

Can Active Management Make a Comeback?

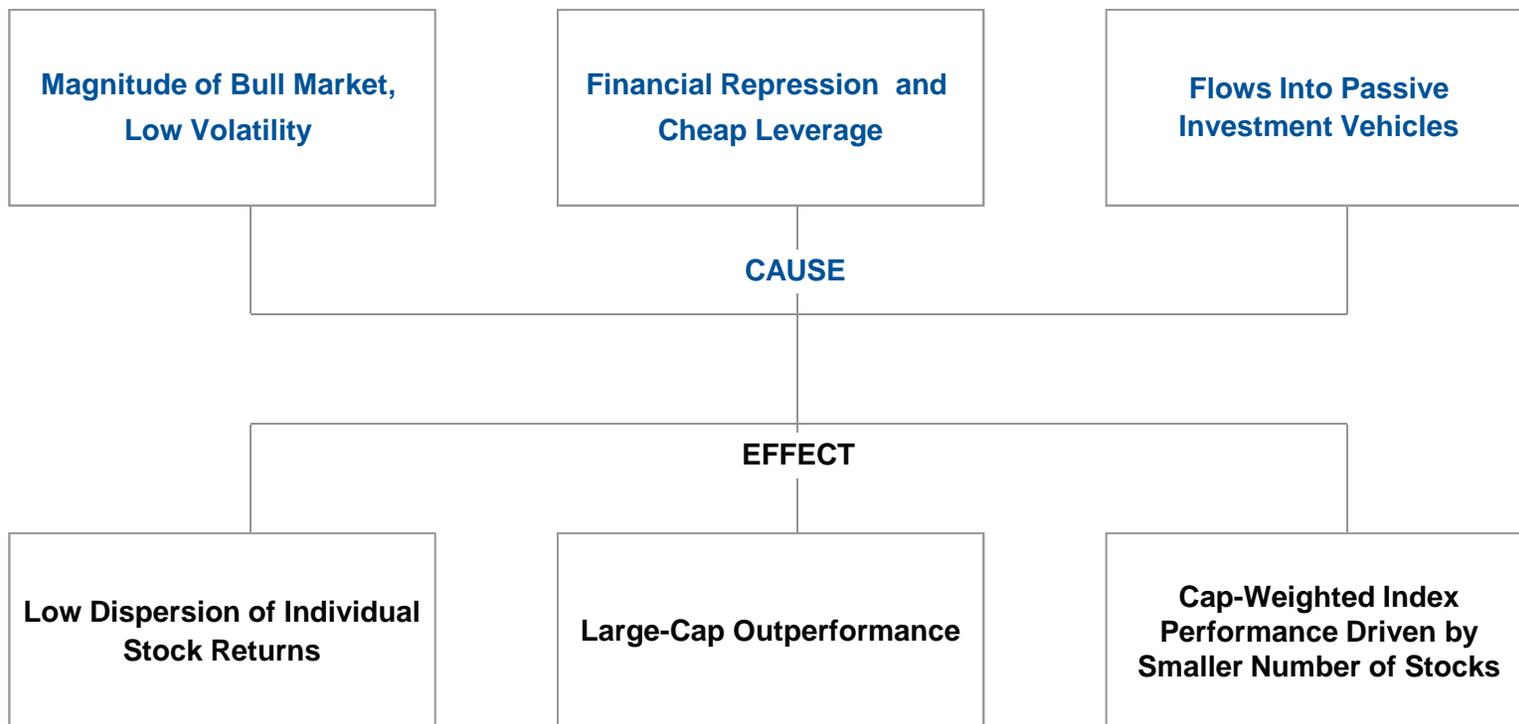
September 2015



Executive Summary

Recent underperformance by active U.S. managers can be easily explained and, in our view, is only temporary

