Buy-Side Bliss: Compensation Up in 2013, Especially Among Top-Performing Firms

Q4 2013

These are good times to be on the buy side. In conjunction with Johnson Associates, Greenwich Associates recently analyzed its compensation data and found that portfolio managers and traders on the buy side are outperforming their sell-side peers in a series of quantitative and qualitative career measures, including total compensation, compensation growth and job satisfaction. Within the buy side, however, not all investment professionals are experiencing the same level of compensation acceleration: Professionals at firms with the best performance find their compensation soaring while those at funds with even average performance are experiencing lower, although still applaudable, compensation growth rates.

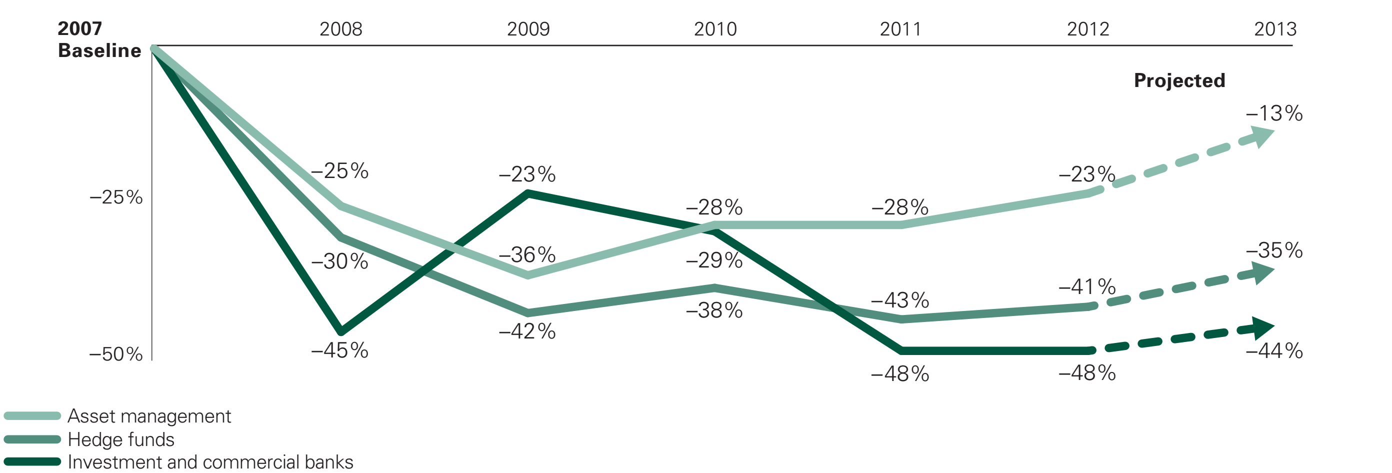
Over the past several years, much has been written about the migration of financial service talent to hedge funds as sell-side professionals who lost jobs, endured large pay cuts or simply became frustrated with an increasingly challenging work environment sought new and better opportunities. What has received far less attention is the fact that traditional asset management firms—which were once perceived as lagging far behind investment banks and other sell-side firms in terms of pay and prestige—are now viewed by many in the industry as the more attractive option. Due to better and more consistent rates of compensation growth, fewer concerns about job security and higher levels of job satisfaction, the buy side has become a more appealing career for many investment professionals:

1. Since 2009, buy-side compensation growth has outpaced that on the sell side. Over that period, buy-side professionals have enjoyed relatively consistent, if gradual pay increases, while their counterparts on the sell side have experienced far greater levels of compensation volatility.

2. Overall buy-side compensation increased approximately 15% last year, versus -10 %–+5% on the sell side. Greenwich Associates and Johnson Associates project that trend to continue in 2012–2013, with buy-side incentives projected to increase 10%–15%, versus 5%–10% growth on the sell side.

3. Since the financial crisis, sell-side firms have been forced to aggressively control costs, leading to repeated headcount reductions. Although cost control also presents as an important issue on the buy side, layoffs have been much less pervasive.

Change in Incentives Since 2007: Senior Buy-Side vs. Sell-Side Investment Professionals



Source: Johnson Associates

About This Report

Greenwich Associates and Johnson Associates present the key findings of a joint 2013 Asset Management Compensation Study. Results are based on data collected by Greenwich Associates through telephone and in-person interviews with more than 1,000 financial professionals in equity and fixed-income investor groups at investment management firms, mutual funds, hedge funds, banks, insurance companies, government agencies, and pension and endowments.

