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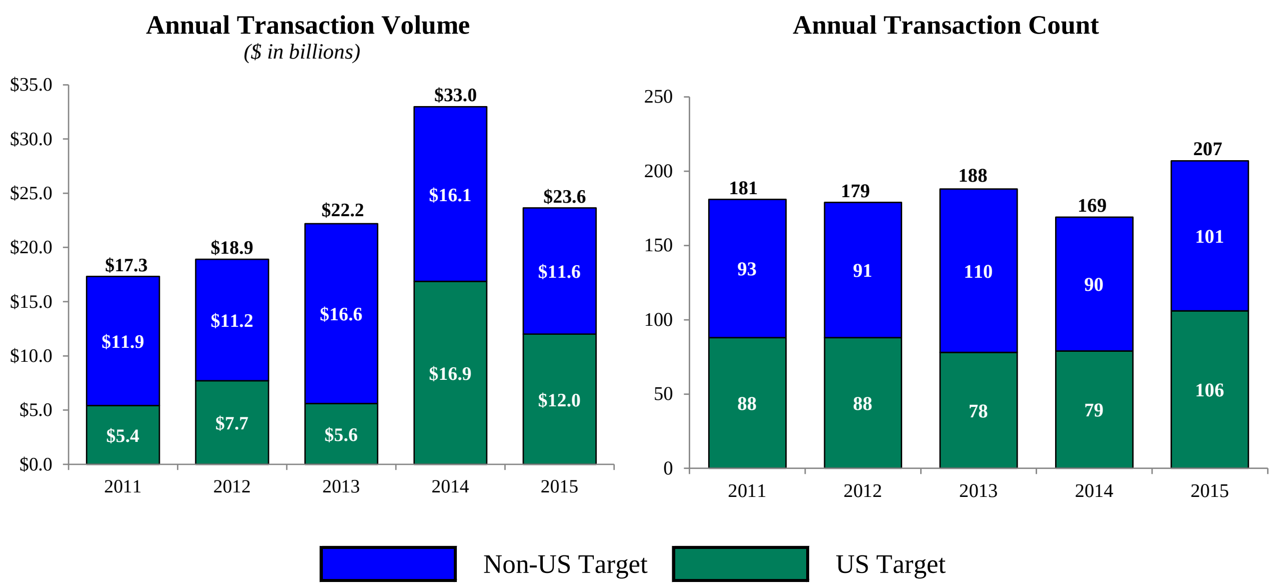
The Cambridge Commentary
A Review of Developments in the Investment Management Industry During 2015

Dear Friends:

It is perhaps surprising in a year where global all-industry M&A volume hit record highs, up 37% over 2014, that global investment management transaction volume was, by contrast, *down* 28%. The most obvious reason for the high all-industry numbers was the record 69 transactions that exceeded $10 billion in value, many of which were cross-border megamergers driven by tax inversions and economies of scale in industries such as healthcare, technology and oil & gas. In investment management, by contrast, there were only five transactions exceeding $1 billion in value, down from seven in 2014, with the largest, the purchase of a majority of First Eagle Investment Management by private equity estimated at $2.4 billion -- substantially less than 2014's largest, the $6.25 billion purchase of Nuveen Investments by TIAA-CREF. Clearly tax inversions and economies of scale do not drive transaction interest in the investment management industry. Nevertheless, despite the lower volume, investment management still had a healthy year with the *number* of transactions up by 34% in the US, primarily due to a surge in private wealth transactions, and up by a more moderate 12% outside the US.



