
2010 Alternative Investment Survey of U.S. Institutions and Financial Advisors

Morningstar and Barron's

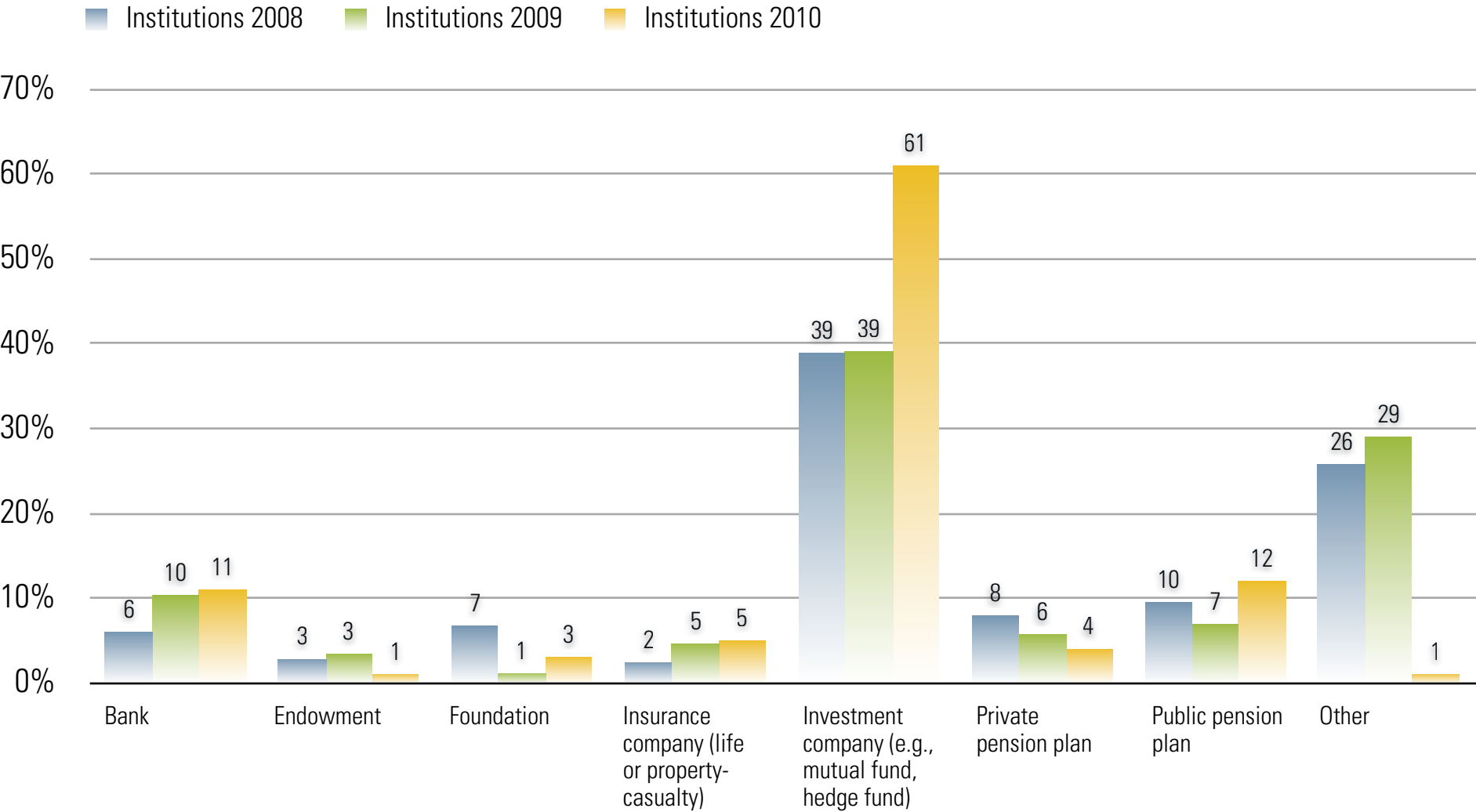


January 17, 2011

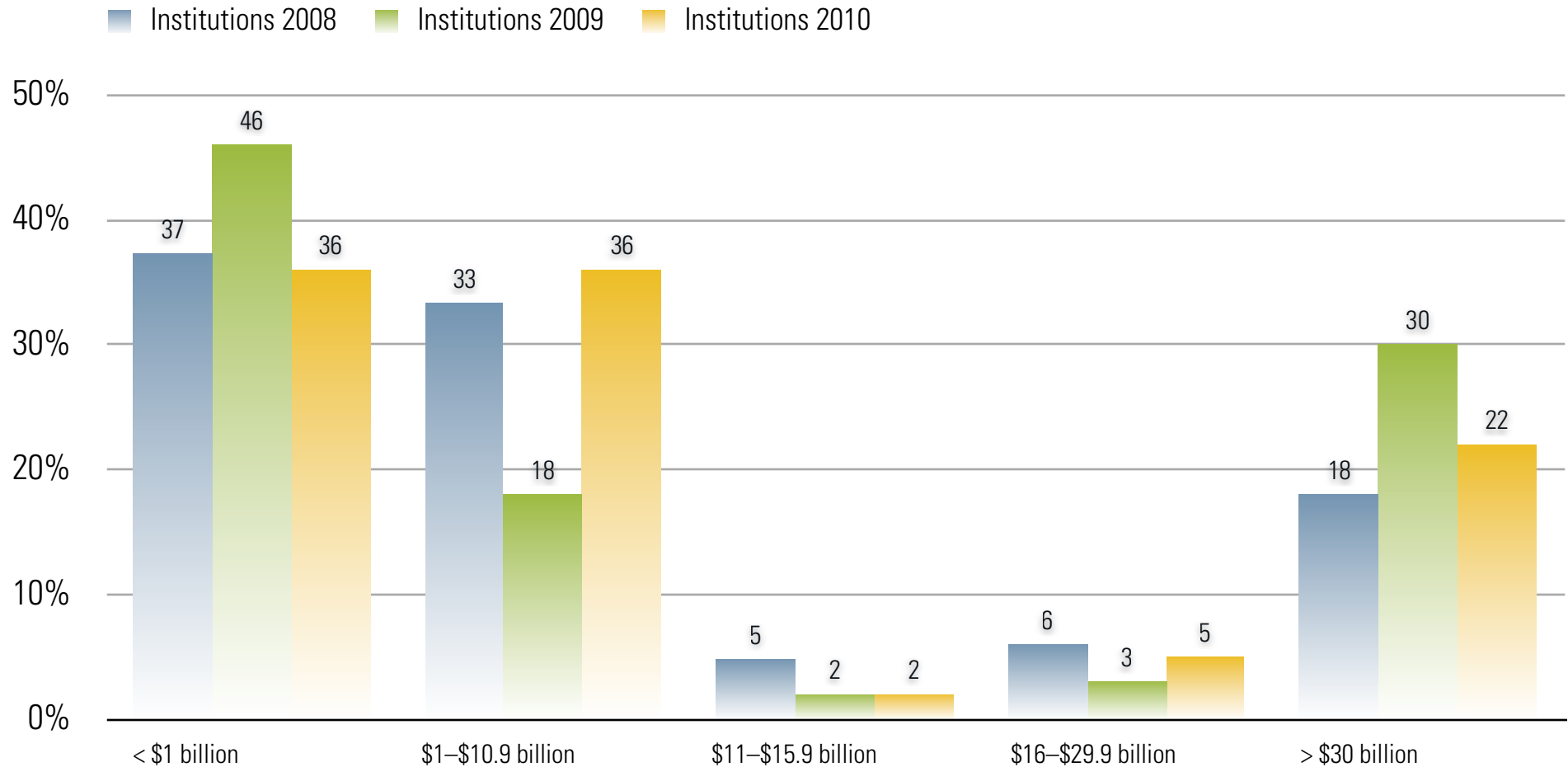
- ▶ Institutional and Advisor Survey Participant Profile
- ▶ Defining Alternatives Investment Strategies
- ▶ Past Growth and Future Growth—Assumptions
- ▶ Alternative Investment Drivers and Disincentives
- ▶ Hot Topics in 2010: Accredited Investors, Commodity Investing, Fee Concessions
- ▶ Appendix: Other Results

- ▶ Nationwide
- ▶ Electronic survey
- ▶ Invited 47,500 institutional investors and 97,500 advisors to respond
- ▶ Conducted between Monday, November 1 and Friday, November 19

Institutional Investor 2010 Survey Participation: 151 Responses

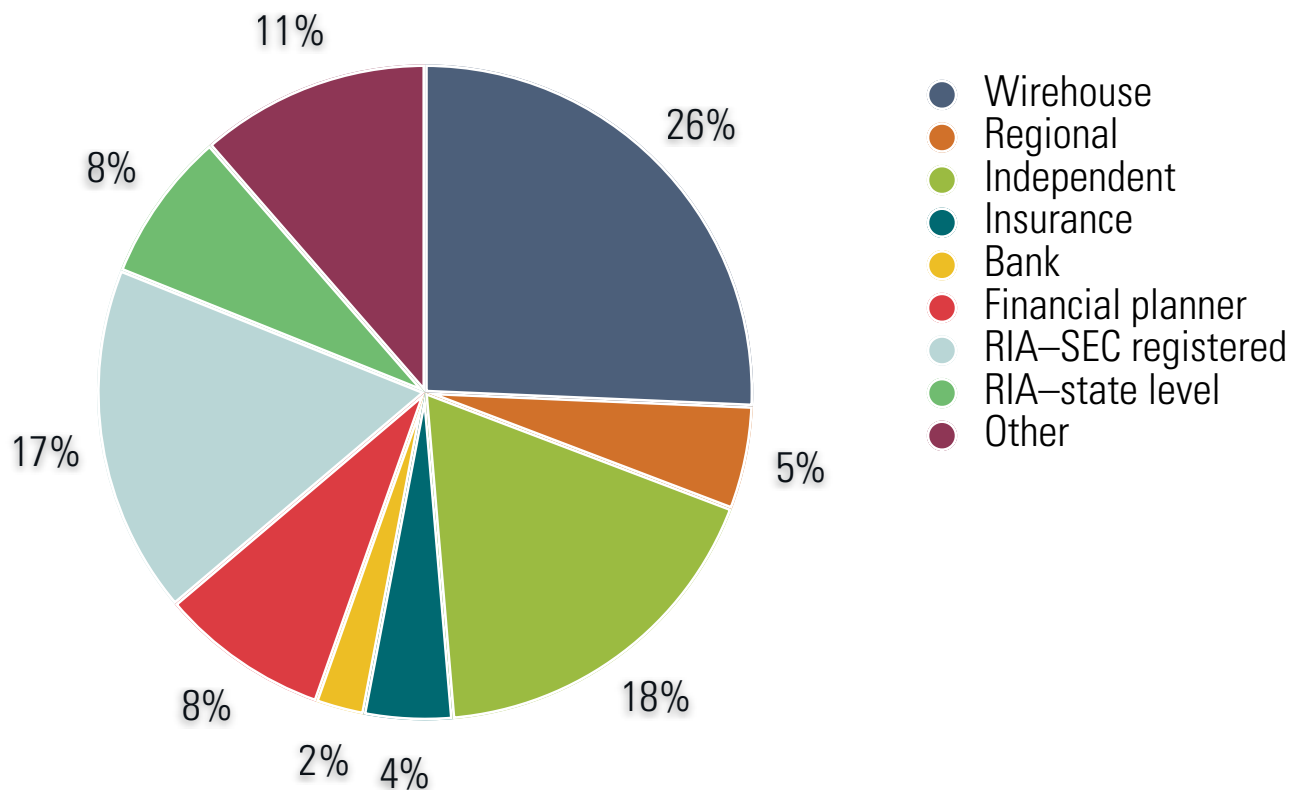


Institutional Investors in the 2010 Survey: 36% with \$1–10 Billion in AUM 29% with Greater than \$11 Billion in AUM

