Issue 4
2nd Quarter 2002

July 31, 2002

Asset Management Focus
Freeman & Co.

Challenges to Growth in a Sliding Equity Market

What a disaster! As we write this on July 31st, the S&P 500 and NASDAQ Composite are down over 20% and 30% YTD, respectively ; the Bear Stearns High Yield Bond Composite is down 8.27% through July 25; and the only sectors not losing money are high grade fixed income, hedge fund of funds and REITs.

The current market environment presents numerous challenges to the asset management industry, with declining AUM, disillusioned retail investors and regulatory investigations clouding the future. In spite of this, we continue to see specialized fixed income and hedge fund of fund firms deliver performance and raise assets in this environment.

Performance as of June 30, 2002

Index	Total Return 1st Half 2002	Total Return Trailing 12 Months	Total Return Annualized 3 Yr	Total Return Annualized 5 Yr
S&P 500	-13.2%	-18.0%	-9.2%	3.7%
NASDAQ	-25.0%	-32.3%	-18.3%	0.3%
FTSE EuroTop 100	-15.7%	-24.8%	-7.5%	2.5%
LBGC*	3.3%	8.2%	7.9%	7.5%
CSFB/Tremont**	1.3%	3.6%	8.6%	9.0%

Lehman Brothers Govt./Credit Index ***CSFB/Tremont Hedge Fund Index*

Inside this issue:

International Deal Activity	2
US Acquisitions / Assets Acquired Globally	3
European Trends	5
Alternative Investments	7
Public Company Valuations	11

Indices at July 31, 2002:

DJIA	8,737
NASDAQ	1,328
S&P 500	912
FTSE EuroTop 100	2,133
10 Year US Treasury Bond Yield	4.47%
Euro to dollar	$0.98

Summary

Our key findings are:

- There were 37 asset management firms acquired in the second quarter, an increase of 32% over the first quarter, but a decrease of 23% as compared to the second quarter of 2001
- Assets under management ("AUM") acquired increased dramatically over the first quarter to $210 billion from $48 billion, but was down from $331 billion in the second quarter of 2001
- Although acquisition targets continue to be focused on smaller targets, the increase in AUM acquired was driven by two large European deals involving $89 billion (Lombard Odier—Darier Hentsch) and $52 billion (Friend Ivory & Sime—Royal & Sun Alliance fund group) in AUM.
- There were 13 acquisitions in the second quarter involving over $1 billion in AUM, compared to 12 acquisitions of this size in the first quarter
- In Europe the evolution of open-architecture platforms continues as firms like Deutsche Bank take leadership positions, however, industry wide progress remains years behind the US
- Structured products have been a strong point in Europe, with numerous product launches of CDOs and capital guaranteed products
- Product innovation progressed in the alternative industry including (1) the launch of the first hedge fund of fund collateralized fund obligations (CFOs) by Investcorp and Man Glenwood and (2) the creation of new investable hedge fund indexes by Standard & Poor's and MSCI
- Lastly, we tracked 8 transactions involving alternative investment firms during the second quarter, including, 5 acquisitions, 2 distribution arrangements and 1 alliance

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Global Asset Management Transactions

M&A activity picked up in the second quarter as measured by the number of deals, increasing 32% over the first quarter from 28 acquisitions to 37. For the first half of 2002, acquisitions are down 23% to 65 as compared to the same period in 2001. The amount of assets acquired increased from $48 billion in 1Q02 to $210 billion in 2Q02 (see page 3).

At June 30th, we were comfortable predicting total deal volume of 120-130 acquisitions globally, with very few large deals over $30 billion, and numerous boutique transactions. With July's market dislocation, we now expect to see 100-110 acquisition this year as large firms focus on internal issues. The majority of these new deals should be less than $5 billion AUM each.

Strategic partnerships (joint ventures, alliances and distribution arrangements) were up slightly from 15 to 17 for the periods ending June 30, 2001 and 2002, respectively. As was the case in the first quarter, a large portion of strategic partnerships involved alternative investment managers, which are highlighted on page 7.

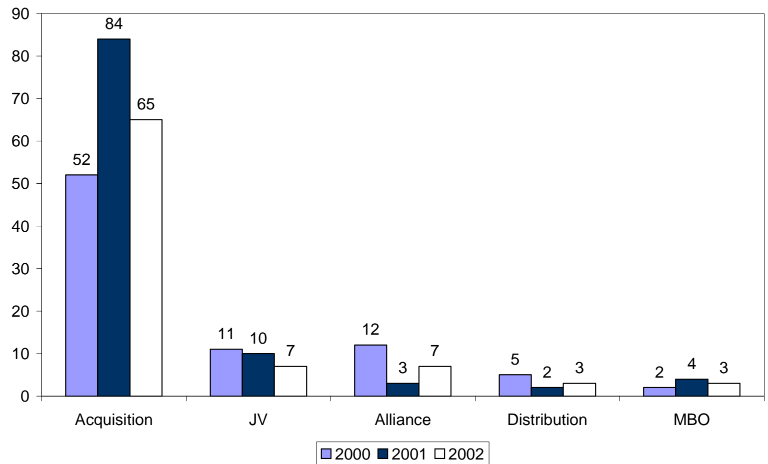
A shift to strategic partnerships may result from the current market environment. In the usual buy vs. build vs. partner business decision, firms may opt to avoid the financial risk of buying and the expenses of building, in favor of partnering to gain product skills or distribution access.

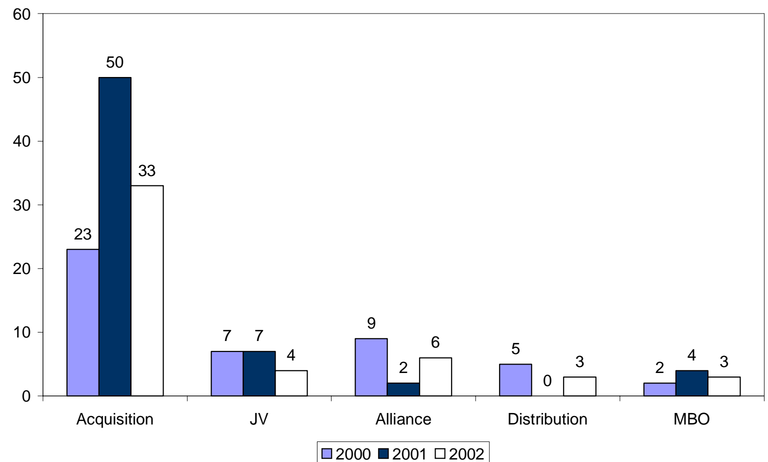
US—Europe Transactions

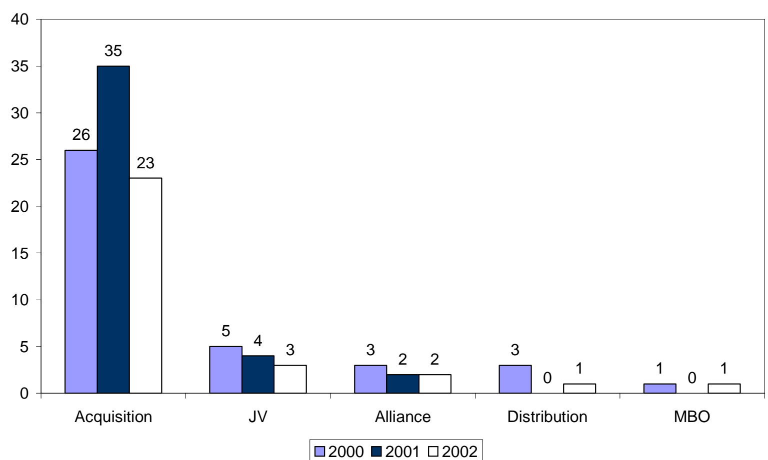
Acquisitions in the first half of 2002 involved more US firms (33) than European firms (23). However, this trend was reversed in the second quarter with more European (17) than US acquisitions (13). The majority of these European acquisitions were concentrated intra-country. Also:

- 8 of 8 acquisitions by a US buyer involved a US target
- 11 of 15 acquisitions involving a European acquirer involved a European target.
- Of the 11 Europe-Europe deals, 7 were intra-country and 3 other were regional (i.e. 1 Scotland-UK, 1 Finland-Sweden, and 1 Italy-Monaco
- 7 of 10 acquisitions involving a Canadian buyer involved a Canadian target, the remaining 3 were US targets

The predominance of local deals is in sharp contrast to 2000 when we saw numerous industry shaping cross-border deals (see *Drivers of Consolidation*, October 2000). We don't expect to see those types of deals again soon. In fact, the recent market volatility may reduce firms' interest in expanding in foreign markets, and the depreciation of the dollar may reduce US firms' appetite for acquisitions abroad, particularly in Europe.







Source: Freeman & Co.

US Companies acquired in the Second Quarter

There were 13 US companies acquired this past quarter, a decline of 15% over the first quarter. Acquisitions in the US continued to be focused on smaller firms and divestitures; 11 of the deals involved less than $5 billion AUM. The largest acquisition was the Bank of Ireland's acquisition of Iridian Asset Management with $11 billion in AUM.

Acquisitions in the US were focused on institutional and high net worth businesses in the second quarter. Firms are moving away from products designed for retail investors and concentrating on products for sophisticated investors. In troubled markets their tends to be an increased desire amongst clients for advice. Compared to the bull market of the 1990s, where investors poured money into high flying mutual funds and traded their own stocks in e-brokerage accounts, clients are seeking investment guidance and are willing to pay for this advice.

Two firms that have been particularly active in acquiring these businesses this year are The Bank of New York and Mellon Financial. The Bank of New York made its second acquisition of a high net worth manager this year with the purchase of Beacon Fiduciary Advisors. This acquisition, along with the earlier acquisition of Gannett Welsh & Kotler, has expanded its high net worth client and given it a foothold in the wealthy Boston market. Mellon made two acquisitions this quarter to increase its products for high net worth clients including HBV Capital Management (a hedge fund) and Weber Fulton & Ferman (a high net worth focused firm).

1st Quarter 2002 US Companies Acquired

Month	Year	Target	Description	Acquirer	Ownership %	Total Deal AUM ($MM)
4	2002	Beacon Fiduciary Advisors	Trust & Estate Services	Bank of New York	100	700
4	2002	Elijah Asset Management LLC	Equity Fund Manager	AIC Ltd.	75	280
4	2002	Embarcadero Securities	Hedge Fund Services	UNX Inc	100	-
4	2002	Jones & Babson Inc	Mutual Fund Manager	Royal Bank of Canada	100	1,500
4	2002	Weber Fulton & Felman	Private Banking	Mellon Financial Corp	100	800
5	2002	Barclays Private Banking (Americas)	Private Banking	Royal Bank of Canada	100	2,900
5	2002	First Union Institutional Debt Management	Institutional Fixed Income Manager	David L. Babson & Co.	100	3,700
5	2002	Iridian Asset Management LLC	Institutional Equity Manager	Bank of Ireland Plc	61	11,000
5	2002	NWQ Investment Management	Institutional/High Net Worth Equity Manager	John Nuveen Co.	100	7,000
5	2002	ValueQuest	Institutional Equity Manager	Thomas Weisel Partners	100	500
6	2002	**Conning's Mortgage Loan & Real Estate Division***	Real Estate/Mortgage Loans	KeyCorp	100	-
6	2002	HBV Capital Management	Hedge Fund	Mellon Financial Corp	100	530
6	2002	Riverview International Group Inc	Institutional Fund of Funds	Gartmore Group	100	360

Source: Freeman & Co. ** Freeman & Co. advised Swiss Re in its sale of Conning's Mortgage Loan and Real Estate Division to KeyCorp*

Assets Acquired in the First Half

Assets acquired globally increased dramatically to $210 billion compared to $48 billion in the first quarter. There were 13 acquisitions involving firms with over $1 billion in AUM in the second quarter compared to 12 deals in the first quarter. Although the number of $1 billion deals was comparable, the increase in acquired assets was driven by two European deals:

- The $89 billion AUM merger of the Swiss private banks Lombard Odier & Cie and Darier Hentsch & Cie
- Friend Ivory & Sime Plc's acquisition of Royal & Sun Alliance Insurance Group's Fund business with $52 billion in AUM

The merger of the two Swiss private banks was caused by a need to partner in the increasingly competitive Swiss market. In the current environment large transactions may be driven by defensive needs to combat market pressure, increased competition or to jettison a struggling business unit. We may also see struggling parents forced to sell successful business units to raise cash or pay down debt. Large transactions that we have seen in the past in this industry (i.e. Schwab—US Trust, Alliance Capital—Sanford Bernstein) are not a priority for firms now that they are faced with declining assets and revenues. A period of stability is required before we expect similar transactions to be considered.

On June 30th, we expected total deal AUM to be similar to levels in 1999 ($685 billion), however, the crashing equity and high yield markets make us question whether AUM volume this year will reach even 1998's total of $480 billion. We'll let you know where it turns out at year end.

Asset Acquired by Region ($MM)

Region 1	1997	1998	1999	2000	2001	2002 YTD
Africa		34,910		28,900		11,700
Asia	21,840	68,982	82,244	28,802	26,842	2,486
Canada	9,000	11,600	8,304	43,181	48,152	20,829
Europe	194,595	126,422	160,057	667,646	115,454	168,565
South America	312	8,285	19,062	2,122	2,047	3,421
US	522,525	229,605	415,067	945,624	647,321	51,126
Total	**748,272**	**479,804**	**684,734**	**1,716,275**	**839,816**	**258,126**

Source: Freeman & Co.

