

Asset Management Focus Freeman & Co.



Introduction to Freeman & Co. Focus

Since our last research report, we decided to follow the lead of our London group, Sector Analysis, and launch a more frequent piece that provides a succinct review of the asset management industry by drawing on our proprietary research in New York and London. We expect these Focus reports to examine:

- M&A and Strategic Partnerships
- US and European trends
- Special Topics

Much of this will draw on tools we have built, such as our proprietary database of over 1,000 M&A and distribution deals, Sector Analysis' research on European distribution and trends, as well as our recent efforts in tracking dynamic changes in the hedge fund and fund of fund industry.

As always, we hope our research is helpful and we look forward to working with you in the future.

Eric Weber

Summary

Although asset depreciation and asset outflows have reduced industry revenue and earnings, our research indicates that activity this year has been strong thus far. While traditional firms have suffered due to market returns, alternative asset classes are maintaining their popularity.

Our key findings are:

- During the first three quarters of 2001 the asset management industry has remained acquisitive with 117 global acquisitions, above last year's pace of 89 acquisitions for the same period; Full year acquisitions should be in line with 2000 with 150 acquisitions, suggesting 33 in 4Q01
- Strategic partnerships are down considerably in 2001 with 22 compared to 40 in 2000
- Average deal size by AUM has decreased to \$7.3 billion in 2001 from \$11.0 billion in 2000, but median size of \$1.65 billion is in line with historical average of \$1.50 billion
- Multiple buyers are re-emerging (Legg Mason, Eaton Vance, Neuberger Berman and Boston Private)
- European acquisitions continue to be driven by universal banks (44% of acquisitions), with strong activity in the UK, France, Germany and Switzerland
- European fund growth remains high, but AUM has been hurt by recent market downturns
- Alternative asset entrants increased with 42 hedge funds and 18 fund of funds in the third quarter
- Institutional allocations to hedge funds and fund of funds continue to increase
- Our survey of hedge fund of funds indicates that they delivered on their promise of providing downside protection as indicated by their performance this September and year-to-date

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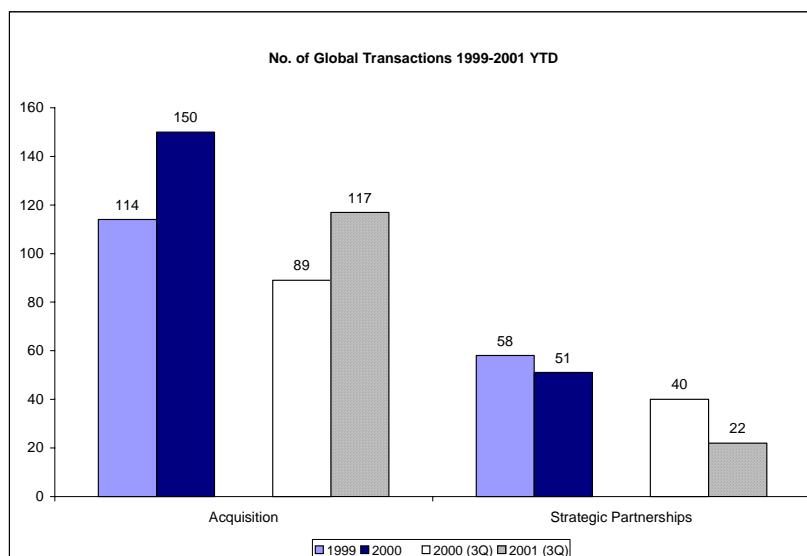
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Global Asset Management Transactions

Overall, the asset management industry has remained acquisitive for the first three quarters of 2001. Year to date the number of acquisitions announced (117) exceeds the number for the same period in 2000 (89) by 31%, however, we do not expect 4th quarter 2001 to match the number of transactions in 4th quarter 2000 which was 61. However, we do expect the total number of acquisitions announced in 2001 will mirror the number of acquisitions announced in 2000 (150), suggesting 33 announced deals in 4Q01.

Moving forward, acquisitions should decrease as many companies will be focused on internal issues and will find it difficult to acquire while simultaneously laying off employees. For 2002, acquisitions numbering perhaps 110-125 could be reasonable, a drop of 16-26% from recent levels.

Strategic partnerships, which refer to joint ventures, alliances and distribution arrangements, continue to decline, reflecting the lack of major changes which initiated them. These major changes, such as deregulation in Japan (1998-99) and the introduction of the Euro (2000-2001) were the drivers of the majority of these tie-ups.



Source: Freeman & Co

Global Acquisitions

Although the total number of acquisitions has increased, despite the global economic downturn, the amount of AUM acquired has decreased significantly from 2000 levels of \$1.7 trillion, but remains well above 1998 and 1999 levels.

Median AUM of \$1.6 billion acquired has also fallen from 2000 but remains inline with long term averages of \$1.5 billion. The average AUM acquired has fallen from US\$11 billion in 2000 to US\$7.3 billion in 2001, a decrease of 30%, but still 27% above 1999 (\$6 billion).

Our report in October 2000, *Drivers of Consolidation*, highlighted the number of large deals in 2000 with eleven deals involving over \$50 billion each and eighteen deals valued at over \$1 billion in proceeds.

In contrast to 2000, only four deals involve over \$50 billion and six are valued at over \$1 billion in 2001. The notable deals to date have been:

- Deutsche Bank AG acquired Zurich Scudder Investments US operations with approximately \$280 billion in AUM
- Eureka NV acquired the remaining stake of Foreign & Colonial Management that it does not own (\$90 billion in AUM)
- Societe Generale SA acquired a majority stake in TCW group with \$80 billion in AUM
- FleetBoston Financial Corp. acquired Liberty Financial Co.'s money management division with \$51.3 billion in AUM
- Mellon Financial Corp. acquired Standish, Ayer & Wood Inc. with \$41 billion in AUM

Assets Acquired by Region in US\$ millions

Region	1998	1999	2000	2001 YTD	Total
Africa	34,910		28,900		\$63,810
Asia	68,982	82,244	28,802	26,401	\$206,429
Canada	11,600	8,304	43,181	47,200	\$110,285
Europe	126,422	160,057	667,646	141,475	\$1,095,600
South America	8,285	19,062	2,122		\$29,469
US	229,605	415,067	945,124	642,729	\$2,232,525
Total	\$479,804	\$684,734	\$1,715,775	\$857,805	\$3,738,118

No. of Acquisitions	103	114	156	117	490
Average Deal size	\$4,658	\$6,006	\$10,999	\$7,332	\$7,629
Median Deal Size	\$1,000	\$1,300	\$2,000	\$1,645	\$1,500

Source: Freeman & Co.

