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The "Zombie" Economy

Wither the U.S. economy? Three years after the collapse of a credit and real estate bubble that had turbocharged growth, America remains mired in a stubborn and unnerving slump. The unemployment rate is stuck around 9%, and the underemployment rate is just as high. The housing market is in the doldrums, with lots of inventory and nearly one-quarter of homeowners holding mortgages that are underwater (higher than the value of their homes). A *Wall Street Journal* analysis indicates that the top-10 U.S. mortgage lenders rejected 27% of all applications in 2010, underlining the shift in credit policies.

The federal government, which through two administrations avoided economic calamity with its massive stimulative and bailout efforts, is tapped out, and many state and local governments aren't doing much better. As millions of Americans watch their standard of living erode and fret about the security of their jobs and retirements, the public is in a downbeat mood. In June, the Conference Board Consumer Confidence Index hit a seven-month low of 59, about half the level reached during the halcyon days of early 2007. "With consumers so worried about their job prospects, I'm not so sure that we can count on demand picking up," a **Wells Fargo** economist told Bloomberg, adding: "The housing market is dead in the water."

Following the most prolonged slump since the Great Depression, many pundits, including purveyors of the "dismal science," are searching for answers. Have technology and globalization finally reached a critical mass to create a new economic paradigm threatening job growth? Can the U.S. fuel solid economic growth minus the speculative surges that goose consumer spending? Will the weight of public and private debt stymie growth for years to come?

Writing in the *Wall Street Journal* in June, Nobel economics laureate Michael Spence intoned that "we must stop pretending that this is only a difficult cyclical recovery. The root of the problem is structural." As Spence looks ahead, he sees a soft service economy and competition for middle-class jobs from an increasingly educated population in emerging markets. "A stimulus package that temporarily restores elements of precrisis demand is unlikely to generate the escape velocity needed to get out of the jobs hole," he says, noting that the nation might have to accept "a period of lower income growth" in order to restore trade competitiveness.

Stephen Roach, the former chief economist for **Morgan Stanley** and current Yale faculty member, delivered a similarly somber assessment that same month in the *Financial Times*, positing "a new generation" of American "zombie consumers" ("the economic walking dead"). Referring to the 13 quarters since the start of 2008 during which inflation-adjusted annualized consumption growth averaged just 0.5%, Roach wrote: "Never before in the post-second world war era have US consumers been this weak for this long." His fear: the U.S. will endure a long period of Japanese-style stagflation as consumers seek to "recover from the ravages of this bubble-induced spending binge" by cutting debt.

Writing in his monthly commentary in July, Bill Gross, the high-profile managing director of **Pimco**, decried both political parties for lacking "awareness of the why or the wherefores of how to put American back to work again. Few economic advisors from either party ever mention structural long-term disconnects in employment — a recognition that cyclical influences will no longer dominate the U.S. labor market." The erosion of manufacturing employment combined with a "reliance on wealth creation via financial assets" that is now approaching a "dead-end cul-de-sac," he writes, has exposed a nation that is "untrained, underinvested and overindebted relative to our global competitors."

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While Americans considered the moribund job market, Europe continued its perilous high-wire act. As the European Union and International Monetary Fund hammered out a Greek bailout deal in June, the Germans held their collective nose, mindful that a free fall in Greece could take Portugal, Spain and Italy along for the ride, not to mention many of Europe's major banks. As part of the agreement, Greece's Socialist government agreed to sharp cuts in spending, tax increases and privatization — a program the nation's conservative opposition New Democratic Party refused to support.

At the same time, European authorities were leaning on banks to rollover their Greek bond holdings, an effective default that they hoped to sugarcoat with euphemisms. In the streets of Athens, meanwhile, violent demonstrations erupted that highlight the potential for political volatility in a time of austerity. It took the leader of the Greek Communist Party to speak plainly about the nation's situation: "Greece is bankrupt," said Aleka Papariga. "The government calls it a crisis but that's a fact. We're bankrupt."

Again, nervous pundits weighed in. Financial Times economics editor Chris Giles warned that policymakers "will not be able to kick the can down the road indefinitely" and questioned whether any crisis with a Greek default "will represent an event that might be dubbed Lehman Brothers 2 and send the global economy tumbling into another deep recession." Economist Nouriel Roubini, who leaped to prominence on the back of his sagacious call about the danger of the U.S. housing bubble, declared in the same newspaper that a continuation of the "muddle-through approach" to the crisis could eventually lead to a "breakup of the [European] union itself — as some weaker members crash out."

Stock markets in the first half reflected uncertainty about a global economy tottering between a weak recovery and relapse into recession or worse. In the first quarter in the U.S., the major indexes continued the climb that began in the third quarter of 2010, on the back of strong corporate earnings and measured optimism about economic growth. In the second quarter, the bullish sentiment retreated and the Dow Jones Industrial Average registered declines for six consecutive weeks — the longest such negative streak since 2002 — before turning up sharply (5.4%) the last week of June. In Europe, the German DAX delivered a strong first-half performance (up 7%), with the U.K. FTSE index up slightly, as both markets enjoyed solid gains the last week of June. Asia's key markets were all in negative territory the first half.