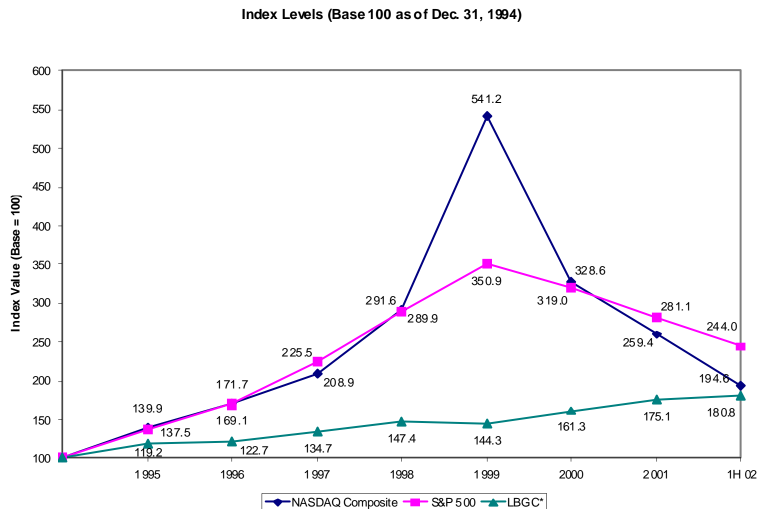
US Asset Management Industry

The US asset management industry has had a sharp reversal of fortune since the end of the 1990s, with equity managers hit sharply by asset deflation and bond managers continuing to perform well — and perhaps regain sizable asset flows with the increased stock market volatility. The chart at the right best illustrates the impact on equity managers, particularly those focused on the NASDAQ growth-based stocks. Since 1994 the NASDAQ Composite has outperformed bonds slightly through June 30, 2002, but if we add July's market returns, then the NASDAQ total return is less than the Lehman Brothers Government Credit index for the period (12/31/94—7/31/02).

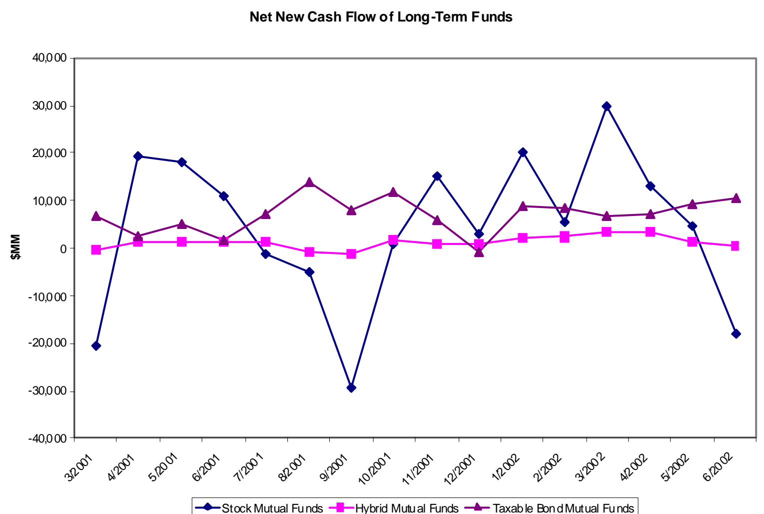
Index Returns

Index	1995	1996	1997	1998	1999	2000	2001	1H 02
NASDAQ Composite	39.9%	22.7%	21.6%	39.6%	85.6%	-39.3%	-21.1%	-25.0%
S&P 500	37.5%	23.0%	33.4%	28.6%	21.0%	-9.1%	-11.9%	-13.2%
LBGC*	19.2%	2.9%	9.8%	9.5%	-2.2%	11.8%	8.5%	3.3%

Lehman Brothers Government/Credit



Perhaps no firm illustrates the growth of the NASDAQ better than Stilwell Financial, which owns Janus and Berger. At the start of 1995, the combined firms managed $22.9 billion, according to the 10-k filing of their parent at the time. During the internet boom, Stilwell's assets reached $325 billion in the spring of 2000, representing a 65% CAGR. Since then its assets have fallen to $148 billion as of July 31, 2002, representing a –28% CAGR during the period, including a drop of $13 billion in July alone. The case of Stilwell illustrates the pressure large asset managers are under to keep their businesses profitable. While the industry has always enjoyed healthy margins and cash flow, this collapse in revenue has forced firms to attack cost bases that were built up during the 1990s. Most firms will have to significantly shrink components of their infrastructure including distribution, customer support, advertising and IT systems.



Source: Investment Company Institute

During this time, many value managers struggled as their performance lagged growth managers significantly. For example, in 1998 the difference between the Barra Large Cap Growth (42.16%) and Value (14.67%) indexes was a staggering 2,749 bps; in 1999 the difference was 1,553 bps (Growth @ 28.25%, Value @ 12.72%). It was not until 2000 that value managers, and their businesses, began to recover in terms of relative performance and asset flows. In that year, Barra Large Cap Value beat Growth by 2,807 bps, with returns of 6.09% and –22.08%, respectively. The real impact of this divergence was a clear separation of deal values for asset management firms that were either growth or value based. Growth firms were exploding in value with AUM expectations that looked like hockey sticks, while value managers were treading water and holding to retain assets during the NASDAQ bubble. When the stock market settles again into normal patterns (perhaps in 2003), we expect value firms to find themselves as the favored target of acquisition minded firms.

US investors began pulling assets out of stock mutual funds in June, with net redemptions of $18 billion, while over $12 billion flowed into bond funds during the period. With the market downturn in July, we expect large outflows of equity assets in July. This would represent the first multi-month downturn since last summer, when equity funds saw small redemptions in July ($1.2 billion) and August ($4.8 billion), before the large withdrawal of $29 billion in September. With the anniversary of 9/11 quickly approaching and the market continuing its difficulties, we expect nervous investors to continue to withdrawal assets through early September. Only after the anniversary and some market stability, would we expect significant mutual fund equity inflows to resume. The results are an extremely difficult period for equity growth managers, a difficult period for value managers and some good business prospects for fixed income managers.

European Mutual Fund Industry

During almost a decade (1992-2001) the growth of the European mutual fund industry (15% CAGR) has been fueled by 3 markets: Italy, UK and France.

In Italy, as inflation was brought under control, investors started swapping bonds for equity funds. Between 1997 and 1999 the Italian fund market grew at a spectacular 74% CAGR and proved irresistible to foreign players looking for new asset gathering channels. According to a recent survey carried out by Sector Analysis in 2002, the Italian financial organizations have selected the following firms as the best-known suppliers of third party funds:

1. Morgan Stanley Dean Witter
2. JP Morgan Fleming Chase
3. Merrill Lynch Mercury

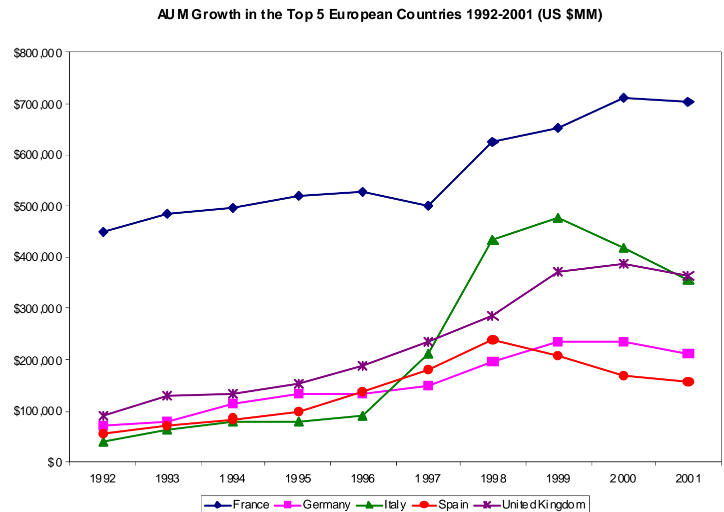
The key driver of growth in the UK fund industry has been the ability to put mutual funds in tax-wrappers. The introduction of the PEP and its successor the ISA has incentivized investment in mutual funds. Mutual funds were the most rapidly expanding sector of the UK saving market between 1997 and 1999 exhibiting a compound annual growth rate of 25%.

