



Financial market institutions

4. Asset Management Firms



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Introduction

- Asset management is the service of professionally investing money
- The largest segment of the asset management in the United States is made up of registered investment companies.
- These companies managed \$18.2 trillion in assets at year-end 2014, largely on behalf of more than 90 million U.S. retail investors.
- The industry has experienced strong growth over the past quarter century from asset appreciation and strong demand from households due to rising household wealth, evolution of employer-based retirement systems, and endowed assets, etc.



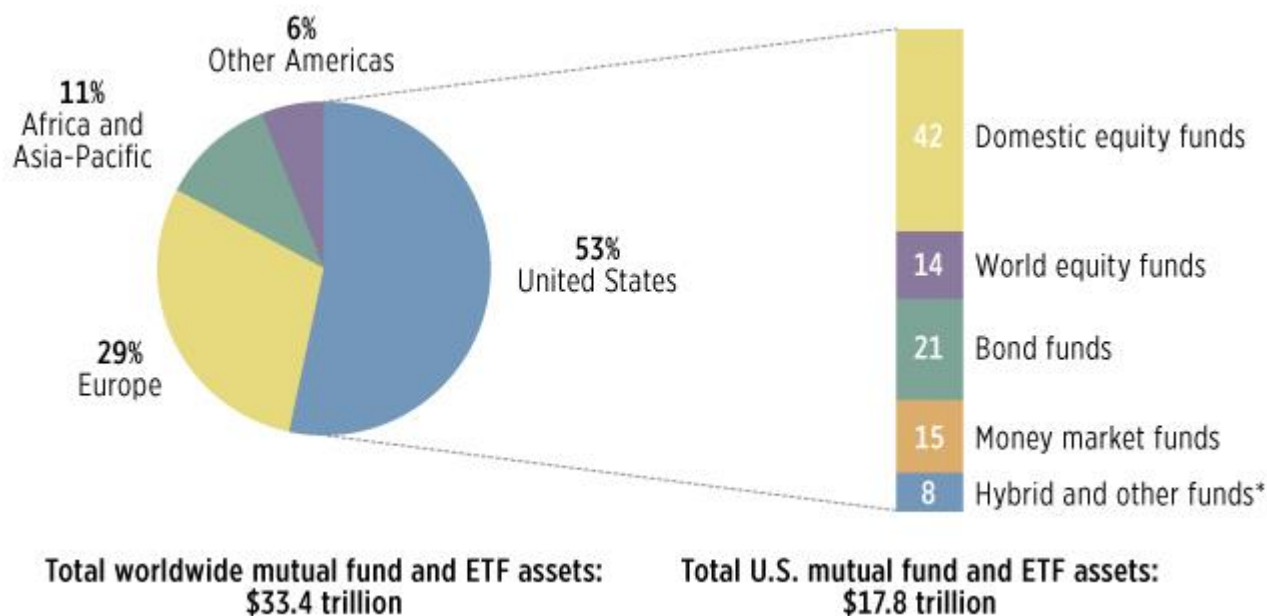
Top Five Investment Management Firms

Source: CNBC, September 2015

Rank	Primary Business Name	Total AUM (\$ bill)
1	Vanguard Group Inc.	\$3,006.42
2	Pacific Investment Management Co, LLC.	\$1,680.39
3	Capital Research and Management Co.	\$1,366.31
4	JP. Morgan Asset Management	\$1,149.34
5	FMR Co, Inc.	\$918.63



