EVESTMENT

ASSET ALLOCATION & CONSULTANT SURVEY 2016

February 22, 2016

Asset Allocation & Consultant Survey

Introduction

The eVestment Asset Allocation & Consultant Survey is based on responses collected during the fourth quarter of 2015 and covers a range of topics including anticipated manager search activity, strategy replacement rates, manager selection criteria and top-level portfolio concerns.

The report draws from responses from a variety of investment consulting firms differing by services offered, geography and size. Total assets under advisory for the group stood at USD 8.1 trillion as of June 30, 2015. Playing the role of advisor to investors and gatekeeper to asset managers, the scope of consultant activity places them in a unique position to act as barometers for institutional portfolio demands.

Key Results

- Mandates for alternative investments are expected to make up a significant portion of search activity, 32.5% on average, in 2016.
- Consultants are primarily concerned about low expected returns, potential market volatility and clients' ability to meet return hurdles in the current environment.
- Consultants expect replacements to dominate long-only equity searches. Searches in the alternatives space are expected to be from new mandates, commodities being the exception.
- Both manager search expectations and institutional investor targets confirm an increase in alternatives allocations, and specifically the demand for private equity and inflation sensitive assets.
- Structured credit and distressed debt are expected to have relatively low manager turnover, while turnover is expected to be high within high yield.

Figure 1: Consultant respondent count by firm location

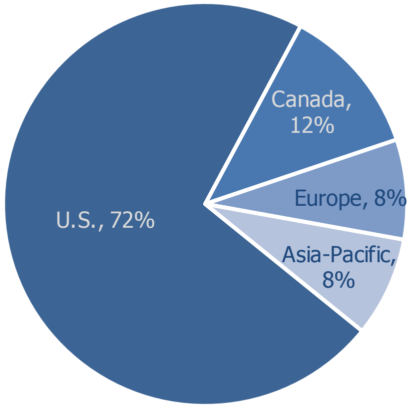
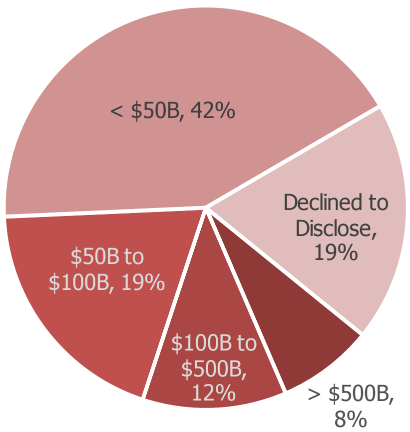


Figure 2: Consultant respondent count by assets under advisory (USD, Jun-30-2015)



Respondent Profile

The majority of our respondents were headquartered in the U.S. with the remainder split fairly evenly across the developed world. Europe, Asia-Pacific, and large U.S. based firms represented global investment consulting practices, while smaller regional operations were generally confined to the U.S. and Canada. While location-based breakdowns suggest a skew toward U.S. advisory assets, the inclusion of brand name global consulting firms and large U.K. and Australia based respondents likely ensures a well balanced geographic and organization type mix of advisory assets. In conjunction with the consultants surveyed, we also solicited responses from a group of institutional investors, asking for current asset allocations and future targets, and qualitative assessments of the investment environment. Composed of public and corporate pensions, endowments, foundations, insurance companies and other organization types, the group managed USD 352.2 billion in assets as of June 30, 2015.

Search Activity Outlook

The following highlights consultants' expectations for manager search activity by asset class in 2016. We also surveyed expectations for manager replacement-based searches versus new mandates. On average, consultants predicted the bulk of search activity for 2016 would be for long-only equity and alternatives managers. Less than one-tenth of our respondents expect traditional fixed income engagements to outstrip equity engagements during the year; only 14.3% of respondents predict the number of fixed income searches would be greater than the number of alternatives searches.

A significant portion of traditional equity and fixed income searches are anticipated to come from manager replacement mandates representing intra-asset class churn, not new allocations, as seen in *figure 6*. Alternatives mandates, on the other hand, are expected to largely derive from new allocations. Investors surveyed are expected to modestly increase exposure to alternative investments, over both the short and long term, at the expense of long-only equity strategies, and to maintain fixed income exposure. Overall, both manager search expectations and institutional investor targets confirm an increase in alternatives allocations, and specifically the demand for private equity funds and inflation sensitive assets.

