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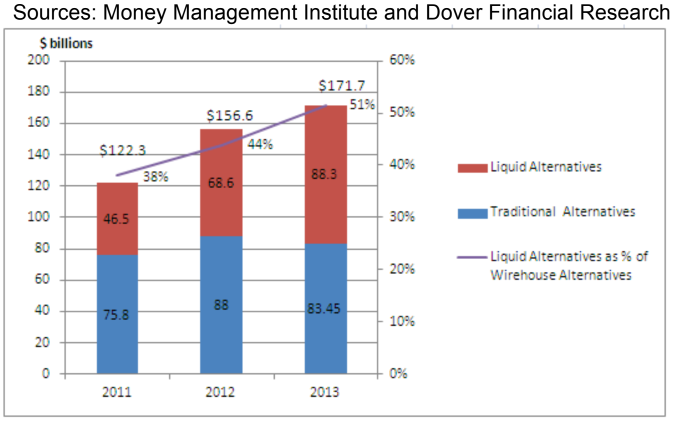
# Key Findings of MMI Research Report

## *Distribution of Alternative Investments through Wirehouses – 2014 Issue*

**May 2, 2014** – MMI has released its 2014 edition of *Distribution of Alternative Investment through Wirehouses*. With a six-year compound annual industry growth rate of 24%, liquid alternative investments is one of the fastest growing financial services asset classes. The report evaluates retail alternative investment trends in the wirehouse channel and factors that are driving investor and financial advisor demand for this fast-growing segment. It is the only industry study that provides a comprehensive overview of this market segment, one that includes analysis of both traditional and liquid alternative investments. Among its key findings:

1. **A Significant Shift – Liquid alternative investment assets surpass traditional alternative assets**. There has been a major changeover in the composition of alternative investment assets from traditional to liquid in wirehouse firms as the share of liquid assets increased from 38% in 2011 to 51% in 2013. The majority of wirehouse executives interviewed for the report view this shift as the cannibalization of core traditional alternative products – hedge funds – by their more liquid counterparts. There are three major factors driving this trend: the acceptance of the '40 Act product structure, the fact that liquid alternatives are better aligned with existing business models than traditional alternatives, and the ongoing shift from retirement accumulation to distribution.

**Wirehouse Firms' Share of Liquid Alternative Assets vs. Traditional Alternative Assets**
Sources: Money Management Institute and Dover Financial Research




Based on a consistent universe of four wirehouse firms reporting. However, since one firm could not provide ETF asset data, an estimate was calculated for that firm.

2. **A Core Component of Outcomes-Based Management – Liquid alternatives provide an expanded range of choices in portfolio construction.** As the industry moves away from product to outcomes-oriented portfolio construction, the role of alternative investments is broadened. Alternatives can now be used as a core component of a portfolio rather than simply a tool for diversification. Since the same strategies are now offered in different product wrappers, an advisor has more flexibility in choosing products which will provide the best solution for a client. In a sense, this means that the solid line between product types – limited partnerships vs. '40 act vehicles – is fading, something with implications for sponsor firms. For example, one leading institution recently announced the reorganization of its due diligence teams to consolidate research on both liquid and traditional alternative strategies. That firm also has specialists who

provide support to advisors across all types of alternative investments. Its strategy is to support solutions rather than products.

3. **Pent-Up Demand – The outlook for liquid alternatives is bullish because wirehouses are committed to increasing the allocation of assets to them.** The outlook for growth in the distribution of alternative investments through wirehouses is strong, which, in turn, has bullish implications for the allocation of alternatives across the entire retail wealth management field. With alternative investments well established in the institutional space, wirehouse firms have become the leaders in "the retailization of institutional" and have committed across the board to boosting their allocations to alternatives. Most investor portfolios have less than 5% of assets in alternatives, which is well below the 15% to 20% levels recommended for achieving proper portfolio diversification and investors' objectives.

