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AMG.N - Q3 2022 Affiliated Managers Group Inc Earnings Call

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OVERVIEW:

AMG reported 3Q22 economic EPS of $4.21.

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PRESENTATION

Operator

Greetings, and welcome to the AMG Third Quarter 2022 Earnings Call. (Operator Instructions)

As a reminder, this conference is being recorded. I would now like to turn the conference over to your host, Patricia Figueroa, Head of Investor Relations for AMG. Thank you. You may begin.

Patricia Figueroa - *Affiliated Managers Group, Inc. - Head of IR*

Good morning, and thank you for joining us today to discuss AMG's results for the third quarter of 2022. Before we begin, I'd like to remind you that during this call, we may make a number of forward-looking statements, which could differ from our actual results materially, and AMG assumes no obligation to update these statements. A replay of today's call will be available on the Investor Relations section of our website along with a copy of our earnings release and a reconciliation of any non-GAAP financial measures, including any earnings guidance announced on this call. In addition, we posted an updated investor presentation to our website this morning and encourage investors to consult our site regularly for updated information.

With us today to discuss the company's results for the quarter are Jay Horgen, President and Chief Executive Officer; and Tom Wojcik, Chief Financial Officer.

With that, I'll turn the call over to Jay.

Jay C. Horgen - *Affiliated Managers Group, Inc. - President and Chief Executive Officer*

Thanks, Patricia, and good morning, everyone. This has been a remarkable last 12 months. We have seen the combination of higher inflation, rising rates and geopolitical risks drive simultaneous declines in both equities and fixed income, resulting in unprecedented disruption in client portfolios. At the same time, it has also been a remarkable period for AMG, having delivered 5% year-over-year growth in Economic earnings per share in both the third quarter and the year-to-date period as the overall diversity and strong performance of our business, together with capital allocated to new investments and share repurchases, more than offset the impact of double-digit market declines.

And given our strong year-to-date performance, we expect earnings per share to grow approximately 10% in 2022 on top of the 37% earnings growth we delivered in 2021. Notably, our results in these two years have been generated in dramatically different markets. In 2021, world markets grew significantly against the backdrop of low rates and easing monetary policies, in stark contrast to the severe drawdown in 2022 amid tightening monetary policies and geopolitical risks.

AMG's strong performance across disparate market environments highlights the efficacy of our model and the diversification of our business. And as we'll discuss today, we believe AMG is uniquely positioned for success and continued growth in the new environment.

Our business profile is intentional and unique. We have strategically evolved AMG over the past decade by deliberately investing in a diversified group of leading independent managers across a broad array of asset classes. Our high-quality partner-owned firms have collectively provided us even greater ballast against the changing environment by strengthening AMG's overall earnings power and stability, enabling us to participate in upward trending markets and simultaneously providing us a buffer against volatility and dislocation. Our Affiliates have distinguished themselves through their investment performance, and enhanced their potential to generate organic growth. We believe there are several factors that will drive client behavior going forward, and that AMG, and our Affiliates are positioned to benefit from these trends.

First, portfolio construction is going to take center stage. After a decade of highly correlated increases in risk assets, this year, investors received a reminder, in many cases a painful one -- of the value of portfolio construction and diversification. As the lessons of the Global Financial Crisis waned over time and markets continued to rise, investor focus on the risk and return considerations that are so critical in building a balanced portfolio over market cycles slowly eroded. As a result, portfolios became far too heavily weighted toward growth at inflated valuations -- in both the public and private markets. Investors either chose to chase growth or unknowingly participated in that chase. Going forward, clients will need to construct portfolios to address the longer-term emerging risks and trends that this new market environment will bring.

Second, the diversification and capital protection provided by liquid alternatives will be critical in building more resilient portfolios. The excellent performance generated by AMG's Affiliates in the current environment provides ample evidence that investors who had previously chosen to underweight these strategies can no longer ignore the meaningful advantages of integrating them into their portfolios. The performance of liquid alternatives, particularly in times of market disruption, remind us of the foundational lessons of portfolio construction. And we strongly believe that these strategies and our Affiliates, including Systematica, Capula, Garda, Winton and AQR are all well positioned to benefit from future allocations to uncorrelated return streams.

Finally, we believe that thoughtful portfolio construction will require even greater valuation-sensitivity and risk awareness. The outlook for risk assets has shifted given changes in long-term assumptions on risk-free rates and terminal value. As investors recalibrate their portfolios, we expect a return to a more fundamental, value-sensitive approach to investing, and our Affiliates are well-positioned for future allocations given their focus on quality and value strategies.

