



GATEWAY INSIGHTS

Researchers – why they are important to our industry and your business

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In markets that continue to be volatile and very negative in sentiment, it may be difficult to see how there might be an opening for any new product in the Australian market and harder still to see why fund managers should go to the effort and often expense of having products researched or rated.

However, even in these difficult times, financial planners continue to see clients, money continues to be invested into superannuation funds, research houses continue to make fund recommendations and provide asset allocation advice and eventually we will see the bottom of this negative cycle.

What role do researchers play?

Researchers provide a valuable role for the financial planner and for the fund manager.

For the planner, they help sort through over 13,000 managed funds that are available to the Australian investor. Whilst, Grant Kennaway Head of Lonsec Research has argued at the November FPA Conference in Brisbane that this number of funds is simply unnecessary, the reality is that the number isn't getting any smaller. New products continue to be developed and bought to market even in very challenging times such as these. Planners still need to be on top of all new developments in the product space and they still need to be able to cite a level of due diligence on the sub-set of funds they are recommending to their clients. By outsourcing this role to an independent research house or internal research department, they are freeing up more time to concentrate on the client relationships and his or her needs.

For fund managers the requirements of research houses provide a standard of information and accountability which provides an aspirational hurdle to entry for start ups and ensures that the industry maintains the highest professional standards.

One of the key benefits of using independent research is the depth to which the research teams can go to give real insight into how a fund manager operates. Nigel Douglas, Head of Investment Research at van Eyk believes this is one of the key attributes of van Eyk's research process. "Our research is in-depth and is developed after a number of face-to-face meetings with fund managers. These meetings involve frank discussions and detailed questioning by our team. If we do not feel we are getting an accurate picture as to how the fund is run, we do not hesitate to make difficult calls to exclude the fund manager from review or to put the fund manager on Hold until further information is provided."

David Wright, Director, from Zenith Investment Partners a Melbourne based boutique research firm, points out that during the recent bull market phase the old adage of a "rising tide raises all boats" was largely true in that most managers were providing attractive returns. This is no longer the case and there is now a huge dispersion of returns between managers. This makes the provision of quality research, in Wright's opinion, even more important in being able to identify those managers most likely to outperform in current conditions and in a generally more difficult environment.

Douglas shares a similar view saying that "advisers can no longer rely on rising share markets to simply make their client's money. Instead, it takes judicious calls as to what asset classes to invest in at this time".

The backlash....

Despite all of this there has been an increasing groundswell of opinion which holds that researchers should be more accountable for their recommendations. The Australian Government has acted on this opinion with Senator Nick Sherry releasing a statement on the 13th November 2008 which said "The global financial crisis has prompted a global consensus for improved regulation of credit rating agencies, whose role has come under scrutiny due to their involvement in providing inaccurate ratings of structured financial products in the lead up to the US sub-prime loans crisis. Retail and wholesale investors in Australia rely heavily on information from credit rating agencies and research houses to make investment decisions, so they play an important gate-keeping role in the financial system and in the general level of system confidence."

To this end, the Australian Government is requiring all credit agencies and research houses to obtain an Australian Financial Services License (AFSL). The irony here is that whilst we agree that the actions of the Australian government can only be a good thing for the transparency and credibility of the industry, the reality is that independent research houses have always required an AFSL to operate. It would appear that research houses are attracting negative criticism by being associated with credit ratings agencies. However, they are not without their challenges in this environment. The next section examines these challenges and how research houses are positioning themselves to deal with them.

The challenges for research houses

According to Grant Kennaway, the role of research has been complicated by "both the proliferation of products and the proliferation of platforms in the Australian financial services industry and, in particular, the emergence of cut-down platforms such as mini-wraps."

Perhaps muddying the waters further has been the emergence of several new research houses – Zenith, S&P, Aegis, Financial Facts to name a few, it is now a very competitive sector. In addition, over the past few years as financial markets have performed very well, many research house staff

have been tempted by big salaries on offer elsewhere, making it difficult to retain the specialist knowledge required to assess fund management operations.

As Grant Kennaway also rightly points out another complicating factor has been “the reluctance of fund managers to provide sufficient information, particularly where after-tax returns were concerned.”

