Operator

Good morning. My name is Dennis, and I will be your conference facilitator today. I would like to welcome everyone to the Goldman Sachs Fourth Quarter 2010 Earnings Conference Call. [Operator Instructions] Mr. Holmes, you may begin your conference.

Dane Holmes

Good morning. This is Dane Holmes, Director of Investor Relations at Goldman Sachs. Welcome to our fourth quarter earnings conference call. Today's call may include forward-looking statements. These statements represent the firm's belief regarding future events that by their nature are uncertain and outside of the firm's control. The firm's actual results and financial conditions may differ, possibly materially, from what is indicated in these forward-looking statements.

For a discussion of some of the risk factors that could affect the firm's future results, please see the description of risk factors in our current annual report on Form 10-K for our fiscal year ended December 2009. I would also direct you to read the forward-looking disclaimers in our quarterly earnings release, particularly as it relates to our Investment Banking, transaction backlog, capital ratios, risk-weighted assets and Global Core Excess. And you should also read the information on the calculation of non-GAAP financial measures that is posted on the Investor Relations portion of our website at www.gs.com. This audiocast is copyrighted material of The Goldman Sachs Group, Inc. and may not be duplicated, reproduced or rebroadcast without our consent.

Our Chief Financial Officer, David Viniar, will now review the firm's results. David?

David Viniar

Thanks, Dane. I'd like to thank all of you for listening today. I'll give an overview of our fourth quarter and full year results and then take your questions. My remarks today will be focused on our new segment disclosure that was discussed in our Business Standards Committee report. The Business Standards Committee evaluated the firm's public financial disclosures with the objective of improving our standards of transparency and disclosure by more clearly explaining business activities and performance and how they relate to serving our clients. The committee recommended changing the firm's three previous business segments into the following four business segments: Investment Banking, Institutional Client Services, Investing and Lending and Investment Management. The composition of the new four segments is described in greater detail in our 8-K dated January 11, 2011.

Full year and net revenues for 2010 were $39.2 billion. Net earnings were $8.4 billion, and earnings per diluted share were $13.18. These results generated an adjusted return of common equity of 13.1%, which is our reported return of common equity excluding the U.K. bank payroll tax, the SEC settlement and the impairment of our New York Stock Exchange Designated Market Maker rights. If these items are included, our return on common equity for 2010 was 11.5%. Over the past year, book value per share was up 10% to $128.72.

Fourth quarter net revenues were $8.6 billion. Net earnings were $2.4 billion and earnings per diluted share were $3.79. During 2010, market participants were faced with a series of broad macroeconomic concerns. European sovereign risk came under heightened scrutiny periodically during the year. Investors have also been intensely focused on the U.S. mortgage market regarding procedural concerns associated with home foreclosures and the potential for mortgage put back risk.

Throughout the year, global financial regulation continued to be a concern, specifically, the implications of the Dodd-Frank Act and Basel III. Finally, the trajectory of the global economy was heavily debated, and there were growing fears about the potential for inflation in growth markets. The ultimate consequence of these concerns lead to greater risk aversions, a deterioration and conviction among institutional investors and thus, a steady decline in client activity.

This reduction of client activity occurred across a broad set of businesses within Investment Banking and FICC and equities client execution. Despite the difficult economic backdrop and lower levels of client business, the firm produced a solid 13% adjusted return on common equity, which is a testament to the strength and breadth of our client franchise and the commitment of our people.

I'll now review each of our businesses. Investment Banking produced fourth quarter net revenues of $1.5 billion, up 30% from the third quarter due to significant increases in Financial Advisory and Equity Underwriting revenues. For the full year, Investment Banking net revenues were $4.8 billion, down 3% from 2009, with a 9% improvement in Financial Advisory, partially mitigating an 11% decline in Underwriting.

Within Investment Banking, fourth quarter Advisory revenues were $628 million, up 26% from the third quarter. Goldman Sachs ranked first in worldwide announced and completed M&A globally for calendar 2010. We advised on a number of important transactions that closed in the fourth quarter, including for Brookfield Asset Management, which led to $24 billion restructuring of general growth properties; E.On's $7.6 billion sale to PPL Corporation; and United Airlines' $6.5 billion merger with Continental Airlines. We're also adviser on a number of significant announced transactions including NSTAR's $17.5 billion merger of equals with Northeast Utilities; Earl Cully's $9.6 billion acquisition of Silvenate [ph] and Toronto-Dominion Bank's $6.3 billion acquisition of Chrysler Financial.