Intra-US Acquisition Activity

Intra-US M&A activity has remained strong with numerous “boutique” firms acquired. During the first nine months 44 US-US deals were announced, compared to only 23 during the similar period last year. The key trend we have found is the re-emergence of “multiple boutique buyers”. In our March 2000 and October 2000 reports, we highlighted trends with buyers like UAM, AMG and others. Since a drop in deals by these types of firms in 1999 and early 2000, the multiple-buyer has returned with firms like Legg Mason (4 acquisitions), Neuberger Berman (3), Eaton Vance (3), Federated Investors (3) and Boston Private Financial (3) making acquisitions in the past 18 months.

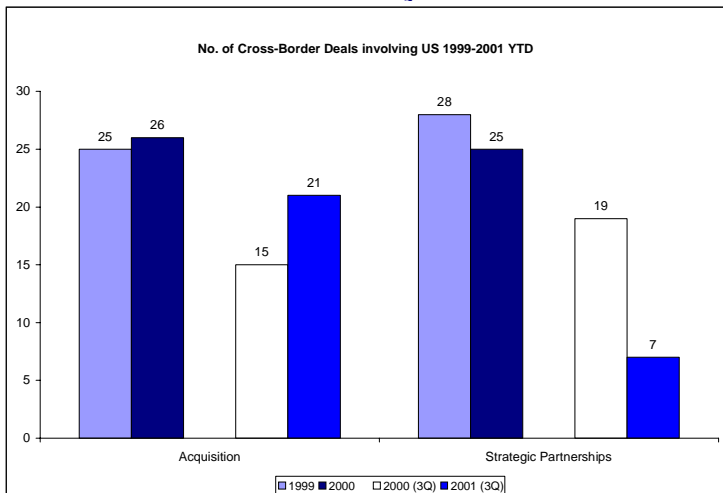
Noteworthy Deals in 2001

Month	Target	Acquirer	Ownership %	Entity Value \$MM	Total Deal AUM (\$MM)
8	Atlanta Capital Management Co	Eaton Vance Corp	70	107	6,400
8	Freiss Associates	Affiliated Managers Group	51	484	7,100
7	Fox Asset Management	Eaton Vance Corp	80		2,000
7	Royce & Associates, Inc	Legg Mason	100	115	5,300
7	Tremont Advisers Inc	Oppenheimer Funds Inc	100	133	
7	Welch & Forbes, Inc	Affiliated Managers Group	60		4,200
6	Liberty Financial Co.*	FleetBoston Financial Corp.	100	1,010	51,300
6	McMorgan & Co.	New York Life Insurance Co	100		27,000
6	Symphony Asset Management	John Nuveen Co.	100	210	4,000
6	Van Deventer & Hoch	Mellon Financial Corp	100		1,600
5	Private Capital Management LP	Legg Mason	100	682	8,000
4	Asset Management Advisors	SunTrust Banks, Inc	100		1,000
4	Standish, Ayer & Wood Inc.	Mellon Financial Corp	100	170	41,000
3	H.D. Vest Inc	Wells Fargo	100	128	16,000
1	Taylor Investments Inc.	Boston Private Financial Holdings, Inc.	100	11	535
1	Walnut Asset Management, LLC	Phoenix Investment Partners	51		800

*Fleet Boston acquired the investment management arm of Liberty Financial Co.

Source: Freeman & Co.

Cross Border Deal Activity



Source: Freeman & Co.

Cross-border M&A deals involving US companies has increased 29% YTD 2001 (21 deals) compared to the similar period in 2000 (15 deals). If this activity continues in 4Q 2001, US cross-border M&A would remain in the range of the past two years, with 25-26 deals annually.

Of the acquisitions YTD, 13 have been US-European deals, with six in the UK and the remainder on the Continent. The remaining M&A deals have been spread evenly between Asia, Australia and Canada. The acquisitions have been evenly split between US firms being buyers (11) versus sellers (10) during the first nine months.

With the absence of regulatory change in 2001, the rate of new partnerships has continued to drop from 1999-2000 levels. Regulatory change in Japan (1998-1999) and the Euro (2000) are the obvious reasons for past activity. Now, the number of strategic partnerships YTD 2001 is down 63% compared to last year (7 vs. 19).

The main area where we expect partnering opportunities to continue will be in Europe, but this comes with a few caveats. The ma-

majority of household assets are held by universal banks, who have been approached by many foreign firms looking for distribution. These universal banks will strike the best deal, often insisting on commissions for fund sales as well as an equity stake in the joint venture. In addition, access to a universal bank’s customers does not mean access to its private banking customers as well. Due to the privacy issues in banking, the asset management division generally does not have direct access to the private bank’s clients, and often must convince the private bank to offer its internally managed products. Foreign firms may find navigating these territories extremely difficult.

