

Strategic key findings report

The use of investment research within the German, Swiss and UK wealth management markets

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THE REAL FUTURE VALUE OF INVESTMENT RESEARCH

LONDON - “Independence, insight, performance, coverage, clients and costs”, among other factors, are all driving the way the European wealth management market value research in the investment process. Indeed, best practice for sourcing research with these drivers in mind is an emerging – and on-going – theme which has already pushed players in the wealth management market to consider their research models.

This is the headline finding on the German, Swiss and UK wealth management industry from research conducted by **Scorpio Partnership**, the leading business strategy advisor to the wealth management industry, on behalf of **Standard & Poor’s (S&P)**.

In today’s economic environment, where wealth levels have been severely impacted and client demands on wealth managers to demonstrate investment performance driven up, the Scorpio Partnership team pooled the collective knowledge of 83 decision makers at leading wealth management institutions across Germany, Switzerland and the UK to gauge the pulse of the market on its use and needs from investment research.

Five primary themes emerged from the analysis:

1. Research is central to the wealth management market’s investment management proposition but there is a tipping point occurring in the context of the balance of use between in-house and third party research;
2. The traditional approach to research relying on in-house capabilities supplemented with freely available research from a huge array of the sell-side sources is being reconsidered in the context of demonstrating value to end investors;
3. The current exposure to paid-for-research is predominantly via macro, data and a small number of specialist market providers. However, there is growing recognition that the external research capabilities may further enhance the value proposition of the wealth managers if integrated in a customised fashion;
4. The business pressures are combining to drive the development of the research agenda and for the market to consider the future value of investment. Drivers include:
 - Requirements for a greater level of independent research
 - A research market that can truly deliver investment insight
 - Leading to investment performance and built on sound rationale
 - Increased need for deeper and wider coverage, impossible via in-house capacity
 - Increased cost pressures across business lines with research not exempt
5. There is an increasing realisation among decision makers of the need for flexible, responsive and private client oriented research delivered by providers without the recommendation bias that is typically reflected in sell-side research. This is pointing toward the decision makers looking toward new answers to developing the role of investment research.

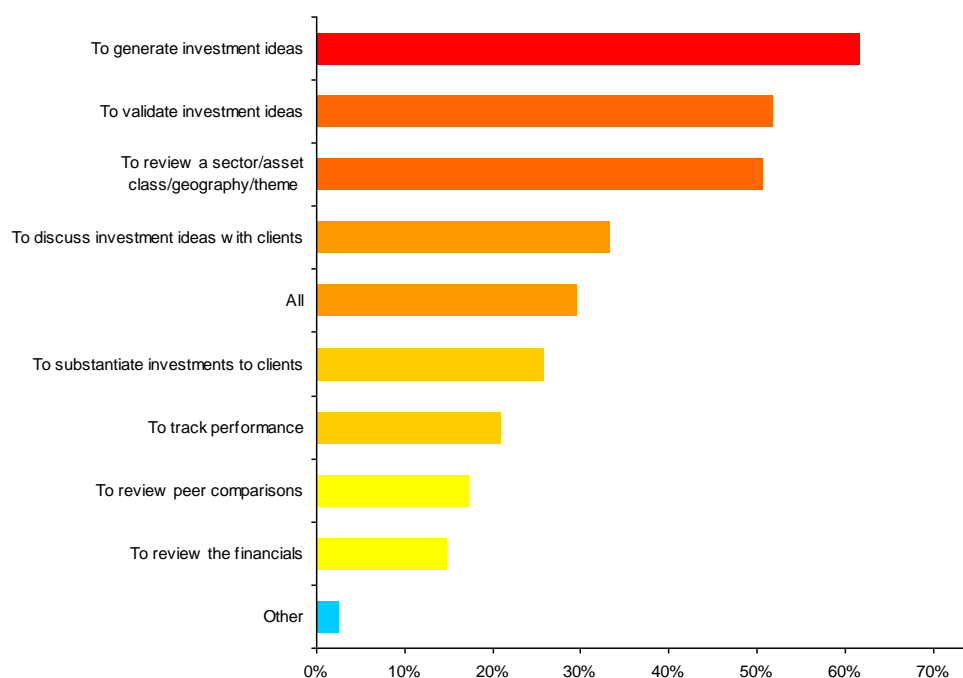
THE THREE-PRONG FOCUS OF INVESTMENT RESEARCH