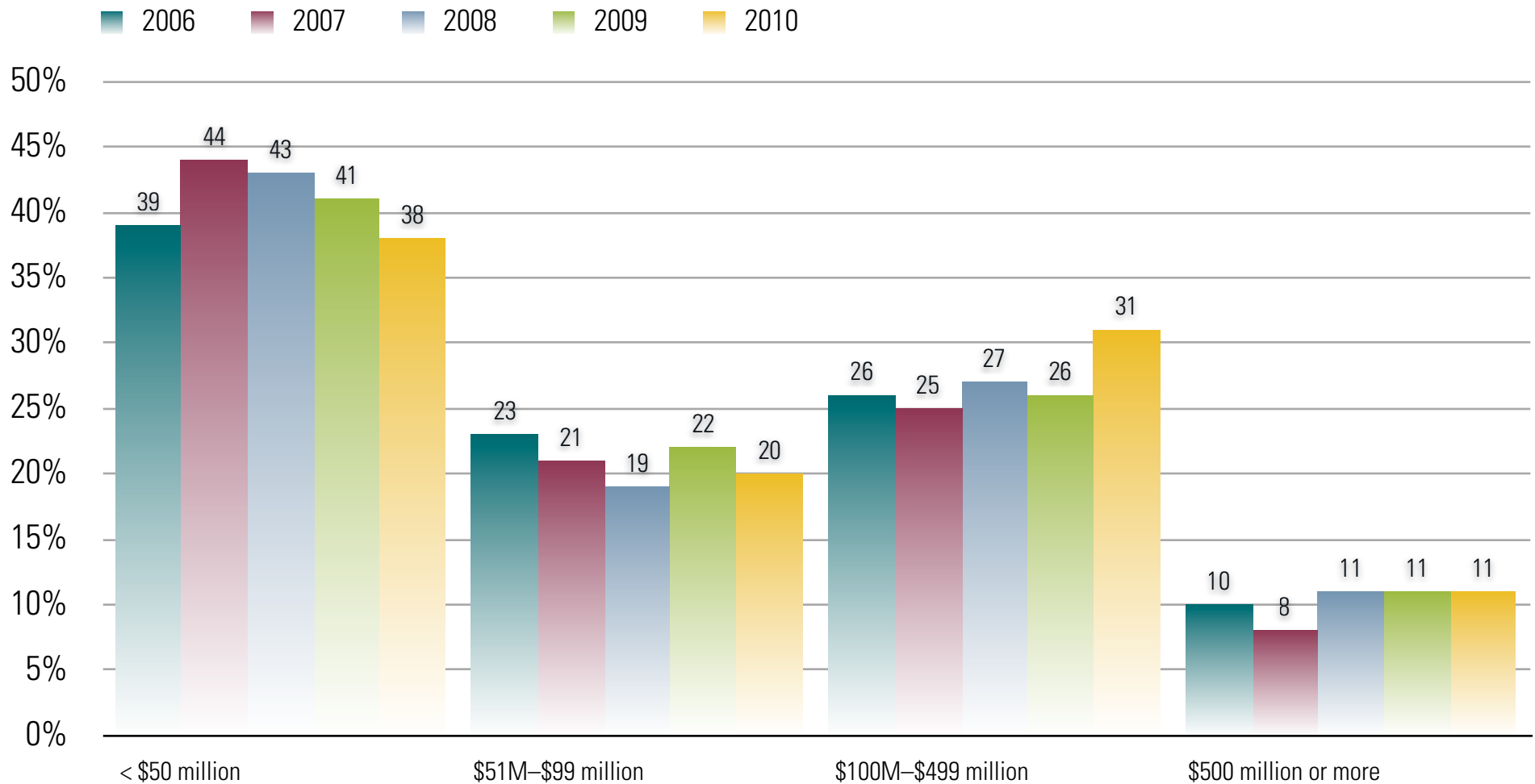


669 Advisors Participated in the 2010 Survey, Most From Broker/Dealers

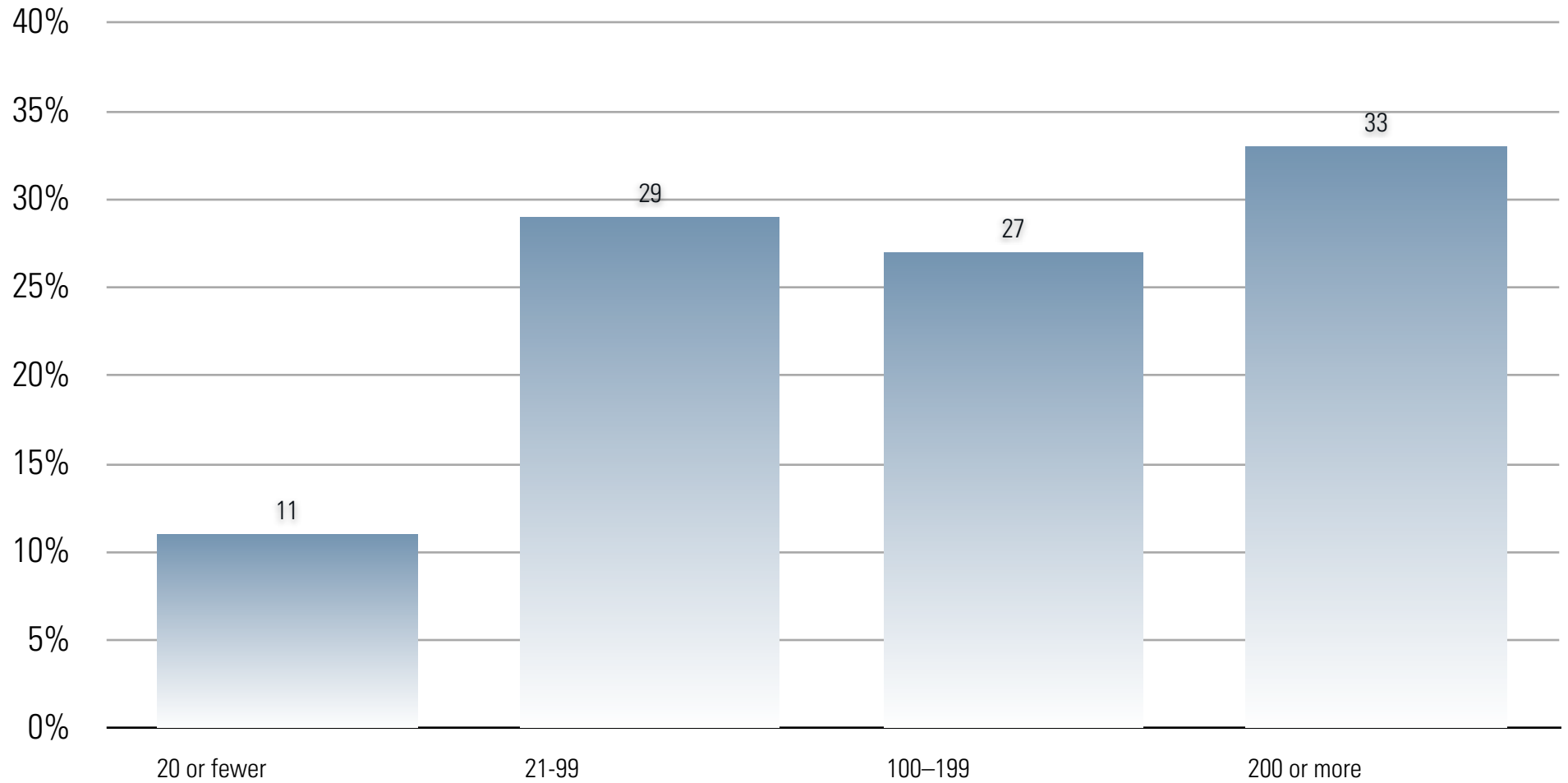
- ▶ 669 Advisors
- ▶ 65% affiliated with Broker/Dealers



Advisor AUM in the 2010 Survey and Compared to Previous Years



Advisors 2010: Most Serving 200 Clients or More

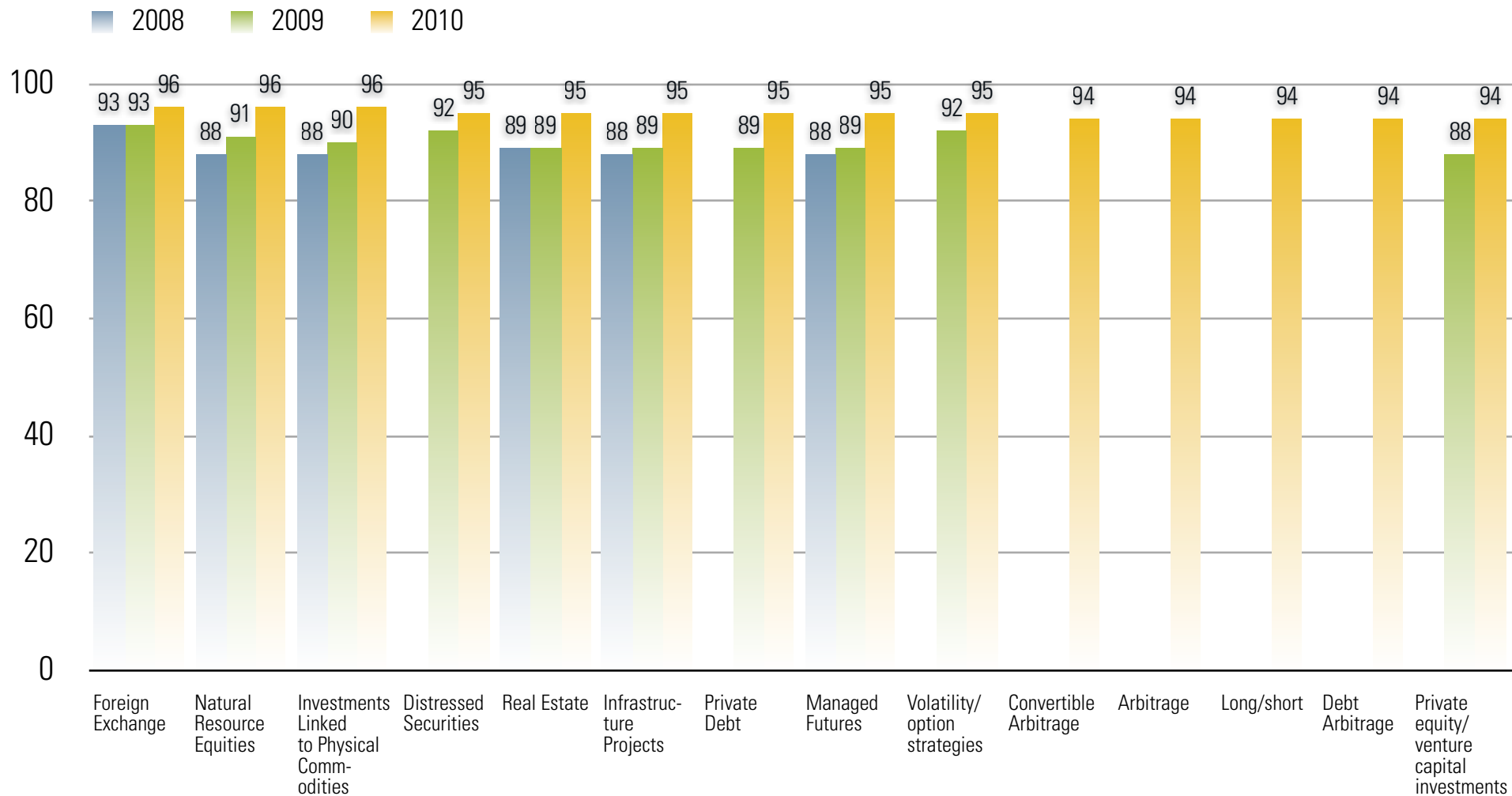


How many overall clients (individual, mass affluent, high net worth, and institutional) do you now serve?

Defining Alternative Investment Strategies—2010

Institutions: What are Alternative Investment Strategies?

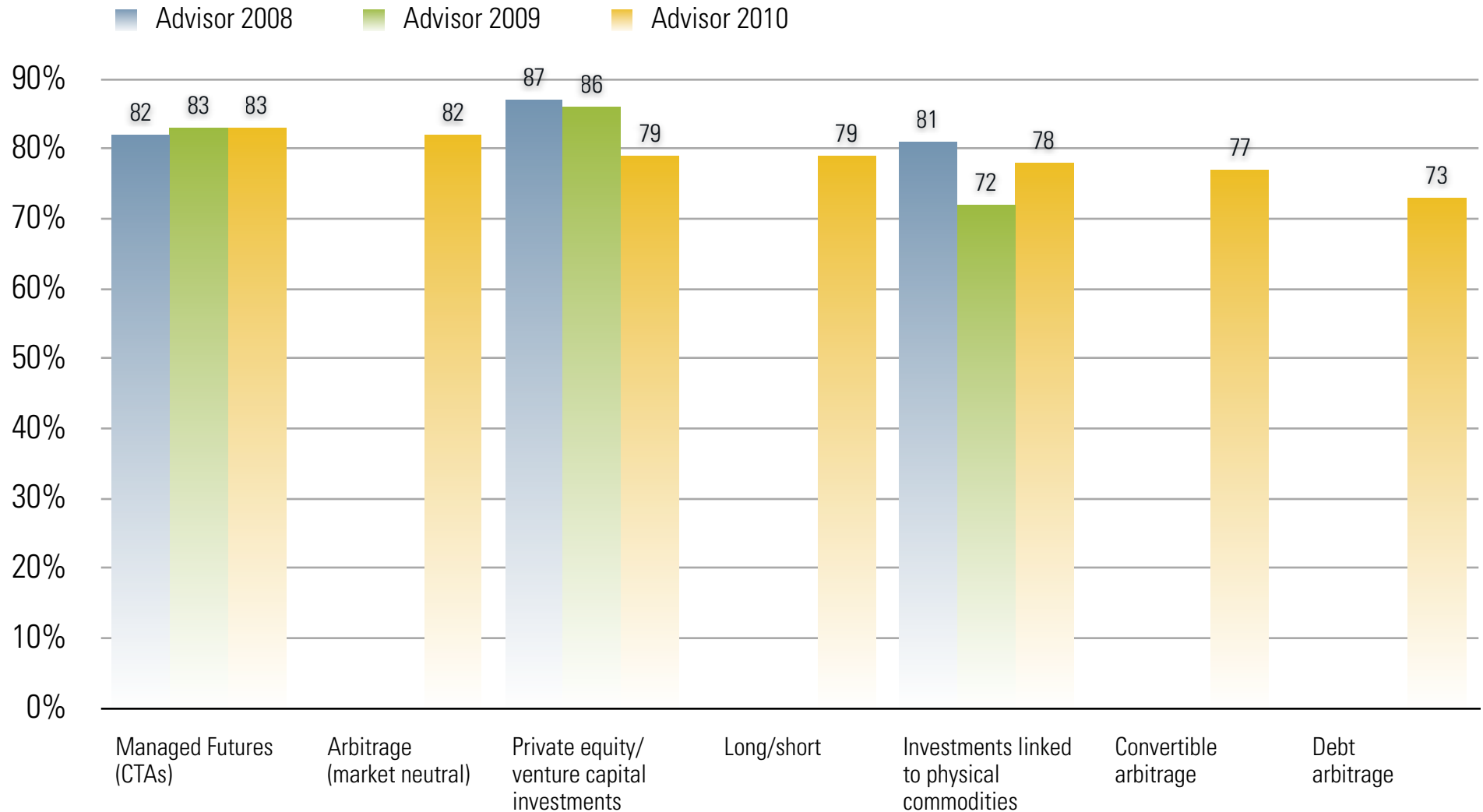
Ranked by highest 2010 agreement



- ▶ Legal Settlements, Life Settlements
- ▶ Insurance-linked securities & catastrophe risk instruments
- ▶ Mezzanine Finance

Advisors: What are Alternative Investment Strategies?