We believe that taking an active approach will be critical to achieving clients' risk and return objectives across both public and private markets. Given their entrepreneurial independent models and alignment with clients, our Affiliates are well-positioned in volatile markets to deliver differentiated long-term returns. Critically, alpha generation is driven by skill, not scale. We believe that knowledge, experience and dynamic decision-making are going to be essential for navigating the new environment.

And while we are still in the early innings of this evolution, our Affiliates are positioned to benefit from the increasing need for active management in portfolios across both liquid and illiquid strategies.

As I said earlier, AMG's business model is uniquely advantaged by our ability to shape our business and scale our earnings power through investments in new and existing Affiliates. As we execute on our strategy of investing in areas of secular growth, our partnership approach continues to resonate with the highest-quality independent firms. In October, we made a minority investment in a new Affiliate, Peppertree Capital Management, a leading $4 billion communications infrastructure firm that is well-positioned to benefit from the ongoing tailwinds surrounding the demand for data. This new partnership enhances our participation in real assets and is our first Affiliate wholly dedicated to infrastructure, bringing further diversification to our business profile. The Peppertree team was attracted to AMG's partnership approach, which preserves their operational autonomy and investment independence while providing access to our strategic capabilities.

As we add more Affiliates in areas of secular growth, we will continue to evolve our business composition towards in-demand strategies, driving long-term organic and earnings growth. Going forward, we expect to see a number of high-quality investment opportunities emerge in the new environment. And with our strong capital position, further enhanced with the proceeds from the sale of our minority stake in Baring, we have increased flexibility to allocate capital across AMG's unique opportunity set to the areas of highest growth and return.

I want to underscore again our commitment to a disciplined capital allocation framework. Capital decisions are fundamental to our strategy, and we evaluate every opportunity on a risk-adjusted basis, factoring in the impact of the investment to our business, cash flows and franchise. Capital decisions require judgment and our allocation discipline is embedded across all elements of our process and culture.

While we believe that growth investments in new and existing Affiliates will drive long-term shareholder value, given our disciplined allocation framework, we have also returned significant capital to shareholders by retiring more than 25% of our shares over the last 3 years.

Finally, we are pleased with our results and our business momentum. Our positive forward outlook reflects our confidence in our strategy and our Affiliates' positioning in this new environment. Our results once again demonstrate that AMG and our high-quality Affiliates represent the best of active management in both public and private markets. As clients reallocate portfolios, we are confident that AMG's Affiliates, and our shareholders, will benefit from the growth and value creation that will follow.

And with that, I'll turn it over to Tom to review the details of the quarter.

Thomas M. Wojcik - *Affiliated Managers Group, Inc. - Chief Financial Officer*

Thank you, Jay, and good morning, everyone. The combination of excellent investment performance and our disciplined approach to capital allocation, enabled AMG to deliver 5% year-over-year growth in earnings per share in the third quarter. As you heard Jay discuss, this year's market environment has demonstrated to investors the importance of the principles of portfolio construction -- diversification, uncorrelated returns, and liquidity.

Clients are beginning to recalibrate portfolios, and we have intentionally built our business to capture the demand trends ahead of us. Our confidence in our business momentum is supported by outstanding Affiliate investment performance this year, most notably in liquid alternative strategies, resulting in our strong outlook for full year 2022 earnings growth.

That earnings growth, aided by strong performance fee earnings, contributes significantly to cash flow generation, and combined with the proceeds from the Baring transaction, further enhances the capital we can deploy toward long-term growth opportunities.

We took the first step in that deployment in October with our investment in Peppertree Capital Management, in line with our strategy to increase our participation in private markets and real assets.

In the current environment, our unique value proposition to shareholders is expressed through a number of key elements -- strong investment performance, consistent performance fee earnings, significant capital generation and balance sheet strength, and our ability to deploy capital towards secular growth areas and return capital to our shareholders -- collectively positioning AMG to continue compounding earnings over time.

Turning to our third quarter results. Economic earnings per share were $4.21, and grew 5% year-over-year as the impact of our new investment activity and share repurchases more than offset the decline in markets, foreign exchange rates and net flows. Net client cash outflows for the quarter were $8.8 billion, and excluding certain quantitative strategies, were $6.5 billion.

Turning to performance across our business and excluding certain quantitative strategies. Within our Alternatives businesses, we reported another strong quarter with $3 billion in net inflows, primarily driven by private markets fundraising at Pantheon, Comvest, Abacus and EIG. Our Affiliates continue to generate outstanding investment performance, and their excellent long-term track records across credit, real estate, secondaries and infrastructure continue to drive fundraising momentum, and we expect our newest Affiliate partnership with Peppertree to be additive to our overall illiquid alternatives growth profile going forward. Within our liquid alternative strategies, performance remains outstanding, and we are confident that our diverse set of Affiliates and products in this area will benefit from increasing client demand as investors seek differentiated sources of return and diversification within their portfolios.