Clients of the eVestment Analytics platform use our database and tools to track quantitative and qualitative characteristics of potential investments, monitor existing allocations and conduct competitive analysis. *Figure 5* depicts an increasing system usage percentage for equity and public markets alternative strategies over fixed income strategies in H1 2015 compared to the prior half, matching anticipated manager search patterns in our survey responses.

Figure 3: Distribution of anticipated manager searches for 2016 by asset class: 25th percentile, average, and 75th percentile

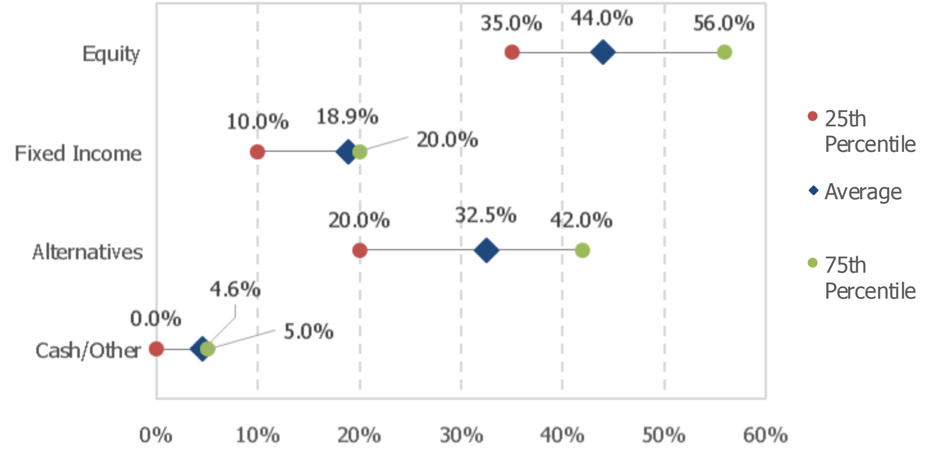
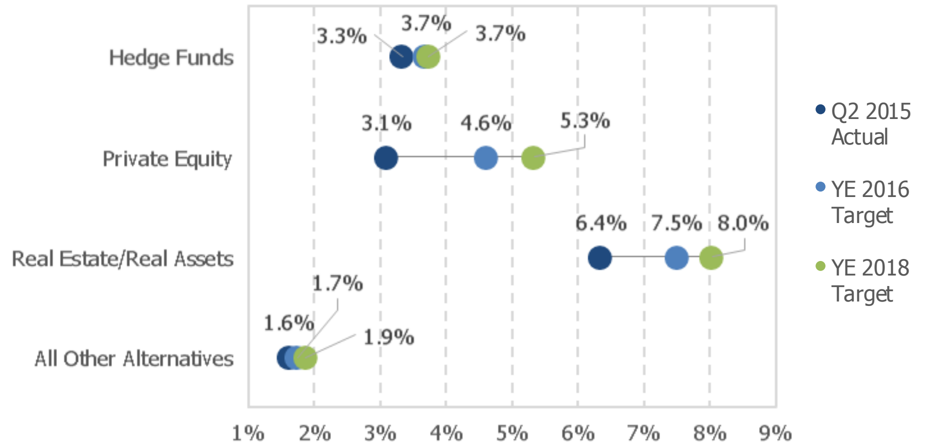
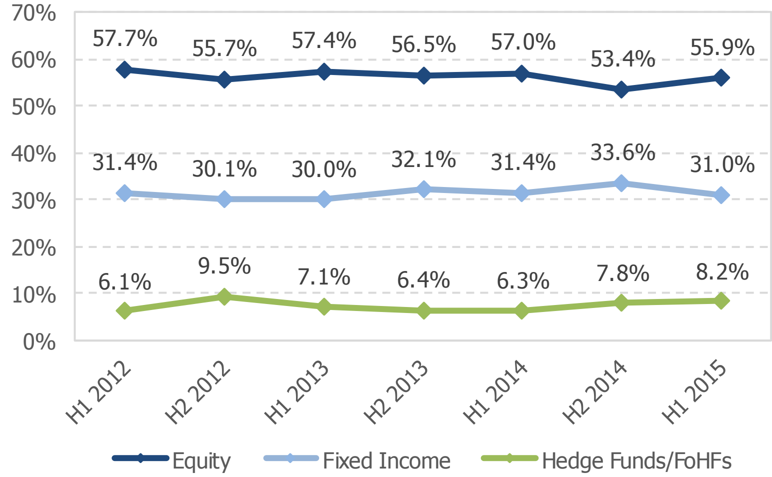


