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MIDYEAR REPORT | 2022

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Inflation, interest rates take the bloom off markets

For the fourth time in this short-lived century, stock markets experienced a significant downturn, but in the first half of this year investors found few safe havens. In particular, as interest rates rose, bond prices dropped sharply, leaving investors in that sector with double-digit losses. The broad-based Bloomberg U.S. Aggregate Bond index declined 10% in the first half while the Bloomberg Investment Grade and High-Yield Corporate Bond indexes were down 14% and 15%, respectively.

The S&P 500 index delivered its worst first-half performance since 1970, dropping 21%, while the Nasdaq sank 29%. The rebounding IPO market went back into hibernation: Listings fell 95% in the first half compared with the year-earlier period as companies raised just $4.3 billion, according to Refinitiv. First-half bond issuance in the U.S. was down 26% for investment grade and 78% in the high-yield market, according to Fitch Ratings. U.S. institutional leverage loan issuance followed suit, falling 60% during the first half due to fewer refinancings and repricing transactions.

By July, when U.S. equity and bond markets revived — the S&P 500 rose 9% and high-yield corporates 5.9% — fund managers were exercising caution: The Bank of America Merrill Lynch Global Fund Manager survey, which covers a group managing $700 billion in assets, revealed that cash levels were the highest in 20 years, at an average of 6.1% of assets.

At midyear, the weekly Sentiment Survey by the American Association of Individual Investors showed twice as many bears as bulls (47% vs. 22%). Although investors brightened by the end of July, bullish sentiment, at 30%, remained below its historical average of 38% for the 35th consecutive week. In a sign of the times, millennial favorite **Robinhood Markets** announced a second round of layoffs in August, cutting 23% of its staff. In the second quarter, the number of monthly active users on the digital platform dropped 34% from the year-earlier period while revenue declined 44%.

As individual investors weighed their options, **Merrill Lynch** responded with an ad campaign reminding them to keep the faith. "These markets — they're a wild ride," said the firm's full-page newspaper ad in July. "But we've seen it before.... With a Merrill Advisor, you can charge forward.... [with] a personalized plan to help you thrive, no matter what lies ahead." Merrill parent **Bank of America** bucked the market's headwinds in its wealth and asset management business, reporting increases in second-quarter revenues and net income of 7% and 16%, respectively.

Amid the carnage, there were a few relative bright spots, including some old-fashioned dividend payers and energy companies. Although dividend-oriented funds were largely in the red, they outperformed the indexes. The **Vanguard** Dividend Appreciation ETF (AUM: $60 billion) was down 16% in the first half, for example, while the **Schwab** U.S. Dividend Equity ETF (AUM: $34 billion) was off 10%. A few such funds managed to eke out positive returns, including the $1.1 billion **WisdomTree** U.S. High Dividend ETF (up 1%). In the second quarter, dividend payouts by S&P 500 companies reached a record $141 billion, according to S&P Dow Jones Indices.

Long-suffering value managers were also outperforming, albeit in the red, and took the opportunity to tout their strategies as investors turned against growth. **AQR Capital Management** Managing and Founding Principal Cliff Asness, a prominent value adherent, told the *Wall Street Journal* last June that he expects such stocks to enjoy a good run over the next three to five years. "People like me, both for legal and honesty reasons, should never use the word guarantee, and I won't," he said. "But I've never been more excited about value."

Asness' forward-looking optimism aside, the *Journal* reported in July that of the 1,342 actively managed U.S. equity funds it tracked, just 32 delivered positive returns during the rolling 12-month period through June. The average return was minus 15.2%, a performance the newspaper described ingloriously but accurately as "ugly."

A high-profile casualty on the ETF side was **ARK Investment Management**, the thematic technology manager led by media-savvy Catherine Wood. ARK shot to prominence with the boom in tech and related stocks, profiting off investments in industry disruptors and innovators such as Crispr Therapeutics, Tesla and Zoom Video Communications. But the flagship and concentrated ARK Innovation ETF (AUM: $7.9 billion) began to tank in 2021, dropping 25% and then another 57% in the first six months of this year. Many investors continued to place bets on Wood, however, pouring $1.5 billion into the Innovation fund in the first half. Simultaneously, one manager was profiting from ARK Innovation's losses: The **Tuttle Capital** Short Innovation ETF (AUM: $355 million), introduced in November 2021 to bet against Wood's portfolio, was up 74% in the first half.

U.S.-listed ETFs in general continued to attract strong inflows, amounting to $294 billion in the first half, although that was down 37% from the record-setting pace during the same period in 2021, **Fidelity Investments** reported. In the second quarter, ETF investors began to rotate into defensive sectors such as utilities, health care and consumer staples while cyclicals registered outflows, led by financials. **BlackRock** reported that dividend ETFs drew net inflows of $42 billion in the first half, nearly equal to the record inflows into the sector for all of 2021. Value-oriented ETFs added $57 billion, or nearly eight times the amount for growth, "the largest notional differential on record," BlackRock noted.

Asset manager shares take a hit

The cause for the downturn in markets was of course inflation, which reached a 40-year high of 9.1% in June, and the end of the Federal Reserve's longstanding easy money policy: The central bank raised rates three times in the first half, including a three-quarter point increase in June that was the highest since 1994. The Fed followed up in July with another three-quarter point hike to bring the federal funds target rate to 2.25% to 2.5%. Analysts expect the Fed to bump that rate to 3% or more by year-end.