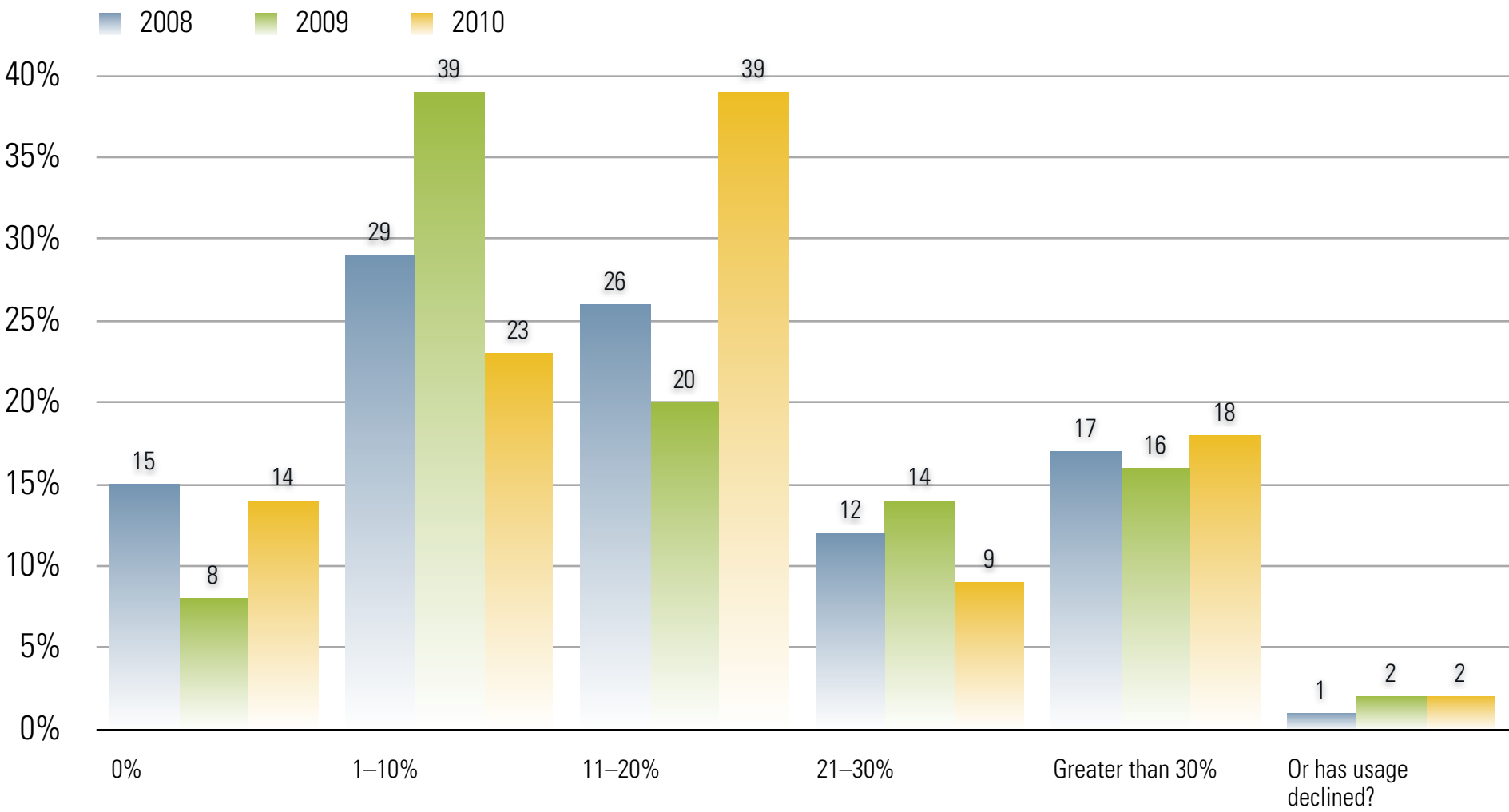
Ranked by highest 2010 agreement



- ▶ A total of 47 responses.
- ▶ Some responses are already covered in the answer choices provided, such as Timberland, and Collectibles. Some responses refer to vehicles instead of strategies, such as Structured Products, and Hedge Funds.
- ▶ Top responses include:
 - ▶ Hedge Funds (17)
 - ▶ Oil/Gas Partnerships (11)
 - ▶ Structured Products (9)
 - ▶ Timberland (8)
 - ▶ FOF (6)

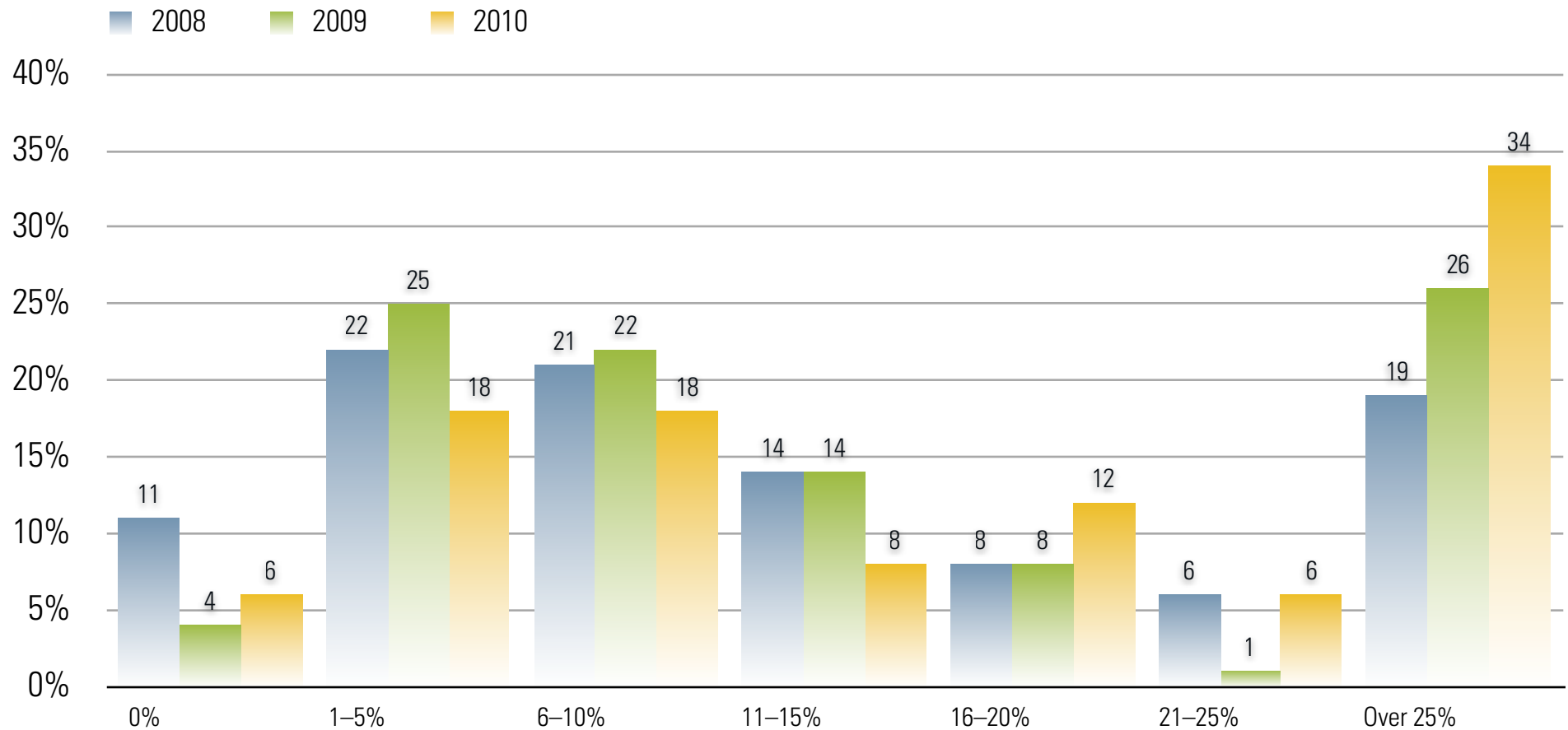
Past and Future Alternative Growth

Institutions: Annual Growth in Alternative AUM Since 2005



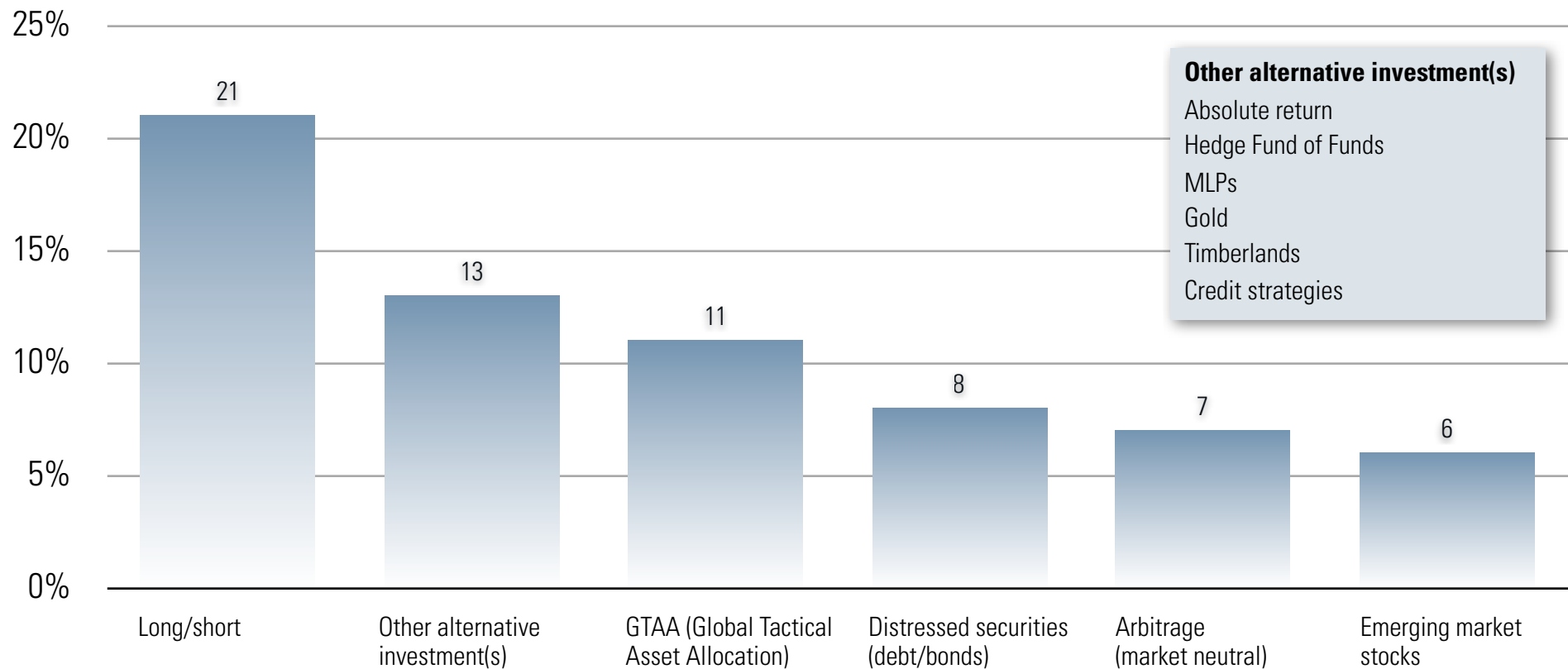
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Institutions: 34% Responded that Over 25% of Portfolio Holdings are in Alternative Assets



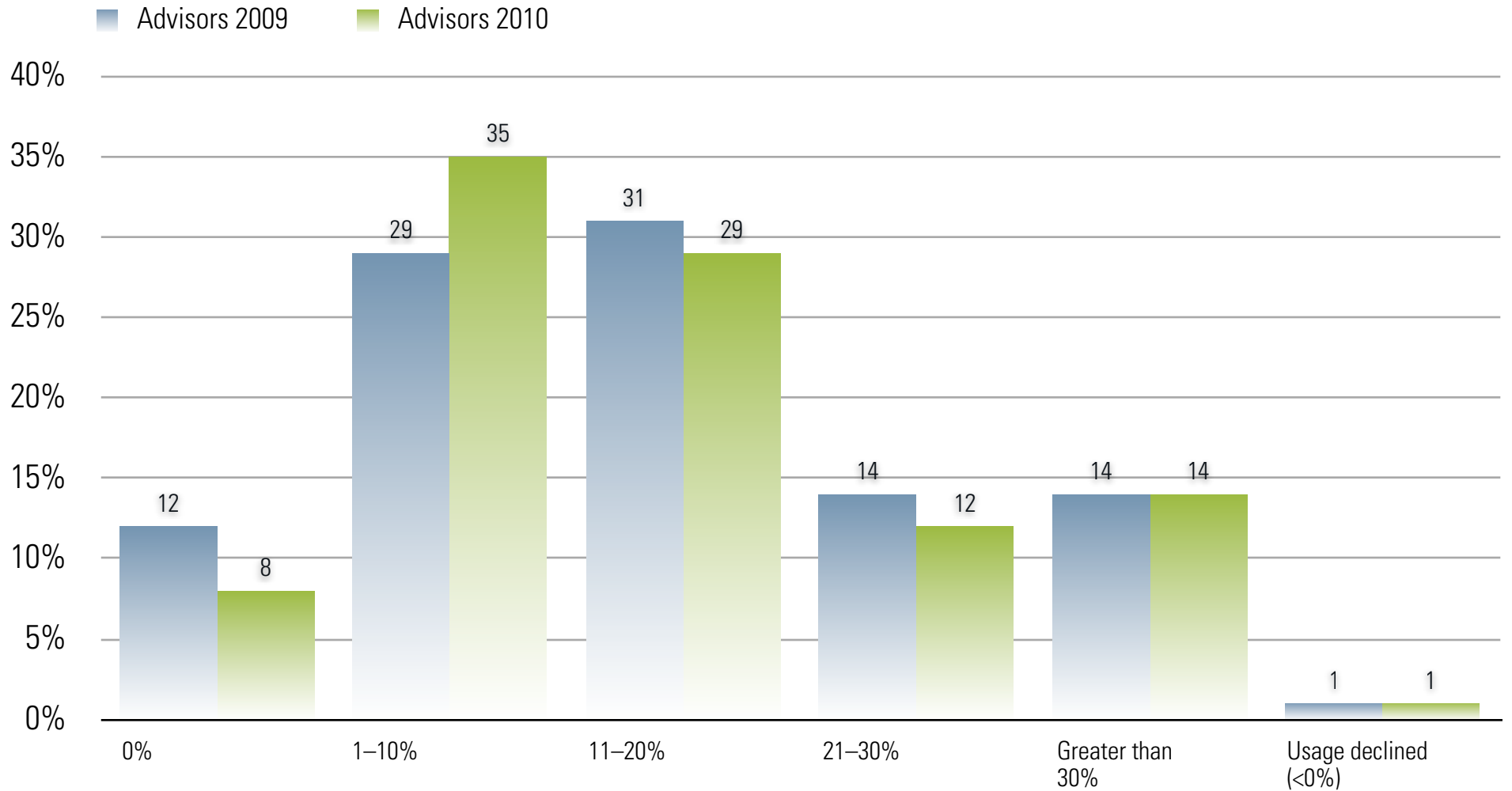
As of September 30, 2010, for the institution or division of the institution you represent, what is the **OVERALL (sum) percentage of portfolio holdings in alternative assets?**

Institutions: 21% Responded that Over the Last Five Years, Long/Short has Come to Represent the Largest (%) Allocation of the Investment Portfolio

