THE BLACKSTONE GROUP

BX Q3 2013 Earnings Conference Call

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OPERATOR: Ladies and gentlemen, thank you for standing by, and welcome to the Blackstone Group third quarter 2013 investor call for the media. At this time, all participants are in a listen-only mode. Later we will conduct a question and answer session. In order to ask a question on today's call, please press star, then one. If you should require offline assistance, please press star then zero. As a reminder this conference is being recorded. I'd now like to turn the conference over to our host, Mr. Peter Rose, Senior Managing Director. Please go ahead, sir.

MR. PETER ROSE: Good morning, everyone, and welcome to our third quarter 2013 earnings call for the media. With me is Tony James, Blackstone's president, Joan Solotar, Senior Managing Director for External Relations and Strategy, and Laurence Tosi, our chief financial officer. As usual, Tony will give a brief recap of the highlights of the quarter, and then he would be happy to take your questions. Before handing over to Tony, a reminder that at 11:00 this morning Eastern Standard Time, there will be a call with investors, and you're all welcome to listen into that. The dial-in numbers for that call can be found in the press release on our website. Tony.

MR. TONY JAMES: Thanks, Pete. And thank you all for tuning in. Overall, the firm's performance for this year as a whole, whether measured by earnings, distributions, investment performance, or growth in AUM, continues at very strong levels. The revenues and ENI for the quarter were about flat with last year's strong third quarter. Distributable earnings jumped 53%, 26 cents per unit. This leaves year-to-date revenues and ENI up 38% 49% respectively. And distributable earnings have surged 83% year-to-date.

In general, the recent quarter showed a pattern of rising fee revenues driven by 21% growth in AUM, offset by lower performance fees due to more modest market appreciation around the world this quarter than last year's third quarter. As we have discussed before, the maturity of our portfolios is driving an upswing of realization activity. The last 12 months, we have realized some $26 billion, more than triple the prior year period. AUM ended the quarter at a record $248 billion, up from 205 a year ago, despite the heavy disposition activity. All totaled, we raised 41 billion of new money, and acquired another 12 billion for strategic partners and capital trust, as LP continued to contribute their allocations to alternatives.

In private equity, revenues and ENI each declined by just over 50% due to the drop in performance fees for the quarter. Year-to-date performance fees, however, are still up 74%. The carrying values of the overall portfolio showed solid appreciation of 4.2% for the quarter, bringing the year-to-date number to 17.4% for just the nine months. The picture at the portfolio company level is consistent with last quarter. Slow but steady progress, with some indications of accelerating growth in 2014. And so a lot of you might ask most of our CEOs think the recent showdown in Washington will not have much impact on their businesses. The flow-through of the portfolio appreciation to accrued performance fees this quarter however was negatively impacted by the fact that stock prices of publicly traded portfolio companies that are in carry dropped, while investments in BCP 5 that are not yet carry appreciated. And that of course affected the performance fees.

During the quarter we invested about 550 million in new deals, bringing the year-to-date total of invested or committed capital to 2.1 billion. Meanwhile, disposition proceeds continued to be strong, totaling 2.5 billion for the quarter, at 6.1 billion for the year so far. AUM and private equity jumped 25% to 52.6 billion, driven by the acquisition of Strategic Partners in August, and strong fundraising for our tactical opportunities efforts. Strategic Partners is our secondaries business as we announced last quarter.

Moving to real estate, revenues grew 42% for the quarter, predominantly driven by a 63% increase in performance fees, to another solid quarter of investment returns. The real estate portfolio appreciated 5.8% during the quarter, bringing the year-to-date total to 17.9%, very similar to the number for private equity. Real estate also had a busy quarter for dispositions, with realizations of some 1.6 billion in the quarter. Dispositions for the year in real estate are now up to 4.6 billion.

Meanwhile, our new investment activity in real estate continues to build, exceeding dispositions by a wide margin, and belying speculation that we are somehow calling a market top in real estate. During the quarter, we closed on 2.4 billion new investments, bringing the year-to-date so for to a whopping 8.4 billion of equity deployed or committed in just nine months. This is almost twice the level of dispositions. The year has also been very successful in terms of fundraising for real estate. We had closings on various real estate debt funds, which are now up to 10 billion in AUM, along with real estate equity funds focusing on Asia, and focusing on Europe. Overall, AUM has jumped 29% from a year ago to 69 billion in real estate.

