2017 Executive Outlook Survey

CERULLI ASSOCIATES
Global Analytics

IAA INVESTMENT ADVISER ASSOCIATION

Overview

2017 Executive Outlook Survey

Sources: Cerulli Associates, in partnership with the Investment Adviser Association

In the first survey done in partnership between Cerulli Associates and the Investment Adviser Association (IAA), executives at U.S. asset managers and wealth managers provided their outlook on the financial services industry headed into 2017. This survey was conducted throughout September and October of 2016, prior to the U.S. election. However, the final two exhibits of the report are from a follow-up survey conducted post-election.

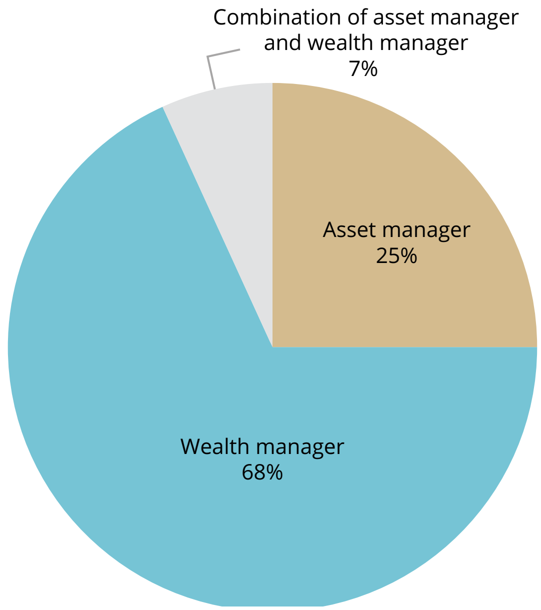
The survey defines asset managers as investment advisers to mutual funds, investment advisers to private funds, and investment advisers to other institutions. Wealth managers are defined primarily as investment advisers to individuals.

The overall outlook for 2017 is positive, with both assets under management (AUM) and headcount expected to increase. However, fee pressure, costs in technology (both cyber and operational), and compliance costs are rising concerns. Interestingly, the study also finds that some of the strategic priorities focused on these concerns are not aligned with where budget dollars are planning to be allocated. This report looks at the economic outlook of the industry, internal firm priorities, and external opportunities and threats. It also delves into budget expectations, technology, and service and product offerings/developments.

Exhibit 1

Profile of Firms, 2016

Sources: Cerulli Associates, in partnership with the Investment Adviser Association



Profile

Exhibit 2

Current Headcount and Expected Change Over Next 12 Months, 2016

Sources: Cerulli Associates, in partnership with the Investment Adviser Association

Analyst Note: "Decrease by more than 10%" was a response option, but was not selected by any firm.

			Expected Change Over 12 Months			
Firm Type	**Average Current Headcount**	**Median Current Headcount**	**Decrease by 1%–10%**	**Stay the Same**	**Increase by 1%–10%**	**Increase by More Than 10%**
All firms	115	22	7%	30%	56%	7%
Asset managers	314	45	9%	27%	64%	0%
Wealth managers	53	14	7%	28%	55%	10%

Exhibit 3

Current Assets Under Management (AUM) Breakdown, 2016

Sources: Cerulli Associates, in partnership with the Investment Adviser Association