That policy turn has forced investors to recalibrate risk and valuations, including GDP and corporate profit projections. Surveys have showed a generally dour mood among consumers in the U.S., and the nation fell into a technical recession in the second quarter, as GDP declined for the second consecutive quarter, by an annualized rate of 0.9%. At the same time, hiring remains strong, with the addition of 528,000 jobs in July.

As in the U.S., Europeans were also grappling with higher prices, although the eurozone delivered higher than expected second-quarter GDP growth of 0.7%. In the UK, the inflation rate reached 9.4% in June, leading the Bank of England to raise rates by a half-percentage point in August — the most in 25 years. The bank also predicted a lengthy recession beginning in the last quarter of this year. The eurozone, confronting war in Ukraine and elevated energy prices, saw inflation touch 8.6% in June. The interest rate disparity between the U.S. and the eurozone also helped drive the greenback to parity with the euro for the first time in 20 years, creating another source of trade-related inflationary pressure for the Continent.

In July, the European Central Bank responded by raising rates for the first time since 2011, by a half-percentage point, abandoning its negative interest rate policy. Simultaneously, the ECB — casting one eye in the rearview mirror on the post-2008 eurozone sovereign debt crisis and another on Italy's burgeoning crisis — announced a new program to continue purchasing sovereign debt. The ECB said the program "can be activated to counter unwarranted, disorderly market dynamics that pose a serious threat to the transmission of monetary policy across the euro area."

In a July update, the IMF cut its global GDP outlook for this year to 3.2%, the third time the institution has lowered its growth forecast since last October. For the U.S. and the eurozone, the IMF now projects 2.3% and 2.6% GDP growth, respectively, while China's gain is expected to be just 3.3%. For 2023, the IMF projects GDP global growth dropping to 2.9% as "disinflationary monetary policy is expected to bite." Citing the Ukraine war, inflation and the potential for "debt distress," the IMF wrote, "The risks to the outlook are overwhelmingly tilted to the downside."

For asset managers, the gloomy first half marked a radical shift from the good times in the second half of 2020 and 2021. **Affiliated Managers Group**, **AllianceBernstein**, **BlackRock**, **Blackstone Group** and **Franklin Resources** saw their shares drop between 14% and 33% in the first six months. Second-quarter results were similarly depressed compared with the year-earlier period, although there was some positive news. For BlackRock, operating income dropped 14% and AUM 11%, but net inflows were $90 billion. Blackstone reported a net loss and the value of its private equity portfolio dropped 7%, but AUM rose 38% and distributable earnings climbed 86%.

At AMG, with its large and diversified portfolio of asset managers, net income was flat with the year-earlier period while AUM declined 9%. Alternatives, a major focus of AMG's acquisition strategy, accounted for 39% of EBITDA. On that front, in the first half the Boston-area company cut one deal to buy out the remaining minority interest of a third party in hedge fund **Systematica Investments** (AUM: $13 billion). AMG, which made its original investment in 2015, was joined in the deal by Systematica founder, CEO and majority owner Leda Braga.

In Europe, asset managers weren't faring much better. The European fund industry in the first half absorbed a €2 trillion ($2.1 trillion) hit to AUM, which dropped to €13.3 trillion, according to Refinitiv Lipper. Asset flows were predictably tilted toward ETFs and index funds, which drew combined net inflows of €71 billion while active funds suffered outflows of €256 billion. As in the U.S., the region's largest asset managers saw their shares decline: For **Amundi**, the drop was 28% in the first six months while **Schroders** shares were down 23%.

The overall M&A market, which generated a record-busting $5.9 trillion in deals last year, declined 21% in the first half to $2.2 trillion compared with the year-earlier period, but recorded two more $1 trillion quarters to bring that pace to a record eight consecutive quarters, according to Refinitiv. The U.S. accounted for 44% of deals, down five percentage points from 2021. Private equity players remained active, accounting for a record 26% of first-half deals, and related multiples remained healthy.

Within the asset management industry, activity remained strong and crossed sectors, led again in sheer volume by a wealth arena that shows no evidence of slowing down. Fidelity counted a midyear record 119 deals for RIAs while June delivered the second-highest monthly number (27) since the asset manager began tracking the sector in 2016.

Smaller transactions (targets with less than $500 million in AUM) doubled over the same period in 2021 to 59, while larger ones ($1 billion or more in AUM) tracked last year's first-half number, at 34. Activity was again led by the growing legion of consolidators, among them **Creative Planning**, **Focus Financial Partners**, **Mariner Wealth Advisors** and **Wealth Enhancement Group**.

The traditional asset management sector lacked the drama of a major deal in the first half, with the largest ones taking place in Asia's developing markets, but there was one public-to-private transaction in the U.S. involving a traditional asset manager. **Manning & Napier** (AUM: $21 billion), a manager of blended vehicles, was acquired by **Callodine Group**, a yield-oriented manager, and family office **East Asset Management**, ending 11 years on the NYSE. In a second such transaction in July, value manager **Pzena Investment Management** (AUM: $45 billion) announced it would buy out the interests of its shareholders. In both cases, shareholders are being offered a significant premium to the prevailing share prices.