Dealmaking in the asset management industry remained busy in the first half, with private equity investors notable for their investments across a range of sectors. In the broader M&A universe worldwide, the value of private equity acquisitions in the first half rose 54% over the year-earlier period, to $123 billion (8.2% of all transactions), according to Thomson Reuters. In the U.S., two major players, **TA Associates** and **Carlyle Group**, registered two transactions. TA took a majority share in tactical manager **Stadion Money Management** and a minority share in hedge fund of funds manager **Evanston Capital Management**.

As part of an effort to expand its lineup of alternatives, Carlyle acquired majority shares in private equity fund of funds manager **AlpInvest Partners**, which handles $46 billion in assets for two Dutch pension fund investors; and **Emerging Sovereign Group** (ESG), a New York-based emerging markets equities and macroeconomic strategies manager. In Europe, Italian private equity fund of funds manager **Advanced Capital** also made two deals: the formation of a $70-million joint seed investment with Dutch hedge fund incubator **IMQubator** and the acquisition of Amsterdam-based **Holland Private Equity**.

Other European and American private equity firms that made deals included **Duke Street, Lightyear Capital, Millennium, Richmond Park Partners** and **Rosemont Investment Partners**. **Ziegler Capital**, minority owned by private equity firm Rizvi Traverse Management, acquired **Lotsoff Capital Management**, which manages a mix of equity and fixed income funds, as well as hedge funds. The purchase of emerging markets specialists represented another trend in the first half. In addition to Carlyle's deal for ESG, **Lovell Minnick Partners** took a minority stake in an established Asian investor, **Matthews International Capital Management**. **Ashmore Group, BMO Financial Group, Goldman Sachs** and **Principal Financial** also tapped emerging markets specialists. Emerging markets also figured in the larger M&A picture, with 24% of first-half deals involving targets based in those markets.

Although wealth management deals were small, the sector did draw a number of noteworthy buyers, including **BNY Mellon, Eaton Vance Corp.** and **Focus Financial Partners**. **SunTrust Banks**, having paid off the last of its $5 billion from the Troubled Asset Relief Program (TARP), acquired **CSI Capital Management**, which enjoys a niche in the entertainment industry. The real estate advisory sector recorded a much-anticipated blockbuster deal when ING Groep divested its advisory business, with **CB Richard Ellis** Group paying $940 million for most of the assets. In Europe, the marquee deal saw **Henderson Group** pay $520 million for Gartmore Group, making Henderson the sixth-largest retail-oriented fund manager in the U.K. In another noteworthy development, **BlackRock** announced it will pay $2.6 billion for the remaining shareholding of **Bank of America**, which gained the stake with the 2009 purchase of **Merrill Lynch**.

Money Management

During the first half of 2010, there was a clear tilt in the mutual fund and institutional sectors toward the purchase of fixed income providers, in line with investor preferences since the start of the financial crisis. This year, a number of the largest deals in the first half related to another post-crisis trend: the flow of investment to emerging markets. Several of the transactions cut with privately held companies left equity in the hands of owners, and two were concluded with long-established emerging markets investors.

London's **Ashmore Group**, a leading emerging markets fixed income specialist, acquired a 63% stake in Virginia-based equities investor **Emerging Markets Management** (EMM), founded in 1987 by several World Bank alumni. EMM adds more than $10 billion in AUM to the $47 billion Ashmore already managed. Ashmore will pay as much as $246 million for EMM, with about half that amount upfront in cash and shares and the rest paid over a three-year earnout period. EMM manages most of its assets for institutions, primarily in Europe and the Americas. Although Ashmore has a similar institutional base, the largest part of its clientele is in Asia (35% by AUM), with Europe close behind. Management and founders of EMM will retain the shares not acquired by Ashmore. Felicia Morrow, chief executive of EMM, called the deal a "unique opportunity" for her company to "become part of a leading multi-strategy, diversified emerging markets asset manager."

Principal Financial cut two deals that expand its exposure to emerging markets, the first involving the purchase of 51% of **Finisterre Capital** of London (AUM: $1.6 billion), a 9-year-old hedge fund manager specializing in emerging markets fixed income investments. "There is already an enormous appetite to invest in emerging economies and we firmly believe the demand will continue as these markets develop," said Principal CEO Jim McCaughan. As in the EMM deal, terms involve an upfront payment ($85 million) and a three-year earnout (up to $30 million). In 2010, the **New York State Common Retirement Fund** provided $250 million in capital for Finisterre's new Emerging Markets Fund. In a second deal, Principal paid $198 million for the Mexican pension fund managed by **HSBC** (AUM: $2.9 billion), which will be merged with Principal's existing pension fund manager in that nation. Principal, which has cut several deals in emerging markets in recent years, is pursuing a "2011 capital deployment strategy" involving $700 million for acquisitions and share buybacks.