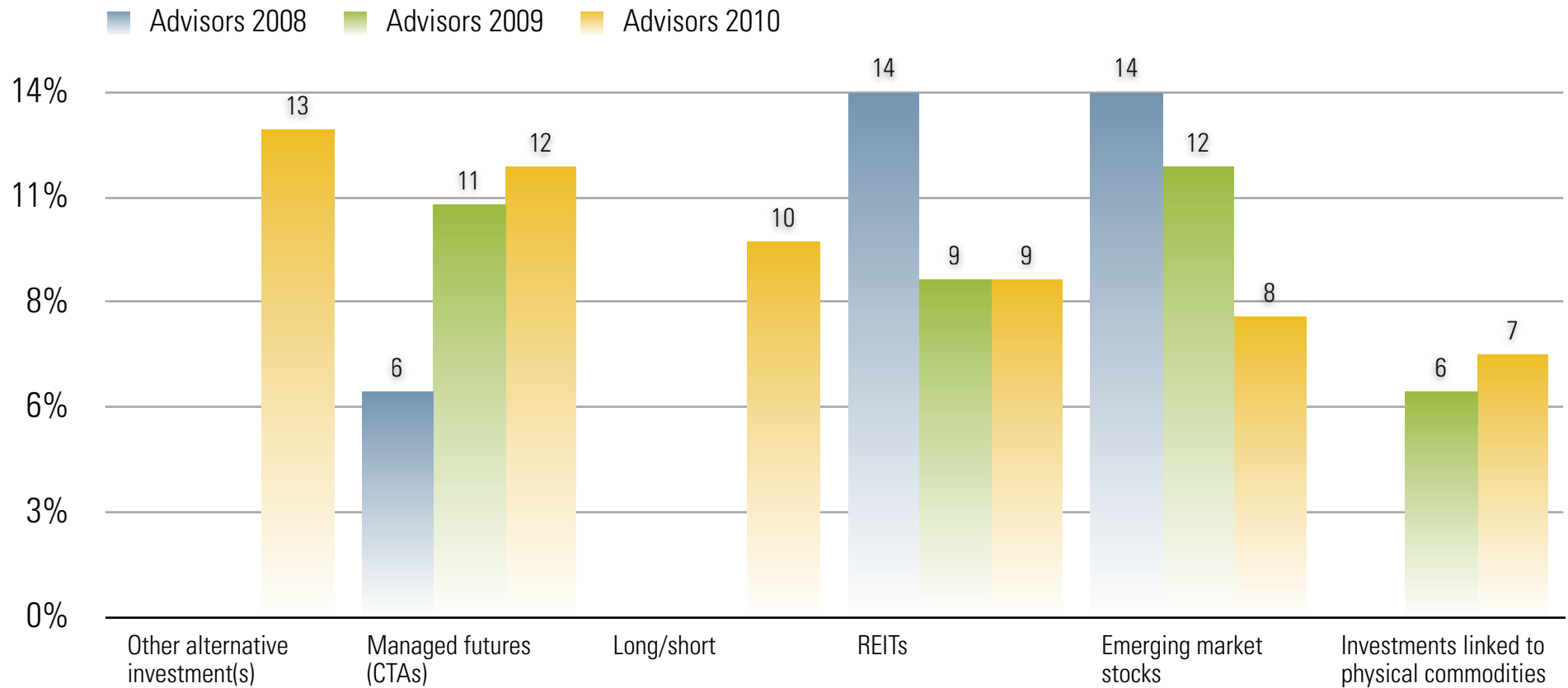


Over the last five years (since 2005), for those investment STRATEGIES that you DO consider alternative, which ONE alternative STRATEGY has come to represent the largest (%) allocation of your investment portfolio?

Advisors: Estimated Average Annual Growth in Alternative AUM Over the Last Five Years



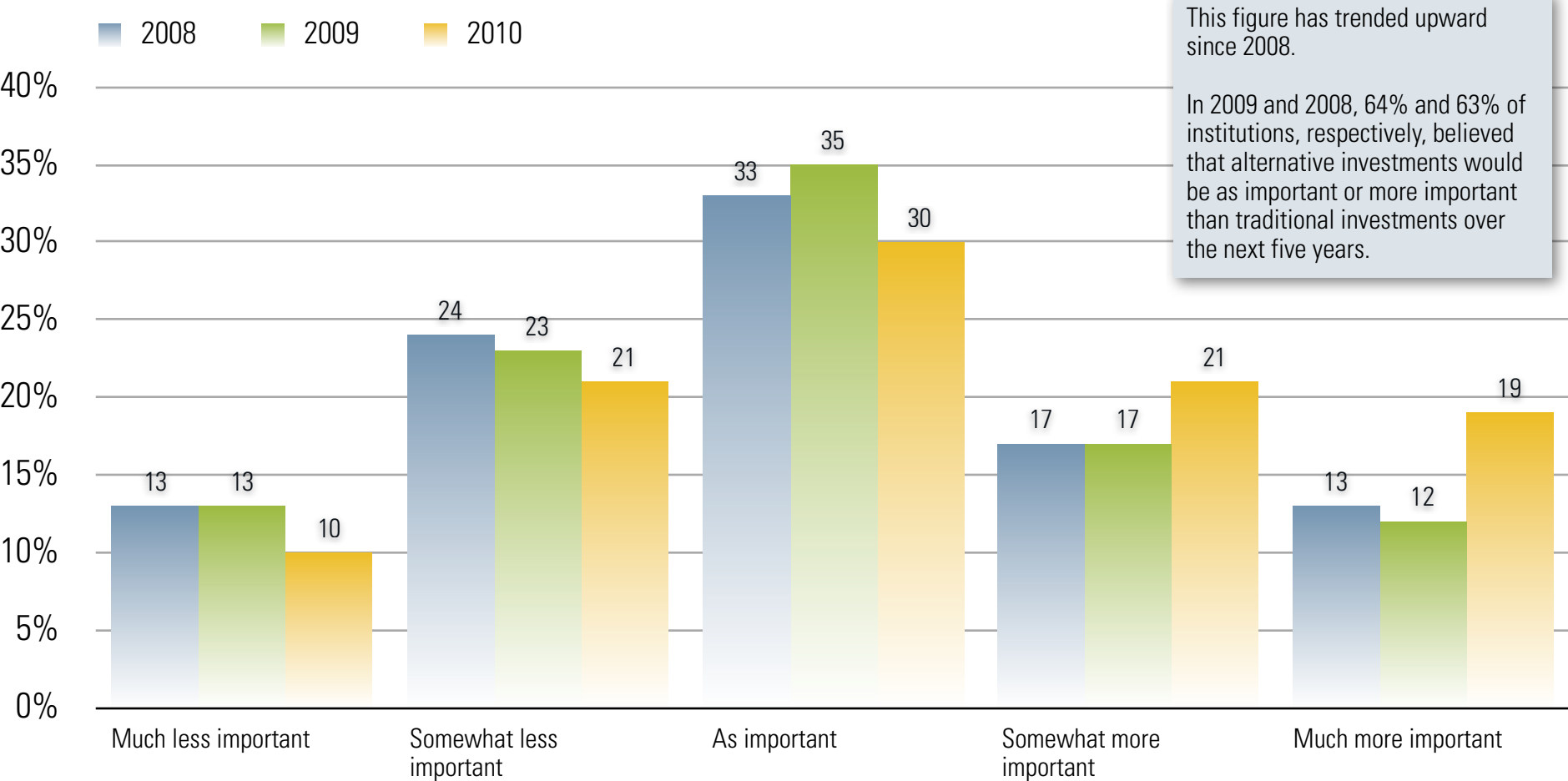
Advisors: Managed Futures Strategies Provided Greatest Growth Over the Past Five Years



Advisors: Over the last five years (since 2005), for those investment STRATEGIES that you DO consider alternative, which ONE STRATEGY has provided the greatest growth to your business/your book of business?

- ▶ A total of 61 comments.
- ▶ Is it really “Other”—or the grey line and lack of agreement on alternatives?
Most responses mix strategies with vehicles.
- ▶ Top responses include:
 - ▶ FOF (7)
 - ▶ MLP (5)
 - ▶ Non-traded REITs (4)
 - ▶ Precious Metals (4)

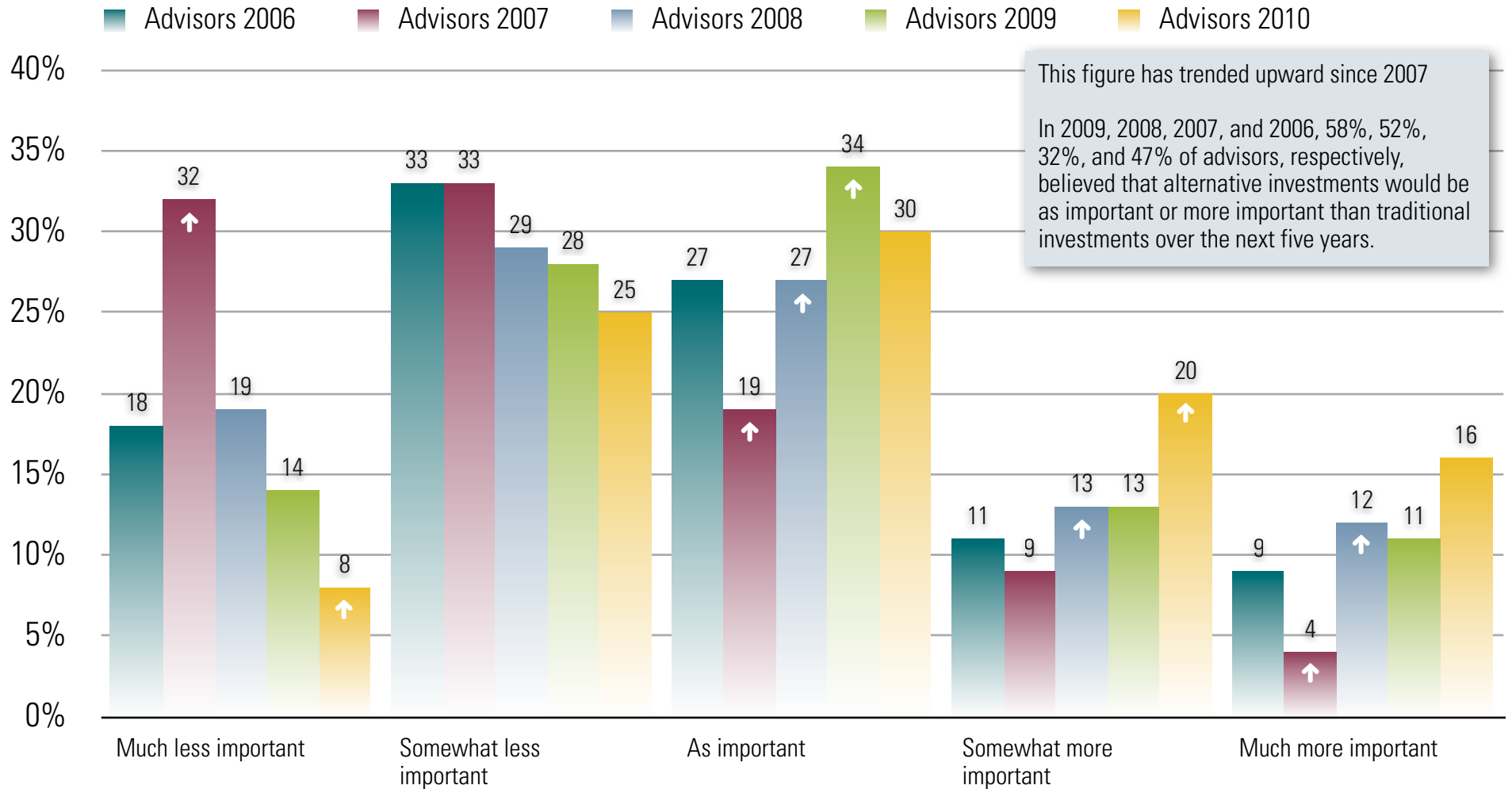
Institutions: 70% Believe Alternatives will Become as Important or More Important than Traditional Investments Over the Next Five Years



To what extent do you think alternative investments will become as important as traditional investments (stocks, bonds, etc.) to your institution's or division's investment portfolio over the next five years?

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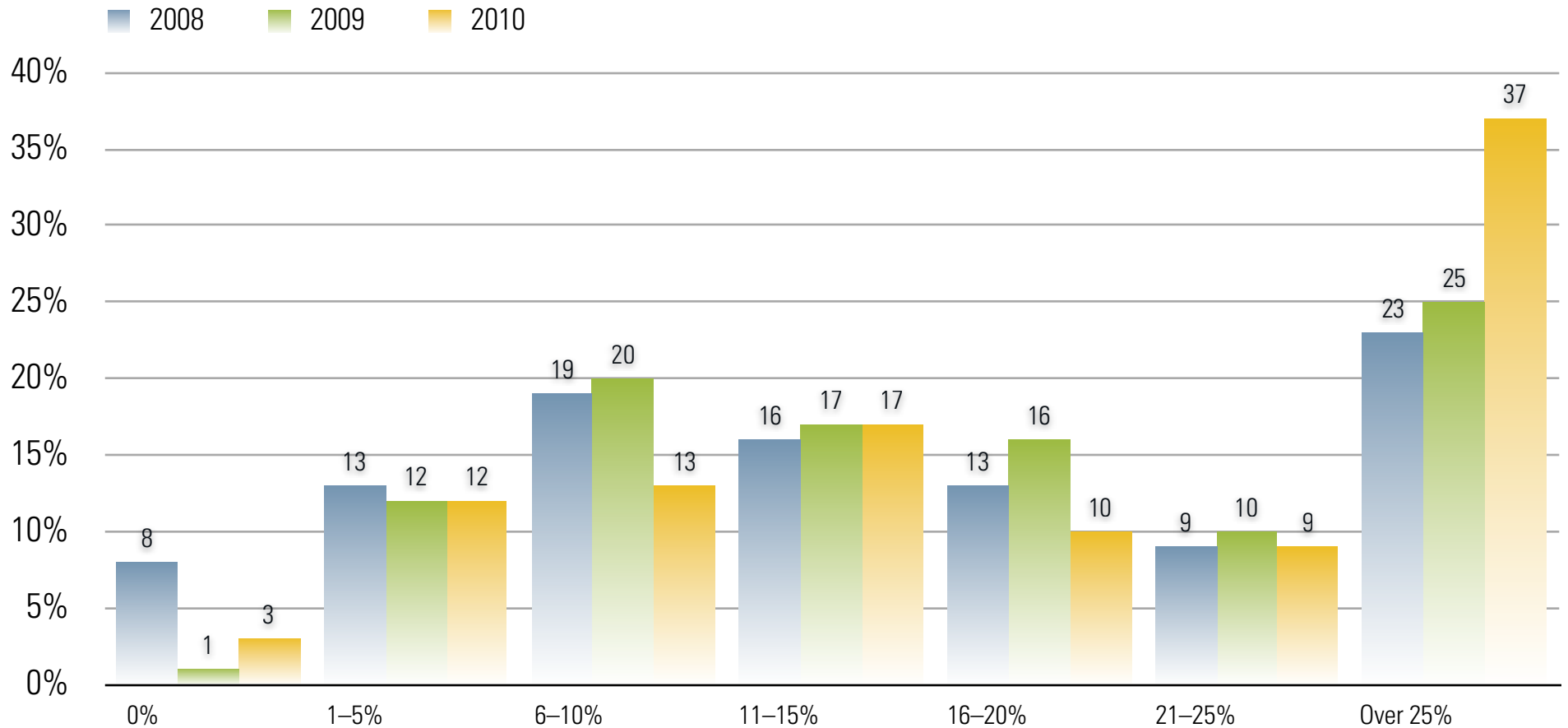
Advisors: 66% Believe Alternatives will Become as Important or More Important than Traditional Investments Over the Next Five Years



This figure has trended upward since 2007
 In 2009, 2008, 2007, and 2006, 58%, 52%, 32%, and 47% of advisors, respectively, believed that alternative investments would be as important or more important than traditional investments over the next five years.

