

Global Asset Owner Survey on Emerging Managers

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(FinCity.Tokyo)

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Introduction – background and objectives of survey

Situation

- FinCity.Tokyo (FCT) has been conducting promotional activities and policy recommendations with the Tokyo Metropolitan Government in order to achieve its “Global Financial City: Tokyo” goals
- One of the measures for this initiative is enhancing the asset management ecosystem in Japan, and as part of this FCT has been working on Tokyo’s EMP*
- EMPs or similar manager seeding programs have been in place in other global financial cities across the world

Problems

- The number of Emerging Managers (EMs) in Japan is gradually increasing as a result of FCT’s efforts
- EMs in Japan are attracting interest from overseas Asset Owners (AOs), and are building up a track record of actual allocations from those AOs
- However, while Japanese AOs have come to recognize the value of the EMP, most continue to refrain from actually making seed investments
- Lack of EM track record, concerns about AOs’ abilities in EM selection, and high management burden vis-à-vis the small scale of investment, are the main reasons given for their hesitation

Objectives

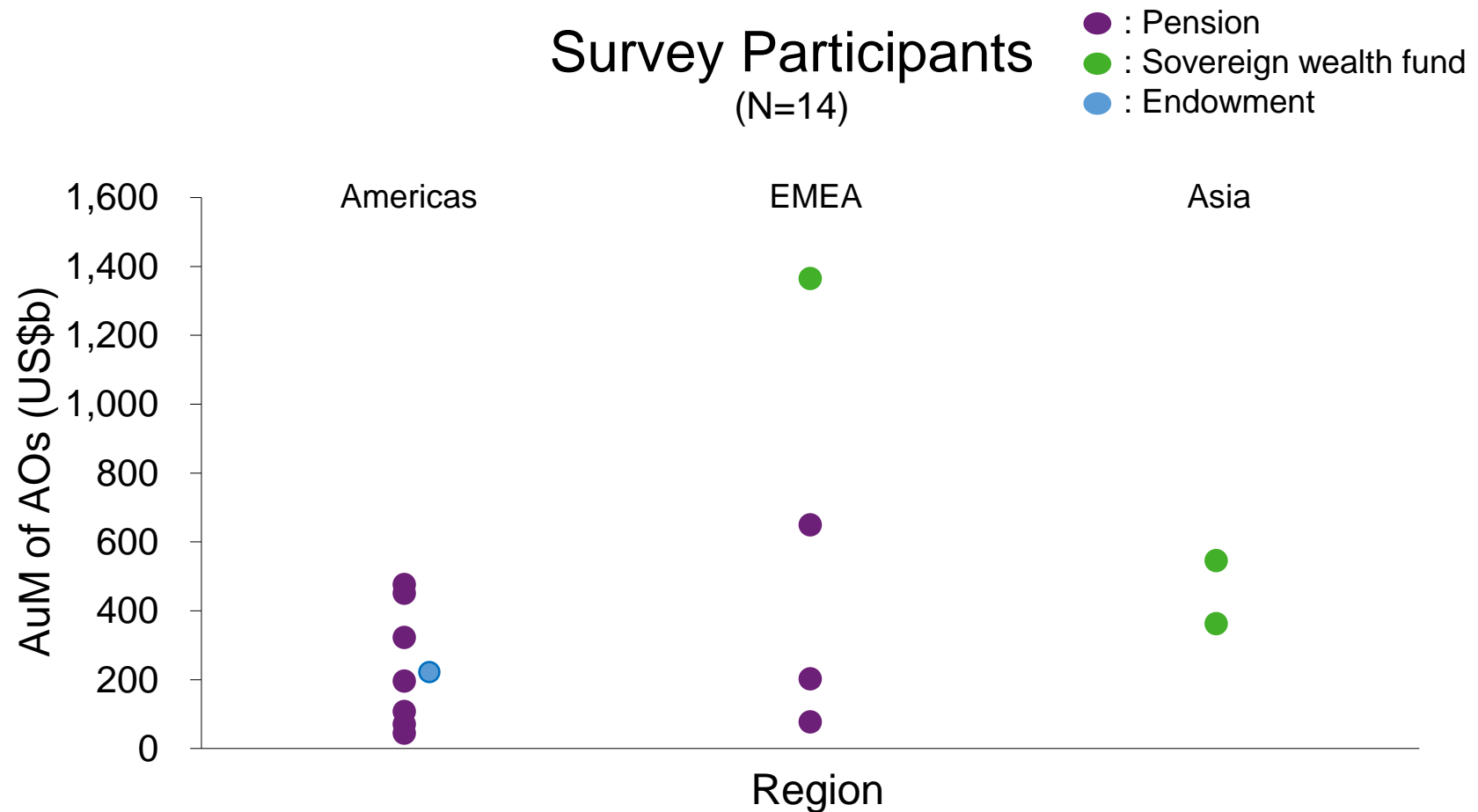
- Confirm rationale of EM allocation by overseas AOs, particularly:
 - ✓ Background and/or purpose of allocating to EMs
 - ✓ EM allocation policy (selection criteria, ticket size, etc.)
 - ✓ How AOs control the risks associated with EM allocation
- Disclose the results of the survey to domestic AOs in order to promote allocation by them to EMs in Japan

