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Asset Management Focus

Freeman & Co. LLC

Putting the Pieces Back Together

While the S&P 500 is still off its peak by over 20%, the asset management industry is putting its pieces back together. The large transformational deals have passed, operating margins are being repaired and compensation/revenue metrics are falling back into line. The beginning of a more normal M&A environment is developing. However, many sectors are different than pre-crisis: many hedge fund of funds (HFOF) didn't perform as advertised (e.g. those with Madoff) and the retail investor has failed to return to equities, preferring the safety of bonds and their low yields for now. Uncertainty and inflation await us.

Performance as of December 31, 2009

Index	Total Return 2H 2009	Total Return 1 Year	Total Return Annualized 3 Yr	Total Return Annualized 5 Yr
S&P 500	22.6%	26.5%	-5.6%	0.4%
NASDAQ	23.7%	43.9%	-2.1%	0.9%
FTSE 100	27.4%	22.1%	-4.2%	2.4%
BGC*	3.9%	4.5%	5.8%	4.7%
HFRI**	9.6%	18.6%	1.8%	5.4%

*Barcap Government & Credit Index

** Hedge Fund Research Institute Fund Weighted Composite

Inside this Issue:	Page
Global Deal Activity	2
Transactions by Company Type & Deal Size	3
Assets Acquired by Region	4-5
Changing Face of Alternatives	6-8
Emerging Markets Managers Revisited	9-10
Public Comps	11

Indices at 12/31/09:

DJIA	10,428
Nasdaq	2,269
S&P 500	1,115
FTSE 100	5,412
10 Year US Treasury Bond Yield	3.84%
USD per GBP	\$1.62
USD per EUR	\$1.44

Summary:

- Deal Activity / M&A:** There were 151 acquisitions of asset managers in 2009, a 27% decrease from 208 in 2008 and a 30% drop from 217 in 2007. However, total AUM acquired skyrocketed to \$4.7 trillion in 2009 from \$1.3 and \$1.7 in 2007 and 2008, respectively, highlighted by BlackRock's acquisition of Barclays Global Investors (\$1.5 trillion AUM).
- Changing Face of Alternatives:** Alternative firms are re-evaluating their business models post-crisis. Institutional investors are becoming an increasingly larger presence in the alternative market and will fuel asset growth in the future. Madoff and other issues like side-pockets and gating have caused risk management to become a primary area of concern. The use of managed accounts will increase as investors favor transparency and liquidity over secrecy. Firms with strong brands, stable operations and robust risk management systems should attract substantial asset flows.
- Emerging Markets:** Despite recent market volatility, institutional interest in emerging markets remained strong in 2009 driven by a continuing belief in the macro growth story and a global demand for non-dollar denominated debt products. Inflows into both equity and debt funds have grown significantly in recent months but have been directed primarily toward the largest, best known global managers. We expect this trend to continue for some time and for specialist and regionally-based managers increasingly to consider strategic partnerships to compete with their larger competitors.

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