

Secular Trends Reshaping the Industry – Analysts' Insights

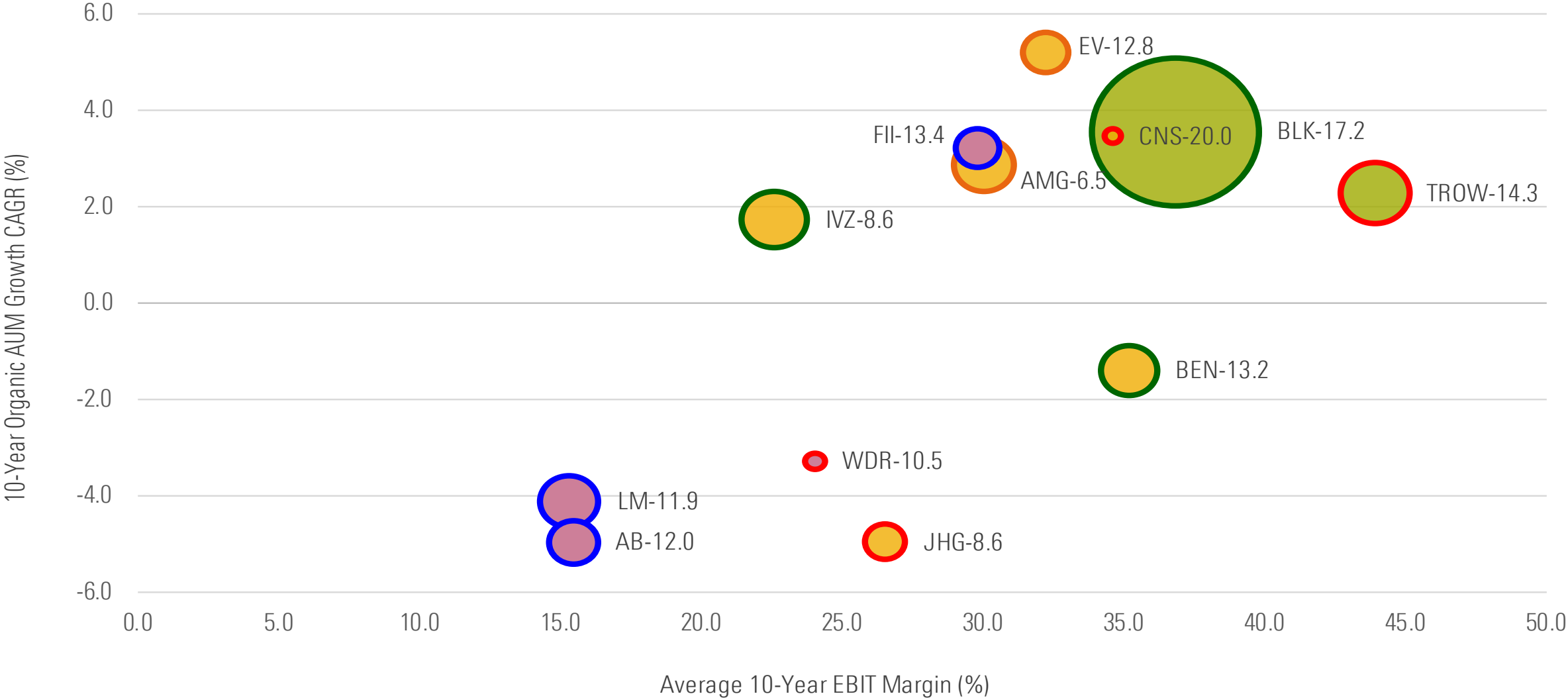


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June 25, 2019

New Era for U.S. Asset Managers:
Growth of Passive and Shifting
Distribution Will Lead to Greater
Fee and Margin Compression