Fourth quarter Underwriting net revenues were $879 million, up 33% sequentially. Equity Underwriting revenues of $555 million were up 79% from the third quarter, reflecting a significant increase in IPO activity. Debt Underwriting decreased 7% to $324 million, reflecting lower activity in investment grade markets.

During the fourth quarter, we participated in many noteworthy Underwriting transactions including AIA Group's $20.5 billion IPO, Renault's $4.2 billion sale of a portion its equity stake in Volvo, and Hutchison Whampoa's $2 billion investment-grade issuance. Our Investment Banking backlog decreased compared with the end of the third quarter.

Let me now turn to Institutional Client Services, which is comprised of FICC and equities client execution, commissions and fees and Security Services. Net revenues were $3.6 billion in the fourth quarter. Net revenue generation within FICC and equities client execution declined significantly, as client activity leading into and through the holiday season was low and exacerbated by several macro concerns. Full year net revenues of $21.8 billion dollars for institutional client services were down 33% relative to 2009 on lower levels of client activity and tighter bid-offer spreads.

FICC client execution net revenues were $1.6 billion in the fourth quarter, down 39% sequentially as client activity slowed meaningfully in the quarter. Credit and rates net revenues, our most significant FICC client execution businesses, were down as macro uncertainties led to lower customer activity levels and weaker revenues. Currencies and mortgages net revenues were also lower sequentially.

Commodity net revenues were up amid more favorable market conditions. For the full year, FICC client execution net revenues of $13.7 billion were down 37% from 2009 as macro uncertainty throughout the year drove lower client activity and led to tighter bid-offer spreads.

Turning to Equities, which includes Equities client execution, commissions and fees and Security Services. Net revenues for the fourth quarter were $2 billion, up 1% sequentially. Equities client execution revenues were down

10% to $772 million, reflecting lower net revenues within our derivatives business. A slight improvement in market volumes and higher market values drove an 11% increase in commissions and fees. Security Services net revenues also increased sequentially by 7% to $368 million, reflecting higher average customer balances. For the full year, equities produced net revenues of $8.1 billion, down 25% from 2009 on lower market volumes in the U.S. and client activity levels across the franchise.

Turning to Risk. Average daily value at Risk in the fourth quarter was $120 million, roughly flat with the third quarter.

Let me now review Investing and Lending, which produced net revenues of $2 billion in the fourth quarter. The firm is investing in lending activities across various asset classes, primarily including debt securities and loans and equity securities, including private equity and real estate, are included in this segment. These activities include both direct investing and investing through fund as well as lending activities. Our investment in ICBC produced a $55 million gain in the quarter. Other equity investments generated net revenues of $1.1 billion across both public and private equity investments, and benefited from the significant increase in the equity markets.

Net revenues from our debt, investing and lending businesses were $537 million from interest income and tightening credit spreads throughout the quarter. Other revenues of $330 million were primarily produced by the firm's investment in consolidated investment entities. For the full year, Investing and Lending generated net revenues of $7.5 billion dollars, driven by $747 million in gains from our ICBC investment, $2.7 billion in gains from our other equity investments, $2.6 billion in revenue from our debt Investing and Lending businesses, and $1.5 billion from other investments. A significant increase in global equity markets and tighter credit spreads provided a favorable backdrop for our Investing and Lending businesses in 2010.

In Investment Management, we reported fourth quarter net revenues of $1.5 billion, up 18% from the third quarter due to higher Assets Under Management and $310 million in incentive fees generated across the firm's alternative asset products. For the full year, Investment Management net revenues were $5 billion, up 9% from 2009 due to a favorable change in the composition of assets managed and a significant increase in incentive fees.

During the fourth quarter, assets under management grew $17 billion to $840 billion. The increase was driven by $5 billion of net inflows, reflecting money market inflows, as well as $12 billion in market appreciation. On a full-year basis, asset under management declined by 4%, mainly reflecting industry-wide outflows in money market assets.

Now let me turn to expenses. Compensation benefits expense, which includes salaries, bonuses, amortization of prior equity awards and other items such as benefits, was down 5% to $15.4 billion. This translated into a compensation to net revenue ratio of 39.3%, which is in excess of 600 basis points lower than our average compensation ratio between 2000 and 2009. When adjusted for the increase in headcount, compensation and benefits declined in line with the firm's overall revenue decline.