FACTORS MAKING FOR A CHALLENGING ENVIRONMENT – 3 CAUSES AND 3 EFFECTS



Active Management Performance Has Been Cyclical

- The factors that have created challenges for active management tend to be cyclical in nature
- They are likely to change course in the future
- U.S. active equity management performance historically has gone in cycles, with periods when a significant number of managers outperformed the market, and other periods when many managers underperformed
- While U.S. large-cap and all-cap active managers have had particular difficulty in outperforming their benchmarks over the past six years, managers in other universes, such as U.S. small caps, developed market ex-U.S. equities and emerging market equities, have fared better

PERCENTAGE OF ALL-CAP MANAGERS OUTPERFORMING THE MARKET



Source: Lipper, Bloomberg; data through August 31, 2015. 12-month net-of-fee excess returns for the Lipper Multi-Cap Core universe, over the Russell 3000 Total Return Index. Indexes are unmanaged and are not available for direct investment. Investing entails risks, including possible loss of principal. **Past performance is no guarantee of future results.**

1. "Active managers" are as determined by Neuberger Berman by excluding managers with tracking error below 2%. We also excluded managers with tracking error above 15% to account for potential outlier managers who might skew the results from style drift. Manager results are net of fees. Where multiple share classes of a fund were available, we selected the one with the longest track record; if multiple share classes had the same length of track record, we selected the institutional share class where available.

Magnitude of Bull Market – Importance of Beta Exposure

- In strong bull markets, beta becomes the dominant source of a manager's returns

- Illustration assuming a manager with a beta of 0.9:

HYPOTHETICAL ILLUSTRATION	SCENARIO 1	SCENARIO 2
Market Return Above Risk-Free Rate	+30.0%	+5.0%
Manager's Expected Beta-Component Return	+27.0%	+4.5%
Alpha Required For Manager's Return to Equal Market Return	+3.0%	+0.5%

- Market and active manager performance since March 2009 (start of the post-global financial crisis recovery):
 - U.S. equity market return: 19.3% annualized¹
 - 25% of U.S. all-cap active managers outperformed the market on net-of-fee basis²
 - Of these managers, 84% had betas greater than 1.0
- What can explain a beta below 1.0?
 - Overweights to sectors or stocks with lower betas than the index
 - Actively managed portfolios may hold some cash
 - Risk mitigation and volatility dampening
 - Subscription/redemption management (frictional amounts of cash needed for this purpose)
 - Tactical expression of overall market view
 - While cash and lower-beta securities act as a drag on returns in bull markets, they can help mitigate losses in bear markets

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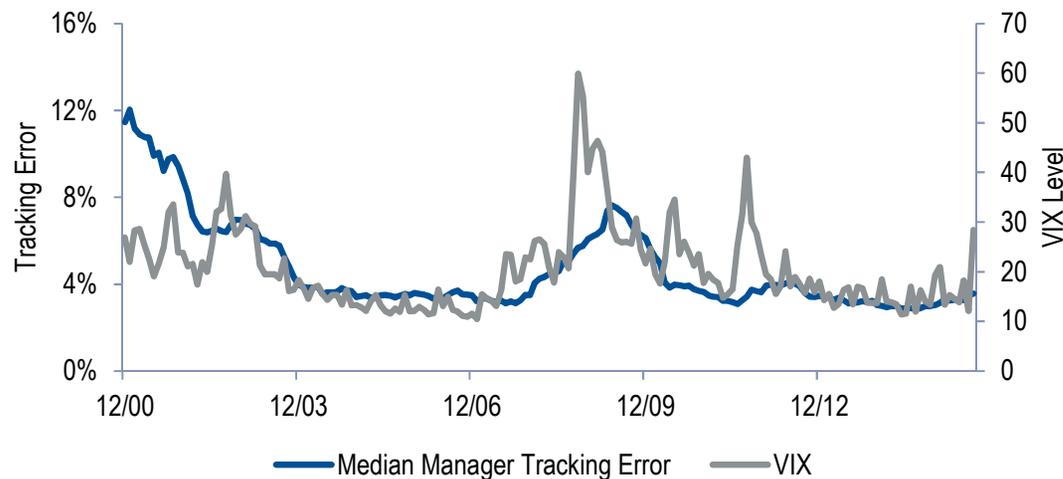
1. Source: Bloomberg. Market is proxied by the Russell 3000 index, through August 2015.