The Market Rewards Above Average Organic Growth & Operating Profits



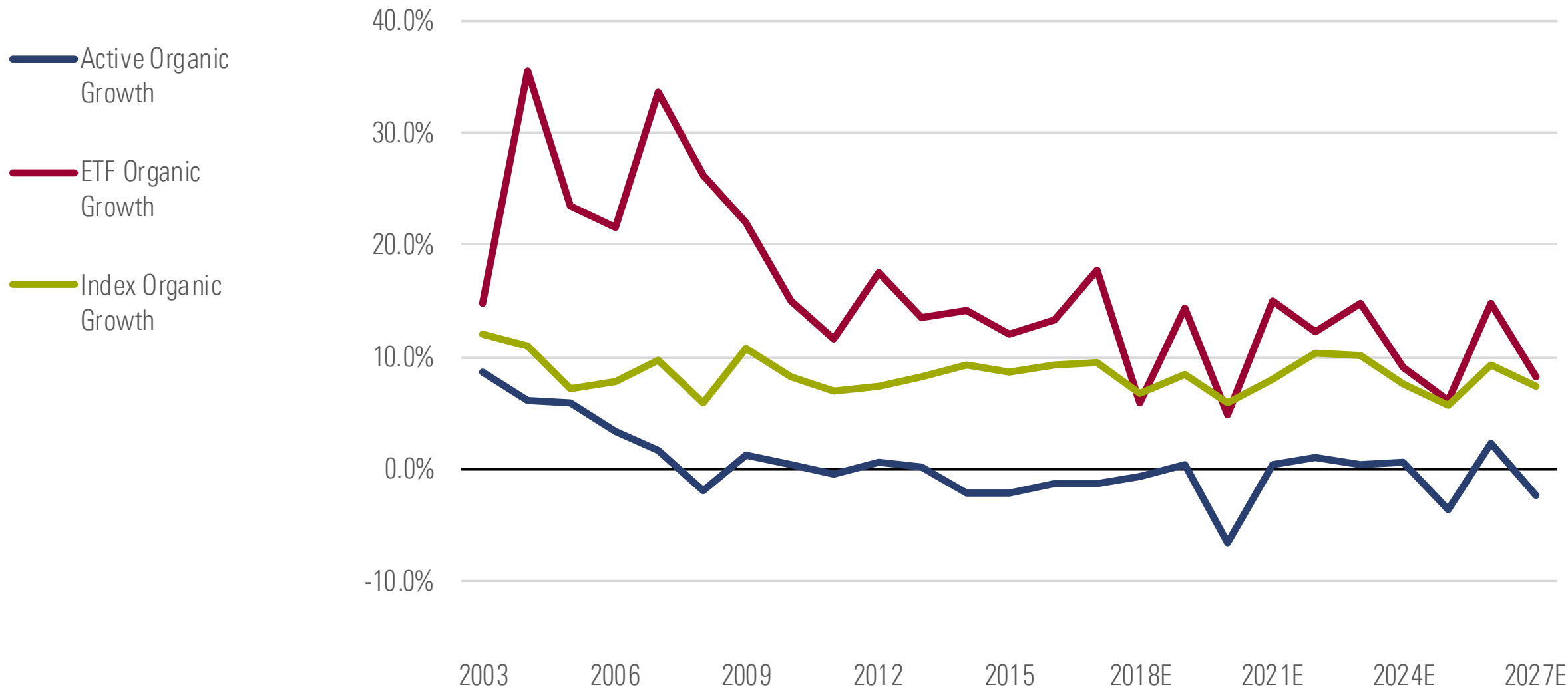
Source: Company Reports and Morningstar Estimates.

POLL: What percentage of mutual fund and ETF assets are invested in index strategies?