Turning to equities. Industry dynamics remain challenging. Within global equities, net outflows of $6.5 billion were an improvement compared to the second quarter, but above longer-term trend levels. Redemptions were concentrated in growth-oriented strategies, consistent with the broader industry. Despite these near-term challenges, we remain confident in the quality of our global equity managers and their ability to generate strong performance and flows across a full business cycle.

In U.S. equities, we saw net outflows of $1.3 billion in the quarter. Long-term performance in U.S. equities remains excellent, and our Affiliates, including Beutel, River Road, and Frontier, continue to enhance their positioning amid the strong relative performance of value equity strategies.

Finally, in multi-asset and fixed income strategies, we saw net outflows of $1.9 billion in the quarter, primarily driven by a single low-fee, cash management redemption.

Turning to financials. For the third quarter, Adjusted EBITDA of $220 million included $23 million of net performance fee earnings. Economic earnings per share of $4.21 grew 5% year-over-year in the quarter and in the year-to-date period, benefiting from new investment activity, excellent investment performance and share repurchases, which more than offset lower markets and a stronger dollar.

Now moving to fourth quarter guidance. We expect fourth quarter Adjusted EBITDA to be in the range of $330 million to $380 million, based on current AUM levels, reflecting our market blend, which was up 3% quarter-to-date as of Friday. This guidance is adjusted to reflect the removal of $10 million of Q4 EBITDA and approximately $30 billion of AUM following the close of the Baring transaction. The range does not include the impact of our latest new Affiliate investment, which will be reported on a one-quarter lag beginning in the second quarter of 2023, and is expected to add approximately 1- 2% to EBITDA on a full year basis.

Additionally, the guidance range includes strong net performance fee earnings of $150 million to $200 million, given the excellent performance in the large and diverse set of strategies that are expected to contribute in the quarter. As we highlighted on our last earnings call, performance fee earnings at AMG are a well-diversified and stable component of our earnings stream with asymmetric upside potential, which we are experiencing this year.

Many of these performance fee generative strategies serve as ballast to our long-only strategies with low, and in some cases, negative correlation to equity markets, ultimately making AMG's overall earnings power stronger and more resilient across market cycles.

Turning to specific modeling items. For the third quarter, our share of interest expense was $28 million, and we expect it to be $29 million in the fourth quarter.

Controlling interest depreciation was $2 million, and we expect a similar level for the fourth quarter.

Our share of reported amortization and impairments was $42 million for the third quarter. We expect it to be approximately $35 million in the fourth quarter.

Our effective GAAP and cash tax rates were 24% and 15%, respectively, for the third quarter, and we expect GAAP and cash tax rates to be at 25% and 20%, respectively, in the fourth quarter, reflecting higher income expectations.

Intangible-related deferred taxes were $13 million this quarter, and we expect $16 million in the fourth quarter.

Other economic items were negative $1 million in the quarter, which included the mark-to-market impact on GP and seed capital investments. In the fourth quarter, excluding any mark-to-market impact on GP and seed, we do not expect any contribution from other economic items.

Our adjusted weighted average share count for the third quarter was 39.5 million, and we expect our share count to be approximately 39 million for the fourth quarter.

Finally, turning to the balance sheet and capital allocation. Given the strength of our balance sheet and our significant free cash flow generation, we are well positioned to deploy capital in today's environment as we look to generate shareholder value. The closing of the Baring transaction enhances our capital position and financial flexibility, further enabling us to execute against our strategy. As a reminder, in connection with the Baring transaction, AMG received approximately $240 million of cash and 28.7 million shares of EQT, translating into gross proceeds of approximately $800 million based on Friday's closing price.

In line with our previous statements, we have allocated 40% of proceeds, or approximately $325 million, of which $150 million went to deal expenses and taxes, and $175 million to future debt reduction, partially through the purchase of matched duration treasuries against our bonds maturing in 2024. We expect the remaining 60% or approximately $475 million in EQT shares to be sold over the next few quarters in a disciplined and methodical manner. Nearly half of those proceeds will be allocated by year-end to fund our recent new Affiliate investment and the increase in our fourth quarter share repurchase guidance. And the remainder will fund the ongoing execution of our growth strategy and additional share repurchases in coming quarters.

In the third quarter, we repurchased $80 million of shares, bringing our total repurchases this year to $345 million. Given the proceeds from the Baring transaction and our expectations for strong performance fee earnings in the fourth quarter, we now intend to repurchase at least $500 million of shares for the full year 2022, which is nearly 10% of our shares outstanding at the beginning of the year.