Private equity firm **Lovell Minnick Partners** took a 20%-plus stake in an established investor in Asia, **Matthews International Capital Management**, which in the past year has seen its AUM jump to $19 billion from less than $12 billion. Executives at the two U.S. firms had a prior relationship and had discussed a potential investment over the course of a year. "Lovell Minnick's history as a patient, value-added investor is consistent with our own philosophy as investors and operators," said Mark Headley, chairman of Matthews. **BMO Financial Group** of Canada bought Hong Long's **Lloyd George Management**, which manages $6 billion for institutions and private clients, with a focus on China and India, as well as other emerging markets. BMO said the acquisition provides "the scale for further expansion" of its asset management business and "bolsters" its investment expertise in Asian and emerging markets.

Goldman Sachs joined in the emerging markets mix by paying a reported $29 million to acquire **Benchmark Asset Management Co**. (AUM: $700 million), the leading exchange traded fund (ETF) provider in India. Goldman said it planned to add actively managed on-shore funds to its suite of products in India, where it already has a team of analysts. Calling the market a "strategic priority," Oliver Bolitho, head of **Goldman Sachs Asset Management** in Asia, said the deal "illustrates our commitment to expand in India."

Within the U.S., **UMB Financial Corp.**, which last year doubled the size of its **Scout Investments** asset management arm via two acquisitions, bought two mutual fund advisory businesses from **Frontegra Asset Management**. The fixed income funds, with close to $500 million in AUM, had been subadvised by **Reams Asset Management**, a fixed income specialist acquired by UMB last year. Scout, which rebranded the two funds under its corporate name, has more than $28 billion in AUM. Lovell Minnick was joined in the marketplace by two other private equity investors in the financial services industry, including **Rosemont Investment Partners**, which bought a 30% stake in **Piedmont Investment Advisors** from three investors. The investors included pension giant **Calpers**, which provided funding to Piedmont in 2007 as part of its emerging managers investment program.

Based in North Carolina, 11-year-old Piedmont manages equity and fixed income investments and has $3.5 billion in AUM, up nearly threefold over the past four years. Management at Piedmont retains a 70% stake. Rosemont, based in Pennsylvania, has made numerous investments in asset managers, including last year's management buyout of **SouthernSun Asset Management**. Prior to its deal with Rosemont, Piedmont made its own acquisition, of Virginia's **Shenandoah Asset Management** (AUM: $140 million), an equity investor for institutions. Another major private equity player, **TA Associates**, bought a 54% share of **Stadion Money Management**, a tactical manager with $6.7 billion in AUM. Stadion, founded in 1991 and based in Georgia, said it will "leverage" its new owner's "financial support, strategic guidance and significant network of contacts." TA pledged to create a "new equity incentive plan" to broaden ownership among Stadion's key investment and operations employees.

In a deal between two privately held Chicago firms, **Ziegler Capital Management** acquired **Lotsoff Capital Management** (AUM: $1.3 billion) to create a firm with nearly $4 billion in AUM in equity and fixed income investments, primarily for institutions. Ziegler, which is 41%-owned by Michigan-based private equity firm **Rizvi Traverse Management**, said the tie-up between the two firms will provide the respective portfolio management teams with "significant infrastructure and resources."

The private equity industry also made its presence felt in the fast-growing ETF market, as **Millennium** of New York led a $70 million secondary share purchase in the equity of London-based **ETF Securities**, a specialist in commodity investments managing more than $27 billion in over 200 exchanged traded products. In a second ETF transaction, **Columbia Management Investments Advisers** acquired **Grail Advisors** (AUM: $20 million), an active ETF provider that uses traditional asset managers as subadvisors. The deal provides Columbia, owned by **Ameriprise Financial**, with entry to the active ETF market. "We intend to utilize this acquisition to build an extensive offering of actively managed ETFs over time," said Colin Moore, chief investment officer of Columbia. **Russell Investments**, which for two years had been seeking Securities & Exchange Commission approval for its own line of ETF products, in January kickstarted that effort by acquiring a small fund-of-funds ETF provider, **U.S. One**. Based in Nevada and started up in mid-2010 by the former director of finance and business development for

Dell Computer, U.S. One has $10 million in AUM invested in several **Vanguard** and **iShares** ETFs. By May, Russell had launched its own line of 16 ETFs.

Wealth Management

Following two consecutive years in which the usually active wealth management industry recorded a negligible number of transactions during the January through June period, dealmakers in the U.S. stepped into the marketplace in larger numbers in the first half of 2011. That increased activity, and the notable list of buyers, may reflect increasing confidence that some semblance of equilibrium has returned to an industry badly shaken by the financial crisis.