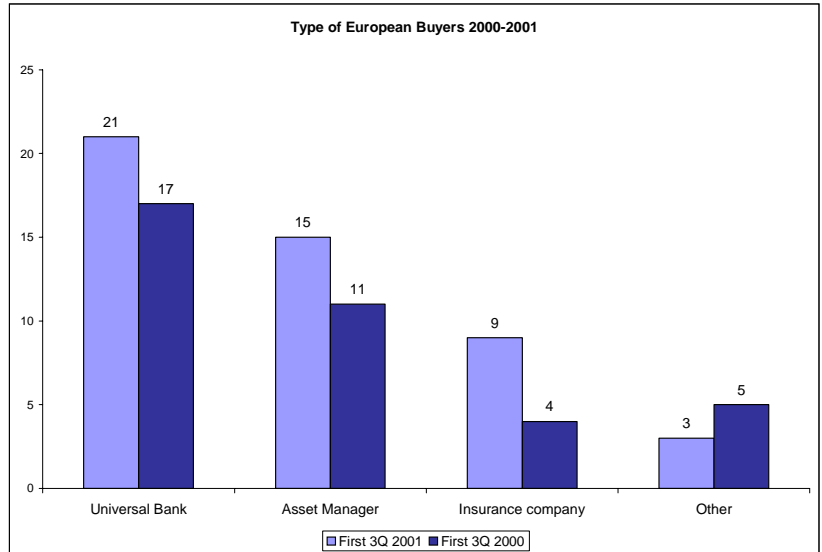
European Activity

M&A activity in the European asset management industry continues as global M&A activity reaches last year's level. However M&A doesn't necessarily mean the industry is consolidating. We don't think that the asset management industry in Europe is consolidating since we believe that it hasn't reached the type of maturity that would trigger the consolidation process.

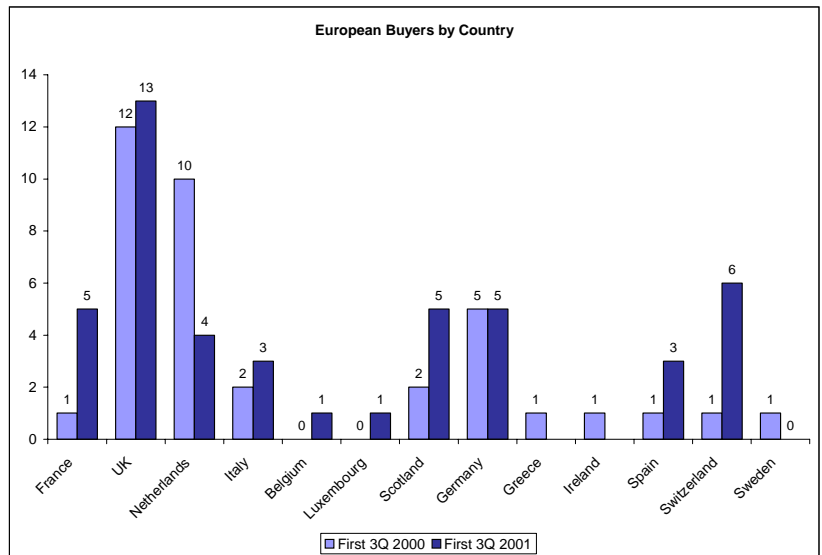
Indeed, out of the 48 transactions involving a European buyer only 15 buyers were pure asset management firms and 30 were either universal banks or insurance companies.

We think that the real consolidation is taking place at the bank and insurance level. This consolidation in the banking sector is a response to mature market conditions and the need to reduce costs and raise margins. Faced with eroding margins in mainstream consumer banking and capital markets losses, universal and saving banks started looking at private asset management, which still yield respectable revenues and high margins (around 30%) for a relatively low level of capital usage.

With the push towards private pension provisions in Europe, life insurers, which currently provide the majority of pensions products, are looking for big growth in their already considerable high-growth market. As life insurance and pension products are increasingly viewed as part of an overall portfolio of savings and investments products, insurers are emerging as competitors to major banks and independent asset management companies. The long-term saving sector will be the battleground where banks and insurers will fight for dominance.



Source: Freeman & Co.



Source: Freeman & Co.

Europe

1. OUTLOOK

The investment management industry in Europe continues to exhibit long-term growth prospects and appears highly attractive for US and pan-European fund companies who are struggling with slower growth and eroding margins in many business lines. The high potential growth shown by Europe is driven by the following key elements:

- Aging population

About 90% of the whole of European provisions consist of public pensions funded by pay-as-you-go systems. With the ageing of the population, Europe cannot ignore the financial implications of this trend on its pension system: increasing social contributions, a growing national debt and higher inflation. But more work is required before pan-European pensions become a reality, since it will not be easy to achieve a common set of standards applying to the diverse system of state and private pension that exist across Europe.

- Growing wealth among High Net Worth Individuals (HNWI)

High Net Worth Individuals and the mass affluent sectors (20 millions households) are the drivers of the developing market, as they represent about 75% of total European investable assets. This context is due to the combination of several factors: GDP expansion, stock market bull runs of the recent past, entrepreneurial IPOs, increasing sales of family businesses and the increasing frequency of significant use of stock options in executive compensation package.

- Relatively new interest in equities

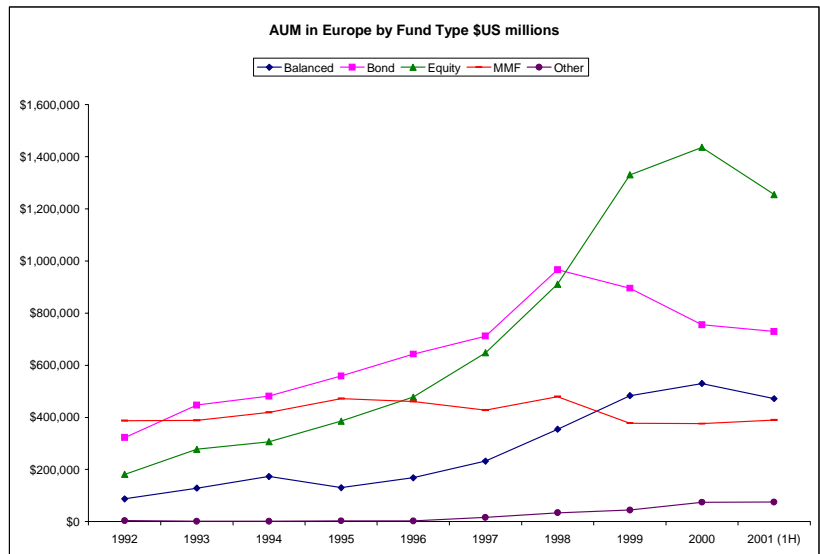
The stock market bull runs of the recent past and well publicized privatizations such as Deutsche Telekom sparked the first wave of enthusiasm for stocks, while traditionally risk-averse (continental) Europeans have been turning away from fixed income investments and real estate funds.