Figure 4: Participating institutional investors' mean alternative investment allocations (Q2 2015 and targets)



Figures 5: Distribution of product views recorded on the eVestment investment manager database by major asset class



Search Activity Outlook

Equity

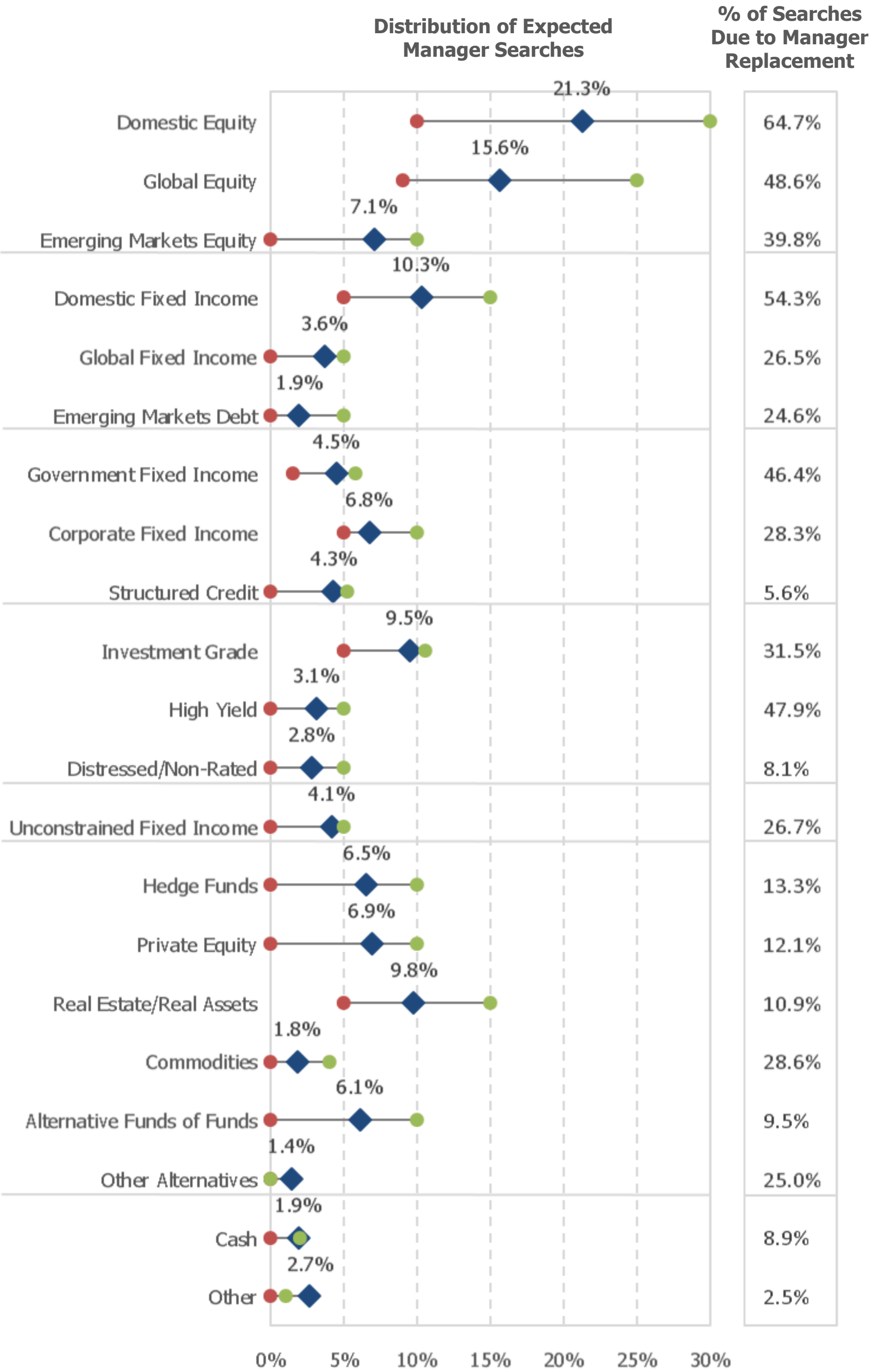
At the time of response collection, the majority of participants cited public equities as having the greatest downside risk over the next three years. Domestic and global equity mandates are forecasted to comprise the bulk of equity searches in 2016, with the majority of domestic equity and almost half of global equity mandates due to manager replacement needs. 73% of respondents indicated at least half of their domestic equity searches were likely to be due to manager replacements.