Across the German, Swiss and UK markets wealth managers most frequently use research for three purposes – to generate investment ideas, validate investment ideas and review a sector/asset class/geography/theme. However, there are small variances by market:

- **Germany** – (1) review a sector/asset class/geography/theme, (2) generate investment ideas, (3) discuss investment ideas with clients
- **Switzerland** – (1) all, (2) generate investment ideas and (3) validate investment ideas
- **UK** – (1) validate investment ideas, (2) generate investment ideas, (3) review a sector/asset class/geography/theme

The two exceptions to the top three themes are the market utilising research to justify its investment decisions with clients in Germany, and more widely using research throughout the investment process among the Swiss. Interestingly, in the UK, there was very little emphasis on the role of research with clients.

Figure 1: The focus of investment research



Source: Scorpio Partnership

In short, research is an active and central part of the wealth management proposition and plays a key role in guiding wealth managers into areas of investment opportunity backed by the data and analysis to support that position. Accordingly, research is considered integral to the overall strategic asset allocation and portfolio construction process.

However, the role of research in the investment process has reached what may be referred to as a tipping point. More specifically the market is searching for resources that will enable it to deliver a stronger and deeper research service within the constraints of today's economics.

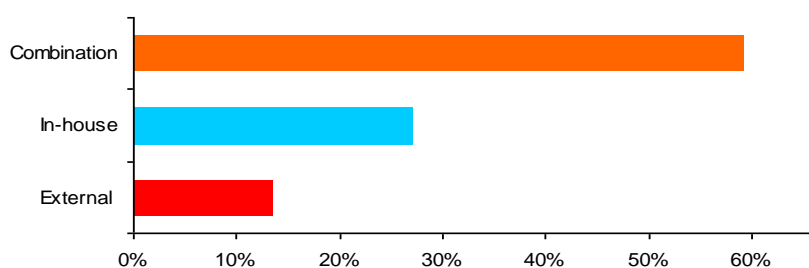
Within the above focus both internal and external research is expected to deliver the investment ideas, opportunities and strategies that drive performance, as well as provide the supporting data and context that frames and supports the in-house debate.

For external research there is also the necessity to be reactive to a wealth manager’s internal ideas and needs. That is not necessarily an easy role to play and the wealth sector often defaults to using free sell-side resources, as this is best placed, they believe, to cover all their requirements.

However, in an increasingly competitive environment, the sell-side, a key supporter of the research process today and historically, is increasingly questioned for its bias. Indeed, the market recognises that employing traditional research routes bolstered by sell-providers may actually limit their competitiveness. New and insightful sources are required. Indeed, the sell-side is now often criticised for delivering dull, uninspiring and repetitive research lacking in insight.

That said the role of the sell-side is well established and often defended. Indeed, thus far its role in the research process is well established. Of the approximately 70% of this sample that use external sources, the clear majority use the sell-side.

Figure 2: Best practice combination approach to sourcing research



Source: Scorpio Partnership

The combination of in-house and external research is the dominant model in driving the investment management research process. Working exclusively through an in-house process is now more marginal and continues to diminish in the face of market pressures.

The reliance on a combination of internal and external sources is a clear sign that the market has moved from an “in-house is best” world view. This shift has come with the realisation that internal research teams are unable to cover the entire research waterfront necessary today.

However, while the role of external providers has been established as key, across each market the providers are almost always the freely available sell-side resources and the macro and data providers. Independent research providers, away from the macro and data firms, lack market penetration despite market interest.

The subsequent use of external providers is limited to a supporting role in the clear majority of instances. That reflects the fact that the market is using the free sell-side providers and the macro and data providers. None of the former has any real interest in building a deeper relationship in the wealth management market.

Interestingly the recent downturn has opened the market up for a new breed of support, even partnership. There is a clearly expressed interest in a deeper discussion on the route forward for research and what can be done. That has been most actively expressed in Germany where above 20% of the German sample (30 firms), due to specific market pressures, have moved to a model that operates fully on external, or outsourced, sources. That trend has most impacted at the level of local and regional specialist private banks.

