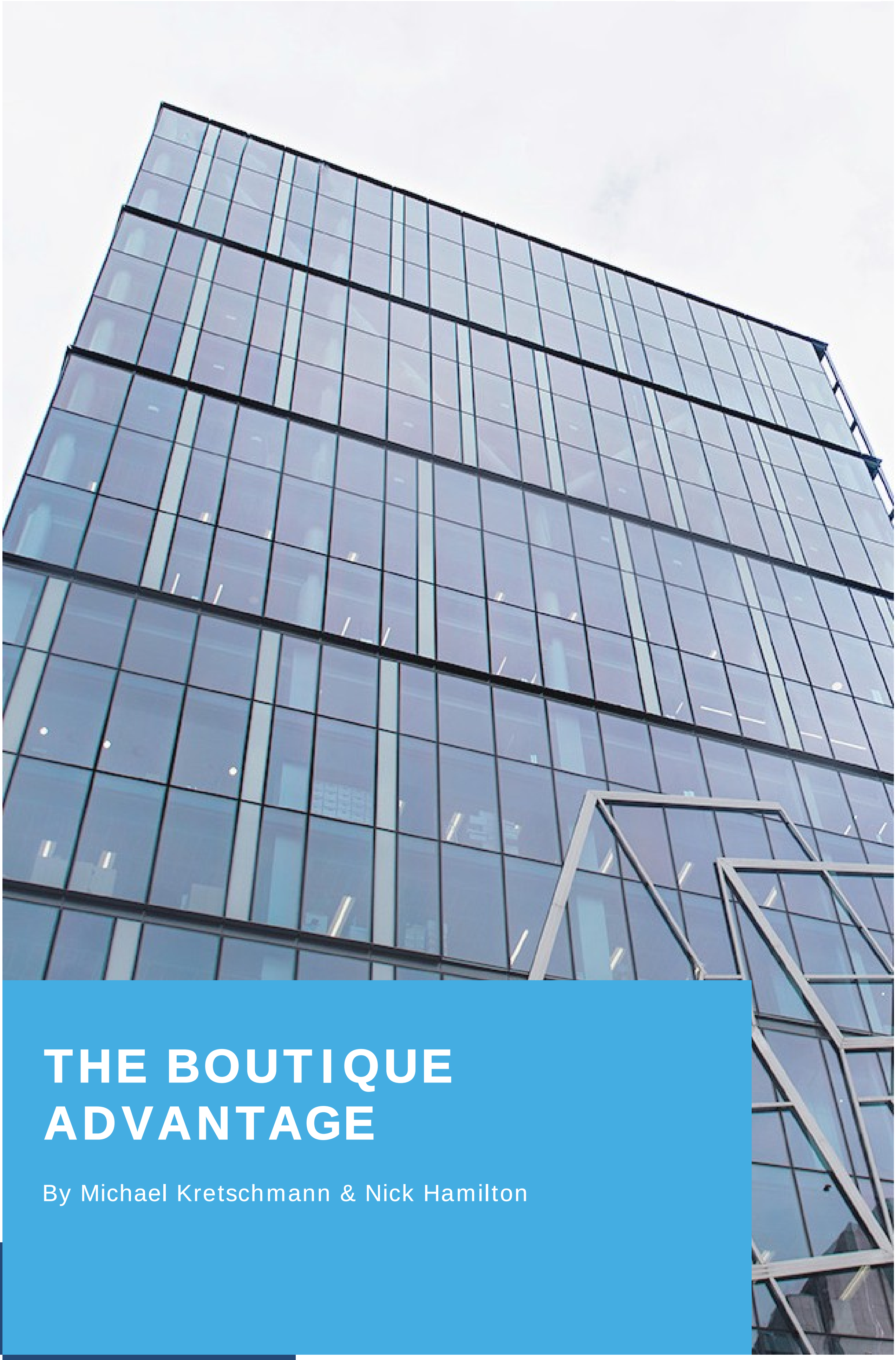

THE BOUTIQUE ADVANTAGE

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The *Boutique Advantage* – a new empirical study of the Australian boutique funds management industry

Active management has been receiving much press of late, somewhat negative and perpetuating a growing belief that active management cannot deliver on its investment promise.