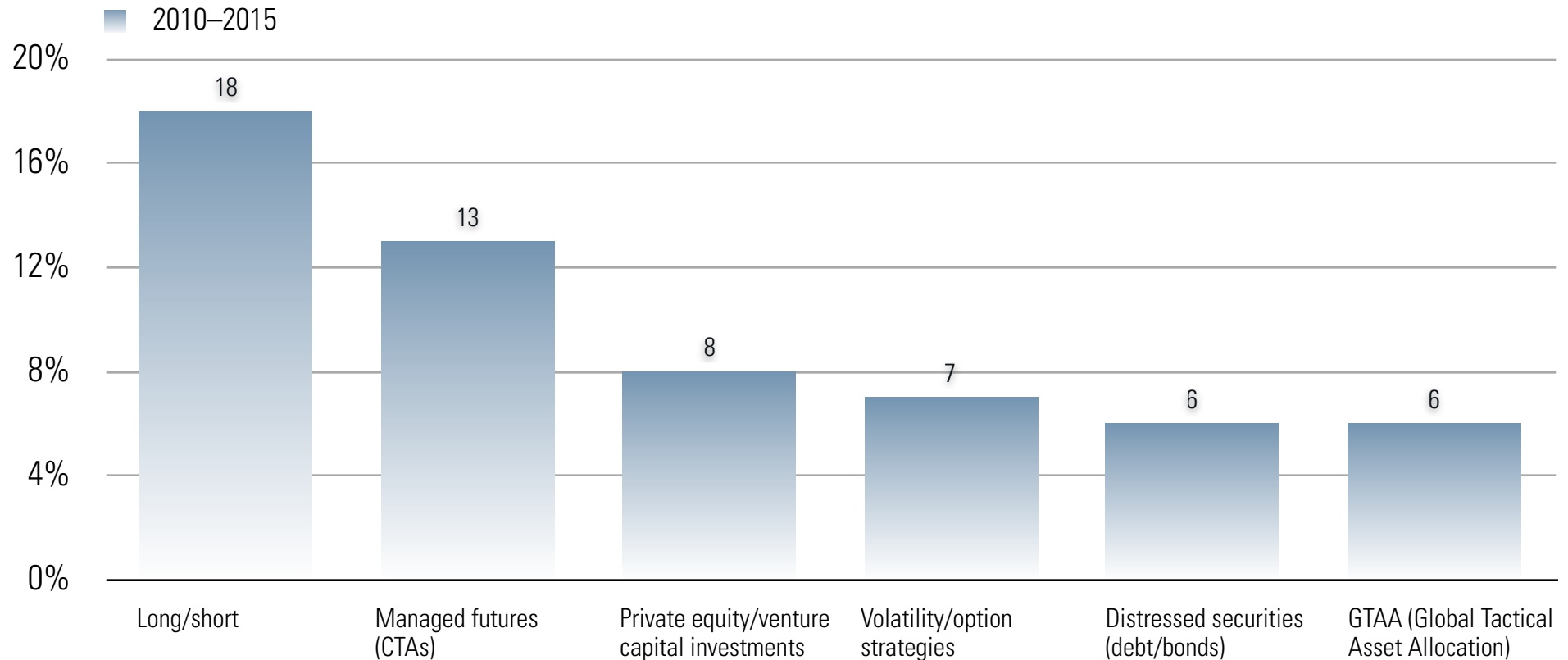
↑ indicates significant change compared to previous year (95% confidence level)

Institutions: 37% Reported that Their Anticipated Allocation to Alternative AUM Over the Next Five Years Will be Over 25%



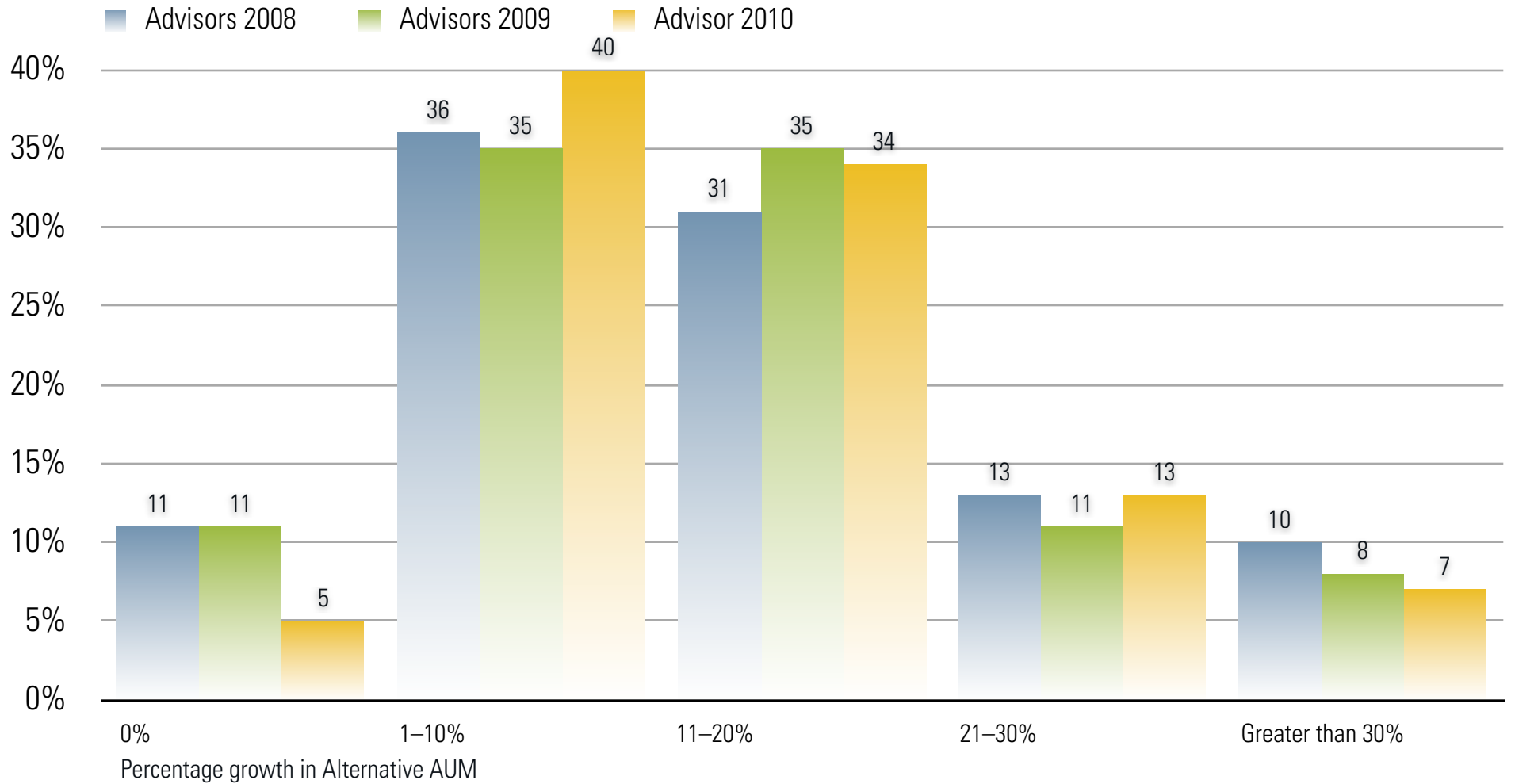
On average, over the next five years (until 2015), what is your anticipated OVERALL allocation to alternative assets under management for the institution or division of the institution you represent?

Institutions: Long/Short & Managed Futures are Top Alternative Strategies that Will be Examined Most Closely for Increased Allocation Over Next Five Years

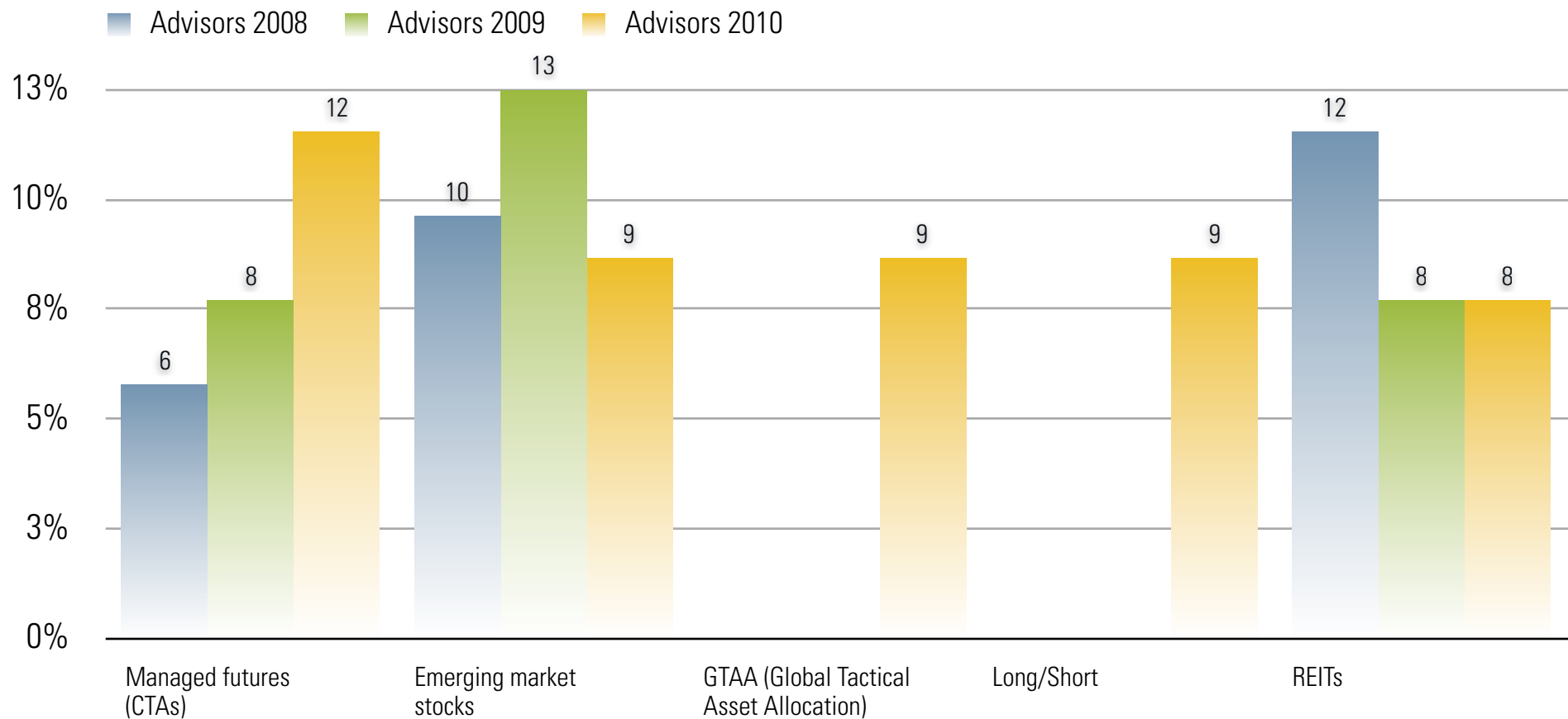


For those alternative strategies that you DO consider alternative, which ONE of the following alternative investment strategies will be examined most closely for an increased allocation in that five-year time span?

Advisors: 52% of Respondents Believe that Annual Growth in Alternative AUM Over the Next Five Years Will be Greater than 10%



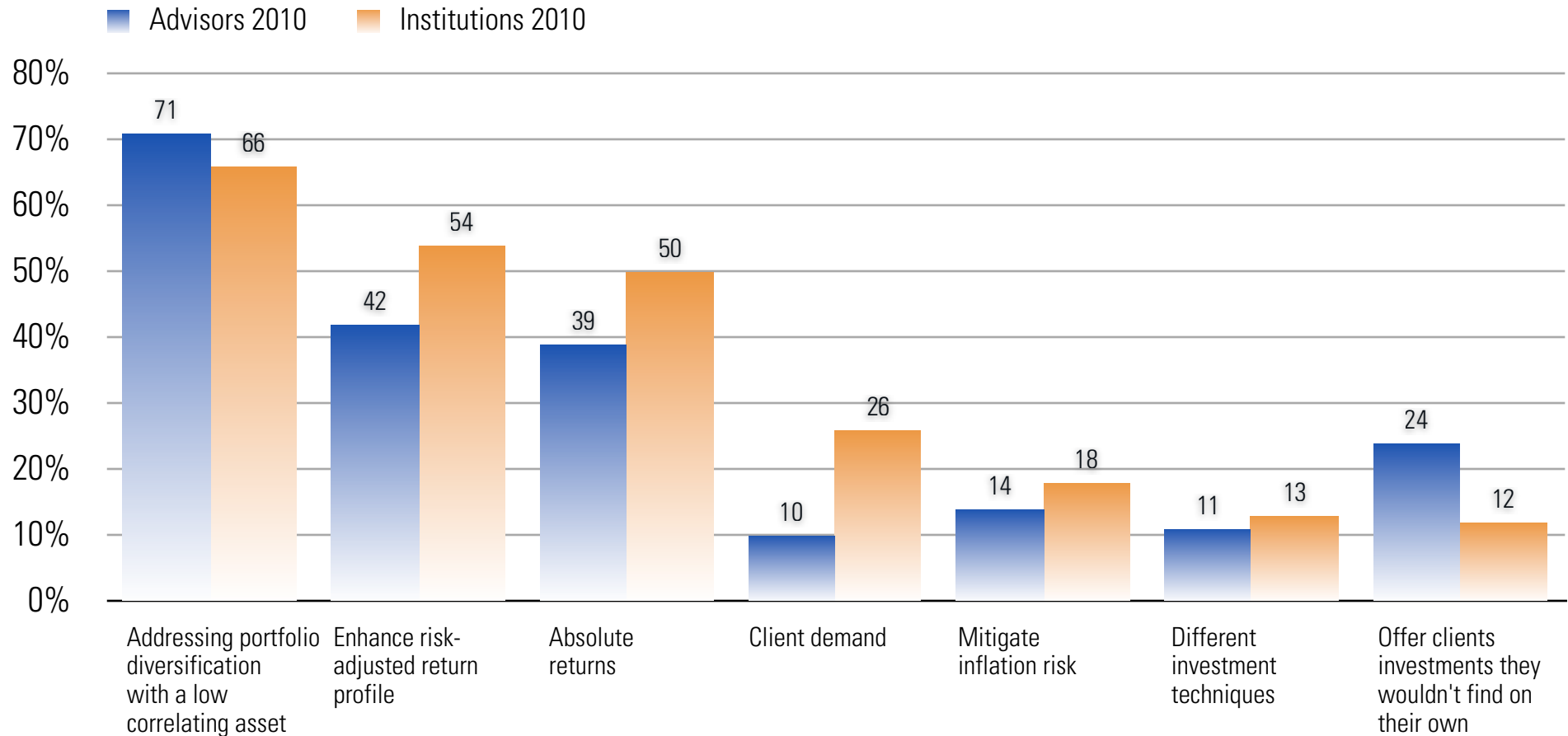
Advisors: Managed Futures Strategies Offer Greatest Growth Potential over the Next Five Years (until 2015)



Advisors: Over the next five years (until 2015), for those alternative strategies that you DO consider alternative, which ONE of the following alternative investment strategies offer you the greatest business growth potential?