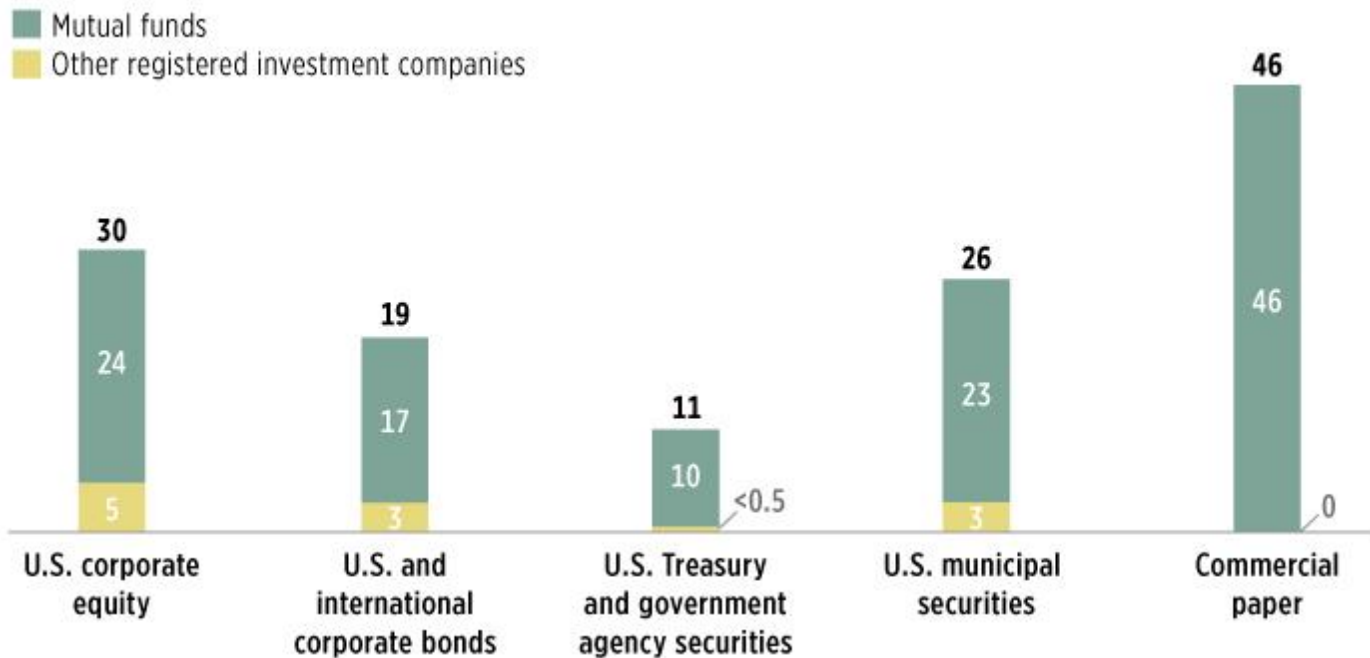
World Largest Mutual Fund and ETF market in the USA





Investment World of Investment Companies

Source: ICI





Who are the Investors?



"To begin with, you'll need assets."



Institutional Investors

- Pension Funds
 - Defined-Benefit Plans
 - Defined-Contribution Plans
 - Hybrid and other Plans
- Foundations and Endowments
 - Foundations
 - Endowments
- The Insurance Industry
 - Life Insurance Companies
 - Non-Life Insurance Companies
- Banks and other Institutional Investors



Portfolio Management as a Process





Portfolio Management as a Process

- Portfolio management is an integrated set of steps undertaken in a consistent manner to create and maintain appropriate combination of investment assets.
 - Planning Step
 - Investor's Objectives and Constraints
 - Investment Policy Statement (IPS)
 - Forming Capital Market Expectations
 - Creating Strategic Asset Allocation
 - Execution Step
 - Portfolio Construction and Revision
 - Portfolio Optimization
 - Tactical Asset Allocation
 - The Feedback Step
 - Monitoring and Rebalancing
 - Performance Evaluation



Investment Objectives

- Risk Objective largely determines return objective
 - How to measure risk?
 - Absolute vs Relative
 - Downside Risk: Value at Risk (VaR)
 - What is the investor's willingness to take risk? Institutional vs. Individual
 - Investor's ability to take risk?
- Return Objectives
 - How is Return Measured? Total/Nominal/Real
 - Stated Return Desire
 - Required Return



Investment Constraints

- Liquidity
- Time Horizon
- Tax Concerns
- Legal and Regulatory Factors
- Unique Circumstances



Defined-Benefit (DB Plan)

- Plan sponsor is obligated in terms of the benefits to plan participants.
 - Promise made by a plan sponsor generates a future financial liability or “pension liability”.
- Return Objective
 - To achieve returns that adequately fund pension liabilities
 - Overhang of trillion dollars liabilities
- Risk:
 - DB plans payout of the pension assets, which are invested in the market.
 - Market Risk
 - Longevity Risk
 - Liquidity Risk
 - Funding status – under-funded/over-funded
 - Overall low risk tolerance



Defined-Contribution (DC Plan)

- Plan sponsor is obligated in terms of contribution to pension fund rather than benefits to plan participants.
 - Promise for DC Plan is for the current stage – there is no future financial liability.
 - DC Plan sponsor bears the legal risk of investing
 - DC plans are portable



Foundations

- Usually grant making institutions funded by gifts and investment assets – usually created by single donor to fund philanthropic goals.
- Investment portfolio provides the dominant source of revenue
- Purchasing power of its corpus is either maintained or not.
- US tax laws essentially mandate minimum level of annual spending.
- Foundations can vary widely in their investment goals and time horizon.
- Foundations, generally, don't fundraise or reach out to donors.
- Risk & Return Objectives:
 - Foundations can have higher risk tolerance
 - Most Foundations want to preserve corpus and target returns accordingly



Endowments

- Long-term funds (inter-generational) generally owned by non-profit institutions like universities, hospitals, museums etc.
- Preserve purchasing power of the principal gift and to use fraction of returns as spending for designated cause.
- Risk & Return Objectives:
 - Return objective is to provide significant, stable, and sustainable flow of funds to support designated programs.
 - Risk is related to spending policy; Averaging rules dampen short term volatility while striving for long term target returns.
 - Risk tolerance depends on the endowment's role in operating budget.