SunTrust Banks, which in the first quarter of this year finished paying off $5 billion from the Troubled Asset Relief Program (TARP), acquired **CSI Capital Management** (AUM: $1.5 billion), a specialty firm serving athletes and entertainers. CSI is based in San Francisco but has offices in the South and on the East Coast. SunTrust, whose affiliates include the ultra-high-net-worth **GenSpring Family Offices**, began focusing on the entertainment industry more than 20 years ago in the Nashville area, a business it expanded to incorporate offices elsewhere in the U.S. before adding a unit for the motor sports industry. In 2006, SunTrust created a consolidated Sports and Entertainment Specialty Group.

In an interview last year with On *Wall Street* magazine, Thomas Carroll, managing director for the speciality group, noted that the business has grown even during the financial crisis, adding, "Based upon the contracts that our clients have we expect strong growth to continue." **BNY Mellon** made another in the long line of tack-on acquisitions that define its strategy, buying **Talon Asset Management** (AUM: $800 million) of Chicago. BNY Mellon described that market as "part of its national and global expansion" plan and said the transaction "will enable us to offer a whole new level of service to wealthy Chicago investors."

BNY Mellon already has 450 employees in the Chicago area providing asset servicing and treasury services. The deal did not include Talon's private equity and hedge fund businesses. Founded in 1994 and wholly owned by its employees, Talon is a mid-cap specialist that has most of its assets in separately managed accounts with a minimum investment of $1 million. Last year, BNY Mellon expanded north of the border into Canada with the acquisition of a Toronto wealth manager, I(3) Advisors. In 2010, the company also combined its asset management and wealth units under one chief executive in an attempt to capitalize on cost- and revenue-related synergies.

There were several deals in local geographies. In an all-Boston transaction, **Eaton Vance Corp.** acquired **Pelican Investment Management**, a 10-year-old company with $500 million in AUM and an additional office in New York. Anthony Pell, one of the principals at Pelican, said his clients would "benefit from a higher level of support and access to a deep research bench." In Pennsylvania, **Bryn Mawr Bank Corp.** of suburban Philadelphia made its second acquisition of a wealth manager in three years, buying **Hershey Trust Co.**'s **Private Wealth Management Group**. Private Wealth adds $1.1 billion in AUM to the $3.4 billion Bryn Mawr already managed, along with 1,200 accounts and 500 clients. The acquisition also expands the bank's presence into the Harrisburg area.

Bryn Mawr, which in 2008 acquired wealth manager **Lau Associates** of Delaware, has made wealth management a core part of its growth plans, setting a goal of $5 billion in AUM in three years. Fees from that business — totaling $15.5 million last year, or more than half the bank's non-interest income — registered 6.2% average annual growth between 2005 and 2010. Hershey Trust said the divestiture will allow it to "return its full focus to its core mission of managing the assets of the Milton Hershey School Trust."

In a second transaction in the Keystone State, and a continuation of a minor trend toward buyouts of wealth managers from larger parents, management acquired the **Pennsylvania Trust Co.** unit of **Penn Mutual Life Insurance**. Pennsylvania Trust, with $1.8 billion in AUM, said its position as an independent firm would allow it "to strengthen our commitment to our clients and the stewardship of their assets." Penn Mutual said the wealth unit's presence in the Delaware Valley did not match its national footprint, or the East Coast footprint of financial services subsidiary **Janney Montgomery Scott**. Pennsylvania Trust was started in 1986 with $50 million in AUM and a staff of four.

In Massachusetts, management at **Kobren Insight Management** joined with **Adviser Investment Management** to buy out Kobren from **E*Trade**. The combined firm, which will retain the Adviser name, has $2 billion in AUM. Adviser, founded in 1994 by the editor of the *Independent Adviser for Vanguard Investors* newsletter, serves clients who hold an average of $1 million in assets with the firm. In Memphis, **Highland Capital Management** founder Steve Wishnia bought out his 24-year-old firm from parent **First Horizon National Corp**. Highland has $1.5 billion in AUM.

Several ambitious wealth managers that have made acquisitions part of a national growth plan cut deals in the first half, including **Focus Financial Partners**, which bought a small Alaska wealth manager, **RNM Financial Management** (AUM: $28 million). The transaction was made through Focus' **Buckingham Asset Management** affiliate, marking the second acquisition St. Louis-based Buckingham has concluded since 2010. RNM had used Buckingham for back-office support prior to the deal. Focus Financial also made a direct investment in the first half in its 20th affiliate or partner, Indiana-based **Pettinga Financial Advisors**, with $600 million in client assets.