It was not so many years ago that many viewed active management as the taking of modest over- and under-weight positions at the security or sector level. As an investment approach, it is necessarily challenged by the interplay of fees, low levels of active risk and typical success in security selection all but guaranteeing underperformance after fees. Active management is a label that should be applied to strategies that deliberately allocate investors' capital based on an investment approach rather than an index consideration.

The risk for active management is that the brand itself becomes inextricably associated with real or perceived poor investment experience.

Our proprietary study of the Australian funds management industry finds that investment teams within what we define as a 'Boutique' fund manager, have outperformed both their benchmarks and their Non-Boutique (traditional, larger, well-known) peers over time – net of fees. We have termed this trend: ***'The Boutique Advantage'***[1,4].

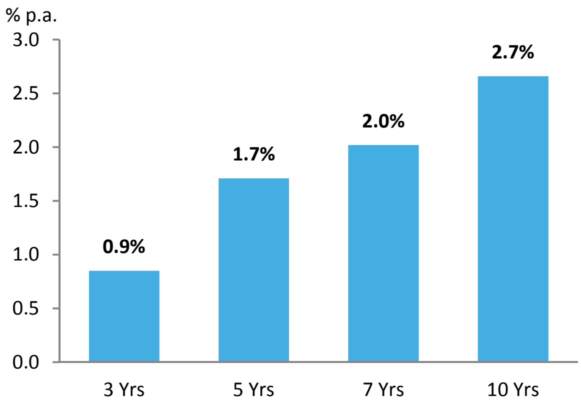
Augmenting the active vs. passive debate to include Boutique active investment managers can show the value that these active investment managers can add to investors' portfolios.

Key Findings from the Boutique Advantage study for Australian Equity Managers:

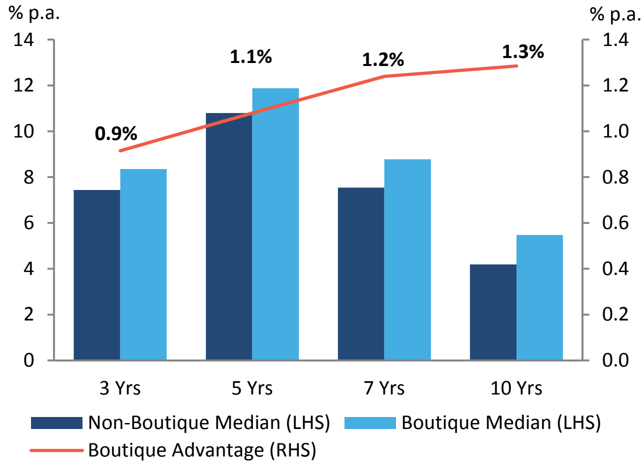
1. Boutiques are higher conviction investors, taking more active risk compared to non-boutiques.
2. The active risk can be rewarded by higher realised returns and information ratios.
3. Australian equity boutiques have outperformed their benchmarks and non-boutique managers over 3yrs, 5yrs, 7yrs and 10 years.
4. The level of excess return is meaningful and is evident in all 6 categories of Australian equity managers - equity income, growth, value, neutral, long/short and smaller companies.
5. The Boutique Advantage results are net of fees and illustrate the after-fee value of conviction active management.

Boutique Australian Equity investment managers have outperformed their benchmarks by 2.7% p.a. over the past 10 years – net of fees (below left).

We examined the after-fee performance of approximately 200 investment strategies in the Australian Equity universe as per our Boutique definition[4]. Boutiques were found to outperform their relevant benchmarks over all trailing periods, with the median Boutique outperforming their benchmark by 2.0% p.a. and 2.7% p.a. over 7 and 10 years respectively.

