Johnson Associates

Financial Services Compensation

Second Quarter Trends and Year-End Projections

August 7, 2023

Financial Services: Year-End Projections

After the second quarter, Johnson Associates projects <u>flat incentive trends across financial services.</u> Traditional asset management flat despite surging markets as investors shift to lower fee products. Private equity, hedge funds, and major investment and commercial banks flat to up moderately. Underwriting, advisory, and equities trading fall.

Inflation declines and the prospect of an economic "soft landing" have helped boost equity markets. Year-end incentives somewhat delinked from market stock performance across asset management, hedge funds, private equity, and banks.

Traditional Asset Management

Incentives flat even with boost in equity markets

- Revenues flat despite surge in equities
- Shift from active equities to lower fee products
- Passive funds continue gaining market share
- Moderate headcount reductions and slowed hiring as firms trim costs to mitigate margin impact
- Bolt-on products (i.e., alternatives, tech platforms) generate higher fees and diversify revenue streams

Alternative Investments

Private equity and hedge funds incentives stable

- Hedge funds flat to up moderately
- Macro funds down from strong 2022 while equities funds lead
- Private equity incentives flat amidst difficult fundraising. Dealmaking and exits down
- Venture capital fundraising down dramatically
- Private credit hottest sector and boosted by tightening of bank lending regulations

Investment and Commercial Banking

Incentives mixed by business segment

- Investment banking dragged down by advisory which is unlikely to rebound until 2024
- Underwriting incentives currently flat to up slightly but gaining momentum
- Trading down moderately but select fixed income groups outperform
- Commercial real estate lenders in turmoil
- Wealth management outshines other business segments on new clients and rising markets
- Compensation expense skews higher on severance costs. Sporadic major bank layoffs continue while boutiques gradually ramp up hiring

Projected 2023 Incentive Funding

- **Headcount-adjusted basis (i.e., felt impact)**

Traditional Asset Management & Alternatives

Sector / Business		% Change from 2022
Asset Management		**-5% to +5%**
AUM up on market appreciation but revenue flat on shift to lower fee products		
Hedge Funds		**Flat to +5%**
Moderate inflows led by largest funds. Market appreciation boosts equity funds while macro funds fall from strong 2022		
Private Equity*	**Mega** **Mid/Large**	**Flat** **Flat**
Funds recalibrate fundraising expectations. Traditional buyout activity strained by higher borrowing costs		
High Net Worth		**+5% to +10%**
Inflows and market appreciation boost asset levels. Product offerings (alternatives) attracting new clients		

Investment & Commercial Banking

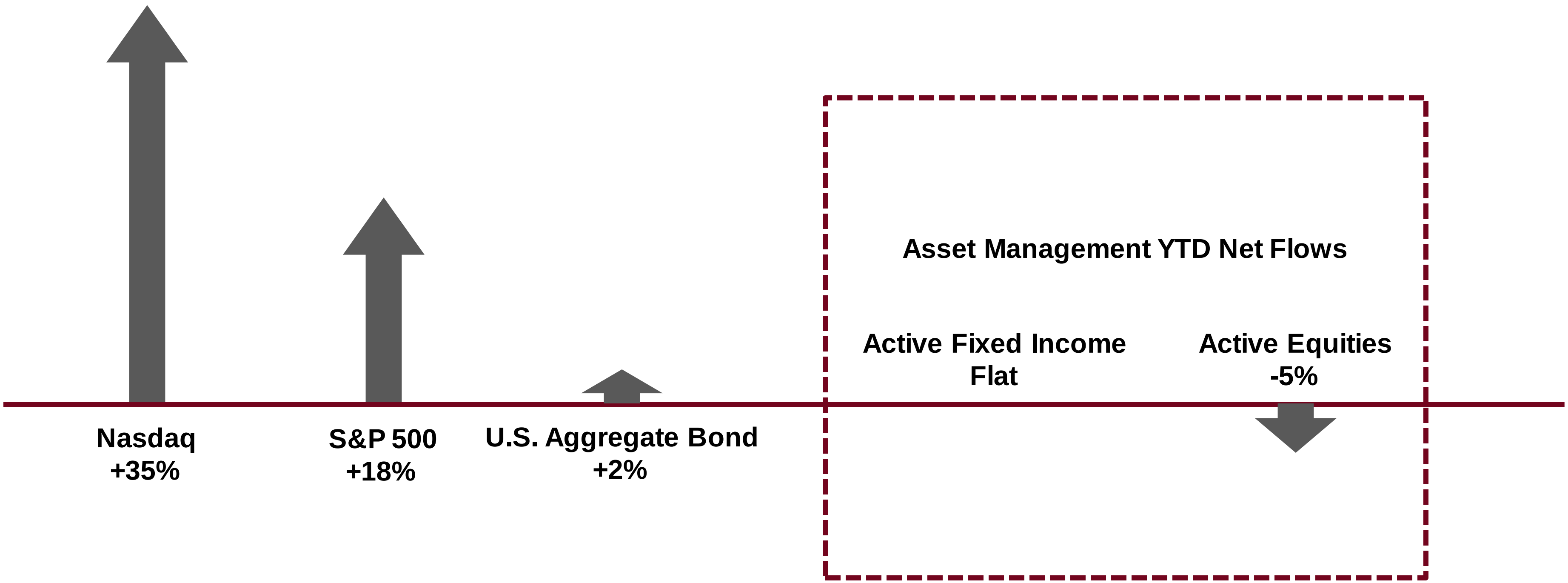
Sector / Business		% Change from 2022
Firm Management **Corporate Staff**		**Flat to +5%** **Flat**
Investment banking results mixed but dragged lower by advisory		
Investment Banking	**Advisory** **Underwriting**	**-20% to -25%** **-10% to Flat**
Advisory revenues tumble as activity remains sluggish. Equity underwriting gains momentum while debt underwriting down		
Sales & Trading	**Equities** **Fixed Income**	**-5% to -10%** **-5% to +5%**
Equity trading down slightly on lower client activity. Fixed income trading outperforms equity trading		
Retail & Commercial	**Major Global** **Regional**	**+10% to +20%** **-10% to -20%**
Major U.S. banks benefit from deposit inflows but net interest income margins squeezed by higher deposit yields		

