

## U.S. Equity Research: Bulge Bracket Down, But Not Out

The mergers of firms such as Bear Stearns, Lehman Brothers and Merrill Lynch within the ranks of bulge bracket research providers in U.S. equities gave a boost to smaller competitors including mid-sized and regional brokers, sector specialists and independent research providers. But the re-construction of these storied names also aided the franchises of the remaining bulge bracket brokers who, as a group, captured a significant portion of the business freed up by market dislocations during the global crisis.

The bulge bracket has been steadily ceding “vote” in equity research to smaller competitors since 2008. Greenwich Associates calculates “research vote” by asking buy-side analysts to name the firms they use for equity research across 60 specific industry categories, and then weights those results based on the amount of U.S. equity trade commissions the institution pays to the named providers. As recently as 2008, bulge bracket firms captured 73.1% of the research vote in U.S. equities. In 2009 that share fell to 68.5%, and in 2010 it dropped to 64.1%.

Meanwhile, the share of analysts’ research vote captured by mid-sized broker-dealers, regional firms and sector specialists increased from 23.9% in 2008 to 28.9% in 2009

and to 32.4% in 2010. After remaining flat at 2.7% from 2008 to 2009, the vote captured by independent research providers increased to 3.4% this year.

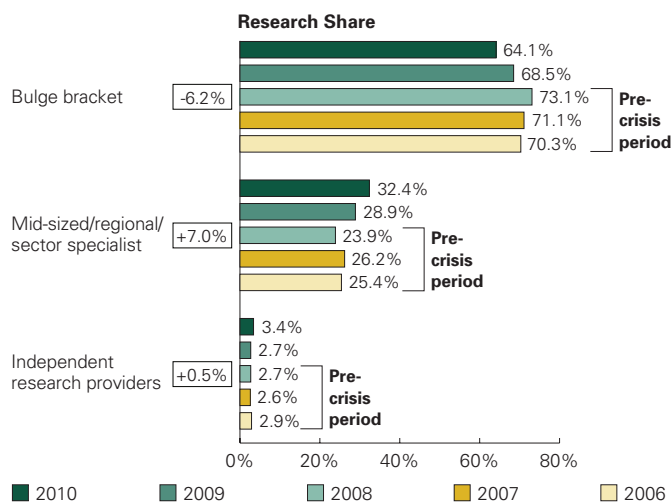
The shift of research vote from the bulge bracket to smaller providers mirrors a similar migratory pattern followed by some of the top analysts on the sell-side. Throughout the global market crisis, large financial institutions were forced to cut costs in their broker-dealer operations, resulting in layoffs, salary reductions and reductions in coverage. These actions spurred the departure of several top-rated equity analysts, who joined large numbers of their industry peers when they were either shown the door or decided to seek out more lucrative opportunities. Many of these displaced analysts found new employment with smaller broker-dealers, regional competitors, sector specialists and independent providers, with the last group including several high profile start-ups.

### Sustainable Shifts?

However, the aggregate amount of research share flowing from the bulge bracket to other research providers since 2008 falls far short of the total share previously held by Bear Stearns, Bank of America, Merrill Lynch and Lehman Brothers, indicating that bulge bracket brokers have succeeded in retaining or capturing some of the freed-up business. Barclays Capital has been especially effective in securing the vast bulk of the relationships and research share formerly held by Lehman Brothers, the core U.S. assets of which were acquired by Barclays in 2008.

Also, it remains unclear whether the shift in research share away from the bulge bracket will prove sustainable over the long term. In trying to compete with industry giants, smaller research providers face structural factors that work to the advantage of their bigger rivals. Clients have an incentive to work with bulge bracket providers in research as a means of building strong relationships and benefitting from these firms’ provision of liquidity via capital commitment access to deal flow and direct access to corporate management teams.