Alternative Investment Drivers and Disincentives

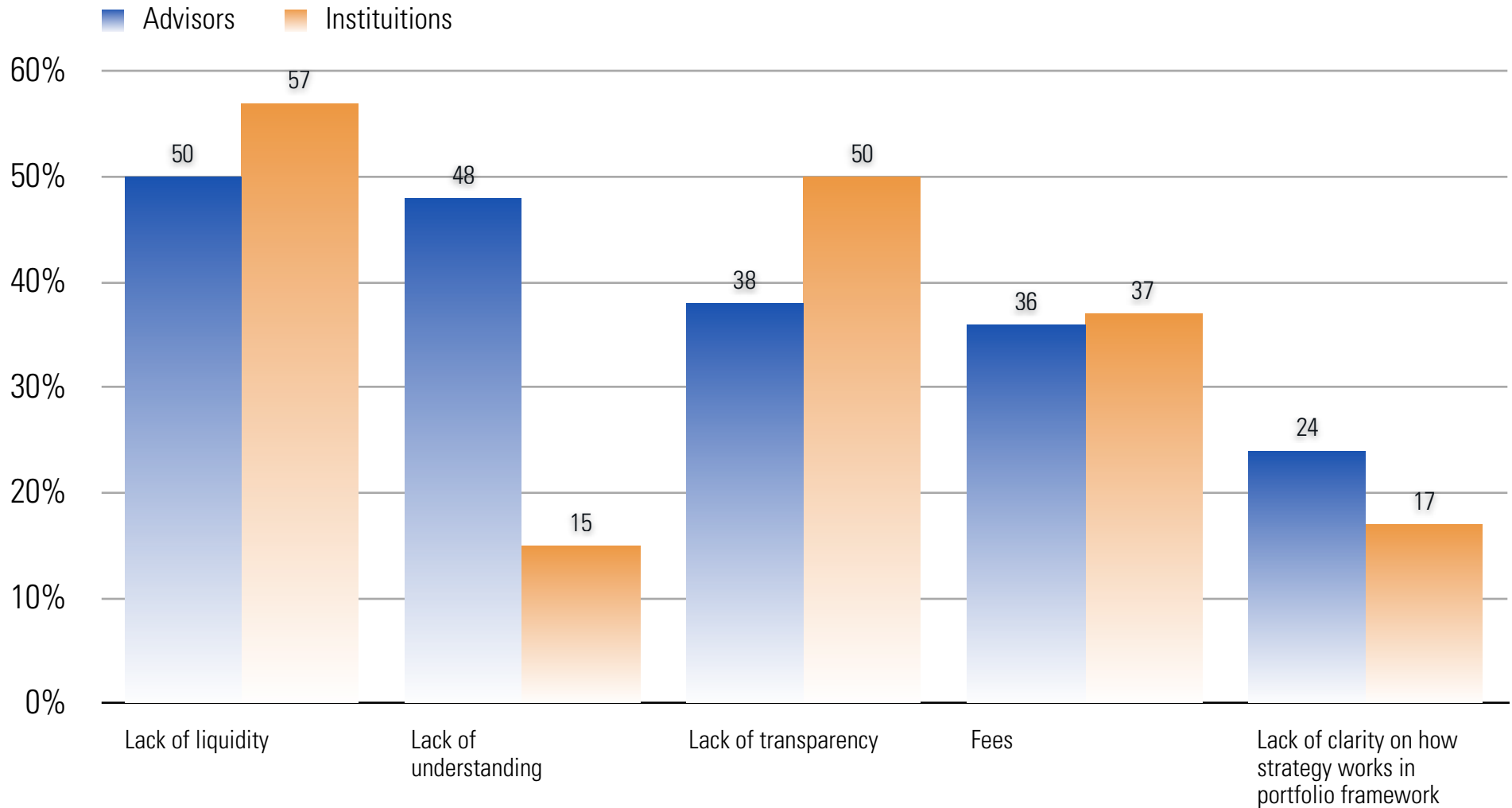
Institutions and Advisors: Same Top Three Factors Driving Their Investments in Alternatives Over Last Five Years



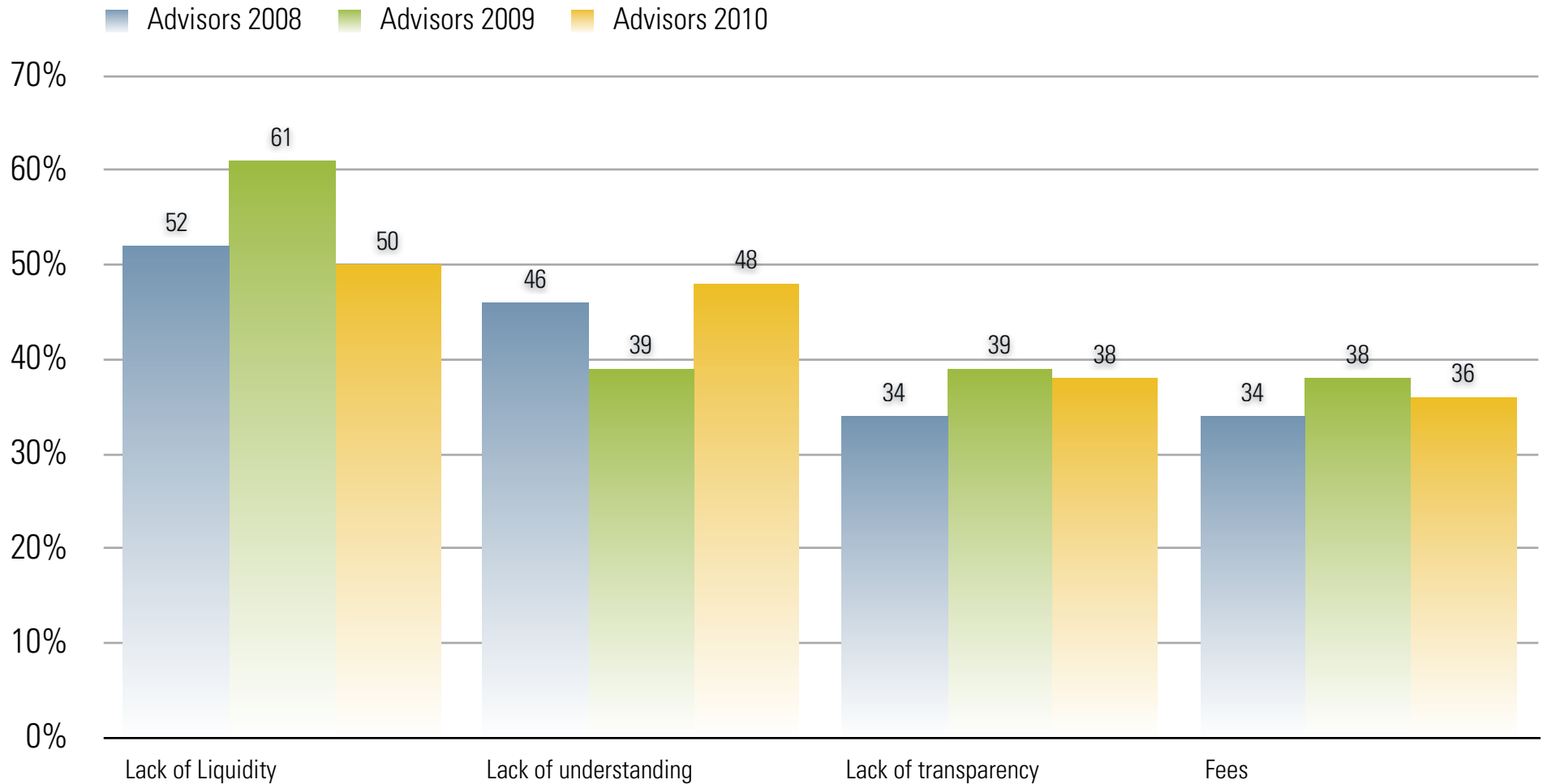
If your institution is investing in alternative investments, what have been the top THREE factors influencing the investment committee to allocate dollars to alternative investments over the last five years?

- ▶ Volatility experienced in recent market fluctuations with more correlative swings in traditional fixed and equity investment options.”
- ▶ “Reduce overall portfolio volatility.”

Institutions & Advisors: Top Reasons to Hesitate Investing in Alternatives: Liquidity, Transparency, Lack of Understanding, Fees

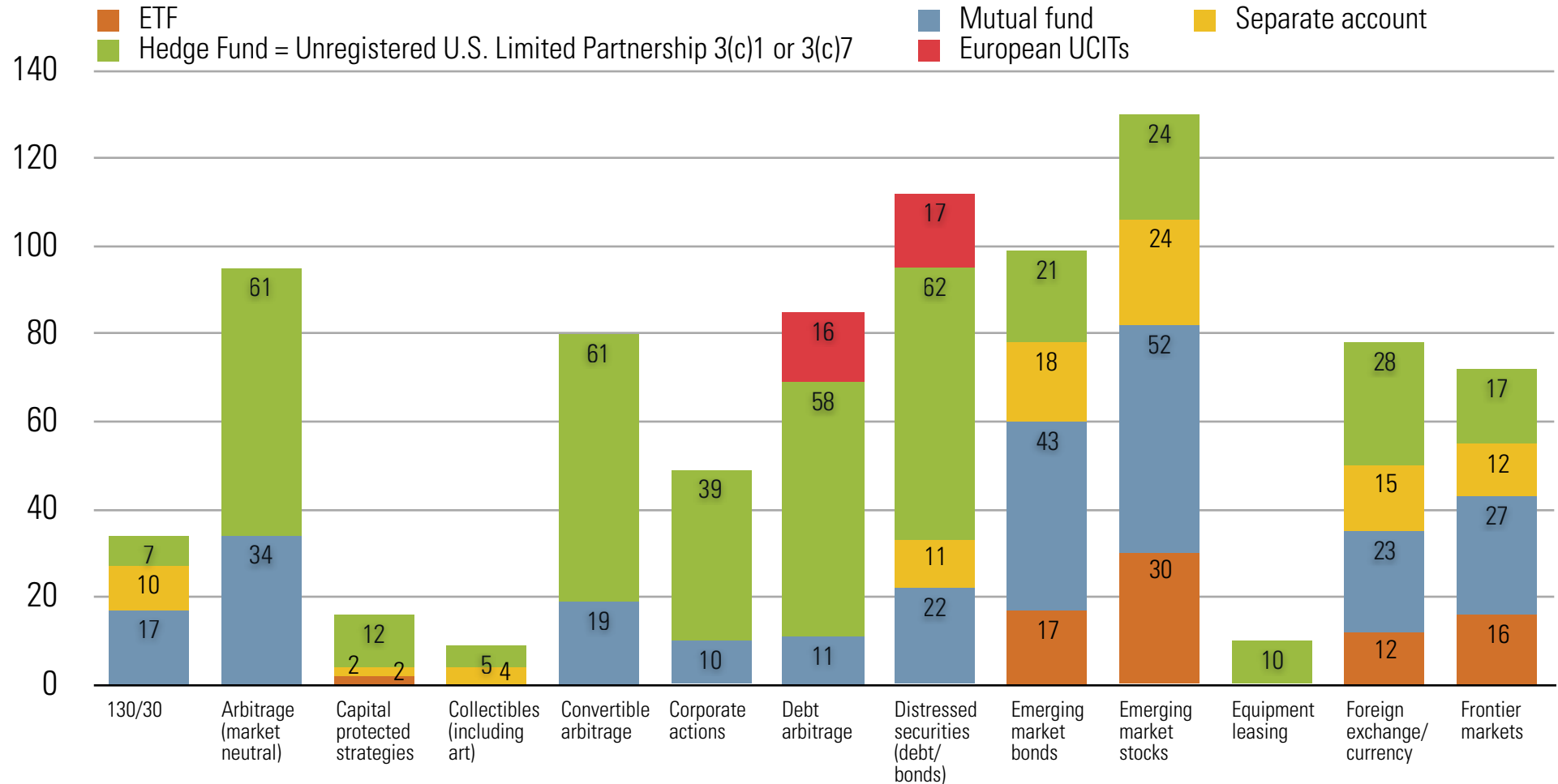


Advisors: Top Reasons to Hesitate to Invest in Alternatives— Some Progress on Liquidity. Understanding Remains a Large Barrier.



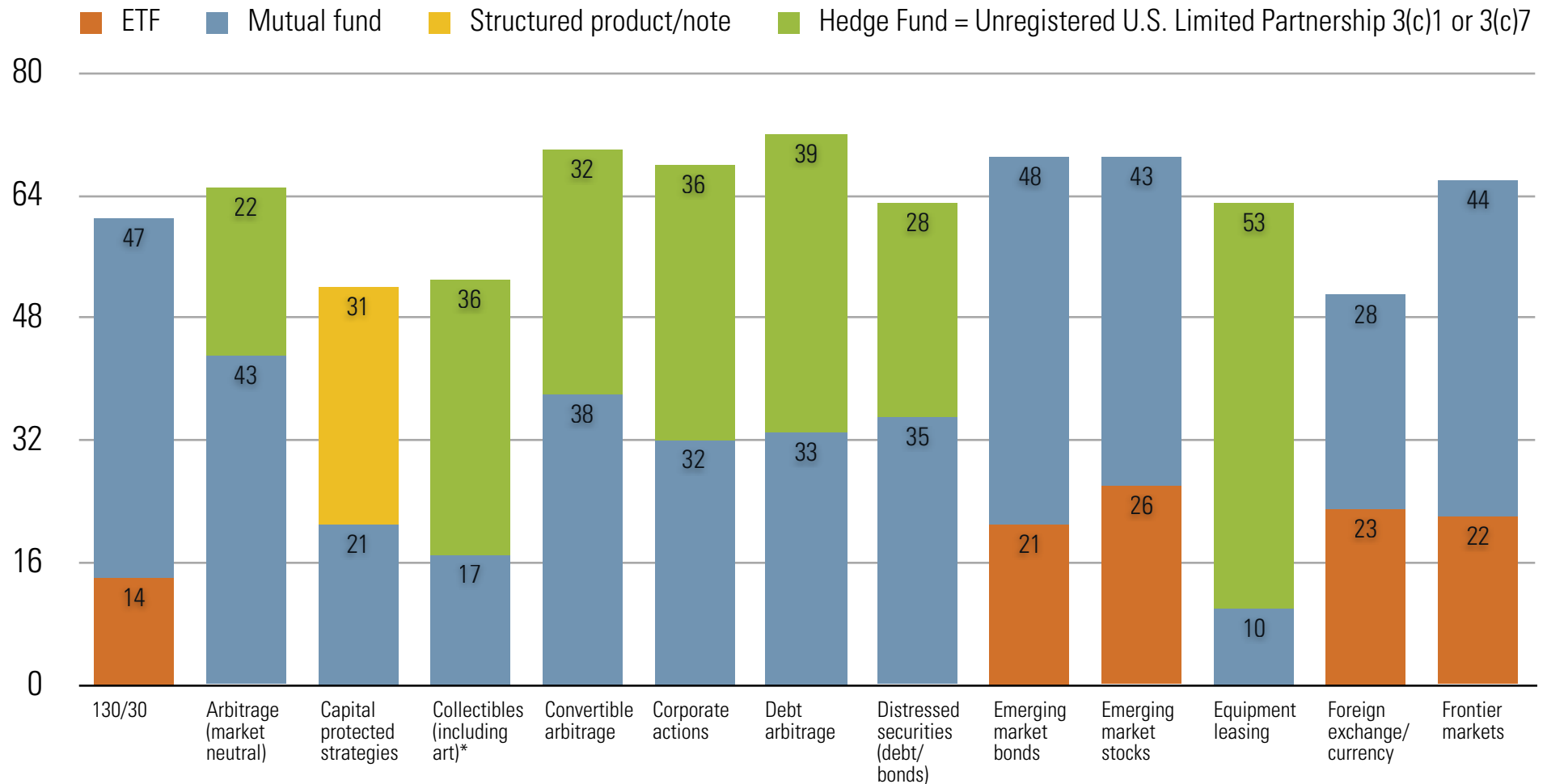
- ▶ “Unable to manage participant self-direction in 401(k) plans; can't educate participants to use properly. No diversified mutual fund option available to represent asset class. Fear that commodities etc. are overvalued.”
- ▶ “Investment minimums and lock-ups.”
- ▶ “Length of track record.”