*Emerging Managers Program: Emerging Asset Manager Seeding Program
(Promoted since 2017, led by Tokyo metropolitan government until 2019, the foundation year of FCT)

Executive Summary

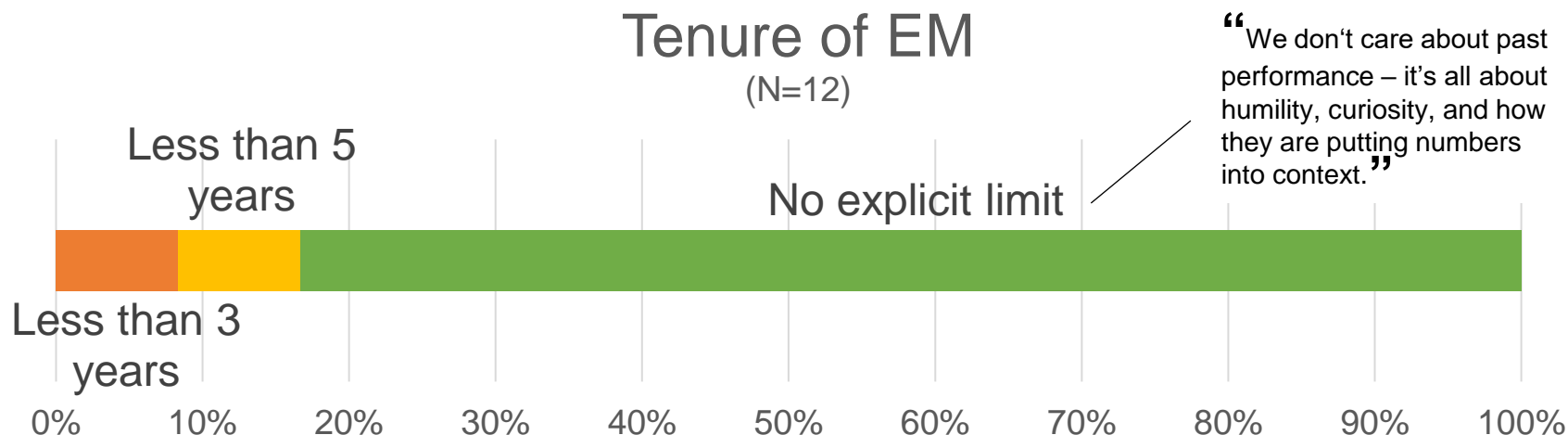
- The survey participants comprised large 14 AOs across the globe, including Pensions, Sovereign Wealth Funds (SWF) and Endowments, with aggregate AuM of roughly USD 4.6 trillion.
- Over 80% of AOs interviewed do not set any upper limit on the number of years since establishment to define EMs, while the size of EMs in their portfolios is generally between USD 1-2 billion AuM.
- There tends to be a direct relationship between size of AO (AuM) and ratio of assets managed internally.
- The majority of AOs, regardless of size, allocate around 1% or less of their total AuM to EMs.
- The ticket size for EMs tends to be around either USD 50 million or USD 200 million.
- Over 40% of AOs interviewed maintain only a minority stake in EMs they allocate to, while some AOs have a clear approach to seek a dominant stake.
- Around half of AOs interviewed allocate to around 10-30 EMs at a time, while some AOs allocate to more than 100 EMs at a time.
- AOs allocate to EMs within the context of their overall portfolios, and there is no bias towards any particular asset class.
- AOs stated various motivations for allocating to EMs, including seeking high returns (alpha generation) and complementing the AO's own capabilities.
- Around 60% of AOs interviewed search for new EMs themselves, primarily through their own networks.
- Reputation risk was the response most given as a key obstacle with respect to EM allocation, surpassing challenges with performance and management burden.

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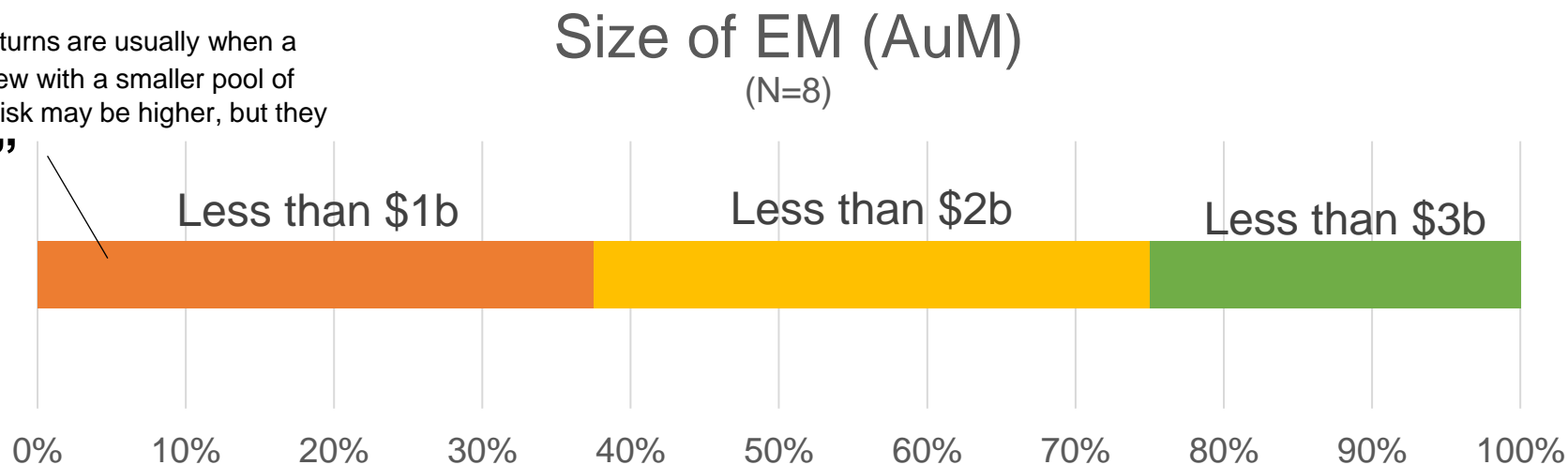