According to Sector Analysis, the best-known suppliers of third party funds in the UK in 2002 are:

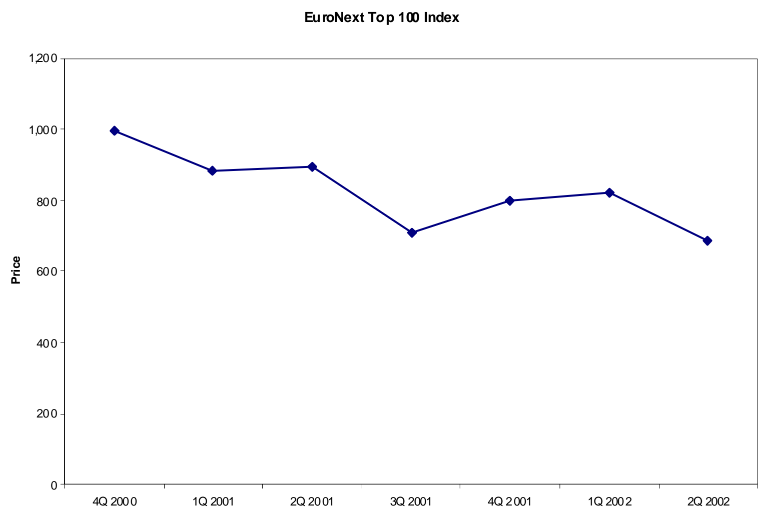
1. Fidelity
2. Invesco Perpetual
3. M&G

The French fund industry, given its maturity (the largest European fund market with AUM: $705bn) and its relatively defensive asset mixes, has experienced a healthy, but not spectacular, growth rate. While this might seem low compared to other European countries, it is growth from a higher base than these countries. According to Sector Analysis, the best-known suppliers of third party funds in France in 2002 are:

1. Fidelity
2. Invesco GT
3. JP Morgan Fleming Chase



Source: FEFSI



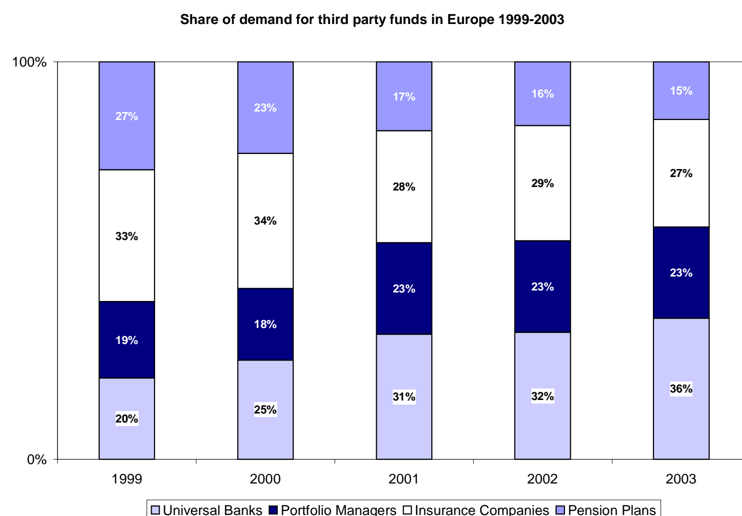
Source: Bloomberg

In 2001, mutual fund flows and valuations have weakened considerably across Europe, albeit with significant differences across countries. Italy and Germany suffered the most by losing 15% and 10% of their asset base, respectively. Across Europe, enthusiasm for equity mutual funds started to wane as investors were hit by the technology bubble decline and market volatility. The EuroNext Top 100 indicator representative of the main European stock markets has lost 14% of its value through June 30, 2002.

European Mutual Fund Industry

We believe that in the current environment, successful mutual fund business models must have the following features in order to retain clients and stabilize revenues: (1) client-focused, (2) advice-driven, (3) open architecture and (4) brand awareness.

Subsequently, we expect to see productivity indicators such as AUM per consultant, gaining more and more importance amongst the wide range of ratios used by equity research groups in analyzing the asset gathering industry. We still think there is room for further growth. Fundamental change in long-term savings will provide a great stimulus to the European fund industry. In addition to these long-term trends (Q4, 2001 Newsletter) it's worth noting that the developed world is enjoying a sustained period of low interest rates, which contributes to the European fund asset growth as investors look for better returns than those available from traditional bank deposits and insurance products.



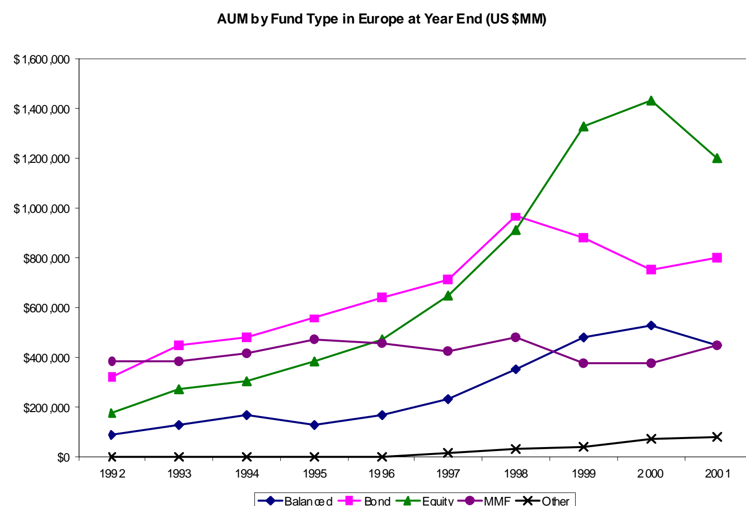
Source: Sector Analysis

Advice-driven

Examples of winning business models are universal banks, such as BNP Paribas and San Paolo IMI. On top of their branch network, these firms decided to add a network of financial advisors (respectively Cortal and Fideuram) increasing their stronghold on their end-customers by integrating their asset allocation process

Brand strength

Both banks benefit from a strong franchise in their domestic market. Amongst local third party fund suppliers both brands rank first or second depending on the year, according to Sector Analysis.



Source: FEFSI

Open architecture

The chart at top, shows a clear dominance of European banks (32%) as distributors of third party funds with a market share constantly increasing since 1999 and expected to reach 36% in 2003. This trend is not easy to identify without the implementation of rigorous and consistent market research techniques over a long period of time.

Banks have been cautious in embracing the "open architecture" approach from fear of seeing the profitability of their fund management business decline. These firms also had to provide further choice to the final investor. The solution was to create multi-manager programs or fund of funds vehicles. This initiative has allowed them (adopted by both BNP Paribas and San Paolo IMI) to make available third party funds to their customer base while maintaining the customer relationship.

