



Arthur J. Gallagher & Co.
BUSINESS WITHOUT BARRIERS™

What Are you Actually Paying an Investment Manager?

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Gallagher Overview

- Institutional Investment & Fiduciary Services practice of Arthur J. Gallagher & Co., Gallagher Fiduciary Advisors, LLC (“Gallagher”)
- Firm and its predecessors founded in 1976
- Independent investment consultant registered with the SEC
- One office located in Pittsburgh and serving Pennsylvania plans since inception
- Other offices in Charlotte, NC; Cleveland, OH; Newark, NJ; New York, NY; and Washington, DC
- Serve contractually as an ERISA 3(21) and 3(38) fiduciary
- Full transparency, no hidden fees

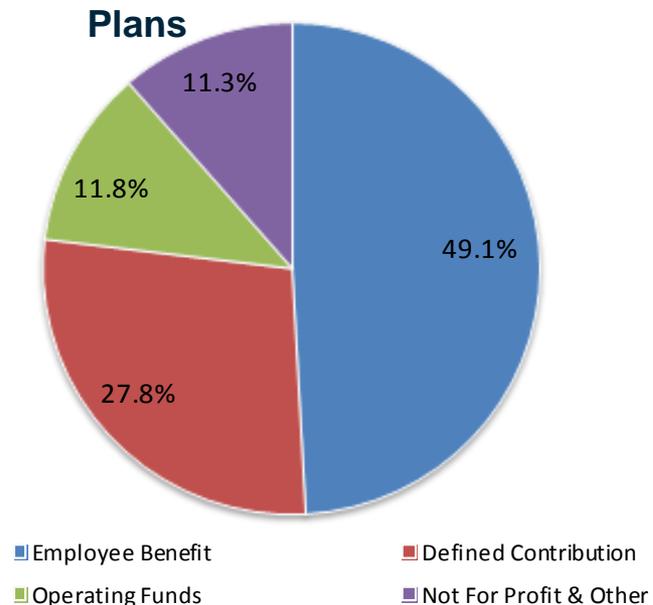
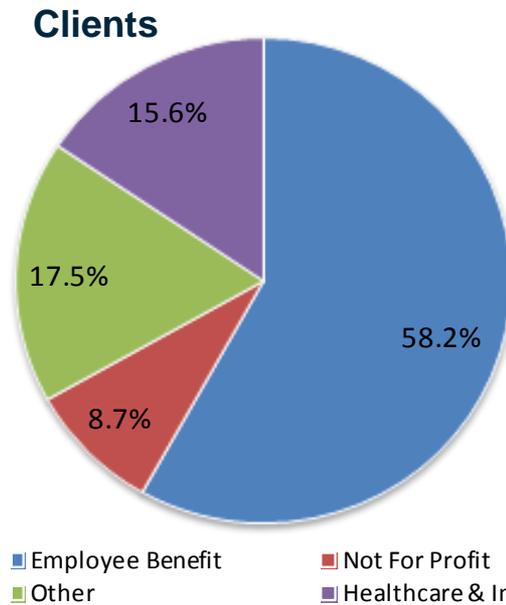
Business focus & range of services

- Institutional investment advice & guidance
- Portfolio design/implementation
- Discretionary & traditional consulting services
- Investment policy statement
- Asset allocation/liability modeling
- Spending policy analysis

- Risk analysis & management
- Investment manager evaluation/selection
- Investment performance monitoring
- Socially responsible investments
- Fiduciary decision making
- Client & fiduciary education



Gallagher Client Base



220 clients, 302 plans and approximately \$45 billion in total assets*
78 Employee Benefit funds with assets ranging from \$0.2 million to \$2.6 billion

* Unless otherwise noted, all data as of 12/31/14..



- Not advocating index funds over active management
- Not advocating mutual funds over separate accounts
- Not referred to as the world's greatest investor of the 20th century



Can We Agree That....

- Data can be used to prove your point for any side of any argument
- It costs no more to trade 20,000 worth of shares than 10,000 worth of shares
- Required reporting and filings to the SEC are required for investment firms that have \$100 million or \$1 billion in assets
- The level of proper due diligence on a stock should be the same for a large manager as it is for a small manager
- Adding to existing infrastructure for additional analysts and technology needed to be an investor should decrease as assets grow and should decrease relative to the gains in assets managed

Did You Know That....