Choppy markets like we've had recently are where our hedge funds solutions business really shines. We continue to deliver healthy returns to investors with less than a third of the volatility of the stock market this quarter in hedge fund solutions. Our composite growth performance was a positive 2% for the quarter, and it's 8.3% year-to-date. Revenues in this segment are up 10% in the quarter, driven by growth in fee revenues and higher AUM, which increased from 46 billion to 53 billion over the last year, a growth rate of 15 percent. We are now more than twice the size of our nearest competitor in this business.

Net inflows for the quarter were 2.2 billion, of which a billion came from our new daily liquidity hedge fund product through Fidelity. In our credit business, revenue dropped 22%, but ENI was about flat. Again, this followed the pattern of lower performance fees through the quarters back up in credit markets partially offset by management fees revenues that are higher due to continued successful fundraising.

The investment performance across our credit business continues to be very strong. Our hedge fund mezzanine and rescue lending strategies delivered gross returns of between

1.5% and 5.6% this quarter. This means returns are up between 14.4% and 20.4% for the year so far. This is pretty spectacular performance in a zero interest rate world. Basically, 15 to 20%, depending on the fund, in just nine months. Our mezzanine and rescue financing drawn down funds, investor-committed, about 500 million for the quarter, and it invested about 1.4 billion so far this year. The excellent investment performance drove continued AUM growth, with AUM rising 16% to 63 billion.

Finally, revenues in our advisory segment jumped 40% for the quarter, with strong performances by all three of our primary advisory businesses, despite ongoing market softness. Some other things I'm proud of is that we were picked as the number one place to work in Vault magazine's annual survey of financial services firms, the highest ranking we have ever achieved. In addition, my partner Steve Schwarzman unveiled the founding of the Schwarzman Scholars Program at Tshinghua University with a $100 million personal gift. This is a remarkable effort, establishing a program equivalent to the Rhodes scholarship for China. The quality and professionalism of every detail in this program is incredible, and I couldn't be prouder of Steve.

Closer to home, Blackstone and our portfolio companies embraced the White House's Joining Forces campaign, and committed to hire 50,000 veterans over the next five years. This is one the largest commitments by any company in the United States. Finally, the Blackstone Foundation announced programs to foster entrepreneurialism in two new states, bringing a total of 17 states where our foundation is active on the ground. Our foundation also organized something called Blackstone Connects, whereby almost all of our employees have now donated over 11,000 hours in community service projects around the world.

Happily, the US government is reopening, and we have avoided a default on US Treasuries. The economy is improving, and employment is rising. While we certainly have our challenges, America remains a bright spot in the global economy. It is easy at times like this to focus on our problems, but sometimes we should also count our blessings. With that, I'd be happy to answer to answer any questions.

MR. ROSE: Thank you, Tony. Operator, we'd be happy to take questions now.

OPERATOR: Okay. And ladies and gentlemen, if you wish to ask a question, please press star, then one. You'll hear a tone indicating you've been placed in queue. You may remove yourself from queue at any time by pressing the pound key. And once again, if you're on a speaker phone, please pick up the handset before pressing the numbers. So for questions, it's star one at this time. And first we'll go the line to Dan Primack with Fortune magazine.

MR. DAN PRIMACK: Hey good morning, Tony. Hey Tony, you mentioned in your comments that I think your most of your CEOs, portfolio company CEOs, don't think that recent showdown in Washington is going to have much impact on their business. Is that specific to what we saw end last night? And I'm kind of curious of their thoughts going forward since it seems like we might be heading towards something similar again in Q1.

In other words, I'm curious if what might be coming is going to impact what they plan to do for the next couple of months.

MR. JAMES: Yeah, we asked them for the most part to focus sort of the recent crisis, shall we say. And that was what their comments were targeted on. However, there's a lot of talk about we just really kicked the can down the road for three months, and are we going to be back in this? I think their prevailing view is they always thought that Washington would muddle through, and they think they'll muddle through again. And there's some optimism that perhaps having been to the brink, and one could question that the political games by the people that took us the brink, that maybe people won't play the brinksmanship again. And so some of them think that it'll be better next time. They don't know; they're not political analysts.