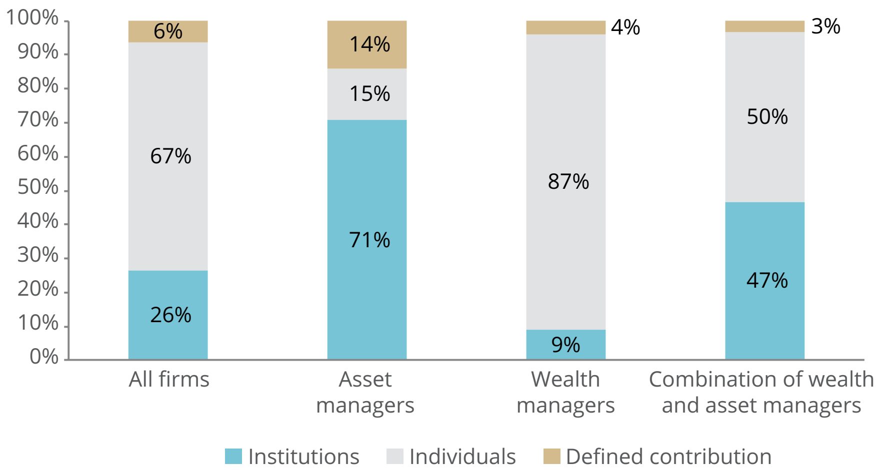
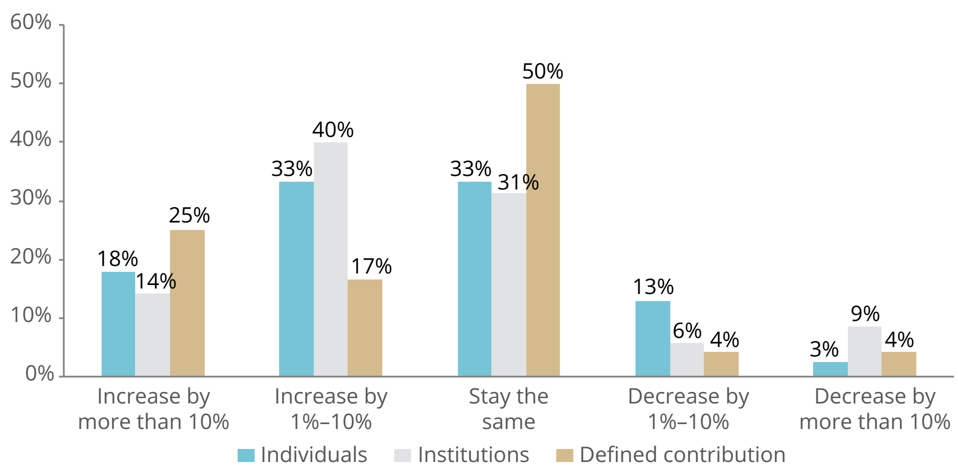


Exhibit 4

Expected AUM Change Over Next Three Years, 2016

Sources: Cerulli Associates, in partnership with the Investment Adviser Association

Analyst Note: Data represents all firms' responses.



Market Outlook

Exhibit 5

Markets in which Firms Offer or Plan to Offer Products and Services, 2016

Sources: Cerulli Associates, in partnership with the Investment Adviser Association

Analyst Note: Data represents all firms' responses.

Market	In Market, But Decreasing Resources	In Market, Maintaining Resources	In Market, Increasing Resources	Not in Market; No Plans to Enter	Plan to Enter in the Next 12 Months
United States	2%	36%	62%	0%	0%
Asia/Pacific	0%	6%	12%	79%	3%
United Kingdom	0%	12%	3%	85%	0%
Europe	0%	18%	3%	79%	0%
Latin America	0%	6%	0%	91%	3%
Middle East	3%	6%	0%	91%	0%

Exhibit 6

Expectations for Market Indices Over the Next 12 Months, 2016

Sources: Cerulli Associates, in partnership with the Investment Adviser Association

Analyst Note: Data represents all firms' responses.

Index Expectation	Average Market Index Expectation
S&P 500	2%
MSCI EAFE	5%
Barclays Agg	-1%

Exhibit 7

Use of Market Indices in Business Planning, 2016

Sources: Cerulli Associates, in partnership with the Investment Adviser Association

Analyst Note: Data represents all firms' responses. This is in reference to the market indices in Exhibit 6.

	Not a Factor	Moderate Factor	Major Factor
Asset managers	64%	27%	9%
Wealth managers	52%	45%	3%

Industry Outlook

Exhibit 8

Industry Opportunities and Threats Over the Next 24 Months, 2016

Sources: Cerulli Associates, in partnership with the Investment Adviser Association

Analyst Note: Data represents all firms' responses.