Fourth quarter non-compensation expenses were up 35% sequentially, largely in depreciation, amortization and other expenses. Depreciation and amortization increased significantly to $725 million, as the firm wrote down the value of our New York Stock Exchange Designated Market Maker rights by $305 million in the quarter.

The increase in other expenses is primarily related to a $320 million donation to Goldman Sachs Gives, our donor-advised charitable fund. Compensation was reduced to fund this charitable contribution. As we discussed last year, GS Gives provides senior employees with a firm-sponsored mechanism for recommending charitable contributions. This effort will continue to be focused on those areas that have been proven to be fundamental to creating jobs and economic growth, building and stabilizing communities, honoring service and veterans and increasing educational opportunities.

For the full year, non-compensation expenses were up 14%. In 2010, non-compensation expenses included the $550 million SEC settlement and the $305 million impairment of our New York Stock Exchange Designated Market Maker rights. Total staffs at the end fourth quarter was approximately 35,700, up 1% from the third quarter and up 10% versus year-end 2009. Our effective tax rate was 35.2% for the full year, resulting in $4.5 billion in tax expense. As you know, economic growth remains the key driver of our operating performance. As we have said in the past, a strong and growing global economic environment usually translates into greater activity among our client base and ultimately drives our business. The operating environment in 2010 was dominated by heightened uncertainty surrounding the global economic outlook, which contributed to a steady decline in activity levels over the course of the year.

While economic activity has improved in recent weeks, the seasonal nature of the fourth quarter, combined with the continued uncertainty surrounding the outlook, makes future activity levels difficult to predict. Longer-term, we remain optimistic about the opportunities that lie ahead for the firm. Our optimism is rooted in our belief that the firm will continue to expand with the growth of the global economy and the further development of the capital markets.

In addition, clients' demand for our advise and execution capabilities remains unchanged. As always, our global client franchise is essential to our success. We believe our fundamental recommitment to our clients and the primacy of their interest coming out of the Business Standards Committee report will further strengthen our existing client relationships and serve as the foundation to build new ones. We also remain committed to expanding our global franchise and footprint.

Even in a difficult macroeconomic environment, we've continued investing in our client franchise and in new market expansion. This commitment will enable the firm to continue its legacy of providing best in class service to our clients, best in class return to our shareholders, and attracting and retaining the best talent in a competitive global marketplace. With that, I'd like to thank you again for listening today, and I'm now happy to take your questions.

Question-and-Answer Session

Operator

Your first question comes from the line Glenn Schorr with Nomura.

Glenn Schorr - UBS

So I hear your thoughts on the financial crisis commission. Look, you reset your disclosure to center around how activity is done for better clarity and I think we appreciate that. But without the rules being set, is there a chance that as the rules are written, some things that are in Investing and Lending are no longer permitted? Like, how do you think about how that business gets re-shaped as the rules get set?

David Viniar

Well, the way you ask the question, Glenn, is there a chance that some things in Investing and Lending aren't permitted, the answer is yes. There's a chance that some things in Investing and Lending aren't permitted. We don't know what the rules are going to be yet. The report came out last night. We're still just going through it. So it's hard for me to give you a more definitive answer on the question. I mean, there's a lot of things in that segment that are basic lending to our clients. Some of our funds do nothing other than lend to our clients, some of it is investing alongside. And in our clients, which of those things are not going to be permitted? We're just not sure.

Glenn Schorr - UBS

So I'm assuming that any Basel III changes, this is the segment that gets impacted the most by both rule changes and cap to risk weightings. Are we going to -- I guess on the 10-K, are we going to get equity and assets and P&L by the new business segments? Is that wishful thinking?

David Viniar

You're certainly going to get assets by the new business segments, and you're going to get P&L by the new business segments.

Glenn Schorr - UBS

And any chance we get a preview on the Investing and Lending side? I know that answer.

David Viniar

If we had it, for sure. If we had it in a form that I was sure it wouldn't change, I'd give it to you. We'll try and get there in the future, but we're not there yet.

Glenn Schorr - UBS

Just the gross leverage is low. You're below 12x. You're below 13x if you just look at common. Curious on your thoughts on being able to move that a little bit higher. And I asked because in a so-so world this year, you produced almost a 100 basis points ROA. So a little bit more leverage and you actually have a decent return.