As always, our expectations remain subject to market conditions and new investment activity. We remain focused on long-term growth, and we will continue to invest our capital in a disciplined manner, evaluating all investment decisions under a common framework.

The momentum in our business demonstrates the diversity and strength of our Affiliates and the stability that is inherent in our model. We have a strong balance sheet and generate significant free cash flow supported by robust and recurring management and performance fee earning streams.

The changing environment represents a significant opportunity for both our business and our Affiliates to deliver differentiated performance. In this new market environment, we are confident in our positioning and in our ability to deploy capital to continue generating earnings growth and shareholder value.

Now we're happy to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from the line of Bill Katz with Credit Suisse.

William Raymond Katz - *Crédit Suisse AG, Research Division - MD*

Just in terms of capital deployment, so I appreciate the extra guidance. But as you step back, Jay or Tom, just what's going on in the -- it's great to see a deal get done in this kind of environment for sure. What's going on in terms of the incremental opportunity set here? Is it getting broader or contracting a little bit? And what's going on with pricing at the same time?

Jay C. Horgen - *Affiliated Managers Group, Inc. - President and Chief Executive Officer*

Bill, thanks for your question. Let me start maybe with the deal that we announced this morning, and then we'll talk about the backdrop of the environment. And I'll take that, and Tom, if you have anything to add, you'll jump in. So Peppertree is in the private market space. This investment is squarely in line with our strategy, and arguably, it's investing in one of the fastest-growing areas within the infrastructure side of private markets, which is in the infrastructure for communications and the demand for data.

So we think the tailwinds as far as we can see, and we're very excited about the growth opportunities of Peppertree. This business has 2 decades of experience investing in the space. It's an expert in communications infrastructure, investing across towers, fiber and other areas. They've thoughtfully built their business over a long period. We believe they have a strong moat and ability to continue to thrive in their specified space here. They were attracted to our model, and this is going to play back to the overall market environment.

They were attracted to us, first and foremost, because they want to remain independent. This was a minority transaction for us. They're going to continue to run their business as owners. They also value the opportunity to engage with us as a strategic partner on their long-term execution of their strategy, and we look to magnify their efforts. It's very much a partnership that we see for us as our sweet spot. It's aligning with a high-quality team. They're passionate and entrepreneurial. They are independent minded. It's an area of secular growth, and it's an area where our engagement and value-added resources can be impactful over time.

So maybe then taking the second part of your question on the opportunity set in the environment. Let me start by just saying that unlike other periods where we've seen volatility and activity freezes, we're not seeing that. I said that last quarter and I don't know that I'm surprised, but our pipeline remains full, and there's plenty of opportunities out there. We do think that our specific differentiated offering is resonating with the highest quality firms. And to kind of put it bluntly, it's the combination of allowing for independence, but then also engaging strategically to help them achieve their goals.

As we continue to talk to prospects and potential new Affiliates, there is an increasing need for help in the environment. That could be strategic advice, but it also could be distribution help, seed capital, growth capital and other services on the distribution side like new products. So that really is resonating for us. We do think the environment has changed. Obviously, the overall environment has changed as I said in my prepared remarks, that has played into the M&A environment. The buyer universe has evolved. A number of traditional buyers have kind of started to look inward, and we don't see them as much.

And the other thing that's happened, I think, is that with pricing coming down overall in public markets, especially even within the private market space. And you can see that in the publicly traded private markets, pricing has just come down. And the other thing that's happened is, you're seeing better structures that share risk between buyer and seller.

So taken together, the sort of shifting environment is good news for us, in our opinion. We continue, as we all know, that is part of our strategy to partner with the highest quality independent firms. So we continue to be very focused on this, and we see good opportunities coming out of this environment. In fact, we're excited about all the capital that we have that we'll probably talk about on this call and our ability to invest that capital in areas of secular growth, which we expect to do and we expect to see opportunities come out of this environment. And so thanks, Bill, for your question.

Operator

Our next question comes from the line of Dan Fannon with Jefferies.

Daniel Thomas Fannon - *Jefferies LLC, Research Division - Senior Equity Research Analyst*

I wanted to follow up on just the outlook for performance fees. And then maybe just talk about the depth, as you guys have highlighted before, in terms of the contribution. But in that context, also would be curious about gross sales and kind of the environment for kind of future growth from these Affiliates. Obviously, performance fees is a good leading indicator for overall performance. So I would be curious if you're seeing any change in demand yet or if that's still on the come and specifically, within some of the quantitative strategies that have been more out of favor.

