

Financial Services Outlook and Top Picks for 2010

Recovery-Oriented, But Focused on Quality

—Highlights

Issued 2010 Outlook and Stock Picks. William Blair's Financial Services Research Group issued its outlook and top investment ideas for 2010 after the market close on December 14, 2009: Affiliated Managers Group, Bank of New York Mellon, Discover Financial, Evercore Partners, IntercontinentalExchange, and MasterCard (please contact your William Blair & Company salesperson for a copy of the presentation). Our one-year list reflects a recovery-oriented bias, modestly less defensive than 12 months ago, but with a focus on quality. We have also updated our long-term list (three-to-five years), adding Greenhill & Co. and Signature Bank and removing PrivateBancorp (PVTB \$9.18).

Financial Group Performance in 2009 Mixed, Banks Big Drag. While markets have recovered rapidly since early March, extremely poor performance early in the year limited returns for financial services stocks. The S&P Financial Index has increased only 13.6% year-to-date versus 22.0% for the S&P 500 (through 12/10), due to significant underperformance and negative performance for banks given lingering capital raising and credit concerns.

Being More Defensive Early in the Year Key Driver of Outperformance. Our one-year list outperformed the financial benchmark for the sixth consecutive year and our three-to-five-year list outperformed the financial benchmark for the fifth time in the last six years. The key driver of the outperformance in our one-year list was missing any blow-ups in the first two months of the year before the market recovery. We also constructed an unofficial "bounce-back" list that also outperformed strongly with the majority of the list up over 100% for a reasonable period of time during 2009 before pulling back more recently.

2010 Should Be a Better Year. Despite a continued challenging fundamental backdrop, we believe the financial services group will perform no worse than the overall market in 2010—given the current set of consensus macro forecasts. The group has underperformed for an unprecedented three years in a row and valuation levels in almost every area we cover are at or below average levels, yet the group carries greater earnings leverage to a greater-than-expected improvement in the economy.

Financial Services |

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—Overview

Financials Still Lagged During 2009, But Performance Within Group Varied Significantly

William Blair's Financial Services Research Group issued its 2010 outlook after the market close on December 14 that included our top investment ideas for the new year (please contact your William Blair & Company salesperson for a copy of the presentation). The report also includes an updated list of best ideas over the next three-to-five years. This note includes a write-up for every company within each list and an industry update by subsegment. Our research universe covers a broad segment of financial services, including asset management, brokerage, commercial banking, custody banks, exchanges, investment banking, payment card networks, property-casualty insurance (commercial), and specialty finance.

The correct strategy for 2009 was to be defensive entering the year and then to load up on capital markets and credit sensitive stocks in late February and early March, when at peak panic levels valuations for most financial services stocks were 40% to 70% below average levels. At that time investors suddenly gained confidence that governments would provide whatever private market support was necessary and central banks' massive easing efforts would eventually stimulate the global economy. While financial services stocks significantly outperformed from the market bottom by roughly double, extremely poor performance early in the year has limited returns year-to-date. The S&P Financial Index has increased only 13.6% year-to-date versus 22.0% for the S&P 500 (through 12/10) due to significant underperformance and negative performance for banks given lingering capital raising and credit concerns. However, performance has varied dramatically across subsegments with asset managers, consumer finance, and investment banks outperforming dramatically.

Financial Services

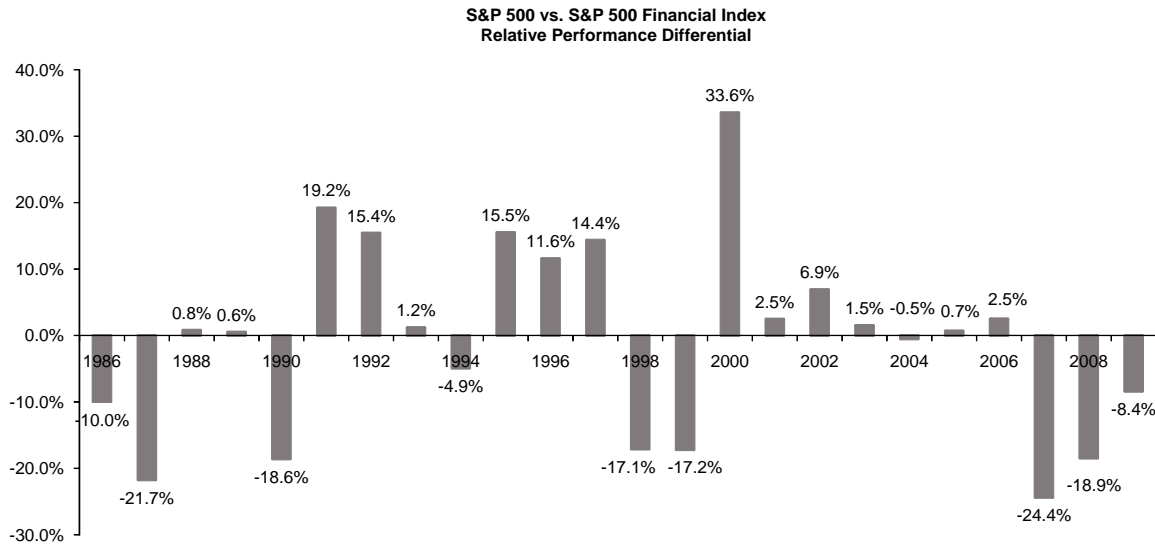
Performance by Sector for 2009¹

Indices	12/10/08 - 12/10/09	2008	2007	2006	Comments
S&P Financials	10.9%	-55.5%	-16.7%	14.2%	Too much ground to make up from significant underperformance in early 2009.
S&P 500	22.6%	-38.7%	3.5%	12.4%	
Asset Management	59.0%	-58.5%	14.8%	15.9%	Transparent, high beta recovery play.
Comm'l' P/C Insurance	13.4%	-35.1%	0.7%	8.9%	Too defensive.
Consumer Finance	57.8%	-54.4%	-15.3%	4.2%	Major laggard in 2008, consumer credit seen peaking earlier.
Custody Banks	-4.7%	-36.5%	18.4%	18.0%	Pulled down by pressure from short-term rates, certain names viewed defensively.
Exchanges	23.8%	-69.5%	32.3%	55.8%	Upside limited by poor performance from cash equities exchanges.
Life Insurance	15.2%	-57.2%	11.0%	10.5%	Pressure on book value and capital dissipating with recovery in equity and credit markets.
Major Investment Banks	124.0%	-79.2%	-26.4%	37.6%	Major laggard in 2008 given business model concerns, fundamentals improving - strong trading results, capital markets recovery, and attractive credit profile.
S&P Banks	-13.1%	-48.3%	-27.1%	10.8%	Massive lingering credit concerns, additional capital raising needs.
3-month LIBOR ²	-87.8%	-57.5%	-3.7%	20.0%	

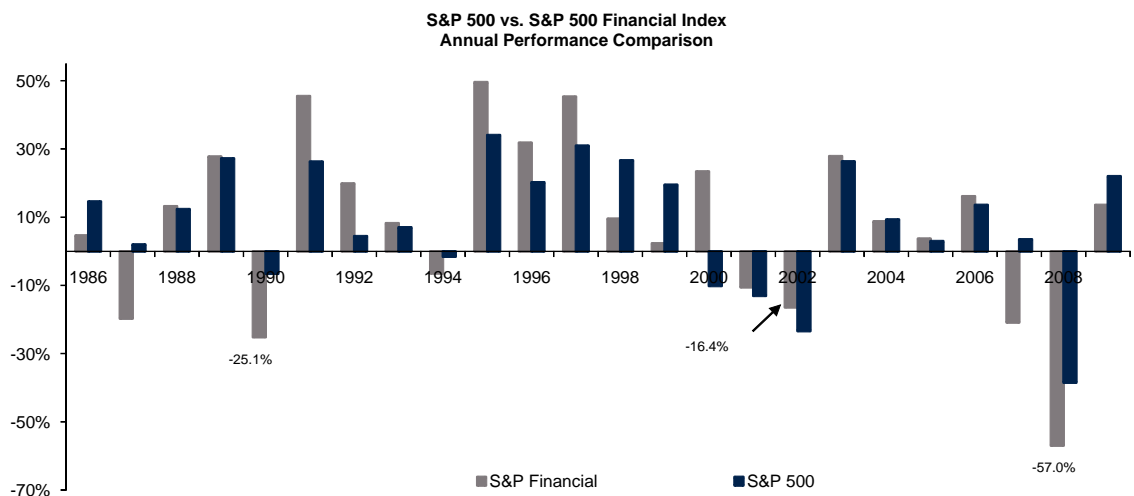
¹Diversified groups are market capitalization weighted. 2008 data from 12/05/07 through 12/08/08. 2007 data from 12/06/06 through 12/05/07. 2006 data from 12/07/05 through 12/06/06.

²3-month LIBOR decreased from 2.10% at 12/10/08 to 0.26% on 12/10/09.

Source: FactSet



Source: Bloomberg, 2009 performance through December 10, 2009.



Source: Bloomberg, 2009 performance through December 10, 2009.