United Capital Financial Advisors of California made three geographically diverse deals for wealth managers, the largest of which involved **Zirkin-Cutler Investments** (AUM: $1.6 billion) of Washington, D.C. United's acquisition of Zirkin-Cutler also represents the largest of the 30-plus acquisitions United has made of brokers and wealth managers during its six-year history. United's goal is to have offices in the top 25 metropolitan markets by 2013. Zirkin-Cutler was owned by **M&T Bank Corp.**, which last year purchased **Wilmington Trust. Mariner Wealth Advisors** of Kansas acquired **CBIZ Wealth Management**, which has offices in seven cities around the U.S., including Kansas City, and around $360 million in client assets. "This is instant geographical expansion for us," Mariner CEO Martin Bicknell told the *Kansas City Business Journal*. In 2006, Bicknell left A.G. Edwards with several brokers to form Mariner, which has grown rapidly since (AUM: $8 billion), bolstered by the 2009 acquisition of **Tortoise Capital Advisers**, a specialist in master limited energy partnerships.

In other deals, **MetLife** of New York established an "affiliation" with a Philadelphia wealth manager, **Firstrust Financial Resources**, in a bid to expand its presence in that area. Firstrust, with $600 million in AUM, said MetLife "provides a huge opportunity to broaden our service capabilities for clients." **Firstrust Bank** will maintain ownership of FFR. In a distress transaction between two banks in Evansville, Ind., **Old National Bancorp** paid $1.3 million for the wealth management unit of financially troubled **Integra Bank**, which adds around $400 million in AUM to the $4 billion Old National already managed. Integra was forced to act when more than half its wealth management employees left for a competitor. In a teaming of two Minneapolis wealth advisors, **White Oaks Wealth Advisors** acquired **Intrinzia Family Office**, saying the "synergies that will be realized with this combination are significant and will add a great deal of value for clients of both firms." In Europe, buyers of wealth managers included **Close Street, Duke Street** and **Societe Generale** (see "Europe").

Alternatives

Hedge funds continued to rebound in the first several months of the year, with industry assets approaching their pre-financial crisis level of some $2 trillion, and institutions appeared more firmly committed than ever to making the investments a part of their portfolios. This year, U.S. public pension funds have a higher allocation level for hedge funds (6.8% on average, according to Preqin) than before the financial crisis — even as industrywide first-quarter performance lagged the Standard & Poor's 500 index. "Almost six months into 2011 and there now exists empirical evidence to suggest that the hedge fund industry's recovery is gathering momentum," wrote **BNY Mellon** managing director Mark Mannion on the *HFMWeek* blog in late May.

At the same time, the guilty verdict in the inside trading scandal at hedge fund Galleon Group served up another black eye for an industry now operating under the scrutiny of the 2010 Dodd-Frank Act. For an increasing number of smaller companies, those compliance costs — combined with the flow of institutional dollars toward larger, more transparent companies — will force some difficult decisions about the value of continued independence. A recent survey of a variety of hedge funds by financial services firm **Rothstein Kass** showed that 70% expect consolidation to increase, with regulatory and compliance costs and the push for clients and assets the primary drivers.

Those expectations aside, in the first half of 2011 dealmaking tracked past years' activity. The largest transaction by AUM involved **TA Associates**, which acquired a minority share in hedge fund of funds manager **Evanston Capital Management**. Founded in 2002 by the former chief investment officer for Northwestern University, David Wagner, Illinois-based Evanston manages $4.2 billion on behalf of institutions and individuals in two commingled funds. TA Associates, a Boston private equity firm that has invested in numerous asset managers, praised Evanston for "delivering top-tier results and high-touch investor service and reporting." TA Associates made a second investment in the first half, in **Stadion Money Management** (see "Money Management").

Within Europe, a second private equity firm, London's **Richmond Park Partners**, also invested in a fund of funds manager, **Olympia Group of Companies**. The deal was concluded with Paris-based **Sagard Private Equity Partners** and other shareholders. An established firm, Olympia manages more than $2 billion in assets in a range of multi-strategy and thematic funds. The company pursues a risk strategy in which it generally limits exposure to any one fund to a 5% to 6% allocation. Richmond Partners was founded in 2009 by former executives of **Dresdner Bank** and **Goldman Sachs**.

There were two transatlantic deals involving fund of funds buyers and targets, including the acquisition by New York- and Paris-based **Nexar Capital Group** of London's **Ermitage Ltd.** (AUM: $1.2 billion), an established firm that specializes in building customized funds of funds for institutions. With the addition of Ermitage, which had been owned by the U.K.'s **Caledonia Investments**, Nexar has $3.7 billion in AUM. The deal marks Nexar's second acquisition in as many years: In 2010, the two-year-old firm acquired **Allianz Group**'s fund of funds unit. Nexar was started by a team of alternative asset managers from **Societe Generale** with the backing of private equity firm **Aquiline Capital Partners**. A second transatlantic deal saw **Arden Asset Management** of New York acquire **Robeco**'s $1.3 billion fund of funds business. Noting the complementary nature of the two businesses, including significant "overlap in underlying managers used by both firms," Arden said the transaction provides "increased scale and a strong foundation for future growth." Arden, founded in 1993, had $7.2 billion in AUM prior to the deal.