Jay C. Horgen - *Affiliated Managers Group, Inc. - President and Chief Executive Officer*

Yes. Well, good morning Dan, thanks for your question. I'm going to let Tom start and then maybe I'll circle back and talk about some of the business -- and the business prospects for our liquid alternatives in particular. So maybe you can start with performance fees first, Tom.

Thomas M. Wojcik - *Affiliated Managers Group, Inc. - Chief Financial Officer*

Sure. Thanks, Dan, for your question. Maybe I'll start by talking about performance fee earnings, and then I'll give you a bit of a view to your second question around what does that lead to in terms of expectations for future flows. Look, performance fee earnings are a really important part of our business. They provide diversification. They provide significant cash generation to execute on our growth strategy. And given the diversity of our Affiliates and investment strategies, they're a real differentiator for AMG in times of market dislocation in particular, and you're seeing that now.

Importantly, I think our performance fee earnings stream is very different from others in the industry. All of our performance fee earnings are reported on a realized basis. So that's real cash that's coming to us, and they're also spread across more than a dozen Affiliates and a multiple of that in terms of individual products. So this is a very diverse and durable earnings stream. If you look back over the course of the last decade or so, our net performance fee earnings have averaged $100 million a year annually.

And as we discussed in our prepared remarks, we expect 2022 is going to be an excellent year, driven primarily by absolute return products that have really shined in this environment. And I think that's leading to some of our expectations for future flows and growth that I'll talk about in a moment.

We also talk about sort of this combination of stability in the base performance fee earnings, but also asymmetry to the upside. And when you look at the pattern -- and there's a page in our investor materials that shows this, when you look at that pattern over time, you can really count on a base level of performance fees being there every year. And then from time to time, we really see this asymmetric upside, and you're seeing that this year.

Those performance fee earnings really spans 3 buckets: absolute return strategies like Systematica, Garda, Capula, AQR, where exceptionally strong performance this year is leading to our expectations for strong performance fees throughout the year and in the fourth quarter, in particular; private markets where we saw some realizations this quarter that translated into performance fees, and we also expect to continue to build that bank over time as we continue to make more investments like the Peppertree opportunity this quarter; and then beta-sensitive strategies where, obviously, this year is a bit of a challenge there. But over time, our beta-sensitive strategies have been very strong performance fee contributors.

So when you think about what that means in terms of our expectations for flows, really, we think this is one of the biggest changes that's happening in the market. And we talked a lot in each of our prepared remarks around portfolio construction and the changes we expect clients to make. And it's likely to impact us in 3 ways. First, we're seeing asset levels rise just driven by the fact that we have excellent performance. Second, our client conversations are accelerating. A number of clients who have moved away from this space over the course of the past decade as markets have moved up and to the right now have to reassess their portfolios and realize that they need this balance, they need these uncorrelated return streams.

And we're really starting to see conversations move a lot more quickly and think more about the role these products should play in our portfolio. And as those things happen, right, it creates more of an opportunity for us to have strong management fees, to have strong organic growth and ultimately, to create more performance fee earnings over time. So we really feel good about our positioning in liquid alternatives overall and really in our book overall when it comes to our long-term growth opportunities.

Jay C. Horgen - *Affiliated Managers Group, Inc. - President and Chief Executive Officer*

So let me take the second part of your question, Dan, and just talk about the outlook for maybe some of the businesses and the flow profile of those businesses really the pipeline. Putting this into the -- in context that overall, we're about 41% alternatives. Of that, something like 20%, 25% in the neighborhood is liquid alternatives. And as Tom said, good performance, the assets are up and in general, pipelines are growing for those firms.

So I would just highlight the names for everyone, Systematica, AQR, Capula, Garda, Winton, and maybe to talk a little bit more about 2 of them. I think I would highlight Systematica, and that's a business that we made an incremental investment in the very beginning of this year. And the performance, again, is kind of a microcosm of all of these firms. Systematica's SAM business, Systematic Alternative Markets is what it's called. It's up more than 50% since the beginning of 2021.

Blue Trend this year is up 36%. That is consistent with a number of products that they have as well as at AQR and some of the other Affiliates. So I'm just trying to give you a flavor using this one as an example.

I think the other thing that I would say is, on AQR, as people know, after some choppy times, their liquid alts business has really come back, and they're having similar performance in their products. They have kind of 2 businesses within AQR, liquid alts business and a long-only quant business. And even in the [long-only] (added by company after the call) quant business, we're seeing the flows begin to ameliorate in particular because of their value consciousness and that's another theme that we've pointed out that value-sensitive investing is coming back.

This year, value has outperformed growth by an enormous amount, and we think that will continue. So taking those 2 businesses together, when you look at pipelines and you look at forward prospects for new client flows, they are both building. And so we're constructive on flows into 2023 in these products.

