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Islamic Finance
A fast moving feast

Fund Boutiques
Is there really something for everyone?

What is Climate Change Risk?
The USA leads the way

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Foreword

The European investment market is always in action. Germany, for example, has just renewed some of its investment laws, mainly to prevent open-end property funds from liquidity strains. This was a reaction to the crisis that three German property funds were facing at end of 2005/Spring 2006. Also, it allows for German REITs, know as G-REITs, and the first ones are already being launched. In this issue of efm, Rock Capital explain how to find alpha in real estate investments.

Europe-wide, financial institutions are preparing for the MIFID implementation. In most countries, the details are still being discussed as to how exactly investors should be informed about front-end commissions and trailer fees. Distributors in Germany are happy because it is now clear that "best execution" does not mean that the distributor has to tell the investor to buy the units at one of the stock exchanges.

This issue takes a special look at Arabic countries. Matthew Craig writes about funds investing in the Middle East, and Alison Ebbage gives us a deeper insight into Islamic Funds that specialise in investing according to Sharia law. Standard & Poors explain Islamic Indices, which have become important benchmarks in this area of investment.

Taking a look at Europe, Matthew Craig offers some insight into one of Europe's most important financial centers: Dublin. Markus Hill explains the pros and cons of fund boutiques, with a focus on the German market. With the G8-conference in Heiligendamm, Germany, the issue of climate change came into the international focus. The fund industry had reacted long before and has launched many sustainability funds to accommodate investors' "green" money. Nedia Miller writes about them in this issue.

This magazine also sheds light on some more technical issues, such as derivatives, which are explained by LatentZero, the nitty gritty of settlement & clearing, which is taken care of by Euroclear, and LDIs, which are demystified by Matthew Craig.

I wish you a good summer, and hope that you stay ahead of the crowd and up to date!

Anke Dembowski, editor

Small is Beautiful

Fund boutiques do show good performance figures and are therefore becoming more and more popular. Markus Hill, an independent Asset Management Consultant, sheds light on some of the reasons why.

"As a dwarf you have to do what giants can't," said Niki Lauda. A provocative sentence which can, however, well be used to describe the essence of the investment class of fund boutiques. Many specialised investment firms (fund boutiques) have for years met with increasing interest on the part of institutional investors and consultants.

New context

Various studies in recent years (i.e. Südprojekt, FAROS, TELOS) have shown that institutional investors increasingly make use of mutual funds as investment instruments. Many independent asset managers (fund boutiques) have frequently launched so-called private label funds with investment companies. In this type of constellation, the asset manager takes the function of a fund consultant who informs the investment company of his portfolio management decisions which the investment company then implements. These funds originally arose out of the need for rationalisation. Many asset managers at some point realised the difficulty of co-ordinating more than a hundred or even a thousand accounts in private asset management. This partly explains the huge number of funds investing worldwide, which at first glance seems to contradict the concept of increasing specialisation. Unless, of course, one counts an above average ability for proper timing as one aspect of specialisation.

Fashion trend or permanent factor?

One example of this pressure on the part of fund boutiques are the results of an evaluation (Citywire: chart overleaf) carried out by Universal Investment. Despite the wide variety of approaches in the asset management sector it is clear that this "class of investments" (in the sense of investment sector) is here to stay. Another interesting aspect for "classic" institutional investors seems to be that these specialised firms – frequently owner-managed – keep their portfolio managers, according to many, for long periods of time. Set against this background, it seems understandable that these firmly established firms