Our general view 12 months ago was that the environment would get worse before it got better, although the stock market would begin to discount a recovery some time during 2009. Being relatively defensive early in the year paid off, although because we anticipated a recovery in equity markets at some point, our stock-picking wasn't too defensive. Our one-year list outperformed the financial benchmark for the sixth consecutive year and our three-to-five-year list outperformed the financial benchmark for the fifth time in the last six years (our group has issued a sector outlook for the last six years). Key outperformers on the one year list were Visa (up 55%) and IntercontinentalExchange (up 37%) and key outperformers on the three-to-five year list were Goldman Sachs (up 133%), Affiliated Managers Group (up 77%), Visa (up 55%), CME Group (up 48%), and T. Rowe Price Group (up 45%).

William Blair & Company Financial Services Group Performance
Best Idea and 3-5 Year Lists: 2004-2009^{1,2,3}

Annualized Since Inception: 1 Year List	-2.9%	Annualized Since Inception: 3-5 Year List	-4.4%
S&P Financial Index	-12.0%	S&P Financial Index	-12.0%
S&P 500 Index	-0.5%	S&P 500 Index	-0.5%
2009: One Year List Average	24.5%	3-5 Year List Average	36.1%
S&P Financial Index	10.9%	S&P Financial Index	10.9%
S&P 500 Index	22.6%	S&P 500 Index	22.6%
2008: One Year List Average	-57.6%	3-5 Year List Average	-61.0%
S&P Financial Index	-58.0%	S&P Financial Index	-58.0%
S&P 500 Index	-39.5%	S&P 500 Index	-39.5%
2007: One Year List Average	-10.9%	3-5 Year List Average	-1.2%
S&P Financial Index	-15.1%	S&P Financial Index	-15.1%
S&P 500 Index	5.1%	S&P 500 Index	5.1%
2006: One Year List Average	18.9%	3-5 Year List Average	19.6%
S&P Financial Index	14.2%	S&P Financial Index	14.2%
S&P 500 Index	12.4%	S&P 500 Index	12.4%
2005: One Year List Average	11.1%	3-5 Year List Average	14.8%
S&P Financial Index	6.2%	S&P Financial Index	6.2%
S&P 500 Index	6.3%	S&P 500 Index	6.3%
2004: One Year List Average	37.3%	3-5 Year List Average	8.2%
S&P Financial Index	3.1%	S&P Financial Index	3.1%
S&P 500 Index	4.5%	S&P 500 Index	4.5%

¹2008 performance measured from 12/5/07-12/10/08.

²Annualized performance since inception includes each new list for annual measurement period.

³2009 performance measured from 12/10/08-12/10/09.

2010 Should Be a Much Better Year

The outlook for the financial services industry has improved dramatically over the past 12 months, but remains ambiguous. The U.S. economic outlook remains fragile, given tight bank credit and a wounded U.S. consumer, due to financial asset and housing depreciation and elevated unemployment. Job losses peaked in January 2009, although the unemployment rate continues to climb and consumer confidence has been badly damaged. Consensus expectations reflect 2.5%-3.0% GDP growth in the United States in 2010, barely enough to drive job growth. Unemployment is expected to peak in early 2010 (same as 12 months ago), with no change in the fed funds rate until at least late 2010.

Key drivers that we are focused on for 2010 include credit, regulatory reform, and Fed/regulatory responses. Credit losses will be the most-significant factor influencing financial services stock price performance in 2010, in our opinion. We expect credit losses to improve generally, but the outlook is mixed depending upon the segment. We expect consumer credit losses generally to peak in early 2010 as job losses cease, with improvement seen more specifically among credit card issuers. Corporate credit losses have not been as severe as consumer, but may not improve as early. The commercial mortgage market remains the key concern, in our opinion.

Financial services regulatory reform is imminent in 2010 and getting clarity on regulation and capital requirements is a key catalyst for potential outperformance for financial services stocks. There are several components within expected financial services reform legislation, but we are focused on a few key provisions. First, capital requirements for banks will be moving higher and processes implemented to unwind large financial services companies in the future if necessary. Some banks will be undercapitalized under the new requirements and need to raise additional capital. And some banks will be overcapitalized under the new requirements, but will continue to manage capital conservatively until more clarity develops. Conservative capital management in the near term suggests minimal share repurchase, a restrictive dividend policy, and reduced risk-taking in certain businesses that could be subject to stricter capital requirements. Second, OTC derivatives trading will be pushed toward centralized clearing, which will lead to larger, more-liquid markets in many OTC derivative asset classes over time, in our opinion. However, uncertainty regarding OTC derivatives regulatory reform is adversely affecting activity levels in certain asset classes during this transition period. The major dealers in the U.S. and Europe are already moving credit derivatives (credit default swaps) toward centralized clearing, but the process has been slow. There are many questions surrounding the

breadth of centralized clearing requirements—the House bill recently approved relaxes many of the requirements from earlier draft legislation. We expect to gain more clarity over the next quarter with new legislation approved by mid-2010, and we believe this clarity overall will help improve investor sentiments toward the financial services sector.

Fed and other regulatory responses will also play a key role influencing financial services stock price performance in 2010. A well-communicated, globally coordinated exit strategy from accommodative policies by global central banks would be most desired, in our opinion. And a moderate tightening that is affirming of a global economic recovery would be the best-case scenario for financial services stock price performance and stocks that are earnings sensitive to a change in short-term interest rates, although we expect some surprises. In the U.S., the Fed is likely to tighten certain alternative accommodative strategies first before raising the fed funds rates, such as stopping the purchase of long-dated mortgage securities. We expect a cautious approach from the Federal Reserve in pulling support for the financial services industry and the U.S. economy, which could suggest short-term interest rates could be lower for longer. However, the consensus view on Fed policy can be very wrong and the Fed could be pushed into a corner if inflationary pressures build. The weak U.S. dollar also remains a wildcard, creating tremendous ambiguity, in our opinion. Other efforts to stimulate job growth and sustain the economic recovery are likely—a new economic stimulus plan in the United States is imminent—at the same time some of the original programs to stabilize the economy and financial markets are eliminated.

Despite the challenging fundamental backdrop, we believe the financial services group will perform no worse than the overall market in 2010—given the current set of consensus macro forecasts. The group has underperformed for an unprecedented three years and valuation levels in almost every area we cover are at or below average levels, yet the group carries greater earnings leverage to greater-than-expected improvement in the economy. Over the long term, we remain big believers in the growth and expansion of capital markets globally including derivatives, as well as the wealth management/retirement savings markets. Our long-term view is thus positive for certain asset managers, brokers, exchanges, investment banks, and trust banks, as well as the payment card networks, which maintain its own unique set of long-term growth drivers.

Our One-Year List Is More Recovery-Oriented, But Focused on Quality

Our one-year list reflects a recovery-oriented bias, modestly less defensive than 12 months ago, but remains focused on quality. Our goal with this list is to outperform the financial services group, and we adopt a portfolio approach. Our underlying assumption is that the recovery will be muted, with certain segments within consumer credit and unemployment peaking in the first half of the year and the Fed getting off its zero interest rate policy prior to year-end, or at least changing its stance regarding its highly accommodative position. We are cautious toward what we view as higher risk segments, particularly regional banks and particularly in the first half 2010. From a subsegment perspective we remain relatively balanced with an emphasis on stock picking, although we have not included any names in the most defensive sector we cover, which is property-casualty insurance. We also believe investors should have some “optionality” within their financial services portfolio to names that are more earnings sensitive to higher short-term interest rates.

**William Blair & Company, L.L.C.
Financial Services Group
Best Stock Picks For 2010**

Company	Ticker	12/10/2009 Market Cap	Rating/ Profile	12/10/2009 Price	2009E EPS	2010E EPS	2010E P/E	Div. Yield %
Bank of New York Mellon Corp (The)	BK	\$32,659	O/C	\$27.12	\$2.09	\$2.47	11.0x	1.3%
MasterCard Incorporated	MA	\$26,798	O/C	\$244.12	\$11.48	\$13.55	18.0x	0.3%
Discover Financial Services	DFS	\$8,468	O/C	\$15.60	\$0.12	\$0.80	19.5x	0.5%
IntercontinentalExchange, Inc.	ICE	\$7,765	O/A	\$106.00	\$4.26	\$5.00	21.2x	0.0%
Affiliated Managers Group, Inc.	AMG	\$2,736	O/C	\$65.07	\$4.38	\$5.35	12.2x	0.0%
Evercore Partners Inc.	EVR	\$473	O/A	\$29.02	\$0.80	\$1.40	20.7x	2.1%
Average (unweighted)							17.1x	0.7%
S&P 500 Financials Index				\$191.81				
S&P 500 Index				\$1,102.35	\$59.26	\$74.95	14.7x	2.2%

Source: FactSet, Thomson Financial, William Blair & Company, L.L.C. estimates.

Our Three-to-Five-Year List Focuses on Long-term, Growth Franchises

Our goal with the three-to-five-year list is to identify quality long-term franchises without respect to timing or valuation. We are willing to stick with out-of-favor business models or stocks, and we adopt a portfolio approach. This group of companies is more geared toward capital-markets-exposed companies, given William Blair's growth stock research orientation. We make changes only one time per year no matter how embarrassing individual stories may develop.