Armed with this self-reported data as a baseline, Johnson Associates uses proprietary information on compensation and other industry data to project compensation levels and trends for 2013. Johnson Associates actively monitors compensation trends and issues through intensive research and ongoing client assignments. In select areas, the self-reported information from investment professionals may not necessarily align directly with overall market trends. Some of these variances can be explained by different sample sets of professionals year-over-year, or specific circumstances related to individuals (transfers, new hires, promotions, change of job, etc.).

4. Aside from the asset management divisions of major banks—so-called "captives"—buy-side firms have not been subject to the same regulatory scrutiny on compensation issues. While public firms have some exposure to regulatory pressures, independent private asset managers have a competitive edge in recruiting talent.

5. More generally, buy-side firms have largely escaped the regulatory pressure and public opprobrium that has fallen on the banking industry, leading to higher levels of job satisfaction and morale.

Buy-Side Bifurcations

The buy side, however, is anything but monolithic, and career and compensation trajectories vary significantly depending on which part of the buy side a professional calls home. While buy side professionals as a whole are seeing more growth than sell-siders, there are "winning" and "losing" segments within the buy side.

High-Performing Funds vs. Average-Performing Funds

WINNER: HIGH-PERFORMING FUNDS The historically low interest rates and investment returns that have come to characterize the post-crisis era have placed a greater premium on investment alpha—a premium that has created a bifurcation in the investment management market. More than ever before, assets are flowing to firms that deliver the strongest investment returns while managers with even middling performance struggle to attract flows. In today's risk averse investor setting, large institutions have been leery of selecting so-so performers. The growing division between top and average performers is reflected clearly in compensation trends: Among the top-performing "winners" in investment performance, total compensation is increasing about 30% year-over-year, while firms with middle-of-the-pack performance experience a lower 10%–15% increase. **Looking ahead, asset managers with average or subpar results will likely see compensation stagnate or fall below previous year levels.**

Independents vs. Captives

WINNER: INDEPENDENTS Although conditions are improving for employees of bank-owned asset management firms, the combination of regulatory pressures and balance sheet issues facing these organizations remains a drag on compensation and job satisfaction. In the years immediately following the financial crisis, bonus awards at captive asset management firms were eroded and in many cases eliminated by the poor performance of other units, balance sheet crises and the parents' need to build capital reserves.

Over the past 12 months, some of those pressures have ebbed and most major banks have delivered solid performance. That turnaround has allowed traders and portfolio managers at many captive firms to collect their full bonus awards. Nevertheless, due to continued issues related to regulation and capital availability at captive firms, independent asset management firms remain the more attractive option.

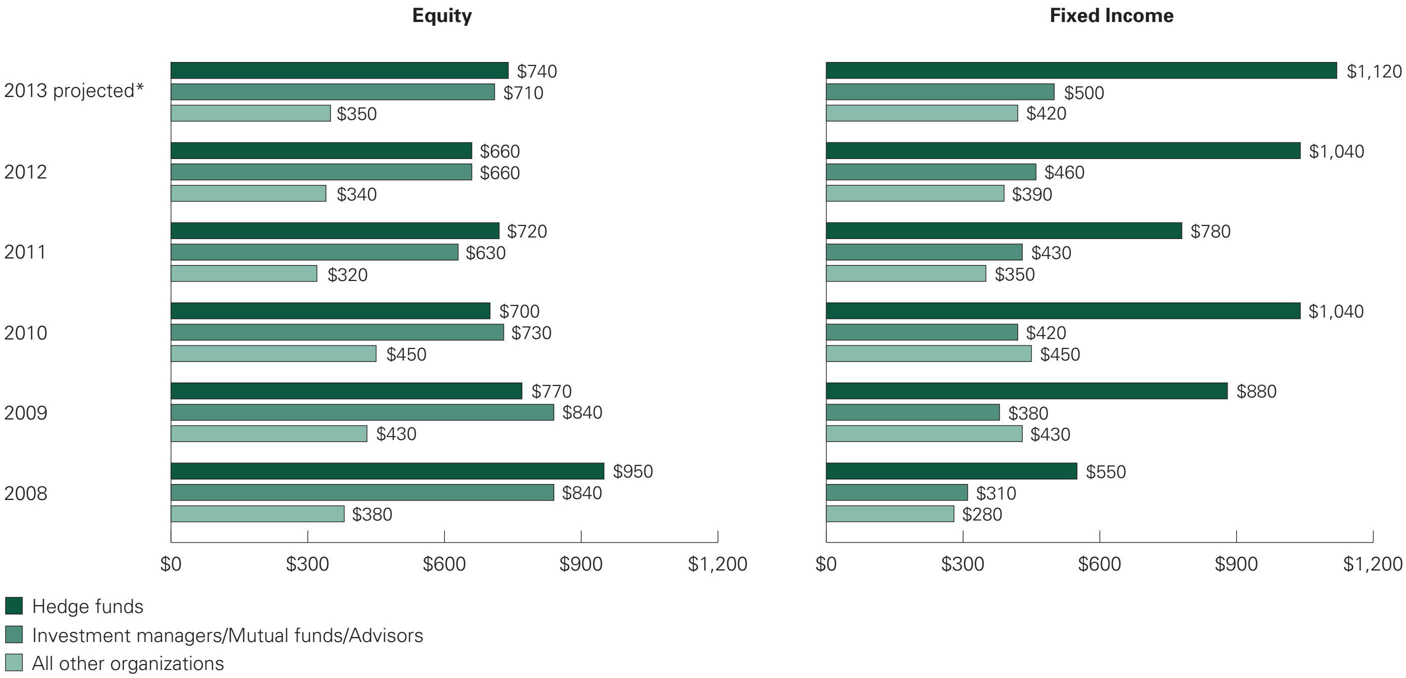
Hedge Funds vs. Traditional Asset Managers