2. Source: Lipper, Bloomberg; data through August 31, 2015. 12-month net-of-fee excess returns for the Lipper Multi-Cap Core universe, over the Russell 3000 Total Return Index. See definition of "active managers" in notes to page 3.

Low Volatility

- Strong bull markets are typically characterized by low volatility levels
- Less volatile environments mean fewer and/or smaller price movements to take advantage of
- Historically, market volatility has been highly correlated to U.S. equity manager tracking error (i.e., volatility of active returns)
- Tracking error is a prerequisite for generating outperformance

VIX VOLATILITY INDEX AND LIPPER MULTI-CAP UNIVERSE MANAGER ROLLING TRACKING ERROR

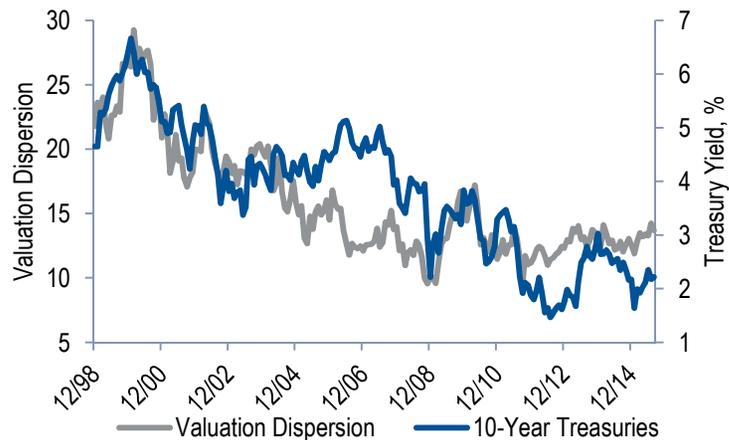


Source: Lipper, Bloomberg; data through August 31, 2015. Results for the Lipper Multi-Cap Core universe as described on slide 3. The Chicago Board Options Exchange Market Volatility Index, or VIX, is a commonly cited measure of implied market volatility. Indexes are unmanaged and are not available for direct investment. Investing entails risks, including possible loss of principal. **Past performance is no guarantee of future results.**

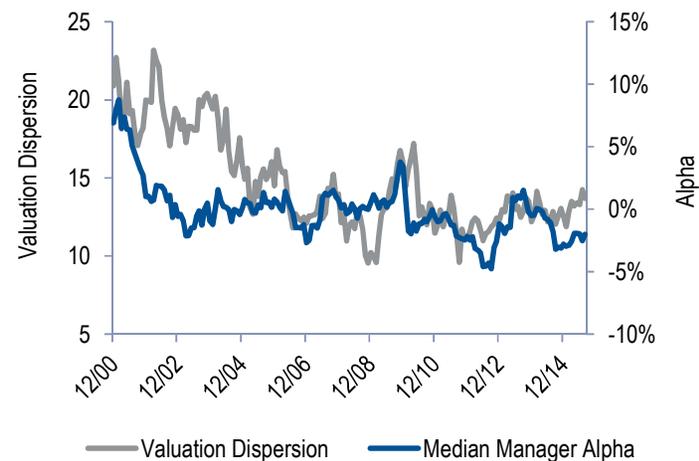
Financial Repression / Cheap Leverage

- Low interest rates have made leverage very cheap, creating valuation distortions
 - When leverage is cheap, the effects of too much debt and relatively thin operating margins tend to become muted
 - Lower discount rates make distant, speculative cash flows relatively more attractive
- Historically, there has been a strong relationship between:
 - Interest rates and valuation dispersion as measured by P/E multiples; and
 - Valuation dispersion and U.S. equity manager alpha
 - Taken together, these relationships show a correlation between interest rates and U.S. equity manager alpha, with rising rates having benefitted active managers, while declining rates having acted as a significant tailwind*.
- Once monetary and interest rate policy becomes more normalized, valuation dispersions may rise, as valuation distortions get rolled back