In Chicago, **William Blair & Co.** bought "certain assets" of **Guidance Capital**, which manages a range of fund of funds strategies, including equities, commodities and managed futures. The deal adds $300 million in AUM to the $44 billion William Blair already managed. Guidance, which last year experienced investor outflows, said its new owner "provides us tremendous resources within an ownership culture." Hedge fund of funds assets rose $45 billion in the half-year ending April 2011, according to *HFMWeek*, the largest such six-month jump since the publication began surveying fund of fund managers in late 2005.

New York's **Asset Management Finance** took minority interests in two hedge fund managers on both sides of the Atlantic whose portfolios include credit-focused investments. The first was in 4-year-old **Brigade Capital Management** of New York, which manages $7.9 billion in assets for institutions and has both hedged and long-only strategies. The second deal involved **Lucidus Capital Partners**, a "fast-growing" London firm with $1.8 billion in hedge funds. Referencing the first deal, AMF president John McAvoy said it "significantly raised our visibility in the alternative manager space" and is in line with the company's "goal to have a balanced portfolio of minority stakes in traditional and alternative managers."AMF, an affiliate of **Credit Suisse**, has made more than 20 investments in asset managers totaling $750 million.

A transatlantic deal between two global macro managers saw **Caxton Associates** of New York take a minority interest in London's **Wadhwani Asset Management**. Wadhwani manages more than $1 billion in assets, while Caxton manages more than $10 billion. As part of the deal, Wadhwani CEO Sushil Wadhwani, an economist and former member of the Bank of England's Monetary Policy Committee, will become a Caxton partner and manage a "meaningful notional capital allocation" for Caxton's flagship fund, **Caxton Global Investments**. Caxton, which also owns a stake in Lucidus Capital Partners, was founded in 1983 by billionaire trader Bruce Kovner, a Harvard Ph.D. dropout who has credited much of his success to the policy decisions made by "stupid governments."

In the U.K., **Man Group** — which in the first half of 2010 made the $1.6 billion acquisition of **GLG Partners** — sold its 25% shareholding in hedge fund manager **BlueCrest** (AUM: $25 billion) for $630 million. Man acquired the shares in 2003. Man said the deal, which enhances the company's capital base, is part of a "strategic focus" on its "internal investment management capabilities." Privately held BlueCrest also bought out the interest of its retired co-founder, leaving the firm wholly owned by its working partners.

Banks continued to respond to new regulations by fine-tuning asset management operations, with both **Bank of America** and **Citigroup** divesting private equity units. BoA announced plans to spin off a $5 billion private equity business it obtained as part of the 2008 **Merrill Lynch** acquisition. The **BAML Capital Partners** business will be taken over by management. In 2010, BoA also sold $1.9 billion of private equity funds and spun off part of its middle-market private equity business, Banc of America Capital Investors. Citigroup, which sold off hedge fund and private equity businesses in 2010, continued the divestitures in the first half of this year by selling a $1.7 billion portfolio of private equity assets to **AXA**'s private equity arm. Last year, AXA also acquired the $1.9 billion private equity business sold by BoA.

The largest private equity deal involved the acquisition of **AlpInvest Partners** by management and **Carlyle Group** in what the two businesses called a "strategic joint venture." AlpInvest manages $46 billion in assets in a global fund of funds program and related direct investment on behalf of parents **APG** and **PGGM**, two Dutch pension fund investors. AlpInvest and Carlyle, which will own 60% of the new venture, said they will continue to honor the environmental, social and governance (ESG) policies of the Dutch pension funds. The deal provides AlpInvest with more independence to expand its client base and APG and PGGM with more latitude as they seek to park money with other private equity managers. AlpInvest already invests in certain Carlyle funds.

There were several notable deals in the real estate advisory sector, the most significant of which involved the much-anticipated sale by **ING Groep** of its real estate advisory business. The largest of those two ING transactions saw **CB Richard Ellis Group** pay $940 million in cash for $60 billion in assets primarily located outside the U.S. The deal made CBRE the largest commercial real estate investment management company in the world, with a total of $98 billion in AUM, and expands the company's reach beyond its core U.S. market to incorporate Europe and other international markets. During a conference call, CBRE chief executive Brett White said the acquisition completes the company's longstanding goal of being "number one globally in every service we provide."

In the second deal, management and New York private equity firm **Lightyear Capital** paid $100 million for ING's U.S.-based real estate advisory business, **Clarion Partners** (AUM: $24 billion). Clarion, founded in 1982 and sold to ING in 1998, will provide ownership stakes to 10% of its employees. Lightyear, founded by former Paine Webber chief executive Donald Marron, invests in financial services firms. ING CEO Jan Hommen said the two transactions are in line with the insurer's "strategic objectives of reducing exposure to real estate, simplifying our company and further strengthening our capital base." In 2008, the Dutch government bailed out ING, which had significant exposure to the subprime real estate market. ING's sale follows previous asset management divestitures it made of private banking businesses in Europe and Asia.