*Applies to incentive and equity, excludes carry

Asset Management Incentives Delinked from Markets

Asset Management Revenues Flat Despite Market Surge

- **Fee pressures coupled with investor shift from active to passive products hamper revenue growth**
- **Delinking of assets under management and revenue. Multi-year trend of fee compression and shift to lower fee products stresses margins**
- **Active equities managers challenged by market phenomenon as outsized portion of gains driven by handful of firms (S&P 500 +18% vs. S&P 500 Equal Weight Index +8%)**

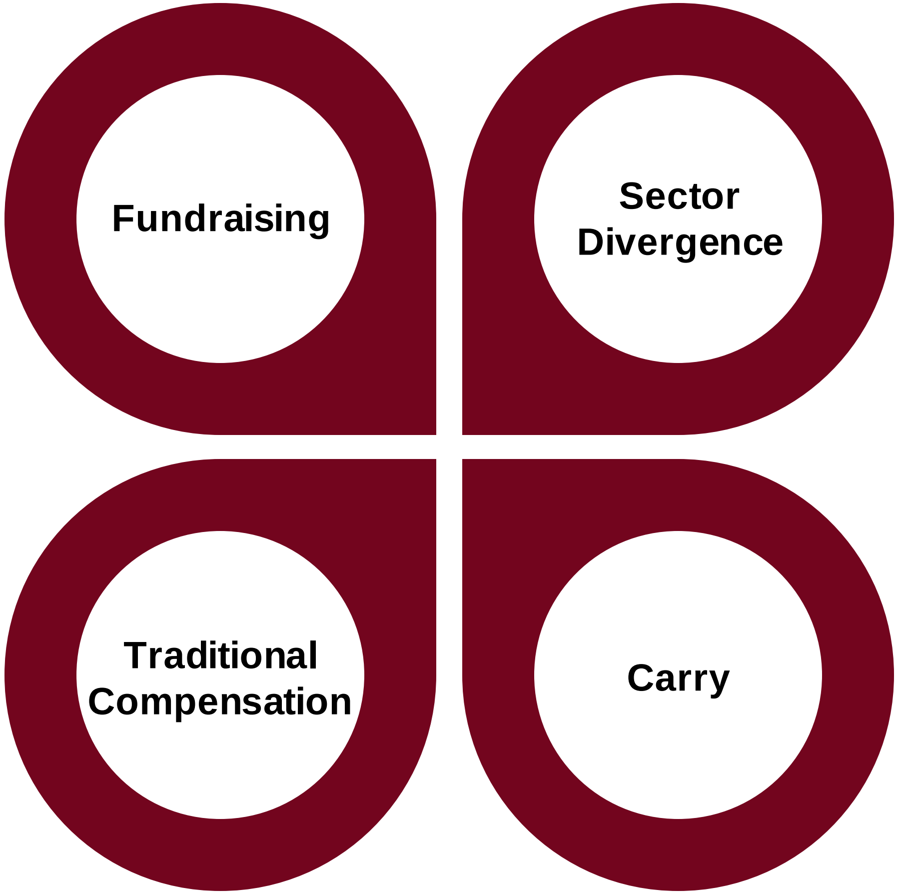


Illiquid Investments Landscape

Challenging environment after years of industry tailwinds

- Mega funds dominate fundraising
- Some firms raise smaller funds than predecessors
- Dry powder levels remain high and first-time fund launches down significantly

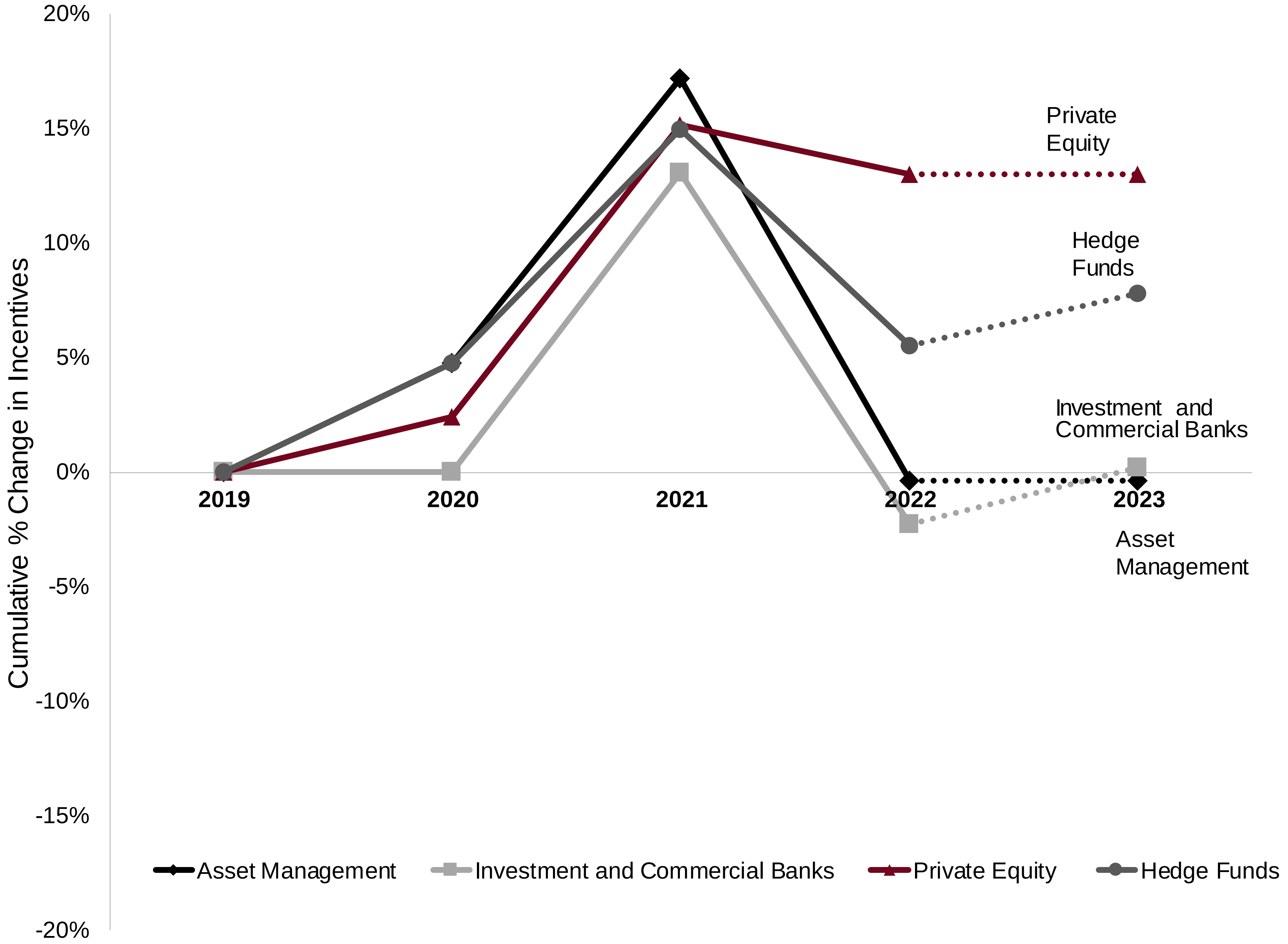
- Private credit benefits from bank lending regulation
- Venture capital fundraising down heavily
- Borrowing costs suppress buyout activity