This year we have added Greenhill & Co, and Signature Bank, and removed PrivateBancorp. Greenhill represents global, cyclical growth with no balance sheet risk. It also provides quality, smaller-cap exposure to our long-term list with superior execution. Greenhill was a new addition to our research coverage universe in 2009. We have also added Signature Bank, which represents unique, quality growth within the commercial banking sector and also provides quality small cap exposure to our long-term list. Signature Bank is replacing PrivateBancorp after a difficult 2009 reduced our confidence in execution.

William Blair & Company, L.L.C.
Financial Services Group
Best Stock Picks 2010 for the Next 3-5 Years

Company	Ticker	12/10/2009 Market Cap	Rating/ Profile	12/10/2009 Price	2009E EPS	2010E EPS	2010E P/E	Div. Yield%
Goldman Sachs Group, Inc. (The)	GS	\$85,713	O/C	\$166.73	\$18.92	\$17.25	9.7x	0.8%
Visa Inc.	V	\$37,878	O/C	\$82.32	\$3.10	\$3.60	22.9x	0.6%
CME Group Inc.	CME	\$21,812	M/C	\$327.90	\$13.40	\$15.30	21.4x	1.4%
ACE Limited	ACE	\$16,851	O/C	\$50.09	\$8.12	\$7.60	6.6x	2.3%
T.Rowe Price Group, Inc.	TROW	\$12,860	O/C	\$49.94	\$1.60	\$2.25	22.2x	2.0%
Northern Trust Corporation	NTRS	\$11,505	O/C	\$47.66	\$2.99	\$3.50	13.6x	2.4%
Affiliated Managers Group, Inc.	AMG	\$2,736	O/C	\$65.07	\$4.38	\$5.35	12.2x	0.0%
Greenhill & Co., Inc.	GHL	\$2,272	O/C	\$80.44	\$2.20	\$3.10	25.9x	2.2%
Signature Bank	SBNY	\$911	O/A	\$30.92	\$1.08	\$1.75	17.7x	0.0%
Average (unweighted)							16.9x	1.3%
S&P 500 Financials Index				\$191.81				
S&P 500 Index				\$1,102.35	\$59.26	\$74.95	14.7x	2.2%

Source: FactSet, Thomson Financial, William Blair & Company, L.L.C estimates.

Industry Subsegments and Company Details

Asset Management (Mark Lane)

Despite some near-term challenges, 2010 should be a fundamentally better year, and industry growth remains attractive, driven by 1) demographic shifts and the shortfall in retirement savings, 2) globalization, and 3) the reemergence of alternatives. We expect net flows into actively managed equity mutual funds to turn positive with more stable equity markets—2009 witnessed significant inflows to bond funds and continued outflows from actively managed equity funds despite the recovery in equity markets. We also expect institutional flows into equity and alternative products to increase as institutional investors finally complete rebalancing decisions after a particularly volatile 2009.

We believe industry consolidation will likely continue in 2010. In 2009, the industry witnessed the largest transaction in its history (BlackRock (BLK \$226.92)/Barclays Global Investors) as well as a number of large-scale, and partially distressed, sales (Macquarie/Delaware, Ameriprise Financial [AMP \$38.40]/Columbia, Invesco Ltd. [IVZ \$21.81]/Morgan Stanley [MS \$29.85] retail). While transformational deals are likely to moderate, we continue to believe corporate owners (banks and insurance companies) will look to divest noncore asset management businesses. In addition, succession-oriented transactions for high-quality small-to-midsize boutique managers with strong investment performance are likely to accelerate with more-stable markets, in our opinion.

The asset management business remains attractive relative to many other areas within financials, in our view. The business model is characterized by strong recurring cash flow, high operating leverage, and minimal capital requirements. The swift market recovery since March and generally positive flows have boosted average AUM levels and improved industrywide revenue yields. Performance for

alternative strategies has improved markedly, regaining high-water marks, in many cases—this bodes well for firms with substantial performance fee potential in 2010, in our view. Companies have also taken action to right-size employee headcount levels, and compensation trends have lagged market gains, in our assessment. As such, operating margins have rebounded to the high 20 percent range on average from first quarter 2009 lows, but still remain below low-to-mid 30s-percent average margins sustained earlier this decade. Earnings leverage for the group therefore remains fairly attractive, in our opinion, but markets need to cooperate for there to be meaningful upside to consensus estimates, in our view.

After significant outperformance during 2009, we view the group as fairly valued overall with multiples generally consistent with the long-term average (18 times), and thus we are more selective at these levels. Key near-term issues include continued caution from retail investors, the timing of institutional rebalancing, consolidation in broker-sold channel, retention of talent, likelihood of increased regulation, and intensified competition from passive vehicles.

Stock Selection—Affiliated Managers Group, Inc. (One-Year List and Three-to-Five-Year List)

We see attractive upside potential in 2010, driven by the reemergence of institutional flows, improved prospects for performance fees, and accretion from acquisitions, the latter of which we view as highly probable. The stock also remains one of our best picks over the next three-to-five years, as we believe it continues to represent among the most dynamic long-term growth stories in asset management.

From a longer-term perspective, we view AMG as an investment in a group of high-quality, small-to-midsize boutique investment managers. Seven affiliates generate about 70% of EBITDA—Tweedy Browne, Friess, Third Avenue, First Quadrant, Genesis, AQR Capital, and TimesSquare—and these firms have grown substantially since AMG's original investment. The business model is well established over a long period of time (since 1994) and over different market cycles, and AMG has great diversity by client type and asset class—global equities generate 40% of EBITDA, U.S. equities 42%, alternatives 15%, and fixed income 3%. Institutional clients generate 63% of EBITDA, mutual funds 24%, and high net worth 13%. Importantly, AMG remains the succession planning partner of choice for high-quality boutique equity managers who wish to remain independent and retain an equity interest in their business and additional investments offer growth opportunities not available to most asset managers.

From a shorter-term perspective, we believe AMG is well positioned to garner inflows as institutional investors return to risk-oriented assets due to solid long-term investment performance and excellent equity style diversification. We also view the company's incremental distribution initiatives as a driver of increased organic growth in both the near and long term. In addition to MIG, the company's U.S. distribution platform for the wire-house channel, the company has built distribution platforms to target institutional investors in Australia, continental Europe, and the Middle East. More recently, AMG invested in Value Partners, a Hong Kong-based investment manager. We believe this investment is likely to drive additional distribution and transaction opportunities for AMG over time, given increasing demand for asset management products in China, Hong Kong, and other Asian markets.

From a shorter-term perspective, the pipeline for succession-oriented transactions has improved along with markets, and impending tax increases may create a sense of urgency for sellers on the fence, in our opinion. On December 14, 2009, AMG announced it was buying 100% of Aston Asset Management through the acquisition of Highbury Financial, Aston's parent company. AMG will issue 1.7 million shares in consideration—a \$114 million purchase price at the time the deal was announced, or less than 9 times a run-rate of current EBITDA. The Highbury deal is unusual given that it is an all-stock transaction, limiting the cash EPS accretion from the transaction to up to \$0.05 per share on an annualized basis for 2010, versus a cash deal that could be up to \$0.20 per share accretive. However, we believe management's willingness to use stock should be viewed as a positive signal for future deal activity, as an all-stock deal conserves cash investment capacity. If additional deal activity does not materialize as expected, the company could simply repurchase the shares issued in this transaction. We would be very surprised if AMG did not announce more accretive investments in the first half 2010, potentially a large one. The pipeline remains very active and recent stability in the market should help get negotiations across the finish line. We estimate that AMG has

\$500 million of legitimate investment capacity; accretion per \$100 million invested is \$0.15 to \$0.20 on an annualized basis, in our estimation.

We see stock price appreciation in 2010, driven by a combination of earnings growth and multiple expansion. The shares trade at about 12 times our 2010 cash EPS estimate of \$5.40 shares and about a 30% discount to the peer average GAAP P/E multiple, versus an average historical discount of 20% and an average multiple of about 15 times forward estimates since the company's IPO in November 1997. The only time that we remember AMG's cash P/E multiple trading above its long-term average multiple is during periods when net flows were strongly positive and deal activity above average, setting the stage for 2010 as a period of potentially strong stock price performance if equity markets remain more stable.

Stock Selection—T. Rowe Price Group, Inc. (Three-to-Five-Year List)

We are maintaining T. Rowe Price on our three-to-five-year best picks list, as we view it as among the highest-quality asset managers and a core holding. The company benefits from an excellent reputation and franchise, a solid execution record, and a well-respected management team that maintains a long-term and client-centric focus. In addition, T. Rowe has a broad equity, fixed income, and money market product offering and has delivered consistently solid investment performance across market cycles—this combination has driven superior organic growth relative to peers, which we expect to continue.

We view T. Rowe as the best-positioned company on our list to capitalize on secular growth opportunity in the retirement market, which provides greater stability and more consistent net flows. Despite increased scrutiny, the company's retirement-date funds have garnered significant inflows over the past two years and should continue to benefit from automatic employee enrollment in 401(k) plans and automatic escalation, in our view. In addition, we believe international distribution efforts will continue to generate incremental growth over time. Non-U.S. clients equal 11% of total AUM, compared with 30%-35% for global peers—T. Rowe was prohibited from distributing products abroad prior to 2000, due to joint venture. The company recently acquired a 26% equity interest in UTI Asset Management Company Limited. UTI Asset Management is an Indian asset manager with average assets under management of approximately \$16 billion. Lastly, T. Rowe benefits from solid financial characteristics including a strong balance sheet with no debt, nearly \$3 per share in cash and an additional \$2 per share in investments as well as industry-leading operating margins.