Fonds	Portfolio Flagg. oder Vermögensver.?	KAG	Advisor
WM Aktien Global UI-Fonds	Vermögensverwalter	Universal-Investment GmbH	Wolfgang Mayr Vermögensverwaltung GmbH
StarPlus SICAV - Starpoint	Vermögensverwalter	IPConcept Fund Management S.A.	Huber Portfolio AG
LINGOHR-SYSTEMATIC-LBB-INVEST	Vermögensverwalter	Landesbank Berlin Investment GmbH	Lingohr & Partner Asset Management GmbH
Global Advantage Funds-Major Markets High Value	Vermögensverwalter	Global Advantage Funds SICAV	Keppler Asset Management, Inc., New York
Albrech & Cie Optiselect Fonds Thes.	Vermögensverwalter	Adviser I Funds SICAV	Albrech & Cie Vermögensverwaltung AG
Portfolio Vermögensverwalter			
Astra-Fonds FI	Vermögensverwalter	DWS Investment GmbH	Dr. Jens Ehrhardt Kapital AG
FMM-Fonds	Vermögensverwalter	FRANKFURT-TRUST	Dr. Jens Ehrhardt Kapital AG
ACATIS Aktien Global UI A	Vermögensverwalter	Universal-Investment GmbH	ACATIS Anlageberatung für Investmentfonds GmbH
PEH-UNIVERSAL-FONDS VALUE STRATEGIE	Vermögensverwalter	Universal-Investment GmbH	PEH Wertpapier AG
4Q-Value Fonds Universal	Vermögensverwalter	Universal-Investment GmbH	TBF Global Asset Management GmbH
Templeton Growth Fund, Inc.	Flaggschiff	Templeton Growth Fund, Inc.	
DWS Vermögensbildungsfonds I	Flaggschiff	DWS Investment GmbH	
UniGlobal	Flaggschiff	Union Investment Privatfonds GmbH	
Portfolio Flaggschiffe			
MSCI World (gross)			
FUX DE Equities Global			
CIF - Global Equity Fund A	Flaggschiff	Capital International Fund SICAV	
Robeco N.V.	Flaggschiff	Robeco Groep (Niederlande)	

Source: Feri Rating & Research GmbH. Date: 28.02.2007. Peer Group: Equity World. Order: Perf. 5 years (p.a.)

frequently talk about a "team concept". Their management fluctuation seems "unnaturally" low.

A fund manager, in the case of fund boutiques, is as a rule a fund consultant or fund advisor, who at the same time is an owner, and is therefore hard to motivate to change jobs by a mere raise in salary. The basic motivation of many of these asset managers is precisely this independence – from superiors but also from group interests. Such a fund manager will often invest his own money in "his" funds. In addition, he often directly participates in the above average performance of his product if the agreement includes such performance awards. This parallels the interests of the investor and those of the asset manager.

A look at performance results of fund boutiques shows some surprises. On the one hand, there is the clear difference from the results of traditional fund companies; on the other hand, there is the large variety of investment approaches. A critical remark points to the fact that smaller investment firms often seem willing to take higher risks (volatility). Every institutional investor should therefore thoroughly investigate the field of "risk adjusted performance" (Sharpe Ratio) and the "diversification of investment styles".

Group	Total number of rated managers (AAA - A)
Invesco	9
JP Morgan	9
Universal	8
DWS Investment	7
Black Rock MLIM	5
Principal Global Investors	5
Alliance Bernstein	5
M&G Investments	4

Source: Citywire – Results of evaluation carried out by Universal Investment (Status: April 30, 2007)

Many employees of large fund companies have gradually learned to value the broad scope of expertise and responsibilities involved in the activities of "little" firms.

Using Fund Boutiques

Fund boutiques are especially interesting if they show high expertise in a particular investment sector. Even if the fund boutique chosen transcends a certain limit in volume it can be of interest for a consultant in terms of individual mandates or in a multi-management mandate (for example see Dr. Jens Ehrhardt, Frank Lingohr). Frequently, these size limitations are not specified or there is a lack of transparency. Mutual funds have contributed considerably to this popularity. Mutual fund managers or fund of funds and boutiques such as Eckhard Sauren and Bernd Greisinger have successfully been using mutual funds and fund boutiques (private label funds) for years. Many big firms such as DWS and Cominvest value these products for use in the fund of funds sector. They enjoy high esteem due to the degree of specialisation of their fund advisors and the huge variety of investment styles – value, growth, quant etc.

There is something for everybody. Large and firmly established asset managers are often mixed with smaller ones for diversified styles. Institutional investors sometimes view fund boutiques as a small "special bet" in a portfolio (risk management). The reasons: benchmark freedom, depending on product choice also in low correlation to the overall portfolios.