Definition of EM

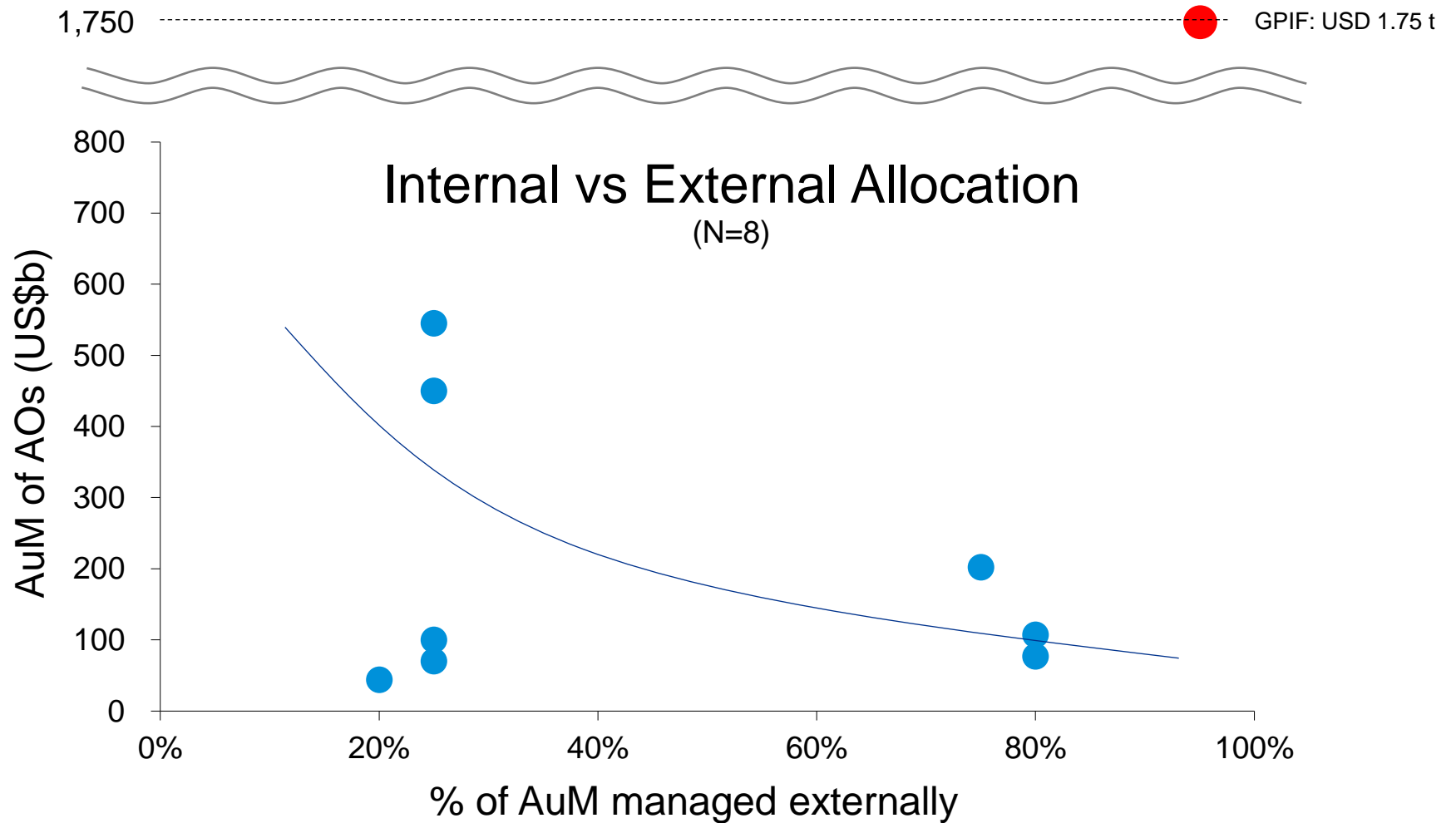
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“The best returns are usually when a manager is new with a smaller pool of assets – the risk may be higher, but they fight harder.”