The shares trade at 22 times our 2010 EPS estimate of \$2.25 (consensus of \$2.39) and 19 times our 2011 estimate of \$2.60 (consensus of \$2.84)—the long-term average multiple of forward earnings is about 20 times. Current valuation is at nearly a 30% premium to the asset management peer group (long-term average premium of about 20%), which partially limits near-term upside potential, but we could see stock price appreciation driven by the company's superior earning growth profile. Our near-term concerns include potentially lower operating leverage relative to some peers, as well as potential legislative or other changes in 401(k) plans, retirement-date funds.

Brokerage - Online Retail and Institutional (Mark Lane)

Overview – Online Retail Brokerage

The outlook for online retail brokerage remains difficult with both activity levels and short-term interest rates under pressure, although these challenges should dissipate during 2010. We expect modest transaction volume growth in 2010, with activity levels improving further with a more durable recovery in equity markets—retail trading tends to be a later cycle business. Continued pressure on short-term interest rates has placed significant pressure on profitability, although the initial increases in the fed funds rate should nearly all drop to the bottom line. Our 2010 estimate includes an average fed funds rate of closer to 50 basis points.

While key revenue drivers are under significant pressure, the competitive environment ironically remains relatively stable, with pricing points largely at levels of indifference, in our opinion. The economics of the equity options business, however, are also influenced by payment-for-order-flow rates. While payment rates have held relatively well over the past few years, we expect rates to come under further pressure with the recent expansion of the SEC-mandated Penny Pilot Program that began back in January 2007. Despite the unprecedented pressure on key revenue drivers, we continue to view the financial characteristics of the online retail brokerage space as relatively

attractive, with limited asset risk, limited credit risk, high margins, and significant free cash flow—the economics are far superior to the institutional brokerage business.

We view valuation as more than reasonable given the recent weakness in the space with most companies falling well short of their long-term earnings potential. Key near-term concerns include the timing for an improvement in volume growth and short-term interest rate levels. Some consolidation is likely given continued market pressure, which should have positive implications for market leaders.

Overview – Institutional Brokerage

The outlook for institutional brokerage also remains difficult, with both activity levels and short-term rates under pressure. Activity levels within certain institutional derivatives markets have been under more pressure than retail cash equities/equity options markets, given the adverse impact from global deleveraging over the past 12 to 18 months. While visibility is not great, we expect modest growth in OTC derivatives and futures volume in 2010 after a difficult environment in late 2008 and 2009, given regulatory clarity, easier credit, and higher risk tolerance. Cash fixed income trading has been one of the few bright spots in 2009 given the resurgence in corporate bond issuance. Continued pressure on short-term interest rates is also placing significant pressure on profitability for certain companies that hold customer cash, but is a less of concern for certain businesses, such as interdealer brokers.

Regulatory changes are imminent sometime during mid-2010 and could be significant. We see most scenarios as a positive for overall industry volume growth over time, including the move to centralized clearing for CDS trading and other OTC derivatives markets. However, in the near term the uncertainty created by regulation is hurting volume growth, particularly in the CDS market, in our opinion. The institutional brokerage business is not as profitable or as stable as the online retail brokerage space, but we view the financial characteristics as relatively attractive with limited asset risk, limited credit risk, and limited capital needs. However, with both activity levels and short-term interest rates under pressure, certain companies are challenged to remain profitable.

We view valuation as compelling for many names in this space from a longer-term perspective, given this group remains heavily out of favor with most companies earning well below their long-term potential. Key near-term concerns include the timing for an improvement in volume growth and short-term interest rate levels. We also believe some consolidation is likely in the institutional space, given continued market pressure, which should have positive implications for market leaders in certain segments.

Commercial Banks (Dave Long)

Overview

The current backdrop facing the commercial banking segment continues to be daunting. Despite the improvement the sector has shown since the market low in March (when the market reflected elevated fears around systemic risk and broad institutional failure), the commercial banking sector still faces concerns about access to capital, further credit quality deterioration, regulation and oversight, and government support programs like TARP. As a result, banks underperformed in 2009, and the regional bank group has now underperformed the broader equity markets since the beginning of 2004. However, banks have led the recovery since the market low in March, outperforming the market during this time period. Moreover, commercial banks have historically started to outperform the broader equity markets shortly after the midpoint of a recession, and before an improvement in their fundamentals become completely evident. We expect 2010 performance in the commercial banking segment to hinge on the health of the commercial real estate market.

The credit environment continued to deteriorate in 2009 as net charge-offs and nonperforming assets are well above the peak earlier this decade. We expect credit costs to continue to rise through the first half of 2010, but note that the rate of loan quality deterioration has slowed. In the third quarter, the net charge-off rate and nonperforming asset rate at large domestically chartered commercial banks stood at 2.44% and 9.12%, in comparison to 0.30% and 2.17% during the technology-led recession.

The aggressive risk-taking and loose credit environment that took place in the commercial banking sector prior to the 2008/2009 recession has proved to be a recipe for disaster and not to be repeated. As a result, commercial banks are returning to traditional deposit gathering and balance sheet lending,

in which long-term growth of the industry will be heavily dependent on gross domestic product, the shape of the yield curve, merger-and-acquisition activity, and market share gains.

The elevated costs of further credit quality deterioration have placed continued stress on commercial banks' capital levels. While many commercial banks still possess the capital investment by the United States Treasury in the form of the Troubled Asset Relief Program (TARP) Capital Purchase Program, some banks have been able to raise debt and equity capital and repurchase the Treasury's preferred equity investment. Consequently, capital ratios have been boosted across the board not only to protect against another downward move in the economy, but also in anticipation of higher regulatory capital levels. We are currently under the impression that the Federal Reserve is pushing Tier-1 risk-weighted capital ratios of 9.0% for regional banks, which is currently at a minimum of 6.0% for banks seeking well-capitalized status.

Commercial bank net interest margins are at a four-year peak as deposit growth and the low interest rate environment have reduced funding costs. Anticipating Federal Reserve action around interest rates in 2010, an increase in interest rates would initially cause margins to contract, as deposit costs would rise while loan yields lag, as it takes additional time to re-price loan yields off of floor rates.

While cost cutting was a theme in 2009, we believe most cost cutting at commercial banks has been largely completed and bank spending should remain relatively low throughout 2010. Following the government-assisted mega-bank mergers and acquisitions in late 2008, merger-and-acquisition activity has been virtually nonexistent throughout 2009 with the exception of an occasional FDIC-assisted transaction—in the event of a failed institution.

Stock Selection—Signature Bank (Three-to-Five Year List)

Our top stock selection in commercial banking for the next three-to-five years is Signature Bank. We expect Signature to post solid EPS growth over the next several years, which should drive strong stock performance. We believe better-than-peer revenue, EPS and balance sheet growth will be driven by Signature's ability to capture market share from its larger bank peers via attracting veteran bankers. The company has hired several veteran group directors and teams over the last couple of years that position the company to accelerate growth as the economic backdrop improves.

In the challenging economic environment, we are attracted to Signature's balance sheet, which is deposit driven—loans represented only 61% of deposits at September 30. Additionally, we expect its net interest margin to expand more than its peers as loans become a larger percentage of earning assets—loans carry a higher yield than the investment securities they are replacing. Furthermore, its conservative underwriting has led to better-than-peer asset quality.

We believe Signature's management team, which once led the consumer and small-business bank unit of a \$50 billion New York City-based commercial bank, can continue to expand the franchise at a rapid pace. The company's lean corporate culture—no middle management and no corporate advertising cost—has led to strong financial performance, which we believe will continue to improve.

We believe Signature Bank's shares deserve to trade at a premium to its peers as a result of its superior growth prospects, consistency of earnings, and lower credit costs. We expect the company to increase its EPS at a compound annual rate of 20% over the next five years, versus its peer group median of 11%. Its shares trade at 17.8 times our 2010 EPS estimate of \$1.75, and 1.6 times tangible book value compared with its peers trading at 20.0 times 2010 EPS estimates and 1.3 times tangible book value.

We view Signature's biggest risk as credit risk. While we believe its net charge-offs will remain below its peers, it is not immune to the challenging economic backdrop, with particular focus on its commercial real estate exposure and the health of New York City as commercial real estate loans (including multi-family residential RE) represents 59% of its loan portfolio and virtually all of its business is in the New York metropolitan statistical area.

Custody Banks (Dave Long)

Overview

We believe the custody banks will continue to produce above-average top-line growth for the next several years. Global secular trends continue to be favorable and are supported by rising cross-border investment, modernization of pension schemes around the world, and favorable wealth demographics. We believe that the increasing complexity of investment strategies and products, as well as a greater attention to operations infrastructure will drive an increased demand for financial services provided by custody banks that include custody, fund accounting and administration, valuation, securities lending, foreign exchange, transition management, compliance, risk management, income collection, operations outsourcing, and recordkeeping.