The other thing though is there's another down leg coming, or another hit from the sequester. And again, they think that that will be managed, and that some of the shrink that's coming primarily from what the anticipated upswing in construction activity will more than offset the added fiscal drag. So when said they expect some acceleration to '14, I think they're seeing economic forces picking up, and that pickup is greater than any added drag from Washington.

MR. PRIMACK: Just as a quick, then more follow up to that, from your perspective, for your business, and I said that broadly for all the pieces of your business, does the uncertainly in that kicking the can down the road, does that have any tangible impact on Blackstone's strategy for the next few months?

MR. JAMES: I don't think it does. I'll ask either my CFO or Joan to jump in here. I don't think it does. We spent an awful of time trying to figure what the effect on us would be, if there was some sort of, if we hit the debt ceiling and had some crisis. And I think we felt we were pretty well-positioned all the way around. One could argue actually that if we had a fairly severe short-term crisis that that would provide some investment opportunities that we could take advantage of, and we were poised for that. Not that we were rooting for it. I don't want anyone to get the wrong impression; it's just absolutely to the contrary. But nonetheless we were poised to take advantage of that because we have a lot of confidence that in the long term, the economic and political and creative strength of the United States would prevail.

MR. PRIMACK: I appreciate it. Thanks, Tony.

OPERATOR: Next we'll go to the line of Ryan Dezember with Wall Street Journal.

MR. RYAN DEZEMBER: Good morning, Mr. James. Thanks for the time. I wanted to ask you about the, you guys have a lot of IPOs registered with the SEC and some other kind of divestitures kind of going on, La Quinta, Broadgate. Can you provide a little bit of color on when kind of we might see some of these deals start to happen, and some of the proceeds coming back to shareholders?

MR. JAMES: Well, you're right, Ryan. I think we have six IPOs on file, and at least one or two of our other companies have been speculated in the press as being for sale. And so we have a lot of activity in the pipeline. However, I really can't comment on public filings as you know because of the "quiet period" for the SEC. But they're at different, let me just say in general, they're at different stages. But once you file, you kind of start a clock ticking. So several of them are in marketing, and some of them are waiting for SEC approvals.

Obviously the government shutdown for two weeks delayed everything for a while. But that stuff is kind of working through the pipeline, and now had we had a Treasury crisis, I think that equity markets would've been in severe retreat, would've put everything on hold. Obviously yesterday's market action says the market's happy, and so presumably things will keep moving forward in a normal pace.

MR. DEZEMBER: Okay, thanks.

OPERATOR: Next we'll go the line of Devin Banerjee with Bloomberg News.

MR. DEVIN BANERJEE: Hi, Tony. Thanks for your time this morning, as always. Wanted to pick on something in the release, which is Tac Ops. It looks like it raised 700 million in the quarter. I know that's ordinarily a separate account strategy. I'm wondering if there's anything you can give us on where that money came from. Is it an LP you've had a relationship with? Is it a new LP? And anything you can provide there.

MR. JAMES: Sure, okay. Well so Tac Ops is partly a separate account strategy, but it also has a pooled fund. And so that money came from both some large separate accounts, and sometimes even then by the way, an investor will make an initial comment to a separate account and then top up. So we often give investors, depending on their own availability of funding, so they might sign up now for say 250 million with the understanding there being another 250 million later, that sort of thing. So it's some large accounts, but it's also some smaller accounts coming into our pool of vehicles. Overall now Tac Ops looks like it's up something, over $4 billion, and it looks like it'll end up at 4.5, when things are all said and done. And I should say we could raise a lot more, but that's all we're going to take.

MR. BANERJEE: And why is that? I mean if there's appetite for more, why not?

MR. JAMES: Well our first responsibility is investing it well and investing it promptly. Frankly investors don't want to sit there and have the money committed, but not investable in time. And the investment period on Tac Ops is only three years. So this is money we need to work promptly. And this fund raise, it's a brand new concept and brand new fund. And it exceeded our expectations. And we're happy with 4.5, and that's where we're going to stop it.

MR. BANERJEE: Okay, got it. Thanks, Tony.

OPERATOR: Next we'll go the line of Greg Roumeliotis with Reuters.