2. ASSET ALLOCATION

In the last decade equity funds outstripped both bond funds and money market funds to become the largest asset class in the European mutual funds market. They expanded their market share from 18% in 1992 to 43% in mid-year 2001. From the 3rd largest asset allocation class, equity funds' AUM increased by more than fivefold in the last decade.

Bond funds and money market funds lost market share during this period. Falling bond yields and a low public issuance of debt is causing a tight market. Bond fund market share fell from 33% in 1992 to 25% in 2001, while money market funds fell from 39% in 1992 to 13% in 2001. As a result, bond funds are now the second largest asset class (as opposed to the first asset class for almost 6 years), and money market fund have become the fourth largest asset class (as opposed to the first in 1992 and the second for the following 4 years).

We also need to highlight the growth in AUM for balanced funds. With \$470bn in 2001, balanced funds grew strongly as a proportion of the European mutual funds market. In 1992 these made up only 9% of the European market whereas in 2001 this figure had risen to 16%. The success of balanced funds has been to a large extent due to two factors: the risk-diversified growth opportunities that these funds offer, and their product packaging as "profiled funds".



Source: Fefsi

Europe

Based on recent market developments, we expect an increase in fund of funds and multi-manager products in response to an increasing demand for more risk-diversified products. Moreover, these structures are favored because of their ability to match investor needs in terms of risk and expected returns. With current levels of market volatility, they have the advantage of providing capital preservation as well.

This trend towards multi-managers has been exploited by few European universal banks and insurance companies to satisfy demand from customers for non-proprietary funds. For instance, French banks and insurance companies made little use of third-party distribution until recently. Since fund of funds were introduced a few years ago it has been possible to get third-party distribution through French banks using multi-manager funds: BNP Paribas multi-manager, AXA multi-manager, SEI-CCF, Frank Russel-Credit du Nord.

3. OPEN ARCHITECTURE

Many European banks are being dragged kicking and screaming into the world of Open Architecture. The idea of selling other firm's products is still only accepted as a distasteful necessity by some. And yet there are reasons why they have to do it. This mismatch shows itself in the difference between banks publicly stated attitudes towards Open Architecture, and research and anecdotal evidence of internal resistance to it. This mismatch is what we describe as the wide "Talk to Action ratio".

In the past, banks have tended to encourage clients to invest in their own products, because they earned the most this way. However customer-owners such as banks have such a strong position in negotiations with their product suppliers, who are desperate for some share of the clients' wealth, that the banks are able to persuade an increasing number of third party mutual fund suppliers to offer very attractive terms (ie large slices of commissions). Some banks are starting to use third party funds in favor of in-house products because they can earn a greater slice of the action with external suppliers. Foreign promoters would offer distributors up to 50 basis points trail commission. The same distributor could expect to receive just 20 to 25 basis points from internal fund products.

In a survey carried out in July 2001 among 300 fund distributors by our subsidiary, Sector Analysis, a pan European specialist asset management research firm, it appeared that Fidelity has the strongest Competitive Position among third party fund suppliers in Europe. Sector has developed one single measure of what it thinks is the Competitive Position of suppliers of third party funds. The combined ranking is based on three separate measures:

- *How well known they are (brand recognition);*
- *How well regarded they are;*
- *How much third party fund business these suppliers do.*

4. MUTUAL FUNDS' AUM BY COUNTRY

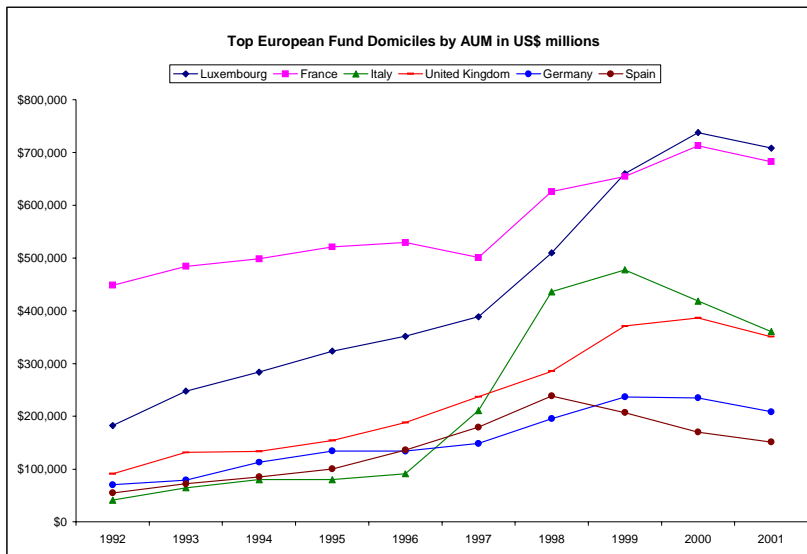
In the early 90's, the only country having largely adopted the mutual fund vehicle was France with \$450bn of AUM, which represented 46% of the European mutual fund market. The other European countries stand far away in terms of enthusiasm towards mutual funds: less than \$100bn market size. Retail deposits, life and pension products and to a lesser extent direct investment were dominating the saving market.

In 2001, only 5 countries have shown their ability to develop a sizable domestic domicile mutual fund market: France, Italy, UK, Germany and Spain. Luxembourg has been intentionally omitted because of its "offshore center" status.

Competitive Position of European Third Party Fund Providers				
Third party Fund Supplier	Best Known	Highly Regarded	Most Business	Combined Rank
Fidelity	1	1	1	1
JP Morgan Fleming	2	2	2	2
Deutsche Bank	3=	3	4	3
Invesco	3=	4	3	4
Merrill Lynch	5	5	5	5
ABN Amro	9	6	6	6=
Credit Suisse	6	7	7	6=
Schroders	7	8=	12	8
UBS	11	8=	8=	9
Morgan Stanley	13	12	8=	10
Templeton	8	18	14=	11
Societe Generale	15=	10	14=	12
HSBC	19	11	10	13
BNP Paribas	14	21	11	14=
ING/Barings	10	24	22	14=
Henderson	21	15	14=	16
Dresdner/DIT	15=	19	24=	17
Barclays	24=	21	18=	18=
Julius Baer	24=	24	18=	18=
Pictet	27	13	24=	20

Source: Sector Analysis, Ltd.