The alternative marketplace was active across all sectors and featured the largest asset management deal by far in the first half: Swedish-based **EQT**'s play on Asia's growth with the €6.8 billion ($7 billion) acquisition of **Baring Private Equity Asia**. The infrastructure sector, usually quiet on the deal front, delivered several notable ones in the first half, including **Colliers**' acquisition of **Basalt Infrastructure Partners** and DigitalBridge Group's purchase of the global infrastructure asset management business of **AMP Capital**. The credit market drew a number of high-profile buyers, including traditional managers with a strategic focus on alternatives such as **AllianceBernstein** and **Franklin Resources**.

Buyers flock to alts

Demand for alternatives from institutions and, increasingly, individuals, has created an active marketplace for transactions across the range of related sectors, drawing pure alternative firms as well as traditional managers building out their portfolios. One of the latter buyers, Franklin Resources, in the first half cut its fourth major alternatives deal since 2018, for **BNY Alcentra Group Holdings** (AUM: $38 billion). The price tag for the European credit and private debt manager could run to $700 million over four years with performance-based payments.

"Three-quarters of a century ago, we brought mutual funds to individual investors," President and CEO Jennifer Johnson wrote in the company's latest annual report, "and our moves in alternatives are aligned with that continuing mission: democratizing access and delivering the best service and outcomes for our investors." Alternatives account for 14% of Franklin's total AUM, on a pro forma basis.

Boston Consulting expects alternative AUM worldwide to climb about 50% to $22 trillion in the five years through 2025. And while BC projects the market share for alternatives will increase just one percentage point to 16% during that time, it could account for 46% of global asset management revenues. In private markets, BC points out that U.S. retail investors are a significant source of potential growth, as they make up just 10% of AUM across the related asset classes and a 1% to 5% allocation in their portfolios. "Even a small percentage increase in retail investor allocations could have a substantial impact," the consulting firm writes.

Private equity, which BC expects to remain the fastest-growing such asset class, was showing signs of stress in the first half. Although the industry accounted for 26% of M&A worldwide between January and June, according to Refinitiv, fundraising dropped 51% in the second quarter compared with the year-earlier period, to $119 billion, by Preqin's tabulations. Bain & Company figures that global buyout fundraising halved in the first six months to $138 billion from the year-earlier period. Preqin data show that at the start of the year the industry was sitting on $1.2 trillion in dry powder.

During Blackstone's second-quarter earnings call, President and Chief Operating Officer Jonathan Gray acknowledged that fundraising is "getting harder," particularly among North American institutions. But Gray said Blackstone remained in an advantageous position, noting that the firm had raised a record $30 billion global opportunistic real estate fund in 90 days "in an environment where markets are falling sharply." In its second-quarter private equity review, PitchBook wrote that while fundraising "continues to hum along.... [the] surfeit of demand far exceeds the funding capacity for traditional institutional allocators, thus creating a backdrop that favors the largest PE firms with the deepest connections and most strategies."

In its midyear review of the industry, Bain warned that the inflationary environment will impact the expanding valuation model that has long supported returns. "Top-tier performance moving forward will depend on nuts-and-bolts value creation and a clear understanding of how to manage effectively during a period of rising prices," the consulting firm wrote.

In the first half, one *Private Equity* cross border mega-deal dominated asset management M&A: EQT'S €6.8 billion ($7 billion) cash and share purchase of Baring Private Equity Asia. Stockholm-based EQT, whose AUM doubled between 2019 and 2021, said the deal for one of Asia's leading private markets managers positions it to "execute on the structural growth opportunity in Asian private markets." Baring, based in Hong Kong and established in 1997, adds €18 billion in AUM to the €77 billion EQT already managed primarily in Europe and the U.S.

Additional deals in the sector saw buyers acquire minority shares. One was **Dyal Capital Partners**, which traveled beyond its home market in the U.S. to target South Korea's largest independent private equity firm, **MBK Partners**. MBK, which focuses on the East Asia region, has $26 billion in capital under management. In 2020, the firm closed a $6.5 billion buyout fund, the largest in its history. Italy's **Azimut Group** also crossed borders to cut its fourth U.S. deal since 2020, buying 10% of **BroadLight Holdings**. Started up in 2021, BroadLight invests in "high-growth, innovative companies."

Bonaccord cut two alternative deals in the first half, including for Florida's **Trivest Partners**, which focuses on North American lower-middle-market founder- and family-owned businesses. Trivest recorded the busiest year in its 40-year history in 2021, when it invested in 52 businesses. Bonaccord, part of Dallas-based private investment firm **P10**, made a second investment in a U.S. and European private debt manager, **Park Square Capital** of London.

Credit attracts mix of buyers

The *Credit* sector was notable for the large number of prominent alternative and traditional managers making acquisitions. In addition to Franklin Resources, they included AllianceBernstein, **Ares Management**, **Brookfield Asset Management** and **Carlyle Group**. Carlyle added $15 billion in mostly collateralized loan obligations from credit manager **CBAM Partners**, a deal that makes Carlyle the largest CLO manager in the world (AUM: $48 billion). In the first-quarter earnings call, Kewsong Lee, Carlyle CEO at the time, said private floating-rate credit investments such as CLOs and direct lending were benefitting from "increasing demand," noting that "the majority of our strategies in our private credit business" feature floating rates.

