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Asset Management Focus

Freeman & Co. LLC

Can a Third Shoe Drop?

Bear Stearns. Lehman. What's next? And what will its impact be on the asset management industry? Already AUM is down 20-50% at many managers, and compensation and operating costs are being cut. While this creates enormous stress, it is also creating great opportunities for firms to differentiate themselves: for FOFs to miss Madoff; for CLO managers to pick the best credits; for LBO firms to have structured the best deals; for stock and bond pickers to have gotten defensive early. These winners will emerge in an environment where many of their competitors will be struggling and this will lead to some significant strategic shifts in the industry landscape. That will be exciting, but now it's all about survival.

Performance as of December 31, 2008

Index	Total Return 2H 2008	Total Return 1 Year	Total Return Annualized 3 Yr	Total Return Annualized 5 Yr
S&P 500	-25.1%	-37.0%	-8.4%	-2.2%
NASDAQ	-26.9%	-40.5%	-10.6%	-4.7%
FTSE 100	-17.5%	-28.3%	-4.2%	3.4%
BGC*	4.7%	5.7%	5.6%	4.6%
HFRI**	-17.5%	-18.7%	0.3%	3.8%
FTSE Hedge***	-13.1%	-19.8%	-14.2%	-9.6%

*Barclays Govt./Credit Index

** Hedge Fund Research Institute Fund Weighted Composite

***in US\$ terms

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Indices at 12/31/08:

DJIA	8,776.39
Nasdaq	1,577.03
S&P 500	903.25
FTSE 100	4,434.20
10 Year US Treasury Bond Yield	2.24%
USD per GBP	\$1.46
USD per EUR	\$1.39

Summary:

- Deal Activity:** There were 208 acquisitions in 2008, a slight decrease from 217 in 2007. Total deal AUM at \$1.6 trillion was up from \$1.3 trillion in 2007 and the number of transactions greater than \$1 billion reached an all-time high.
- Minority Deals:** However much of this activity was in minority deals. Nippon Life Insurance's 5% stake in Russell Investments (\$211 billion AUM) and Mitsubishi UFJ Trust and Banking Corporation's 10% stake in Aberdeen Asset Management (\$183 billion AUM) were two key highlights for 2008, making up approximately 25% of deal AUM. Weighting these deal AUM's by the ownership bought, would lead to a drop in industry activity of 23%.
- Deleveraging:** US financial sector debt grew to 114% of GDP, up from 21% in 1980. A return to that level would require \$14 trillion of debt to be repaid. Mortgage debt grew 10x since 1980, compared to 7x growth for other debt types (government, consumer credit, non-financial businesses), and would need to drop by \$4 trillion to be in line with the historical growth of these other debtors.
- Combo Deals:** With AUM and revenue plunging, firms have pursued "combination" deals, such as the merger of asset management units of Soc Gen and Credit Agricole. We have seen other deals by Aberdeen and GLG – we expect to see more.

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