been made available to you and will be expanded in the course of this year. Below is a summary of these new features:

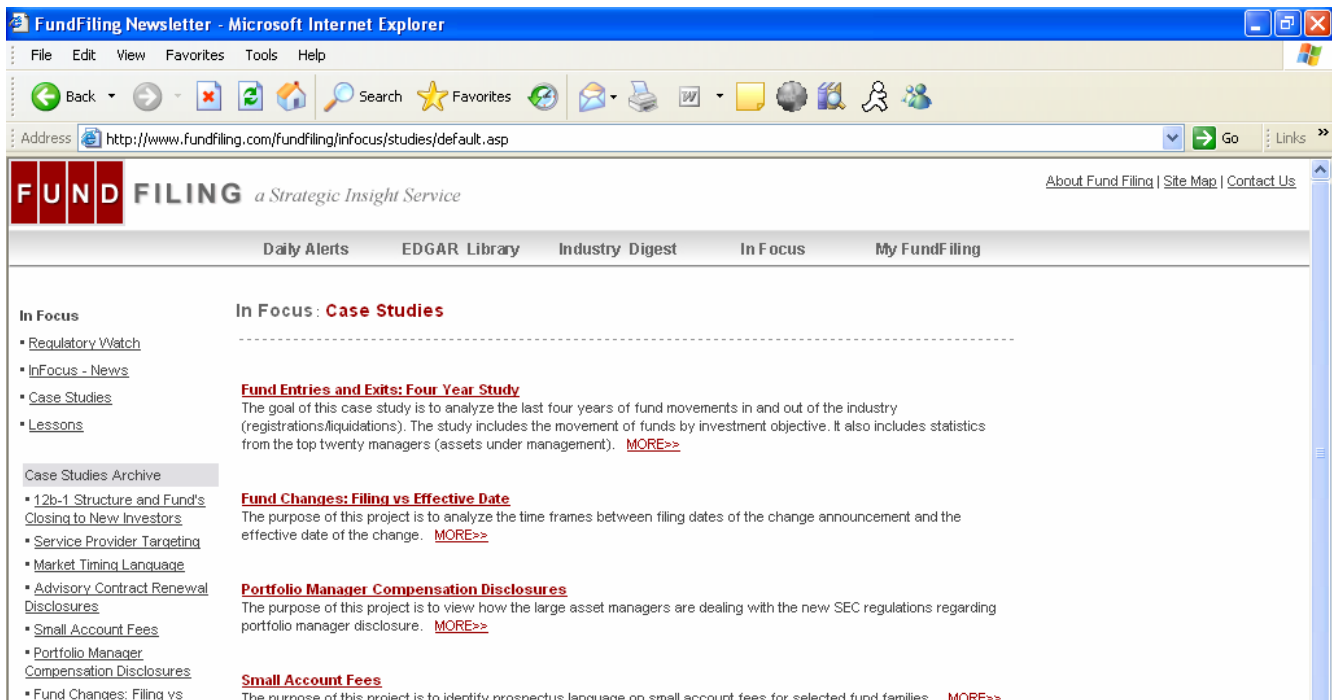
1. **Case Studies:** Currently, we offer a tutorial-type Case Studies library on Fund Filing—see partial screen shot below. These studies are often initiated by client requests for certain more complicated searches. The Fund Filing team will publish many more such tutorial-type case studies this year. Note that these studies can be further customized to your needs.

2. **In The News:** Prominently displayed on the upper right hand corner of the home page, this new Fund Filing section is a connection between the day-to-day filings to the SEC and industry headlines. “In The News” has helped many clients quickly identify articles of interest and further research the topic. This new section is currently updated on a weekly basis and we are creating an archive where you will be able to see all the articles at your convenience.

3. **Monthly Stats Reports:** You will be able to access useful statistics on new fund registrations and fund changes, which will be available on a monthly basis in a tabular downloadable form.

4. **Full-Text Search:** This section will be upgraded to accommodate more refined searches which will allow you to find difficult information with greater ease.

5. **Fund Filing Help Desk:** Our help desk will be renovated: following up on our existing clients’ suggestions received in response to our survey last year. You will be able to access Fund Filing Tutorials that will help you better utilize the website. We will also conduct WebEx sessions offering Focused Lessons on a bi-weekly basis.



# SI Internet Libraries: Learn on Your Own

## Sionline.com

### US Mutual Fund Research

**Windows:** Monthly snapshot of asset management essential knowledge.

**Executive Insights:** Periodic commentaries on special topics contributed by our US fund, global asset management and variable annuity teams.

**Overviews:** In-depth analysis of themes important for success (competitive strategy, distribution dynamics, product development, fee analysis, retention, etc).

**Latest Month's Highlights:** Recent cash flows, investor sentiment, performance trends, and new product launches published three weeks after each month-end.

**Latest Month's New Fund Filings:** Noteworthy funds recently registered; key product development themes.

**Statistical Reports: FlowWatch** seven reports providing latest month's results, for the overall industry and by distribution channel. The **Quarterly** reports offer relevant competitive analysis by manager.

## FundFiling.com

### Awareness of SEC New Filings

Fund Filing facilitates easy, timely, and comprehensive access to EDGAR filings. Each day our research team reads all newly-filed sticker documents and extracts key information that is then made available on the site. Daily changes monitored cover advisory and sub-advisory fees, pricing, redemption fees, portfolio manager changes, benchmark changes, and much more. We also daily track newly registered funds as they are filed. The FundFiling.com combines user-friendly access to EDGAR with a digest of information offered via weekly newsletter, monthly reports as well as through a historical database.