And lastly there is the ever present threat of litigation from disgruntled investors who may pursue action over a single investment option, even though the broader recommended strategy has performed well.

In light of these challenges and extraordinary volatile markets, researchers are taking their own initiatives. S&P Research will be conducting a comprehensive review of the financial strength and corporate sustainability of fund management companies for funds rated by S&P Research. Leanne Milton, Head of Research has said “While we normally assess business management as part of our ongoing reviews, we believe current circumstances demand an immediate and deeper investigation, ‘off-line’ from our normal schedule.”

Opportunities for investment managers and researchers alike

All crises create opportunities and for the astute fund manager there are opportunities at present.

Firstly, anecdotal evidence is that substantial sums are still going in to cash and cash related products.

The interest in Structured Products continues, evidenced by a number of industry researchers participating in an Innovative Investor [Issue 7, August 2008] round table. The discussion focused around the more cautious and discerning approach being taken by investors over the past six months, and the fact that buyers of structured products are starting to return to the market. As this happens, the focus is clearly on capital protection and underlying investments with clear and well defined themes.

Michael Elsworth, Lonsec’s Head of Ratings – Debt & Structured Products has commented “Thematic products are also very popular, and there are a lot of these types of products available in the market at the moment. Some of the newer, open-ended forms of capital protection, for 75 or 80 percent of the fund’s highest NAV, can be well suited to thematic-style investments, especially where the timeframe over which that particular theme could play out is uncertain, and where the volatility of that theme, or of the index which provides exposure to the theme, is high.”

van Eyk has recently released, through their fund of fund Blueprint Series new funds designed specifically for the new environment. Douglas says these funds are “specifically designed for the new financial environment – one of less predictable and higher inflation, greater market volatility, and segments of concentrated growth. This new environment requires skilled active managers who employ a greater variety of tools to generate returns”. Their new funds include a Listed Property and Infrastructure Fund as well as a Gold Bullion Fund.

Zenith Investment Partners David Wright’s view is that as a result of the financial market turmoil all research groups will have a renewed focus on the liquidity of underlying assets in funds, gearing and

leverage within products and avoidance of very complex, non transparent structures. This should always have been the case he says, but is now very much in focus.

The way forward

Whatever the asset class and whatever the bias of the planner's clients, research houses play a very important role in the operation of Australia's financial markets. Understanding what researchers want is essential to your business success:

- Maximum performance with minimal risk
- To add value to a client's portfolio
- Better than the incumbent
- Consistency – IFSA Questionnaire, marketing material, presentations, performance

Understanding how fund managers benefit from dealing with researchers is just as critical:

- Independent and objective assessment of your investment capabilities
- Support of your product made available to their clients – invaluable distribution
- Keeping good company – small boutique players can be just as highly rated as large incumbents with huge resources

Whichever way you look at it your success and their success are entwined. It is important that we work with them to achieve the best results for our industry going forward, not make them a scapegoat for these difficult times.

About Gateway

Gateway Financial Marketing (Gateway) was established in February 2004 by Amanda Rethus and Edwina Best for the purpose of offering fund managers, other product providers and international new entrants, expert advice, services and assistance in negotiating entry into the Australian Retail Financial Services market. Use of Gateway's services provides the opportunity for clients to overcome the hurdles that can often confront fund managers when transitioning from institutional to retail and hence improve participation in retail funds flow. Prior to Gateway, Amanda and Edwina spent over 30 years combined with major institutions in the Retail Financial Services market.

Our qualifications

Amanda has over 20 years experience in the Financial Services industry and was formerly a Divisional Director in the Financial Services Group of Macquarie. Amanda managed investment portfolios for over 10 years, and has spent in excess of 10 years introducing investment products to the Australian Retail market.

Edwina has a Bachelor of Business from UTS majoring in Marketing and International Business. She has over 12 years experience in the financial services market, concentrating in relationship management, product management and marketing. They both have extensive contacts in the retail financial services market especially with key decision makers.

If you would like to confidentially discuss your current approach to the retail market or have any questions on the above please do not hesitate to contact us on – Edwina 0404 046 179 or Amanda or 0414 658 323.