- 21%
- 52%
- 39%
- 15%
- 63%

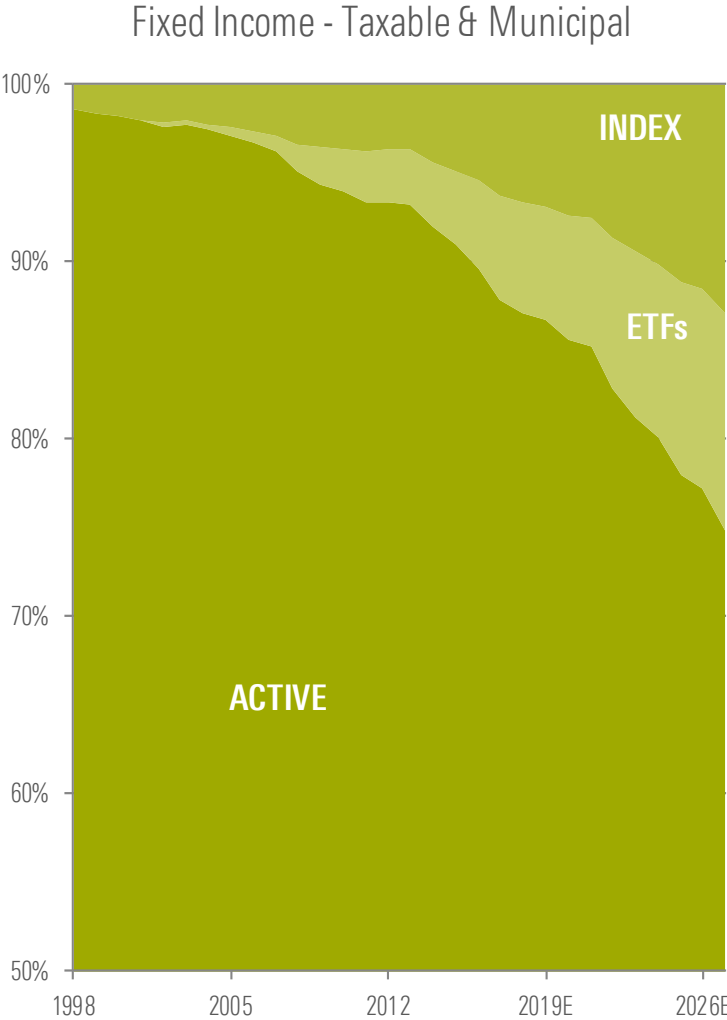
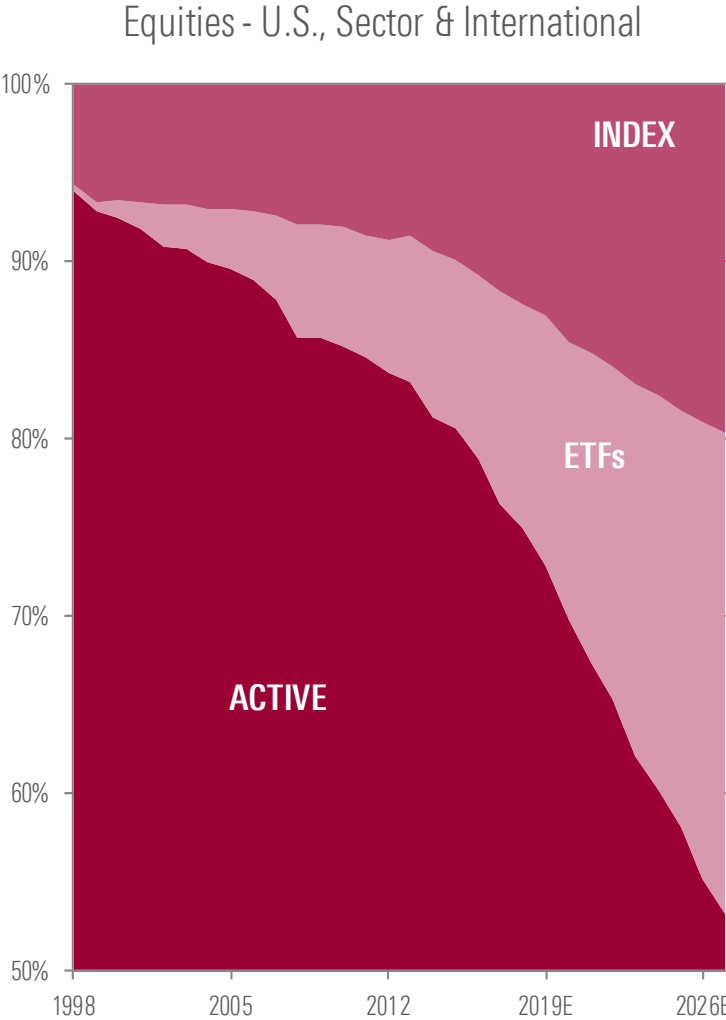
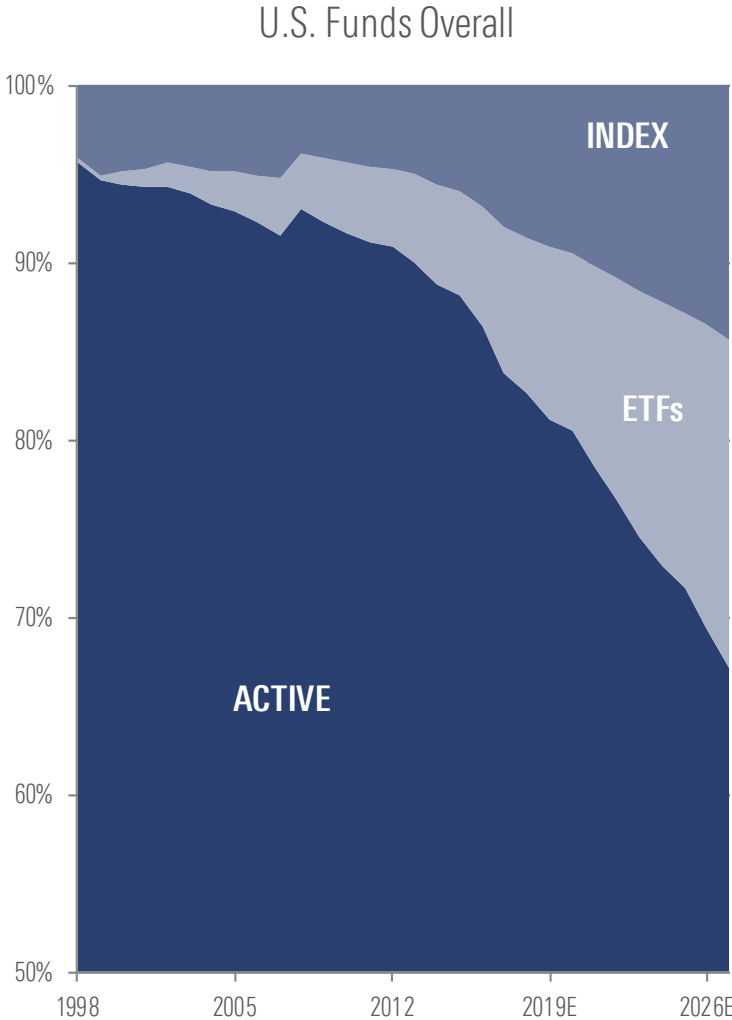
Poll Results

