Cerulli Quantitative Update

ETFs and Retail Alternative Products and Strategies 2012

CERULLI ASSOCIATES
Global Analytics

Overview

This annual report analyzes alternative investment products which are distributed through the retail distribution channel and ETFs. The report defines the retail alternatives universe and analyzes the strategies and asset classes that comprise this marketplace. Asset managers' product plans, distribution strategies, staffing trends, and other challenges are also closely examined. ETFs are addressed in this report, including sponsors' product plans, and tactics for differentiation, and remaining competitive.

Unique proprietary research elements and analyses include:

- 275 pages and 222 exhibits
- More than 30 executive interviews contribute to the qualitative content
- Retail alternatives market sizing
- Product development and staffing benchmarks
- Advisor alternatives and ETF usage trends
- Two proprietary surveys of asset managers and ETF sponsors

What's New in 2012?

- Expanded analysis of retail alternatives by category comparing the mutual fund, ETF, closed-end, and ETN markets to see the true size and how each category differs
- Analysis of ETF servicing and fees, active ETFs, and hedge funds' move into retail distribution

Answer These and Other Critical Questions:

1. What is the size of the retail alternatives market and how is it defined?
2. What is the growth outlook for retail alternative mutual funds and ETFs?
3. What percent of mutual funds and ETFs are considered alternative?
4. What is driving asset managers' interest in alternatives?
5. What type of education would advisors find most helpful in increasing their use of alternatives?
6. Which alternative mutual funds categories are attracting flows?
7. How are asset managers positioning alternative products?
8. What factors do ETF sponsors believe most impact firm success?
9. What are the greatest challenges facing the ETF industry?
10. Where are ETF sponsors focusing their product development?

274 pages, 216 exhibits

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13 pages of report content

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Methodology

Cerulli Quantitative Update: ETFs and Retail Alternative Products and Strategies 2012 is the third report in an annual series, which is the result of ongoing research and analysis of both ETF sponsors and asset managers that manufacture and distribute retail alternative products in the U.S. by Cerulli Associates (CA). The report focuses on two key areas: the U.S. retail alternative product landscape and ETFs.

Cerulli Quantitative Update: ETFs and Retail Alternative Products and Strategies 2012 leverages CA's ongoing qualitative analysis of the asset management industry, and primarily utilizes two proprietary surveys: (1) Retail Alternative Products and Strategies Survey and (2) ETF Sponsors Survey. Other proprietary analysis was compiled utilizing ongoing surveys of financial advisors in partnership with *Financial Planning Association*, *Investment Management Consultants Association*, *College of Financial Planning*, *Advisor Perspectives,* and *Morningstar* and a survey of investors in partnership with *Phoenix Marketing International*.

This report is designed as a business planning tool, and additional support interpreting this data is also available. All exhibits include explanations that highlight key developments and implications, each of which state the important tactical ramifications for asset managers. In addition, most exhibits contain cross references to other related charts in this publication. ***ETFs and Retail Alternative Products and Strategies 2012*** is designed as a stand-alone publication but also as a complement to ***Cerulli Quantitative Update: The State of Retail and Institutional Asset Management*** and ***Cerulli Quantitative Update: Retail Products and Strategies.***

CA analysts' opinions and perspectives are shaped by a methodology based on three components:

- **Industry understanding:** All CA analysts come to the firm with a background shaped by relevant experience at leading financial services firms, which contributes to the internal pool of industry knowledge.
- **Quantitative analysis:** CA maintains an online, password-protected survey engine as part of a voluntary, information-sharing relationship whereby participants complete confidential surveys in exchange for an aggregate summary of key findings. All information is presented in aggregate form, and proprietary survey information is not directly attributed to participants.
- **Qualitative research:** CA analysts conduct background research interviews with industry executives in a confidential format allowing for open dialogue about the current state and future outlook for the industry. This provides a means for synthesizing the other components of our methodology into research products that are independent, insightful, and grounded in the industry's current climate.

In addition to survey data, CA analysts compiled information available through third parties (such as Strategic Insight/SIMFUND, Morningstar Direct, and HedgeFund.net).