David Viniar

It's really, honestly, it's a question of opportunities. We're not artificially holding that down. We just have not seen the opportunities to do things that would increase the leverage. If we see them, given the amount of capital we have, given the amount of liquidity we have, we would take advantage of them.

Glenn Schorr - UBS

And just so I'm clear, you can do it if you want to, meaning there's a couple of turns of leverage are within your operating ability.

David Viniar

I think, yes, absolutely.

Operator

Your next question comes from the line of Guy Moszkowski with Bank of America Merrill Lynch.

Guy Moszkowski - BofA Merrill Lynch

On FICC during the quarter, I was wondering if you could give us a sense for how skewed the results were by month. And to what extent were either customer activity levels or just inventory valuations impacted by what happened in the muni market and in the interest rates market.

David Viniar

Let me do it in reverse order. The muni market, it's just not that big a part of our business. So it wasn't a positive for us, but it was a very immaterial negative to the firm. Look, it was really customer activity levels more than anything else. And while you know I don't like to talk about one month or another month, clearly, in the month of December, things were just dead. There was just very little activity.

Guy Moszkowski - BofA Merrill Lynch

And turning back to some of the more principal activities in the Investing and Lending segment, you've had debt securities and lending revenue of about $500 million in the quarter and $2.6 billion in the year. I was hoping maybe you could better characterize that for us, maybe a little bit to Glenn's point about things that might or might not persist. I think investors really want to understand what types of revenue really are so lending driven that we could really anticipate that they would not necessarily be affected by Dodd-Frank, by Volcker Rules.

David Viniar

There's two things in there. We're going to have to get back to you with the exact breakdown. One, you know we mark everything to market. We mark our loans to market. So if we lend to someone and their spreads widen, we mark them down. If their spreads narrow, we mark them up, because we mark everything we have to market, loans, loan commitments. Everything is mark-to-market at Goldman Sachs. So that mark-to-market is in there, and interest income is in there as well. So we lend to people. They pay us interest, and that revenue is in there as well. So those two things are both in there on the debt securities side.

Guy Moszkowski - BofA Merrill Lynch

Yes, again, there is just some aspect of some of that, that are more likely to persist, we can assume, than others but obviously, there's a lot of rule writing in front of us.

David Viniar

Correct.

Guy Moszkowski - BofA Merrill Lynch

On the equity securities side, within that Investing and Lending segment, I mean, we know that private equity and real estate, as you said, are in there. Where would we find things that we thought of more as prop equity such as GSPS and statistical arbitrage?

David Viniar

Anything that you would consider prop trading would be in the other line in Investing and Lending. And most of that line is our consolidated investment entities, which really are revenues which we have to take because of the accounting and they're really largely offset by expenses. So anything that you would consider as prop trading would be within the other, and it would not be the bulk of other.

Guy Moszkowski - BofA Merrill Lynch

And again, you say that the revenues that we see there is the revenue that's net of the direct expense load.

David Viniar

No, it's not net. It's divested gross number, the expenses within expenses.

Guy Moszkowski - BofA Merrill Lynch

And in terms of the equity revenues that we saw for the year in the quarter, the equities security, excluding ICBC, can you give us a sense of in the quarter in particular for how much of that was realized gains versus marks and a sense for the concentration in particular positions?

David Viniar

Well, it's not heavily concentrated. It's quite broad. I would tell you it was roughly equal between public securities and private securities, and I mean, I have to get back to you on the private securities, how much was realized and how much wasn't. That I don't have off hand.

Guy Moszkowski - BofA Merrill Lynch

In comp, was there any significant change in the cash equity mix for the year?

David Viniar

Not really significant.

Guy Moszkowski - BofA Merrill Lynch

And was there a significant increase in the stock amortization component for the year relative to what there was last year?

David Viniar

I don't think it was that meaningfully different.

Operator

Your next question comes from the line of Howard Chen with Credit Suisse.

Howard Chen - Crédit Suisse AG

On FICC, you noted the lower client activity and the macro concerns a few times, but I was just hoping that you could touch on the competitive landscape and how you think the firm's market share has potentially evolved over recent quarters?