Operator

Our next question comes from the line of Mike Brown with KBW.

Michael C. Brown - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

So I guess I wanted to just hear a little bit more about just investor sentiment across all of your asset classes here. Can you touch on the equities and fixed income side as well. How is investor sentiment lately? Are you starting to see any green shoots of activity coming through?

Jay C. Horgen - *Affiliated Managers Group, Inc. - President and Chief Executive Officer*

So yes, Tom, why don't you just broadly describe activity and flows?

Thomas M. Wojcik - *Affiliated Managers Group, Inc. - Chief Financial Officer*

Sure. Thanks, Mike. So I think importantly, putting this all in the context of our strategy, as we continue to execute, we're looking to continue to driving our business mix more and more towards secular growth areas. And as we continue to execute against that strategy, it really does give us an opportunity to capitalize on more of the client trends that are manifesting themselves in the business today and those that we expect to manifest themselves over the course of the coming years.

And again, I'll point to the Peppertree announcement as another example of how we're trying to position our business for the future. In terms of the traditional equity side, right now, kind of the combination of our business's performance and what we see in the market, I think there are some pluses and minuses. On the plus side, in U.S. equities, we're really well positioned. We have 2 tilts there, if you will, in terms of our Affiliates, one toward value strategies and then one towards ESG.

And on the value side, 90% of our U.S. fundamental value managers are outperforming benchmark in the 3-year period. And as Jay just mentioned in response to the last question, we think that's an area where you're going to see continued strong demand. And in terms of ESG, when we think about the long-term secular trends around energy transition and a number of core elements of the ESG value proposition, we're still incredibly bullish on the long-term trends in sustainability as well.

On the flip side, it continues to be a little bit challenging for global equities. Our flows improved there sequentially in the second quarter. But I think the sentiment in the market, particularly around growth strategies, is still a bit choppy. So we feel very good about the quality of our Affiliates and their long-term performance track records, but I think the market environment there still needs some time to heal. Then when you move over to the alternative side of the business, we really have 2 primary focus areas, private markets and then liquid alternatives.

And in private markets, our fundraising remains strong, our client conversations remain strong, and our performance remains strong. We do see some things changing in that area, though. I think there's been a lot of discussion about this in the industry, but it has been a bit of the last decade of sort of rising tide lifting all boats in private markets, and we absolutely see that changing. We see this next decade shifting much more towards a winner and loser type market, and that's an area where we think the underwriting in our new investment process and the way that we engage with our Affiliates really will allow the quality of those businesses at AMG to stand out over time.

Second, and Jay mentioned this a bit as well in some of his remarks, we think certain subsets of private markets are going to be better positioned than others and client demand trends are likely to move more in that direction. So think about solutions businesses like Pantheon that are really focused on helping clients to right-size allocations at a time when there's been such disruption and also areas like real assets and like infrastructure, where we see strong secular growth trends that can kind of work through cycles. And then lastly, we think capital formation becomes even more important.

Starting with product strategy and product development moving all the way through being able to create the right products and then ultimately, leverage distribution to get them into the market. And we think that's an area that AMG's strategic help as well as our sales help on the institutional side and the complete solution that we offer on the U.S. wealth side can really be differentiating.

And then lastly, I talked about this in the last question to Jay, but liquid alternatives, I think, is really the big area of change. And we continue to see those client conversations increasing in terms of what those products have done over the course of the last 12 to 18 months in portfolios. And I think the view that people are coming back to that space and saying, I need this to be part of my portfolio in the future.

Jay C. Horgen - *Affiliated Managers Group, Inc. - President and Chief Executive Officer*

Yes. One other thing I would add -- and that was a good summary, Tom. It might be challenging for you to kind of think about exactly where does AMG fit into this sort of broad spectrum of changes in the environment. And I would venture to say that we actually just look different, right? You have in the main public companies that run operating models in the long-only space, some people call those traditional managers. And then on the other side, you have some of the stake buyers who are in the private equity space and then operating models within private equity, but we're sort of different than all of that, right?

We have liquid alternatives, making up 20% to 25% of our business. We have a long-only business is about half, and then we have private markets as well. So I do think you're seeing that diversification in that -- almost that portfolio allocation play out really nicely in the environment that we're in, which is why we gave the guidance that we did that we think our earnings are going to be up 10% year-over-year on a '22 over '21 basis off the back of 37% last year.

Operator

Our next question comes from the line of Craig Siegenthaler with Bank of America.