SAMPLE SECTION
from

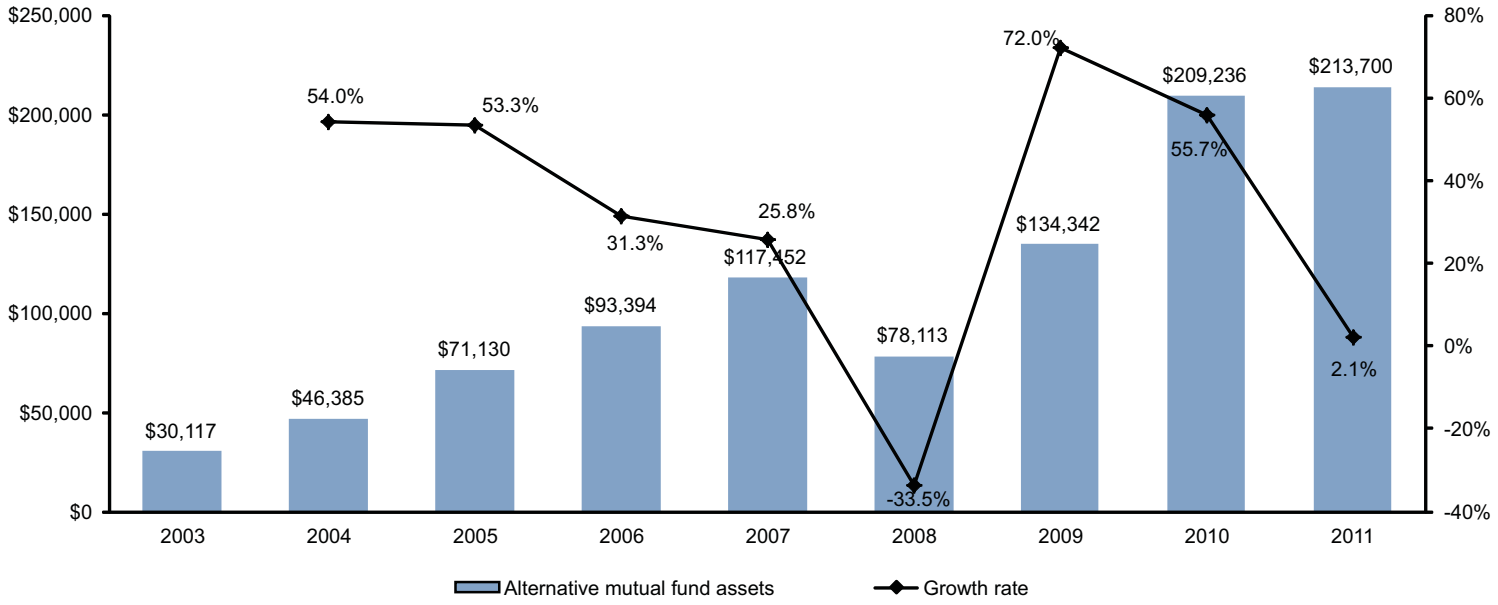
CERULLI QUANTITATIVE UPDATE:
ETFS AND RETAIL ALTERNATIVE PRODUCTS
AND STRATEGIES 2012

EXHIBIT 5.02

Alternative Mutual Fund Assets, 2003-2011
($ millions)

Sources: Strategic Insight/SIMFUND, Cerulli Associates

Analyst Note: In conjunction with Cerulli's annual survey of asset managers, Morningstar alternative categories, and a thorough fund by fund analysis of funds' individual strategy and asset class by Cerulli analysts, Cerulli defines alternative mutual funds in the following manner. Cerulli's definition includes all funds from the following Morningstar categories: bear market, commodities, currency, equity precious metals, long/short equity, managed futures, market neutral, multialternative and natural resources; plus a customized list of funds that meet alternative criteria but are not part of the aforementioned Morningstar categories including infrastructure, alternative energy, leverage, inverse, listed private equity, and master limited partnership (MLP) funds. Cerulli uses Strategic Insight/SIMFUND to analyze its custom definition of alternative mutual funds. This definition is different from Morningstar's alternative and commodity asset classes which are used in The Cerulli Edge: U.S. Monthly Product Trends.