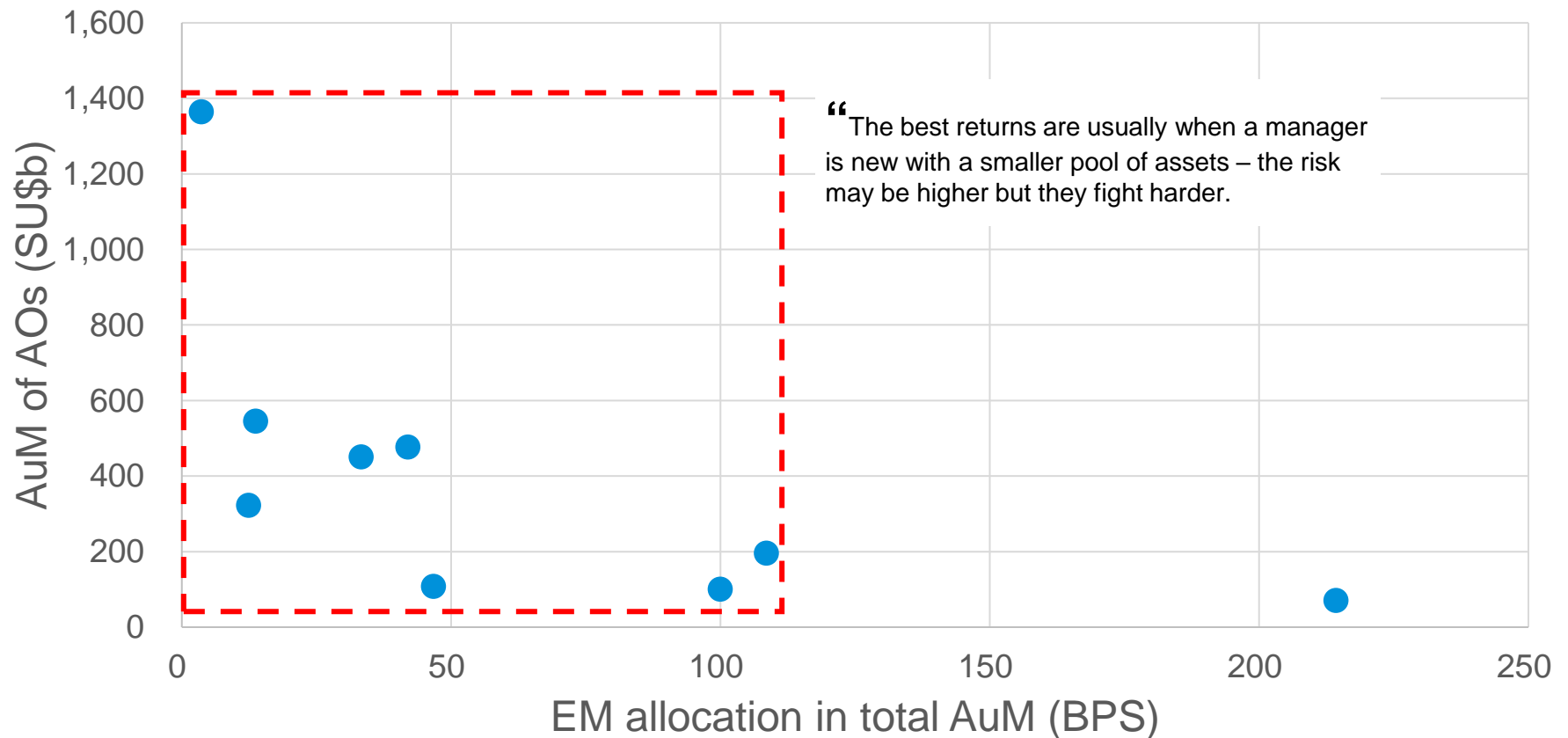


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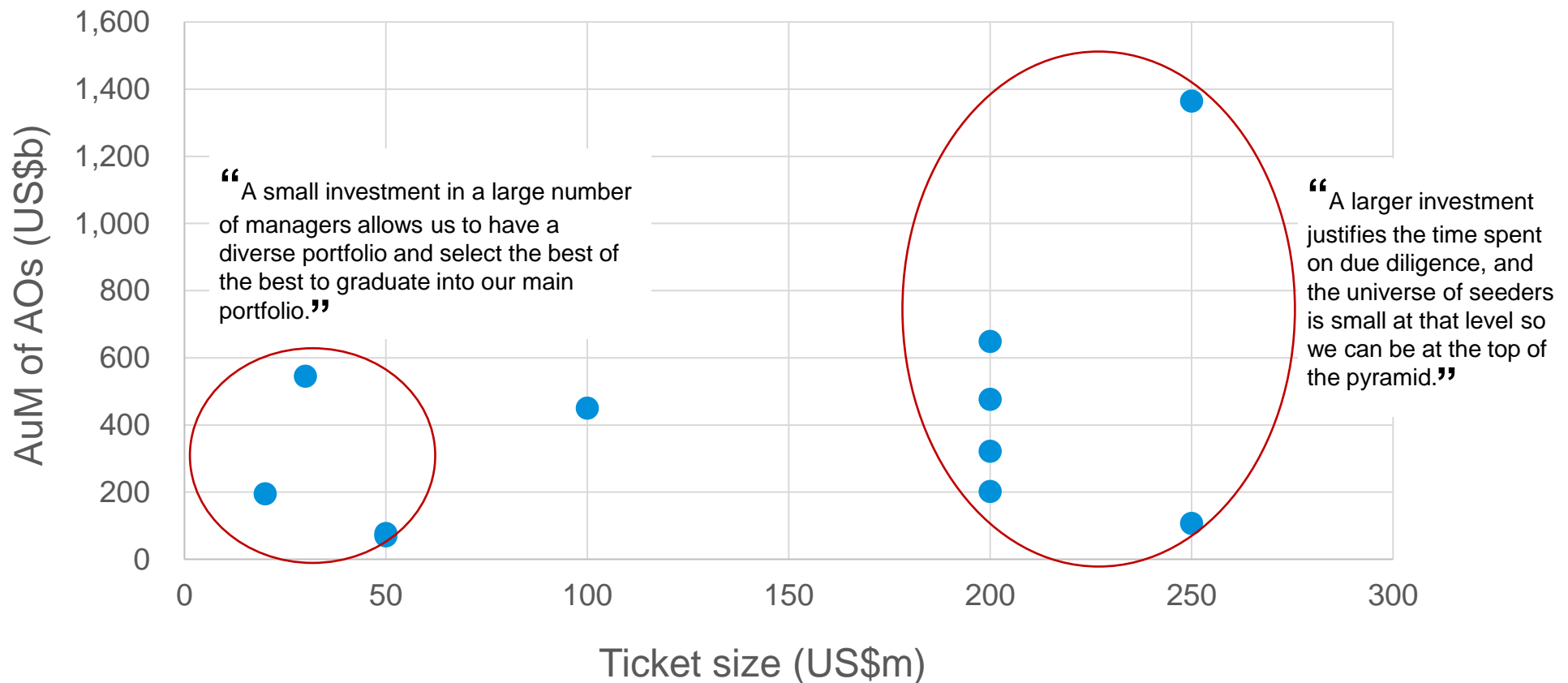
The majority of AOs, regardless of size, allocate around 0.5% of their total AuM to EMs.

EM allocation as proportion of total AuM (N=9)