Revenue can be capital markets sensitive on a quarter-to-quarter basis due to the volatility within equity values, fund flows, cross-border flows, foreign exchange volatility, trading activity, and interest rates. As a rule of thumb, a 10% change in the global equity markets impacts revenue for the custody banks by 2%, all else equal. The current low interest rate environment is a near-term negative for the custody banks in the form of lower net interest margins, securities lending revenue and money market mutual fund management fees; however, we believe this does not impact the long-term earnings power for the custody banks.

We foresee an opportunity for \$7.5 trillion in new mandates over the next three to five years, resulting in \$4.8 billion in annualized revenue available to the custody banks. The potential mandate opportunities will principally come from the modernization of pension schemes in Europe and the Pacific Rim regions. We see additional mandate opportunities coming in the form of asset manager's decision to increasingly outsource back-and middle-office functions to "variabilize" expenses to better match revenue, as well as the outsourcing by hedge funds to custodians in order to increase investor confidence in their endeavors.

The low interest rate environment has resulted in tighter net interest margins and lower securities lending and money market mutual fund management fees, negatively impacting recent stock price performance; however, we expect this headwind to abate by the end of 2010. Additionally, we believe the custody banks' long-term earnings power has been unaffected.

The custody banks have underperformed in 2009, as the low interest rate environment negatively impacted profitability. The custody banks declined 4.0%, compared with the S&P 500 appreciation of 22%. Relative P/E multiples for the group have declined to a 20% discount to the S&P 500, compared with a slight premium over the last five-plus years; we believe the discount is unjustified given positive secular growth trends in the global custody business and visibility of earnings.

Stock Selection—Bank of New York Mellon Corp (One-Year List)

Our top stock selection among the custody banks for the next year is Bank of New York Mellon. We have a high level of confidence in the durability of Bank of New York Mellon's business model and its ability to navigate through this dubious environment. We believe Bank of New York Mellon will capitalize on attractive new revenue opportunities that have been created from recent market disruption and expect it to benefit from positive long-term secular trends in global custody and asset servicing.

Low interest rates are negatively impacting the company's profitability, reducing quarterly EPS by roughly \$0.06 via lower net interest income, securities lending revenue, and money market fees. Additionally, foreign exchange trading, issuer servicing, and clearing revenue are at or near trough levels. Lastly, credit costs remain elevated with its loan loss provision reducing EPS by \$0.08 in the third quarter; we expect its provision to reduce EPS by roughly \$0.02 per quarter by the end of 2010. Net, we expect these headwinds to abate as we move through 2010, particularly as the Federal Reserve begins raising interest rates and the global markets continue to improve. Therefore, we expect EPS growth to accelerate in the second half of 2010.

Two risks to owning Bank of New York's stock were recently removed with the company restructuring its investment securities portfolio and settling the Russian lawsuit. The company restructured its securities portfolio in the third quarter, removing the risk of future other-than-temporary impairments (OTTI) and potentially adding \$175 million to net interest income in 2010 on a GAAP basis.

We believe that BNY Mellon has the best risk/reward profile of the custody banks, and that the discounted valuation compared with its peers and commercial banks is too steep. Its shares trade at 10.8 times our 2010 EPS estimate, a discount to the S&P 500 (14.9 times) and commercial banks (15.1 times). We believe its shares deserve to trade at least in line with the overall equity markets, given attractive revenue opportunities, relatively low risk profile, and good earnings visibility. We believe there is an opportunity for P/E multiple expansion as interest rates rise and the company capitalizes on its growth opportunities, reaps the benefits of scale from its successful merger, and amasses capital from strong profits.

We view weakness in the global equity markets, further deterioration in the credit markets, and a continued low interest rate environment as the biggest risks to our outlook for the company.

Stock Selection—Northern Trust Corporation (Three-to-Five-Year List)

Our top stock selection among the custody banks for the next three-to-five years is Northern Trust. We view its business model (focused on two durable businesses: global custody and wealth management) as the most attractive of the custody banks. We believe the company's relative size, competitive positioning, and leadership in personal wealth management position the company to produce the best growth for the custody banks over the next several years.

Growth in Northern's Corporate and Institutional Services (C&IS) business will continue to be driven by the positive secular trends in global custody, including the privatization of retirement assets, globalization of investing, and new opportunities caused by the recent market disruption. We believe growth over the next few years will come primarily from new opportunities in Europe. However, activity in China, Australia, and the rest of the Pacific Rim region has accelerated recently and is likely to become a larger portion of AUC growth over the next several years.

Our outlook for Northern's Personal Financial Services (PFS) business, which includes wealth management, is supported by strong demographics—growth in the millionaire population (wealth creation) and wealth transfer (driving demand for fiduciary services). We expect strong inflows of new business in its personal financial services (PFS) business, including wealth management, as competitors deal with lack of investor confidence following tax-related law suits, merger-and-acquisition activity, and concerns with capital levels.

Its shares trade at 13.8 times our 2010 EPS estimate, a discount to the S&P 500. We believe Northern's shares deserve a premium to the overall equity markets given superior growth opportunities, low risk profile, and earnings visibility. We view a premium multiple to its peers as warranted given its focus on new business opportunities, higher profitability, diverse revenue stream, safer balance sheet, and scarcity value of the franchise. Its shares have consistently traded at a forward P/E multiple of 15-20 times forward EPS for more than six years prior to the acceleration of the credit crisis last fall.

We view weakness in the global equity markets and a continued low interest rate environment as the biggest risks to our outlook for the company. We view the company as a conservative lender, but it is not immune from credit risk. Current EPS are being negatively impacted by approximately \$0.10 per quarter due to the unusually low interest rate environment via a tighter net interest margin, lower money market management fees, and depressed securities lending revenue; we expect the low interest rate environment to begin to abate by the second half of 2010.

Exchanges (Mark Lane)

Overview

Although visibility is limited, we expect growth in 2010 within cash equities, equity options, and futures given increased risk tolerance, broader credit availability, and positive flows into alternative funds. Importantly, more regulatory clarity and higher inflation expectations could further help growth in the futures space. In 2009, volume growth was mixed relative to our original expectations with better performance in U.S. cash equities and equity options and weaker volume growth within the U.S. futures space, particularly within the interest rate business. We forecast a 5%-10% increase in each of the three major U.S. exchange-traded markets.

One key development regarding the exchanges is regulation. We believe that OTC derivatives market reform is ultimately positive for the futures exchanges, as it reinforces the value and the hallmarks of the exchange business model—highly transparent, electronic trading with centralized clearing in order to eliminate counterparty credit risk. And, we do not expect any changes in the near term that will alter the structure of the futures exchanges business model. A centrally cleared OTC derivatives market could result in a larger and more robust OTC derivatives market over time, which could complement the growth of the listed futures market. The exchanges also have the opportunity to offer centralized clearing services directly to the OTC derivatives market.

Regulatory scrutiny has also increased for off-exchange execution in the cash equities business. Our position has been that the SEC's scrutiny of off-exchange execution would result in changes in certain order handling rules, like the elimination of "flash orders," and increased transparency requirements associated with the execution in dark pools. The SEC's recent actions support this view, but it is unclear to us if these changes would shift significant market share back to the regulated exchanges in total, and we believe that the brokers continue to have a huge economic incentive to execute trades off-exchange. That said, the SEC's push toward increasing transparency in general favors regulated exchanges, and if the changes extend more aggressively to level the playing field, the benefit could be more positive, in our opinion, if the impact of changes does not hurt liquidity in the market and overall volume growth.

While some near-term uncertainty remains, we believe the development of global capital markets over the long term will continue to drive above-average long-term growth for the exchanges—faster growth for derivatives. Importantly, the financial characteristics of the exchanges, particularly the futures exchanges, also remain among the best, if not *the* best, within financial services. Exchanges are cash businesses with high margins and high returns, have minimal balance sheet risk, and limited capital needs. Barriers to entry are also high. We continue to favor the futures exchanges over the cash equities exchanges as competition is likely to remain fierce within cash equities and equity options business given the current regulatory structure, including within European cash equities. We see limited competitive threats for futures exchanges.

Valuation levels are reasonable for the futures exchanges and we believe could lift further with more regulatory clarity and growth in volume in 2010. We view a 15 to 20 times 12-month forward P/E multiple for the futures exchanges as reasonable over the long term given the favorable long-term growth opportunities and competitive and financial characteristics of the futures exchange space. If markets remain more buoyant in the near term and clarity regarding legislation improves, then we believe a 20-to-25-times 12-month forward P/E multiple for the futures exchanges would be feasible in the near term. We actually see more value in the cash equity exchanges, particularly with transaction fees at less than 50% of total revenue, but we struggle with the competitive dynamics and limited volume growth visibility. We view a 12-to-15-times 12-month forward P/E multiple for the futures exchanges as reasonable over the long term once the competition stabilizes over the next few years.

Our key near-term concerns include near-term volume growth visibility, heightened regulatory risk, and heightened competition within the cash equities and equity options markets. The primary concern regarding regulation within the futures space is whether the continued/lingering debate regarding OTC derivatives market reform will have a more adverse impact on near-term volume growth than expected.