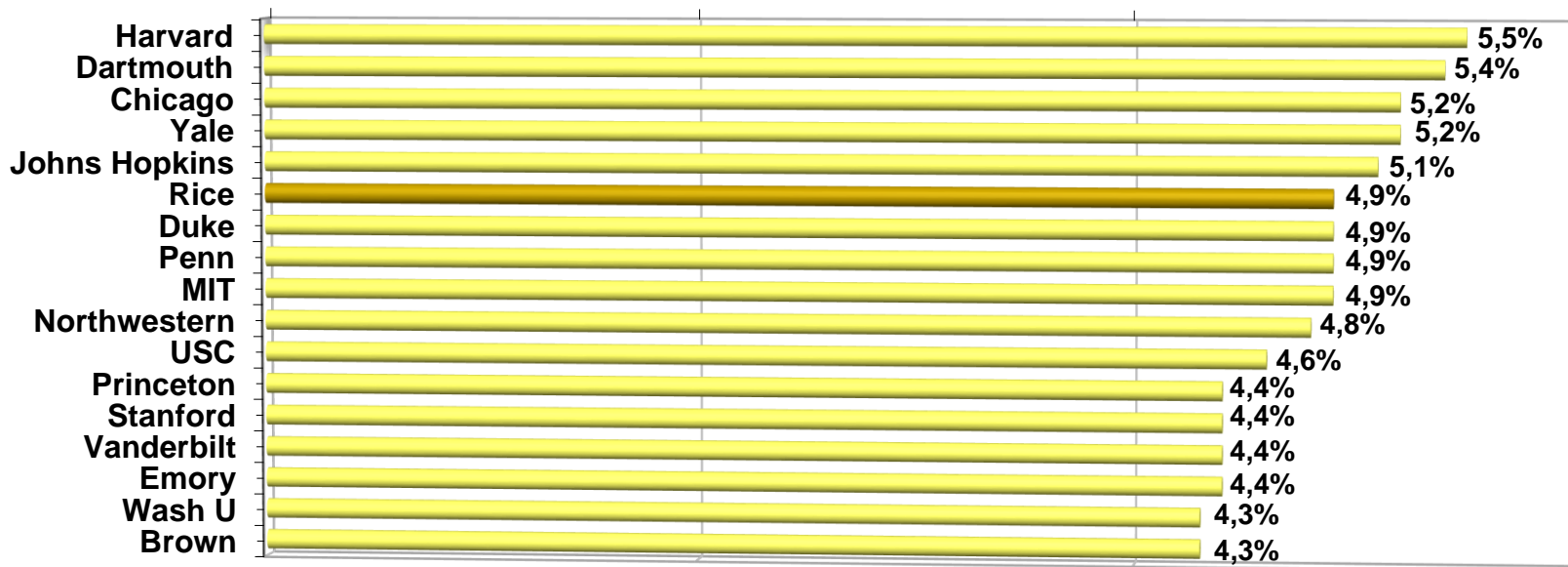


Private Universities Ranked by June 30, 2012 Endowment Market Value

		\$Billions
1	Harvard	30.4
2	Yale	19.3
3	Stanford	17.0
4	Princeton	17.0
5	MIT	10.1
6	Columbia	7.7
7	Northwestern	7.1
8	Pennsylvania	6.8
9	Chicago	6.6
10	Notre Dame	6.3



Fy12 Endowment Spending as a % of the Market Value





Risk Management as Process

- Risk management is a process involving:
 - Identifying Risk factors
 - Quantification of exposure to risk
 - Map various risks in to risk estimation calculation
 - Identify overall risk exposure
 - Continuous measurement of exposure
 - Adjustment to exposure according to agreed risk exposure limits
 - Alteration based on new information



Portfolio Risk Universe

Systematic Risk: Influences large number of assets, difficult to diversify

Unsystematic risk: Influences small number of assets, manageable

Credit and Default Risk: Associated with Bonds and Stocks

Geo-political Risk: Related to policies and internal situation of a region or country

Foreign Exchange Risk: due to financial policies of various countries

Interest Rate Risk: Related to Fed policy

Market Risk: Related to market volatility

Headline Risk: Avoid Bad Publicity



Asset Class

Traditional	Alternative
Stocks	Hedge Funds
Bonds	Private Equity
REITS	Private Real Estate
Commodities	Natural Resources