Top Ten Investment Management Transactions of 2015

(All amounts in US$) **Target**	**AUM ($bn)**	**% Acq'd**	**Purchaser**	**Amount Paid ($mn)**	**Strategic Rationale**
First Eagle Investment Management *New York, NY*	98.8	60%e	Blackstone and Corsair Capital	2,400e	Blackstone's first significant private equity foray into investment management, acquiring a majority stake in First Eagle in conjunction with Corsair Capital, provides a successful exit for TA Associates' 2007 leveraged recap.
Pioneer Investments *Milan, Italy*	243.5	67%	Banco Santander, Warburg Pincus and General Atlantic	1,985	The combination of Pioneer Investments, Santander Asset Management and long-term distribution agreements from UniCredit and Santander, creates a major new European asset management champion and brings to a successful conclusion a sale process for Pioneer and its parent UniCredit that began in 2010.
Amundi *Paris, France*	1,021.5	22%	Public	1,795	The largest European asset manager, Amundi, formed in 2010 by the merger of Crédit Agricole's and Société Générale's asset management divisions, has its initial public offering in November, with SG taking the opportunity to sell its entire 20% ownership stake.
Russell Investments *Seattle, WA*	266.0	100%	TA Associates and Reverence Capital Partners	1,150	The London Stock Exchange Group settles for a much reduced price from private equity after China's largest securities firm, CITIC Securities, backed away from a $1.8 billion offer amid a collapse in its share price and investigations by the Chinese authorities.
American Century Investments *Kansas City, MO*	149.3	41%	Nomura Holdings	1,000	Nomura steps into CIBC's shoes acquiring its non-controlling stake in mutual fund manager, American Century, thereby gaining access to the US market.
Coutts International *Geneva, Switzerland*	33.3	100%	Union Bancaire Privée	950e	Following the acquisition of the Swiss wealth management businesses of ABN Amro in 2011 and Lloyds Banking Group in 2013, UBP acquires Royal Bank of Scotland Group's Geneva-based Coutts International. The final price will depend on the assets of the clients that transfer.
EnCap Investments *Houston, TX*	27.5	20%e	Dyal Capital Partners (Neuberger Berman)	750e	Dyal Capital Partners, part of Neuberger Berman's private equity platform, makes a big bet that oil prices have bottomed, acquiring a minority stake in EnCap Investments, the leading provider of private equity to upstream and midstream US oil & gas companies.
DNCA Finance *Paris, France*	16.6	71%	Natixis (BPCE)	625	Natixis Global Asset Management acquires an initial majority stake which is expected to reach 100% in time as management sells down. It provides TA Associates another very rewarding exit, from an investment only made in 2011.
The Mutual Fund Store *New York, NY*	9.8	100%	Financial Engines	560	The original robo-adviser, Financial Engines, offering retirement planning and investment advice to individuals and 401(k) plan participants, beefs up its human advice component with this acquisition of 125 mutual fund retail stores.
BT Investment Management *Sydney, Australia*	62.5	28%	Public	520	Australian bank, Westpac, bolsters its capital ratios by selling nearly half its ownership in this Sydney-based multi-boutique while maintaining its existing distribution relationship.

e: Indicates estimate

Private Equity Comes of Age

Looking behind the numbers, the most immediately noticeable difference in 2015 compared to prior years was the dominance of private equity buyers. In 2014, private equity accounted for nearly one-third of the *sales* in volume terms, understandable in the sixth year of a bull market, but private equity purchases were under 10% and in fact below the average of the prior three years of 14.3%. In 2015, private equity became the largest category of *buyer* in the industry, accounting for 34% of the dollar volume globally and an astonishing 49% in the US. This dominance was particularly apparent among larger transactions with four of the top ten transactions having private equity involvement on the buy-side. We think the reasons for this are several: the overhang of limited-life money in private equity funds waiting to be invested, a related increase in interest in finding non-traditional industries, such as investment management, in which to invest, and a reduction in competition from strategic acquirers, particularly for the purchase of large diversified investment managers. Among the many smaller transactions, private equity's involvement was much less obvious, accounting for 10% of the number of purchases globally.