Europe



Source: Fefsi

success can be explained by the reduction in inflation and the massive transfer of the Italian government bonds held by Italian families into mutual funds. The decline of the AUM since 1999 is not only due to falling markets but to net outflows as well (especially in bond funds invested in short-term euro-zone fixed income). Indeed, Italian investors have shown at different occasions (1987, 1993-95) how volatile their holding periods are. But the upside of this behavior is that we can expect a quick recovery after a bounce in the markets. We believe that the growth momentum has been only temporarily paused and that the Italian mutual fund market will restart growing at a fast pace of 40% CAGR in the next 5 years.

- UK is the third largest domestic mutual fund market in Europe with \$350bn. It has benefited from a steady and strong growth rate of 16% CAGR since 1992. The UK mutual fund market is heavily equity invested and has relied on the technology boom to capture most of its growth. Falling markets have obviously affected the size of the market but only lately in 2001 and on a smaller-scale. This is due to the importance of the institutional market in the UK mutual fund market, which is known to be less volatile than the retail market (e.g. Italy). Product innovation in the UK and the highly sophisticated and mature institutional market will help the market grow at a reasonable growth of 17% in the next 5 years.
- Germany lies in the top tier of Europe's mutual fund markets in terms of size with \$208bn in domestic funds. The strongest contributor to the German mutual fund industry is the growth in domestic and international equities. This rising level of investment in equity funds is related to the strong performance of the DAX and the number of successful IPOs on the Neuer Markt. Falling bond yields led many savers to flee this asset class and shift to equity funds. To protect themselves from securities market volatility, German investors have favored lower-risk property funds. We believe the German market will grow at 13% CAGR in the next 5 years.
- Spain has the fifth largest mutual fund market in Europe, with \$150bn in domestic funds. Spain is comparable to France and Italy in terms of the proportion of the savings market invested in mutual funds (around 30%). Mutual funds in Spain have expanded vigorously in assets under management; overall, mutual funds achieved a 12% CAGR since 1992. However, growth has been hindered since 1998, with AUM falling from \$238bn to \$150bn, reflecting an annual growth rate of -14%. The main reason for this decline was the fiscal advantages that other savings products gained over mutual funds during 1999. In terms of asset allocation, the Spanish mutual funds market is still dominated by bond funds and money market funds. Equity funds gained an interest after the strong performance of the Spanish stock exchange but the level of investor confidence has diminished due to recent volatility of the global equity markets. We believe the Spanish mutual fund market will grow at a 27% CAGR in the next 5 years.

Note: We have looked at each country based on domestically domiciled funds. In our next newsletter we begin to examine the role of offshore fund centers and cross-border sales.

- France still remains the largest domestic mutual fund market with \$680bn in 2001, holding 23% of the European market. The reason for this fall is not a contraction in the French mutual funds markets, but rather because France already had a well-developed market for money market funds when other European mutual fund markets were still in their infancy. The French mutual fund market grew at a 5% CAGR since 1992. We believe it will grow moderately at 4% a year in the next 5 years.

- The Italian market is the second largest domestic mutual fund market with \$360bn. Since 1992, Italy has shown significant growth (27% CAGR) closing the gap with France. Many analysts predicted that Italy would become the largest mutual fund market in Europe in 2004.

In 1999, the size of the Italian market represented almost 75% of the French mutual fund market. A large part of its

Alternative Investments—Growth Opportunities

In Freeman & Co.'s March 2001 report, *Changing Tides*, we highlighted the increasing demand for hedge fund products and the increased activity in the alternative investment space. We predicted that the hedge fund market would be a 20%-25% growth sector for the next 5 years. Since then we have tracked the number of new entrants launching hedge funds, with much of the activity concentrated in institutional entrants. In the third quarter alone, we tracked 42 firms or managers announcing the launch of new hedge funds; since many start-ups, like a Segovia Capital, do not make grand announcements, we estimate that the total number of new hedge fund start-ups may approach 90-100 for 3Q 2001.

In addition to the benefits enjoyed by portfolio managers, independent firms and large institutions from this growth, we believe that numerous other types of companies will be beneficiaries of this growth. Our bets are on the following types of companies:

- prime brokers
- service providers (accountants, administrators)
- technology providers (risk management, trading software)

These firms should be able to capitalize on the infrastructure development to support the alternative industry. Currently many of these services are provided by a highly-fragmented pool of mostly smaller firms. As these firms expand their capital development, many will be forced to look for ways to finance their business growth. Their high top-line growth rates will make these firms attractive targets for acquirers, such as Advent, ADP or CITCO, that can provide capital and national or global reach.

The major change we see is the entrance of institutional financial services firms to the market for hedge funds, generally to add a high-profile, high-profit product set. Firms such as Mellon, American Express, Deutsche Bank, BlackRock, Dexia and KBC come to mind. We think this has two major implications, one positive and one negative. On the positive side, institutions should add risk management tools, transparency and institutional processes. On the negative side, institutions will need to be extremely careful in how they provide incentives to and retain control over hedge fund managers. Providing capital and a track record to managers may provide them with the perfect launching pad to leave the institution. Obviously this turnover is detrimental, so firms will need to manage this by enhancing variable compensation schemes, creating manager teams to provide consistency or by using contractual obligations.

To illustrate the institutional growth in demand, we illustrate recent commitments to hedge funds, \$5.5 billion, and fund of funds, \$4.4 billion (below and on the next page). These hedge fund allocations alone could provide normalized revenue of \$220 million, or 4% of \$5.5 billion AUM; the fund of fund allocations would add another \$44-65 million of revenue (1-1.5% of AUM), plus the money that would then flow back into hedge funds adding another \$176 million in revenue. These allocations that we have identified represent approximately \$450 million in revenue, and are a small slice of the market and future allocations to come.

3rd Quarter Activity

Transaction Type	Hedge Fund	Fund of Funds
New Entrants (Managers)	6	4
New Entrants (Companies)	27	9
Acquisitions/JV	9	5
Total	42	18

Source: Freeman & Co.