CLO issuance in the first half in the dominant U.S. market was $71 billion, 14% below the previous-year's period but the second-highest first-half total ever, according to **Doubleline**. The J.P. Morgan CLO Total Return index returned a negative 2.6% in the first six months, and yields for below-investment grade CLOs rated triple- and double-B reached 8.1% and 12.6%, respectively, by midyear, reflecting investors' macroeconomic concerns. That compared with 4.9% and 8.5% at the end of 2021, creating what **Oaktree Capital Management** in its midyear commentary called a "significant compensation for credit risk." In June, **J.P. Morgan Securities** reduced its full-year U.S. CLO new issuance forecast to $90 billion to $100 billion, $20 billion below earlier forecasts.

Private debt funds raised $93 billion in the first half, tracking the record $214 billion raised in 2021, while dry powder was $413 billion, according to Preqin. "Many institutions are still underallocated to private credit, relative to their target," Chris Acito, CEO of credit-focused RIA **Gapstow Capital Partners**, told *Pensions & Investments* in July. "With fixed income under pressure, if institutions have room to make new allocations to alternative credit where the yields are still strong, they're going to do it."

In its latest report on private markets, McKinsey & Co. notes that the "top end of the [private debt] market has grown faster than the tail end as the market becomes more consolidated." Last year, for example, the top-10 private debt funds accounted for 40% of total fundraising compared with 27% five years ago. Funds are also gaining heft: five with $10 billion or more in capital were raised in the last two years compared with just one in the previous decade.

Among the deal-makers, Ares Management targeted the middle-market lending platform of **Annaly Capital**, paying $2.4 billion for U.S. senior secured loans to more than 40 private equity-backed companies. Ares said that it is familiar with many of Annaly's underlying investments through its own business, allowing a "diligent underwrite of each loan in the portfolio to create what we believe is a highly informed and granular view of value." Direct lending accounts for a majority of the assets in Ares' credit unit (AUM: $200 billion).

AllianceBernstein acquired **CarVal Investors**, an opportunistic and distressed global credit manager that adds $14 billion to the $35 billion in private markets assets AB already managed. AB, whose alternative assets have averaged 28% annual growth over the last five years, paid $750 million in equity but could add another $650 million in earnouts. AB parent **Equitable Holdings** has committed to allocating $10 billion of permanent capital to AB's illiquid platform. Another insurer, **Guardian Life Insurance Company of America**, expanded its exposure to alternatives by purchasing a minority stake in **HPS Investment Partners**, one of the largest private credit firms, with $80 billion in AUM. In 2021, Guardian had 17% of its assets in private placement debt.

Brookfield Asset Management paid A$1.5 billion (US$1.1 billion) for an Australian firm owned by Blackstone, **La Trobe Financial**, which manages retail funds for qualified investors, primarily in residential property-backed loans. Acquisitive multi-manager boutique **Spouting Rock Asset Management** also tapped the market, buying a majority of **Old Hill Partners**, an established credit manager focused on small and medium-sized enterprises.

Infrastructure draws capital and buyers

The real assets marketplace is generally dominated by real estate advisory deals, but in the first half there were a number of notable transactions focused on infrastructure of various types, in an indication of the increasing investor interest in that sector. Digital Bridge Group, **I Squared Capital**, **KKR & Co.** and **Stonepeak** all closed infrastructure funds at between $8.3 billion and $17 billion in the first four months. In the first half, infrastructure funds raised $120 billion, "frantic fundraising" Preqin likened to a year's worth of capital.

The evolution of KKR's business is instructive. Its initial flagship infrastructure fund 10 years ago raised $1 billion, followed by $3 billion and $7.3 billion funds prior to the fourth fund that closed in March at $17 billion. KKR has also launched two additional funds, including an Asian vehicle capitalized at $3.9 billion. The first two flagship funds (closed in 2012 and 2015) delivered "high teens" gross returns, "attractive multiples" on divested capital, and an annual dividend yield of 5% to 6%.

Between 2018 and 2020, KKR's infrastructure management fees nearly doubled to $158 million, with KKR projecting them to potentially double again by 2023. "To put this in context, our infrastructure business today is only one-quarter the size of our global PE business, with multiple ways to grow and scale from here," co-CEO Joe Bae told investors last year.

Toronto's **Colliers** took part in one of the key such first-half deals, buying a 75% stake in **Basalt Infrastructure Partners** (AUM: $8.5 billion) of London and New York, with management retaining the rest. Basalt focuses on mid-market equity investments in utilities, transportation, energy/renewables and communications in Europe and North America. Colliers is primarily a professional services firm, but in recent years has been building an alternatives business. For Basalt, Colliers provides a source of permanent capital.

DigitalBridge Group took part in two deals, paying $800 million in cash and shares for **Wafra**'s 31.5% ownership of Digital's digital infrastructure asset manager and $330 million for the global infrastructure asset management business of Australia's **AMP Capital**. AMP's business is made up of four funds with US$5.5 billion in AUM and has a growing digital focus. In both deals, DigitalBridge could add to the total payout based on performance.

In a second cross border deal involving an Australian-based infrastructure firm, London's **Foresight Group Holdings** paid A$105 million (US$73 million) in cash and shares for **Infrastructure Capital Holdings**, a price that could climb another A$60 million based on performance. ICH has the equivalent of £2.8 billion ($3.4 billion) in AUM in transportation, renewables and utilities, bringing Foresight's total to more than £12 billion. Foresight, which went public last year, noted that ICH's renewable energy business accounts for 44% of assets, saying the transaction strengthens its own position as an "international sustainability-led alternative asset manager" while creating a "pathway" to Asian markets.