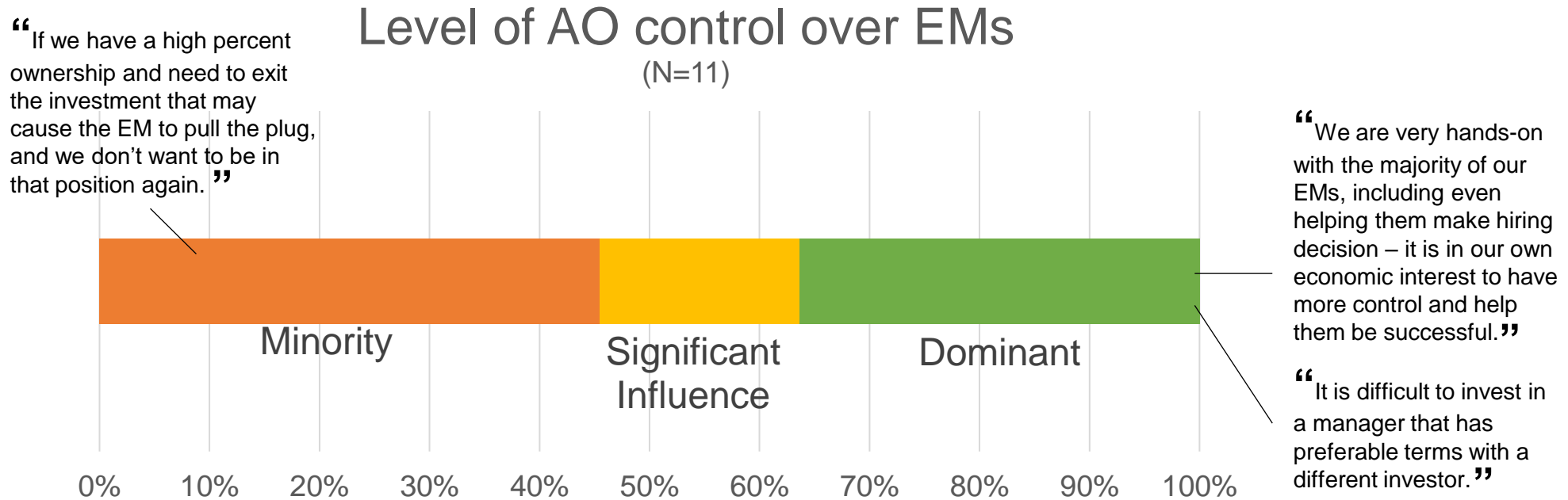


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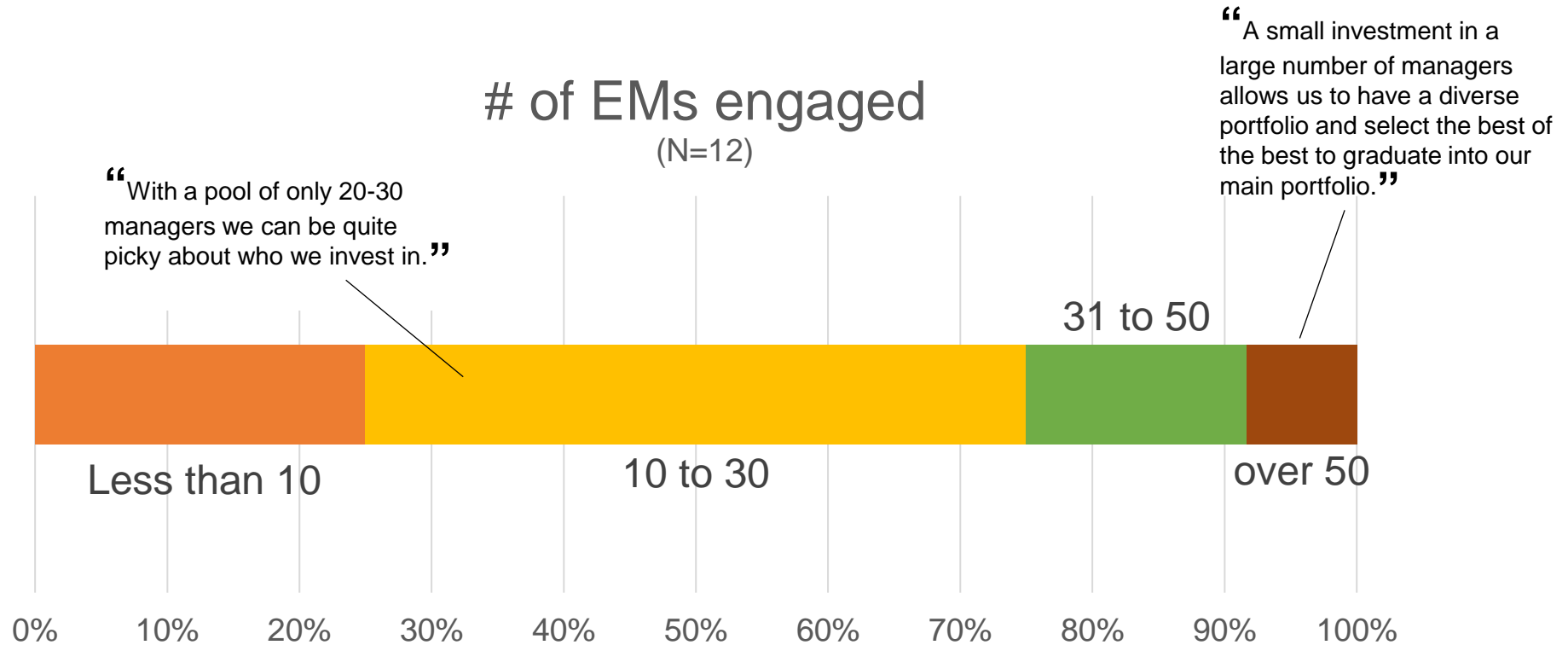
Size of the ticket to EMs
(N=11)