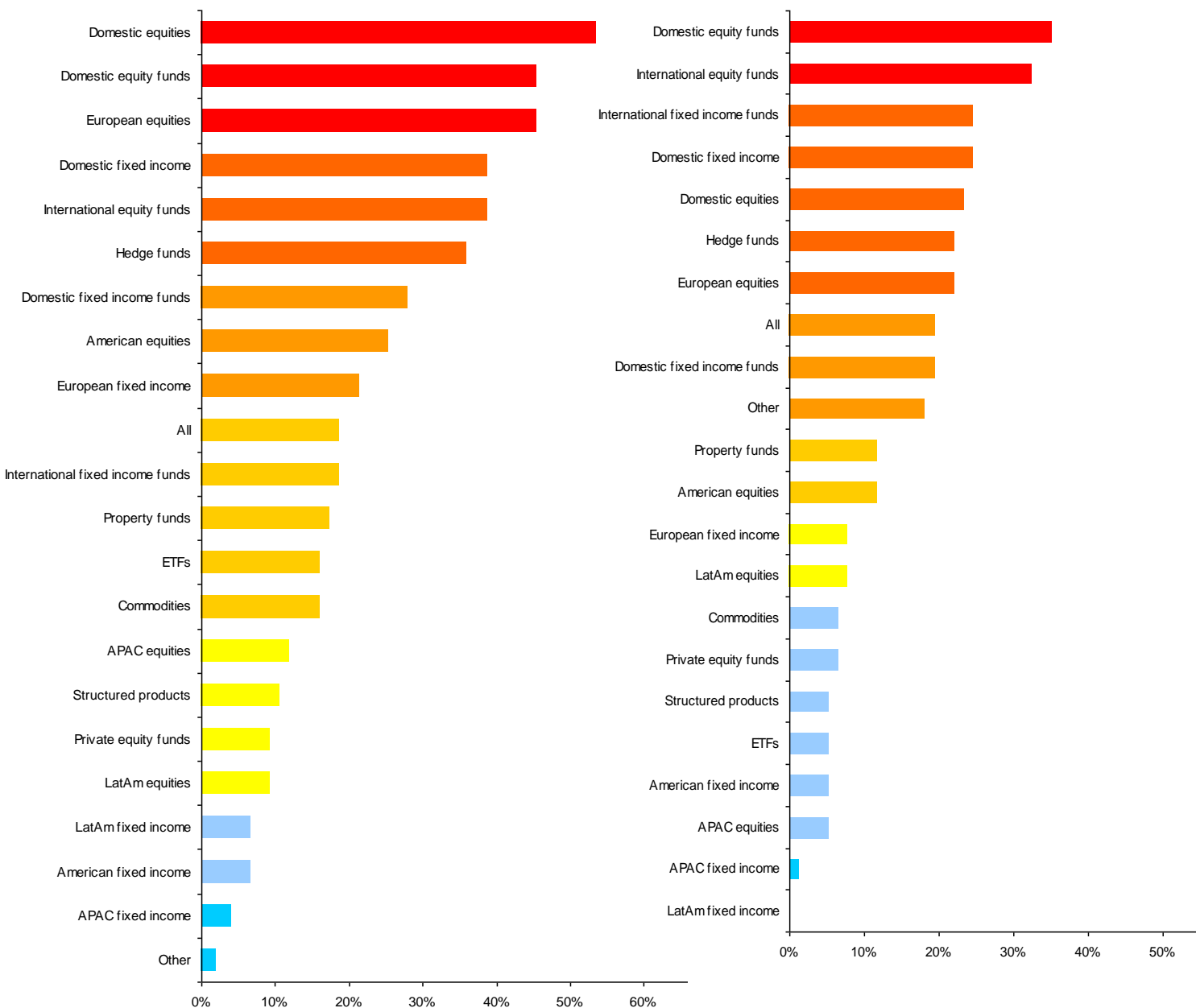
THE FOCUS OF RESEARCH – TRADITIONAL MARKETS AND ASSET CLASSES

Hedge funds aside wealth managers focus their research on the traditional asset classes and markets both through their in-house teams and the research that is sourced externally. The market has however reached a point where its current and future needs outweigh its internal research capacities, and the insights and depth of coverage delivered by its traditional research resources.

Figure 3: The focus of in-house and external research

IN-HOUSE

EXTERNAL



Source: Scorpio Partnership

The top areas for coverage for both in-house and external are equity and fixed income by asset class and domestic, European, North American and international by geography. For each market these are the foundations of their portfolios and, given the domestic orientation of the client bases in the UK and Germany, are particularly evident in those markets.

Indeed, it is in those markets where firms feel the pressure to be most skilled, particularly the domestic space, with the goal of branding and differentiation. That is certainly true for the UK and Germany where a skill in researching and understanding the domestic market is seen as key to matching the expectation of the client base.