Poor Relative Performance, High Fees & Growth of ETFs Impacting Flows



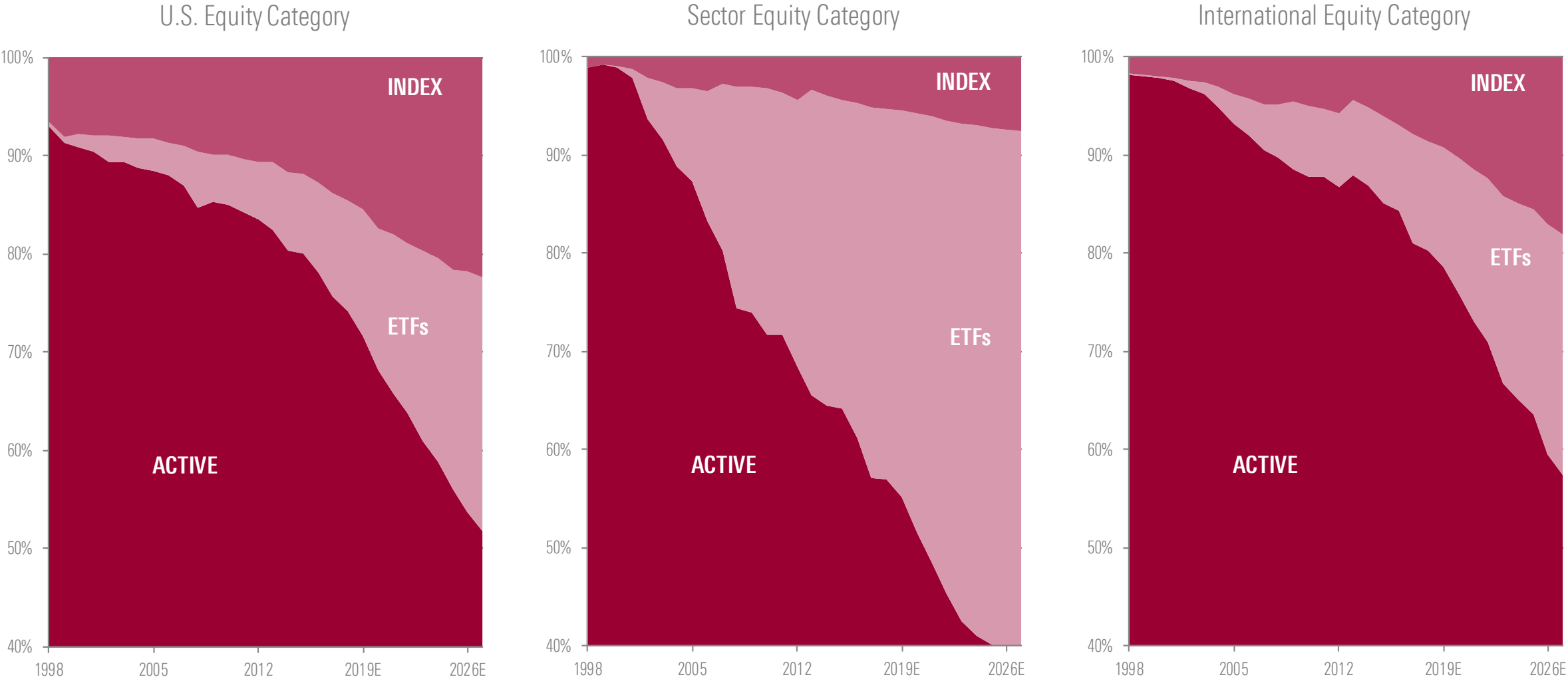
Source: Morningstar Direct - U.S. Open-End Fund (excluding Money Market and Fund of Funds), ETF, Separate Account and CIT Historical Data and Morningstar Estimates.

Passive Product Growth has Altered the Investment Fund Landscape



Source: Morningstar Direct - U.S. Open-End Fund (excluding Money Market and Fund of Funds), ETF, Separate Account and CIT Historical Data and Morningstar Estimates.

But Most of Growth has Come at the Expense of Large-Cap Equity Funds



Source: Morningstar Direct - U.S. Open-End Fund (excluding Money Market and Fund of Funds), ETF, Separate Account and CIT Historical Data and Morningstar Estimates.