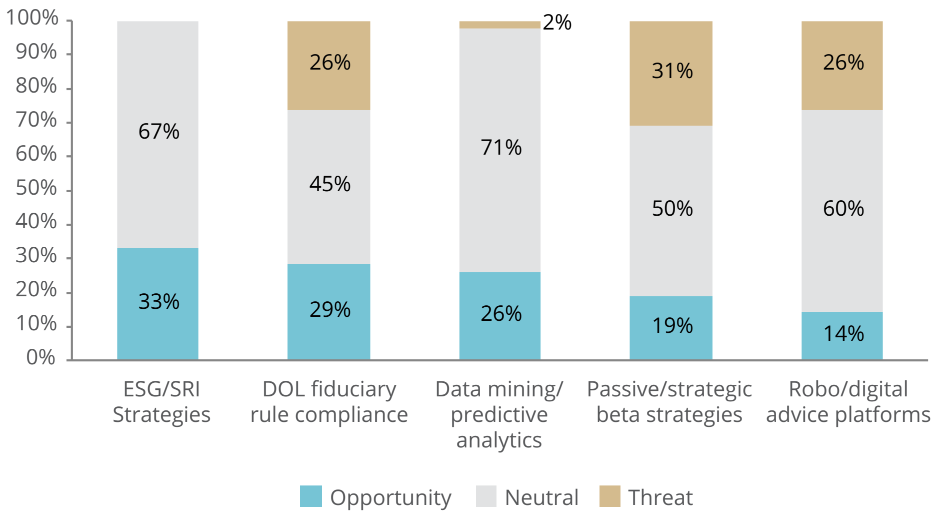


Exhibit 9

Level of Concern Regarding External Factors Over the Next 24 Months, 2016

Sources: Cerulli Associates, in partnership with the Investment Adviser Association

Analyst Note: Data represents all firms' responses.

Factor	Not Concerned	Moderately Concerned	Very Concerned
Fee compression	18%	36%	45%
Potential significant market crisis	0%	73%	27%
Regulatory environment	18%	55%	27%
Cybersecurity	0%	82%	18%
2016 U.S. election	36%	45%	18%
Globalization/increased competition	27%	64%	9%
Competitive pressure to invest in new technology	9%	82%	9%
Brexit	64%	36%	0%
Other geopolitical events	50%	50%	0%

Throughout 2016, concerns about volatile markets and fee compression continued to dominate mindshare at firms, followed closely by regulation and compliance issues. The Department of Labor (DOL) Conflict of Interest Rule and cybersecurity will remain at the forefront of a variety of challenges and opportunities stemming from the potential for regulatory changes. Cybersecurity will become an area of growing concern, while the DOL Conflict of Interest Rule, if implemented in a version close to its present form, will have a significant impact across the industry. However, the rule is expected to have a larger impact on broker/dealers.