Institutions: Investment Vehicles Used to Access Alternative Strategies



For a given strategy, what investment vehicle do you use?

Advisors: Investment Vehicles Used to Access Alternative Strategies



Advisors: For the client type that is the largest of your book of business USING ALTERNATIVE strategies, which investment VEHICLE do they use to access them?

- ▶ Diversification and absolute as well as risk-adjusted returns are the top alternative investment drivers for institutions and advisors
- ▶ Liquidity remains the leading barrier to alternative investment for both institutions and advisors, but decreased from 2009
- ▶ Lack of transparency and fees are the next largest barriers for institutions. Advisors rank lack of understanding, then transparency.
- ▶ As in previous years, the survey results again indicate that institutions and advisors are often addressing the liquidity and transparency shortfalls of alternative investment strategies by accessing them with traditional investment vehicles, where possible.

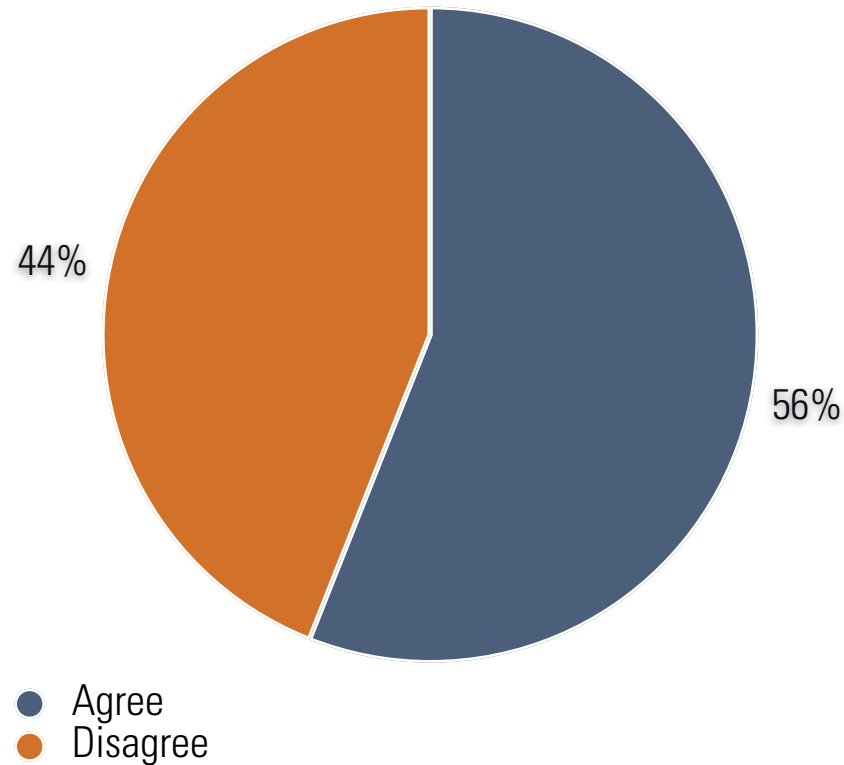
Hot Topics in 2010

Accredited Investor Rule Change

Rationale for Commodity Investment

Fee Concessions

Advisors: Split on the Accredited Investor Recent Rule Change



Do you agree with the change of the accredited investor rule to exclude the value of a person's primary residence in determining net worth? Will it change the way your clients access alternative strategies?

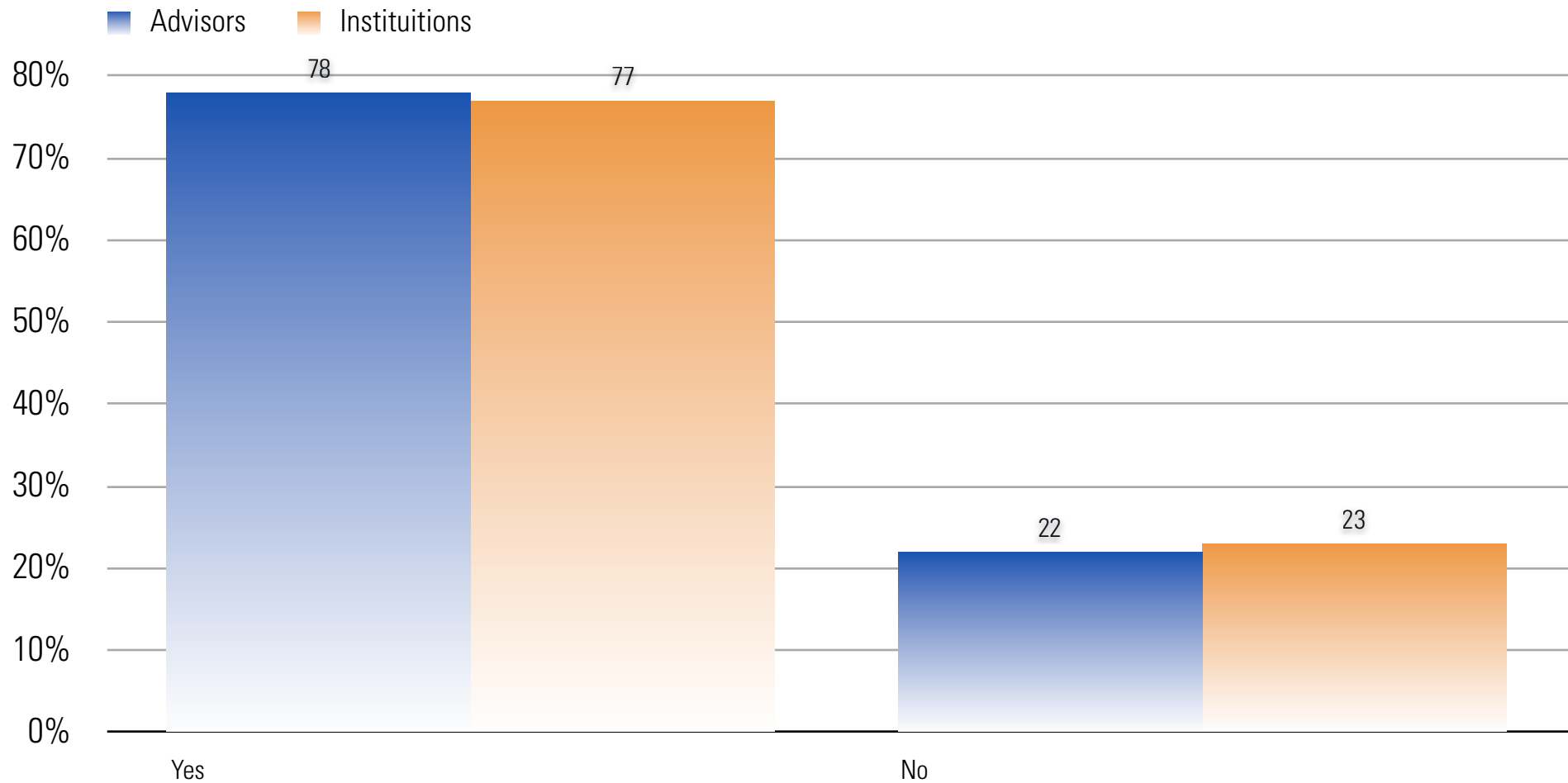
Agree

- ▶ “It is common practice amongst investors to include their primary residence in the net worth equation. I think this incorrectly overstates wealth from an investment perspective.”
- ▶ “Most clients/prospects who ask for alternatives are people who have no business taking on all the risks that alternatives provide a person. They hear about the potential large returns but do not want to participate in the risks. The accredited investor rule provides a rule the advisor can utilize to protect the prospect/client from themselves.”
- ▶ “I think that excluding the home is appropriate to make sure that the client has sufficient liquidity.”
- ▶ “We want people investing in alternative assets who clearly fit the profile. If it takes a primary residence to qualify, they are a pretty marginal candidate to begin with.”
- ▶ “Mutual fund alternatives offer the strategies to clients that otherwise don't qualify.”

Disagree

- ▶ “...Many alternatives are high quality investments and should not be reserved only for high net worth/high income individuals. This rule may have been put in place with good intentions, the protection of the individual investor, but in actuality it's financial discrimination.”
- ▶ “It locks out investors with significant values in their primary residence from opportunities for diversification.”
- ▶ “It is a valuable asset that many clients see contributing toward their overall wealth. As clients retire, many see the potential of a cash outflow from the asset...”
- ▶ “Why should Justin Bieber have better access to an alternative strategy than a junior analyst of a long/short investment strategy (which one is really more qualified to make the investment decision?)”

Institutions: Are Commodity Returns Driven by Investor Demand/Sentiment?



Agree

- ▶ “Demand from China is driving returns as well as weaker dollar.”
- ▶ “Investors are moving towards hard assets as an alternative store of wealth to paper currency. This trumps the natural supply/demand equation for commodities.”
- ▶ “Increased investor demand, coupled with investment vehicles such as ETF's give easier access to the commodity space.”
- ▶ “Speculation and sentiment appear to have a disproportionate role in commodity prices. Fundamental factors appear to be secondary in many cases.”

Disagree

- ▶ “While no one factor can ever be either the whole story or eliminated entirely as a factor, investor demand is secondary to (1) planetary limits; (2) the rise of populous developing economies and (3) paper currency debasement.”
- ▶ “Driven by horrific monetary policy that is lowering the dollar.”
- ▶ “Supply side fundamentals and political risk are important in assessing commodity prices.”

Institutions: At the present time, do you believe commodity returns are driven by investor demand/sentiment? Please answer yes or no below and describe.

Agree

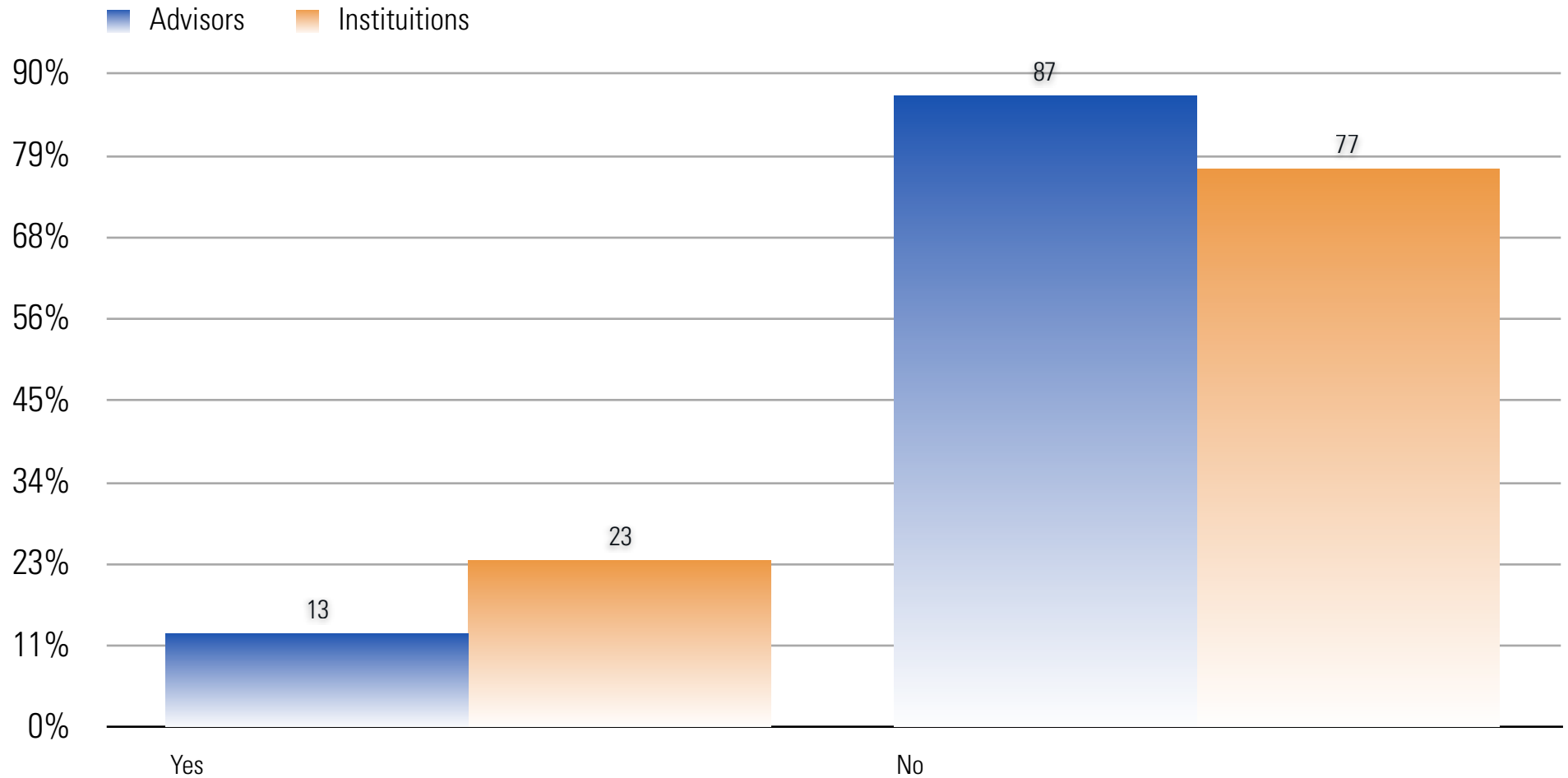
- ▶ “Time will tell. The fundamentals seem to support their growth but the recent run ups in some of the metals seems more sentiment driven.”
- ▶ “Commodity returns are being driven by demand and investors are buying commodities as a hedge against inflation and to diversify their portfolios.”
- ▶ “Fundamental analysis has been overridden by greed.”