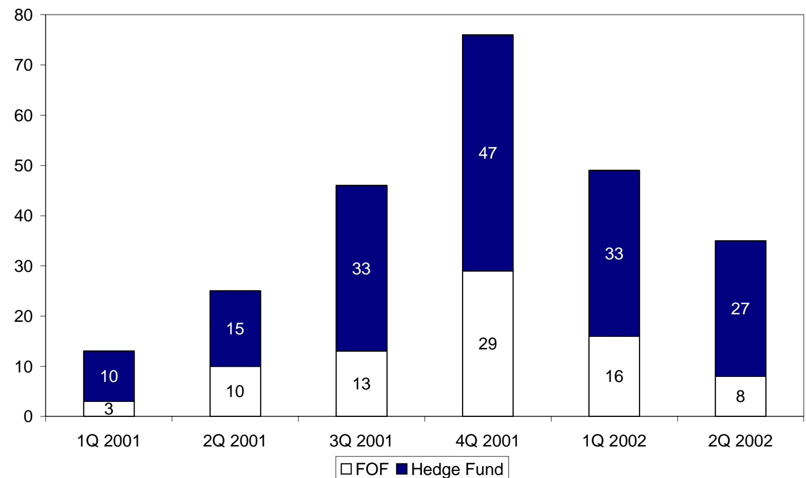
In 2001 we noticed the trend of investors shifting out of the higher-margin, higher-risk equity funds and into the lower margin, lower-risk money market funds mix of products. Equity funds lagged behind the market losing 16% in asset value together with balanced funds (-14%). Strength in the market has come from cash and bond funds with assets increasing respectively by 21% and 6%. Given the fall in investor confidence, we expect investors to continue to prefer money market funds in the near term whilst testing new investment alternatives. New products derived from the structuring capabilities of a new breed of fund managers are flourishing including, (1) guaranteed products, (2) enhanced index-linked products, (3) asset backed securities and (4) collateralized obligations

The so-called "structured" products are becoming an essential component of institutional asset manager product offerings. Many of these products offer downside protection on top of the possibility to generate higher returns.

Therefore we expect a substantial increase of specialists mandates awarded by investors seeking above-average performance on top of capital preservation in down markets. We believe that the switch from multi-asset approach to specialist will create opportunities for high-quality foreign managers in those countries that have traditionally invested with domestic players.

Alternative Investments—New Entrants

New entrants into the alternative investment marketplace declined for the second consecutive quarter after reaching a peak in the fourth quarter of 2001. We have seen a drop in individual hedge funds of about 20% and hedge fund of funds of 50%. Although this may seem dramatic, it represents the product and business launches that we are able to track. It does not represent all activity in the industry (which we are examining how to capture). We think of it as a proxy for industry activity and also a measure of euphoria. In the latter case, we think it is a good thing if euphoria for hedge funds cools a bit to allow the managers to absorb the capital and put it to profitable use.



Source: Freeman & Co.

Fund of fund new product launches were nearly in line with the number of transactions involving fund of funds with 8 of the former and 5 of the latter occurring in the second quarter of 2002. It appears that more firms are abandoning plans of launching their own funds in favor of partnering to gain instant traction. With the rapid growth in the industry, new entrants may have significant difficulty in building a top 10 or top 20 firm without partnering with an existing player.

Within the fund of fund world, $1 billion is now regarded as the critical size level. We believe that most firms below this level will have difficulty competing in the institutional investor marketplace, where due diligence by consultants will focus on infrastructure, risk management systems, reporting capability, management depth and financial stability. This leads to the next two questions: when and where does the critical size level move to?, and what happens to firms below this level? First, we believe that the next critical size point will be $2 billion AUM, but we don't believe that investors will begin to reference this level until the end of 2003. Asset inflows are still healthy, but pension funds move slowly through the process of a new asst class allocation — studying, proposing, approving, searching and selecting. Also, the low returns by fund of funds in the first half of the year naturally slows the compound effect of growth. Second, those firms below critical size should continue to prosper, but with different business models, marketing strategies and future expectations. Many of these boutique firms will succeed with regional and smaller clients, and may be unable or unwilling to support a national or international distribution team. We believe that many of these smaller firms will continue to be innovators in product creation and structuring, as the market will continue to increase its differentiation of products. Most of these firms need to set their sites on reasonable AUM goals and work to achieve the $500 million or $1 billion level. Everyone now realizes that the interest in hedge fund of fund products does not automatically grow every $200 million firm to the $2 billion level without a solid team, effective execution and aggressive marketing.

2nd Quarter 2002 Alternative Investment Transactions

Month	Year	Partner 1 / Target	Partner 2 / Acquirer	Details
6	2002	Attica Asset Management	Threadneedle Asset Management	Acquisition - Fund of Funds
6	2002	Riverview International Group Inc	Gartmore Group	Acquisition - Fund of Funds
6	2002	HBV Capital Management	Mellon Financial Corp	Acquisition - Hedge Funds
6	2002	DB Absolute Return Strategies	PNC Advisors	Distribution - Fund of Funds
6	2002	Global Asset Management	PNC Advisors	Distribution - Fund of Funds
5	2002	3C Fund Management Ltd	Mandatum (Sampo Group)	Acquisition - Hedge Fund
5	2002	RMF Investment Group	Man Group Plc	Acquisition - Hedge Fund
4	2002	LJH Global Investments, LLC	LaSalle Bank (ABN Amro)	Alliance - Fund of Funds

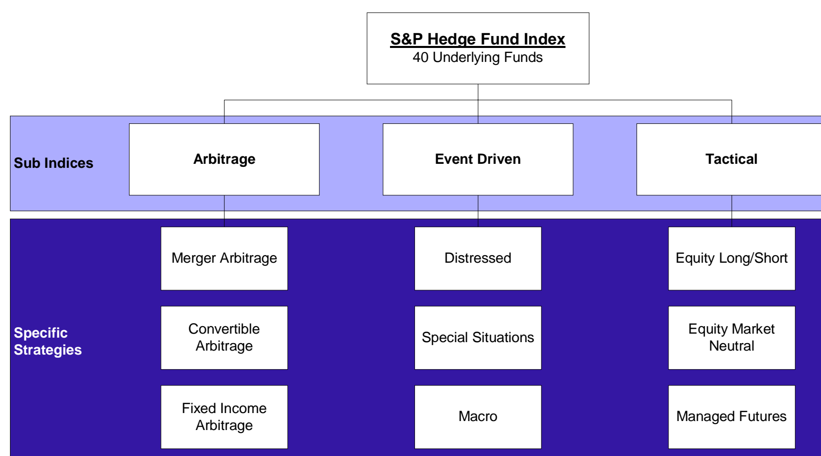
During the quarter we tracked two fund of fund acquisitions, both of which involved smaller firms. These included Threadneedle's acquisition of London-based Attica Asset Management ($300 million AUM) and Gartmore's acquisition of US-based Riverview International ($360 million AUM). After the quarter ended, Robeco announced on July 15th its purchase of US-based Sage Capital ($300 million AUM). These deal sizes are significantly below the earlier deals involving Ivy Asset Management ($2.4 billion), Glenwood ($1.4 billion) and Grosvenor ($3.8 billion). We believe that as large firms, which lack this product capability, continue to explore the competitive landscape and educate themselves about fund of funds, we will see larger acquisitions that fill both the product manufacturing and critical size criteria.