Within the U.S., value manager **Westwood Holdings Group** added the alternative business of **Salient Partners**, which has $4.5 billion in AUM, the majority in energy infrastructure. Publicly traded Westwood could pay up to $60 million for the business, which it said delivers "significant immediate accretion to earnings." Westwood said the deal will benefit its multi-asset portfolio, comprising 41% of AUM ($12.1 billion) prior to the transaction.

Rates rise, property falls?

For years, low interest rates have helped the property market enjoy a generally steady rise, in sync with other asset classes, while drawing the enthusiastic capital of institutions and wealthy individuals. This year, rising rates and inflation are forcing a reassessment within the industry, but at least in the first quarter commercial real estate giant **JLL** described the global real estate markets as "remarkably positive." Global transaction volume rose 47% vs. the year-earlier quarter to $292 billion, the highest first-quarter total on record. Investment into sectors that had slumped during the Covid crisis — hotels, retail and offices — was "growing on par with or in excess of the overall market."

Property funds that closed in the first three months were oversubscribed by 10%, with private investors playing a larger role, representing some 43% of volume. Dry powder, at $388 billion worldwide, remained near all-time highs. By the second quarter, however, Preqin was painting a more guarded picture, with fundraising of $26 billion down by one-third from the first quarter and 11% year-on-year.

Preqin noted that investors were also shunning higher-risk strategies. "There is pressure on the market from multiple fronts, leading to lower valuations, a rise in the cost of debt and likely weaker returns," said Dave Lowery, Preqin head of research insights. "In a market like this, we could see managers and investors adopt a 'wait and see' approach." JLL also took note of a shift in sentiment resulting from the higher-rate environment, as well as geopolitical risk, but said it expects "ongoing strength" through 2022 while acknowledging that "risks have increased, and a degree of caution is now needed."

Following a hyperactive 2021, M&A in the *Real Estate Advisory* sector in the first half was relatively quiet but included several high-profile buyers. One was **Neuberger Berman**, which acquired a minority stake in value-add investor **Waterton**, cutting the deal through its private real estate investment unit, **Almanac Realty Investors**. For Waterton, the connection provides additional scale, including for larger deals. The company's $9 billion portfolio targets U.S. multifamily, senior living and hospitality properties.

A second major buyer was **Nomura Holdings**, which purchased 41% of Australian forestry asset manager **New Forests Pty**. Simultaneously, existing shareholder **Mitsui & Co.** increased its equity from 23% to 49%. New Forests is the second-largest unlisted forestry asset manager in the world and the largest in Asia-Pacific, with some A$8 billion (US$5.6 billion) in AUM.

Australia factored into a couple of other deals, including the largest in the first half, as Sydney-based **Charter Hall Group** joined Dutch pension fund manager **PGGM** to pay A$1.2 billion for Australian real estate advisory firm **Irongate Group**. In a second deal, Australian-based multi-boutique manager **Pacific Current Group** paid US$35 million for a 35% stake in **Banner Oak Capital Partners**, a private equity real estate firm with some $6 billion in diversified U.S. assets. In return, Pacific Current will receive 35% of Banner Oak's earnings, excluding carried interest.

In the REIT market, M&A in the U.S. remained strong with $71 billion of deals in the first half, according to Nareit, but that was down from the record year in 2021 when $100 billion took place in the first six months. This year's activity is led by **Prologis**' proposed $26 billion acquisition of **Duke Realty** in a merger of two complementary industrial REITs. Blackstone also weighed in with four deals via its nontraded REIT, **Blackstone Real Estate Income Trust**. The first-half performance of REITs, weighed down by higher interest rates, was another matter — off 19% in aggregate. The previously hot industrial sector was harder hit, down 27%, along with office, also off 27%.

Passives continue to outperform

The first six months provided active equity managers with the opportunity to show investors they are sagacious and nimble enough to beat their passive competitors in turbulent markets. But in the short term at least, and as a group, they failed, according to an analysis by **AJ Bell**, one of the the UK's largest investment platforms. Globally, only 30% of such funds outperformed their passive peers compared with 34% during the strong market in 2021, but there were marked differences by region. (AJ Bell tracks 1,000 open-ended funds across seven major sectors.) In the U.S., 40% of active funds outperformed — double the number in 2021 — while in the UK only 12% did.

The specialized active managers that investors hope will fare better than large-cap managers battling broad indexes such as the S&P 500 didn't necessarily beat their indexes either: Only 21% of active global emerging markets funds outperformed, for example. Notably, AJ Bell points out that the technology exposure of U.S. active and passive funds was around the same at 25%, negating the opportunity for managers to "play catch up on their passive rivals, who blindly buy into the biggest companies in the market, come what may." Still, the company advises investors to pursue a healthy mix of the two strategies through "judicious active fund selection and diversification."

That advice aside, in the passive vs. active tussle ETFs retain the momentum by far: They continued to draw strong inflows in the first half, with funds in the U.S. on pace to exceed all full-year totals save for 2021, according to FactSet. In an interview with *ETF Express*, Elisabeth Kashner, director of ETF research and analytics at FactSet, added that "the persistence of investor preference for ever-cheaper funds across asset classes and investment strategies reminds us that price sensitivity remains a powerful force."

