

>>> **Test Your Perceptions:**

1. A 2007 study found that 60% of top-performing managers had ___ in AUM.¹

- a. More than \$10 billion
- b. Less than \$10 billion
- c. More than \$40 billion
- d. Less than \$4 billion

2. What percentage of funds in the Morningstar 500 database had no investment by their managers?²

- a. 46% of U.S. stock funds
- b. 59% of international stock funds
- c. 65% of taxable-bond funds
- d. 70% of balanced funds
- e. 78% of municipal bond funds
- f. All of the above

You can learn about where to find a performance advantage by reading this paper.

For the correct answers turn to page 3.



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Boutique Asset Managers Offer Competitive Advantages

While the rally that began in March of 2009 has helped reinvigorate investors' appetite for investing, few financial advisors expect that navigating the recovery will be easy.

They will need to identify money management firms that have the qualities required to produce strong performance for clients—in any market circumstances. Also, financial professionals will need to conduct careful due diligence to avoid the more unexpected pitfalls that were brought to light during the crisis, including exposure to companies that used excessive leverage and to unscrupulous operators. For many, this has focused the search on “boutique” management firms.

BOUTIQUE MANAGEMENT MAY:

- > offer a performance advantage over larger asset management firms
- > align the interests of money managers and investors
- > have differentiated and disciplined investment processes
- > make investment decisions based on independent, original research

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¹ The Journal of Investing, **Potential Benefits of Investing with Emerging Managers**, Spring 2007, Vol. 16, No. 1, pp. 8-14.

² Morningstar, Fund Spy, **Managers' Investment Secrets Revealed**, June 16, 2008 [<http://news.morningstar.com/articlenet/article.aspx?id=241183>].

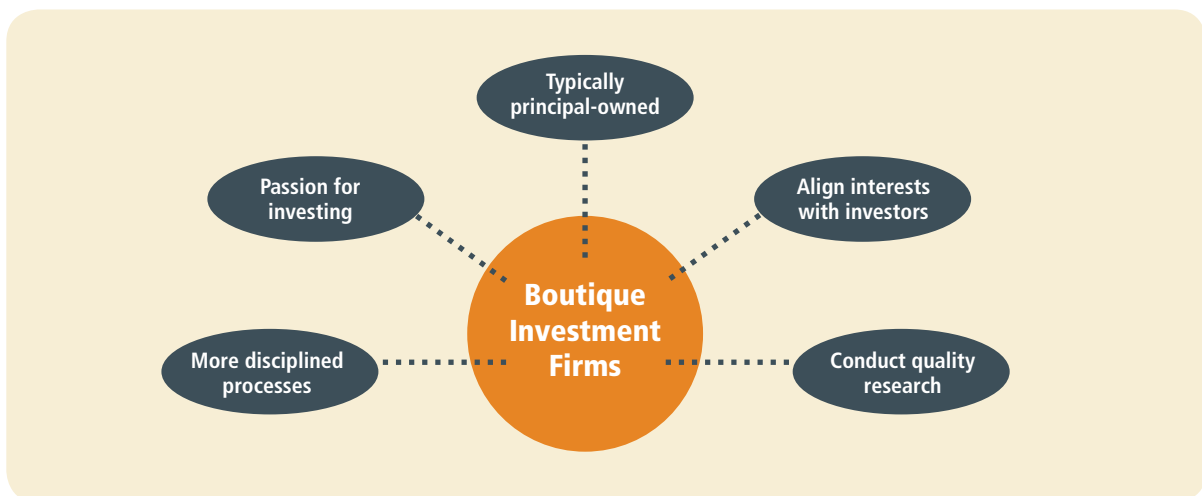
>>> Asset management has always been a boutique business. Sometimes boutiques have been housed within large firms; more often they are small, independent operators. Boutique investment firms are attractive because their managers, who often have left larger more traditional work environments, tend to have great passion for markets and investing. Moreover, they have conviction in the investment processes they've developed and fervent commitment to disciplined execution of those processes. These qualities have the potential to produce attractive investment results for investors whose risk profiles match a firm's offerings.