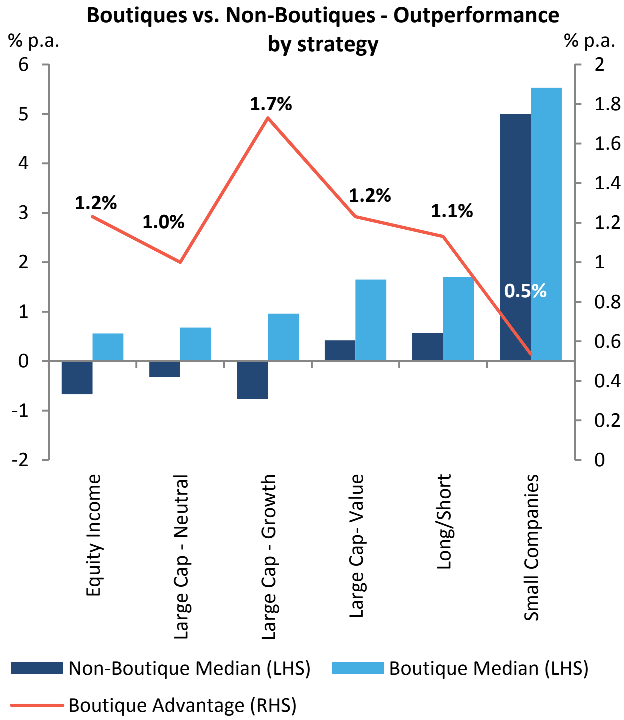


Median outperformance of Australian Equity Boutique Funds vs. Benchmarks to 30 April 2017 (net of fees). Source: Fund managers, Zenith Investment Partners.

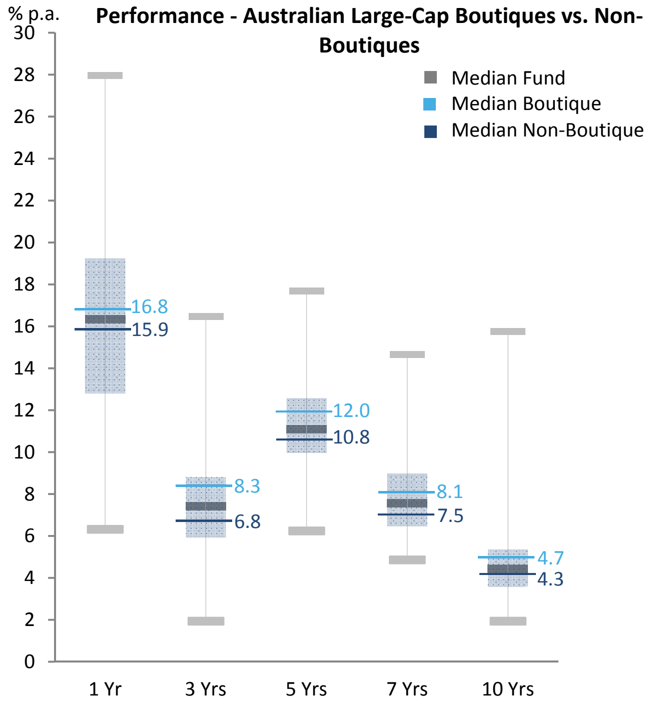


Median Australian Equity Boutique & Non-Boutique performance to 30 April 2017 (net of fees). Source: Fund managers, Zenith Investment Partners.

Australian Equity Boutiques have significantly outperformed Non-Boutiques (more traditional, often larger managers) over 10 years, generating returns that are 1.3% greater than their peers (above right).
Boutique Australian Equity funds outperformed Non-Boutiques over all trailing periods, with the median Boutique outperforming Non-Boutiques by 1.2% p.a. over 7 years and 1.3% p.a. over 10 years.



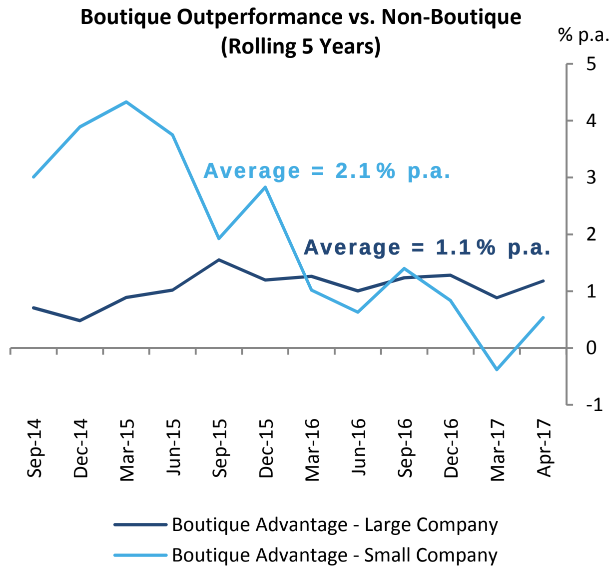
Boutique & Non-Boutique median performance vs. benchmarks by strategy over 5 years to 30 April 2017 (net of fees). Source: Fund managers, Zenith Investment Partners.