In the first half several small such managers caught the attention of deal-makers, drawing two South Korean buyers — **Mirae Asset Global Investments** and **Samsung Asset Management** — and **SS&C Technologies Holdings** of Connecticut. A smaller player, New York's **AXS Investments**, cut two deals to enhance its portfolio of alternative ETFs, including for what it called the industry's first certified carbon-neutral ETF, from **Change Finance**. In an indication of the ongoing efforts of smaller ETF providers to compete with differentiated products, AXS launched a suite of eight single-stock leveraged bull and bear ETFs. The company described the ETFs as allowing "traders and sophisticated investors to express their high-conviction views" on actively traded stocks ranging from Tesla to Pfizer.

The *Traditional Investment Management* sector was otherwise notable for what did not take place in the first six months: There were no major consolidation or similar deals, in a departure from the usual activity. The largest deals took place in Asia, including China, where **Mackenzie Financial** of Canada paid C$1.1 billion (US$860 million) to double its ownership in publicly traded **China Asset Management**, the nation's No. 2 asset manager. **Blackstone** reportedly paid $1 billion for a majority stake in an established and fast-growing Indian asset and wealth management firm, **ASK Investment Managers**, cutting the deal through one of its private equity funds.

One of the more significant U.S. deals saw **Voya Financial** acquire most of the U.S. business of **Allianz Global Investors**, which assumed a 24% stake in Voya's asset management unit in return. Voya, a largely institutional manager whose primary business involves wealth and health-related employee benefits, gains $120 billion in retail-oriented equity and fixed income assets to bring its total AUM to $370 billion. Voya will also benefit from Allianz's global distribution network of 19 locations in Europe and Asia-Pacific and more than 500 relationship managers.

In a management buyout, a veteran team acquired the value business of **LMCG Investments**, a Boston firm managing equity, fixed income and structured credit products, and subsequently began operating as **Leeward Investments** (AUM: $2.8 billion). At U.S. large-cap equity manager **Argent Capital Management** (AUM: $3.3 billion), employees bought out the minority share held by investors while Canada's **Fiera Capital** acquired the minority shareholding of **Natixis Investment Managers**.

Specialist managers remained on the radar screens of U.S. buyers. For multi-strategy manager **Shelton Capital Management**, the target was **Vitruvian Capital Management**, which manages an established U.S. small-cap equity fund and a newer international strategy. Investment bank and broker **Loop Capital** zeroed in on a fixed income manager, **Taplin, Canida & Habacht**, a Miami-based institutional firm with more than $6 billion that was part of **BMO Global Asset Management**. Pennsylvania multi-boutique Spouting Rock Asset Management crossed the Atlantic to acquire a "top-quality pure-play" socially responsible UK asset manager, **Alquity Investment Management**.

Wealth sector remains red hot

In an interview with *Barron's Advisor* in July, Rudy Adolf, CEO of Focus Financial Partners, laid out an ambitious goal for his acquisitive firm: $1 trillion in assets, or nearly triple the current level, "and not in the too-distant future." Toward that end, the firm had announced 13 transactions this year by the time of the interview, on top of a record 38 in 2021. Saying that the "crisis of 2020 strengthened our business," Adolf wrote in Focus' annual report that the M&A pipeline remains "strong and well-diversified as succession needs and the demand for scale continue to drive ever-increasing transaction activity."

In the first half, Focus was joined by the other headline consolidators, among them **Beacon Point Advisors**, **CI Financial**, Creative Planning, Mariner Wealth Advisors and Wealth Enhancement Group. Those six firms accounted for some 50 transactions while consolidators in general accounted for more than half.

In counting 119 RIA deals in the first half — a 47% increase over the same period in 2021 — Fidelity Investments tabulated $161 billion in total transferred AUM, up 21% over 2021. Deals included a healthy mix of targets, ranging from **Laird Norton Wealth Management**'s purchase of **Wetherby Asset Management** (AUM: $6.5 billion) to **Mercer Advisors**' acquisition of **Convergent Wealth Management** (AUM: $130 million).

Significantly, transactions such as Mercer's for firms with less than $500 million in AUM doubled to 59 from the year-earlier period. There could be multiple reasons for the uptick, but lower valuations for some smaller firms is one. (Smaller RIAs are generally valued on multiples of revenues rather than EBITDA, providing a level of support, however.) Having endured the brief but alarming Covid-related hit in 2021, many of these owners are now weighing their prospects in a potentially more turbulent inflationary environment. Then there's simple supply: Having aggressively targeted the universe of larger firms in recent years and taken many off the market, buyers are pursuing smaller ones.

In an interview last year with *Asset TV*, Jim Cahn, Wealth Enhancement's chief investment and business development officer, explained how the market is impacting smaller firms. "If you look back 10 years, if you were an RIA with a couple of hundred million dollars and a team of four or five people you could really compete with the best offerings out there. But as technology has evolved, as the compliance environment has gotten more complex … as the product offering and the services offering the client expects broadens…. That's created all these complexities that lend itself to having scale to deliver a better and more efficient client experience."