### Smaller Research Providers Taking Share From Bulge Bracket

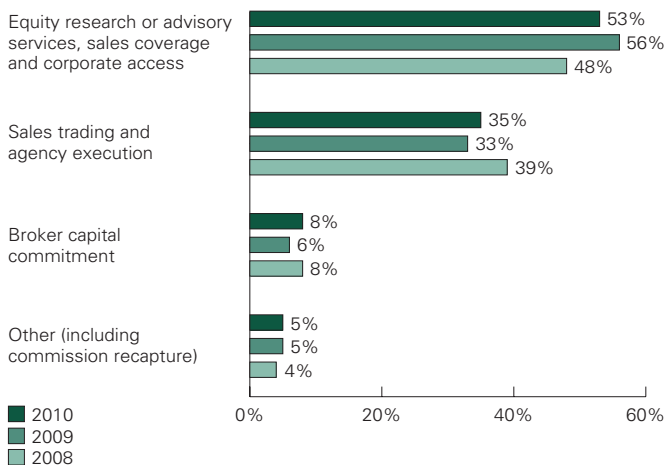


Note: Categories include 9 bulge bracket, 39 non-IB or regional/sector specialists, and 14 independent research providers. Source: 2010 U.S. Equity Analysts Study

### Latest Greenwich Associates Findings on the Web

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## Allocation of Institutional Commission Payments



Source: 2010 U.S. Equity Investors Study

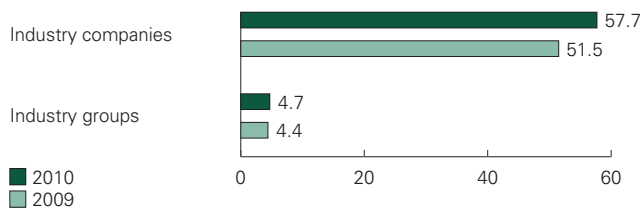
Perhaps more importantly, much of the bulge bracket's loss of share over the past two years has been the result of structural issues at the corporate level, as opposed to any direct breakdowns within the equity functions and research franchises of these firms. Now that the crisis has at least temporarily receded, several U.S. bulge bracket firms have begun rebuilding depleted research franchises and hiring back top analysts. They are joined in this effort by foreign firms like Nomura, CLSA and Macquarie, which aspire to commit significant resources to the U.S. equity research market.

The increased penetration of these foreign firms in U.S. equity research is particularly relevant to the business strategies of mid-sized and regional providers, sector specialists and independent providers. "More than ever before, research providers need global capabilities in order to capture a full share of the research vote in a large buy-side organization," says Greenwich Associates consultant Jay Bennett. "To a large extent, some of the top mid-sized brokers and other non-bulge bracket providers are limited in the amount of the vote they can capture because they are only able to compete in U.S. equities. For this reason, several of these firms are trying to build capabilities in Europe and Asia, while foreign firms look to build a bigger presence in U.S. equities."

### Buy-Side Analysts: Working Harder, Relying on Sell-Side Help

Challenging business conditions and volatile investment markets have left many buy-side institutions under significant financial pressure. With resources scarce, buy-side analysts are being asked to do much more with considerably less. As the graphics in this section illustrate, the number of companies covered by buy-side analysts increased more than 10% over the past 12 months to an average 57.7.

## Buy-Side Analysts' Increasing Workload



Source: 2010 U.S. Equity Analysts Study

This increase in workload helps explain why buy-side institutions are devoting a growing portion of their research commission allocation to rewarding brokers who help facilitate direct access to company management teams. Buy-side traders estimate that their organizations use 53 cents from every dollar in commission payments on U.S. equity trades to compensate brokers for research and advisory services, sales coverage and corporate access, for a total of approximately \$7 billion. About one-third of that amount is now used to reward brokers for corporate access, including 21% allocated as direct compensation for the facilitation of meetings between the institution and company management and 14% allocated as payment for invitations to conferences in which buy-side analysts and portfolio managers have the opportunity to speak with management teams preferable in one-on-one meetings.