The largest transaction of the year, Blackstone Group and Corsair Capital's purchase of First Eagle Investment Management, is a good example. Not only does it mark the first significant investment in a traditional manager by Blackstone, one of the industry's largest private equity firms, but it also marks a successful exit for TA Associates, the most prolific of private equity investors in this industry. Blackstone has been an important acquirer for its own account of alternative managers especially real estate, credit and fund-of-fund managers. However, Blackstone's private equity funds, with $91 billion under management of which 40% is still waiting to be invested, has not previously been an acquirer of traditional managers although it does have one fund, Strategic Capital Partners, which takes minority investments in hedge funds.

This contrasts with TA Associates which has made over a dozen private equity investments in traditional managers since we started compiling our transactions database in 1990, more than any other private equity firm. In 2015, TA teamed up with Reverence Capital to acquire Russell Investments in the fourth largest transaction of the year and increased its investment in Keeley Asset Management, a $4 billion AUM value equity firm in which TA already had a significant ownership position. TA also participated on the sell-side in both the largest and eighth largest transactions of the year, selling its stake in First Eagle Investment Management to Blackstone and Corsair, and its stake in DNCA Finance to Natixis.

In a demonstration of the increasing firepower of private equity funds taking minority stakes in institutional alternative managers, Neuberger Berman's Dyal Capital Partners purchased a stake estimated to be valued between $700 million and $800 million in EnCap Investments, itself the leading private equity investor in the independent sector of the US oil and gas industry. This was Dyal's fourth minority investment of the year, the others being stakes in Vista Equity Partners, Jana Partners and Chenavari. Private equity was also an important buyer in the US private wealth segment, participating on the buy or sell-side in four of the top five transactions, as described later in this letter.

Strategics Stay Focused -- Across Borders and Within the US

The much-anticipated interest by Japanese buyers in US investment managers was at least partially realized in 2015 with Nomura's announcement in late December that it would buy Canadian Imperial Bank of Commerce's 41% stake in American Century Investments. Comments to the press suggest the relationship will be as much or more about Nomura gaining access to the US market as it is American Century gaining access to Nomura's Asian distribution. It is a surprising change of heart for seller, CIBC, which had bought the non-controlling stake from JPMorgan Chase just four years ago. A couple of months prior to this transaction, Mizuho Financial Group had announced its intention to purchase a 16% position in San Francisco-based Asian investment specialist, Matthews International Capital Management, which will partially realize an investment made by Lovell Minnick Partners in 2011.

Notwithstanding CIBC's sale, the biggest national contingent of inbound cross-border investors was the Canadians with Sun Life Financial making two fixed income acquisitions, one of duration specialist, Ryan Labs, and the other of insurance client specialist, Prime Advisors. This extends Sun Life Investment Management's third-party business, launched in Canada in 2014, into the US. Fiera Capital Corporation also continued its push into the US by acquiring a fixed income manager, Samson Capital Advisors, which Fiera combined with its 2013 acquisition of equity manager, Wilkinson O'Grady, to form a US institutional platform. Meanwhile, AGF acquired the majority of an $800 million Boston-based ETF strategist, FFCM.

With Man Group, Henderson and Insight Investments focused on integrating their 2014 US purchases, the only British cross-border acquirer in 2015 was Aberdeen Asset Management. Against the backdrop of a dismal year of outflows in its core emerging market and global equity products, Aberdeen beefed up its alternative offerings by acquiring FLAG Capital Management, a $6.3 billion manager of private equity and real asset solutions, and Arden Asset Management, a fund of hedge funds with $5.9 billion under management.

US strategic buyers also stayed disciplined in their acquisition agendas within the US, acquiring only specific product or distribution capabilities that could be easily integrated and leveraged by their existing organizations. ALPS Holdings, better known for its fund servicing capabilities, increased its asset management business by acquiring private equity fund-of-fund manager, Red Rocks Capital, and Neuberger Berman also acquired a private equity fund-of-funds business from Merrill Lynch. Encouraged by a backdrop of prospective increases in interest rates, Federated Investors continued to vacuum up money market assets through its acquisitions of both Reich & Tang's and Huntington Bancshares' funds while BlackRock offered some competition in this asset class by acquiring Bank of America's money market funds. Robert W. Baird, after a long search, found its global equity partner by acquiring Chautauqua Capital Management and Victory Capital bulked up its multi-boutique structure by announcing the acquisition of RS Investments from Guardian Life Insurance, bringing its total assets under management to $54 billion.