Delivering outperformance

Past studies of the performance of financial firms have found that larger asset management companies benefit from economies of scale in distribution, compliance, and technology. However, the cost advantages they gain often do not translate into performance advantages for investors. In fact, research studies completed in 1995¹, and again in 2005², showed remarkably similar results: Approximately 70 percent of managers in the top performance quartile had less than \$20 billion in assets under management. The 2007 study showed that 60 percent of managers in the top performance quartile had less than \$10 billion in assets under management. While selecting a boutique asset management firm does not guarantee better performance, research indicates that these firms offer the potential for superior performance.

Aligning managers' interests with investors' interests

One reason for the performance advantage of boutique firms may be related to their structure. Typically, boutiques are owned by their principals, who often are responsible for asset management. Consequently, these managers have a vested interest in the success of the firms' offerings. In fact, many have a significant portion of their personal assets invested in the portfolios they manage. While it may seem commonsensical for managers to have assets invested in the portfolios they run, it is not always the case. During 2008, Morningstar found that 46 percent of U.S. stock fund managers, 59 percent of international stock fund managers, 65 percent of taxable-bond fund managers, 70 percent of balanced fund managers, and 78 percent of municipal bond funds managers did not invest in the portfolios they managed.³ One of the many benefits of boutique investment firms is that they align the interests of managers and investors.



¹ The Journal of Investing, **The Performance Advantage of Small Portfolio Management Firms**, Spring 1995, Vol. 4, No. 1: pp. 40-46.

² The Journal of Investing, **Potential Benefits of Investing with Emerging Managers**, Spring 2007, Vol. 16, No. 1, pp. 8-14.

³ Morningstar, Fund Spy, **Managers' Investment Secrets Revealed**, June 16, 2008 [<http://news.morningstar.com/articlenet/article.aspx?id=241183>].

Executing a disciplined investment process

The failure of a high percentage of managers to invest in their own portfolios would seem to indicate a general lack of conviction in their investment processes. There are many reasons that investment processes may be less crisp and decisive at larger firms.

LARGE FIRM MANAGERS MAY:

- > have greater liquidity issues, if their funds are sizeable
- > navigate bureaucratic work environments that do not support crisp decision-making
- > experience greater complacency, if they do not have a vested interest in performance
- > be less able to respond nimbly to changing market environments

Boutique management firms, on the other hand, often are built on the passionate belief of the firms' principles that well-defined and repeatable investment processes have the potential to deliver solid and consistent risk-adjusted performance over time.

Research-driven investment decisions

High net worth investors' appetite for return on investment has returned, and now rivals their desire for return of investment.⁴ However, selecting investment opportunities in this challenging financial environment will require careful research. While many analysts agree that the recession has ended and recovery is underway, the future of some industries and many companies remains unclear. Consequently, quality research is likely to play a vital role in performance during 2010. Firms that differentiate themselves through the originality of their perspective, the depth of their insight, and their ability to uncover unrecognized industry trends have the potential to provide investors with attractive returns. Investment decision-making at many boutique firms is grounded in high quality, independent, fundamental research.

Boutique asset management firms have the potential to deliver

The best boutique investment portfolios reflect their managers' appreciation of financial markets and their passion for investing through a disciplined process that is grounded in quality research. These portfolios align the manager's interests with those of their investors, so that performance success provides rewards to all. As the industry's and investors' perceptions change, assets under management may become a less important measure of a firm's investment success. If it is replaced by the quality of a firm's investment offerings and the significance of those offerings in asset allocation strategies, then boutique management firms will lead the way. As you search for investment managers who have the potential to deliver strong results, be sure to consider boutiques. ■

QUIZ ANSWERS: 1. B. Less than \$10 billion in AUM.¹ 2. F. All of the above.²

¹ The Journal of Investing, **Potential Benefits of Investing with Emerging Managers**, Spring 2007, Vol. 16, No. 1, pp. 8-14.

² Morningstar, Fund Spy, **Managers' Investment Secrets Revealed**, June 16, 2008 [<http://news.morningstar.com/articlenet/article.aspx?id=241183>].

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Russell Parker is Chief Marketing & Distribution Officer of FBR Asset Management Holdings, Inc. Mr. Parker joined FBR Asset Management Holdings in July 2007. Prior to joining, Mr. Parker worked in sales and marketing management for several leading financial services firms. He has built a successful track record in establishing and expanding distribution and has been responsible for strategic planning, product development, the growth of assets under management, and marketing to retail and institutional clients.

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