STOCK VALUATION DISPERSION AND 10-YEAR TREASURY YIELD



STOCK VALUATION DISPERSION AND LIPPER MULTI-CAP UNIVERSE MANAGER ROLLING ALPHA



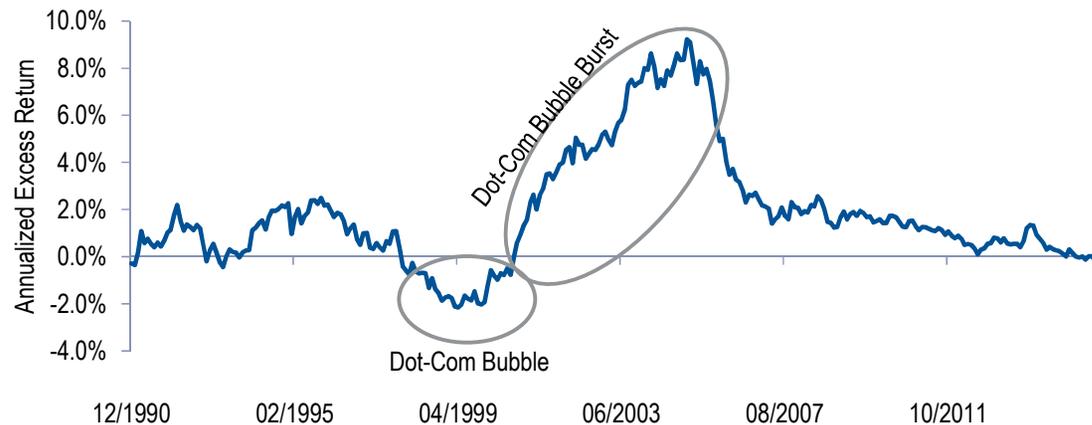
Source: Lipper, Bloomberg; data through August 31, 2015. Valuation dispersion is the difference between the 80th percentile and 20th percentile price-to-earnings ratio of the stocks in the S&P 500 Index. Median rolling 12-month net alpha for the Lipper Multi-Cap Core universe as described on slide 3, over the Russell 3000 Index. Indexes are unmanaged and are not available for direct investment. Investing entails risks, including possible loss of principal. **Past performance is no guarantee of future results.**

*For an analysis of this relationship going back to 1962, please see "Interest Rates and Active Management's Outlook," Nomura Securities, December 2, 2014.

Flows into Passive Investment Vehicles

- Most passive vehicles track broad, capitalization-weighted market indices, investing in proportion to companies' index weights
- Passive investing therefore commoditizes a heterogeneous group of companies, ignoring their fundamentals
- Risk-on/risk-off environment of the post-crisis recovery has been a further compounding influence
- In the long run, fundamentals (e.g., earnings) drive equity returns
- Passive investing represents a momentum strategy and is sensitive to market bubbles
 - A passive investor would have held 33% of his portfolio in Information Technology stocks in March 2000
 - Active managers have the ability to mitigate the fallout from a bubble burst by underweighting the bubble sector
- Passive investing often underperforms benchmark due to fees (although the magnitude of underperformance is small)