Stock Selection—IntercontinentalExchange, Inc. (One-Year List)

ICE pioneered the electronic trading of energy futures globally and the electronic trading of OTC energy derivatives in the United States. ICE is among the fastest-growing global exchanges of any size and we view as one of the more dynamic growth companies within financial services. The company's transaction fee revenue is split 34% OTC electronic energy trading, 28% electronic energy futures, 15% credit brokerage, 11% soft commodities, 8% CDS clearing, and 4% financial futures (2010 estimate).

In 2010, we expect continued growth in transaction fees given increased risk tolerance, broader credit availability, positive flows into alternative funds, and increased regulatory clarity—our underlying volume growth assumption is 8% to 10%. Management also has a proven track record of identifying

new growth areas, and it is possible new opportunities could develop during 2010. We estimate up to 20% EPS growth in 2010 and 2011.

We expect CDS clearing to be an important growth driver in 2010 and into 2011. We continue to view ICE as best positioned for CDS clearing in the United States and Europe, which we expect to accelerate in the near term. Increased competition from CME Group and regulatory clarity both will aid in the expansion of CDS clearing, in our opinion, and momentum should build once ICE receives approval to clear single names CDS in U.S., which could occur any day. Our 2010 EPS estimate includes \$0.22 from CDS clearing, but the potential for upside exists. Our 2010 CDS clearing revenue is only 50% higher than the run rate of the third quarter 2009, a quarter in which ICE served less than 50% of the market and the dealers were distracted and focused on converting their existing business to CDS clearing. Importantly, ICE's credit brokerage business should also benefit from the move to CDS clearing and the positive impact we expect centralized clearing to have on the growth of the CDS market over time.

The shares trade at 21.3 times our 2010 EPS estimate. If markets remain more buoyant in the near term and clarity regarding legislation improves, we believe a 25-times 12-month forward P/E multiple would be possible in the near term, driving the potential for 30%-40% upside over the next 12 months. Our key near-term concerns include a lack of near-term visibility regarding volume growth and regulatory risk.

Stock Selection—CME Group Inc. (Three-to-Five-Year List)

CME is the world's largest and most diverse futures exchange: interest rates 44%, equities 26%, energy 15%, foreign exchange 6%, commodities/other 7%, and metals 2% based upon volume; interest rates 26%, equities 23%, energy 30%, foreign exchange 7%, commodities/other 10%, and metals 4% based upon transaction fees (as of third quarter 2009). In November 2009, 82% of volume was traded electronically.

While the company faces some near-term cyclical pressure, we believe the futures market remains a growth market over the long term. Importantly, we view all of the exchanges as beneficiaries of the general increasing demand for more transparency and the demand to eliminate counterparty credit risk through centrally cleared trading. Futures exchanges still remain among the most attractive business models within financial services and CME's financial characteristics stand out. It is a cash business, has minimal balance sheet risk and credit risk, with limited capital needs. Given the favorable competitive characteristics of the business and the high fixed cost component of the business model, consolidation adds significant strategic and financial benefits, and we believe the CME will remain an important consolidator in the space over time.

We expect the CME to introduce centralized clearing solutions in all major OTC markets that are not exhaustively served today, including CDS, foreign exchange, and interest rate swaps. We view this strategy as a multi-hundred-million-dollar revenue opportunity over time (CME Group is roughly a \$3 billion revenue company), although because the competitive dynamics in these markets are more fluid, quantifying the impact is challenging, in our opinion. The fact that CME dominates the futures markets for foreign exchange and certain interest rate products gives the company a major competitive advantage in clearing OTC products by allowing market participants to more effectively manage capital. The company has attracted support for its CDS initiative from founding members, including several buy-side members and eight major dealers and launched its CDS clearing on December 15, as expected. We believe the dealer's primary emphasis has been to move CDS to centralized clearing first, which has delayed CME's progress on the interest rate swap side—we expect momentum to build during 2010. Foreign exchange clearing is being launch internally before year-end and with a formal launch some time in 2010.

The shares trade at 21.6 times our 2010 EPS estimate of \$15.30, and we believe a valuation of 15 to 20 times 12-month forward P/E multiple is reasonable over the long term, given its financial and growth profile. Our primary near-term concern is volume growth. Regulatory risk is both a short-term and long-term concern.

Investment Banking (Mark Lane)

Overview

The outlook for investment banking has improved dramatically over the past 12 months, after questions of survivability threatened Goldman Sachs and Morgan Stanley in late 2008. Fixed income trading results have been fantastic in 2009, despite continued asset write-downs, and issuance levels have rebounded sharply with the recovery in equity and credit markets over the past few quarters. We expect investment banking revenue broadly to grow in 2010 with the most-pronounced improvement in M&A and IPOs. We expect industry M&A volume levels to accelerate in particular in 2010 and into 2011 as the global economy recovers, financial markets continue to stabilize, confidence levels improve, and credit availability expands. That said, equity and credit markets need to continue to remain stable to see a more durable recovery in these more confidence driven segments

The outlook for fixed income trading is more ambiguous given uncertainty associated with the outlook for the global economy and the prospects for increased competition. Earnings tied to fixed income, as well as equity trading, are much more significant near-term earnings growth drivers than M&A/underwriting. In the first nine months of 2009, nearly 70% of Goldman's net revenue was generated by trading—equities and fixed income. Morgan Stanley's net revenue is modestly less dependent on trading, given the completion of Smith Barney brokerage joint venture deal.

Regulatory changes are imminent and the impact will have a major impact on the large investment banks, although the details are still developing. Capital requirements will be moving higher, certain structural changes could be positive for the growth of trading activity over the long term, and certain businesses and risk-taking levels will be curtailed. Gaining clarity on regulation is important, because it is limiting capital management options in the near term. While leverage, returns, and risk-taking will be reduced, the basics of the full-service model—M&A advisory, advising on capital raising, and the facilitation of client trading in every asset class globally—will not change. Market leaders will emerge stronger from this period, and M&A advisory-focused investment banks will take market share over time, in our view.

We remain bullish on the long-term development of global capital markets and investment banking. Long-term growth opportunities remain compelling in emerging markets, derivatives, and alternative investments. We believe M&A advisory is also a long-term growth business, with independent firms benefiting from both secular and cyclical trends. The secular trend toward independent advisors continues to be driven by demand from high-performance bankers for partnership-type cultures committed to excellence and demand from corporate clients for senior-level attention and execution from un-conflicted advisors. Advisory firms have also capitalized on the unprecedented hiring opportunity more recently, and senior bankers have fled bulge bracket firms for boutiques, given greater ability to control their own well-being (including compensation).

Investment bank price-to-tangible book multiples are well below what we consider normalized levels of closer to 2.0 times—Goldman is currently trading at 1.52 times our fourth quarter 2009 tangible book value per share estimate, compared with 1.38 times for Morgan Stanley. Advisory firm shares are currently trading at about 23 times 12-month forward EPS estimates on average, or about 10% to 15% above historical averages, although we note trading history is somewhat limited. We believe valuation levels for M&A advisory firms can be viewed as reasonable under more optimistic recovery scenarios in 2010 and 2011. Key concerns include the pace and magnitude of any economic recovery, the sustainability of improved competitive conditions within fixed income trading, increased competition for talent, and changes in regulation.

Stock Selection—Evercore Partners Inc. (One-Year List)

Evercore is a leading boutique investment bank with strong relationships with large multinational corporations; differentiated by its ability to drive repeat business and consistently land megadeals. Evercore has advised on more than \$1 trillion of transactions since its founding in 1996, including both the largest M&A transaction (Pfizer [PFE \$18.35]/Wyeth) and largest restructuring engagement (General Motors) in 2009.

We expect industry M&A volume levels to accelerate in 2010 and 2011, as the global economy recovers, financial markets continue to stabilize, confidence levels improve, and credit availability expands. We are very confident Evercore will participate strongly in the M&A upcycle, given the quality of its franchise, and

potentially take market share, given growth in headcount over the past few years (41 advisory-focused SMDs currently, double the amount since the end of 2006; about \$11 million average revenue per beginning-of-year advisory-focused MD over the past four years). Importantly, Evercore has greater operating leverage to an improvement in a recovery in the M&A market than competitor Greenhill, given less stringent expense management over the past few years. While we believe competition for talent has picked up, we believe Evercore has an opportunity to continue to build out industry verticals in the United States and expand globally. We view growth in the SMD ranks, coupled with average productivity per banker, as the best leading indicator of revenue potential. Restructuring activities have also helped offset depressed M&A-driven revenue and should continue to provide near-term earnings support, in our view.

Evercore recently recruited Ralph Schlosstein to be its CEO, taking a significant step in its efforts to strengthen its management team and evolve into a more institutionalized firm, in our opinion, and we expect better alignment with shareholders. Co-founder of BlackRock and president of that company for nearly 20 years, Mr. Schlosstein is a change-agent with a strong record of execution. Under his leadership, we believe Evercore will extend its franchise in investment management, and we anticipate continued improvement in profitability over the next 12 months, in addition to greater operating leverage within the investment advisory business. The asset management business is roughly a \$0.50 per share drag on earnings in 2009, and we believe could be close to breakeven by the end of 2010 with a continued recovery in financial markets.