Craig William Siegenthaler - *BofA Securities, Research Division - MD and Head of the North American Asset Managers, Brokers & Exchanges Team*

So my question is on debt and higher interest rates. So of your $2.5 billion of debt and convertibles, what is the composition of fixed versus floating? Do you guys use swaps and derivatives to hedge any of that rate exposure? And how has higher rates changed the calculus for new investments?

Jay C. Horgen - *Affiliated Managers Group, Inc. - President and Chief Executive Officer*

Yes. So I'm going to have Tom take that question, but let's also put in the liquidity as well on our balance sheet because that's probably the most important, and duration. So those would be the other things I would throw into the question. I know that you're asking here, Craig. So maybe, Tom, if you'll pick it up.

Thomas M. Wojcik - *Affiliated Managers Group, Inc. - Chief Financial Officer*

Sure. Thanks, Craig. So I think our balance sheet overall, first of all, we feel like is in excellent shape, not only from the perspective of where we are on duration and where we are on leverage, we continue to run with exceptionally long duration on our balance sheet. Our leverage levels are below 2x. But also in terms of the ongoing ecosystem, if you will, around cash flow, liquidity and leverage. And I'll kind of mention a couple of elements. One, we generate significant cash flow every year. We've talked about a number of different elements of our business model in the past around the diversification of the top line.

The fact that we do not really have exposure to margin either at the Affiliate level or very much at the AMG level and a number of other elements that really just contribute to the strength of cash flows that are replenishing liquidity year after year after year and allowing us to put capital to work to execute against our growth strategy.

Secondly, we've got the added boost of the Baring transaction and the significant proceeds that are coming to us as a result of that. And we've talked about sort of the uses of those and where we expect to put them to work and part of that is thinking about the balance sheet. When we think about the balance sheet, it really, to Jay's point, is a combination of liquidity and also capacity over time. And if you think about the value of liquidity, right, liquidity becomes more and more valuable, the more challenging the market environment gets.

So we always want to be in a position where we feel like we can squarely be on offense when opportunities present themselves, and that's exactly where we feel like we are today. We have a consistent cash flow stream. We're sitting on significant liquidity. And in addition to what we have on balance sheet, we also have the ability to draw a $1.25 billion revolver. So we have plenty of capacity to execute against potential opportunities.

In terms of the nature of our balance sheet, the vast majority is fixed rate, the vast majority is long duration. We have a small floating rate term loan. And I think in terms of the calculus, I'm not sure that it's necessarily rates that have changed our view. It's really just an ongoing focus on optimizing our balance sheet and optimizing liquidity in the context of the current and our view of the forward economic environment. So you heard me mention in my prepared remarks, we did earmark some of the capital from the Baring transaction to pay down some debt.

We actually bought some treasuries to offset against our 2024 bond maturities. So we feel like we're in great shape on the balance sheet, but we continue to optimize as the market environment changes.

Jay C. Horgen - *Affiliated Managers Group, Inc. - President and Chief Executive Officer*

The other thing that's happened to us in this quarter that we're in, the fourth quarter, is we obviously got the EQT proceeds, and Tom elaborated in his prepared remarks on the uses of that. But that liquidity that's sitting on our balance sheet gives us plenty of flexibility going into an uncertain '23, which we hope to use for new investments because we see lots of opportunity, but can also go to repurchases or further debt pay down, if needed.

Operator

Our next question comes from the line of Brian Bedell with Deutsche Bank.

Brian Bertram Bedell - *Deutsche Bank AG, Research Division - Director in Equity Research*

Great. If I could just circle so back on the private market side and a little bit more detail there. So maybe if we can talk about it in 2 angles, both from the fundraising side of illiquid private markets and what you see as sort of the outlook coming into 2023 in terms of fundraising cycles. And then on the other side of monetizations, and first of all, I guess, what was the contribution in the fourth quarter from that side versus, say, the absolute return strategies? And then as you think about that going forward is just looking at, say, Slide 7, do you see the private market side of that performance fee contribution increasing over time or just -- or rather it's coming from the absolute side like you initially set?

Jay C. Horgen - *Affiliated Managers Group, Inc. - President and Chief Executive Officer*

Yes. So Tom, do you want to start with the outlook for illiquids?

Thomas M. Wojcik - *Affiliated Managers Group, Inc. - Chief Financial Officer*

Yes. Brian, thanks for the questions. So I think with respect to the overall fundraising sort of opportunity, I would take the word cycle out of your question. I think as we've talked about a fair amount in the past, we have a very diverse group of private markets Affiliates, and within those businesses, each of them are diversified businesses into themselves. So we generally always have a range of products out in the market at any given time in different channels, in different wrappers. So we don't really have a fundraising cycle type business overall. So we continue to see strong fundraising across our businesses.