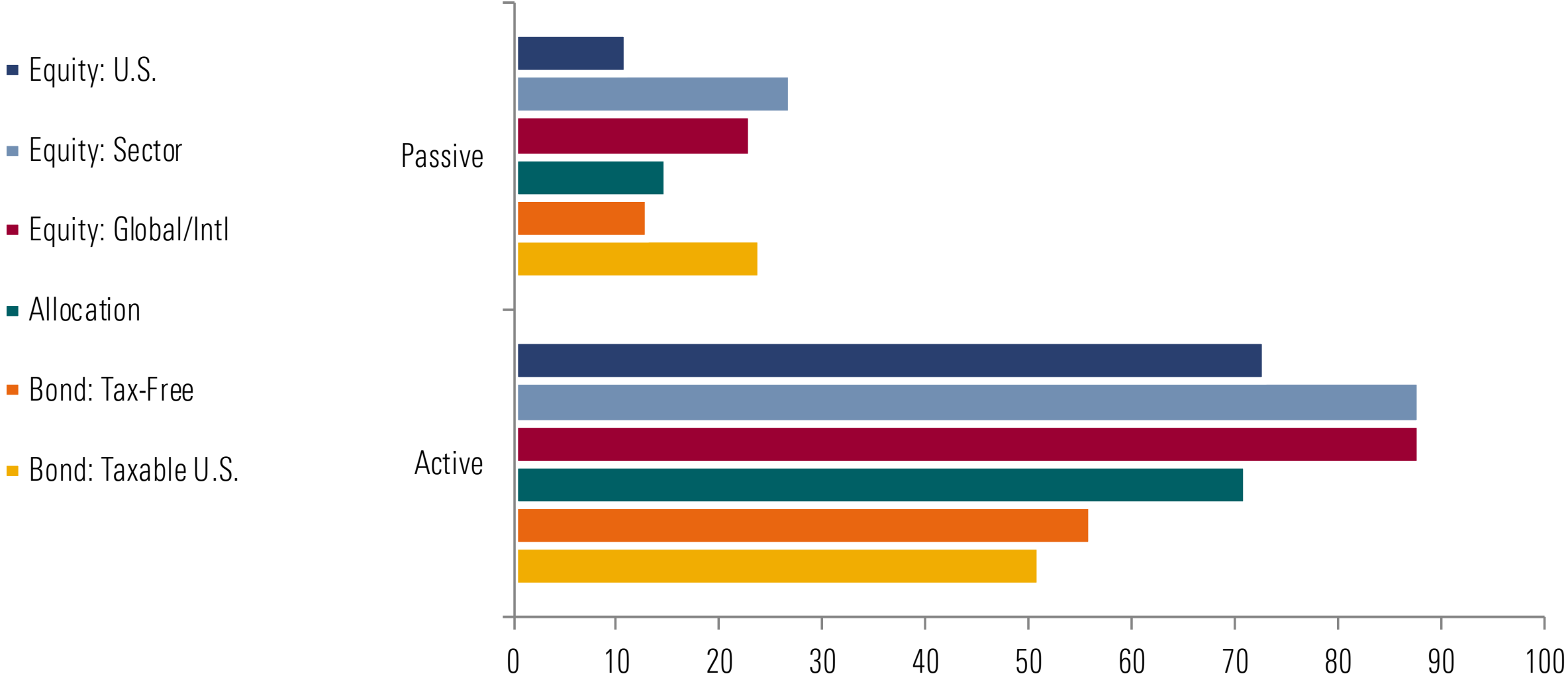
Improving Relative Performance is One Key to Turning Around Flows

Active Funds' Success Rate by Category (%)

Category	1-Year	3-Year	5-Year	10-Year		
				Overall	Lowest Cost	Highest Cost
U.S. Large Blend	31.1	15.5	16.4	10.9	17.3	2.1
U.S. Large Value	30.1	12.6	13.5	8.3	16.0	5.3
U.S. Large Growth	48.9	29.7	21.0	8.3	14.4	3.1
U.S. Mid Blend	31.4	19.3	17.9	11.9	21.9	12.5
U.S. Mid Value	22.0	12.5	7.5	9.4	7.7	0.0
U.S. Mid Growth	75.8	58.9	48.6	30.3	35.7	25.0
U.S. Small Blend	21.3	21.2	19.0	24.9	41.0	25.6
U.S. Small Value	15.9	16.8	23.6	33.3	38.5	34.6
U.S. Small Growth	52.1	51.4	35.1	24.3	20.4	24.4

Source: Morningstar. Data and Calculations as of 12/31/18.