Furthermore, while far from the majority, several institutional asset owners were expected to shift equity allocations from active to passive strategies – enough to move the mean percentage actively managed in our sample significantly. Participants who anticipated shifts to passive equity exposure targeted large deviations from current passive allocations revealing a non-incremental approach. The median active multi-sector domestic equity strategy outperformed against managers' preferred benchmarks over the past 1 and 3 year periods, with particularly strong performance from core style strategies. We take this as a potential indication of equity style rotation, specifically away from growth toward value. Overall, both structural (passive gaining institutional traction) and cyclical factors (poor global growth expectations, risk-off) appear negative in the aggregate for active equity managers.

The negative sentiment can be seen as a continuation of trends seen in 2015. Net institutional investor flows were -$277.8B in 2015 for domestic (U.S.) equities, -$25.5B for global equities and -$19.5B for EM equities mirroring widespread concerns about global growth, see *figure 7*. There were pockets of inflows, but overall allocation results were unconstructive for the asset class.

Figure 6: Distribution of anticipated manager searches for 2016 by asset class (25th percentile, average, and 75th percentile) and weighted average percentage due to manager replacement

**Fixed income dissected by geography, sector, quality and unconstrained; segment sums not equivalent due to firms declining to forecast certain categories and due to rounding*



Search Activity Outlook

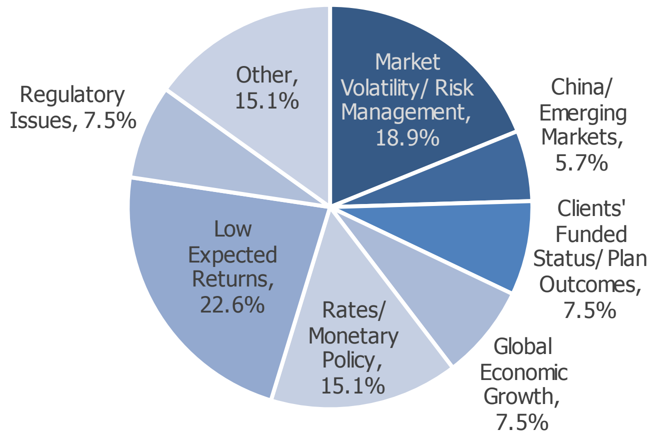
Fixed Income

Contrary to trends seen for institutional equity allocations, fixed income allocations, particularly with respect to global and corporate fixed income mandates, are anticipated to be increasingly in favor of active management. Looking at fixed income managers on a geographic basis, searches are expected to be highest for domestic strategies. Likewise, consultants anticipate corporate and investment grade fixed income searches to dominate by sector and quality, respectively. With the exception of structured credit and distressed/non-rated strategies, manager replacement is expected to drive a significant portion of total activity.