David Viniar

Across the full year, the competitive landscape got much tougher. And this was not a surprise, and we talked about it in the past. Certainly, in the early part of 2009, our competitors were hurt probably more than we were financially, were much less willing to commit risk capital on behalf of clients than we were. We picked up quite a lot of market share. I think we've told you through last year, we did not expect that, that market share would stay. I think we've kept a small amount of it, but our competitors are stronger financially.

Howard Chen - Crédit Suisse AG

And then switching gears, as we're in the middle of a rule making process specifically for derivatives reform, we're just hoping you could provide some initial thoughts on the recent proposals we've seen such as those for swap execution facilities, et cetera.

David Viniar

I think it's just too early for me to give you much. A whole big report came out last night, yesterday afternoon, we're still reading through it. And as we understand it better, we'll get back to you on it.

Howard Chen - Crédit Suisse AG

And then the firm purchased some stock again this quarter to offset the share issuance. But how should we be thinking about potentially upsizing that to potentially just doing more than just offsetting share issuance? Clearly, you gave us a lot of detail on Basel III and the pro forma ratios last quarter. And it looks like as all the other banks have kind of taken your lead, that you guys sit at the high end of capital for the group.

David Viniar

I think we are -- we're going to see how the world unfolds. We're going to get -- see how the rules are ultimately written, and then we'll see how that all plays out with our capital ratios. If we remain this elevated, hopefully, we'll find -- our number one choice would be to find opportunities to use the capital profitably. And if not, we will probably give some more back.

Howard Chen - Crédit Suisse AG

Just any impact of DVA this quarter, David?

David Viniar

Yes, it was pretty small. There was about $120 million loss and about, I think, three quarters of that was in FICC.

Operator

Your next question comes from the line Chris Kotowski with Oppenheimer.

Christoph Kotowski - Oppenheimer & Co. Inc.

I mean in looking at the Investing and Lending line, the activities that would conceivably be disallowed going forward, I guess, my question is to what extent can you do all that in fund of vehicles? And is it the same from a client perspective and the internal process perspective? In the past, you just used to be able to write a check from your own balance sheet. Now you're going to have to do it through a fund vehicle, where you presumably you have fiduciary duties to the investors and all that. Does it change your relationship with the corporate clients to morph your business model in the way that these regs are going to force you to?

David Viniar

I would actually say it a little differently. Most of the investing we have done over time has been through funds. There's been some on our balance sheet but most of it has been through funds. I think one thing we know the rules do, it limits the percentage we can have in the funds to 3%. We have traditionally had more than that in the funds. We're going to have to have smaller percentages than we've had in the past. We'll still have some money, so our clients will know that we're there. But I think the most important thing for our clients is that we are still going to use our franchise to find the opportunities which is what we've done in the past for the funds. And so I think the biggest difference is going to be we know we have to have a smaller percentage of our own capital in those funds going forward. Other than that, we expect we will operate similarly, using the franchise to help source opportunities for our clients with some small amount of coinvestment by the firm and the funds.

Christoph Kotowski - Oppenheimer & Co. Inc.

Now another bank that reported earlier today kind of referenced that they were hoping for a 25% or 30% payout of their earnings. I mean, whatever it is, whatever the regulators give the banks, fine. If taking capital out of this investing and lending line freeze up additional capital, above and beyond, is it your understanding that you're able to use that to retire a stock, or does it all get driven by this percentage of earnings ratio that the fed is talking about, at 30%?

David Viniar

I think, over time, as long as we have sufficient capital ratios and a sufficiently robust capital plan going forward, we should be able to manage our capital prudently.

Christoph Kotowski - Oppenheimer & Co. Inc.

And in terms of buyback versus dividends, you've clearly tilted more towards buybacks rather than dividends, right?

David Viniar

We have generally been tilted more towards buybacks than dividends. Not one at the exclusion of the other, but more tilted towards buybacks.

Christoph Kotowski - Oppenheimer & Co. Inc.

And then finally, was there an impact or can you gauge what is the impact of the sheer rise in U.S. bond rates in the course of the fourth quarter? It was a pretty violent decline in treasury bond prices during the period. And to what extent was that a factor in the weak FICC trading results?

David Viniar

I think it was a factor in that the extent and, as you say, the violence of the move especially coming when it did as we were getting towards the end of the year, caused even more uncertainty and caused more clients to sit on the side and say, "Let's wait till the year-end. Let's see how things unfold and call me in January."

Christoph Kotowski - Oppenheimer & Co. Inc.

But not necessarily positioning losses as in the course of market making activity.