Asset Class Characteristics

Asset Class/Strategy	Risk	Characteristics
Public Equity	Market beta/high Volatility	High return/Growth
Private Equity	Illiquid/high Volatility	Higher return/Growth
Real Estate (REITS)	Market beta/high Volatility	High return/Growth/Inflation Protection
Real Estate (Private)	Illiquid/regional/Volatile	High return/Inflation protection
Bonds	Low Volatility	Low return/Risk minimizing
TIPS	Low Volatility	Low return/Inflation protection
Natural Resources/Real Assets	Illiquid	High Return/Inflation protection



Portfolio Construction: Risk Reward Trade-off

- Rational portfolio choices based on the efficient risk (Modern Portfolio Theory).
- Capital Markets Expectations
- Asset class and strategy diversification
- Use of quantitative methods in portfolio management
- Risk budgeting

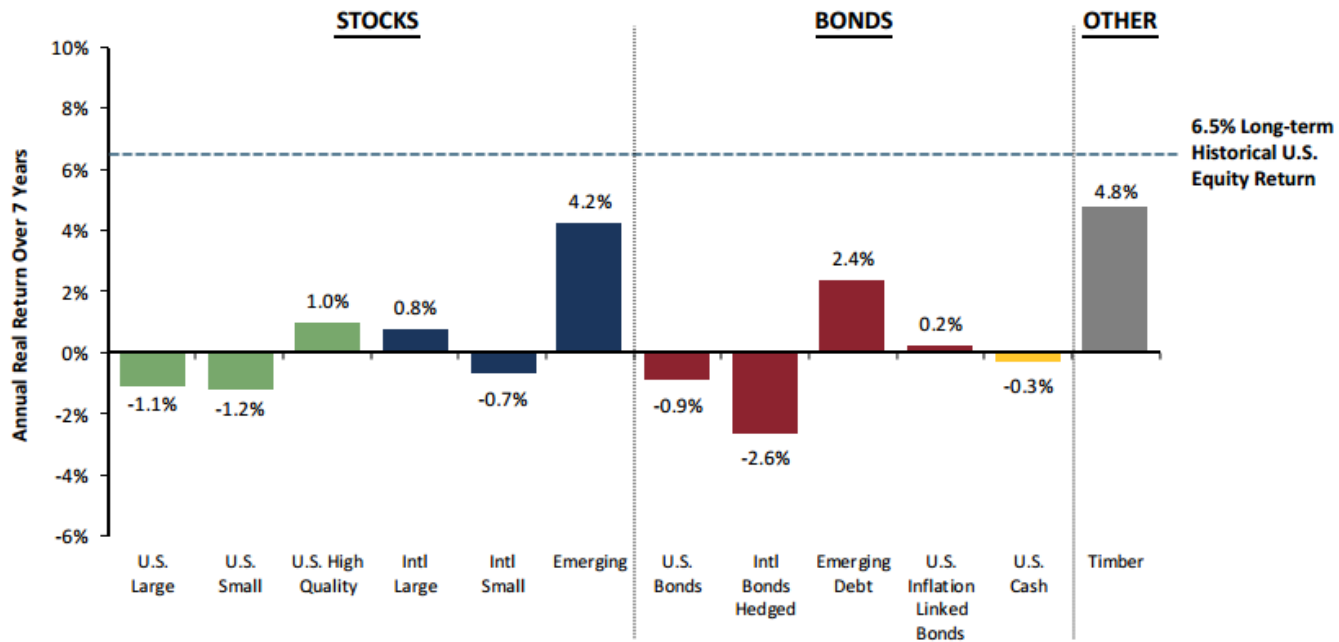
20-years Asset-Class Returns

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Best	Lg Cap Value 38.4%	Lg Cap Growth 23.1%	Lg Cap Value 35.2%	Lg Cap Growth 38.7%	Lg Cap Growth 33.2%	Fixed Income 11.6%	Fixed Income 8.4%	Fixed Income 10.3%	Sm Cap 47.3%	Int'l 20.3%	Int'l 13.5%	Int'l 26.3%	Lg Cap Growth 11.8%	Fixed Income 5.2%	Lg Cap Growth 37.2%	Sm Cap 26.9%	Fixed Income 7.8%	Lg Cap Value 17.5%	Sm Cap 38.8%	Lg Cap Core 13.7%
	Lg Cap Core 37.6%	Lg Cap Core 23.0%	Lg Cap Core 33.4%	Lg Cap Core 28.6%	Int'l 27.0%	Lg Cap Value 7.0%	Cash 4.4%	Cash 1.8%	Int'l 38.6%	Sm Cap 18.3%	Lg Cap Value 7.1%	Lg Cap Value 22.3%	Int'l 11.2%	Cash 2.1%	Int'l 31.8%	Lg Cap Growth 16.7%	Lg Cap Growth 2.6%	Int'l 17.3%	Lg Cap Growth 33.5%	Lg Cap Value 13.5%
	Lg Cap Growth 37.2%	Lg Cap Value 21.6%	Lg Cap Growth 30.5%	Int'l 20.0%	Sm Cap 21.3%	Cash 6.2%	Sm Cap 2.5%	Div Portfolio -9.8%	Lg Cap Value 30.0%	Lg Cap Value 16.5%	Div Portfolio 5.4%	Sm Cap 18.4%	Fixed Income 7.0%	Div Portfolio -22.8%	Sm Cap 27.2%	Lg Cap Value 15.5%	Lg Cap Core 2.1%	Sm Cap 16.4%	Lg Cap Value 32.5%	Lg Cap Growth 13.1%