National Australia Bank (NAB) took a 35% stake in New York-based **AREA Property Partners** as part of a partnership, in line with the bank's effort to expand its exposure to global real estate and a "wealth management strategy" involving tie-ups with "selected, quality fund managers." AREA, founded in 1993, has $13 billion in AUM in property investments in North America, Europe and Asia. NAB noted that while real estate continues to be attractive to institutions, the small Australian market offered limited investment-grade opportunities. The transaction marks the third investment asset manager nabinvest, the investment management arm of NAB, has made in a non-Australian fund manager since NAB established the unit in 2007. This includes the 2010 acquisition of Canadian real estate investment trust (REIT) **Presima**.

Europe

The U.K. played host to the highest-profile transaction in Europe in the first half, as **Henderson Group** paid $520 million to acquire **Gartmore Group** (AUM: $27 billion). The all-shares deal between the two brand name fund managers bumps Henderson up seven places to No. 6 among the U.K.'s largest retail-oriented fund managers (AUM: $125 billion); adds global and emerging markets equity products; and extends Henderson's range of hedge fund products. The addition of Gartmore's higher-margin business also boosts Henderson's margins an impressive eights points to more than 55 basis points on a pro forma basis.

But Gartmore has also endured its share of challenges recently. Acquired from **Nationwide Mutual Insurance** in 2006 by San Francisco-based private equity firm **Hellman & Friedman** and Gartmore management, the company went public in 2009 but quickly suffered a black eye when an investment partner was suspended for inappropriate trading activity. Soon after, the departure of star fund manager Roger Guy generated more bad news. Investors reacted by withdrawing assets, and the share price dropped sharply (Henderson paid less than half Gartmore's offering price). In acquiring a troubled manager, however, Henderson is entering familiar territory: in 2009, the company bought U.K. fund manager **New Star Asset Management**, a onetime high-flier taken over by creditors during the financial crisis.

Henderson says it has successfully merged New Star into its operations, providing it with confidence it can make the Gartmore deal work. Andrew Formica, chief executive of Henderson, called Gartmore a "natural fit ... with a highly complementary strategy and stable of products," adding that "its recent travails should not overshadow the fact that Gartmore is one of the best-known firms in U.K. fund management and its assets are performing well."

In a second transaction between two publicly traded U.K. companies, **Close Brothers Group** paid $42 million for **Cavanagh Group**, adding $2.4 billion in private client AUM to the $13.5 billion it already managed for private clients and institutions. The deal also enhances Close's reach geographically in Scotland and South East England. Close, which paid a 31% premium to Cavanagh's prior-day closing price, said the deal "is in line with [its] strategy to create a high-growth wealth and asset management business in the U.K." In the six months through January 2011, Close registered a 20% jump in AUM. In addition to its asset management arm, Close — which within the past year has also acquired a financial advisor and discount broker — has banking and securities operations.

There were several other deals involving private client targets. **Duke Street**, a London- and Paris-based private equity firm, took a majority stake in **UK Wealth Management** (AUM: $2.3 billion), the parent for several wealth management and employee benefit companies. The deal meets Duke's goal of building a significant wealth management arm via the acquisition of small-to-mid-size advisory firms. In assuming that goal, the company points to the opportunity provided by "once-in-a-generation structural change" driven by new regulations in the U.K. financial advisory business. Duke bought the shares from another private equity player, **J.C. Flowers**. Founded in 1988, Duke has nearly $3 billion in committed capital in a range of 10-year funds. The U.K. private banking subsidiary of **Societe Generale** acquired the private client business of **Baring Asset Management** (AUM: $1.6 billion), based in the U.K. and Guernsey. **Societe Generale Private Banking Hamros** said the deal underlines its "ambition to continue to grow" its established business in the U.K. and Channel Islands.

London-based **Brewin Dolphin** added to its private client network with the acquisition of Ireland's **Tilman**, a 16-year-old privately held company with $1.3 billion in AUM. Publicly traded Brewin paid $30 million upfront, with performance-based payments that could add as much as $22 million by 2014, tied to the same price-earnings (P/E) ratio of 11.5 used for the initial payment. Brewin said the financial crisis in Ireland had crystallized its longstanding view regarding the "strong demand" for private client services in that nation. "Recent events in Ireland have only made this opportunity greater with many clients moving from banks and other institutions which were dominant in our field," the company said. In the six months through March 2011, Brewin's AUM rose nearly 8% to $36 billion.

Employee-owned **Hume Capital** of London cut separate U.K. deals for two small affiliates of publicly traded **Syndicate Asset Management** (subsequently renamed **Ashcourt Rowan**). In the first, Hume paid $2.9 million for Syndicate's Guernsey-based fund management arm, **Syndicate Asset Management** (**C.I.**). The offshore unit manages the $370-million **Zenith International** range of funds. In the second transaction, Hume paid $3.4 million for **EPIC Investment Partners**, which manages $1.2 billion in fixed income assets for institutions. Syndicate Asset Management called the two holdings non-core and said its "focus is now squarely on the wealth management sector." Hume, founded in 2007, offers a mix of hedge funds and global and regional equity funds.