MR. GREG ROUMELIOTIS: Good morning, Tony and congratulations on a strong quarter, particularly in real estate where you appeared to have achieved the equilibrium that many alternative asset managers strive for in realized performance fees, but also unrealized fees. And I was [inaudible] you can achieve such equilibrium in your other businesses, particularly in private equity?

MR. JAMES: Sorry Greg, but something happened with the phone. You clicked out there. Could you ask that question again?

MR. ROUMELIOTIS: Sure. So in real estate this quarter, but this has developed a little bit as a trend, you have rising realized performance fees, but also you have rising mark, realized. And I was wondering whether you think that is something you can achieve in your other business including private equity.

MR. JAMES: Okay. So I think the simple answer is yes. I think we can have both rising marks, [inaudible], rising unrealized performance fees alongside rising realizations. LT?

MR. LAURENCE TOSI: Yeah Greg, if I could add to that, I actually think, I wouldn't say that we aspire to get that equilibrium in the other businesses. I think it's already there. So if you look back at year-to-date for 2012, we like to see a nice balance of the cash-earning components of our earnings, which were very strong year-to-date with respect to realizations and growing. Right now the cash flow in components of our earnings are about 62%. Last year it was 57%. In prior years it was the forties. But that 62%, even though realizations are up very sharply, we are still in fact creating future value in the accruals in all the businesses that can be harvested in the future. So it's really the business model. You do want to see healthy cash earnings, and you do want to see mark to market above that that you can realize in future periods.

MR. ROUMELIOTIS: Okay--

MR. TOSI: [Interposing] But I don't think we're, not emptying the cupboard.

MR. ROUMELIOTIS: No, and I guess it depends over which time period you judge it. In BCP 5, do you see getting over the carry threshold too?

MR. TOSI: Well let me give you a couple of stats that might be helpful, Greg, on BCP 5. So BCP 5 was up 27% over the last 12 months. And that had the effect of cutting the gap, if you will, to earning performance fees in half, down to 3.1 billion. As of the close of the third quarter, we would need a 7% increase in total enterprise value to reach carry. So it's certainly closer. As to when, that's market dependent.

MR. ROUMELIOTIS: Okay. And lastly, I wanted to ask about dry powder in private equity. You spend a little over $2 billion out of BCP 6. But you've got quite a bit to spend, I believe, something like $10.6 billion into the investment period on BCP 6 expires in January 2016. Of course you can extend that agreement with your LPs, but at the moment this means that over the next years, you would need to spend [inaudible] wondering whether you have any thoughts on that in general, given where valuations are at the moment out there, whether you think the private equity industry overall may have a dry powder problem a little bit, how to spend the money.

MR. JAMES: Okay, so one of the things we try to do is get the vintage year right. I mean there are some years where it's just compelling that you want to be a buyer. Other years you want to kind of back off a little bit. And we've done some interesting work to sort of like, sort of maybe a little bit academic. But regression analyses, trying to figure out when we look at certain environmental statistics. Is this a good year or is this a bad year? And our model on this would say that this would be sort of an average vintage year. Maybe a slightly below average vintage year. In any event, so that's kind of a sideline. I guess it's irrelevant to your question.

But bottom line is yeah, prices are full, in some parts of the world, in some parts of the sector. And not all by any means. But prices are full if you look at a regular way, US, LBO, of a solid, predictable company. That sort of thing is full. And in addition, almost equally difficult is deal flow is relatively low, as you look at the number of M&A deals is down a lot. It's one of the lowest levels of many years. So of the kind of sort of size that private equity focuses on in the US. So those two things provide challenges, but we have a lot of time left. We're not in any way feeling pressure to put money out.

And what we are doing, the investments we are making, we feel really good about. We actually think that they'll return, returns that are above our historical targets. And if you look at BCP 6 returns so far, and energy returns so far, which are our two open funds, two funds we're still investing, they're the two funds that are off to the strongest start of any funds in our history in terms of immediate performance of the investment. So we feel really good what we are finding to do, and very relaxed about not pushing volume into a market, which at least in the core US buyout market, is pricing. And then you asked about the industry. I think the industry is sort of in balance. Yeah, there are some, for all the reasons I mentioned, everyone's deal flow is light, I would say. On the other hand, the amount of uninvested capital is down a lot also. So I think the industry's in reasonable balance right now.

OPERATOR: And next we'll go to the line of Kayla Tausche with CNBC.