	Sm Cap 28.5%	Sm Cap 16.5%	Sm Cap 22.4%	Div Portfolio 17.0%	Lg Cap Core 21.0%	Div Portfolio -1.1%	Div Portfolio -4.8%	Lg Cap Value -15.5%	Lg Cap Growth 29.8%	Lg Cap Core 10.9%	Lg Cap Growth 5.3%	Lg Cap Core 15.8%	Div Portfolio 6.0%	Sm Cap -33.8%	Lg Cap Core 26.5%	Lg Cap Core 15.1%	Div Portfolio 1.8%	Lg Cap Core 16.0%	Lg Cap Core 32.4%	Div Portfolio 8.1%
	Div Portfolio 27.4%	Div Portfolio 13.6%	Div Portfolio 20.6%	Lg Cap Value 15.6%	Div Portfolio 13.6%	Sm Cap -3.0%	Lg Cap Value -5.6%	Int'l -15.9%	Lg Cap Core 28.7%	Div Portfolio 10.5%	Lg Cap Core 4.9%	Div Portfolio 13.0%	Lg Cap Core 5.5%	Lg Cap Value -36.9%	Div Portfolio 20.8%	Div Portfolio 13.0%	Lg Cap Value 0.4%	Lg Cap Growth 15.3%	Int'l 22.8%	Fixed Income 6.0%
	Fixed Income 18.5%	Int'l 6.1%	Fixed Income 9.7%	Fixed Income 8.7%	Lg Cap Value 7.4%	Lg Cap Core -9.1%	Lg Cap Core -11.9%	Sm Cap -20.5%	Div Portfolio 23.5%	Lg Cap Growth 6.3%	Sm Cap 4.6%	Lg Cap Growth 9.1%	Cash 5.0%	Lg Cap Core -37.0%	Lg Cap Value 19.7%	Int'l 7.8%	Cash 0.1%	Div Portfolio 12.2%	Div Portfolio 20.3%	Sm Cap 4.9%
	Int'l 11.2%	Cash 5.3%	Cash 5.3%	Cash 5.2%	Cash 4.9%	Int'l -14.2%	Lg Cap Growth -20.4%	Lg Cap Core -22.1%	Fixed Income 4.1%	Fixed Income 4.3%	Cash 3.1%	Cash 4.9%	Lg Cap Value -0.2%	Lg Cap Growth -38.4%	Fixed Income 5.9%	Fixed Income 6.5%	Sm Cap -4.2%	Fixed Income 4.2%	Cash 0.1%	Cash 0.0%
Worst	Cash 6.0%	Fixed Income 3.6%	Int'l 1.8%	Sm Cap -2.6%	Fixed Income -0.8%	Lg Cap Growth -22.4%	Int'l -21.4%	Lg Cap Growth -27.9%	Cash 1.2%	Cash 1.3%	Fixed Income 2.4%	Fixed Income 4.3%	Sm Cap -1.6%	Int'l -43.4%	Cash 0.2%	Cash 0.1%	Int'l -12.1%	Cash 0.1%	Fixed Income -2.0%	Int'l -4.9%

Source: Informa Investment Solutions. Past performance is no guarantee of future results. The information provided is for illustrative purposes and is not meant to represent the performance of any particular investment. Assumes reinvestment of all distributions. It is not possible to directly invest in an index. Diversification does not guarantee a profit or protect against loss.