WINNER: IT DEPENDS... For fixed-income professionals, hedge funds are the place to be. Despite erratic and often disappointing investment performance, assets continue to flow into hedge funds as investors hunt for yield in the low-rate environment. Hedge fund fixed-income traders and portfolio

Historical and Projected Compensation for Senior Buy-Side Investment Professionals

By Type of Firm

(in $U.S. 000s)



Note: "All other organizations" includes weighted average results from banks, insurance companies, government agencies, and other.
Source 2008-12: Greenwich Associates U.S. Equity and Fixed-Income Investors Compensation Benchmarks Studies
Source 2013: Johnson Associates projections on changes from Greenwich Associates 2012 data

managers have been among the biggest beneficiaries. Total annual compensation averaged $1 million among this group in 2012, versus $460,000 among fixed-income professionals at traditional management firms, and the pay differential between the two groups increased to approximately 2.2X in 2012 from 1.8X in 2011.

Equity traders and portfolio managers face a much different environment. For them, compensation at hedge funds and traditional managers fell slightly to be roughly at parity from a differential of 1.14 in 2011, with average pay at about $660,000 in 2012.

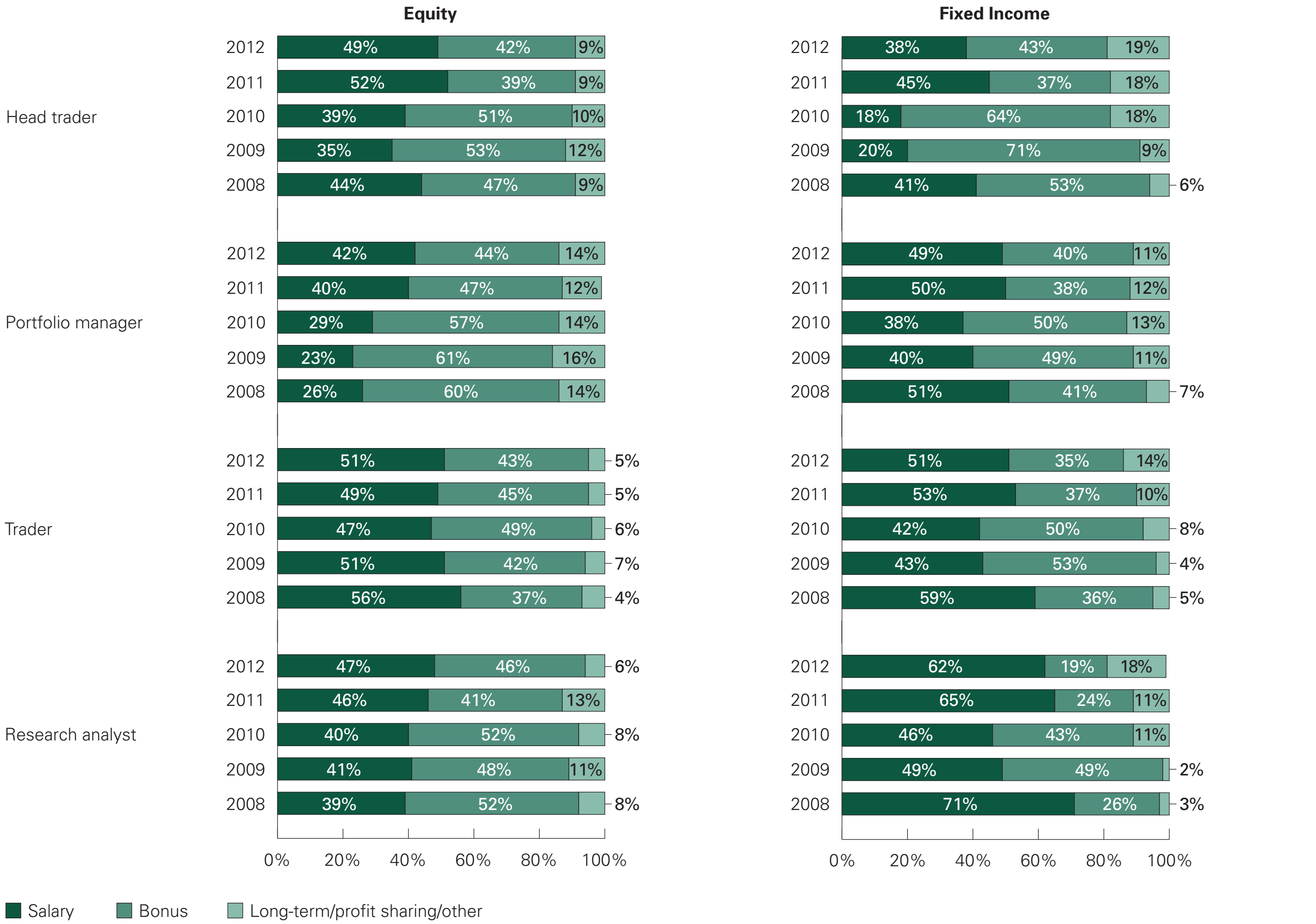
Moving forward, Greenwich Associates and Johnson Associates expect the pay differential for fixed-income professionals to level off around 2X. For equity professionals, hedge funds are expected to move ahead as they "make-up" ground, with incentives projected to rise for the foreseeable future. The gap between hedge funds and traditional firms is likely to reach 1.1X to 1.5X in next few years.

Compensation Structure

In the wake of the financial crisis, asset management firms followed the example of banks and other sell-side firms that, under heavy pressure from regulators, were shifting compensation toward salary and long-term incentives and away from cash bonus plans viewed as having the potential to incentivize excessive risk-taking. That trend has apparently run its course on the buy side—at least among independent firms free from the lingering regulatory concerns of captive managers. From 2011–2012, buy-side salaries were essentially stable and compensation growth was driven by increases in incentives.