MS. KAYLA TAUSCHE: Hey, guys. Good morning, and thanks for doing this call. The first question I have is about the hedge fund solutions business. It says 97% of incentive fee earning AUM had passed the hurdle mark. That's a fairly high number. I was wondering if you could comment at all about what strategies you saw working in terms of getting to that mark.

MR. JAMES: Well Kayla it's pretty much across the board. I mean you don’t get to a number. We have a lot of different strategies in our hedge fund solution business, some 25 to 30 different strategies, plus a whole lot of separate accounts. You don’t get to anything like 97% unless everything's working. And so let's face it. We had some pretty good markets here for the last few years, and our investment performances have been really good, much better, much better than the hedge fund industry as a whole. And so we're in great shape in terms of being above the marks, with all of our strategies. So I can't say there's any one thing that's particularly working.

MS. TAUSCHE: Any set of things that's particularly working?

MR. JAMES: Well I would say that, let me answer the question a different way. I think in this market, with a little choppiness, it's opening up some more opportunities for traditional hedge fund managers because the correlations are down, and there's more ability to sort of outperform market averages. And so the sort of fundamental, the fundamental guys that are doing long/short equities and stuff like that, have more scope for creating alpha, as they say in the business, right now than we've seen for a few years. And we think that's good for hedge funds in general and good for obviously our business, hedge fund solutions. Where things have been a little tougher have been on the macro side, and some of the what we call with the CTA, the commodity trading accounts. Those have been a little tougher for a lot of reasons, but mostly particularly, particularly in the commodities area. Of course commodity prices have been a bit soft. So I don’t know if that gives you the picture you were looking for.

MS. TAUSCHE: Yeah, that's helpful. The second question pertains to the closed-end mutual fund space. I know that there have been a lot of your competitors that have been getting into this recently. I was just wondering if you could comment a little bit of investor take up and what sort of sentiment you've been hearing from some of the more retail-focused investors who have been catered to by some of these funds.

MR. JAMES: Yeah, sure. Well it's not so much closed-end mutual funds, but there a lot of permanent capital vehicles and things like BDCs or ETFs or RICs or so on that we're doing. So I'll just assume that you're kind of referring to all of those retail products--

MS. TAUSCHE: [Interposing] Right.

MR. JAMES: --in which our products are embedded. Retail appetite is strong. And nothing like frankly, very low rates. It's very hard for an investor to come and say how am I going to earn any money on my money right now? So when they want to put money back in the market, where do they go? The stock market's already had a pretty good run. A number of investors are saying geez, I wish I had bought two years ago, but I didn't. Now is it too late? They're not putting money in bonds 'cause yields are low. They're earning nothing on their savings accounts, so when they want to come in, they want to earn some money, and I don't blame them. And they're feeling better about the world and the markets. And particularly I think now that this government overhang is gone, it'll continue to have a lot flows coming in. So we're seeing a lot retail appetite for those kinds of products, for those kinds of vehicles, in which our products are embedded.

MS. TAUSCHE: Okay, and then just last question quickly. I was wondering at this point in time how much money is committed to Invitation Homes and what your outlook is, given the fact that there were a couple of companies that tried to test the rental REIT IPO market in the summer, and you could say it didn't go very well.

MR. JAMES: Okay. Well we have 5.5 billion committed to homes. And near on 40,000 homes. And we're not at all fazed by the sort of smaller, weaker players that tried to get public earlier. There's no one close to us in terms of the quality of the operation, the scale of the operation, the diversity of the operation, the track record or anything else. So we feel very comfortable that we'll have not only the REIT exit option, but we'll have strategic exit options.

MS. TAUSCHE: Okay, great. Thanks so much.

OPERATOR: And next we'll go to the line of Shasha Dai with Dow Jones.

MS. SHASHA DIDE: Hi, good morning everybody. Tony, first I had a follow-up question on the dry powder in private equity. I'm looking at slide 11 of the press release. It seems like of the total 41 billion, dry powder private equity accounts for the largest share, which is 18 billion. However in about 20 billion of assets that are not yet earning base management fees, private equity only accounts for 3.5 billion. So it seems like more than 14 billion of private equity have already started earning management fees, but are still sitting on it. Now am I right in assuming that most of that 14 billion plus comes from BCP 6, for which investment period had already kicked in?