7-Year Asset Class Real Return Forecasts





Endowment Management

Investment Strategy Implementation

- Manager searches
- Manager evaluation
- Investment Portfolio Monitoring
- Portfolio risk management
- Performance measurement
- Performance reporting
- Performance and attribution analyses
- Capital markets monitoring
- Other



Investment Risk Management

360 degree risk management

- ❖ Risk minimization is one of the three objectives
- ❖ Investment decisions are based on better risk adjusted returns and downside risk protection.
- ❖ Investment portfolio is diversified across asset classes, markets, and strategies to mitigate risk.
- ❖ Manager selection is based on stringent quantitative and qualitative due-diligence.
- ❖ Risk reporting is part of the culture



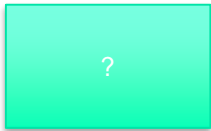
Types of Risks

- Market Risk
- Manager Performance Risk
- Counter-party Risk
- Manager Business Risk
- Concentration Risk
- Style drift Risk
- Fraud Risk



Endowment Investment Return Goal

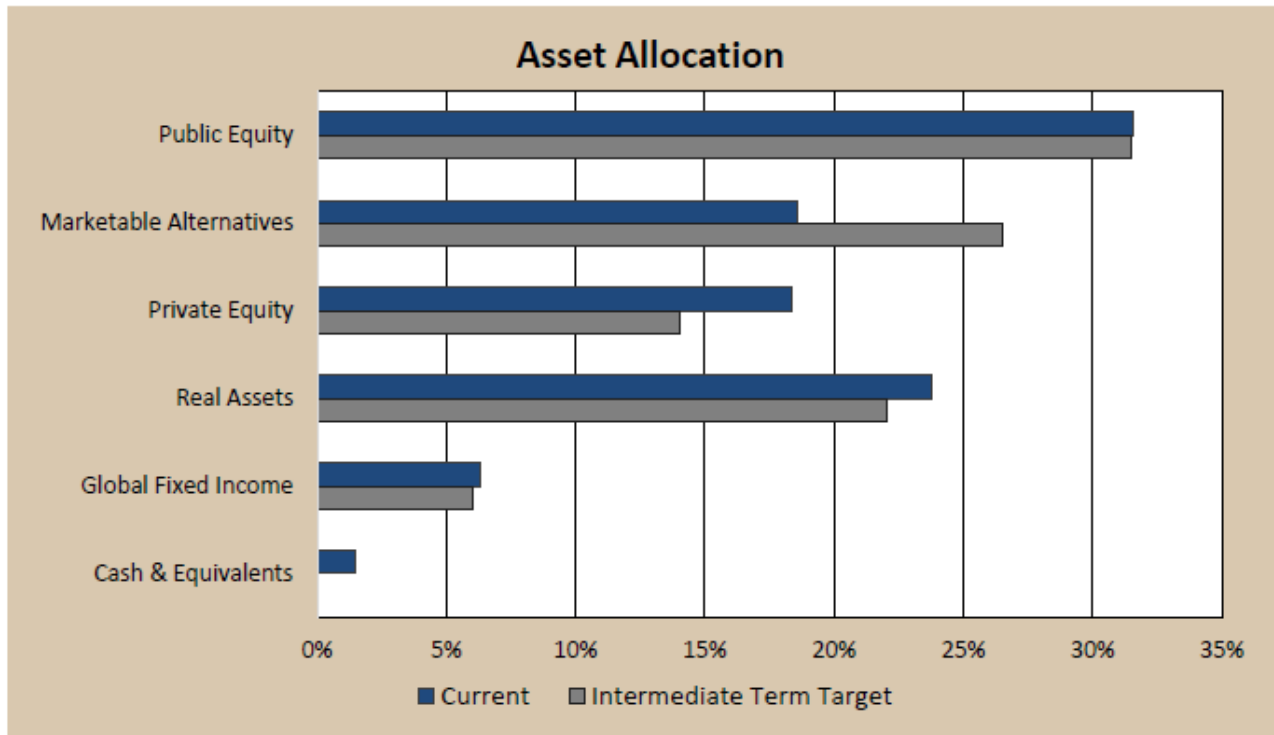
Return – Inflation – Spending – Admin fee >
0



