TRADER DAILY

TOP STORIES

Bonus Forecast: Hazy Sunshine, Then Downpour

Aug 31 2007

By **Jon Jacobs**

Apart from the battered mortgage sector and its kin, bonuses for 2007 remain on track to surpass last year's windfall pace. But for 2008, it's "Look out, below!"

That good news/bad news message comes from compensation consultant Alan Johnson, managing director of Johnson Associates.

Notwithstanding recent dire headlines about hedge fund blowups and shrinking credit, Johnson says pay for this year "is going to be surprisingly good for most people" in the investment business. "Unless there's a catastrophe, the average person on Wall Street is going to make more this year than they did last year," he says.

"Bonuses will be fine outside fixed income," concurs Brad Hintz, financial services analyst at Sanford C. Bernstein.

But enjoy it while you can. Johnson expects to see layoffs at the end of this year, slowed hiring, and a depleted M&A pipeline leading to smaller bonuses across the board for 2008.

Other industry observers differ about what the recent selloff in mortgages and leveraged credit bode for year-end payouts, which provide the bulk of compensation on both Wall Street and the buy side. Johnson's views may merit particular attention because his firm specializes in designing pay plans for financial services clients, ranging from investment banks to hedge funds to insurance companies.

Here's how experts handicap the bonus outlook for various sectors.

Investment Bankers

M&A bankers are set for another bumper year, despite fears that the credit retreat pulls the plug on new leveraged buyouts. Hintz says that while financial sponsor (private equity) M&A may slow, tighter credit won't deter big companies like PepsiCo from making acquisitions. He also sees M&A continuing to boom in Europe, where private equity is behind only 20 percent of deals, compared with 40 percent in the U.S.

Johnson agrees that M&A pay is still climbing. For this category, he's sticking with his last quarterly projection, released Aug. 9, of a 20 percent year-on-year rise.

Although fewer new deals are being slated, Johnson says it takes three to five months to close a deal - and banks' fees (and bankers' bonuses) are earned upon closing. Since plenty of deals inked before the credit pullback have yet to close, the pipeline for the remainder of 2007 is pretty good. But he cautions that once these pending deals get completed, 2008 "is going to be really hard" for M&A.

Burke St. John, vice chairman and head of the global financial services practice at executive search firm CTPartners, is more pessimistic. He sees some of the street's biggest profit engines - leveraged finance, M&A and structured credit - grinding to a halt. That will crimp this year's bonuses, he says. However, the wild card is proprietary trading. If a particular firm succeeds with its proprietary bets in the year's second half, it could mitigate profit declines from other business segments, he says.

Hedge Fund Managers, Staff, and Prime Brokers

Hedge funds shouldn't be considered as a single group, because the fees they collect and bonuses they pay are closely tied to the current performance of individual funds. While some funds have suffered well-publicized disasters since June, others prospered by betting against sub-prime mortgages. "Probably they're going to do either really well or terrible," Johnson says of fund managers' bonus prospects. "There won't be too many in the middle."

That points to greater employee turnover in the months ahead. Anticipating the hit to their wallet, portfolio managers whose strategies fared poorly might be receptive to overtures from better-performing funds, says Sandy Gross, managing partner of Pinetum Partners, a recruiter for hedge funds.

Still, a fund's results can turn around quickly, observes George Yulis, principal at Rothstein Kass, a New York recruiting firm focused on hedge fund back-office staff. Some funds that lost ground in July and early August might make it all back if they have a great September.

For Wall Street's prime brokers, who cater to hedge funds, Johnson sees bonuses up about 10 percent over last year. That's a downward revision from his Aug. 9 forecast, which called for a 15-20 percent rise.

For Fixed Income, Gloom

All the experts we spoke with view bonds as the dark cloud on this year's bonus horizon. For traders in mortgage-backed securities, the most troubled sector of the market, bonuses are set to shrink 20 percent to 40 percent from last year, according to Johnson.

Other bond traders may suffer too. For instance, Johnson says structured credit, the category that includes asset-backed securities, will pay 5-10 percent less than 2006. Still, "suffering" may be too strong a word: In those same fixed-income segments that face haircuts now, bonuses soared last year.

Even within fixed income, Hintz says firms might choose to "cut from the top" - thin their ranks of highly paid managing directors - and use the savings to cushion the pay of directors and vice presidents.