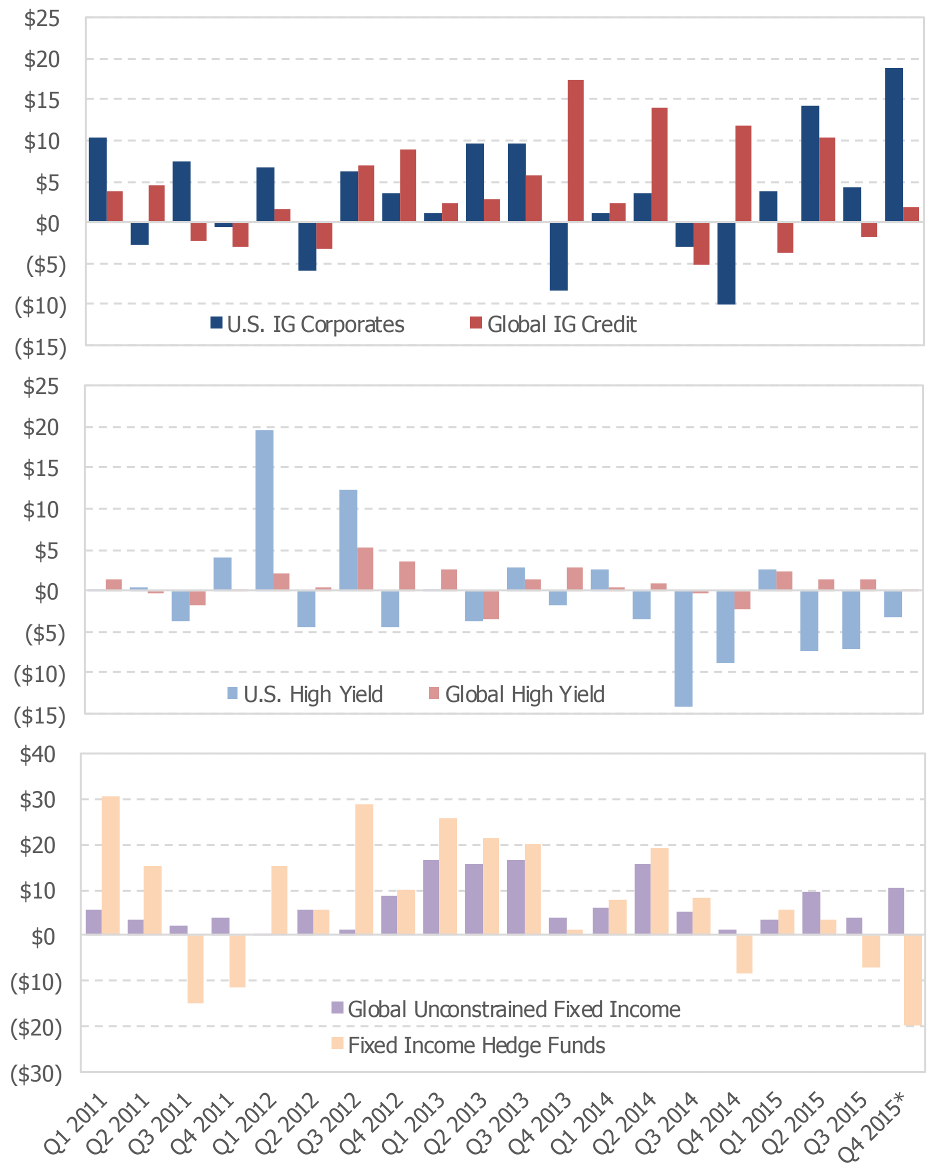
Given manager replacement estimates, there looks to be significant intra-strategy churn for government and high yield credit managers. Total search activity for corporate and investment grade credit strategies are expected to be high compared to other fixed income strategies in 2016 – according to our data, U.S. investment grade corporate strategies experienced significant net institutional investor flows going into 2016, and it seems that trend may continue.

On the opposite end, U.S. high yield and U.S. core strategies witnessed net outflows of -$45.3B and -$15.3B, respectively in 2015. High yield strategies were expected to produce the most manager turnover for fixed income on a quality basis in 2016, and second highest overall only to domestic fixed income managers, we note these are not mutually exclusive. The elevated replacement figures may be due to strategies caught wrong-footed on commodities-related credits. Looking over our qualitative responses, the outlook for credit and commodities was mentioned as a primary concern for a few institutional investor respondents, but mostly alongside economic growth and market volatility.

Figure 7: Consultants' top concerns for the next three years



Figures 8-10: Quarterly net institutional investor flows for long-only fixed income segments and fixed income hedge funds (USD billions); **Q4 2015 figures subject to revision*