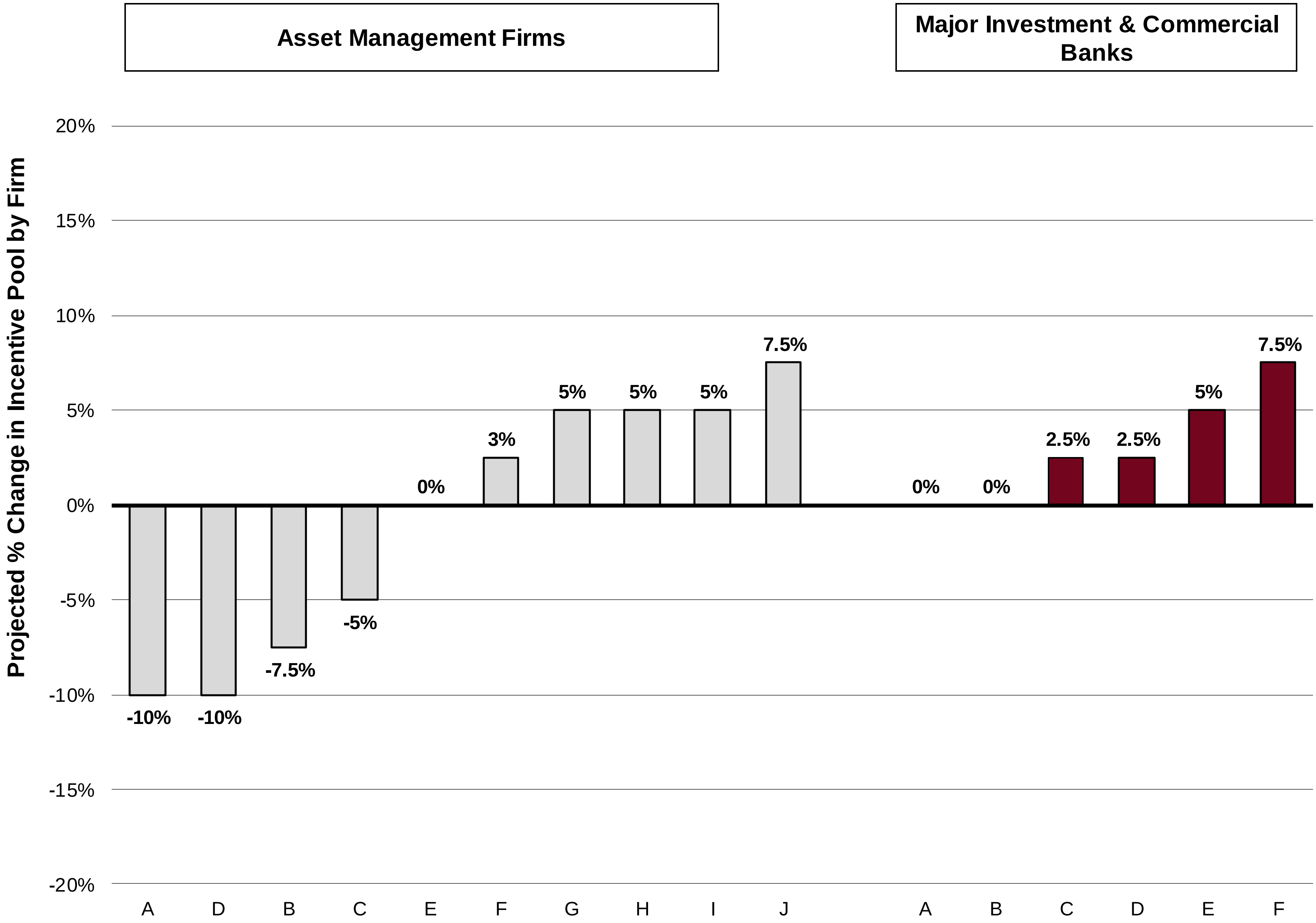
- Base and bonus levels mostly stable
- Meaningful incentive declines unlikely unless subsequent funds smaller
- Small/mid-size funds focus on developing junior talent

- Realizations plummet
- Vesting schedules and GP commitment in focus
- Firms explore creative approaches to provide early distributions