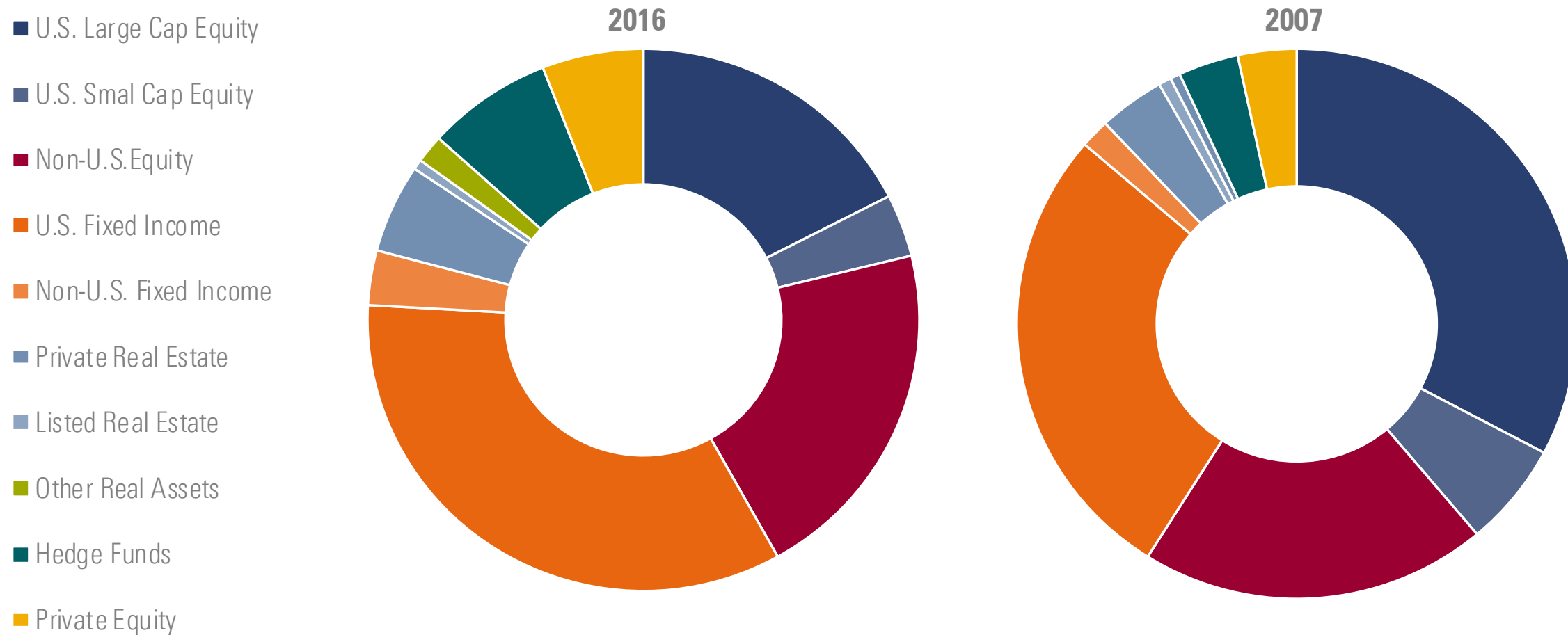
And Fees Need to Come Down for Active Funds to be More Competitive



Source: Morningstar. Data as of 12/31/18.

Migrating to Asset Classes with Less Exposure to Fee Cuts Would Help

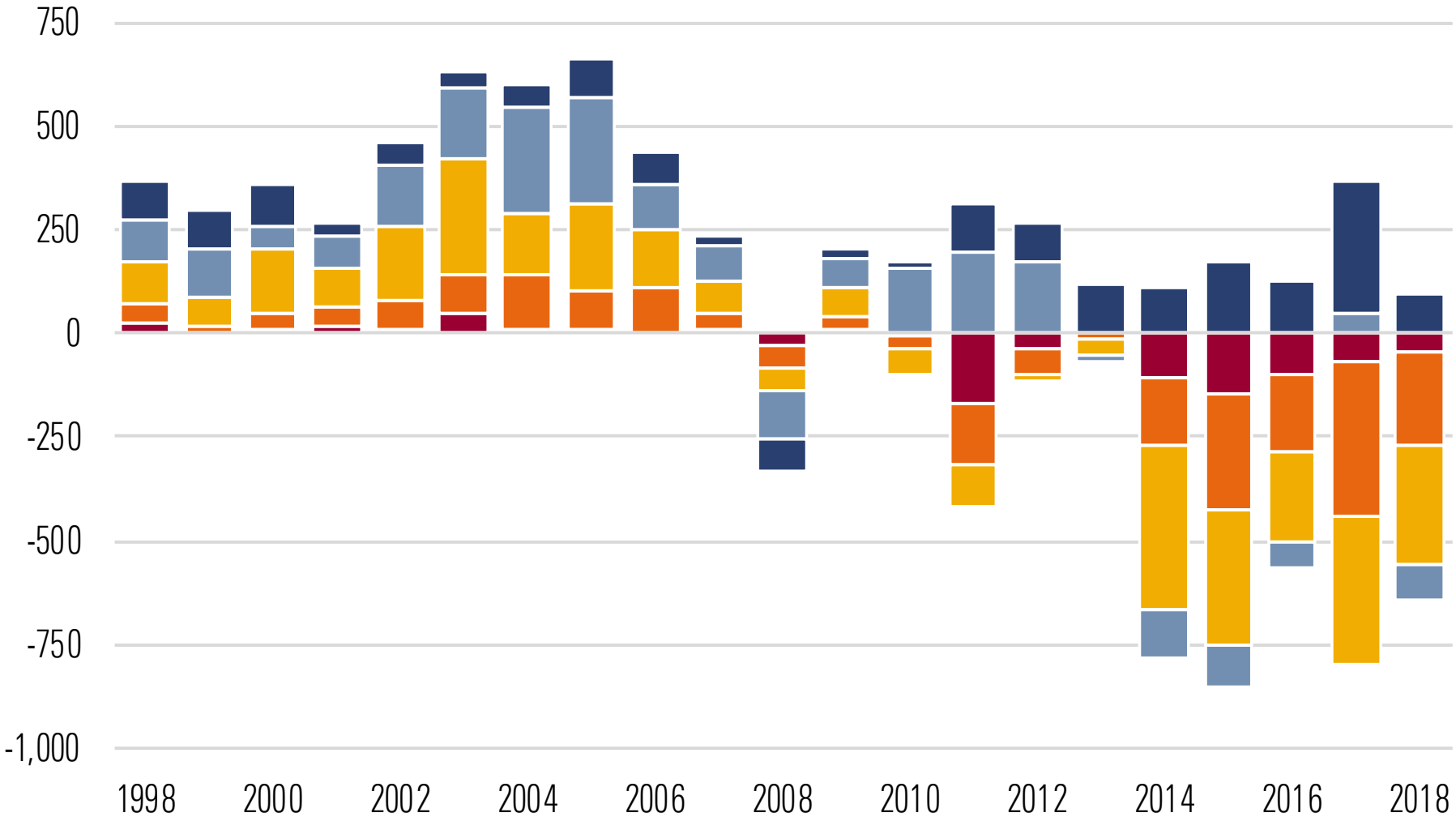
Average Asset Allocation of U.S. Defined Benefit Pension Plans