The same theme can be seen in US strategic buyers' interest in cross-border investments in 2015 in which purchases were mostly small and focused. Both Legg Mason and BlackRock acquired infrastructure managers, in Australia and Mexico respectively. Janus Capital acquired a global bond manager in Australia and Raymond James Financial acquired a Canadian ETF strategist. Most of the remaining dozen transactions were minority investments in private equity, real estate or hedge fund managers by a mix of financial and strategic buyers.

This more focused approach to investment management acquisitions by US strategic buyers since the financial crisis accounts for the more sober tone to the transactional environment in investment management, even as M&A in all industries reaches new highs. Most noticeably, pricing of investment manager transactions, which had recovered nicely in the last few years, seems to have stalled at below previous pricing peaks reached in 1999/2000 and again in 2007/8. This has enabled private equity to step up its participation in the industry.

Technological Disruption on the Horizon

As 2015 came to an end, a McKinsey report concluded that blockchain, the distributed ledger technology underlying bitcoins, is "one of the most disruptive innovations since the advent of the Internet." Custodians and clearing brokers, rather than investment managers, may face the most threat from this innovation longer term but, in our industry, private wealth is facing a more imminent technological disruption, namely from "robo" financial advice services which a recent Deloitte Consulting study estimates will manage $5 trillion to $7 trillion within a decade. Most RIAs argue that their clients are looking for a human adviser and see little short-term threat from robo-advisers but few dispute that the technology is especially appealing to millennials and that it may become increasingly difficult to attract younger clients without such technology. At the very least this adds a further headwind to RIAs' biggest historical challenge – new client acquisition.

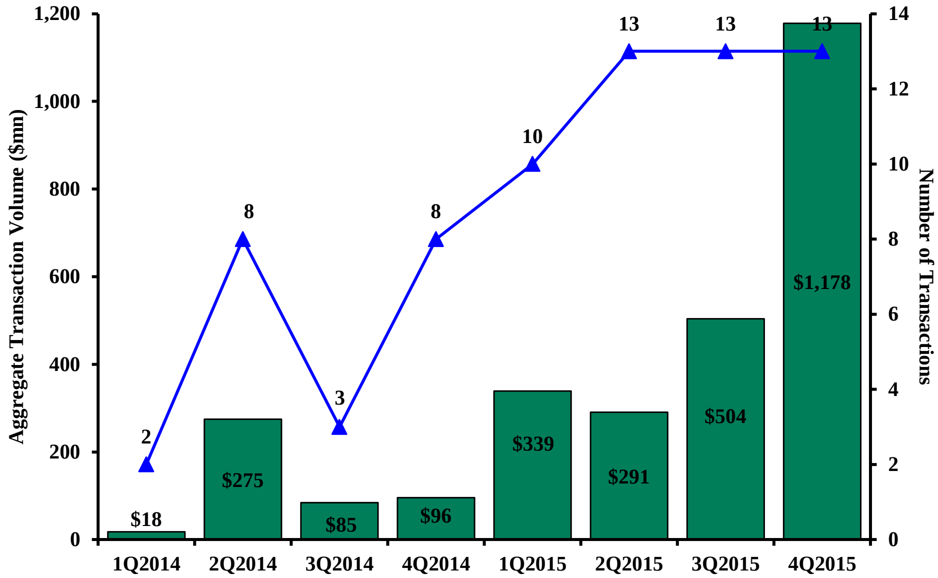
Not surprisingly, hybrid offerings are emerging as well. It is instructive that Financial Engines, which can be considered the original robo-adviser, acquired The Mutual Fund Store in the largest US private wealth transaction of 2015, adding 125 locations nationwide and pairing human advice with its technology-driven recommendations. Arguably, Northwestern Mutual's purchase of online financial planning platform, LearnVest, announced earlier in the year, achieves the same pairing.