David Viniar

No, nothing material. It was much more client-activity driven.

Operator

Your next question comes from the line Roger Freeman with Barclays Capital.

Roger Freeman - Barclays Capital

I guess just on the topic of sort of reduced client activity, I'm just wondering how much do you think that your businesses are impacted by externalities, for example, like concern around OTC regulation? Because otherwise, it seems like we're in a fairly robust GDP environment, a barely normalized capital markets environment, certainly Investment Banking. A lot of trading, plus or minus certain segments. And I'm just wondering if you think that we're in an unusually slow period here that may be driven by customers shifting to maybe more listed, liquid products or cash instruments that are less profitable.

David Viniar

I didn't say we were in an unusually slow period. I said we had an unusually slow period in the quarter because they're different. And I think external events actually affect client philosophy a lot and client psychology and therefore, their willingness to take risk and their willingness to do things. I think some of the things that we saw over the course of the year when you had as you said, some concerns about regulation but also about Europe, about inflation, about many other things caused people to be very unsure. Even though we basically had a year where for the most part, asset prices kept going up, it was not a year where anyone felt confident asset prices were going to keep going up. And so I think that caused a lot of people to sit on the side line.

Roger Freeman - Barclays Capital

Would you think like, for example, in the commodities business like energy and CDS, are those businesses, do you think, being impacted by clients not wanting to trade OTC products, given the pending regulatory reform? Because it seems like that -- we've heard that, and I'm just curious of your view.

David Viniar

I think that there is more focus on cash products than derivative products right now partially because of the concern of uncertainty around regulation.

Roger Freeman - Barclays Capital

And then as you think about your sort of the longer-term, you've touched on this a little bit with some prior questions. Sort of longer-term return expectations, say over the next three years, right, ROE expansion, if you were to rank growing top line, reducing comp expense structurally further or reducing the equity investment of the business, how would you rank how those are going to contribute to rising ROE, particularly relative to your 20% cross-cycle target?

David Viniar

I always think the most important thing in growing ROE is growing the top line. That's what's going to drive the business over time. We're not going to cut expenses to being a successful firm over time. You might do it in a year, where we don't perform as well, we'll cut our comp. We've told you that. But, over time, what is going to drive the business at Goldman Sachs, what's going to drive the returns to our shareholders is growing our top line revenue.

Roger Freeman - Barclays Capital

So what do you think is really missing right now? I mean, obviously, derivatives is a slow part. But what do you think is holding back that greater revenue producing capability?

David Viniar

I think what we need, really, is conviction on the part of our customers and clients, some more level of conviction and therefore, wanting to really be active in the markets.

Roger Freeman - Barclays Capital

Your liquidity position is still pretty high. I think we've talked last quarter a lot of that is -- or a decent amount of that is sitting in treasuries. I mean how should we think about that, given that treasuries could be a negative returning asset class?

David Viniar

It's a drag on our return. There is no question, having all of that liquidity is a drag on our return. As you heard me say, we think about everything in terms of risk and reward. And we think right now, the risk of having too much cash and having somewhat lower returns versus not having enough is very skewed towards having too much.

Richard Staite - Atlantic Equities LLP

Does that show up in FICC or is that across the P&L?

David Viniar

It's really across our inventory, but more of our inventory would be in FICC, some more of that would be affected.

Operator

Your next question comes from the line of Jeff Harte with Sandler O'Neill.

Jeffrey Harte - Sandler O'Neill & Partners L.P.

You mentioned Investment Banking pipeline being down. It seems like there's still a lot of kind of client conversations going on out there. Can you give us a little color as to what you're seeing as far as client conversations go? And I'd be kind of interested in, regionally, is Asia still where a lot of the equity is coming from? And then even kind of within Equity, are we continuing to move away from kind of bank recaps into non-financial demand for equity?

David Viniar

Here's what I'd say: One, you always have to be careful when we talk about the backlog. We tell you what it is. Backlog is probability weighted revenues that we're going to get. But things like backlog is probably a reasonably good indicator when you're talking about merger deals, because they take a long time to go through backlog. It's not necessarily a good indicator on equity and fixed income because many of those come up quickly, get executed quickly. Many of those come up and get executed within the quarter. So it's not necessarily that good an indicator. But I think in a way, you answered much of your own question. There's still a lot of dialogue. I think in keeping with the answer I just gave, if there was more conviction, I think you'd see even more activity. So there's a lot of dialogues, some of which turns into deals, some of which doesn't. And I think the equity markets continued to be pretty good and pretty receptive, and the debt markets as well. So I think you'll see some more issuing activity, and I think you're going to see a lot of it coming out of Asia, as you've seen in the past.