Alternative Investments—Hedge Fund Indices

This quarter Standard & Poor's announced the creation of its hedge fund index. The structure of the index (shown below) uses three broad categories—arbitrage, event driven and tactical—which each consist of three specific investment strategies. Within this framework, the index will be built using 40 different hedge funds, which will all be equally weighted to avoid "popularity" biases.

S&P plans to work with other partners to create unique features for this index. Among the partners, Albourne Partners will act as a consultant, monitoring the hedge funds to ensure they adhere to their investment parameters. One feature is that to be included in the index, a hedge fund must agree to offer daily transparency, which will be used by Derivatives Portfolio Management, a S&P partner, to verify prices. In addition, this feature will allow daily pricing of the index.

S&P has granted PlusFunds an exclusive license to develop certain products based on the index. S&P's approach appears to eliminate the issue of index creation and pricing we raised in our 1st Quarter report, where we highlighted that CSFB/Tremont issued two convertible index returns, with a total difference of 362 bps, due to the Lipper & Co. collapse. PlusFunds' plan to offer investible indices raises two questions: if they are cash-based, how much capacity can these funds absorb?; if they are derivative based, how does the swap counterparty hedge its position?



Source: Standard & Poor's

Alternative Investments—Guaranteed Funds

The European marketplace continues to create and sell a myriad of capital guaranteed funds, including single strategy and multi-strategy hedge fund products. We have listed a number of European firms that offer capital guarantee products, and all of them have been created through partnership. These products create a business relationship between product manufacturers and distributor/underwriter that has existed infrequently in the US.

In the US, many large firms that would like to distribute hedge fund of funds may find the economics of distributing a third-party product uneconomical after the fee is split between the manufacturer, salesperson and distribution platform. In Europe, large universal banks appear eager to help distribute third-party guaranteed products due to the higher fees they receive for that guarantee. In the list below, the guarantee fee for European products range from 175-250 bps, which provides enough economics in the value chain for the guarantor to assist in the distribution of the product. We believe that in certain US client segments, there would be significant demand for a guaranteed product to eliminate career-risk in choosing an Askin or Lipper fund in the future.

Date	Type of Product	Firm	Fees Annual/Guarantee/Performance	Other Features	Assets
Jul-02	Fund of Fund	HSBC Republic	1.70% / 1.75% / 10.0%	Leverage; step-up in guaranteed amount	NA
Jul-02	Fund of Fund	Coronation Intenational Principle Protected Notes		Dresdner Bank offers guarantee	$170 million
Jun-02	Fund of Fund	Coutts Private Banking Orbita Diversified Strategy Deposit		Zero coupon and yield; three year term	$170 million
May-02	Hedge Fund	New Star Asset Management Asian Hedge Fund		Guarantee offered by HSBC	$125 million
Feb-02	Fund of Fund	AXA - Credit Lyonnais	1.50% / 2.50% / 10% over 7%	Partnership between AXA and Credit Lyonnais	$500 million
Jan-02	Hedge Fund	New Star Capital Guaranteed Fund		Guarantee offered by HSBC	$180 million
Jul-01	Fund of Fund	Bank of Ireland Private Banking		Asset Alliance is sub-advisor	
May-01	Fund of Fund	Unicredito/Pioneer Alternative Investments		MTNs backed by Societe Generale	

Source: Financial News, Hedgeworld

Alternative Investments—Collateralized Fund Obligations

The first publicly rated hedge fund of fund collateralized fund obligations (CFOs) were launched during the 2nd quarter. The first was a $250MM deal managed by Investcorp and underwritten by CSFB, and the second was a $550MM deal managed by Man Glenwood and underwritten by J.P. Morgan Securities. These product launches continue the rapid development of products and services that capitalize on the growth in the hedge fund arena, which have included CFOs, start-up and incubation funds, hedge fund indexes, reinsurance businesses, risk management systems and administrative services.

Diversified Strategies CFO - Investcorp

Tranche	$MM	%	Rating	Spread over 6 Months $LIBOR
A	$125.0	50%	AAA	+60 Basis Points
B	$32.5	13%	A	+160 Basis Points
C1	$10.0	4%	BBB	+280 Basis Points
C2	€ 16.2	6%	BBB	+270 Basis Points
D	$67.5	27%	Unrated	-
Total	**$250.0**	**100%**		

Man Glenwood Alternative Strategies I

Tranche	$MM	%	Rating	Spread over 6 Months $LIBOR
A	$242.0	44.0%	AAA	+70 Basis Points
B	$33.0	6.0%	AA	+95 Basis Points
C	$41.3	7.5%	A	+185 Basis Points
D	$57.7	10.5%	BBB	+300 Basis Points
Equity	$176.0	32.0%	Unrated	-
Total	**$550.0**	**100%**		

Source: S&P, Moodys and company press releases

We believe the successful pricing and placement of these CFOs leads to important, long-run developments for the industry. First, it launches a new product class for the industry, which should help sustain the long-term growth in the hedge fund and fund of fund industry. For example, the CDO business is estimated at $90-100 billion annually by Lehman Brothers. Although we do not expect the CFO business to reach anything close to this level, the CFO structure does open the hedge fund market to investors that must own investment grade securities.

Second, the product opportunity will not be equal for all competitors. Small fund of fund managers (under $1 billion), we believe, lack the resources to capture this business opportunity. The underwriters will focus their efforts on the larger firms that have the personnel, risk management systems, brand names, infrastructure and capital resources to support this product. Also, the rating agencies will play a large role in segmenting this market opportunity and effectively eliminating small managers that would not pass the ratings criteria. Fitch Ratings, for example, has published ratings criteria for CDO management companies that leans heavily on infrastructure issues (Jan. 25, 2002).

Third, the CFO product should have a great influence on institutional investors and their views of and appetite for hedge funds in general. Although the investors in the debt pieces of the CFOs are buying investment grade paper, the underlying exposure is to multi-manager hedge fund product. As such, these investors, which may be insurance companies or banks, need to educate themselves about the underlying hedge fund styles (long/short, arbitrage, event-drive, etc.) and their risks (market movements, interest rates, credit spreads, etc.). Combining this investor exposure with the rating agencies work, should increase institutional investors understanding of and interest in hedge funds.

Man Glenwood Alternative Strategies I Investment Restrictions	
Manager Diversification	
Minimum # of managers:	35
Maximum % to any manager:	8%
Maximum % to Top 10 managers:	50%
Liquidity	
5 months or less	>= 40% of assets
6 months or less	>= 60% of assets
15 months or less	>= 93% of assets
Strategies (Maximum %)	
Commodities & Futures:	20%
Distressed Securities:	30%
Equities Long/Short:	60%
Industry Sectors:	60%
Interest Rate Strategies:	20%
International regional:	50%
Mergers and Reorganizations:	40%
Relative Value:	20%

Fourth, CFO structures increase transparency of hedge fund of fund managers and the underlying hedge fund investments. This increased transparency and monitoring will be beneficial to the industry by setting standards, giving investors more access to information and by setting limits on risk and positions (see box). In fact, some of the investment restrictions are significantly more conservative that one would see in a typical fund of fund. For example, a typical fund of fund would normally have 12-18 managers, while the Man Glenwood CFO requires 35 managers. The additional manager diversification requirements (no more than 8% in one manager and no more than 50% in ten managers) would likely be exceeded by many successful and popular fund of funds. We question whether these diversification requirements create a more diluted talent pool of managers in the fund that inadvertently leads to a more passive, index style approach.