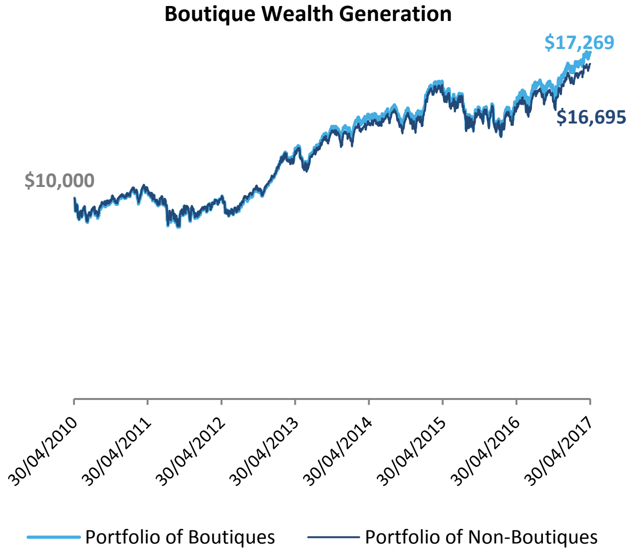
Median performance of Australian Equity Large-Cap Boutique & Non-Boutique Funds to 30 April 2017 (net of fees). Source: Fund managers, Zenith Investment Partners.

Australian Equity Boutiques have outperformed Non-Boutiques across multiple investment strategies (above).
Boutiques generated more outperformance vs. benchmarks compared to Non-Boutiques across multiple Australian Equity strategies. The median Boutique generated approximately 1.1% p.a. more outperformance over 5 years compared to Non-Boutiques. In the highly competitive Australian Equity - Large Company universe, Boutiques outperformed Non-Boutiques across all trailing periods.

Australian Equity Boutiques have consistently outperformed Non-Boutiques over time (below left).
Boutiques consistently outperform Non-Boutiques over rolling 5-year periods. On average, Australian Large Company Boutiques have generated 1.1% p.a. more outperformance and Small Company Boutiques 2.1% p.a. excess outperformance.

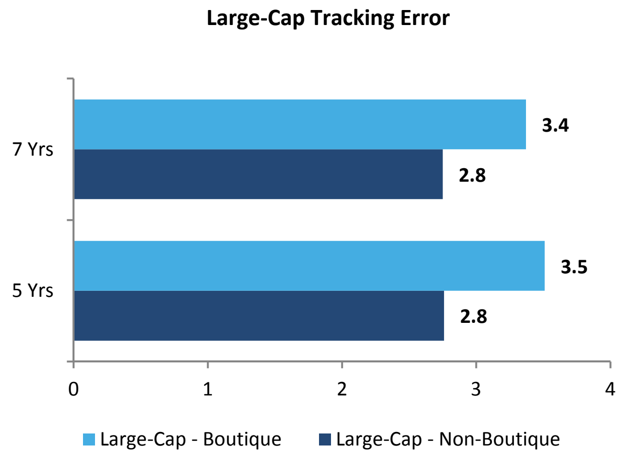


Australian Equity Large & Small-Cap Boutique performance vs. benchmarks, rolling 5 year periods to 30 April 2017 (net of fees). Source: Fund managers, Zenith Investment Partners.

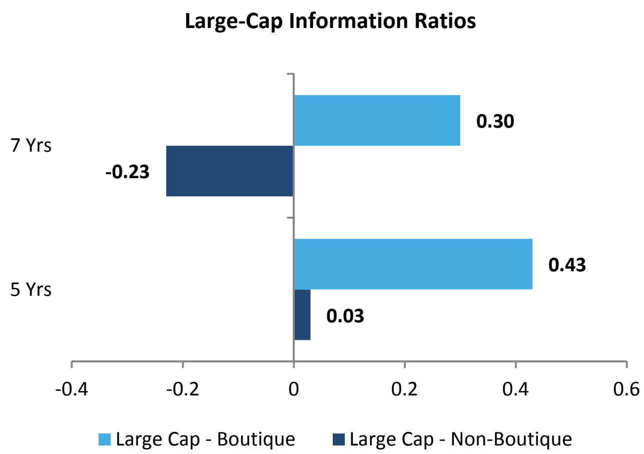


Growth of $10,000 over 7 years to 30 April 2017 in an equally-weighted portfolio of Large-Cap boutiques vs. Non-Boutiques. Returns source: Morningstar.