TOP QUARTILE MANAGER EXCESS RETURN DURING AND AFTER DOTCOM BUBBLE

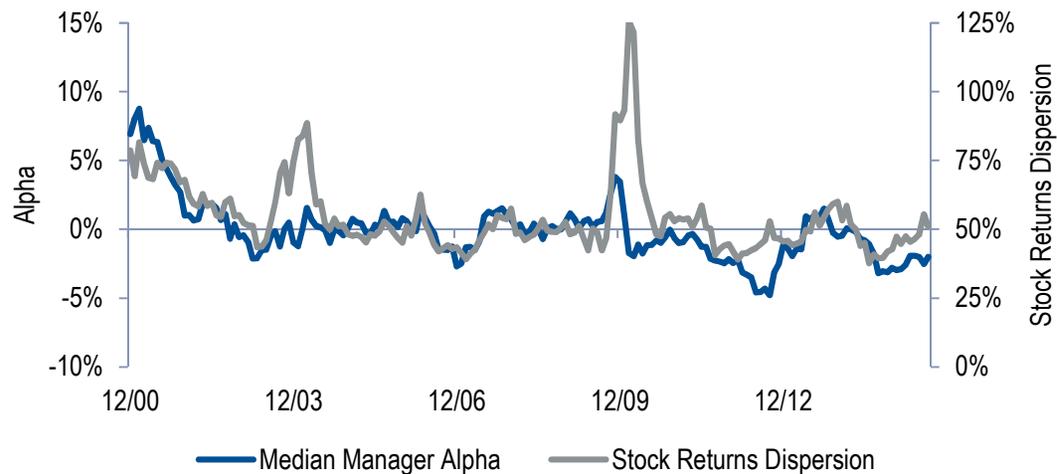


Source: Lipper, Bloomberg; data through August 31, 2015. Top-quartile manager's net 5-year rolling excess return in the Lipper Multi-Cap Core universe as described on slide 3, over the Russell 3000 Index. Indexes are unmanaged and are not available for direct investment. Investing entails risks, including possible loss of principal. **Past performance is no guarantee of future results.**

Low Dispersion of Individual Stock Returns

- Low dispersion of individual stock returns means smaller impact from fundamental analysis and security selection
- Low dispersion is a cause of a decline in tracking error, which means less opportunity for alpha generation

STOCK RETURNS DISPERSION AND LIPPER MULTI-CAP UNIVERSE MANAGER ROLLING ALPHA

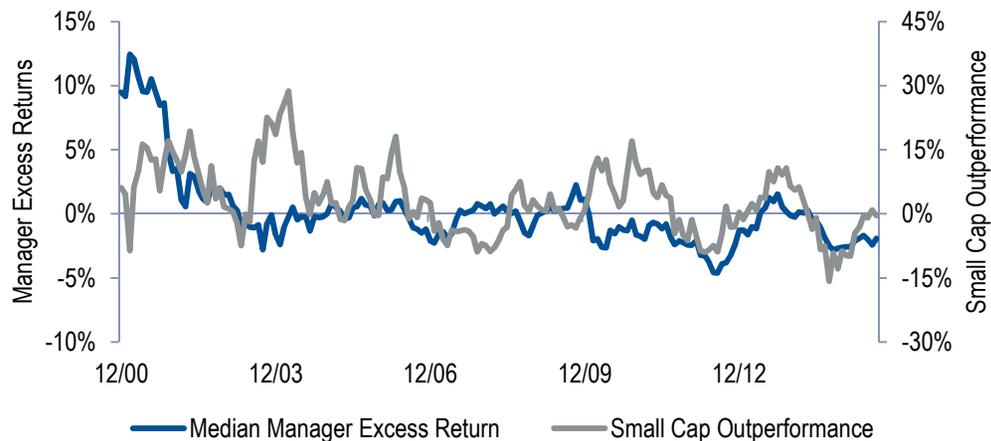


Source: Lipper, Bloomberg; data through August 31, 2015. Stock returns dispersion is the difference in the rolling 12-month return between the 80th percentile and 20th percentile stocks in the Russell 3000 Index. Median rolling 12-month net alpha for the Lipper Multi-Cap Core universe as described on slide 3, over the Russell 3000 Index. Indexes are unmanaged and are not available for direct investment. Investing entails risks, including possible loss of principal. **Past performance is no guarantee of future results.**