4. **Blockbuster Funds – The halo effect.** Some funds are dominating their alternative categories. For example, the top five liquid hedge mutual funds accounted for 75% of wirehouse net sales in 2013. The rise of blockbuster funds reflects trends throughout the mutual fund industry as wirehouses streamline their recommended lists and their model portfolios. This practice has led to a migration of products to the best-of-breed within a category, and one result is the emergence of a number of bestsellers that dominate their asset classes and/or product categories. Other important factors contributing to the rise of blockbusters are investment performance, firm reputation and the distribution strengths of certain asset managers.

**Top Five Liquid Alternative Mutual Funds by Net Flows Reported by Wirehouses, 2013 ($ millions)**

Sources: Money Management Institute, Dover Financial Research

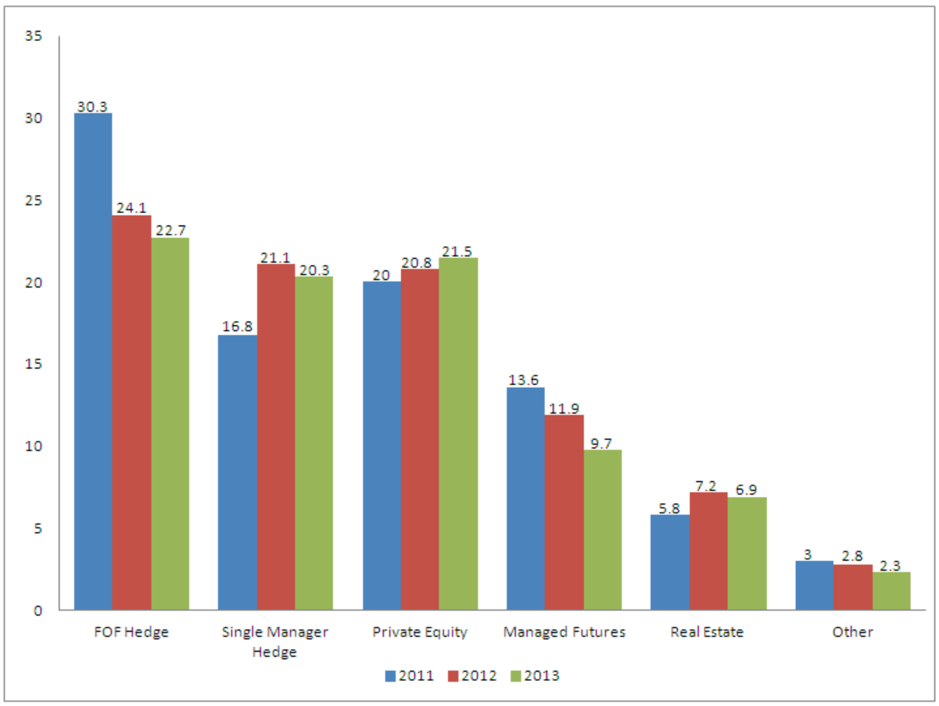
| Rank | Liquid Alternative Products - Mutual Funds | Net Flows | % of Wirehouse Net Flows |
|---|---|---|---|
| 1 | MainStay Marketfield Fund | 7,071 | 26% |
| 2 | Goldman Sachs Strategic Income | 4,811 | 18% |
| 3 | JPMorgan Strategic Income Opps | 3,214 | 12% |
| 4 | BlackRock Strategic Income Opps | 2,674 | 10% |
| 5 | BlackRock Global Long/Short Credit Fund | 2,333 | 9% |
| | Total Top Five Funds | 20,103 | 75% |
| Total Wirehouse | | 27,200 | |

Wirehouse firms use different schema for categorizing liquid alternative investments. As a result, the fund universe may vary from firm to firm.

5. **Reversal – Liquid alternative investments account for almost half of wirehouse fund net sales**. In 2013, there was a dramatic reversal in wirehouse net flows between liquid alternative mutual funds and long-term funds. The proportion of net sales associated with traditional long-term funds fell sharply from 85% in 2012 to 54% in 2013. This is particularly significant because the assets in long-term funds dwarf liquid alternatives. Although alternative ETFs and mutual funds have a small share of total wirehouse assets, they accounted for about 43% of the net flows in 2013. This shift, a leading indicator, is yet another signal that the prospects may be excellent for the continued strong growth of liquid alternatives.