MR. JAMES: Yeah, most of the money that's un-invested but earning management fees is definitely BCP. Don’t forget though you have in private equity now, you have Strategic Partners, which is a new acquisition, and you have Tac Ops, which is a new business. And they're scaling quickly. So they're kind of moving the dial a little bit in terms of the business mix. But you're absolutely right. Most of it's BCP 6.

MS. DAI: Okay. Now what is your outlook for deal pace, for private equity over the next 12 months? And which pockets, if you would, or geographic markets, are you seeing the most interesting opportunities?

MR. JAMES: Are we talking just private equities?

MS. DAI: Yeah, just private equity. Mm-hmm.

MR. JAMES: Well as I mentioned before, right now I'd say deal flow is light. And it's light because there just aren't a lot of the big traditional chunky buyouts getting done. Prices are high, and just the M&A volume, the sale of petrol is soft. We like certain things. We like, so what we're deploying money behind is finding great management teams in smaller teams where we can consolidate industries and do some things like that. And number one, number two, is-- are still some industries that have not recovered from the financial crisis, where they have lots of growth opportunities, but are still capital constrained. So for example, sub-prime finance in various of its incarnations is one of those areas.

Thirdly, there's a lot of interesting stuff going in energy. I mean the energy picture in the world is changing a lot. We have a great amount of very specialized expertise that other firms don't have on the ground, real energy expertise. For example, we have a team, all they do is buy royalties. And that's been very active for us, and it's away from change of control markets, so to speak. We're starting to see some interesting things in Europe. Of course we think they’re interesting because we feel Europe's bottomed out.

If we're wrong about that, then they won't have been interesting in retrospect. But to us they look interesting. And then in India, for all its problems, it suddenly looks like we might be somewhere near a bottom. And we've recently done some interesting things in Brazil. Again, a bit like the currency has come down a lot. And they're certainly had some issues lately. But if you believe that in the long-term future of Brazil, this might be an interesting buying opportunity.

MS. DAI: And didn't you recently announce this going-private transaction in China, Pactera? Is that the way you pronounce it?

MR. JAMES: Yes Sasha, you're very well-informed. We announced that about an hour ago, so. Yes, we did. And we're excited by that. And we think it'll be a very good deal.

MS. DAI: And what's your general sense about China, opportunities there? Slowing growth on the top line, but at the company level you're still seeing interesting opportunities?

MR. JAMES: Well China, for the private equity industry, China has been a very difficult market for the last five years, for the entire private equity industry. The number of transactions and the gains in those transactions, I'd have to admit it's been disappointing. So China is a challenging market. And if you step back and get away from the all the details, you have to remember that what private equity is is it's a high, we require high returns. That is to say our money is highly costly. And so it's hard to bring costly equity to a very capital-rich economy where they already have a lot of money. So that fundamental issue makes it a challenge in China.

MS. DAI: And is it starting to change now with this new deal? Or do you --?

MR. JAMES: I don't think you can conclude that this new deal means there's a shift in the market, honestly. This was one of the themes that we kind of got on which was that there are a whole lot of Chinese companies that are publicly traded in foreign markets, in this case in the United States. And a number of companies had accounting problems, and a number of them had operational problems. So that as a sector, those stocks got devastated, and were very illiquid. And we felt like in that rubble, we might find a diamond or two. And that were good companies and where the market wasn't appreciating their potential. And so we've been working on, that's one of the themes we've been working on for a while. And this is a result of that. It's almost less a China play, if you will, you could argue than a US market play.

MS. DAI: Got it. That's really helpful. Now if I may ask another question, Joe Baratta spoke at our conference in September. During his speech, he mentioned this epic credit bubble which caused a lot of buzz in the media. So he did follow up to clarify that what he was referring to at the conference was, indeed, sub-investment grade corporate credit, not the entire US system. However when you come to think about it, though, when you talk about sub-investment grade credit, corporate credit, it sounds like a GSO is part of the problem, isn't it?

MR. TONY JAMES: Well Sasha, I'm shocked you'd say that, the GSO is not part of any problem.

MS. DAI: [Laughing] Well it's a part of the--

[Crosstalk]

MS. DAI: --being raised for sub-investment grade credit.