- From 1980 to 2010, the size of the equity mutual fund industry increased 135x (\$26B to \$3.5T)¹
- From 1980 to 2010, the total expenses paid to equity mutual fund managers increased 141x (\$170.8M to \$24.1B)¹



Asset-Weighted Expense Ratios for Domestic Equity Funds (in basis points)

	<i>Including index funds</i>	<i>Excluding index funds and ETFs*</i>	<i>Share of equity mutual funds actively managed</i>
1980			
Expense ratios (basis points)	66.0	66.1	
Total assets (billions)	\$25.81	\$25.71	99.7%
1990			
Expense ratios (basis points)	83.3	85.0	
Total assets (billions)	\$136.11	\$131.69	96.8%
2000			
Expense ratios (basis points)	83.8	94.9	
Total assets (billions)	\$2,158.50	\$1,817.48	84.2%
2010			
Expense ratios (basis points)	69.2	90.9	
Total assets (billions)	\$3,488.35	\$2,473.59	70.9%

Source: Journal of Economic Perspective, Burton G. Malkiel & Lipper Analytics



Average Fees Paid to Fund Managers for Institutional Investors

(in basis points, asset weighted)

A: Active domestic equity managers for corporate funds, public funds, and endowments

	1996	1999	2002	2005	2008	2011
Corporate funds	52.9	54.4	54.2	54.9	53.5	55.0
Public funds	38.7	39.7	42.0	49.3	46.6	48.0
Endowments	51.3	51.3	59.9	59.1	64.4	64.0
Total	46.8	46.6	52.4	54.1	54.7	55.0

B: Active fixed-income managers for corporate funds, public funds, and endowments

	1996	1999	2002	2005	2008	2011
Corporate funds	32.6	34.3	27.5	28.0	29.7	30.0
Public funds	26.2	25.6	23.2	25.2	25.7	26.0
Endowments	29.6	30.4	27.1	29.0	34.7	36.0
Total	29.0	29.1	26.3	27.3	30.0	30.1

Source: Journal of Economic Perspective, Burton G. Malkiel & Greenwich Associates



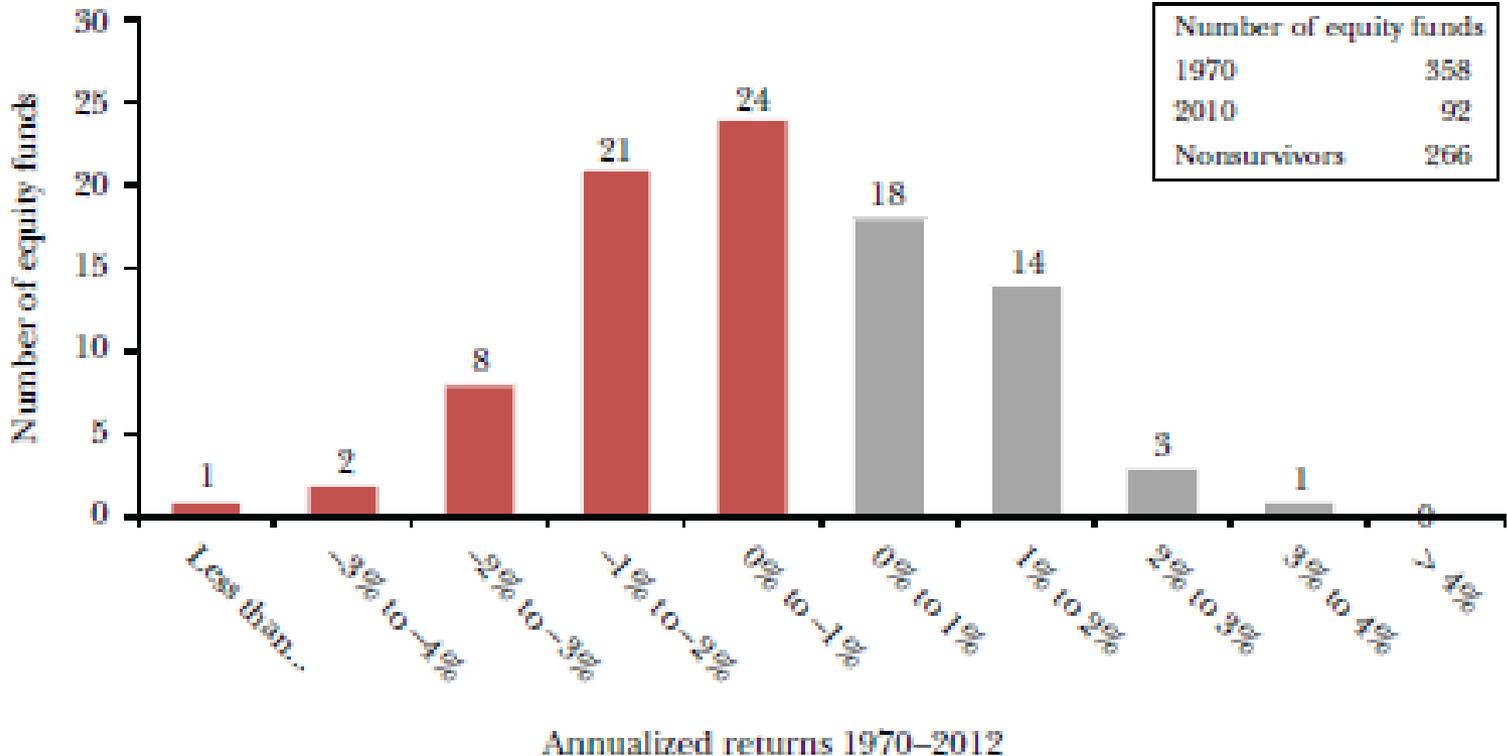
Percentage of US Equity Funds Outperformed by Benchmarks