6. **Funds of Funds – The downward spiral at wirehouse firms continues.** At the close of 2013, traditional alternative assets stood at $83.5 billion reflecting a relatively small decline of 5% from the previous year. The most notable trend across traditional alternative investments has been the continuing decline in funds of funds (FOF) hedge assets from 2011 to 2013. This reflects the movement occurring across the broader hedge fund industry. Although pockets of funds of funds continue to thrive, FOF assets at wirehouses dropped 25% over the last three years as the bull market made it difficult to justify the higher fees and lower returns associated with these products. Managed futures assets also suffered a significant decline as investors questioned the "cyclical" value of these vehicles. Lastly, private equity was the only category to experience consistent positive growth over the last three years, driven primarily by a ripe deal market fueled by higher valuations.

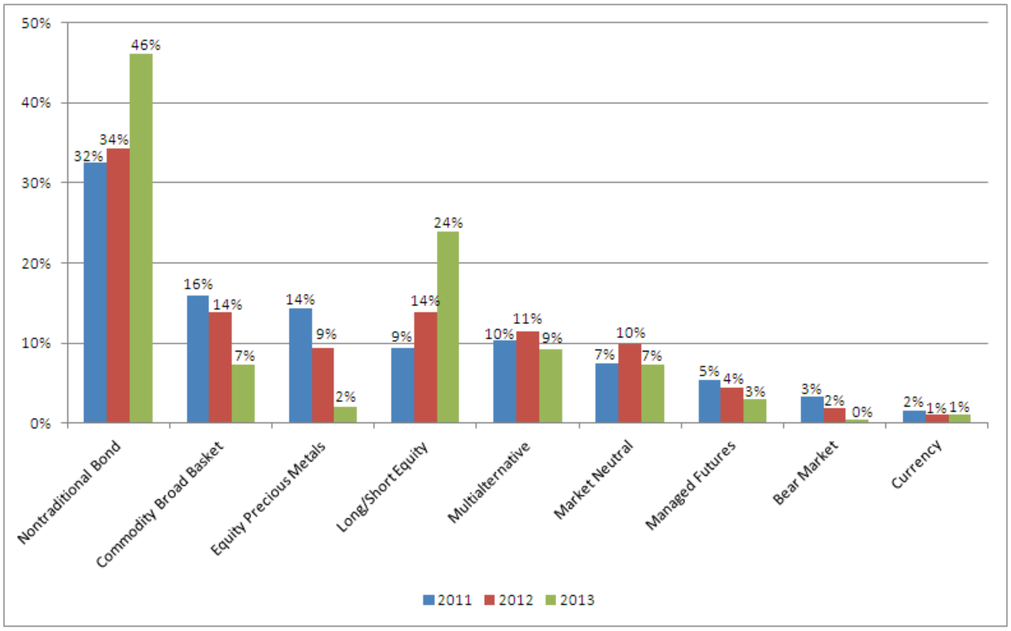
**Traditional Alternative Assets by Product Type, 2011 to 2013 ($ billions)**
Sources: Money Management Institute, Dover Financial Research




7. **Revising Allocations – As financial markets shift, investors turn to alternative investments.** An analysis of liquid alternative mutual fund assets reveals a jump in the allocation to the nontraditional bond category from 34% of assets in 2012 to 46% in 2013. This surge has occurred due to concerns about rising interest rates and investor interest in enhanced income strategies. The allocation to the nontraditional bond category is an example of how investors are using liquid alternatives as a complement to their fixed income holdings rather than as a stand-alone allocation to alternatives. Long/short equity is also rising in popularity, with 24% of assets in 2013 compared with 14% in 2012. This strategy is increasingly used as a complement to equity exposures, making long/short equity particularly appealing in a bull market.

**Wirehouse Liquid Alternative Mutual Fund Assets by Strategy**

Sources: Money Management Institute, Dover Financial Research




Excludes commodities.

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