## Breakdown of the Institutional Research Spend

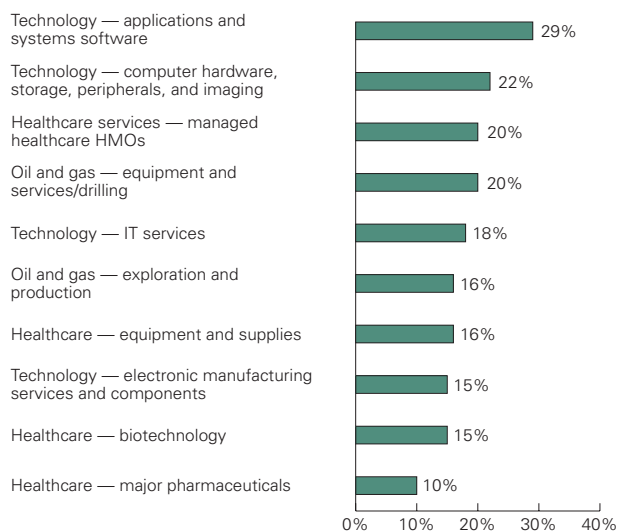


Source: 2010 U.S. Equity Analysts Study

## Institutions Predict Best Performing Equity Sectors for 2010

Computer technology will be the best performing sector of the U.S. large-cap stock market for the remainder of 2010, according to the estimates of U.S. institutional portfolio managers. Approximately 30% of portfolio managers predict that Technology: Applications and Systems Software will be the best performing sector over the period and 22% believe those honors will go to Computer Hardware, Storage, Peripherals, and Imaging. The following chart shows the large-cap sectors on which U.S. portfolio managers are most bullish for 2010.

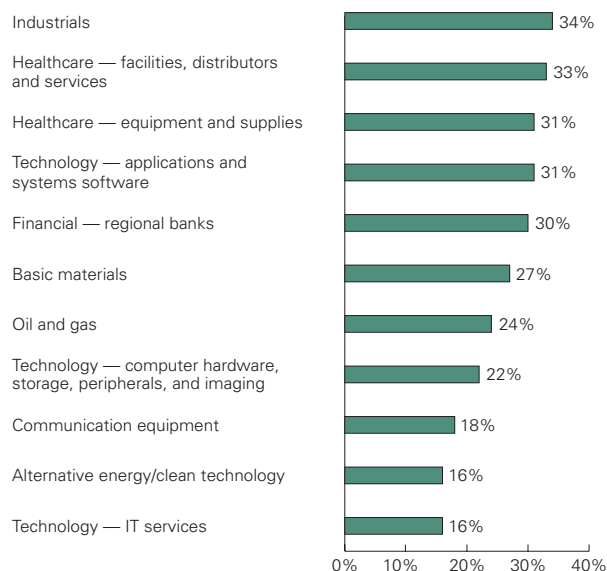
### Institutions' Picks for Top 2010 Performance Large Cap Stocks



Note: Percent citing sector as one of 3-4 best performers in next 12 months.  
Source: 2010 U.S. Equity Investors Study

U.S. institutions say Industrials and Healthcare Facilities, Distributors and Services will be the best performing sectors in small and mid-cap equities for the remainder of 2010. About one-third of institutions active in small and mid-cap investing rank each of these sectors in their lists of "3-4 sectors most likely to outperform in 2010." Next on those lists: Healthcare — equipment and supplies and Technology — applications and systems software, each of which are cited by about three-in-10 institutional small and mid-cap investors.

### Institutions' Picks for Top 2010 Performance Small and Mid-Cap Stocks



Note: Percent citing sector as one of 3-4 best performers in next 12 months.  
Source: 2010 U.S. Equity Investors SCF Study

*Greenwich Associates consultants Jay Bennett, John Colon, and John Feng advise on the institutional equity markets globally.*

### Methodology

*Greenwich Associates conducted interviews with 1,007 equity analysts at buy-side institutions in the United States. Interviews were conducted between November 2009 and March 2010.*

*Participants were asked to evaluate the research services they receive from sell-side analysts. They were also interviewed about important market trends and compensation. In preparing the research analyst quality leaders in this Greenwich Report, we first asked each analyst to nominate their five to 10 most important research sources across 60 distinct industry sectors.*

*The findings reported in this document reflect solely the views reported to Greenwich Associates by the research participants. They do not represent opinions or endorsements by Greenwich Associates or its staff. Interviewees may be asked about their use of and demand for financial products and services and about investment practices in relevant financial markets. Greenwich Associates compiles the data received, conducts statistical analysis and review for presentation purposes in order to produce the final results.*

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