Interestingly, there is a high level of mirroring in the top areas of focus for the in-house and external research. This underlines the extent to which the in-house teams are using external research to support the in-house process rather than cover something completely different. With that they are best able to deliver the investment idea generation, validation and review of a sector/asset class/geography/theme that is required.

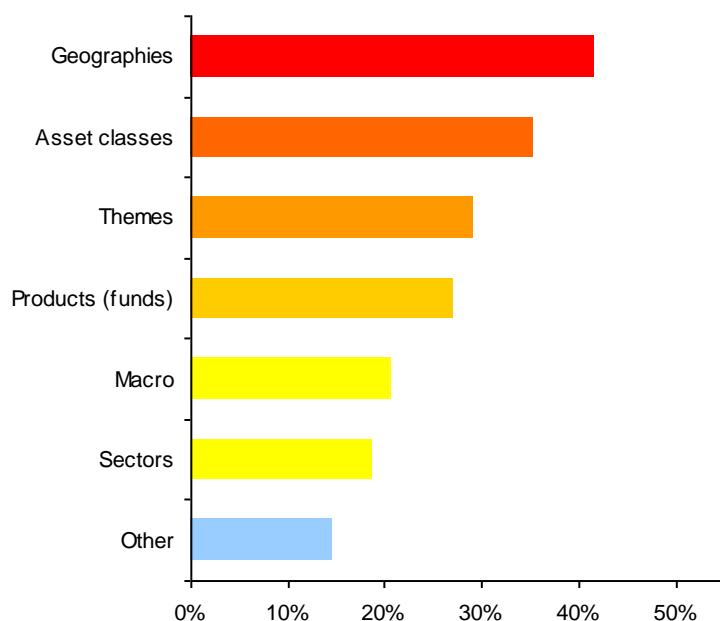
While there were some instances of external research providers being used to fill the gaps in the in-house capability the majority were found to duplicate coverage. This research, with the exception of fund and macro data, largely tends to emanate from the sell side providers or alternatively from the parent group. The willingness to incorporate research often viewed as biased into an in-house research process is somewhat troubling.

The positioning of hedge funds in the chart is testament to the extent to which that alternative asset class has become a key part of private client portfolios. That strength is a feature in both the UK and Switzerland where coverage, in-house and externally, is high. Interestingly, while the market often suggests that this speciality area is covered in-house research, the truth is that few wealth managers have the skills or capability in-house to conduct the necessary extensive research and due diligence on hedge funds. Accordingly, the majority of wealth managers are consumers of the research being generated by specialist research providers.

BUT WIDE AREAS OF RESEARCH WEAKNESSES

Despite the mirroring, or because of it, wide gaps or weaknesses figure in the market's approach to research. In fact, almost 60% of respondents believe they have wider needs than they are currently unable to cover. Critically these gaps cannot be covered in-house and, so far, have not been patched up well enough by other sources.

Figure 4: Areas identified as a weakness



Source: Scorpio Partnership

The top need, geographies, is a concern for the Swiss and German markets. It received no recognition in the UK, a market happy in accessing more distant geographies via funds. For the Swiss, advisors to a highly international client base, access to diverse and changing geographic investment is a continual requirement, but one that research has failed to deliver. The need for support in wider geographies is most keenly expressed by the smaller wealth managers.

The Swiss also point to asset classes. Despite heavy exposure into alternatives the greatest focus is placed on traditional asset classes of equity and particularly fixed income. Indeed, the extent to which the market focused on more aggressive asset classes during the five-year plus bull market appears to have killed off or severely diminished the internal skills set for traditional asset classes with fixed income suffering most.

“Bonds are a challenging area for the bank because they require specific research skills.”

The German market focuses first on weaknesses geographically. With a traditional focus on the domestic market followed by a selective focus on the top stocks in Europe and the US primarily, international coverage beyond that has been weak and, from an internal capability perspective, is likely to remain so. Therefore, in a market where participants feel research is too often regurgitated from house to house, there is a clear opportunity for a provider to deliver wider geographic research beyond the traditional markets; if it can deliver the “gut feelings” and “courageousness” that the market is seeking.

For the UK concern focuses on a need for greater levels of macro and theme based research.

“We definitely need more macro research. There is plenty of single equity research out there, of which the majority is not very good and adds little value, but not enough proper macro research that takes into account thematic issues that will affect a particular sector or stock in the long term.”