## StrategicInsightGlobal.com

### Asset Management beyond Funds; Monthly Details on Flows and Opportunities in Europe and Asia

SIG offers in-depth studies that focus on evolving institutional asset management, new investment

strategies and themes, and distribution opportunities and structures within local foreign markets.

For each of about 20 capital markets around the world, each month a Global FlowWatch report details fund demand (by investment style) and key changes.

SIG research is used by asset managers as an input in their efforts to monitor and anticipate industry developments, changing investment preferences, product trends, and flows in order to position themselves strategically on a worldwide basis or in local markets. At times, SIG use is spread throughout multiple teams working in multiple cities and countries.

## MutualFundInsight.com

### Education for Directors

Designed to provide fact-based answers to specific questions asked by independent trustees, and general industry trends, helping directors with context and perspective.

## AnnuityInsight.com

### Variable Insurance Tracking

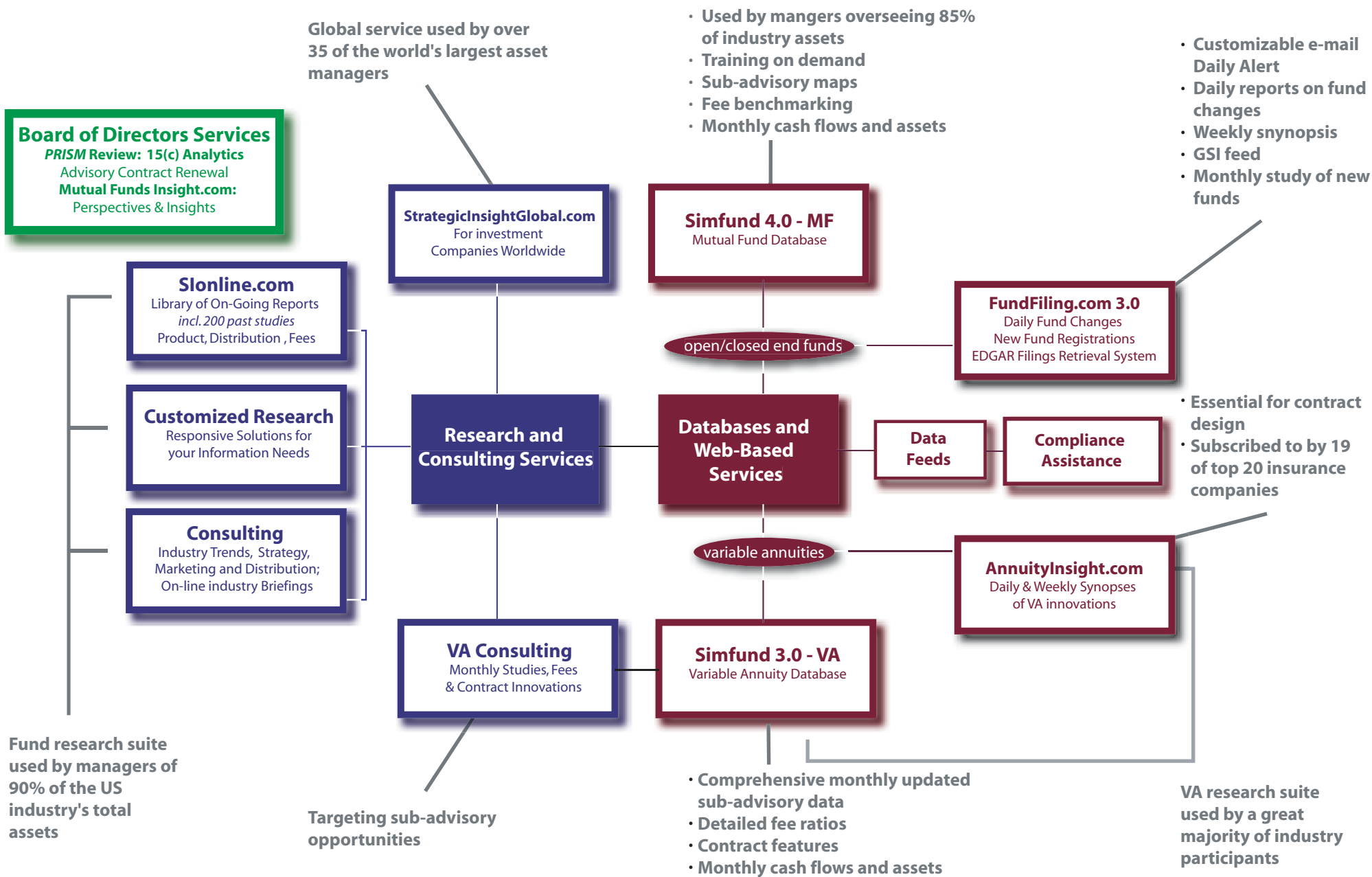
Designed for competitive intelligence in the variable insurance business, this daily updated site identifies and describes every new contract and its features, and offers commentary on the latest trends in VA contracts, underlying funds, policy features, and fees and expenses. Subscribers, who include insurers, asset managers, law offices, actuarial firms, and broker dealers, view latest SEC filings related to VAs, get ideas for new product and sales generation, and stay current on the most important industry themes.

For access or subscriptions, please contact Dana Chehayeb ([dana@sionline.com](mailto:dana@sionline.com) or 212-944-4459)



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