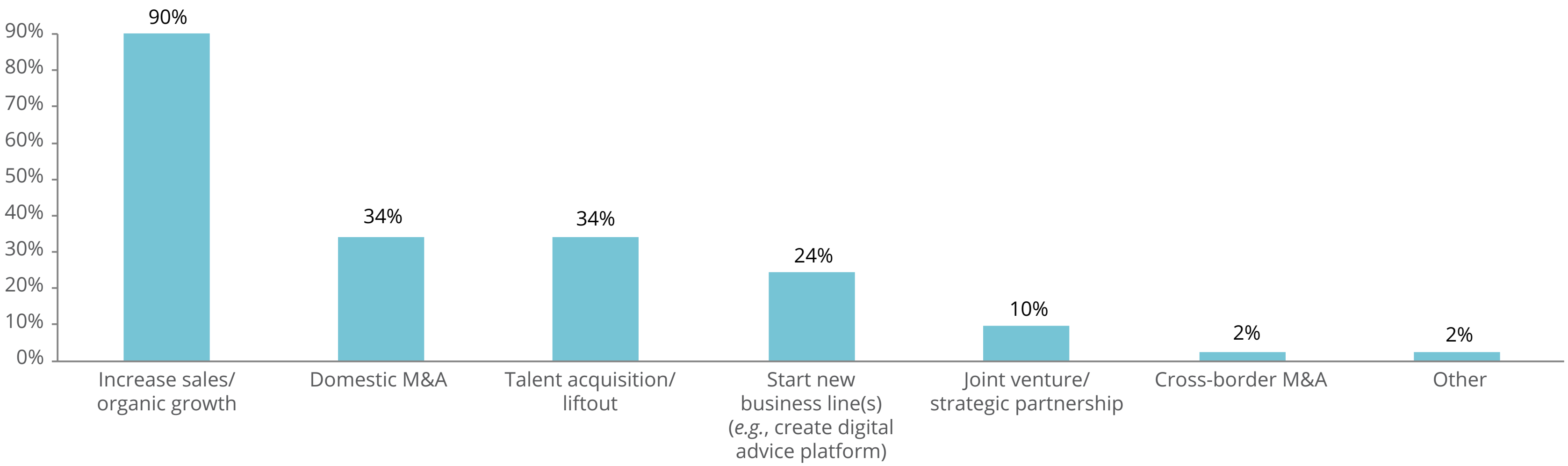
As documented in Cerulli's other research efforts, fee compression is driving growth in passive strategies. Almost one-third of respondents to this study state that passive and strategic beta are a threat. It is important to stress that this survey sample includes active asset managers as well as wealth managers that position asset allocation as core components. As many providers consider consolidating their fund platforms, active managers' ability to create alpha as well as differentiate themselves and outperform their peers at reasonable costs will, in all likelihood, benefit from reduced competition.

Exhibit 10

Growth Plans Over the Next 12 Months, 2016

Sources: Cerulli Associates, in partnership with the Investment Adviser Association

Analyst Note: Data represents all firms' responses. Participants were allowed to choose more than one response.



The overall increasing costs of compliance, including acquiring new technology and talent, spurs discussion about maximizing the cost-effectiveness of individual clients. The profitability of each client will also become a larger factor as advisers shift some of their resources toward compliance requirements instead of asset gathering. Fortunately, with the opportunity of new business lines or strategic partnerships, most prominently the rise of digital advice, firms have the ability to adapt. As asset managers face pressure to invest in technology while decreasing fees, they have re-evaluated their distribution methods by partnering with or acquiring digital advice platforms. Large wealth management firms are also investing in, or partnering with, automated services that can keep less profitable clients on the books, albeit with a different level of service.

Interestingly, 34% of firms state that talent acquisition/liftout is part of their growth plans (Exhibit 10). More than 50% of firms say that developing the next generation of talent is very important (Exhibit 12) with 38% stating that succession planning is a top priority over the next year (Exhibit 11). However, only 31% of firms plan to increase their hiring, training, and retention budgets (Exhibit 15). Cerulli believes an uptick in acquisitions and succession planning will unfold during the next two years. Firms with the capacity to acquire other businesses will head into a buyer's market and will find the opportunity for both vertical and horizontal growth, depending on where they want to strengthen their own firm.

Exhibit 11

Top Strategic Priorities for Next 12 Months, 2016

Sources: Cerulli Associates, in partnership with the Investment Adviser Association

Analyst Note: Data represents all firms' responses. Participants were allowed to choose up to three responses. "Market research" was a response option, but was not selected by any firm.

Strategic Priority	% of Respondents
Sales/distribution	55%
Product or service expansion development	43%
Succession planning	38%
Non-cybersecurity technology investment (*i.e.*, CRM, operations)	33%
Regulatory/legal/compliance	33%
Customer service	31%
Brand awareness	26%
Training/hiring/retention	21%
Cybersecurity	17%

Exhibit 12

Importance of Initiatives on Profitability of Firm, 2016

Sources: Cerulli Associates, in partnership with the Investment Adviser Association

Analyst Note: Data represents all firms' responses.