Fund category	Benchmark index	Percent outperformed	
		2011	5 years through 2011
All domestic equity	S&P 1500	84%	62%
All large cap funds	S&P 500	81%	62%
All mid-cap funds	S&P Mid-Cap 400	67%	80%
All small-cap funds	S&P Small-Cap 600	86%	73%
Global funds	S&P Global 1200	69%	63%
International funds	S&P 700	69%	78%
Emerging market funds	S&P/IFCI composite	54%	83%

Source: Journal of Economic Perspective, Burton G. Malkiel & Standard & Poor's and CRSP Survivor Bias-Free US Mutual Fund Data Base. Information for periods ending December 31, 2011.



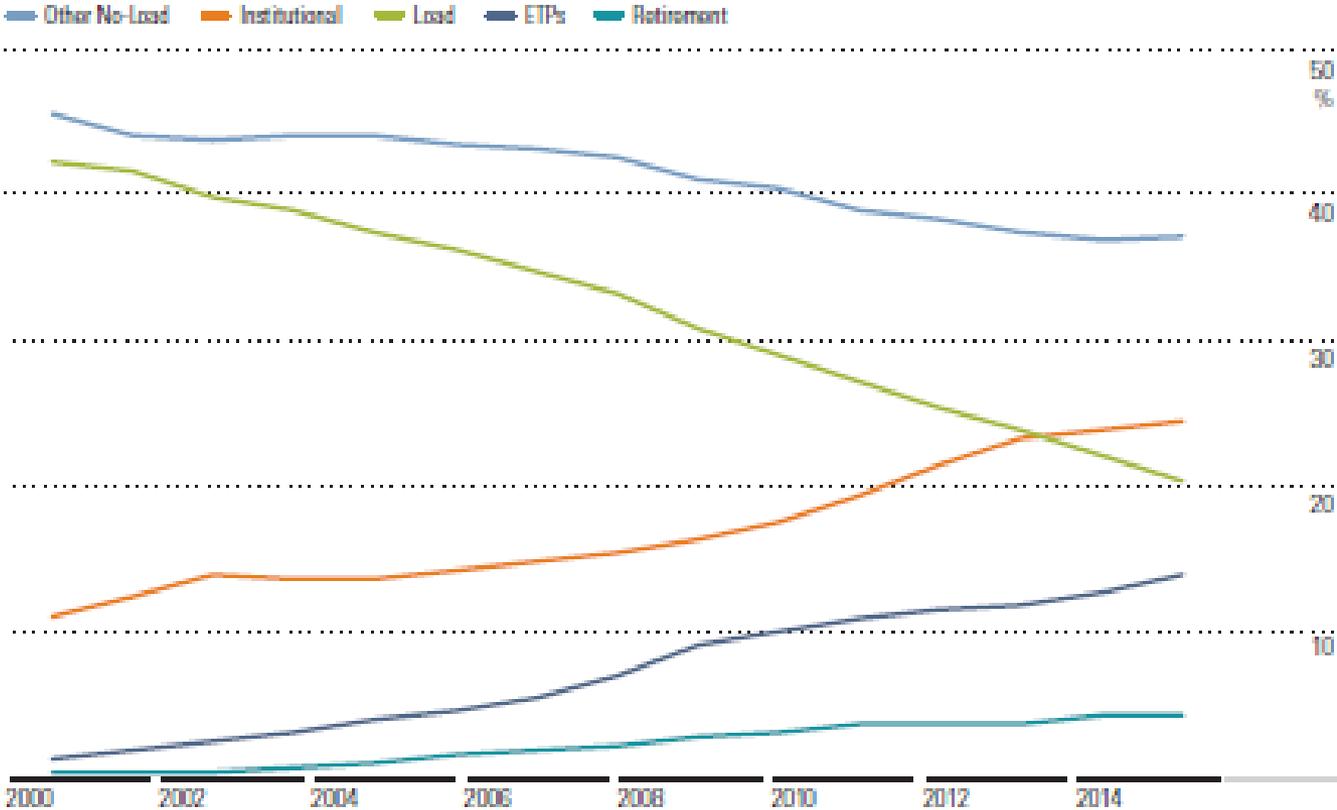
Returns of Surviving Funds: Mutual Funds 1970 to 2012, Compared with S&P Returns