Elsewhere in Europe, UBS paid $36 million for **Luxembourg Financial Group**, a structured products boutique and specialist asset manager with $3.1 billion in AUM. UBS said Luxembourg would be an "important building block" in expanding investment products within the global equity derivatives and global synthetic equities businesses. In Poland, **IPOPEMA Securities** acquired **Credit Suisse Group**'s local asset manager, calling the "strengthening" of its position in institutional asset management a "strategic priority." **Credit Suisse Asset Management** (**Polska**) has more than $800 million in AUM. IPOPEMA, an independent investment and financial services provider, focuses on institutional and corporate clients. In the Netherlands, **Sparinvest** acquired **Atrium Asset Management**, which manages two European small-cap value funds with a total of $80 million in AUM. Sparinvest already manages nearly $5 billion in assets in similar funds. The deal follows Sparinvest's 2010 acquisition of another small domestic funds manager and is in line with the company's efforts to strengthen local distribution. Founded in 1968, Sparinvest has a total of $12.6 billion in AUM.

Italian private equity fund of funds manager **Advanced Capital** cut two deals in Europe, including the formation of a $70-million joint seed investment with Dutch hedge fund incubator **IMQubator** (*see "Alternatives" for more on hedge fund deals involving European firms*). The new hedge fund, **mCapital European & Asian Special Situations Fund**, will focus on small-to-mid-size distressed Asian companies. Hong Kong-based **mCapital** is led by Mark Devonshire, a noted distressed debt trader who had previously been in charge of **Merrill Lynch**'s proprietary credit trading operation. Devonshire had been seeking seed capital for two years, but institutions chastened by the financial crisis proved hesitant to make commitments. Founded two years ago, IMQubator has allocated more than $240 million to seven alternative investment managers, with an additional $110 million in unallocated capital. In a second deal, Advanced Capital acquired Amsterdam-based **Holland Private Equity**, which focuses on late-stage growth investments in small and mid-cap European technology companies.

Securities

Charles Schwab, the broker that built its name on cut-rate trades for the average investor, added to its leading online trading operation with the $1 billion all-stock acquisition of Chicago-based **optionsXpress**. Founded in 2001, publicly traded optionsXpress is an equity options and futures platform designed for active traders. The site also incorporates a well-regarded menu of analytic and educational tools. Walt Bettinger, president and CEO of Schwab, said the combination "will offer active investors an unparalleled level of service and platform capabilities." OptionsXpress, which will retain its brand identity, has more than 385,000 client accounts and $8.1 billion in client assets.

In striking the deal, Schwab is seeking to capitalize on the rapid growth of derivatives trading, with optionsXpress having more than doubled its customer assets, accounts and total trades since 2005. The transaction was priced at 10 times and 8.6 times 2011 and 2012 EBITDA (earnings before interest, taxes, depreciation and amortization), respectively. In a deal between two venerable Wall Street firms, investment bank Cowen Group paid $193 million for **LaBranche & Co.**, a market-maker in options, exchange traded funds and futures on U.S. and international exchanges. The all-stock transaction combines two independent companies that have been reorganizing as they grapple with declining trade volume and red ink — and attempt to compete against bigger rivals.

Last year, LaBranche sold its Designated Market-Maker assignments on the New York Stock Exchange to **Barclays** as it sought to focus its market-making operations in such areas as ETFs and equity and foreign exchange options. In 2009, Cowen merged with alternative asset manager **Ramius** as part of a diversification move. "The combined organization will benefit from an increased capital base and will accelerate our time to market in a number of high-growth areas in sales and trading," said Peter Cohen, chairman and CEO of Cowen.

GMP Capital of Toronto could pay as much as $59 million for New York-based **Miller Tabak Roberts Securities**, a fixed income specialist in institutional sales and secondary trading and research. GMP's sell-side orientation and focus on equity sales, trading and research mesh well with Miller's buy-side relationships in North America and fixed income specialty. GMP also hopes to capitalize on Miller's fixed income relationships to expand its product and underwriting capabilities beyond equities. The purchase price includes an earn-out provision capped at $11 million.

As exchanges worldwide continue to circle one another — and regulators scrutinize the activity — Kansas City-based **BATS Global Markets** cut a deal to acquire London's **Chi-X Europe**. The acquisition, terms of which were not disclosed, would create the largest pan-European trading platform based on market share and notional value traded. In the fourth quarter of 2010, the two firms combined accounted for some $700 billion in equity trades, with Chi-X Europe making up 72% of that number to become the second-largest European equity exchange. In June — four months after the announcement — U.K. regulators began a comprehensive review of the deal that could potentially delay any decision until early 2012. The proposed tie-up between **NYSE Euronext** and **Deutsche Borse**, announced in February, is scheduled for shareholder votes in July, with a long and arduous process of regulatory review to follow. ▲