Again, within that the wealth management market also referenced the weakness of the research providers in delivering the qualitative context it requires. For instance, too often research providers fail to offer the direction necessary on the execution of a particular viewpoint. In that sense, what is provided only adds to the research requirements of the market. A route to execute then needs to be established.

“Sometimes a research firm will express a qualitative opinion in a vacuum. This is just as bad as just dumping a lot of quantitative data on us. We would like to receive some direction on how to execute the qualitative view.”

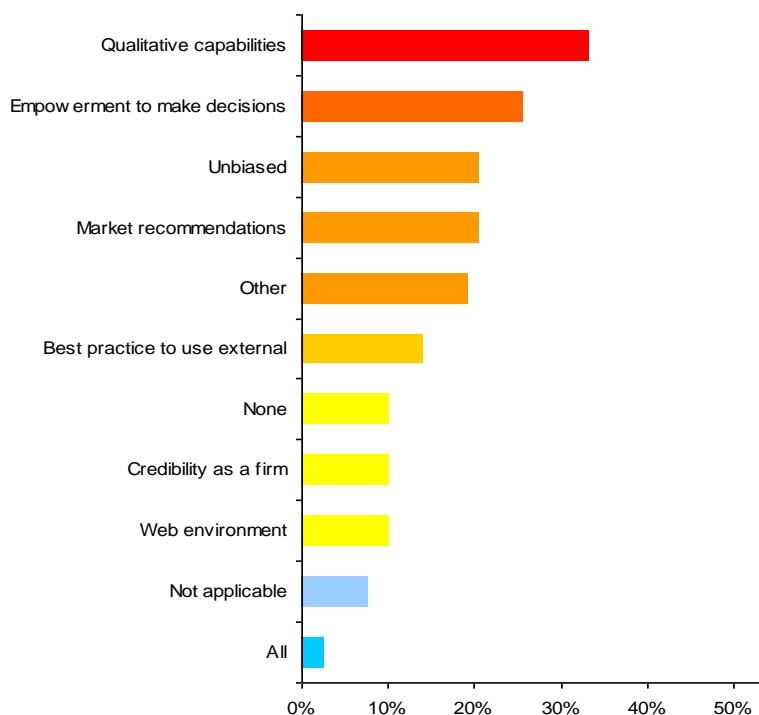
“We are interested in hearing views on asset allocation but no one seems willing to offer up anything. This is because of the way that the industry is structured and as an analyst offering an opinion you better be right about the call or you can kiss your career goodbye. That is why no one is being original – there is safety in the herd.”

The UK also identified asset classes with a focus towards opaque asset classes such as hedge funds which have grown significantly in their exposure in private client portfolios but which have also witnessed a marked decline in investor confidence recently. The market struggles to deliver the necessary understanding on their holdings, risk profiles and counter party risks. ETFs were also identified as having risen in prominence as a low cost product that has yet to be fully incorporated into portfolios.

STRONG VALUES IN EXTERNAL RESEARCH BUT WEAK DELIVERY

The role of external research in the market is central and wealth managers identify several areas where external providers add value. Interestingly, in each there are weaknesses in how the market is currently served. As such, these are areas for independent research providers to take the lead.

Figure 5: The value today of external research providers



Source: Scorpio Partnership

The top quality, qualitative capabilities, is cited in the UK and Germany, and reflects a need not delivered upon by the dominant sell-side model. While market participants have access to highly valued quantitative data and macro providers, the same level of quality is not existent among providers delivering qualitative research, particularly that delivered within a private client context.

“A lot of the time the research is clearly not written for a private client. Particularly single equity research which tends to drill down into the details and then bang on for about ten pages about the P/L. How is this useful for an end client? Research providers need to realise that private clients need to be told an investment story and not given a large set of data.”

Indeed, respondents were pointed in referencing the need (and therefore opportunity) for an external provider to deliver independent, high quality and insightful research, framed within a qualitative framework. The combination with strong data feeds could be a winning combination.

“Qualitative capabilities aid us in our relationship with the client as it helps us tell the investment story and fit it in with the broader investment strategy. In essence we can say to clients, ‘this is what is happening in the markets and this is how we intend to take advantage of it’.”

“Independence of thought will continue to be the biggest selling point as well as the ability to tell an investment story as opposed to getting bogged down in facts.”

For the Swiss the top value is giving them the empowerment to make decisions. This again references the market’s desire for research to aid the generation and validation of investment ideas.

However, it is another area where the unimaginative and biased sell-side approach is not delivering on market need or expectation. The market's empowerment would be heightened by greater independent, high quality and insightful research.