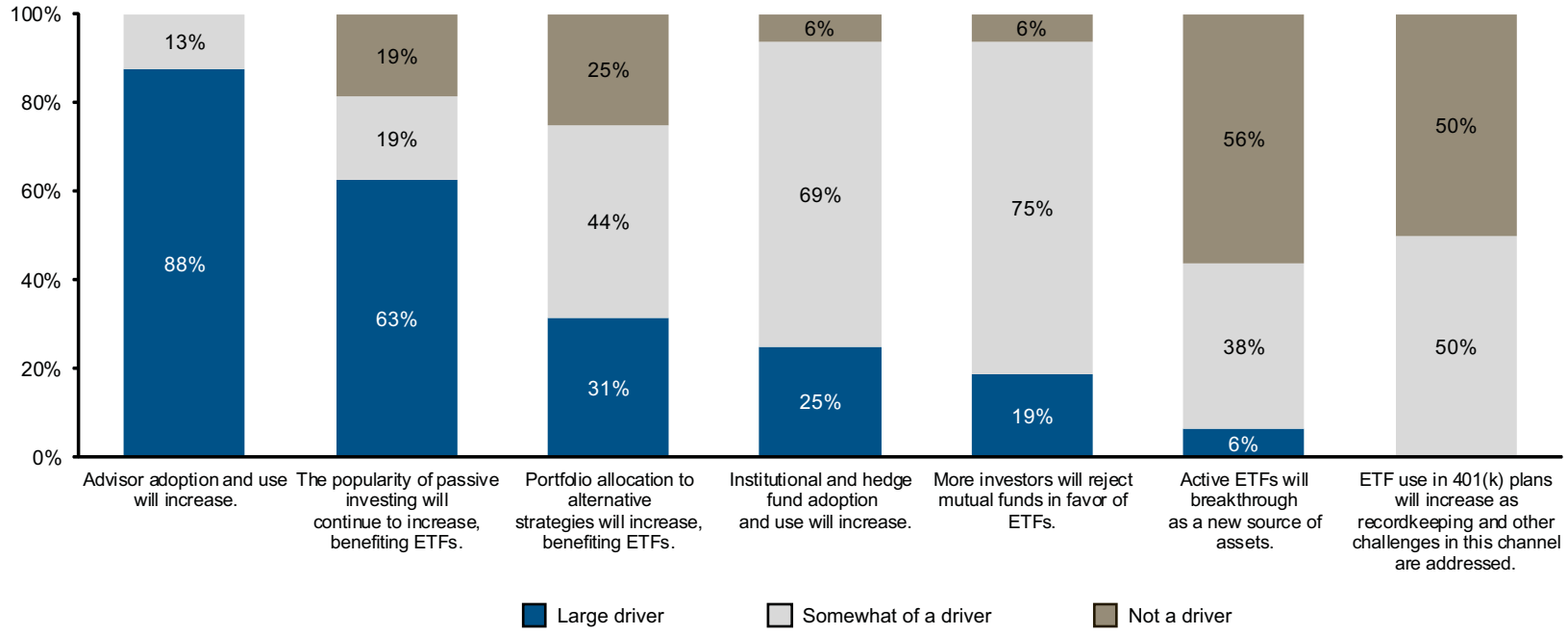
- **Alternative mutual funds grew 2.1% in 2011 to end the year at $213.7 billion, a much lower growth rate than past years. The three-year compound annual growth rate (CAGR) for these funds is 39.9%.** While the annual growth rate for these funds is down dramatically, mutual funds as a whole decreased assets 1% for the year.

Key Implication: Alternative mutual fund asset growth stumbled in 2011; however it is important when looking at this market to look deeper as many different categories of mutual funds within this universe are experiencing very different fortunes. For example, commodity and natural resources lost combined assets of $10.7 billion in 2011 (see Exhibit 5.08) despite net inflows while assets in alternative allocation funds increased $4.2 billion. Managers who are considering the alternative market should look past these top line growth numbers to other trends, which include fund correlation and risk reduction potential to fully evaluate the potential of these funds.

EXHIBIT 6.14

ETF Sponsors Rate Drivers of Future Growth, 2012

Source: Cerulli Associates



- **Advisor adoption and passive investing are cited by 88% and 63% of sponsors, respectively, as the largest drivers of future ETF growth.**

Key Implication: In 2012 ETF sponsors will take on many initiatives in an effort to increase adoption in the advisor community. **A key theme that Cerulli found through speaking with sponsors for this research was that advanced ETF education is pivotal toward increasing advisor adoption.** At this point, most sponsors feel as though the advisor community understands the basic fundamentals of ETFs. They now feel it's time for the education to become more sophisticated and address issues like liquidity and product saturation misconceptions which can falsely affect the marketability and traction of these products.

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