Source: CEM Benchmarking - Asset Allocation and Fund Performance of Defined Benefit Pension Funds in the United States (1998-2016).

Culling of Retail-Advised Platforms has Skewed Active Flows of Late

- 5-Star
- 4-Star
- 3-Star
- 2-Star
- 1-Star



Source: Morningstar Direct - U.S. Open-End Fund (excluding Money Market and Fund of Funds), ETF, Separate Account and CIT Historical Data.

Entering the World of \$0 Fees: The Value Chain Squeeze and Vertical Integration



\$0-Fee Concepts

Transaction Fee

Concept	Examples	Monetization Strategy
ETF & Mutual Fund Platforms	Schwab ETF & Mutual Fund OneSource	Revenue Sharing
Promotional	JPMorgan You Invest	New Accounts
Account Breakpoints	Merrill Edge	Account Consolidation
Broad Free Trading	Robinhood	Cross-Sell

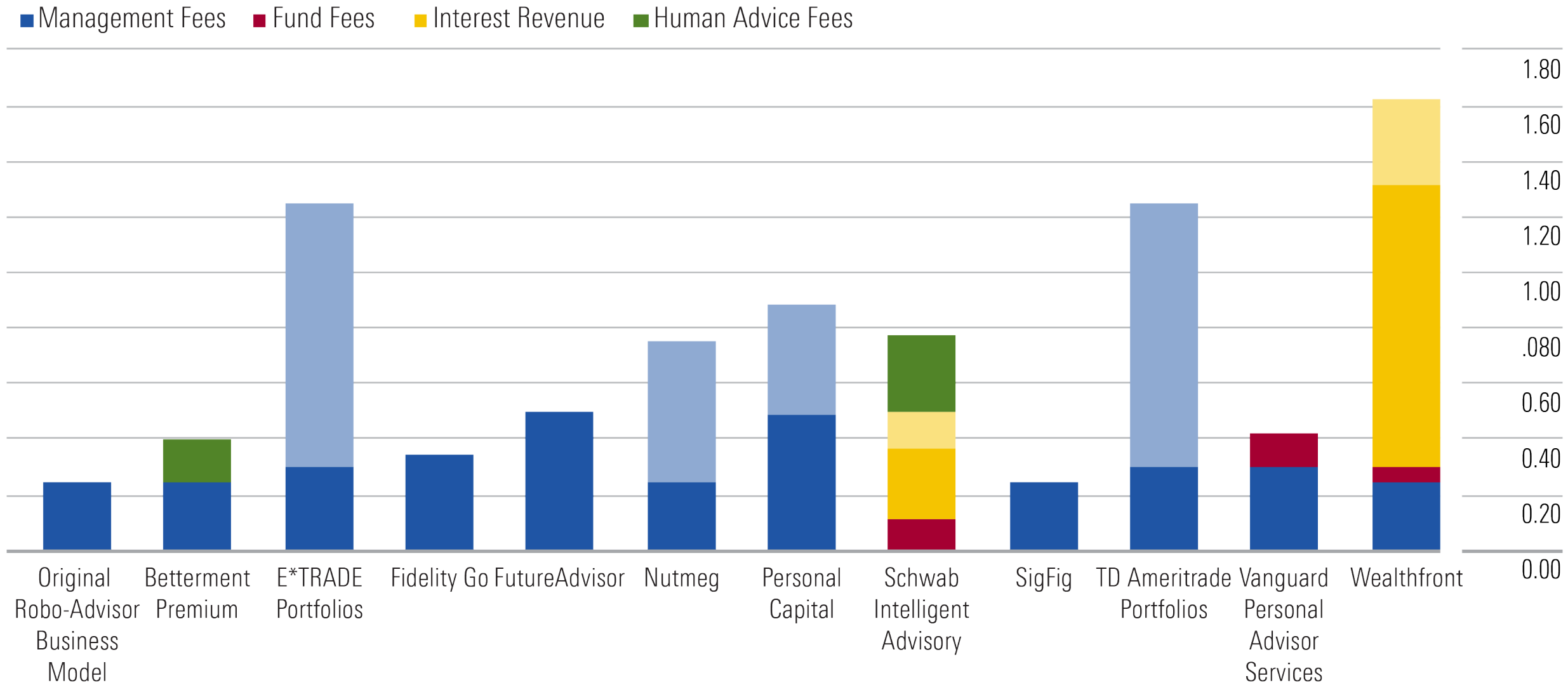
Investment Management Fee

0% Mutual Fund Expense Ratio	Fidelity ZERO Index Funds	Cross-Sell
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Advisory Fee