Lastly, the creation of CFOs continues the product development innovation in the hedge fund industry, which has numerous secondary benefits. It continues the growth of the industry, not just in assets, but also in service and support firms, which helps create a solid infrastructure to support the continued health and growth of the industry.

Alternative Investments

Max Re Capital Ltd. (Tk: MXRE) reported its second quarter earnings and investment results on July 29th. MaxRe continues to provide excellent clarity on its investment allocations and returns (see table). For the first half of the year, MaxRe's diversified strategies has returned 29 basis points (bps), with an 11 bps return in the second quarter; this compares to returns of 134 bps YTD and 62 bps in the second quarter for the CSFB/Tremont Hedge Fund Index.

Max Re Financial Data as of June 30, 2002

Asset Type	Market Value ($000)	Total %	Alternative %	Returns 2Q02	Returns YTD	Returns TTM	Asset Change Q1-Q2 $000	Asset Change Q1-Q2 %
Cash & Fixed Maturities	1,208,517	65.3%	NA	3.12%	2.74%	7.61%		
Global Macro	106,830	5.8%	16.7%	4.29%	1.93%	7.93%	(16,197)	-3.2%
Long/Short Equity	73,269	4.0%	11.4%	-2.77%	-3.09%	-7.99%	(1,747)	-0.5%
Convertible Arbitrage	66,077	3.6%	10.3%	0.73%	2.19%	7.50%	(10,344)	-2.0%
Merger Arbitrage	106	0.0%	0.0%	-0.19%	-0.43%	1.53%	(42,268)	-7.5%
Diversified Arbitrage	100,311	5.4%	15.6%	1.43%	3.90%	7.66%	11,976	1.8%
Distressed Securities	90,188	4.9%	14.1%	-2.98%	-1.07%	-0.22%	(6,446)	-1.4%
Opportunistic	55,176	3.0%	8.6%	-1.12%	-3.17%	1.74%	(6,604)	-1.3%
Emerging Markets	14,834	0.8%	2.3%	-0.88%	-0.88%	-0.88%	14,834	2.6%
Fixed Income Arbitrage	25,300	1.4%	3.9%	2.62%	2.62%	2.62%	25,300	4.4%
Event-Driven Arbitrage	40,647	2.2%	6.3%	-0.65%	-0.76%	0.96%	40,647	7.1%
Max Re Diversified Strategies	**572,736**	**31.0%**	**89.3%**	**0.11%**	**0.29%**	**2.05%**	**9,149**	**0.0%**
Insurance Underwriting	68,492	3.7%	10.7%	3.31%	5.84%	3.81%		
Alternative Investments	**641,228**	**34.7%**	**100.0%**	**0.44%**	**0.85%**	**2.53%**		
Total Investments	**1,849,745**	**100.0%**	**NA**	**2.13%**	**2.05%**	**5.55%**		

Source: Max Re Press Release

During the quarter, MaxRe made some changes to the asset allocation in MaxRe Diversified Strategies (MDS) program. Overall assets in MDS increased by $9.2 million, while significant style shifts were made including (1) reducing global macro by $16.2 million, or 3.2%, (2) reducing convertible arbitrage by $10.3 million or 2.0%, (3) re-classifying merger arbitrage as event driven strategies (approximately $40 million or 7.5%) (4) making new allocations to emerging markets ($14.8 million, 2.6%) and fixed income arbitrage ($25.3 million, 4.4%).

We believe that one of the benefits of MaxRe to the industry is that it provides transparency on asset allocation, changes is styles, individual style returns and overall portfolio results. The closed world of fund of funds and their investment decisions is moved, in one case, into the realm of an SEC document. This public access to information was unheard of previously, and it should lead to further disclosure. Now investors can have a comparison point and may be able to pressure fund of funds to provide greater disclosure as MaxRe has done.

One point on asset allocation that often comes up in the industry regarding merger arbitrage and convertible arbitrage is that these are "bad" sectors to invest in due to a supply/demand imbalance. The argument suggests that falling volume in M&A and over-issuance of convertibles, combined with increased cash flows into hedge funds and fund of funds, will lead to poor investment results and some type of eerie, hidden risk. Although this might be a fine argument for a direct investment in one hedge fund, we believe that much of the press on this topic has missed the role of asset allocators and their risk management skills. Contrary to some, it might just be possible that a hedge fund of fund might be aware of this phenomena and reduce exposure to these sectors, as MaxRe has done in the latest quarter. We'll be waiting to see a mainline publication focus on this not-so-sexy, but rather important example.

Service Providers

The growth in the hedge fund market continues to provide opportunities in service and support companies, such as primer brokers, administrators, systems providers, etc. In the first half of 2002, two large public companies, BISYS ($2.7 billion market cap.) and State Street ($13.4 billion market cap) entered the hedge fund administration business through acquisitions. We think these trends will continue and expect these and other firms to extend their acquisitions to include a wide range of support companies such as analytics providers, trading systems, order routing systems, etc. When we began tracking and calling on hedge fund of fund providers five years ago, we were not projecting that firms like Bank of New York, BISYS and State Street would make hedge funds a major focus area. We believe that five years from now, hedge funds will no longer be viewed as an "alternative" asset class.

Hedge Fund Administrator Acquisitions

Date	Acquirer	Target	# Clients	Assets $B	Price $MM
3/7/2002	BISYS Group	Hemisphere Group	400	$50.0	$130.0
7/5/2002	State Street	Int'l Fund Services		$3.0	

US Public Money Managers—Valuations

Valuations of the public money managers are currently struggling with the falling capital markets.. Between December 31, 2000 and December 31, 2001 the overall market cap of the public money managers fell only 4.7%, while trailing 12 month EBITDA decreased 13.3%. However, between year-end 2001 and June 30, 2002 the overall industry market cap fell 30.2% , and our estimate of run-rate EBITDA at June 30 was down 15.4% from year end, while trailing 12 month EBITDA decreased 1.9%. We estimate run-rate EBITDA for these firms at July 31 to be down another 12% from the June 30 figure, totaling a 25% drop year-to-date.