MR. JAMES: Let's take a step back. Let's take a step back. For 30 years, we've basically had a down trend in Treasury rates to near zero. I don't think there's anyone in the world who thinks that it's going to be like this forever. I mean eventually there's going to be tapering and eventually are going to go back up.

I think what Joe was saying is interest rates, taken as a whole, are at some kind of [inaudible] point right now sort of the low point. Of course with the bond, the lower interest rate is, the higher the price is.

One could argue that bond prices in general right now are full in a historical context. Now that does ripple through to buy-out financing 'cause when bond prices are high, usually credit markets are ebullient. People have made money and people are putting more money into it 'cause most people chase historical returns. Therefore there's a lot of credit available for deals.

Ironically in the sub-investment grade financing for either corporate or real estate, there's not quite the same credit bubble as there is in investment grade Treasuries because while base rates, i.e. Treasury rates, are low, the spreads over those rates paid by sub-investment grade borrowers are not very low. When base rates go back up the spread would be expected to narrow and that would cushion for sub-investment grade, some of the effectively anticipated rise in Treasury rates when the Fed tapers.

It kind of depends on how you would look at it and in a historical context I think we'll look back at this as being sort of one of the lowest interest rates many of us have seen in our careers. It doesn’t necessarily mean it would have to devastate the sub-investment grade market. I certainly don't think it's GSO's fault.

MS. DAI: I guess a related question was what is your outlook for the credit but the pace of investment there. It seems like for the last quarter, credit as well as private equity wasn't nearly as robust as real estate in terms of the amount of capital that was put to work. What is your outlook for the credit business for the next few months?

MR. JAMES: I think this is one of the great things about the balance of Blackstone. Frankly there's no other firm that has four major businesses that are industry-leading. They're all about the same size. One of the great things is, yeah, we can have one business like real estate which is booming and other businesses disciplined enough not to be forced to push into the market when it's not the ideal time.

I couldn't be prouder of our credit guys. Man, their return, think of it, like 20-40% in 9 months in credit with almost no losses. In the Mez, for example, they've never had a down quarter. So spectacular performance, spectacular capital preservation, spectacular risk management, yet they're driving returns that are equity-like returns in a zero interest rate world. I mean oh my god, you couldn't write that scenario in a movie. I think they're unbelievable.

So let me get to your question. Sorry for the ad.

But it's important everyone keeps context. I don't think--so their business varies. One of their businesses is rescue financing. If the economy gets stronger and even troubled companies can finance out of their issues, which doesn't solve the issues by the way, it just delays them, then their drawdown of the rescue financing will be delayed.

In the mezzanine business, it's not a function of those factors; it's more a function of the number of deals that private equity firms are doing because they provide the debt to private equity firms, not us, but to the world. So if the private equity business is softening then they'll be a little softer in terms of their putting out money. But both those funds, the private and the Mez fund are brand new funds. They were just raised within less than a year so we have a long time to go on those.

Then the last big vehicle that they have that is the hedge fund, again, they've always got opportunities here and there. They can be long or they can be short. Markets that are overpriced are just as appealing to them as markets that are underpriced. There's no shortage of opportunity there. They're fully invested. Although interestingly they don't really have any interest rate risk in the book and our boys would have been poised to jump all over the effects of a Treasury crisis.

MS. DAI: Mm-hmm. Okay. Well somehow I knew that this, what's going to happen, I thought I was referring to a horrible question but you used that as an opportunity to advertise your business. That's just the way it is. Thank you so much for taking the question, Tony.

MR. JAMES: Thank you Sasha.

OPERATOR: Next we'll go to the line of Evelyn Lee with Private Equity Real Estate.

MS. EVELYN LEE: Hi, Tony. Thanks for taking my questions. I just had a question regarding disposition and investment activity in real estate. You mentioned that I think investment activity was about double the disposition activity this year. I was curious how that compared to previous periods.

MR. JAMES: Okay. Real estate for like the last two and a half years has been on a huge--they've invested a lot of money. For the several years before that they invested very, very little so that's the cycle on the investment activity. On the disposition activity, there's been actually no dispositions until sort of fairly recently.

Now a disposition is starting and is starting to swing up. Just by judging what's on file, what's been in the press, you can anticipate they will be bigger next year than they are this year.