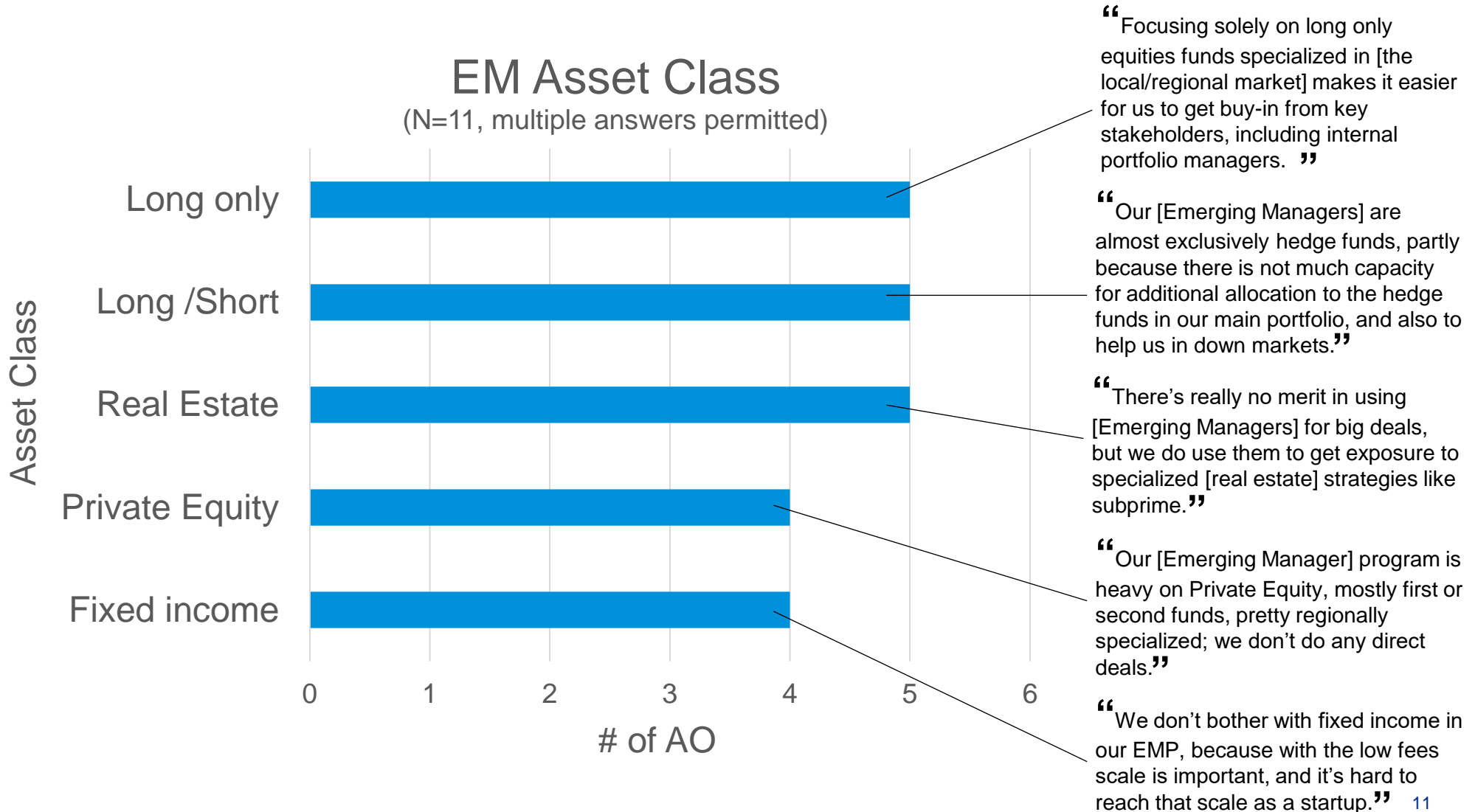
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