Limiting factors

Although many small asset management firms show impressive results there are "natural" market barriers. When an asset manager is in

WKN	ISIN	Currency	Rating	Perf. 1Y	Perf. 3Y (p.a.)	Perf. 5Y (p.a.)	Volatility	Max. Drew down 6M	Sharpe Ratio
979075	DE0009790758	EUR	(A)	14.72%	10.01%	15.58%	16.70%	-15.23%	0.45
940076	LU0114997082	EUR	(A)	8.47%	17.33%	12.01%	11.94%	-8.31%	1.25
977479	DE0009774794	EUR	(A)	10.68%	19.14%	10.86%	10.46%	-6.28%	1.59
972580	LU0044747169	EUR	(A)	14.53%	18.93%	9.82%	8.47%	-5.42%	1.94
933882	LU0107901315	EUR	(A)	4.65%	12.87%	9.62%	9.48%	-7.01%	1.10
				8.96%	14.51%	9.57%	10.13%	-7.31%	1.19
977700	DE0009777003	EUR	(A)	9.19%	19.64%	9.28%	10.93%	-5.89%	1.57
847811	DE0008478116	EUR	(A)	8.55%	18.79%	8.80%	10.56%	-8.09%	1.55
978174	DE0009781740	EUR	(A)	3.67%	12.73%	8.17%	11.45%	-12.49%	0.90
976741	DE0009767418	EUR		3.33%	3.87%	5.98%	8.94%	-12.15%	0.16
978163	DE0009781633	EUR		10.47%	15.26%	3.89%	8.71%	-5.60%	1.47
971025	US8801991048	USD	(B)	4.87%	11.24%	3.88%	7.95%	-5.39%	1.10
847652	DE0008476524	EUR	(B)	3.49%	11.12%	3.81%	9.17%	-7.05%	0.94
849105	DE0008491051	EUR	(B)	6.10%	12.59%	3.44%	8.80%	-5.70%	1.15
				3.78%	10.97%	2.48%	8.63%	-6.27%	0.99
		USD		4.65%	11.90%	2.46%	8.42%	-6.26%	1.12
		EUR		3.80%	10.49%	1.38%	9.10%	-6.54%	0.88
970741	LU0006013907	USD	(C)	1.47%	8.26%	1.07%	9.28%	-6.98%	0.62
970259	NL0000289783	EUR	(D)	2.62%	11.62%	-0.07%	9.66%	-7.23%	0.95

the "build-up phase" he may be unable to find access to special funds or individual mandates. Many consultants in Germany are engaged in dealing with mutual funds ("easy market access") but this core discipline continues to be the choice of managers for mandates.

The majority of fund boutiques in recent years have concentrated their investments on becoming more professional in their sales structures. How does this become noticeable? Many employees of large fund companies have gradually learned to value the broad scope of expertise and responsibilities involved in the activities of "little" firms. A change often appears attractive. Capital investment companies specialising in fund boutiques are also steadily expanding their sales and marketing services. Firms like Universal Investment, LRI Invest, AmpegaGerling or Hauck & Aufhäuser are intensifying their efforts to extend their services here.

Another main obstacle to faster growth, in addition to being relatively unknown to the potential "consultant bottleneck," is the purchasing policy of institutional investors. On the one hand, insurance companies, utility companies, and foundations are very interested in optimising their asset allocation capacities. They are on the lookout for alternatives or complements to their decision-making processes. On the other hand we often see decision-making by investors characterised by remarks like: "If I make a mistake in picking an established asset manager for a year – too bad. If I choose the wrong smaller consultant, it can cost my job." This attitude may be understandable in view of the weight of responsibility for large investment sums. It is not understandable in view of increasing dissatisfaction of investors with the services of established asset management firms.

Institutional investors sometimes view fund boutiques as a small "special bet" in a portfolio

Outlook

Fund boutiques will continue to increase in popularity with institutional investors last but not least under the cover of mutual funds. It is interesting to note that this development tends to put increasing pressure on consultants to focus more and more on the analysis instruments of mutual funds ("retail"). First developments in terms of transparency in a seemingly cloudy market scenery of specialised asset managers could for instance be seen in the increasing implementation of qualitative fund ratings of mutual funds. The company Feri – on the one hand established consultant; on the other hand an analyst company – has a firm standing in investment choosing for many private investors and asset managers and is a growing factor in their decision-making. Many managers of fund of funds, banks, and classical institutional investors welcome this development. Investors should turn their focus more and more to names like Standard & Poor's, Lipper, and Morningstar in the wake of this trend: analytical know-how and the "whip of transparency" from the classical mutual fund industry.

Markus Hill works as independent investment fund consultant in Frankfurt (marketing, sales, PR). He helped initiate the first "Suedprojekt" study and therefore had the opportunity to implement the first nationwide consultancy survey in cooperation with RCP/TELOS. Further information: Markus Hill phone: +49 69 280 714, email: markus.hill.cologne@t-online.de