Incentive Trend by Business Segment



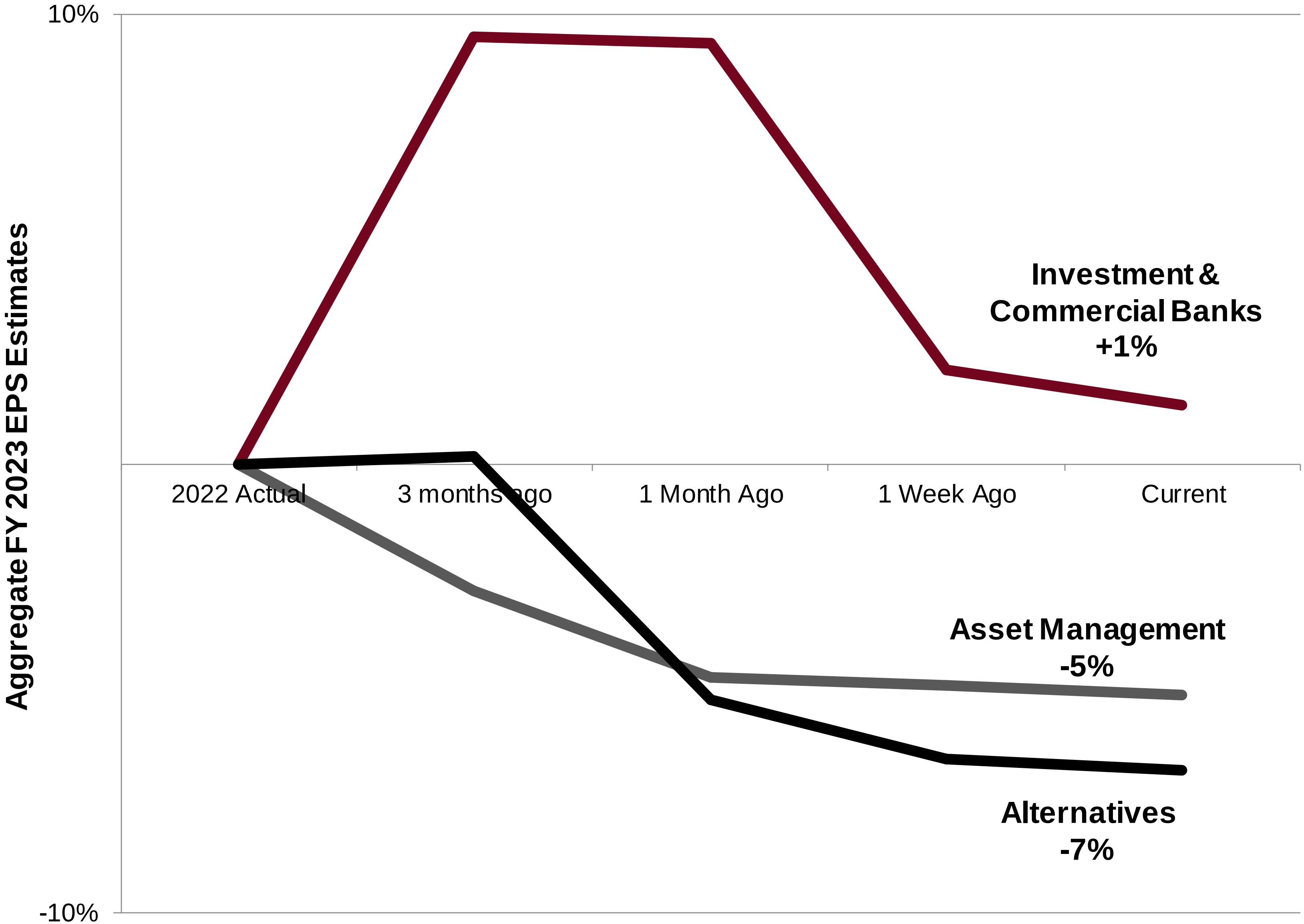
Projected % Change in Year-End Incentive Pool by Firm*



** 6 months actual data with projection for remainder of year*

Analyst Estimated EPS Trend

- Analyst estimates for banks flat while asset management and alternatives estimates trend downward
- Chart a sample of 6 investment & commercial banks, 6 alternatives firms, and 10 asset management firms



YTD Stock Performance Across Sectors

- **Divergence in stock performance by sector. Despite dramatic uptick from first quarter lows, KRE Regional Bank ETF still down significantly versus other sectors**