Large-Cap Outperformance

- Abundant central bank liquidity has helped drive demand for equities from investors searching for yield
- In liquidity-inspired bull markets, the benefits tend to accrue to the most liquid (i.e., largest) names
- Most commonly used benchmarks are capitalization-weighted
 - A narrow group of the biggest stocks in these indices have meaningful weights
- All-cap active portfolios tend to be skewed towards mid/smaller-cap names vs. the index
- The relative performance of the mid/smaller caps vs. larger caps can make a significant impact for an active equity portfolio
- Similarly, the outperformance of U.S. stocks over international stocks has created a drag on returns for many U.S. active managers
 - In 2014, U.S. stocks outperformed by 16%*
 - A 5% international allocation would have created an 80 basis-point headwind before accounting for the impact of security selection decisions

SMALL CAP VS. LARGE CAP RELATIVE PERFORMANCE AND LIPPER MULTI-CAP UNIVERSE MANAGER ROLLING EXCESS RETURNS



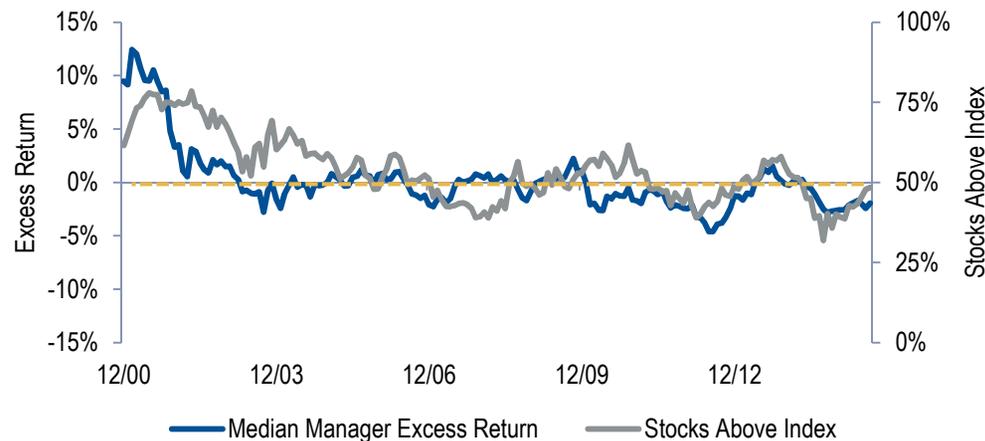
Source: Lipper, Bloomberg; data through August 31, 2015. Small cap outperformance measured as the rolling 12-month returns of the Russell 2000 Index over the S&P 500. Median rolling 12-month net excess return for the Lipper Multi-Cap Core universe as described on slide 3, over the Russell 3000 Index. Indexes are unmanaged and are not available for direct investment. Investing entails risks, including possible loss of principal. **Past performance is no guarantee of future results.**

* Source: Bloomberg. Measured as the difference in performance of the Russell 3000 Total Return Index and the MSCI ACWI ex-US Total Return Index in USD.

Cap-Weighted Index Performance Driven by Smaller Number of Stocks

- The percentage of constituent stocks outperforming the index had recently dipped to lows not seen since the dot-com era
 - Overall market has been driven by a narrow group of names
- This may be due in part to strong flows into passive products
 - The larger the proportion of new market inflows that replicates the index, the more difficult it becomes for an individual stock to outperform the index itself
- The fewer the names that outperform the benchmark, the harder it typically is for an actively-managed portfolio to outperform