Disagree

- ▶ “I believe commodity returns are driven by increasing end user demand, and declines in the US dollar.”
- ▶ “...There are individual commodities that have strong fundamental drivers behind their appreciation.”

Advisors: At the present time, do you believe commodity returns are driven by investor demand/sentiment? Please answer yes or no below and describe.

Institutions & Advisors: Most Advisors and Institutions Have NOT Obtained Fee Concessions When Investing in Alternative Strategies.



The majority of respondents did not receive fee concessions

- ▶ “We only use 40 Act vehicles”
- ▶ “Included under standard asset-based fee schedule”

Those who did

- ▶ Fee concession with Fund of Hedge Funds managers
- ▶ “Portfolio size warrants negotiating lower fee structure”
- ▶ Fee concession through limited partnerships (slow down of investing)
- ▶ Fee break and/or rebates in conjunction with seed capital investments

The overwhelming majority of respondents did not receive fee concessions

- ▶ “Fee concessions have not been necessary as I primarily use mutual funds to access alternative investments.”

Those who did

- ▶ “We have used the scale of our firm and practice to obtain pricing that would ordinarily be unavailable.”
- ▶ “We have arranged concessions in both minimum investment and percentage charged by managers in separately managed account scenarios. I think being a wirehouse firm gives us an advantage based on size and scale of potential assets that can be placed with managers.”
- ▶ “Non-traded REITs normally pay an upfront commission”

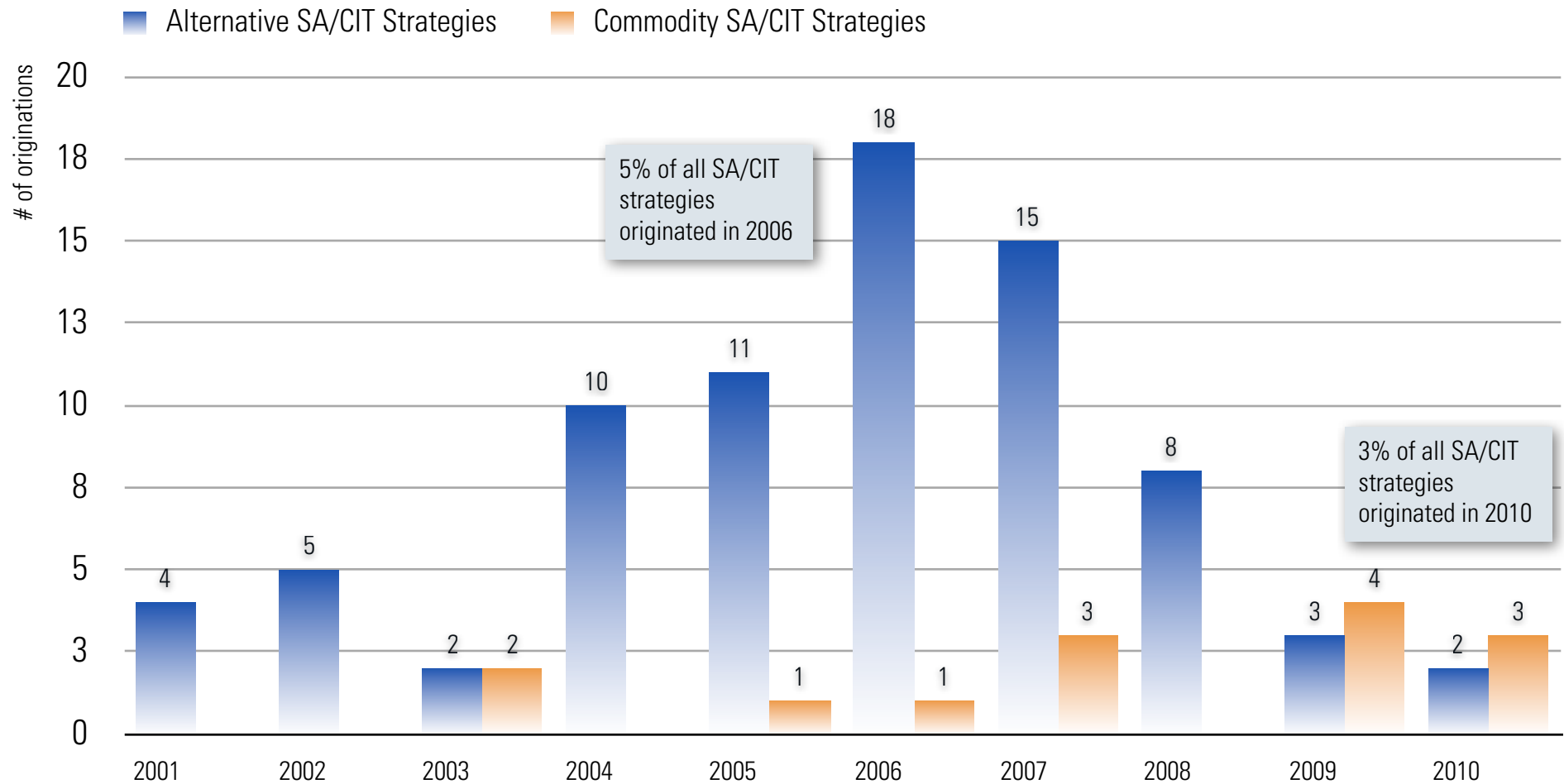
- ▶ Fairly rapid evolution of U.S. market into great level of comfort and adoption of alternative investment strategies
- ▶ Diversification and enhanced returns sought
- ▶ The march continues: convergence—seeking the best of both worlds
- ▶ Convergence: Registered investment vehicles encompassing alternative strategies reflect demand and facilitate further adoption
- ▶ Advisors working through how/when to provide alternatives to clients: understanding and accreditation
- ▶ Commodities—some current causes for concern
- ▶ It's still a seller's market: limited fee concessions. Or, is this also determined by the vehicles being used (registered vehicles with fixed schedules?)

Please see Appendix for further information on convergence

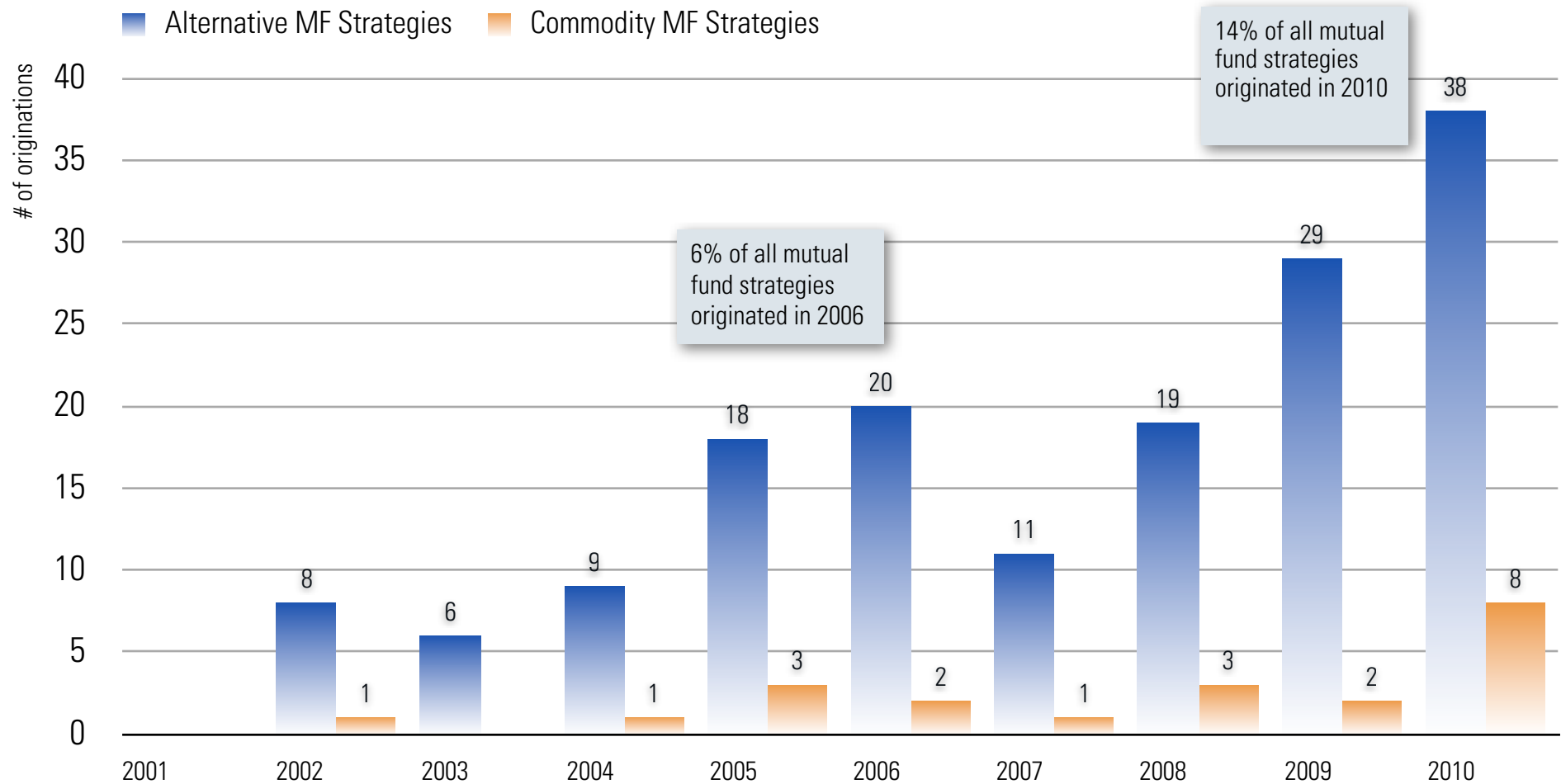
Appendix

The Market is Transforming—
Trends in the Morningstar Databases

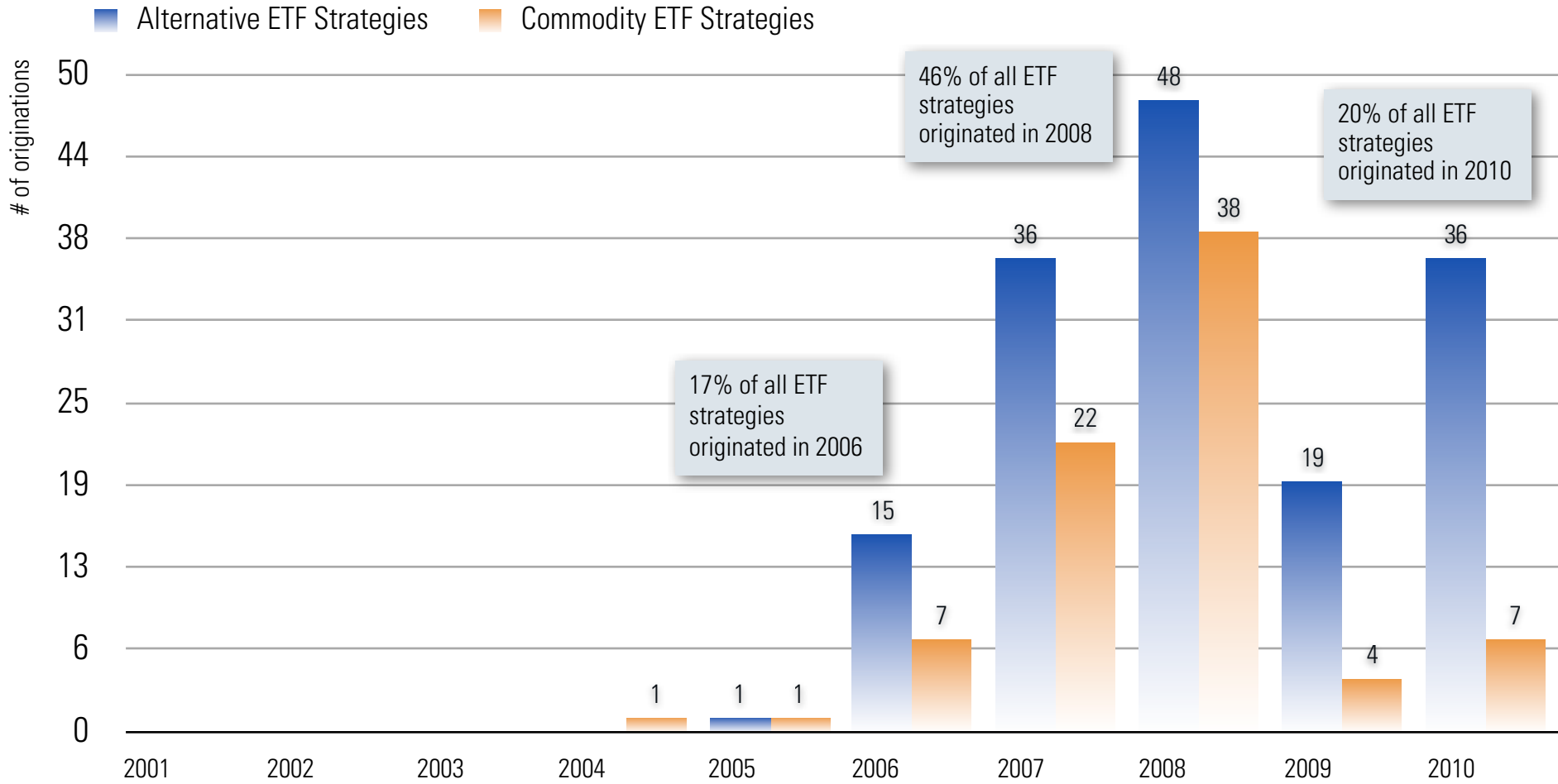
Alternative/Commodity Institutional Strategy Originations: Peak of Activity Precedes Registered Products by About Two Years



Convergence: Alternative/Commodity Mutual Fund Strategy (Not Share Class) Originations—Trying to Address Demand for the “Best of Both Worlds”



Convergence: Alternative/Commodity ETF Strategy (Not Share Class) Originations—Trying to address demand for the “Best of Both Worlds”



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Special Thanks

Leslie Banks, Caroline Dase, Jon Hill, Tory Knappenberger, Mark Meyer, Adam Middleton, Scott Burns

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Institutions: What are Alternative Investments?