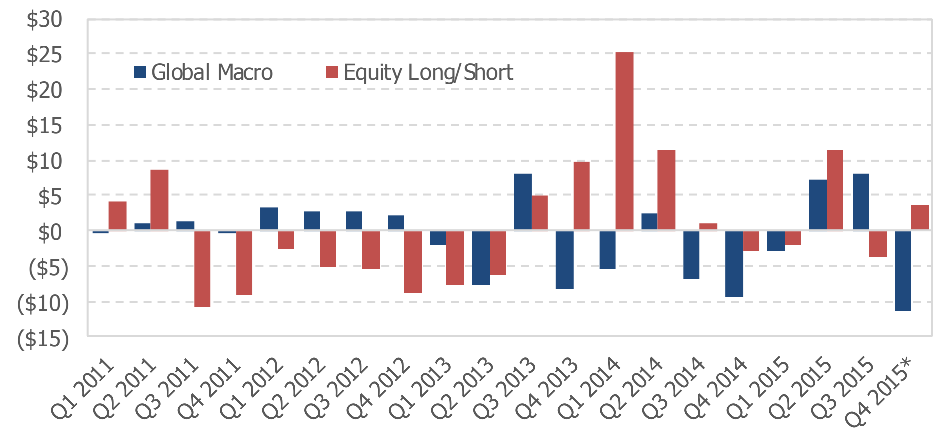


Search Activity Outlook

Fixed Income

The only other major fixed income group to experience steep outflows were EM strategies with outflows of -$25.2B. Global IG and HY flows were more muted, but positive, for both groups over the same period. The number of unconstrained fixed income engagements are expected to be moderate in 2016, however searches for replacements are relatively low indicating the limited number of engagements may still skew positive, even after enjoying a multi-year run of successful capital raising.

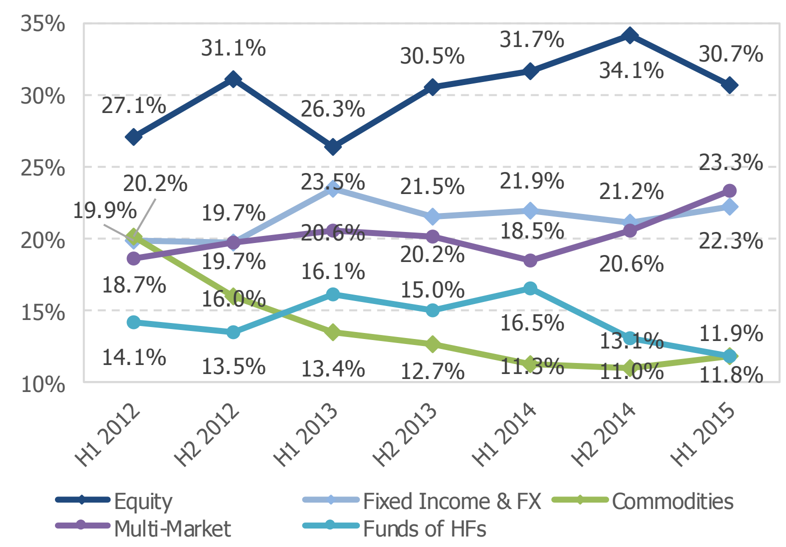
Figure 11: Quarterly net institutional investor flows for global macro and equity long/short hedge funds (USD billions); **Q4 2015 figures subject to revision*



Alternatives Allocations

Mandates for alternative investments are expected to make up a significant portion of search activity in 2016, 32.5% on average. Inflation sensitive assets, namely real estate/real assets, are projected to see the most search activity, while queries in eVestment's Analytics for commodities strategies appear to be rising after a prolonged decline.

Figure 12: Distribution of product views recorded on the eVestment database, hedge funds by asset class focus and funds of hedge funds



We note that lock-ups and other structural features may affect the relatively low replacement figures for alternatives, noting the higher expected replacement rates for the less liquidity restrictive commodities category. However, taken together with elevated manager search figures and current market volatility, we believe the capital raising environment and capital retention outlook appears positive for alternatives products. For institutional investor participants, target allocations indicated near unanimous intentions to either increase private equity and real estate/real asset exposures or leave them unchanged; planned changes for hedge fund allocations were more mixed.

Consultants expected global macro, equity long/short, and relative value to drive public markets focused alternative strategy allocations, see *figure 13*. Contrary to respondents' expectations, equity focused hedge funds experienced declining search volumes on the eVestment database. Fixed income/FX and multi-market strategies, which includes global macro funds, gained our clients' attention over H1 2015. The consideration would be a welcome change for global macro funds which experienced a high degree of net investor redemptions in Q4 2015, closing 2015 out with inflows of $0.8B and recording outflows of -$29.1B over the two years prior.