STOCKS OUTPERFORMING INDEX AND LIPPER MULTI-CAP UNIVERSE MANAGER ROLLING EXCESS RETURNS



Source: Lipper, Bloomberg; data through August 31, 2015. Stocks above index represented by rolling 12-month returns of Russell 3000 Index constituents, compared to the performance of the Russell 3000 Index itself. Median rolling 12-month net excess return for the Lipper Multi-Cap Core universe as described on slide 3, over the Russell 3000 Index. Indexes are unmanaged and are not available for direct investment. Investing entails risks, including possible loss of principal. **Past performance is no guarantee of future results.**

Our Outlook and Perspectives

- Given our continuing moderating outlook for equities, we believe alpha generation could become a relatively more significant source of excess returns
- We see the potential for volatility moving higher over time and believe this should create more opportunities for active managers to take advantage of price movements
- The potential end of financial repression and prospect for rising interest rates should mitigate valuation distortions, which could help drive greater valuation dispersion among individual stocks
- Should we begin to see greater dispersion between individual stock returns, it could provide attractive opportunities for fundamental stock pickers with effective security selection skill
- We believe the relative outperformance of large caps vs small caps and U.S. stock vs international stocks may change
- Flows to passive strategies may moderate
 - Should the environment for alpha generation become more favorable, investors may “rediscover” active managers
 - Stock performance gains could become more broadly based, providing greater opportunities to beat the benchmark
- In a virtuous cycle, we believe these developments should further improve the environment for active managers

Year-To-Date Update

Through August 30, 2015

- The environment for active management has improved
 - The market, as proxied by the Russell 3000, has returned -2.6% year-to-date
 - Stock returns dispersion and valuation dispersion have ticked up a bit, although they remain below long-term averages
 - Small caps and large caps are trading almost in-line year-to-date as of August 30
 - The percentage of stocks outperforming the market has picked up after a trough in September 2014, and is now in the 48% range
 - Volatility rose in August after a few below-average months
- The manager universe performance has improved as well
 - Year-to-date, 43% of the managers in the Lipper U.S. all-cap active manager universe have outperformed the Russell 3000, compared to 29% for the period through December 2014
 - On average, both excess return and alpha are still slightly negative, although much less so than for the period through December 2014
 - Median tracking error has seen an uptick as well compared to 2014 levels

Source: Bloomberg, Lipper. Net-of-fee returns for the Lipper Multi-Cap Core universe as described on slide 3, vs. the Russell 3000 Total Return Index. Indices are quoted on a total-return basis. Indexes are unmanaged and are not available for direct investment. Investing entails risks, including possible loss of principal. **Past performance is no guarantee of future results.**

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Lipper Multi-Cap Core Universe: consists of fund classified as Multi-cap core by Lipper. Includes funds that, by portfolio practice, invest in a variety of market capitalization ranges without concentrating 75% of their equity assets in any one market capitalization range over an extended period of time.

Morningstar Large Blend Index Fund universe: Large-blend portfolios are fairly representative of the overall U.S. stock market in size, growth rates, and price. Stocks in the top 70% of the capitalization of the U.S. equity market are defined as large cap. The blend style is assigned to portfolios where neither growth nor value characteristics predominate. This universe consists of large blend funds that have been identified by Morningstar as being index funds based on their investment attributes.

Russell 3000 Index: Float-adjusted market capitalization total return index that measures the performance of the largest 3,000 U.S. companies based on market capitalization, representing approximately 98% of the investable U.S. equity market.

S&P 500 Index: Capitalization-weighted index of 500 stocks, designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 U.S.-listed stocks representing all major industries.

Russell 2000 Index: Measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represents approximately 8% of the total market capitalization of the Russell 3000 Index. The index is market cap-weighted and includes only common stocks incorporated in the United States and its territories.

MSCI ACWI ex-US Index: A free float-adjusted market capitalization total return index that is designed to measure global equity performance, excluding the US.

The Chicago Board Options Exchange Market Volatility Index, or VIX, is a commonly cited measure of implied market volatility. Past performance is not indicative of future results.

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