Usually what happens is or always what happens is the disposition cycle lags the investment cycle because we're in a business of raising money, buying troubled assets, fixing those assets, and once they're fixed, selling them. We're not in the business of playing the market and market cycles and whatnot. We leave that to public investors. We're not smart enough to do that and we don't have to do that 'cause we have an easier business if you will.

It's pretty obvious what assets are troubled and it's pretty obvious how to fix them if you have the capital and the expertise to do it. Then once they're fixed, you sell them. So it's buy it, fix it, sell it.

So you always have the cycle where you buy it first and then you've got a period of time of fixing it and then you have a period of time of selling it. Now when you get major dislocation like we had in the global financial crisis, that could open up more buying opportunities because you have more distress and it'll just naturally there's no markets open so it'll probably delay a little bit your disposition cycle.

Fundamentally you always have this cycle of investments and then dispositions. Right now I think the market's in reasonable balance. Yeah, we're putting a lot of money out but we're also taking some off the table. I think there's value to be had on the buy side and it's a reasonable time to start exiting. This is one point. When we file a company to go public, let's just say Brixmor which started its road show today. We don't often sell any shares in that IPO.

Many times we actually want to see that stock come out at a price which is a bargain for the IPO buyers so that they have a good experience and that stock trades well and is viewed favorably because we're going to be owners for three or four years after that. Only after it's public will we start to sell most of our shares.

You can't look at IPOs for us as exits. You can look at it as the appetizer before the meal, in a way. That's important to remember. The actual exit, even when we have a spate of IPOs is two or three years out.

MS. LEE: Right. You mentioned disposition. You anticipate disposition activity even being bigger next year. I just wondered how that would compare with, again, investment activity next year or just in the near term.

MR. JAMES: Our investment activity, our pipeline is still very full. I think it'll be another year which feels like it's in balance but it's kind of inexorable just because of the lifecycle I mentioned where eventually your high investment activity has to lead to high disposition activity. That's inexorable. It's just… all the investment activity accumulates and you get more and more dispositions as it catches up.

Our investment pace continues very strong. There have been some shifts in that. Europe's been picking up and has really been very, very active. We got active first in the United States and Europe was pretty quiet. But now Europe is rocking. There's been a shift. Europe is a higher percentage of the new investment activity. Nonetheless, overall, taken as a whole, it's the pattern that I mentioned.

MS. JOAN SOLOTAR: I just wanted to add one thing before you ask the next question.

MS. LEE: Okay.

MS. SOLOTAR: Just to correct something earlier because we gave Tony a dated number. He mentioned that we've invested $5.5 billion in residential housing. We've been buying about $100 million per week and that's actually up to slightly over $7 billion.

MS. LEE: Okay, great, just one last question regarding your Asia Fund, the Real Estate Asia Fund. I understand you recently started investing. I see that you have a really high 207% net IRR. Can you talk a little bit about what's led to the success of the fund so far?

MR. JAMES: Sure. First of all there's a lot of opportunities in Asia. It's a huge market. There are very, very few Pan-Asia funds. I don't know that there's another Pan-Asia fund in existence.

We have a huge market, growing, with kind of like we're the only guy home. On top of that with the hiccup that has come from the sort of the fact of the credit market tapering and China ratcheting up a little bit on the banking system and India with its issues, capital has fled from these Asian countries. Lenders have pulled in their horns. So all of a sudden we can buy growing assets at less than physical replacement costs in economies which are booming at least by Western standards.

I think you'll see that that combination of factors is powerful. The cool thing about this fund is usually what investors don't like is they don't like the fact that they put money up and then they have to wait many years for it to be invested while they're paying management fees and it creates something called a J Curve where they go down negative for a while 'cause they're paying management fees on uninvested capital and not much is invested. Then as they put more money out in those investments, sure, they swing positive in terms of their return.

There's so much going on in Asia that by the time--that fund's already 30% invested, I think, so the J Curve is evaporating fast. I hope that gives you a sense for why investors like it.

MS. LEE: No, that's terrific. Thanks so much.

OPERATOR: No one else is in queue with a question. Any closing remarks, Speakers?

MR. PETER ROSE: No, thank you very much everyone and if you have any further questions, just call the Media Relations Office and we will get you an answer. Thank you all for joining.

OPERATOR: Ladies and gentlemen, that does conclude your conference for today. Thank you for your participation in using AT&T Executive Teleconference. You may now disconnect.

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