Recent Allocations to Hedge Funds

Date	Firm	Total Assets	% Allocation	Value of Allocation (\$MM)	Notes
8/1/00	Mount Holyoke College	430	7%	29	Boosts hedge fund exposure to 10% of assets
11/13/00	California Employees' Retirement System	171,000	1%	1,710	More than twice the previous amount was approved for allocation
11/13/00	Teacher Retirement System of Texas	71,700	0%	200	The allocation is the pension fund's first alternative investment
11/20/00	Varma-Sampo Mutual Pension Fund	13,600	2%	272	Will boost its total alternative investments exposure to 5%
3/27/01	AstraZeneca Plc	2,857	4%	100	Plans to invest in hedge funds as part of its specialty portfolios
3/27/01	San Diego County Retirement Assoc.	3,700	1%	50	Invested in hedge fund products
5/19/01	University of Connecticut Foundation	260	2%	5	Planning to makes its first direct investment in hedge funds
6/1/01	New Hampshire Retirement System	4,500	1%	50	Trustees will interview hedge fund managers
6/21/01	International Paper	7,000	5%	350	May allocate \$350 mil. to specialists for 'portable-alpha strategies'
7/19/01	Retail Employees Superannuation Trust	1,500	2%	35	The REST has allocated \$35 million to a US hedge fund
8/21/01	Assumption College	40	5%	2	Trustees have approved hedge funds
10/2/01	Oklahoma Police Pension and Retirement	1,200	3%	40	Added a multi-strategy hedge fund to its \$405 million bond portfolio
10/5/01	North Carolina State Retirement System	52,000	5%	2,600	The state Senate passed the bill allowing investments in hedge funds
10/5/01	Pennsylvania State Employees' Retirement	26,000	0%	35	The allocation is part of the fund's alternative investments asset class
		355,787	2%	5,478	

Alternative Investments— Capital Allocations

Recent Allocations to Fund of Funds

Date	Firm	Total Assets	% Allocation	Value of Allocation (\$MM)	Notes
12/1/00	Loyola University of Chicago	700	10%	70	Loyola said it was interviewing hedge fund-of-funds specialists
5/17/01	Drake University	125	15%	19	The allocation would be the fund's first
5/21/01	ABP	135,200	2%	2,704	Said it will put 2% of its assets into funds of funds
7/11/01	GM Investment Mgmt	99,153	0%	100	Glenwood appointed as hedge fund manager
7/19/01	Ontario Municipal Employees Retirement	22,293	5%	1,115	Fund goes looking for hedge fund managers
7/31/01	Golden LEAF Foundation	160	12%	19	Fund agreed to invest in fund of funds
8/9/01	Smith College	1,000	8%	75	Smith College makes first hedge fund investments
10/5/01	Pennsylvania State Employees' Retirement	26,000	1%	260	The allocation is part of the fund's domestic equities asset class
		284,631	2%	4,362	

In our March 2001 report (*Changing Tides*) we estimated the US hedge fund of fund industry at \$78 billion with a potential for \$260 billion in 2005 (27% CAGR). Within the institutional area we estimated \$35 billion in fund of funds demand, and predicted a 29% growth rate. The fund of fund allocations above add \$4.4 billion in AUM, \$43-65 million in annual revenue and provide 12.5% growth to the business. If we assume that we have captured 50% of the allocations, then institutions are adding about \$8.7 billion in AUM and \$86-130 million in revenue growth. Individuals' asset allocations to these products may be at similar levels, fuelling further industry growth.

Alternative Investments— Revenue Growth

We decided to lay out the revenue opportunity for firms in detail by using our data on allocations to make total AUM assumptions for both institutions and individuals, and to follow these through to revenue assumptions.

Based on our research and assumptions the total incremental revenue opportunity this year is approximately \$1.6 billion for hedge funds, \$227 million for fund of funds and a combined total of \$1.8 billion. We estimate that \$568 million would be recurring base fees, and \$1.2 billion would be performance fees.

In our March 2001 report, we sized the hedge fund market at \$344 billion and the fund of fund market at \$78 billion — so our estimates at the right indicate growth rates of 11.5% for hedge funds and 22% for fund of funds. The hedge fund growth rate is almost certainly too low—representing a much greater revenue opportunity that becomes difficult to estimate. The implied fund of fund growth rate is probably low by 3-8% points, adding incremental revenue to the pool of perhaps \$50 million.

Some may disagree with our key assumptions which were that we only captured 50% of the institutional allocations, and that for now, individual allocations would equal those of institutions. We have provided the tables to the right so you can adjust the figures if you see fit.

Investment Type	Announced Amount	Est. Share	Est. Amount	Base Fees	Perf. Fees	Total Fees
Hedge Funds - Direct						
Institutions	\$5,478	50%	\$10,956	\$110	\$329	\$438
Individuals			10,956	110	329	438
Total Hedge Fund Direct			\$21,912	\$219	\$657	\$876
Hedge Funds - through FOF						
Institutions	\$4,362	50%	\$8,724	\$87	\$262	\$349
Individuals			8,724	87	262	349
Total Hedge Fund - FOF			\$17,448	\$174	\$523	\$698
Total Hedge Fund			\$39,360	\$394	\$1,181	\$1,574
Fund of Funds						
Institutions	\$4,362	50%	\$8,724	\$87	\$26	\$113
Individuals			8,724	87	26	113
Total			\$17,448	\$174	\$52	\$227

Source: Freeman & Co.

All figures in US\$ millions

Hedge Fund Assumptions		Fund of Fund Assumptions	
Base Fee	1.0%	Base Fee	1.0%
Performance Fee	20.0%	Performance Fee	2.5%
Returns	15.0%	Returns	12.0%

Alternative Investments—New Entrants & Competition

Over the past year the rush by firms to enter the fund of fund business has been overwhelming. Our research indicates that 18 firms have either entered the business or launched new products (top table), and 11 firms have partnered or acquired fund of fund firms (bottom table). This has outpaced our previous thoughts on how firms would view the attractiveness of the business. The method of entrance has varied from acquisitions, joint ventures and alliances to new start-ups, team lift outs and key hires. In addition to the many entrants, other firms continue to examine the opportunities. The typical issues that arise when evaluating this business are concerns about sustainability of growth, fees and margins. For now, these do not seem to be affected as demand is outpacing supply.