Greenwich Associates and Johnson Associates expect similar results for the current year, projecting 3% growth in salary budgets in the current year with another 0.5% for promotions and adjustments for professionals outside senior management. In the context of asset management, having a meaningful portion of pay vest over time into sensible deferral vehicles helps to better align pay and incentives with long-term.

Estimated Mix of Pay for Senior Buy-Side Investment Professionals



Note: Estimated split of cash compensation between salary and bonus. Incorporated retirement across salary, bonus and long-term/profit sharing/other. May not total 100% due to rounding.
Source: 2013 Greenwich Associates U.S. Equity and Fixed Income Investors Compensation Benchmark Studies

The Year Ahead

All in all, 2013 was a positive year for asset management, and momentum should continue into 2014. Investment returns will likely remain a key differentiating factor for investors and again drive firm success in the same way it did this year.

The asset management sector is expected to keep a close eye on costs and headcount moving forward. Some firms expect turnover to increase from the current historically low levels as job opportunities become more plentiful and gradually returning stability quells the risk of moving. Firms continue to monitor the balance of business need and attrition levels against headcount as they proceed with leaner teams into 2014. Smart asset management professionals with strong performance and an eye toward strategic career moves can and should take advantage of opportunities within this growing sector.

Contributors include Analyst Kevin Kozlowski from Greenwich Associates and Managing Director Francine McKenzie and Vice President Andria Cardillo from Johnson Associates.

GREENWICH ASSOCIATES

6 High Ridge Park Stamford CT 06905 USA

Tel: +1 203.625.5038/+1 800.704.1027 Fax: +1 203.625.5126 email: ContactUs@greenwich.com www.greenwich.com