Evercore's shares are currently trading at 21 times our 2010 pro forma EPS estimate of \$1.40 (consensus of \$1.50) and 13 times our 2011 estimate of \$2.20 (consensus of \$2.00). We view 20 to 25 times forward estimates as reasonable, given the potential for improvement in key financial metrics, driving the potential for at least 50% upside over the next 12 months in a healthy recovery scenario as the market starts to discount the earnings growth potential in 2011. The key concerns include the company's U.S.-centric focus and the length of the tail to the restructuring cycle, which has been a major contributor to strong advisory revenue growth in 2009. The company's business has clearly outperformed in 2009 and therefore we also have some concern of heightened near-term expectations.

Stock Selection—Greenhill & Co., Inc. (Three-to-Five-Year List)

We are adding Greenhill to our best stock picks for the long term. Greenhill is a preeminent independent advisory investment bank with exceptional intellectual capital, a sterling reputation, and a solid execution record, in our opinion. We believe the company differentiates itself through its ability to attract high-performing senior-level bankers, owing to its pay-for-performance and partnership culture, combined with its shareholder-friendly policies and attractive financial characteristics, including high employee productivity, strong expense discipline, and minimal capital requirements. Financial execution has been far superior to competitor Evercore.

We believe Greenhill will continue to recruit senior talent and win an increasing share of advisory engagements. We believe the company's restructuring business provides near-term earnings support and we see significantly increased earnings capacity and leverage to a sustained economic improvement. Greenhill has expanded revenue capacity by nearly 75% since 2007 and now boasts 55 advisory-focused managing directors. We view growth in bankers as the best leading indicator of future revenue growth, and advisory revenue per beginning-of-year advisory managing director has averaged nearly \$8 million since 2003. Despite the rapid headcount growth, we expect the company to hold the line on compensation expense and continue to generate best-in-class pretax margins in the high-30% to low-40% range and high returns on equity.

Greenhill's attractiveness as a high-quality recovery play has not gone unnoticed and shares are currently trading at about a 30% premium to the company's average forward price-to-earnings multiple since its 2004 IPO. Shares currently trade at 26 times our 2010 EPS estimate of \$3.10 (consensus \$3.18) and 18.5 times our 2011 EPE estimate of \$4.35 (consensus of \$4.41). We continue to recommend a disciplined and opportunistic approach to shares in the near term, but we view valuation as reasonable for long-term growth investors given the potential for meaningful upside to earnings in late 2010 and 2011 as new (and incremental) bankers fully ramp.

Stock Selection—Goldman Sachs Group, Inc. (Three-to-Five-Year List)

We view Goldman Sachs as a high performance play on the long-term expansion of global capital markets and the best positioned global investment bank. The net revenue breakdown for first nine months of 2009 was asset management/prime brokerage 12%, equity commissions/trading 22%, fixed income commissions/trading 54%, investment banking 9%, and principal investments 2%. The net revenue breakdown for fiscal 2006 was investment banking 15%, asset management/prime brokerage 13%, equity commissions/trading 24%, FICC 40%, and principal investments 8%.

Goldman's execution and risk management has been unparalleled, and the company has a history of outperforming in favorable and unfavorable market environments—the firm largely avoided subprime RMBS losses in 2007 for example. The firm's return on tangible equity for 2009 will be in excess of 20%, the highest among any major financial services company in the U.S. with any noticeable balance sheet risk.

While heavily dependent upon trading, its activities are highly diverse and benefit from a global franchise with high barriers to entry. The firm is a leader in commodities, credit, foreign exchange, mortgages, and rates. Goldman also has leading market share in high-margin M&A and equity underwriting—both feeding other business lines—and its principal investment performance is top notch. Importantly, lost in the focus on investment banking and trading, Goldman has a high-quality, emerging asset management business (\$848 billion of AUM as of 9/09) with a heavy emphasis on alternative investments (17% of total AUM).

The balance sheet and its funding needs are in great shape, with the firm continuing to hold significant excess liquidity and capital, for which the company incurs a major opportunity cost. We expect management to continue to hold excess liquidity and capital in the near term, given some ambiguity in the market environment, but more due to the uncertainty associated with imminent increases in regulatory capital requirements. Regarding liquidity, Goldman's global core excess funds averaged \$167.47 billion for the third quarter 2009, compared with only \$96.73 billion in fiscal 2008 and significantly higher than is necessary in a more stable environment. Regarding capital, Goldman's Tier-1 capital ratio under Basel I (regulatory guidelines applicable to bank holding companies) as of September 25, 2009, was 14.5%, up from 13.8% in second quarter 2009. We believe increased minimum levels will be set well below those levels. As of September 25, 2009, the firm's gross leverage ratio (assets to total shareholders' equity) was 13.5, declining by over 50% from its peak on February 29, 2008. It seems that there will be a simple, maximum leverage ratio test established for bank holding companies in the 15 to 1 area that could limit some of Goldman's return opportunities at market peaks, although not driving any required near-term changes.

Goldman shares trade at roughly 1.52 times estimated fourth-quarter tangible book value per share of \$106.69. We see valuation as very reasonable and attractive over the next 12 to 18 months. We believe Goldman should trade closer to 2.0 times tangible book value per share over time as regulatory clarity develops and global capital markets continue to recover. Our primary near-term concerns include increased competition in fixed income trading and regulatory risk, including higher capital requirements.

Payment Card Networks (Dave Long)

Overview

We believe payment card volume is poised for attractive long-term growth, due to the continued move toward card-based payments, the development of new payment solutions and categories, the modernization of payment infrastructures within developing nations, and the increase in cross-border travel. We expect card volume growth to continue to take market share from paper-based payment forms worldwide. In the United States, we believe the market share of card-based payment transactions will exceed 50% of consumer payments volume by 2011, up from 46% in 2008. Outside the United States, card-based volume represents less than 20% of total payment volume.

We believe an inflection point will be reached in the fourth quarter 2009 for global credit card payment volume, which has declined from 6%-15% over the last four quarters. Moreover, we believe global credit card volume should turn positive as year-over-year comparisons become favorable and foreign currency translation headwinds turn into a tailwind.

The payment card networks do not extend credit, issue cards, or determine fees or interest rates charged to cardholders. In our view, the economics of the payment card network business are among the best in financial services. Business attractions include pricing power, relatively small capital requirements, strong cash flow, increasing operating margins, and long-term EPS growth of at least 20%. The resiliency and attractiveness of this business model was also recently supported by a Government Accountability Office study, which published a benign conclusion in regards to regulating interchange fees charged to merchants for accepting electronic payment forms. Subsequently, we believe this does not give Congress enough support to pass new interchange regulation and believe investors' concerns over interchange risk are overblown and misguided.

MasterCard and Visa shares have outperformed the S&P 500 in 2009, due to an absence of credit risk, strong EPS growth, and predictability of earnings. We expect their shares to continue to outperform the S&P 500 in 2010 due to strong earnings growth, attractive and expanding operating margins, and reduced headwinds from potential interchange regulation. Additionally, we expect their P/E multiple to expand as they are currently below our forecast five-year growth rate of 18% for MasterCard and 22% for Visa. We believe a price-to-earnings-to-growth (PEG) rate greater than one is deserved.

Stock Selection—MasterCard Incorporated (One-Year List)

Our top selection among the payment card networks for 2010 is MasterCard. Shares of MasterCard provide investors with an opportunity to own a global financial institution that we expect to produce attractive top- and bottom-line growth over the next several years. The company is positioned to benefit from the positive secular trends affecting the payment card networks, primarily the shift to card-based payments from paper-based payments.

In 2010, we expect MasterCard to benefit more than Visa from the weakness in the dollar compared with one year ago as 57% of MasterCard's purchase volume comes from outside of the U.S. compared with 40% for Visa. Additionally, as the U.S. economy continues to rebound, we see more upside to credit card volume improvement than debit card improvement benefiting MasterCard more so than Visa as MasterCard has a higher concentration of credit (59%) versus debit in the U.S. than Visa (47% credit).

MasterCard shares are comparatively inexpensive, trading at 18.1 times 2010 EPS, a 24% discount to Visa (23.9 times). Its shares trade at a 19% premium to the S&P 500 compared with its peak valuation of a premium of 137% in April of 2008. We believe a premium P/E multiple to our five-year EPS growth forecast is warranted given its attractive global growth opportunities, expanding operating margins, and visibility of earnings.

MasterCard's credit card concentration makes its shares more sensitive to the ups and downs of the global economy. Additionally, headline risk regarding interchange remains despite our view that the recently released GAO study on interchange reduces the possibility that Congress will attempt to pass legislation. We note that Visa and MasterCard do not get paid interchange (interchange is paid to the credit card issuers such as Capital One [COF \$40.09]), but that interchange restrictions could have a modest negative impact on the payment card networks' revenue.

Stock Selection—Visa Inc. (Three-to-Five-Year List)

Our top stock selection among the payment card networks for the next three-to-five years is Visa. We expect Visa's market leadership and higher concentration of debit card volume, which we expect to continue to produce better growth than credit card volume, to lead to better top- and bottom-line growth than MasterCard over the next several years.