Initiatives	Not Important	Moderately Important	Very Important
Developing next generation of talent	2%	40%	57%
Increasing scale	12%	45%	43%
Improving service model	7%	62%	31%
Compensation analysis and adjustment	38%	48%	14%
Reducing costs	31%	57%	12%
Developing higher margin products	36%	57%	7%
Consolidation of investment platforms	78%	17%	5%
Developing passive/low fee products	71%	29%	0%

For wealth managers, as the adviser population ages, discussions of succession planning are increasing across the industry. These discussions encapsulate not only how and when succession will occur, but also what comes after.

The majority of firms agree that developing the next generation of talent is very important. Cerulli believes that these new advisers will be increasingly critical for heightened service delivery, especially in relation to a firm's ability to connect with other generations. This new talent can help retain current clients' beneficiaries, attract younger clients, and be integral to succession planning for the firm. The next wave of advisers, including both Generation X and Millennials, are also entrenched in technology use. The ever-growing digitization in the industry plays into these generations' ability to understand and use it where applicable.

Exhibit 13

Asset Managers: Interest in Developing Various Products or Strategies Over the Next 12 Months, 2016

Sources: Cerulli Associates, in partnership with the Investment Adviser Association

Analyst Note: Question was directed only to asset managers.

		Over the Next 12 Months		
Products/Strategies	**Currently Developed**	**Not Interested**	**Moderately Interested**	**Very Interested**
Smart beta solutions	0%	64%	14%	21%
Environmental, social, governance (ESG)/ Socially responsible investing (SRI)	14%	29%	43%	14%
Retirement income solutions	7%	43%	36%	14%
Multi-asset-class solutions	7%	57%	29%	7%
Custom/outcome-oriented solutions	7%	50%	36%	7%
Alternative/nontraditional asset classes	0%	64%	29%	7%
Passive/low-fee solutions	0%	93%	7%	0%

Exhibit 14

Wealth Managers: Interest in Investing in the Following Strategies Over the Next 12 Months, 2016

Sources: Cerulli Associates, in partnership with the Investment Adviser Association

Analyst Note: Question was directed only to wealth managers.

		Over the Next 12 Months		
Strategies	**Currently Offer**	**Not Interested**	**Moderately Interested**	**Very Interested**
Retirement income solutions	19%	25%	34%	22%
Passive/low-fee solutions	16%	44%	28%	13%
Custom/outcome-oriented solutions	22%	38%	31%	9%
Alternative/nontraditional asset classes	19%	56%	16%	9%
Environmental, social, governance (ESG)/ Socially responsible investing (SRI)	9%	69%	13%	9%
Multi-asset-class solutions	22%	41%	34%	3%
Smart beta solutions	3%	78%	19%	0%

Between fee compression and conflict of interest worries, low-fee products and strategies are here to stay. In general, use of exchange-traded funds is on the rise, but the space is dominated by very few players, which explains asset managers' overwhelmingly (93%) being "not interested" in passive/low-fee solutions (Exhibit 13). In an effort to maintain marketshare, managers are attempting to innovate their product lineups by offering value-add strategies, such as strategic beta, which allows competition in the space while still retaining active qualities. However, as noted in Exhibit 14, wealth managers have little interest in smart beta solutions heading into 2017. Given this, Cerulli advises asset managers to proceed with these solutions after thorough due diligence.

Wealth managers are most interested in retirement income solutions (Exhibit 14), which is understandable as Baby Boomers are retiring and the DOL Conflict of Interest Rule changes the view on rollovers. Cerulli believes that an increase in low-fee solutions will ensue if the DOL Conflict of Interest Rule is implemented, as asset managers in the space are already trying to undercut one another to gain marketshare.

Exhibit 15

Budget Expectations Over the Next 12 Months, 2016

Sources: Cerulli Associates, in partnership with the Investment Adviser Association

Analyst Note: Data represents all firms' responses.