For Convergent, a 13-year-old St. Louis-area firm, succession planning was a key motivation in selling, as in many such deals, but the company also cited Mercer's compatible culture and client services. "The fact that we could also offload onerous and time-consuming back-office responsibilities to them was icing on the cake," added John Stobbs, one of two co-founders. Mercer made nine other acquisitions in the first half to bring its AUM to around $37 billion.

Toronto-based CI Financial has aimed for far larger targets in aggressively building its wealth business over the past three years. In the first half, CI delivered four more deals: three in the U.S. and one Canada, adding a total of US$19 billion in AUM. The acquisitions ranged from **Galapagos Partners**, a Houston family office with $900 million in AUM, to the wealth business of Boston's **Eaton Vance WaterOak Advisors** (AUM: $11.4 billion). Seller **Morgan Stanley** inherited the Eaton wealth business as part of its 2020 deal for asset manager **Eaton Vance**.

But in CI's first-quarter earnings call, CEO Kurt MacAlpine noted that the company has "absolutely slowed down the pace of acquisitions" following a hyperactive 2021 and is "focused on integrating." The company also announced that it plans to float its U.S. wealth unit (AUM: $112 billion) — the focal point for most of the acquisitions — selling up to 20% of equity, with "size, conditions and timing … subject to market conditions."

Another active consolidator, Mariner Wealth Advisors, made three deals in the first half, but its most notable transaction took place in July for a back-office provider, **Financial Services Network**, acquired from **LPL Financial**. FSN provides administrative, consulting, compliance and operational services for more than 400 independent financial advisors nationwide and has $26 billion in assets under administration. The deal scales up Mariner's existing such business, **Mariner Platform Solutions** (AUA: $2.6 billion), and delivers a relationship with LPL.

Wealth Enhancement cut six deals in the first half for a geographically diverse group of wealth managers, including **Kings Point Capital Management** of Long Island, N.Y., and suburban Nashville, Tenn. Established in 2005, Kings Point has $1.7 billion in AUM and pursues investments in a concentrated portfolio of stocks rather than funds. WEG also cut its sixth deal in California since its expansion there in 2021, adding $400 million in AUM.

Creative Planning made some one dozen deals in the first half in a variety of geographies, adding $10 billion in AUM in total; the firm has assets under management and advisement of $225 billion. The largest by AUM was for **Reilly Financial Advisors**, a 22-year-old San Diego-area firm that manages more than $2 billion. Reilly enhances Creative's existing presence in San Diego and provides a niche among American expatriates.

Two private equity firms added RIAs to their portfolios. One was an all-Chicago transaction in which **Vistria Group** made its first wealth deal by taking a majority stake in **Mather Group**, an 11-year-old firm with $8 billion in AUM. Mather was listed among the 50-fastest-growing RIAs in the U.S. by *RIA Channel*, with AUM climbing 53% in 2020-21. Mather, which made three acquisitions of small RIAs in the first half, said Vistria will provide capital to support its growth organically and via acquisitions. **Parthenon**, which sold its interest in wealth consolidator **Allworth Financial** in 2020, acquired another fast-growing wealth manager that was sold by accounting firm **RSM**. The firm, rebranded as **Choreo** and based in Minneapolis, has $10 billion in assets under management and advisement. Both Choreo and Mather's clients have average accounts of some $2.5 million, according to *Financial Advisor*.

A major deal between two independent managers saw ambitious **Cresset Asset Management** acquire **Meristem Family Wealth** (AUM: $5.4 billion) to create a multi-family office with $27 billion in AUM. Chicago-based Cresset was founded in 2017 by two private equity veterans, a background the founders say gives their clients an edge in private markets investing. The company has been acquiring wealth managers since 2019 and has quickly become one of the largest independent firms in the U.S. The Laird Norton deal for Wetherby was another notable marriage of two independents, both based on the West Coast. Laird Norton said the combination, with $15 billion in AUM, "will create an expanded platform from which to source high-quality investment opportunities."

Outside the U.S., Switzerland and the UK remained active deal-making centers with British aggregators adding to their portfolios and new consolidators being minted. In Switzerland, buyers included **Bank Syz**, **Decisive Capital Management** and **Gonet & Cie**. In a cross border deal of note, Focus Financial Partners established a Swiss beachhead by adding a Geneva-based wealth manager to its portfolio, **Octogone Holding** (AUM: $4.3 billion). Octogone, founded in 1995, has three other offices in Europe and the Americas. By contrast, **Julius Baer** was in divestiture mode, selling to management two of its Swiss wealth boutiques with total AUM of CHF 2.7 billion ($2.8 billion) as part of a strategy to "reduce the complexity of its portfolio of companies." In the first half, Julius Baer's AUM declined 11% to CHF 428 billion due to market corrections.

Private equity buyers continue to scour the large and fragmented UK wealth marketplace. Corporate finance boutique **Dyer Baade & Co.** says private equity firms backed 16 new consolidators last year and counts 31 such firms active in the UK. Bolt-on acquisitions by those wealth managers climbed to 88 last year, nearly quadruple the number four years ago, while also hiking valuations. "At the heart of most private equity strategies is EBITDA multiple arbitrage," writes Dyer Baade. "Buy a number of smaller businesses, consolidate them into one larger firm, and benefit from the valuation premiums given larger firms."