And I think when we look to the future, there's nothing that changes our expectation that we're likely to continue to see strong fundraising given the quality of those businesses, given the areas that they are in across infrastructure, real assets, credit, private market solutions, we feel like we're very well positioned against the key themes that clients are focused on. And frankly, we don't have a lot of exposure to some of the themes that perhaps are facing more headwinds in terms of potential fundraising, given how much capital has been raised in some of those areas in the last couple of years like more traditional corporate buyout-style private equity.

In terms of the performance fee side, I mentioned that some of the realizations this quarter did lead to some small performance fees. I would say, in terms of our guidance for the fourth quarter, the majority of that is not linked to private markets. And as we've talked about private markets performance fees, we do expect that bar to continue to grow over time, but I would think about it as more of an intermediate to long-term opportunity for us as the investments that we've made in these businesses continue to season.

We continue to build that carry bank, and we look out 2, 3, 4 years. We think that's going to be a big opportunity for us: one, to just continue to generate more cash flow; but also, two, to further increase the diversification of what is already a very diverse performance fee-generative asset set.

Jay C. Horgen - *Affiliated Managers Group, Inc. - President and Chief Executive Officer*

Yes. I'll just make one last comment. Obviously, putting it into context at only about 15% to 20% of our business is in the private markets, I know your question is probably more of a broader industry one. And I know that you have a lot of people in your coverage universe that are there. But I do think there's a denominator issue that's going on in portfolios today. And I come back to my prepared remarks, which is portfolio construction is going to take center stage at the end of this year when people go to their committees and into next year, and they're going to have to think about the liquidity in their portfolios and where they're allocated.

As Tom said, though, I think we see more of the specialty areas of private markets, real assets, infrastructure, some of the specialty credit areas as being the areas that will have follow through fundraising next year, but there will be slowdowns in other areas. And I do think that portfolio construction is going to need to take center stage as clients deal with the emerging risks of the new environment, including keeping their portfolios more liquid and the ability to generate absolute return out of their portfolios.

Operator

Our next question comes from the line of Patrick Davitt with Autonomous Research.

Patrick Davitt - *Bernstein Autonomous LLP - Partner, United States Asset Managers*

On that last point, I think you guys usually talk about 4Q seasonal redemptions on the institutional side. But as you've highlighted on this call, it's a strange year. Everyone's allocation targets are off. So any early signs that maybe this year could be a little different than a normal year-end? Kind of -- what kind of institutional behavior are you seeing now that we're halfway through the quarter?

Jay C. Horgen - *Affiliated Managers Group, Inc. - President and Chief Executive Officer*

Yes. Thanks, Patrick. I think, Tom and I will tag team this one. You're right. This is a very unusual year. Actually, it's a very unusual year followed by a previously very unusual 2021. So look, I'm not sure that anyone really knows the answer to your question. I will say again that we are seeing pipelines build on the liquid alternative side. I think people are reacting to the need to have some uncorrelated return in their portfolios. That may play out in the fourth quarter for us. It may take until 2023.

I think on the illiquid side, obviously, there's some carryover fundraises that people are going to final close, and that kind of is bolstering the whole industry, including us on the illiquid side. And then I think the last thing that I would say is, people have to be more value sensitive in their portfolios. They have to be quality sensitive in their portfolios after kind of 10 years of momentum and growth. And whether we like to admit it or not, I think we were all somewhat complicit in the run up to just buying growth in a passive way.

And so more active management has to come into these portfolios. So will that play out in the fourth quarter? It might. Do I think it's going to play out in '23 and '24? Yes. I don't know, Tom, if you have anything to add to that.

Thomas M. Wojcik - *Affiliated Managers Group, Inc. - Chief Financial Officer*

Maybe just to your specific question on seasonality, I think some of the core trends are likely still to be there, and I think this is implied in your question on Jay's answer. They may just get trumped by other things that are happening in the market. So perhaps will not be quite as visible. And obviously, one of those trends is around retail tax loss harvesting. And we're in a very different environment than we've been in the last several years. So I think some of these things will likely still occur, but the magnitude, it's pretty early to try and understand. And there are just bigger factors at play, I think, this year.

Operator

Ladies and gentlemen, that concludes our question-and-answer session. I'll turn the floor back to Mr. Horgen for any final comments.

Jay C. Horgen - *Affiliated Managers Group, Inc. - President and Chief Executive Officer*

Thank you all again for joining us this morning. As you heard, we are pleased with AMG's third quarter results, and given our strong business momentum, we're confident in our ability to generate earnings growth both in 2022 as well as compounded growth over the long term. We look forward to speaking with you next quarter.

Operator

Thank you. This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.
