



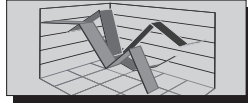
Creating Sustainable Product Lineups

FRC has debuted the first installment of a new product series titled *FRC State of the Industry Bulletin*. This tri-annual series seeks to validate and quantify trends impacting the mutual fund industry, using both propriety and secondary data sources. To provide context to these quantitative results, as well as to offer actionable advice, FRC also applies its unique understanding of the marketplace gained through qualitative research.

In this inaugural issue, FRC lays a strategic framework for firms seeking to optimize their product lines. Declining asset levels, competitive pressures, and economic uncertainty require asset managers to simultaneously rationalize their product sets while developing new products to take advantage of the changing landscape. Topics covered in the first issue include:

- I. Factors Driving Product Development & Rationalization**
- II. Mutual Fund Product Lines: Evolution Since 2000**
- III. Determining the Factors of Product Line Success**
- IV. Choosing the Right Asset Class Mix**
- V. Steps in Developing a Sustainable Product Lineup**

ANALYSIS



Product rationalization activity is peaking. While the number of fund launches per year has increased in recent years, so too has the number of mergers and liquidations, which rose sharply in 2007. On a net basis, product development/rationalization levels are down around 2003 levels, after reaching a high in 2006. During the 2009-2010 period, FRC expects rationalization activity to at least match, and perhaps surpass, 2008 levels, as firms look for further areas to trim expenses, and ongoing M&A activity in the asset management industry requires the elimination of redundant products.

The fact that firms need to rationalize their product lines does not diminish the importance of product development. From an investment perspective, virtually nothing delivered during the recent downturn, and as a result intermediaries and investors are looking for new product solutions. With an unprecedented amount of money in motion in the mutual fund space, the gulf between winners and losers will widen. With profitability down and resources scarce, asset managers need to be highly focused and thoughtful in their product development efforts.

To provide you with a preview of this new product series, below is an excerpt from the *FRC State of the Industry Bulletin: Creating Sustainable Product Lineups*. For more information on the *FRC State of the Industry Bulletin*, please contact us at 866-532-8009 or email frinfo@frcnet.com.

- III.**
Determining the Factors of Product Line Success
- A.**
Diverse vs. Niche
- B.**
Large vs. Small
- C.**
Wholesale vs. Captive
- D.**
Role of Performance in Sales

III. DETERMINING THE FACTORS OF PRODUCT LINE SUCCESS

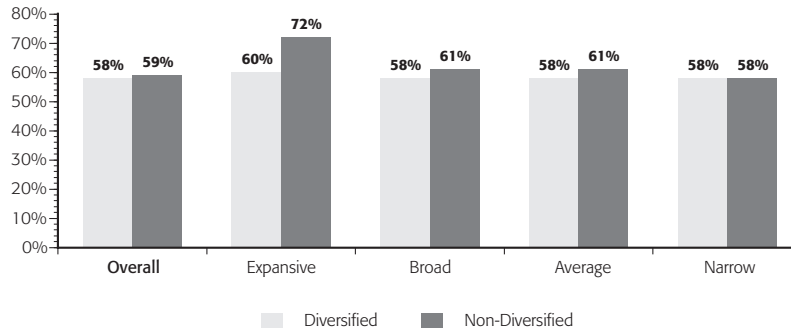
In this section, we look at a number of firm attributes, including level of diversity, size, and distribution model, to determine which factors seem to influence product line success. While the number and types of asset classes offered have a definitive impact on firm success, we evaluate their influence separately in the next section.

A. Diverse vs. Niche

As discussed in Section II, over the last decade mutual fund complexes have become more diverse in their offerings in an effort to protect assets and revenues against volatile market performance and shifting investor sentiment. To isolate the impact of asset class diversity on firms, we separated firms into two categories—diversified and non-diversified. Diversified firms are defined as those with at least 25% equity assets and 25% fixed-income assets. We further segmented the two groups by breadth of total product line (narrow firms with fewer than five funds might nonetheless be diversified, while a broad product line could have all funds in a broad asset class, like equity). We then looked at the number of months of positive flows from 1993 to 2008. As illustrated on the following page, overall, diverse firms generated positive monthly flows about 58% of the time, a percentage that did not vary significantly by number of offerings.

EXHIBIT 3-1

Percentage of Months of Positive Net Flows for Diversified vs. Non-Diversified Firms (1993-2008)



Expansive - >50 funds; Broad - >15 funds; Average - >5 funds; Narrow - <5 funds
 Source: FRC IMPACT

Niche firms were similar to their diverse counterparts in that they gathered positive monthly net flows about 59% of the time. However, in contrast to diverse firms, the number of offerings of niche firms seemed to influence sales, as firms with an expansive product line (>50 funds) had the highest percentage of positive net sales months.

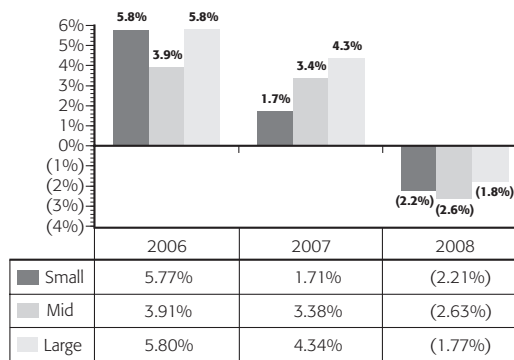
These findings imply two circumstances. First, diverse firms are not necessarily protected from sales volatility. Second, niche firms with expansive product lines experience the least sales volatility. These firms likely possess brand association with a particular asset class, and are benefiting from the growing diversification of investor portfolios.

B. Large vs. Small

It has long been believed that success in the fund industry will increasingly take on a barbell shape, whereby large, globally diversified asset managers and niche specialists will squeeze out mid-sized players. To determine whether this trend has taken shape over the last few years, we evaluated the annual net flows-to-assets ratios of large, mid-sized, and small firms from 2006-2008.

EXHIBIT 3-2

Net Sales-to-Assets Ratios of Small, Mid-Size, & Large Firms (2006-2008)



Source: FRC IMPACT