Framing this, the Swiss and Germans also pointed to the unbiased nature of independent research providers. Part of this is to do with concerns about demonstrating best practice to clients. It also refers directly to the business model of the sell-side and particularly the large investment banks, dominant in each of the three markets. Wealth managers have indicated a growing frustration with the quality of research emanating from these sources and have begun to recognise that the bias within the model does not necessarily operate in their best interests.

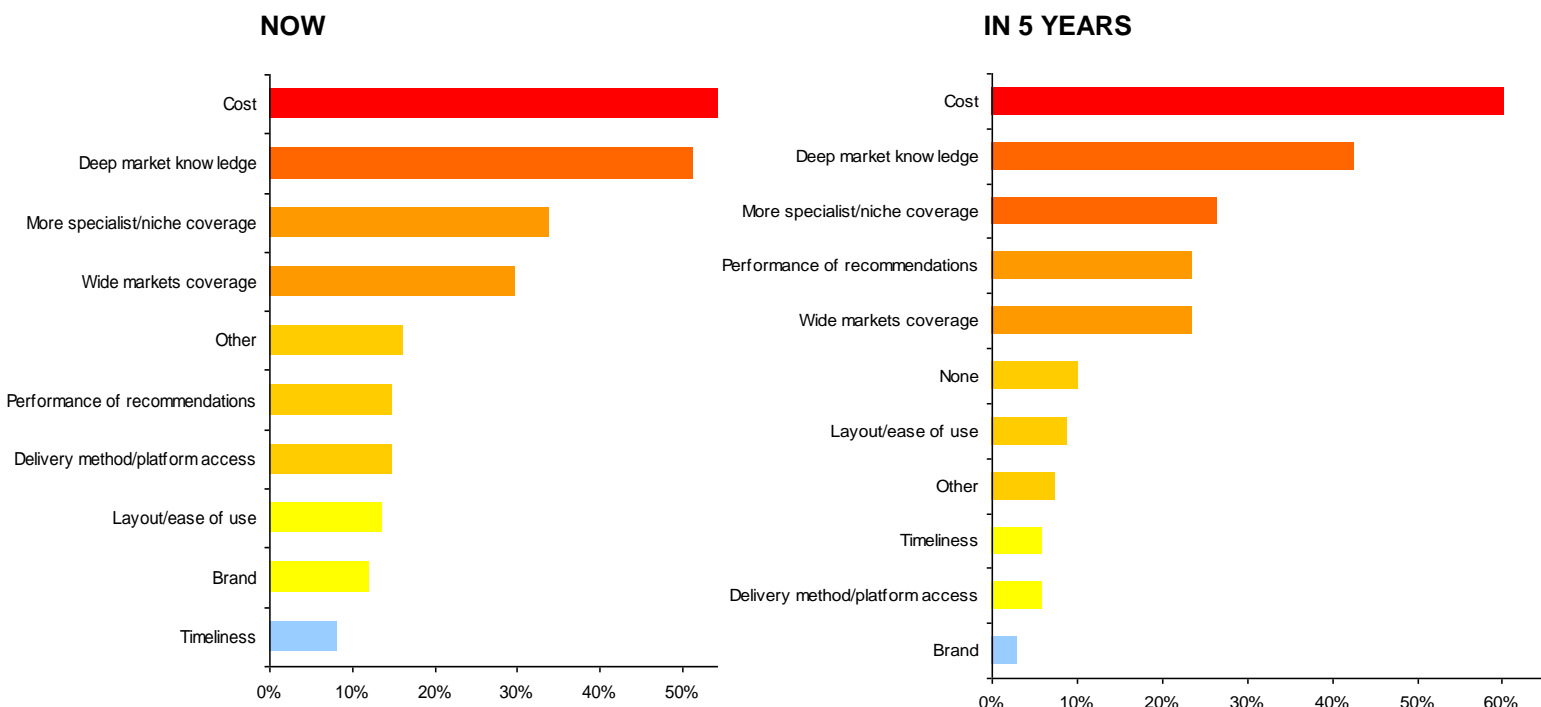
“So far we have worked almost exclusively with research provided by the investment banks or other large institutions. However, the recent turbulence in the markets has made us think more on the bias and conflict of interest.”

Finally, there is a value placed in the ability of external research to make recommendations. Again, however, there is frustration that current resources are not meeting that need. There is discontent that much of research flow is undifferentiated and lacking in opportunity and insight or, more simply, market recommendations and direction on execution.