Blackrock made clear its interest in this technology for its Blackrock Solutions business by acquiring three-year old venture capital-backed robo-adviser, FutureAdvisor, for a reported $152 million. With just $600 million of AUM and a 50bp fee, this valuation may seem high at 25% of assets and 50 times revenues but it is in line with valuations in recent venture capital rounds for robo-advisers and it is also an interesting measure of the potential venture capital sees for these firms.

US Private Wealth Transactions Increase by Leaps and Bounds

As shown on the next page, there has been a remarkable rise over the last eight quarters in the number and value of US private wealth management transactions and it is by no means clear that this trend has peaked. Of the 49 transactions in 2015 valued at $2.3 billion, 38, or 78%, were

US Private Wealth Transactions by Quarter



sales of independent firms. This statistic underlines both the fragmented nature of this industry as well as the role played by generational exits in driving transactional activity in this space. The principal reasons cited for selling by independent firms were succession and monetization of founder equity, more so even than seeking distribution. Combine this imperative with market cycle timing and we suspect that, with the market stalling in 2015 after six strong years, there is a major element of catch-up in these numbers as owners facing retirement rush to sell after a lackluster 2014. More controversial, however, is the possibility that the emergence of robo-advisers, albeit with only limited assets under management so far, is already encouraging sellers to accelerate their exit plans. Arguably closed architecture firms that pick stocks for their clients are less vulnerable to robo-adviser competition but the market has shifted and nowadays a majority of US private wealth transactions involve firms that have embraced open architecture as a core component of their asset allocation strategies. These firms offer many of the same services as robo-advisers, including asset allocation, manager selection, tax harvesting and rebalancing, but at a considerably higher fee.

Along with The Mutual Fund Store purchase, one of the largest US wealth management transactions of the year was private equity firm Hellman & Friedman's majority purchase of $15 billion AUM Edelman Financial Services from Lee Equity Partners, another private equity firm. On the back of a near-doubling in assets, the valuation of Edelman increased from $263 million at the time of Lee's 2012 investment to more than $800 million in the 2015 transaction. While Lee remains a minority investor in Edelman, it also took a majority position in WealthTrust, another $15 billion AUM firm consisting of eight WealthTrust affiliates previously owned by Falcon Investment Advisors and eight high net worth firms that were once part of Edelman. In two other "pass-ons" from one private equity firm to another, Genstar Capital, acquired $6.0 billion AUM Mercer Advisors from Lovell Minnick Partners, and Lightyear Capital acquired $4.7 billion AUM Wealth Enhancement Group from Norwest Equity Partners.

Whereas these four private equity purchases accounted for about one-third of value transacted in US private wealth in 2015, it was the aggregators who accounted for the most deals -- 27% of the number but only 10% of the value transacted -- with Focus Financial and affiliates making seven purchases, United Capital Financial Advisers four and AMG Wealth Partners two.

Strengthening service or product capabilities and local market share were also important themes for existing wealth managers, whether independent or divisions of financial institutions. First Republic's purchase of Constellation Wealth Management for $115 million was the largest such strategic deal. Started by two managing partners who broke away from Citigroup's Family Office Division in New York in 2007, Constellation had grown rapidly to its current $6.1 billion in assets in a story that shows many similarities to that of Los Angeles-based Luminous Capital which First Republic acquired in 2012. The six partners of Luminous had broken away from Merrill Lynch private banking and investment group to start their business in 2009 and had grown it to $5.5 billion by the time of their sale. Together, the purchases reinforce First Republic's commitment to wealth management for its ultra-high net worth clients on both the east and west coasts, while shifting First Republic Investment Management predominantly into the open architecture camp. Other strategic examples include Westwood Trust's expansion into Houston through the purchase of Woodway Financial Advisors and Fiera Capital's product extension into fixed income through the acquisition of Samson Capital Advisors.