$$- 2.5\% - 4.25\% - 2\% > 0$$

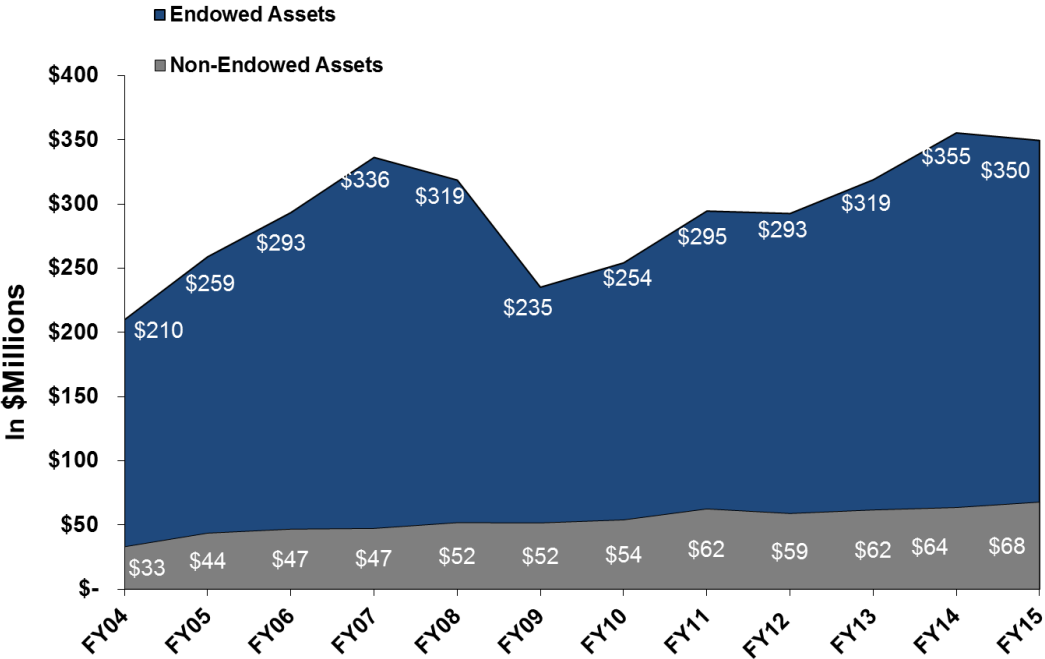


UConn Foundation





Managed Assets

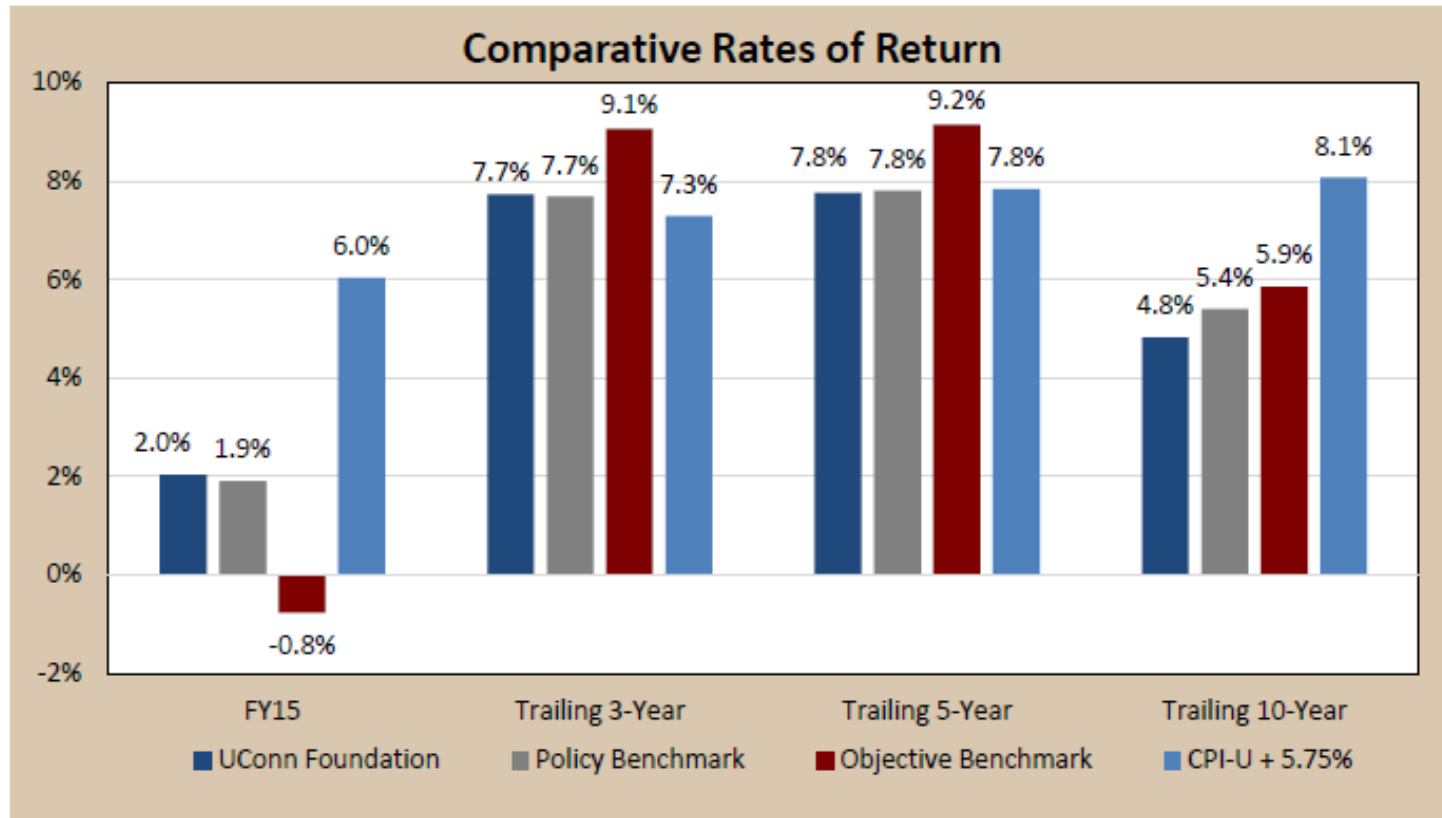




Fiscal Year	Net Return
2007	16.76%
2008	-5.55%
2009	-19.87%
2010	9.04%
2011	15.47%
2012	0.67%
2013	8.52%
2014	12.93%
2015	2.04%
FYTD 2016	2.95%



UConn Foundation



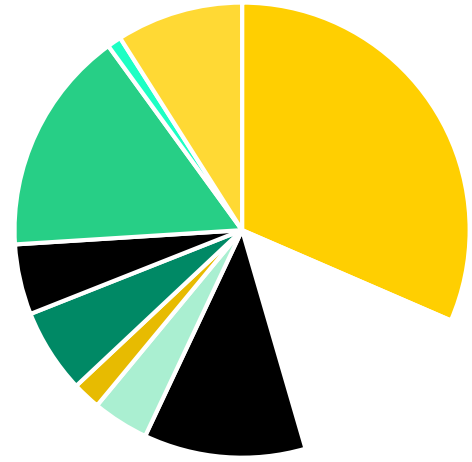


Policy Benchmark Composition

Asset	Benchmark	Weight
Global Equities	MSCI ACWI	31.5%
Private Capital	PE Median TW	14%
Long Short Equities	HFRI Equity Hedge Index	11.5%
Global Macro	HFRI Macro Index	4%
Event Driven	HFRI Event Driven Index	2%
Real Estate	Weighted Public/Private Index	6%
TIPS	TIPS	5%
Natural Resources	Weighted Public/Private Index	16%
Investment Grade	Barclay Aggregate	1%