COSTS SIT ATOP DECISION MAKING FACTORS, BUT CAN BE TOPPLED

The markets cite cost, both now and looking forward, as their principal selection factor when choosing – and buying – an external research provider. This is particularly true for Germany and Switzerland. The UK, however, is today focused on a provider's deep market knowledge and ability to deliver more specialist/niche coverage. In the future, perhaps driven by today's economic pressure, the market also cites cost as becoming the lead factor alongside deep market knowledge.

Figure 6: The principal factors for choosing a research provider – now and in 5 years



Source: Scorpio Partnership

To some extent, however, the role of cost, albeit emphasised here, becomes (more) marginal once a provider has established itself as a necessity and able to fill at least one, and preferably more, of the other selection factors. Key here is the market's willingness, indeed insistence, to pay for the data and macro providers and their subsequent high level of market penetration.

"There needs to be a value add in the way that the research firm will go the extra mile to cover specific areas or unearth new investment ideas."

"If I wanted more of the same why would I pay? I buy challenging views that make me think - even if I don't use it all the time."

Indeed, while cost may rise in the future decision making process, note that the importance of other factors does not seriously diminish. Deep market knowledge, more specialist/niche coverage and wide markets coverage remain strong factors. Indeed, the market will pay for this level of insight as it is not deemed commoditised.

Interestingly, having been burnt by performance in the recent crisis, performance of recommendations grows in importance. That is particularly relevant for independent research firm since the sell-side's motivations for recommendations are now under far greater scrutiny.

Further, the German market example highlights how cost plays a key role, but when put on the opposite scale to a desire for deeper and wider coverage its importance subsides.

There are specific reasons in each market to believe that the role of independent research providers will grow and, while the market will not tolerate disproportionate costs, the contradictions evident in the current proposition can be more widely exposed, understood and exploited. The German market, in particular, has likely arrived at that stage, and with a largely underdeveloped market for paid-for-research, there is opportunity to win market share. Wealth managers are certainly calling out for help. The UK, on the hand, while seeing some of the problem exposed needs to better understand how the independent research market can deliver support.

The preponderance of freely available sell-side research, while impacting on the cost argument, has also pushed the market to maintain weak rather than deep relationships with most research providers apart from those defined as "key". Wealth managers go where they believe they can get an answer or an opinion for free, rather than seeking out a trusted source, in many instances. The independent research community need to counter this tendency in the current environment and looking forward.

Interestingly, despite key factors playing a role in the selection of third-party research providers, each market often demonstrates an ad-hoc and unstructured approach to its selection of third party research providers. This reflects the reliance on the sell-side and is also driven by a current and specific research need. It is also often directed by who knows who. In this environment the market also demonstrates a reluctance to be tied to any one provider unless, of course, that provider offers a specialist service.

RESEARCH OVERVIEW

During May, June and July 2009 Scorpio Partnership was engaged by Standard & Poor's to undertake an assessment of the role of investment research within the wealth management market across Europe. To fulfil this mandate Scorpio Partnership took expert insight from decision making personnel at 83 of the leading wealth management firms across the three largest and most developed markets – Germany, Switzerland and the United Kingdom.

The research focused on a range of business models active in the sector - universal banks, retail global private banks, regional private banks, local private banks, multi-family offices and investment managers/IFAs/platforms – serving a domestic and offshore private client base. Client wealth levels ranged from the mass affluent through to high-net-worth (HNW) and ultra-high-net-worth (UHNW).

The typical titles of those who took part in the research were Chief Executive Officer, Partner, Chief Investment Officer, Head of Research, Director – Investment Management, and Head of Fund Research. Interviews lasted for one hour on average with the vast majority conducted in person.