New Entrants

Date	Firm	New Firm / Fund	Notes
7/23/01	Aon Consulting		Will offer multi-manager product alongside its traditional investment advice
6/5/01	CIBC Oppenheimer Advisors	Alyeska Fund LLC	Will offer a closed end fund that invests in hedge funds
3/15/01	Collins Stewart	Hirzel House Absolute Returns Funds	Adding two products manage downside risk and volatility
11/27/00	Commerzbank Securities	Comas 2, Comas 3	Comas 2 offers an absolute return strategy
7/3/01	Credit Suisse Private Banking		Launched two fund of funds for its Asian clients
6/4/01	Frank Russell Co.	Alternative Investments Funds	Launched its first multi-manager hedge fund for clients outside US
7/24/01	Global Asset Management	GAM Trading III	Promises uncorrelated returns to the equity markets
6/27/01	Harris Associates LP	Pleiades Offshore Fund Ltd.	Fund similar to nine-year old onshore sibling
2/27/01	HSBC	HSBC European Absolute	Closed-ended fund with leading funds invested in UK and Europe markets
7/18/01	HypoVereinsbank	Value Vision, Value Vision Protect	Raised \$267 million in its first two hedge FOF aimed at retail clients
5/4/01	ING Furman Selz Asset Mgmt.	Topaz Fund	Launched the second sub fund in its umbrella fund on May 1
6/26/01	Investec	Investec Absolute Return Fund	Launched hedge FOF for South African high-net-worth individuals
7/20/01	John A Levin & Co	AltVantage Group	Launched AltVantage Group for fund of funds
6/18/01	Lazard LLC	Lazard Alternatives LLC	New unit will offer Lazard Diversified Strategies Fund LLC
5/25/01	Pioneer Alternative Mgmt.	Pioneer Alternative Strategy Fund	Launching notes issued by Societe Generale with 100% capital guarantee
6/11/01	Raymond James Financial		Alternative investment group will launch a fund of funds within a year
7/12/01	RMB Investments Services	Alternative Strategies Fund of Funds	Launched and simultaneously closed fund of funds
8/22/01	Turner Investment Partners	Ascendant Capital Partners LLC	Gary Shugrue will develop and manage Ascendant's structured funds.

However, all of this activity is not without its consequences. The competition is increasing, and as we outlined in March 2001 we do not believe that firms will share equally in this growth. Our past estimates were that large- and mid-sized firms would grow at 30% and 25% per year and small firms at 16%. We think we were wrong. Larger firms could grow at 40-50% rates for the next two years, with slower growth thereafter. Small firms may grow at only 10-15%. As an example, Ivy Asset Management has grown from \$2.7 billion to \$4.3 billion in the one year since its acquisition, a 60% growth rate. Other mid- and large-sized firms have had similar growth rates over the past year, too. As a result, we think that 10-15 large firms will control perhaps 60-70% of the industry, and these firms will have the resources to develop new product innovations, advanced risk management systems and other tools to keep their lead.

However, we do not believe in the demise of the small firm. Although they may experience slower growth rates, firms with less than \$1 billion will be profitable and able to develop innovative products with strong performances. Like the traditional asset world, there is room for numerous boutiques. In the short run, we also believe that smaller firms will be able to leverage other resources, such as prime brokers and research desks, for intellectual capital and technology.

Partnerships & Acquisitions

Year	Target	Acquirer/Partner	Total Deal AUM \$MM	Comments
2001	Alternative Investment Managers	Indocam	1,500	Acquisition - Fund of Funds
2001	Arden Asset Management	Phoenix Investment Partners	1,800	Joint Venture - Fund of Funds
2001	Fauchier Partners	BNP Paribas	300	Joint Venture - Fund of Funds
2001	P/E Investments LLC	Asset Alliance Corporation	130	Acquisition - Hedge Fund
2001	Symphony Asset Management	John Nuveen Co.	4,000	Acquisition - Hedge Fund
2001	Systeia Capital Management	Credit Lyonnais Asset Mgmt	234	Acquisition - Hedge Fund
2001	Tiney Group	Dexia Group		Acquisition - Hedge Fund
2001	Tremont Advisers Inc	Oppenheimer Funds Inc		Acquisition - Fund of Funds
2001	Zola Capital Management	Asset Alliance Corporation	100	Acquisition - Hedge Fund
2000	Asset Alliance	Lehman Brothers International		Alliance - Hedge Fund
2000	Glenwood Capital	ED&F Man Group	1,400	Acquisition - Fund of Funds
2000	Hennessee Group LLC	MassMutual Financial Group		Alliance - Fund of Funds
2000	High Star Capital Management	Capital Z Partners LLC	250	Joint Venture - Fund of Funds
2000	Ivy Asset Management	Bank of New York*	2,700	Acquisition - Fund of Funds
2000	Optima	Mellon Bank		Alliance - Fund of Funds
2000	Tremont Advisers Inc	Mackenzie Financial Corp		Alliance - Fund of Funds
1998	Grosvenor Capital Management	Value Asset Management	3,800	Acquisition - Fund of Funds

*Freeman & Co. acted as adviser

Alternative Investments—Performance

There has been a great deal of industry focus regarding both the value provided by fund of funds as well as the potential industry-wide capacity constraints. Generally, fund of funds have offered three main advantages to investors: (1) uncorrelated investment returns; (2) downside protection; and (3) product structuring skills. The detractors of these products have noted (a) the double layer of fees, (b) tax inefficiency and (c) lack of measurable comparisons amongst fund of fund products.

We thought to examine if and how fund of fund products delivered on their promises of uncorrelated returns and downside protection. Our discussions with firms and the product performance list below generally indicates that they have delivered on expectations. We compared our sample of fund of fund performance to the capital market indexes. Across the board, this fund of fund sample beat any of the market indexes that had exposure to the equity markets.