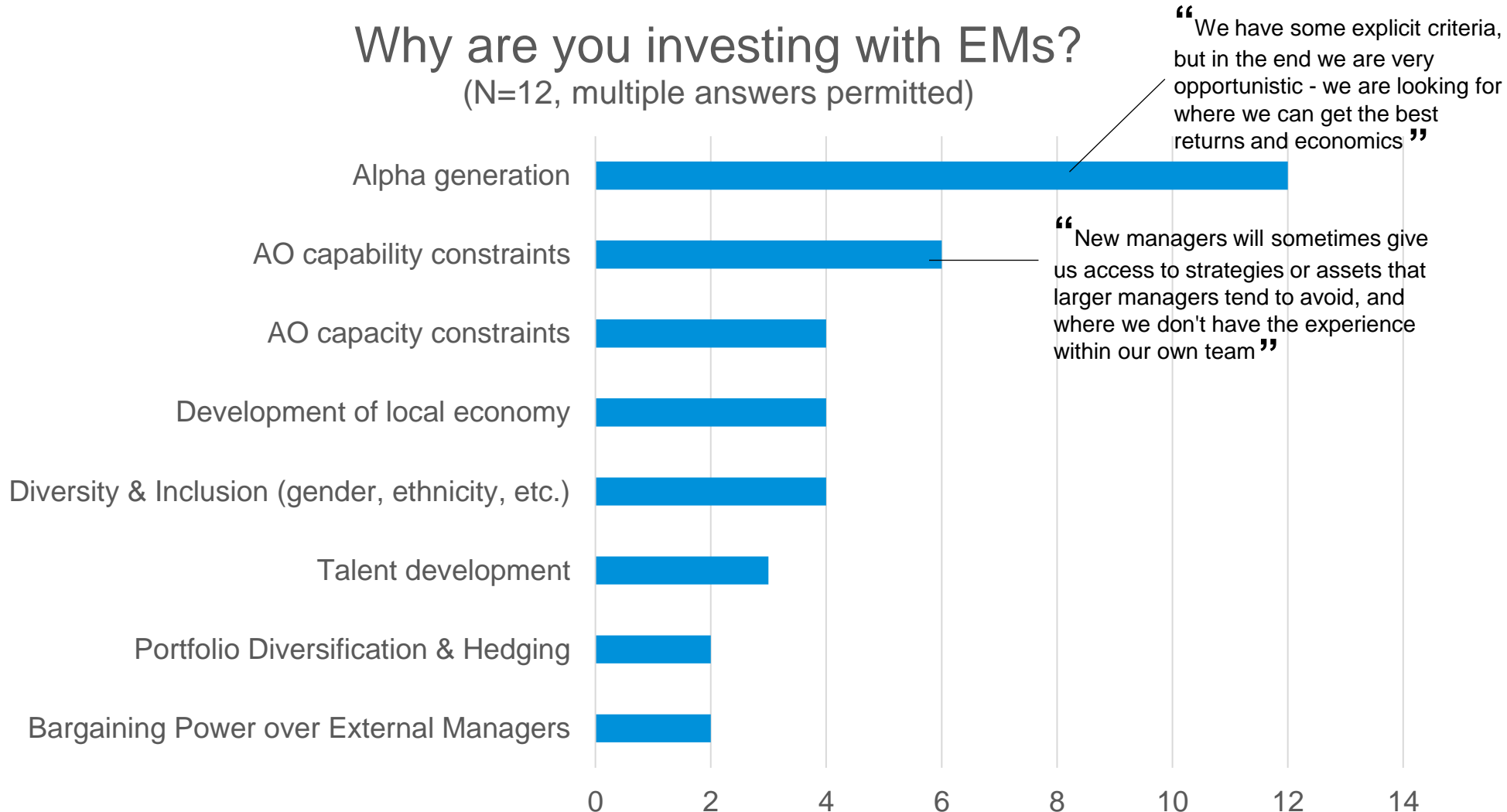