Budget Item	Not Applicable	Decrease	Stay the Same	Increase
Cybersecurity	0%	0%	45%	55%
Non-cybersecurity technology investment (*i.e.*, CRM, operations)	0%	2%	45%	52%
Sales/distribution	0%	0%	50%	50%
Regulatory/legal/compliance	0%	0%	50%	50%
Product or service expansion development	0%	0%	50%	50%
Brand awareness	2%	0%	62%	36%
Training/hiring/retention	2%	2%	64%	31%
Customer service	0%	0%	71%	29%
Market research	2%	2%	90%	5%

Exhibit 16

Priority of Technology Investments Over the Next 12 Months, 2016

Sources: Cerulli Associates, in partnership with the Investment Adviser Association

Analyst Note: Data represents all firms' responses.

Technology Investment	Not Applicable	Low Priority	Moderate Priority	High Priority
Improve cybersecurity	5%	2%	37%	56%
Update older technology	10%	17%	43%	31%
Improve data management/analytics	5%	21%	43%	31%
Implement regulatory/reporting requirements	7%	15%	54%	24%
Improve digital content (*i.e.*, mobile)	5%	39%	32%	24%
Maximize resource allocation and distribution opportunities (*i.e.*, client segmenting, predictive analytics)	10%	33%	33%	24%
Improve/build social media marketing strategy (*e.g.*, Twitter, LinkedIn)	7%	40%	33%	19%

As part of the overall positive outlook on 2017, there is little to no decrease in budget expectations over the next year. In fact, many firms are planning an increase in their budgets across the board. This is also in line with similar IAA findings regarding the rising cumulative costs of compliance and the need to direct more dollars toward compliance programs.

With respect to cybersecurity and technology improvements, respondents indicate a need to catch up rather than get ahead, with 56% stating cybersecurity improvement as their No. 1 technology investment in the next year. Exhibit 16 is consistent with the 2016 Investment Management Compliance Test Survey (a joint program of the IAA, ACA Compliance Group, and OMAM), which also shows cybersecurity as advisers' No. 1 compliance concern. Cerulli recommends that the scrutiny of third-party vendors be of utmost importance. Passing the blame baton after a data breach could be mitigated if firms conduct proper upfront analysis and monitoring, although even highly sophisticated systems are still vulnerable. Cerulli understands this is easier said than done as technology is a rapidly evolving, complex engine with high upkeep costs. Investing in a plan is critical not only because tougher regulations are on the horizon, but also for the mental preparation and protocol that can minimize the impact when it does happen.

Exhibit 17

Wealth Managers: Services Offered by Firm, 2016

Sources: Cerulli Associates, in partnership with the Investment Adviser Association

Analyst Note: Question was directed only to wealth managers.

					Subject to Additional Fee?		
Service	**Primary by Firm**	**Secondary by Firm**	**Outsourced**	**N/A**	**Yes**	**No**	**Not Applicable**
Portfolio management	94%	0%	6%	0%	14%	86%	0%
Asset allocation	91%	3%	0%	6%	4%	92%	4%
Consolidated reporting and performance reporting	53%	28%	0%	19%	0%	91%	9%
Basic financial planning	41%	38%	6%	16%	4%	83%	13%
Cash management	25%	28%	3%	44%	11%	61%	28%
Charitable/Philanthropic planning	25%	31%	0%	44%	0%	68%	32%
Family counseling and planning (including governance, meetings, and education)	25%	31%	0%	44%	0%	70%	30%
Alternative manager search and selection	22%	6%	0%	72%	0%	41%	59%
Trust administration and trustee services	19%	13%	25%	44%	42%	5%	53%
Risk modeling	19%	16%	6%	59%	0%	44%	56%
Estate planning	16%	22%	31%	31%	14%	38%	48%
Traditional manager search and selection	16%	9%	3%	72%	12%	35%	53%
Foundation management	16%	19%	3%	63%	0%	47%	53%
Internally managed hedge funds or fund of hedge funds	9%	3%	6%	81%	0%	13%	88%
Internally managed common trust funds	6%	0%	6%	87%	7%	7%	86%
Risk management/insurance	6%	9%	16%	69%	17%	17%	67%
Tax planning, preparation, and compliance	6%	19%	31%	44%	15%	40%	45%
Bookkeeping	6%	9%	6%	78%	31%	0%	69%
Concierge/Lifestyle services	3%	6%	3%	87%	6%	22%	72%
Bill pay	3%	13%	9%	75%	28%	6%	67%
Private banking	0%	0%	10%	90%	7%	0%	93%

This exhibit showcases the array of services offered to clients at wealth management firms. The more general advisory and investment services are offered as a primary service by the vast majority of firms and at no additional fee. The lesser-offered services, such as trust administration or tax planning services, that are typically found at family offices or high-end independent RIAs, are more likely to be subject to an additional fee. These services showcase where some firms are able to home in on a specific niche and deliver more bespoke offerings mostly targeted at high-net-worth clients.