	December 31, 2000			December 31, 2001			June 30, 2002			June 30, 2002	
($ in millions)	**Market Cap**	**TTM EBITDA**	**x EBITDA**	**Market Cap**	**TTM EBITDA**	**x EBITDA**	**Market Cap**	**TTM EBITDA**	**x EBITDA**	**Est. Run-Rate EBITDA**	**Est. x EBITDA**
BlackRock Inc. (BLK)	$2,717.4	$155.4	17.5x	$2,712.62	$180.6	15.0x	$2,649.60	$195.6	13.5x	$187.1	14.2x
Federated Investors (FII)	$3,487.8	$298.2	11.7x	$3,782.90	$327.3	11.6x	$3,370.07	$348.3	9.7x	$310.6	10.9x
Eaton Vance (EV)	$2,307.4	$184.7	12.5x	$2,542.90	$193.1	13.2x	$1,808.91	$198.3	9.1x	$170.7	10.6x
Franklin Resources Inc. (BEN)	$9,233.4	$682.6	13.5x	$9,196.51	$557.0	16.5x	$8,300.39	$589.1	14.1x	$601.1	13.8x
Gabelli Asset Management (GBL)	$997.1	$92.2	10.8x	$1,390.26	$104.8	13.3x	$974.66	$108.1	9.0x	$91.9	10.6x
Neuberger Berman (NEU)	$2,653.3	$257.6	10.3x	$3,118.05	$242.1	12.9x	$2,063.46	$241.0	8.6x	$207.0	10.0x
SEI Investment Co. (SEIC)	$6,423.4	$165.5	38.8x	$5,109.37	$183.2	27.9x	$2,822.12	$199.0	14.2x	$180.4	15.6x
Stillwell Financial (SV)	$8,907.0	$1,117.5	8.0x	$6,073.93	$661.0	9.2x	$2,917.34	$574.0	5.1x	$429.9	6.8x
T Rowe Price (TROW)	$5,370.1	$498.6	10.8x	$4,419.85	$370.8	11.9x	$3,184.83	$349.3	9.1x	$289.9	11.0x
Waddell & Reed (WDR)	$3,187.9	$244.9	13.0x	$2,616.45	$197.9	13.2x	$1,469.13	$171.1	8.6x	$141.1	10.4x
John Nuveen Company (JNC)	$1,973.0	$176.1	11.2x	$2,690.26	$198.2	13.6x	$2,062.13	$204.8	10.1x	$172.7	11.9x
Affilliated Managers Group (AMG)	$1,244.1	$205.5	6.1x	$1,613.07	$120.1	13.4x	$1,017.36	$128.9	7.9x	$113.9	8.9x
Boston Private Financial Holdings (BPFH)	$321.4	$16.4	19.6x	$507.17	$28.5	17.8x	$501.13	$35.3	14.2x	$33.9	14.8x
Wilmington Trust (WL)	$2,041.5	$205.8	9.9x	$2,087.39	$198.2	10.5x	$1,858.54	$200.0	9.3x	$181.8	10.2x
Alliance Capital Management (AC)	$11,708.0	$799.0	14.7x	$11,917.27	$859.7	13.9x	$6,706.95	$794.6	8.4x	$632.6	10.6x
Total	**$62,573.0**	**$5,099.9**	**12.3x**	**$59,777.99**	**$4,422.6**	**13.5x**	**$41,706.62**	**$4,337.4**	**9.6x**	**$3,744.6**	**11.1x**

US Public Money Managers— Current Valuations

				7/31/02	Last 12 Months							
	Avg, AUM $Bil.	Enterprise Value (EV)[1]	Market Cap $MM	Share Price	Revenue	EBITDA[2]	EBIT[3]	Core Net Income[3]	EV/ EBITDA[2]	EV/ EBIT[3]	Price/ Core Income[3]	Price/ TTM Income
Diversified												
Blackrock (BLK)	238.0	2,738	2,738	$41.95	567.0	195.6	190.0	118.9	14.0x	14.4x	23.0x	22.5x
Eaton Vance (EV)	58.4	2,323	2,049	$26.76	514.3	198.3	198.3	132.3	11.7x	11.7x	15.5x	15.9x
Federated Investors (FII)	176.5	3,420	3,345	$28.42	728.0	348.3	327.5	203.5	9.8x	10.4x	16.4x	17.7x
Franklin Resources (BEN)	264.4	9,641	9,032	$34.33	2,514.1	589.1	538.6	377.3	16.4x	17.9x	23.9x	20.2x
Gabelli (GBL)	24.1	1,000	950	$29.40	224.5	108.1	108.1	71.0	9.3x	9.3x	13.4x	15.9x
Neuberger Berman (NEU)	57.9	2,337	2,161	$30.48	621.9	241.0	226.4	130.5	9.7x	10.3x	16.6x	16.6x
SEI Investments (SEIC)	76.8	3,044	3,007	$26.31	646.3	199.0	199.0	123.5	15.3x	15.3x	24.4x	22.3x
Stilwell (SV)	184.5	3,652	3,041	$13.55	1,334.4	574.0	464.9	247.4	6.4x	7.9x	12.3x	11.2x
T Rowe Price (TROW)	151.3	3,611	3,478	$27.03	963.2	349.3	334.8	200.3	10.3x	10.8x	17.4x	17.4x
Waddell & Reed (WDR)	30.7	1,677	1,477	$17.94	458.7	171.1	161.7	93.2	9.8x	10.4x	15.8x	15.5x
Total	***1,262.6***	***$33,442***	***$31,278***		***$8,572***	***$2,974***	***$2,749***	***Average***	***11.3x***	***11.8x***	***17.9x***	***17.5x***
								Median	***10.1x***	***10.6x***	***16.5x***	***17.0x***
Insurance												
John Nuveen (JNC)	68.2	2,202	2,183	$22.02	382.1	204.8	198.1	120.4	10.8x	11.1x	18.1x	18.3x
Total	***68.2***	***$2,202***	***$2,183***		***$382***	***$205***	***$198***		***10.8x***	***11.1x***	***18.1x***	***18.3x***
Consolidators												
Affiliated Managers (AMG)	75.9	1,430	1,080	$47.22	456.0	204.7	184.4	126.0	11.1x	13.2x	21.5x	19.7x
Total	***75.9***	***$1,430***	***$1,080***		***$456***	***$205***	***$184***		***11.1x***	***13.2x***	***21.5x***	***19.7x***
Bank/Trust Companies												
Boston Private Fincl. (BPFH)	6.2	538	538	$22.87	106.7	35.3	34.6	25.2	15.2x	15.6x	21.3x	45.4x
Wilmington Trust (WL)	36.2	2,170	2,005	$30.19	491.6	200.0	193.8	126.1	10.8x	11.2x	15.9x	15.5x
Total	***42.4***	***$2,708***	***$2,542***		***$598***	***$235***	***$228***	***Average***	***13.0x***	***13.4x***	***18.6x***	***30.5x***
								Median	***13.0x***	***13.4x***	***18.6x***	***30.5x***
Limited Partnerships												
Alliance Capital L.P. (AC)	444.0	7,971	7,354	$29.00	2,934.9	794.6	697.9	634.5	10.0x	11.4x	11.6x	11.6x
Total	***444.0***	***$7,971***	***$7,354***		***$2,935***	***$795***	***$698***		***10.0x***	***11.4x***	***11.6x***	***11.6x***
Overall												
Total	***1,893.1***	***$47,753***	***$44,436***		***$12,944***	***$4,413***	***$4,058***	***Average***	***11.4x***	***12.1x***	***17.8x***	***19.0x***
								Median	***10.8x***	***11.2x***	***16.6x***	***17.4x***

Notes
1 Enterprise Value (EV) includes equity plus long term debt
2 Before tangible depreciation and amortization
3 Excludes extraordinary items and minority interest expense/income

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