Relative Value	HFRI Relative Value Index	6%

The Policy Benchmark mirrors the target portfolio allocation. Indexes were chosen by consultants at Wilshire Associates and approved by IC.

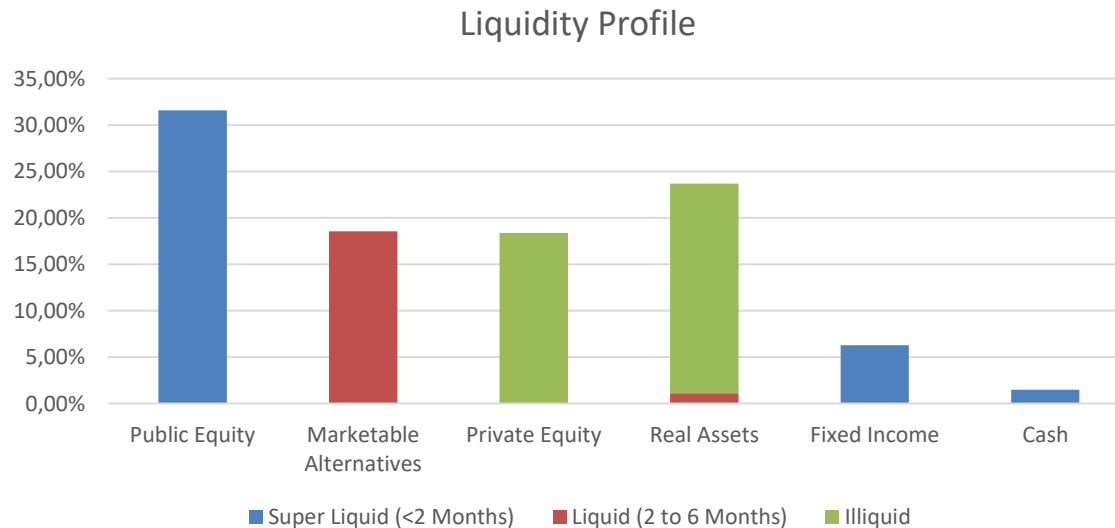
PBM Composition



- ML HY Master II
- PE Median TW
- HFRI Macro Index
- Weighted Public/Private Index
- Barclay Aggregate
- MSCI ACWI
- HFRI Equity Hedge Index
- HFRI Event Driven Index
- Weighted Public/Private Index
- HFRI Relative Value Index



Liquidity



- The portfolio has a meaningful allocation to locked-up investments, to capture an illiquidity premium.
- A large portion of the portfolio is super liquid and the majority of these assets can be liquidated in under three days.



REFERENCE AND SOURCE

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Q & A