Jeffrey Harte - Sandler O'Neill & Partners L.P.

What do you think it takes to move the conviction toward more deals getting done?

David Viniar

I think you need final certainly around regulatory reform, some people feeling a little bit better about how things are going to unfold in peripheral Europe, and I think a little more confidence around inflation in the market. I think you're seeing, really, certainly in the U.S., pretty positive economic data. So I think if that continues, I think that will help as well.

Jeffrey Harte - Sandler O'Neill & Partners L.P.

And I guess, finally, any of us on the banking side thinking about kind of Debt Underwriting, I mean, we've come from some very strong activity levels, a lot of pre-funding. How do you think about the kind of macro demand or even supply-side for Debt Underwriting, given how strong the last couple years have been?

David Viniar

I think there's still plenty of demand. If economic activity picks up, there will be plenty of demand for Underwriting.

Jeffrey Harte - Sandler O'Neill & Partners L.P.

And then, quickly, you mentioned, when talking about client risk appetites, call me in January, how are you seeing risk appetites pick up year-to-date? And it's anybody's guess, I guess, but how are you kind of looking forward in 2011 as well?

David Viniar

Again, you answered it well. It's anybody's guess. You know I don't like to look forward. And 2 1/2 weeks don't tell you a whole lot. And I wouldn't say it's the best period we've ever seen, but it's sure a lot more active than December.

Operator

Your next question comes from the line Kian Abouhossein with JP Morgan.

Kian Abouhossein - JP Morgan Chase & Co

I have a question on more looking at staff hirings and staff levels that we should look at going forward. How should we think about that for 2011? And in what regions or businesses would you expect staffing levels to increase?

David Viniar

I would expect, subject to the economic environment not changing very dramatically. I would expect we will continue to grow our staff. And it will be more focused on the growth markets than anywhere else with some growth in other places as well.

Kian Abouhossein - JP Morgan Chase & Co

And in terms of business segments, is there any focus as well, specific focus?

David Viniar

I would say there's probably more focus on the Investment Management division than other places. But again, we would expect all the businesses to grow somewhat.

Kian Abouhossein - JP Morgan Chase & Co

And should we think about the staff increases in line with what we saw in 2010 relative to '09?

David Viniar

I would say somewhere in the mid-to-high single digits is what I would expect. But I'm almost certainly going to be wrong either high or low by the time we get to the end of the year. But as we sit here today, that's what I would tell you.

Kian Abouhossein - JP Morgan Chase & Co

And if I look at the FSOC [Financial Stability Oversight Council] study that came out last night, it seems to me they do give some exact details of metrics that one should look at in order to determine prop trading. And I was wondering how you think about these, because some of them to me seem to be realistic, some of them questionable, if they make really any impact or really realistic to assess risk?

David Viniar

I don't think we've had enough time to really go through it in enough detail for me to respond.

Kian Abouhossein - JP Morgan Chase & Co

And in terms of Basel 2.5 and III, is there a possibility to give the risk weighted asset breakdown between Basel 2.5, and how much it would be for Basel III now that we have the final rules?

David Viniar

I'm sure the answer to that question is yes. We're going to have to get back to you. I don't have that breakdown with me right now. So we can get that to you though.

Operator

Your next question comes from the line of Mike Mayo with CLSA.

Michael Mayo - Credit Agricole Securities (USA) Inc.

What would FICC have been under your old reporting?

David Viniar

Because we're not doing our old reporting, I don't have that. But we can calculate it and get back to you. I'm going to guess, Mike, it would have been in the range of $2.5 billion, but we'll get you the exact number.

Michael Mayo - Credit Agricole Securities (USA) Inc.

And you've kind of alluded to it being a little bit worse than I think what you might have expected. You said December was dead, and the rise in the U.S. bond rates. How much of the lower than typical level was due to structural changes or regulatory changes?

David Viniar

It's impossible for me to answer that question. I don't know why people were really sitting on the side line. There was a lot of uncertainty. I don't think most of it was due to structural changes. I think people are -- you've heard me say this before, I think when we're through with all the regulatory changes, people are still going to need the same things they needed before. So I don't think much of it was because of that, but it's hard for me to answer the question.