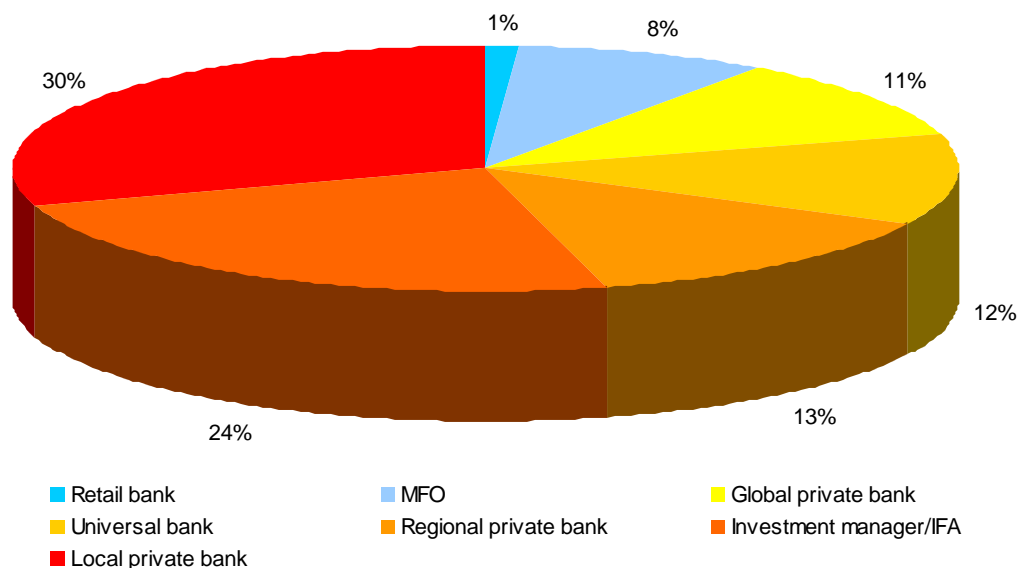
Due to the sample size and interview methodology the charts in this report are only intended to be illustrative of general findings. Not all interviewees responded to each question and because responses were unprompted interviewees may have given multiple responses to each question.

PARTICIPANT PROFILE

As revealed the Scorpio Partnership team engaged with 83 firms, all of which are significant players within the wealth management market either across all its levels or within specific segments. To better gauge the market temperature, respondents to this process have been broken into seven categories. By type, these are:

- Local private bank
- Regional private bank
- Global private bank
- Retail bank
- Universal bank
- Multi-family office
- Other

Figure 7: Respondents by business model across the three markets



Source: Scorpio Partnership

ABOUT STANDARD & POOR'S

Dedicated to providing global clients with timely, objective and actionable investment intelligence, **Standard & Poor's** delivers a broad range of research, analysis, news and commentary as well as strategies and advice which enable clients to navigate and seek success in even the most complex global markets.

For over 50 years, Standard & Poor's have provided actionable, multi-asset class research, analysis, strategies and services to Wealth Managers, Advisors and Asset Managers, as well as Institutional Investors and the clients they serve.

An international team of equity analysts enables Standard & Poor's to respond to wealth management clients' ever-changing needs with customized, relevant research solutions. Ranging from **customized equity coverage** for wealth managers and their clients to **access to equity analysts**, S&P's equity research solutions are one facet of a larger global franchise including:

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At the core of its ability to serve Wealth and Asset Managers, Standard & Poor's investment research offers both breadth and depth in its quantitative coverage of 8,200 stocks and qualitative coverage of almost 2,000 companies. In the fund space, quantitative U.S. coverage extends to over 21,000 funds, while close to 2,000 global funds are given qualitative ratings by teams of analysts.

Starting in 2008, Standard & Poor's began coverage of ETFs, and currently ranks close to 500 such funds. Standard & Poor's currently provides fixed income research coverage on *MarketScope Advisor* with intra-day data, commentary and ratings actions on over 45,000 Issuers and 200,000 Issues. Rounding out the core offering, Standard & Poor's provides coverage on over 18,000 variable annuities and supports financial professionals with Options coverage, based on 1,200 U.S. Stocks and ADRs.

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ABOUT SCORPIO PARTNERSHIP

Scorpio Partnership is a strategy consultancy to the wealth management industry, based in London. The firm has conducted more than 300 global assignments across the wealth spectrum for over 120 institutions in private banking, fund management, family offices, technology and resource management, as well as for related service providers to the wealth management industry.

Scorpio Partnership specialises in interview-based insight gathered from financial industries connected to global wealth. The firm does this with HNW individuals directly and wealth management industry professionals to support strategic assessments and future initiatives for clients. This long term pulse testing, refined over 10 years' expertise, forms the foundation for strategic recommendations to clients.

Scorpio Partnership has interviewed over 6,000 HNW and UHNW global consumers of wealth management services and more than 12,000 wealth management staff and intermediaries. In 2008*, Scorpio Partnership was voted the best global consultancy to the wealth management industry for the third consecutive year, ahead of the top three global management consulting firms. The firm is independent and owned by management.

*WealthBriefing, 2006 – 2008

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