A portfolio of active Boutique managers generates more wealth for clients (above right).
An equally-weighted portfolio of Large-Cap Boutiques vs. Non-Boutiques generated 5.7% more wealth over 7 years. The Boutique portfolio had annualised returns of 8.12% p.a. and total a cumulative return of 72.69%, whilst the portfolio of Non-Boutique managers delivered 7.60% p.a. and 66.95% cumulatively.



Tracking Error of Large-Cap Boutique & Non-Boutique funds to April 2017. Source: Zenith Investment Partners.



Information Ratios of Large-Cap Boutique & Non-Boutique funds to April 2017. Source: Zenith Investment Partners.

Boutiques take more active risk, but deliver better risk-adjusted returns compared to Non-Boutiques (above).
Large-Cap Boutiques take approximately 23% more active risk (as measured by Tracking Error[2]) compared to Non-Boutiques over 7 years. Despite taking more active risk, Boutiques were rewarded for their active portfolio positions (as measured by their Information Ratios[3]) compared to Non-Boutiques.

Conclusion – Boutiques provide a compelling choice for active management

Boutique DNA drives outperformance

The outperformance of Boutiques can be attributed to a number of their core characteristics:

- *Investment forms the cornerstone of a Boutique* – Unlike their larger, well-known and more traditional peers who operate across multiple asset classes and strategies, Boutiques principals are asset-class specialists. They are more often small teams of close-knit, asset-class experts that are focussed on what they love doing: investing.
- *Boutiques are aligned with investors and incentivised to outperform* - Boutique principals hold direct equity in their businesses and most often principals invest personal wealth in their funds. This alignment ensures that the principals have a direct interest in the success of the business and are incentivised to deliver outperformance for their clients.
- *Boutiques are free to optimise internal processes and focus on investing* – Whilst the Boutique principals have control over the day-to-day running of the investment team, many will recognise the importance of partnering. From the formation, working capital, seed capital and activities such as distribution, operations and business services, Boutiques can remain independent, yet be backed by an institutional platform.
- *Boutiques are focussed on the long-*term – As Boutique principals hold direct ownership stakes, they are committed to the long-term growth and success of their businesses. This leads to lower turnover in investment teams, an important feature of high performing teams. It also drives succession planning to help future-proof their businesses.

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1. A similar study was conducted by Affiliated Managers Group entitled 'The Boutique Premium' in which similar results were observed.

2. Tracking Error is a measure of the amount of active risk that is being taken by a fund manager. It is calculated by subtracting the benchmark return from the manager's return and then calculating the standard deviation of those differences. A higher tracking error indicates a higher level of risk (not return) being taken by the manager relative to the benchmark.

3. The Information Ratio is a measure of the value added per unit of active risk by a fund manager over an index. It is calculated by first determining the fund manager's excess return by subtracting the benchmark return from the fund manager's return. The excess return is then divided by the standard deviation of excess returns (Tracking Error). Fund managers taking on higher levels of risk are expected to generate higher levels of return, so a positive Information Ratio indicates efficient risk-taking by fund managers.

4 We classified Australian Equity investment managers as Boutique when the investment team collectively held more than 20% direct ownership of the business. This excluded many large managers where profit sharing arrangements were in place and no direct ownership is held.

Methodology

Net return data was sourced primarily from performance surveys produced by Zenith Investment Partners (Zenith). Fund return data was also sourced directly from monthly fund manager disclosure. Index data was provided by eVestment. Tracking Error and Information Ratios were provided by Zenith.

We classified Australian Equity investment managers as Boutique when the investment team collectively held more than 20% direct ownership of the business. This excluded many large managers where profit sharing arrangements were in place and no direct ownership is held.

Our analysis incorporated more than 190 Australian Equity funds. We analysed trailing returns across the following Australian Equity strategies:

- All-Cap
- Long/Short
- Large Cap
- Equity Income
- Small-Cap

Australian Equity – Large Cap was further broken down into the following styles:

- Large Cap – Neutral
- Large Cap – Growth
- Large Cap – Value

Multi-managers were removed from the analysis, as were index funds and listed investment companies. For funds with custom benchmarks, benchmark figures were sourced directly from disclosure from the fund manager.

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