Performance as of September 30, 2001

Index	Sept.	YTD
S&P 500	-8.17%	-21.16%
NASDAQ	-16.98%	-39.33%
LBGC*	+0.92%	+8.44%
60% S&P 500 / 40% LBGC	-4.53%	-9.32%
1/3 S&P 500, 1/3 NASDAQ, 1/3 LBGC	-8.08%	-17.35%

Looking at average performance, these fund of funds have outperformed:

- S&P 500 by +25.20% YTD, and +6.86% in September
- NASDAQ by +43.37% YTD, and +15.67% in September
- 60% S&P 500 / 40% LBGC index by +13.36% YTD, and +3.22% in September
- an equal blend of S&P 500, NASDAQ and LBGC by +21.39% YTD, and by +6.77% in September

Firm	Fund	Sept.**	YTD**
Berens Capital	BCP L.P.#	-0.50%	+1.49%
Commerzbank	Global Alternatives	-0.07%	+6.69%
Ivy Asset Mgmt.	Defenders Fund	-0.19%	+7.80%
K2 Advisors	K2 L.P.	+0.60%	+6.84%
Lighthouse Partners	Diversified Fund	-0.60%	+5.34%
Marquee Investments	Marquee Fund	-6.20%	-3.66%
Parker Global	Sentinel Fund	-2.22%	+3.78%
Average		-1.31%	+4.04%
High		+0.60%	+7.80%
Low		-6.20%	-3.66%

The key question remains as to whether returns will be sustainable with the increased flow of assets. We can speculate, but believe the keys will be supply and demand of the underlying securities, natural constraints (e.g. short side), and allocation decisions by fund of fund managers to move money to styles with capacity.

*Lehman Brothers Government/Corporate index

** Net of fees # Long/short equity

Public Money Managers

	Avg. AUM \$Bil.	Enterprise Value (EV) ¹	Market Cap \$MM	Share Price	11/1/01				Last 12 Months				Price/ Core Income ³	Price/ TTM Income
					Revenue	EBITDA ²	EBIT ³	Core Net Income ³	EV/ EBITDA ²	EV/ EBIT ³	EV/ EBIT ³	EV/ EBIT ³		
Diversified														
Blackrock (BLK)	210.9	2,809	2,809	\$43.31	532.3	177.3	166.8	100.8	15.8x	16.8x	27.9x	27.1x		
Eaton Vance (EV)	49.5	1,942	1,925	\$28.67	474.7	187.7	187.7	128.0	10.3x	10.3x	15.0x	16.7x		
Federated Investors (FIL)	151.3	3,596	3,189	\$26.48	704.0	319.1	305.0	179.3	11.3x	11.8x	17.8x	18.9x		
Franklin Resources (BEN)	241.4	8,651	8,206	\$32.35	2,354.9	568.6	512.0	348.4	15.2x	16.9x	23.6x	16.9x		
Gabelli (GBL)	23.8	1,208	1,140	\$37.65	231.3	102.5	102.5	62.6	11.8x	11.8x	18.2x	18.7x		
Neuberger Berman (NEU)	55.2	2,252	2,167	\$35.28	619.2	250.7	238.2	137.5	9.0x	9.5x	15.8x	15.8x		
SEI Investments (SEIC)	77.1	3,626	3,595	\$31.17	651.2	181.1	176.8	111.3	20.0x	20.5x	32.3x	29.9x		
Stilwell (SV)	250.3	5,078	4,653	\$20.76	1,752.1	802.3	686.1	401.9	6.3x	7.4x	11.6x	12.4x		
T Rowe Price (TROW)	153.6	3,810	3,538	\$27.30	1,077.8	393.2	364.3	205.7	9.7x	10.5x	17.2x	17.1x		
Waddell & Reed (WDR)	34.2	2,358	2,164	\$25.59	491.9	213.7	202.1	111.8	11.0x	11.7x	19.4x	18.5x		
Total	1,247.2	\$35,330	\$33,385		\$8,889	\$3,196	\$2,941	Average	12.1x	12.7x	19.9x	19.2x		
								Median	11.2x	11.7x	18.0x	17.8x		
Insurance														
John Nuveen (JNC)	63.0	1,841	1,804	\$47.06	361.3	191.9	183.7	109.9	9.6x	10.0x	16.4x	16.0x		
Total	63.0	\$1,841	\$1,804		\$361	\$192	\$184	Average	9.6x	10.0x	16.4x	16.0x		
								Median	9.6x	10.0x	16.4x	16.0x		
Consolidators														
Affiliated Managers (AMG)	71.5	1,654	1,416	\$62.54	412.5	181.7	155.6	107.6	13.4x	17.0x	28.7x	27.1x		
Total	71.5	\$1,654	\$1,416		\$413	\$182	\$156		13.4x	17.0x	28.7x	27.1x		
Bank/Trust Companies														
Boston Private Fincl. (BPFH)	5.7	347	347	\$20.47	79.7	24.7	23.4	17.2	14.0x	14.8x	20.1x	23.8x		
Wilmington Trust (WL)	38.4	1,580	1,412	\$57.19	461.8	194.4	186.2	121.1	8.1x	8.5x	11.7x	11.5x		
Total	44.1	\$1,926	\$1,758		\$541	\$219	\$210	Average	11.1x	11.7x	15.9x	17.7x		
								Median	11.1x	11.7x	15.9x	17.7x		
Limited Partnerships														
Alliance Capital L.P. (AC)	437.8	12,866	12,171	\$48.04	3,020.6	886.1	713.3	635.2	14.5x	18.0x	19.2x	19.9x		
Total	437.8	\$12,866	\$12,171		\$3,021	\$886	\$713		14.5x	18.0x	19.2x	19.9x		
Overall														
Total	1,863.7	\$53,618	\$50,534		\$13,225	\$4,675	\$4,204	Average	12.0x	13.0x	19.6x	19.4x		
								Median	11.3x	11.8x	18.2x	18.5x		
Notes														
1 Enterprise Value (EV) includes equity plus long term debt														
2 Before tangible depreciation and amortization														
3 Excludes extraordinary items and minority interest expense/income														



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