Last year, Stockholm's **Nordic Capital** joined the mix of buyers when it secured a deal to acquire one of the UK's largest independent firms, **Ascot Lloyd**, from owner Oaktree Capital Management as well as Ares Management. Ascot, which operates nationally, has £10 billion ($12 billion) in assets on behalf of 20,000 clients. For U.S. firm **Lovell Minnick Partners**, the target was **London & Capital**, an established firm with 800 clients and £4.1 billion in AUM. L&C praised its new parent's "excellent track record of working with management teams to scale and enhance wealth and asset management firms." Lovell bought a majority stake.

In other private equity-related deals, HPS Investment Partners of New York acquired a majority of financial planning platform **Nucleus** from **Epiris**, which retained a minority shareholding. Epiris said HPS will bring "fresh capital and insight" to accelerate growth. Another U.S. player, **Crestline Investors**, paid £100 million for a minority stake in **Foster Denovo**, which said the capital will fund the firm's "acquisition and growth strategy" as it seeks to build out a national business. Foster Denovo said acquisitions this year will "transform" earnings, tripling EBITDA while "creating a highly attractive platform on which to add newly recruited advisers and acquisitions." In March, Crestline closed a series of funds totaling $3.6 billion and pursuing multiple strategies.

In a major cross border deal — and one of the first half's mega-deals — **Royal Bank of Canada** announced it will pay C$2.6 billion (US$2 billion) in cash for one of the UK's largest independent wealth managers, **Brewin Dolphin** (AUM: £59 billion). The combination will create a top-three wealth manager in the UK and Ireland with £64 billion in AUM. The price amounted to 2.8% of assets. RBC called the UK "a key growth market" and said Brewin Dolphin provides "an exceptional platform to significantly transform our wealth management business in the region."

Wealthtech draws traditional buyers

The fintech industry as a whole took a breather in the second quarter: Funding dropped 33% (to $20.4 billion) from the first three months and 46% from the 2021 period to the lowest quarterly level since 2020, according to CB Insights. Mega-round funding, comprising $100 million or more, was off 45% quarter to quarter to $9.7 billion, once more the lowest since 2020. Fintech M&A exits were also in negative territory, down 30% from the first three months.

Wealthtech was the only sector to show a quarter-on-quarter increase in deals: CB Insights counted 188, a 36% increase from the first quarter. Although related funding globally was flat at $3.5 billion, Europe recorded a sharp increase of 57%. Of the top-10 wealthtech fundraising deals in the second quarter, half took place in the U.S., led by the $165 million Series B round for four-year-old **Clear Street**, which manages a cloud-based prime brokerage platform that averages $3 billion in trades a day in U.S. equities and options. With the capital infusion, New York-based Clear Street plans to expand its business to serve active traders, fintechs and market makers.

The wealthtech space drew a slew of major pure-play fintech wealth and asset management companies, including **Envestnet**, **iCapital Network** and **Orion Advisor Solutions**. They were joined by an impressive roster of commercial banks such as Bank of America and **JPMorgan Chase**, as well as asset managers **Apollo Global Management** and **UBS**.

For JPMorgan, which did two fintech deals last year, the target in the first half was **Global Shares**, an established software provider for employee share-plan management. The Ireland-based company serves more than 600 companies and has $200 billion in assets under administration. The addition of Global Shares ties in with the bank's corporate business. **Goldman Sachs** added a digital retirement advice provider, **NextCapital Group** of Chicago, in a bid to enhance the services it provides defined contribution plan clients.

Apollo was joined by Franklin Resources and others in a $225 million round of financing for alternative platform **CAIS**, valuing the firm at more than $1 billion. Last December, Apollo acquired the wealth distribution and asset management business of **Griffin Capital**, a longtime channel for alternative investments to advisors. Bank of America also had its eye on alternatives in making an investment in an established such firm, iCapital Network. The deal valued iCapital, with $130 billion in assets on its platform, at $6 billion.

Among the traditional firms, UBS cut the headline deal by paying $1.4 billion in cash for an established robo advisor, **Wealthfront**. The Silicon Valley-based firm has 470,000 clients and $27 billion in assets. While tiny in comparison to UBS' global wealth business, Wealthfront provides a younger U.S. clientele "with significant domestic growth potential" and a digital platform.

iCapital, a perennial fintech buyer, stepped into the market multiple times in the first half to extend its platform, with **Simon Markets** among its targets. Simon provides a platform for structured products, annuities and other risk-managed products and serves 100,000 advisors. Envestnet was another active acquirer, including for **40lkplans.com** in a bid to strengthen its retirement business. 401kplans.com technology provides advisors with a documented due diligence process as they consider plan providers. During the first-quarter earnings call, Envestnet CEO Bill Crager noted that he spent much of the early part of the year with clients, saying, "Every company I spoke with is accelerating digital transformation. There is no mistaking the transformation that is coming."

Two other pure-play fintech serial acquirers, Orion Advisor and **AssetMark Financial Holdings**, cut deals in the first half. Orion added a couple of firms, including investment and trading platform **TownSquare Capital**. A four-year-old company based in Utah and with $6 billion in AUM, TownSquare's platform delivers institutional asset managers for its advisory clients. AssetMark added to its wealth capabilities with the acquisition of **Adhesion Wealth**, which serves 180 RIAs. Adhesion's platform includes overlay trading services, client engagement technology, and managed account programs. ◆

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