Source: Journal of Economic Perspective, Burton G. Malkiel & Lipper Analytics



Exhibit 4 Market Share of Fund Assets by Share Class Type



Source: Morningstar, Inc.


Table 1. All-In Investment Expenses for Retirement Plan Investors

	Actively Managed Funds	Index Funds	Index Advantage
Expense ratio ^a	1.12%	0.06%	1.06%
Transaction costs	0.50	0.00	0.50
Cash drag	0.15	0.00	0.15
Sales charges/fees ^b	<u>0.50</u>	<u>0.00</u>	<u>0.50</u>
All-in investment expenses	2.27%	0.06%	2.21%

^aData are from Sharpe (2013).

^bThe 0.50% estimate for sales charges/fees is the midpoint of the range between 0% for DIY investors and 1% for investors who pay sales loads and fees to brokers and registered investment advisers. I have chosen not to include the "service charges" for loans, withdrawals, and so forth, often paid by investors in 401(k) retirement plans.

Table 2. Total Wealth Accumulation by Retirement Plan Investors, Assuming a 7% Nominal Annual Return on Equities

	Actively Managed Fund	Index Fund	Index Enhancement	
Gross annual return	7.00%	7.00%	—	
All-in costs	2.27	0.06	-2.21%	
Net annual return	4.73	6.94	+2.21	
Accumulation period				% Increase
After 10 Years	\$44,000	\$50,000	\$6,000	13%
After 20 Years	130,000	164,500	34,500	27
After 30 Years	286,000	412,000	126,000	44
After 40 Years ^a	561,000	927,000	366,000	65

^aFor the DIY investor in the active fund who incurs 0% distribution costs, the accumulation would amount to \$626,000. For an active fund investor who incurs the full 1% distribution cost, the accumulation would total \$504,000. For the index fund investor who incurs distribution costs of 0.5%, the accumulation would total \$824,000.

Source: Financial Analysts Journal, John C. Bogle



- Suppose you believe in active management and your ability to consistently select managers that will outperformance their policy index
- You are the asset owner – your choice is to whom to invest with and how

Manager ABC can generate an annualized return of 7%

Manager ABC charges a 1.0% (100 bps) investment management fee

The manager's fee compared to the returns produced equals 14% of the annualized return

What if fees were examined against the manager's ability to generate EXCESS return versus an index?



Average Returns, Active Funds, versus Index

(20 years through 12/31/2011)

Large-Cap Equity Funds Average	7.18	Small-Cap Equity Funds Average	5.50*	Fixed Income Funds	5.69
S&P 500 Index	7.81	MSCI US Small-Cap 1750	6.98*	Barclays US Aggregate Bond Index	6.50
S&P 500 Index Advantage	0.64	MSCI US Small-Cap 1750 Advantage	1.48*	Barclays US Aggregate Bond Index Advantage	0.82

Source: Journal of Economic Perspective, Burton G. Malkiel & Lipper Analytical Service and Vanguard

Why Do We Continue to Pay?



Arthur J. Gallagher & Co.
BUSINESS WITHOUT BARRIERS™



Kleenex®

vs.



Tissue Paper



Tylenol®

vs.



Ibuprofen



Q-Tips®

vs.



Cotton Swabs



- ¹Journal of Economic Perspectives – Volume 27, Number 2 – Spring 2013 - P. 97-108, Burton G. Malkiel (Chemical Bank Chairman's Professor of Economics, Emeritus, Princeton University)
- Morningstar Direct
- Financial Analysts Journal – Volume 70 – Number 1 – January/February 2014, John C. Bogle



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