When asked for top concerns for evaluating hedge funds, fees compared to actual alpha creation was the most oft mentioned issue. Risk management and controls, employees' experience, and capacity constraints were also on the top of consultants' minds.

Alternatives Allocations

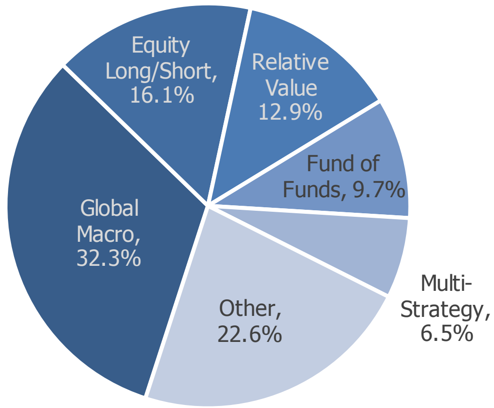
Among private markets alternatives, small/middle market buyout, distressed, infrastructure, and secondaries were expected to be most in-demand strategies. Responses for credit, which likely includes distressed debt funds, but did not specifically mention them, were also well represented.

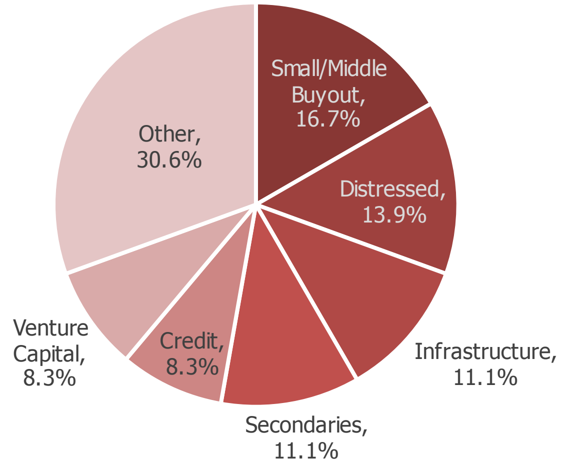
Consultants' top concerns for private equity similarly included fees and management experience. However, unlike the responses for hedge funds, survey participants were more vocal about potential liquidity issues and funds' ability to exit investments favorably – most likely colored by recent declining M&A volume, the turn in public market investor psychology and well publicized drops in large venture backed startup valuations.

The most popular real asset and commodities concerns mentioned were the macroeconomic backdrop and the ability to deliver uncorrelated returns/provide efficient diversification. As iterated earlier, real estate and real assets are expected to see a fair amount of search activity in 2016 – on a related note, a number of investor respondents mentioned inflation as a top three macro concern for the near future. Corroborating increased investor interest, commodities hedge funds broke their downward trend for queries logged on our platform which started as early as 2012, see *figure 12*, and experienced positive investor flows in H2 2015.

Asked to identify which investment vehicle type would most likely lead search activity in the "Other Alternatives" category, most respondents chose liquid alternatives; the "Other" category responses (non-alternative) were largely for target date funds.

Figures 13-14: Anticipated highest demand strategy for public and private market alternative investments (2016, by respondent count)





Conclusion

Developments in the financial markets to end 2015, and to start 2016, have been nothing but volatile with continued pressure on the commodities complex, the spillover into credit, further unprecedented central bank action and declining equity markets. Given our survey responses were collected at the onset of the current market regime change, deviations from the forecasts outlined are possible. With that being said, institutional investors, and the investment consultants that advise and represent them, necessarily take the long view and are not likely to over-adjust to the current environment. In that case, we should expect continued redemption pressures within long-only equities, elevated replacements in volatile segments of fixed income and interest in alternatives, well beyond their current relative proportion within most institutional portfolios, with a focus on private markets to address concerns of meeting target returns while limiting exposure to traditional risk premia.

COMPANY DESCRIPTION

eVestment provides a flexible suite of easy-to-use, cloud-based solutions to help global investors and their consultants select investment managers, enable asset managers to successfully market their funds worldwide and assist clients to identify and capitalize on global investment trends.

With the largest, most comprehensive global database of traditional and alternative strategies, delivered through leading-edge technology and backed by fantastic client service, eVestment helps its clients be more strategic, efficient and informed.

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