0% Robo-Advisory Fee	Schwab Intelligent Portfolios	Value Chain
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The Robo-Advisor Landscape Illustrates the Flexibility In Fee Structures



\$0 Transaction, \$0 Investment, \$0 Advisory

Concept	Examples	Monetization Strategy
Free Investment Services	No one yet...	Cash Float, Stock Loan, Payment for Order Flow, Internalization

Summary

1. \$0-fee business models are proliferating
2. Companies are utilizing various strategies to monetize clients
3. Vertically integrated business models have the most flexibility in charging fees and siloed investment service firms could be pressured

Guided Discussion Questions

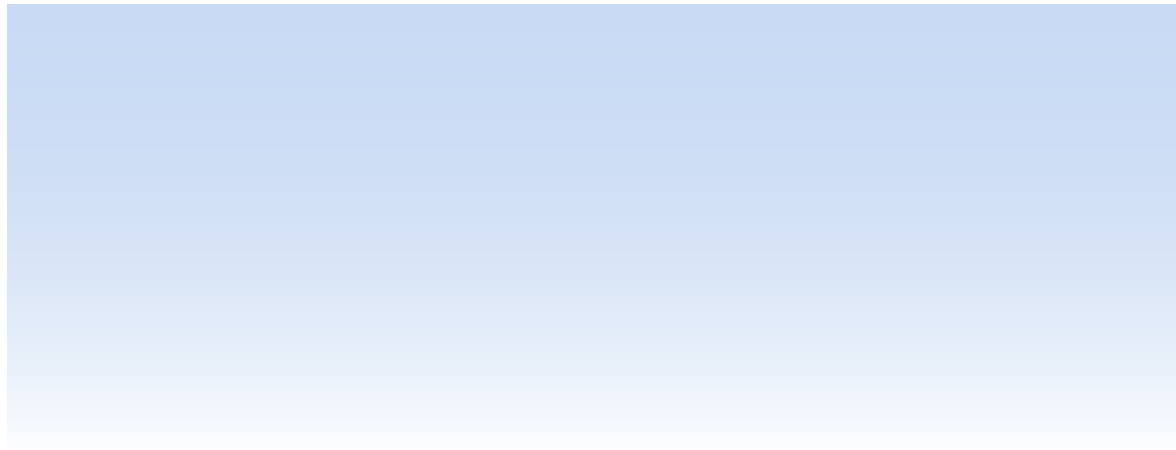
What links in the investment services value chain are most likely to be squeezed and how can players in that space thrive?

Do all large asset managers need passive and alternative products to continue growing?

How likely is it that the SEC's Regulation Best Interest will further change the financial advisor distribution channel?

Is global expansion a real opportunity or are the hurdles of regulation, incumbent players, etc. too steep?

Guided Discussion Questions



Do you believe that active will outperform in the next market correction? If active doesn't outperform, will active outflows accelerate?



Morningstar Research (Direct & Office Cloud)

The screenshot displays the Morningstar Research interface. At the top, there is a navigation bar with a 'Menu' icon, the word 'Research', a search bar containing 'Search for Securities and Research...', and notification icons for 24 alerts and a help icon. On the left side, a sidebar menu lists 'Featured', 'Latest', 'Publications', 'Topics' (highlighted with a blue arrow), and 'Videos'. Below this, the 'My Research' section includes 'Alerts', 'Bookmarks', 'Lists & Screens', and 'Following' (with a sub-entry for 'Kevin McDevitt, CFA' and a '9+' badge).

The main content area is titled 'Topics' and features a grid of 16 topic cards. Each card includes a title, a representative image, and document statistics:

- Stewardship**: 263 Documents 5 Hours Ago
- Morningstar Canada**: 9573 Documents 6 Hours Ago
- Dividend Investing**: 189 Documents 21 Hours Ago
- Advisor Practice Management**: 341 Documents 23 Hours Ago
- Exchange-Traded Products**: 760 Documents Yesterday
- UCITS & Cross-Border Manager Research**: 473 Documents Yesterday
- Fixed Income**: 748 Documents Yesterday
- APAC Manager Research**: 891 Documents Yesterday
- Asset Allocation**: 252 Documents Yesterday
- Goals-Based Investing**: 128 Documents Yesterday
- Passive Investing**: 581 Documents Yesterday
- North America Manager Research**: 1155 Documents 2 Days Ago
- Fund Flows**: (No document count visible)
- Closing the Behavior Gap**: (No document count visible)
- Behavioral Finance**: (No document count visible)
- Rating Ourselves**: (No document count visible)

Questions?