The following two exhibits are from a follow-up survey to participants gathering sentiment on external factors to the industry and on opportunities and threats over the next 12 months. The two exhibits showcase the new results compared directly with the same aggregate firms' prior results. The exhibits contain pre-election and post-election sentiments.

Exhibit 18

Level of Concern Regarding External Factors Over the Next 24 Months Pre- and Post-Election, 2016

Sources: Cerulli Associates, in partnership with the Investment Adviser Association

Analyst Note: Data represents firms' post-election follow-up responses. "Other" included terror attacks, war, and political upheaval. Some "change" figures are off due to rounding.

	Not Concerned			Moderately Concerned			Very Concerned		
External Factor	**Pre-election**	**Post-election**	**Change**	**Pre-election**	**Post-election**	**Change**	**Pre-election**	**Post-election**	**Change**
Regulatory environment	13%	8%	-5%	42%	56%	14%	46%	36%	-10%
Fee compression	21%	16%	-5%	46%	52%	6%	33%	32%	-1%
Cybersecurity	4%	4%	0%	67%	48%	-19%	29%	48%	19%
Competitive pressure to invest in new technology	38%	40%	3%	42%	48%	6%	21%	12%	-9%
2016 U.S. election	42%	52%	10%	46%	40%	-6%	13%	8%	-5%
Globalization/increased competition	63%	64%	2%	29%	32%	3%	8%	4%	-4%
Potential significant market crisis	21%	32%	11%	75%	64%	-11%	4%	4%	0%
Other geopolitical events	21%	8%	-13%	17%	4%	-13%	4%	12%	8%
Other	0%	8%	8%	0%	0%	0%	0%	4%	4%
Brexit	71%	72%	1%	29%	28%	-1%	0%	0%	0%

Exhibit 19

Industry Opportunities and Threats Over the Next 24 Months Pre- and Post-Election, 2016

Sources: Cerulli Associates, in partnership with the Investment Adviser Association

Analyst Note: Data represents firms' post-election follow-up responses. Some "change" figures are off due to rounding.

	Opportunity			Neutral			Threat		
Opportunity/Threat	**Pre-election**	**Post-election**	**Change**	**Pre-election**	**Post-election**	**Change**	**Pre-election**	**Post-election**	**Change**
Data mining/predictive analytics	33%	20%	-13%	67%	76%	9%	0%	4%	4%
DOL fiduciary rule compliance	29%	16%	-13%	29%	56%	27%	42%	28%	-14%
ESG/SRI strategies	29%	28%	-1%	71%	72%	1%	0%	0%	0%
Passive/strategic beta strategies	25%	32%	7%	38%	52%	15%	38%	16%	-22%
Robo/digital advice platforms	21%	32%	11%	46%	56%	10%	33%	12%	-21%

The industry anticipated that a Hillary Clinton administration would be supportive of the DOL Conflict of Interest Rule. However, with the election of Donald Trump as the 45th U.S. President, some uncertainty has crept into the market as to whether or not this regulation may be changed. While a Trump administration is likely to focus on federal deregulation, the President-elect has not yet identified the Conflict of Interest Rule as a priority. In light of this and the difficult path required to undo this regulation, Cerulli recommends that clients continue with their current preparations to be compliant with the regulation's applicability date in April 2017. ◆

CERULLI
ASSOCIATES
Global Analytics

Cerulli Associates
699 Boylston Street
Boston, MA 02116
+1 617 437-0084
info@cerulli.com

www.cerulli.com