Divestitures Drag On

The retreat from asset management by major banks primarily in Europe continued unabated in 2015, accounting for over half of non-US transaction volume and four of the top ten transactions. Driven principally by a need to raise capital, 2015 saw UniCredit finally succeed in divesting itself of the majority of Pioneer Investments after five years of frustrated efforts, Royal Bank of Scotland Group (RBS), which is still majority owned by the British Government as a result of its 2008 rescue, sold Coutts International to Union Bancaire Privée, Société Générale sold its remaining 20% stake in Amundi in the only IPO in the industry in 2015 and the Australian bank, Westpac, sold nearly half its ownership in BT Investment Management in a secondary offering. One exception was CIBC's divestiture of its American Century investment as CIBC is well capitalized, in common with the Canadian banks generally, instead citing its inability to see a path to control as the reason for the sale.

Swiss private banks continue to be an exception to the bank divestiture trend as the private wealth market continues to consolidate in that country. Apart from UBP's acquisition of Coutts International, Banque Syz acquired Royal Bank of Canada's Swiss private bank and Julius Baer, Raiffeisen and Vontobel all acquired smaller Swiss private banks. Julius Baer also acquired Commerzbank's Luxembourg international wealth management business. US banks are also an exception, having mostly completed their post-financial crisis divestitures and, as a group, they are as much buyers as sellers. Nevertheless, JPMorgan Chase, just five years after buying it, sold Brazilian hedge fund and private equity manager, Gavea Investimentos, back to management. There was also a significant pull-back in India where Deutsche, Goldman Sachs, KBC, Nomura and Santander sold all or parts of their asset management or private banking operations. These divestitures were likely prompted by a re-rating of the prospects for emerging markets in general following a 17.0% fall in the MSCI emerging market index in 2015, the third consecutive year in which this index declined.

Outlook for 2016

The prospect of a gradual tightening in US money supply was roiling the markets as 2015 came to an end. Compounded by the market's pessimistic view of the prospects for China and commodity prices, especially oil and gas, riskier asset classes in general and not just emerging markets suffered towards the end of the year. High yield bonds were down 4.7% in 2015, their first decline since 2008, hurt by defaults in the energy sector that are expected to reach 11% in 2016. Hedge funds failed to add alpha, with HFR estimating a loss of more than 3% on average compared to the 1.4% total return of the S&P 500 including dividends. Within long-only equity classes, small cap and value were down substantially more than large cap and growth stocks respectively.

Despite this negative market sentiment as we enter 2016, economic conditions look more promising in the developed countries than in recent years with accommodating monetary policy in Europe and Japan helping to lift those economies even as the US continues to lead the growth parade. While commentators may not be expecting a double digit increase in the market during 2016, they are also not predicting the sort of declines that might undermine buyer confidence. Consequently, we expect transactional activity in investment management to continue to be solid in 2016 with increases in the number, if not in dollar volume, of transactions.

One reason that dollar volume may be down is that the pipeline of large divestitures by European banks has shrunk significantly. Not that European banks have stopped raising capital but rather the headline divestitures have now mostly been accomplished – one likely exception being the Italian bank-owned asset manager, Arca, which had reportedly received several proposals at year-end valuing it at close to $1 billion. This shrinkage is clearly a healthy development in terms of bringing the buy- and sell-side into balance although undoubtedly it will be a factor much regretted by private equity. Countering this, strategic buyers will likely stay disciplined, continuing to focus on acquiring specific product and distribution capabilities. Private wealth transactions are expected to continue at a rapid pace driven by generational transfer in the US and regulation-driven consolidation in the UK and Switzerland. Absent an unexpected and unpredicted meltdown in an asset class or region of the world, we are looking forward to a healthy year of transactional activity for the investment management industry in 2016.

Our best wishes to you all for 2016.

Sincerely,

John

Rod

Rick

John H. Temple David W. Abbott Richard H. Haywood, Jr.