Long term, the company will be the primary beneficiary of strong secular growth, including the conversion of check and cash-based transactions to card-based transactions. Visa has helped create more than a dozen new categories for card use over the last few years, including quick-service restaurants, utilities, taxicabs, transit, and parking. Additionally, the increasing prominence and adoption of emerging electronic payment verticals like prepaid and money transfer will aid in this robust secular growth story. We expect card-based transaction share to reach 50% of U.S.-based payment volume in the next couple of years up from 46% in 2008.

The company has a strong balance sheet with \$4.6 billion of unrestricted cash and only \$56 million of debt. Furthermore, it recently announced its first ever share repurchase program. Visa can purchase up to \$1 billion (13 million shares) of its stock over the next year.

Visa's shares trade at 23.9 times our calendar 2010 EPS estimate (\$3.60), compared with 14.9 times for the S&P 500. Its shares trade at a 49% premium to the S&P 500, but have traded at a premium as high as 110%. We believe its P/E multiple will expand as we believe a premium to its five-year annual EPS growth forecast (22%) is warranted given attractive global growth opportunities, market leadership, expanding operating margin, and credit exposure.

We see two key risks to an investment in Visa. First, while we believe Visa is more insulated from the effects of deteriorating economic conditions, it is not immune from the global economic recession. Second, headline risk regarding interchange remains despite our view that the recently released GAO study on interchange reduces the possibility that Congress will attempt to pass legislation. We note that Visa and MasterCard do not get paid interchange (interchange is paid to the credit card issuers such as Capital One), but that interchange restrictions could have a modest negative impact on the payment card networks' revenue.

Property-Casualty Insurance (Commercial) (Mark Lane)

Overview

Commercial property-casualty insurance is the one sector we cover where we expect fundamentals to deteriorate in 2010. We believe that pricing will remain under pressure in 2010, despite nearly five years of price declines, absent a greater-than-expected deterioration in underwriting profitability in the near term that would push companies to more aggressively raise rates. The recovery in equity and credit markets over the past few quarters has adversely impacted the movement toward positive pricing changes in early 2009 and the weak economy is also limiting exposure growth, placing further pressure on industry premium growth and profitability. According to second quarter 2009 (third quarter data will be released the end of this month) industry results provided by ISO and the Property Casualty Insurers Association of America (PCI), net written premiums in the second quarter declined 4.8%—the ninth consecutive quarterly decline. If this trend continues through the balance of the year—which we believe is likely given that exposure growth is a lagging economic indicator—2009 will mark the first three-year consecutive decline in premiums since the Great Depression.

The property-casualty insurance industry in the aggregate averted most of the carnage from the deterioration in credit markets given relatively less equity market and credit risk within their investment portfolios (in general underwriters take risk in their underlying underwriting business and not within their investment portfolios). Credit quality and investment leverage (assets to equity) for commercial property/casualty insurers also remain superior relative to the life insurance industry, and we foresee no major additional credit concerns.

Despite pressure on near-term fundamentals, we view valuation for the underwriters at very attractive levels on an absolute and relative basis, below recent trough valuation levels in early March 2000 at less than GAAP book value per share. Despite the expected deterioration in profitability, we would have selective exposure in the space based on valuation alone—more defensive investors should be more open to this position. The level of the relative multiple for the insurance brokers that we cover (Aon [AON \$37.86] and Marsh & McLennan [MMC \$21.89]) is less compelling than the underwriters, in our opinion. A potential catalyst for the underwriting group is an improvement in consolidation activity as credit and equity markets show signs of lasting stabilization and industry profitability comes under pressure. Increased activity could provide some valuation support. The key risks we see are greater-than-expected margin deterioration in the near term, due to the cumulative impact from pricing pressures over the past few years. We would also expect the group to perform in line with the market at best in a broad equity market recovery from current levels despite current valuation levels.

Stock Selection—ACE Limited (Three-to-Five-Year List)

We view ACE as a “best-in-class” commercial property-casualty underwriter globally and an emerging franchise within the industry. The company is well diversified by line of business and geography with above-average growth and profitability, and it operates a unique accident and health insurance franchise (20% of underwriting earnings). The company has significantly outperformed its peer group

over the past few years with very strong execution under CEO Evan Greenberg and financial flexibility is among the highest within its peer group and absolutely strong. We believe ACE's financial flexibility will allow the company to pursue acquisitions opportunistically and view ACE as arguably the largest beneficiary of the continued competitive degradation of AIG over time.

We view valuation as attractive on an absolute and relative basis, and we view an entry point below GAAP book value excluding other comprehensive income (\$54.68 as of September 30, 2009) as very attractive over any reasonable period. The shares trade at 0.87 times fourth-quarter estimated GAAP book value per share of \$57.00, 0.91 times GAAP book value per share excluding OCI, and 1.08 times tangible book value per share. We view a normalized valuation level in a range of 1.30 to 1.50 times GAAP book value per share. Key risks we see include further pressure on underlying margins in 2010 due to the soft pricing environment over the past few years. The weak economy is also limiting exposure growth in the near term and some investors have been turned off by the company's redomestication to Switzerland.

Specialty Finance (Dave Long)

Overview

Credit quality has deteriorated across the board for lenders, and we expect credit costs to continue to rise for most specialty finance companies in early 2010, peaking in the first half of the year. We believe the extent of credit deterioration is uncertain and specific to each type of lender, and therefore, have a varying degree of confidence in EPS estimate for specialty finance companies. However, unemployment data will be fundamental to an improvement in general credit quality. Recent positive unemployment data confirms our view that credit card net charge-offs are likely to peak in the first quarter 2010, and expect loan loss provisions to materially decline by late 2010.

Loan and lease origination volume have been relatively slow across all specialty finance segments. Credit card issuers have reduced credit limits and balance transfer offers due to the implementation of the CARD Act and continued deterioration in consumer health. In leveraged finance origination activity has slowed; however, terms—higher spreads and lower leverage (debt-to-EBITDA)—remain favorable for those with origination platforms and funding. Additionally, funding is improving in the leveraged finance markets in the form of collateralized loan obligations, and growth may be reinvigorated by year-end.

The student lending environment faces an uphill battle, as the Federal Family Education Loan Program (FFELP) is in jeopardy. However, we believe private lenders may maintain a role in origination activity, in which private lenders have received recent support from a group of senators that are reviewing the impact of outsourcing some origination activity to the private companies. Offsetting the elimination of the FFELP was an outsourced servicing contract provided by the Federal Government that provided additional business to a few private lenders.

The global economic recession has virtually impacted all industries, affecting global commerce and trade, which has reduced demand for shipping containers, and, thus, container leases. However, we believe shippers are more likely to lease containers before buying containers, providing container leasing companies with a strong inflow of new business opportunities at the start of meaningful shipping recovery.

Share-price performance of specialty finance companies in 2009 has been inconsistent as a group with individual performance dependent on company specific developments. We believe 2010 stock price performance will be driven by credit quality, expecting to see a positive relationship between the eventual point in time when general credit costs decline and the performance of the group.

Stock Selection—Discover Financial Services (One-Year List)

Our top selection within the specialty finance sector for 2010 is Discover Financial Services. We believe Discover is the best play on the recovery of credit losses for credit card issuers as it is more leveraged to improving consumer health than its peers given its high concentration of net interest income and sizable level of loan loss provisions to total revenue—its provision for losses represented 75% of total revenue over the last 12 months, which we conservatively forecast declining to 40% in 2012. The greater leverage creates the potential for greater share price appreciation, but comes with a higher level of risk.

We forecast its loan loss provision to begin materially declining in the second half of 2010, causing EPS growth to accelerate. We believe 2010 and 2011 EPS estimates will be revised higher if charge-offs peak in the first quarter of 2010 as we forecast, providing positive momentum for the stock. The acquisition of Diners Club International's non-North America payment network accelerates Discover's objective to build a global network, broadening customer relationships and enhancing its global market share. Discover just began processing transactions in the United States for holders of non-North American Diners Club International cards. The company's core U.S.-based Discover cardmembers, who cannot use their cards outside the United States today, will be able to use their cards wherever the Diner's Club International card is accepted in 50 other countries and territories by year-end 2009 and the rest of the world by the end of 2010.

We believe its shares are relatively inexpensive trading at only 10.3 times our 2011 EPS estimate of \$1.55, which we view as conservative. We believe the shares deserve to trade above their three and five- year average forward P/E multiple of 11.5 times as investors anticipate substantial acceleration in EPS growth over the next few years. We therefore believe appreciation potential over the next 12 months can be driven by multiple expansion as investors start to discount earnings growth in 2011, as well as upwards earnings revisions.

The biggest risk to an investment in Discover is the possibility that job losses reaccelerate or unemployment significantly exceeds expectations, which will likely cause the company to experience higher credit costs than we forecast resulting in lower EPS.

Additional information is available upon request.

Current Rating Distribution (as of 11/30/09)			
Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	64	Outperform (Buy)	4
Market Perform (Hold)	36	Market Perform (Hold)	0
Underperform (Sell)	0	Underperform (Sell)	0

*Percentage of companies in each rating category that are investment banking clients, defined as companies for which William Blair has received compensation for investment banking services within the past 12 months.

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