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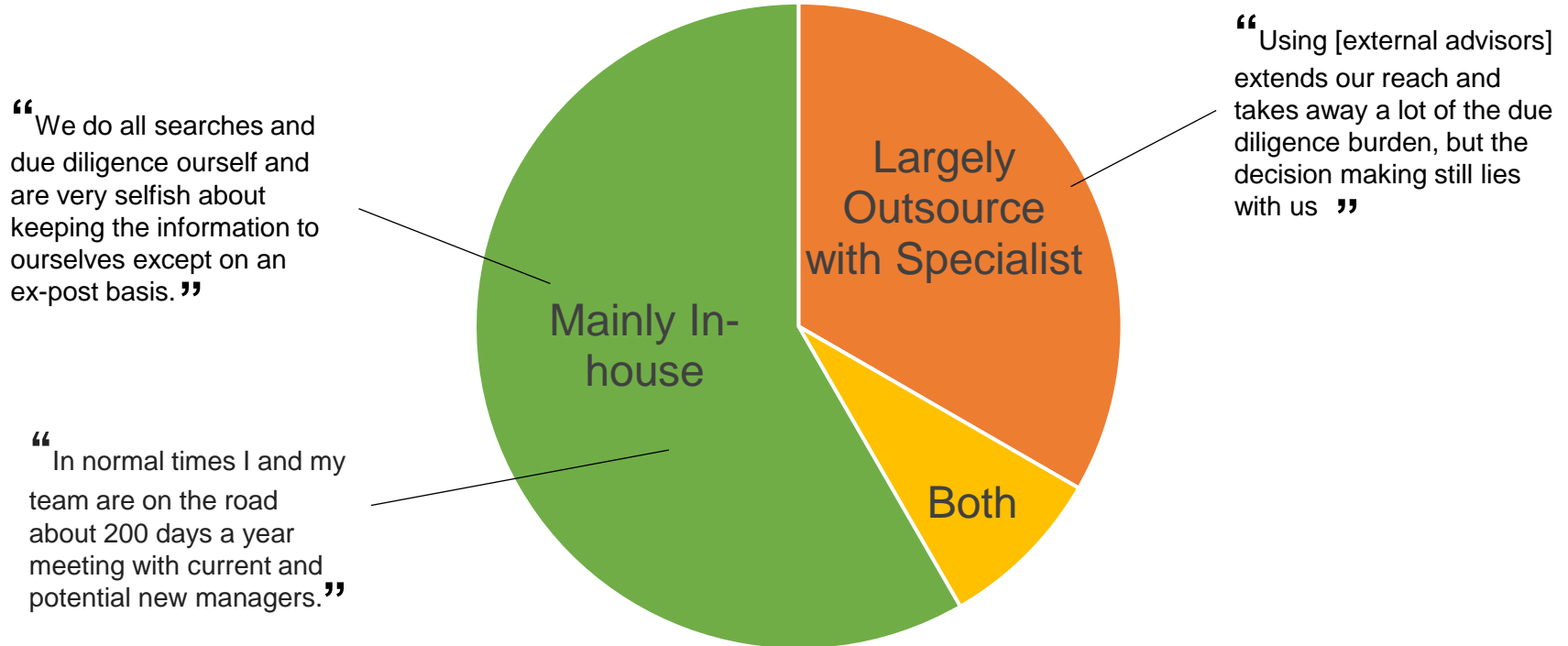
Why are you investing with EMs? (N=12, multiple answers permitted)



Around 60% of AOs interviewed search for new EMs themselves, primarily through their own networks.

How do you conduct EM search?

(N=12)



Reputation risk was the response most given as a key obstacle with respect to EM allocation, surpassing challenges with performance and management burden.

Top 4 Obstacles of EM Allocation

(N=9)

Reputation risk

*1

Lack of risk control experience

Challenges with performance

*2

Cost performance (high DD cost/management burden)

0 1 2 3 4

“When you’re a public pension like we are and your mandate is handed to you from elected officials, you sense a strong aversion to any kind of negative publicity.”

“We don’t hand-hold with new managers...we want them to be fully responsible for their own investments, including middle-back operations.”

“It’s actually really hard to pinpoint the source of underperformance, or even outperformance.”

“We set our initial ticket size pretty high intentionally, to justify the time we spend on due diligence.”

*1 Risk of misconduct by the EM itself / reputational risk of terminating contracts with unsuccessful EMs (possibility of negative publicity with respect to using hedge funds)

*2 Performance of EM investments does not meet expectations in some cases

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More information

<https://fincity.tokyo/en/>