Michael Mayo - Credit Agricole Securities (USA) Inc.

And the cyclical part of the decline, the rise in U.S. bond rates, you said things have picked up here so far in January. Is that because rates are stabilized, or what are some of the factors behind that?

David Viniar

I think that there was so much uncertainty. Traditionally, things get slower at the end of the year. There was so much uncertainty in the macro environment, that it got even slower than usual. And as you get to the new year, people come back and are wanting to be more active.

Michael Mayo - Credit Agricole Securities (USA) Inc.

Shifting gears, the percentage of revenues outside the U.S. versus in the U.S. and linked quarter changes.

David Viniar

We've been running pretty much in the mid-50s in the U.S., and mid-40s outside the U.S.

Michael Mayo - Credit Agricole Securities (USA) Inc.

And how are the growth rates to the recent quarter, U.S. versus non-U.S.?

David Viniar

It was right around there. Right around there, it's right around there pretty much for the whole year. I said mid-to-high 50s in the U.S., mid-to-low 40s outside the U.S., probably that being in the range of 60-40, Europe, Asia, outside U.S. And those changed by a few percent quarter-over-quarter. But it's not all that meaningful when I give you a couple of percent change, because you have a U.S. client doing an Asian acquisition or an Asian client do a U.S. equity offering or a global booking in foreign exchange that moves around the world. So those are the rough numbers. They haven't changed very much.

Michael Mayo - Credit Agricole Securities (USA) Inc.

And as it relates to just activity levels, are you seeing any incremental pickup or decline in, say, Asia versus Europe versus the U.S.?

David Viniar

No.

Michael Mayo - Credit Agricole Securities (USA) Inc.

And then last question, Facebook was in the news. We got the press release a couple days ago. Do you want to comment on what happened there? I think it's pretty clear, except the only question is since this was such a high-profile deal, wouldn't it be expected that it would become public? And what was your thought process behind that?

David Viniar

I have nothing to add other than the statement we've already made.

Operator

Your next question comes from the line of Matt Burnell with Wells Fargo Security.

Matthew Burnell - Wells Fargo Securities, LLC

In terms of the Asset Management net flows in the quarter, those were negative both in alternative investments and in equity. One of your competitors showed at least positive numbers for equity. Can you give us a little sense as to what was going on at least on the equity side of the inflows in the quarter?

David Viniar

There is really nothing special there. You can see while there were net outflows, they were quite small. So there was nothing special in there.

Matthew Burnell - Wells Fargo Securities, LLC

And in terms of the CVA and DVA, sorry to get so specific on this, but where in the new reporting, where do those -- should we expect those numbers to reside going forward?

David Viniar

They'll be mainly in the Institutional Client Services section.

Matthew Burnell - Wells Fargo Securities, LLC

Just thinking about China, we've seen a number of competitors start or move from one form of business opportunity there into another. Do you think that, that's -- is there an increase in competition from non-Chinese competitors in that business? And does that imply that there could be some margin reduction in that business over time?

David Viniar

No doubt that there's an increase in competition. And there's going to continue to be an increase in competition. I actually generally assume there will be an increase in competition in all of our businesses everywhere in the world, all the time. We had a multi-year start on our presence in China, along with one other firm. We knew other firms were going to get there, and think they're getting there now. And I think that will lead to more competition and likely, over time, it'll take a while, that will lead to lower margins. And I think generally what happens is as that happens though, it is offset by a dramatic increase in volumes. As their markets continue to grow, I think their capital markets will continue to grow. The growth rate in China is expected to be pretty high, and so I think the volume of activity will pick up many more times and decrease in margins.

Matthew Burnell - Wells Fargo Securities, LLC

Just switching gears in terms of S&P's recent commentary on U.S. bank ratings, including some commentary about their view of investment banks being a bit riskier than a traditional commercial bank, have you updated your thinking about how you're intending on maintaining your current ratings?

David Viniar

I would tell you, we do not share their view.

Matthew Burnell - Wells Fargo Securities, LLC

And is that largely due to your capital position and liquidity?

David Viniar

I'll just leave it at we don't share their view. As you saw, they kept their ratings stable. Their most recent report on us talked about our risk management, our capital and all those other things. And our expectation is that our ratings will reflect our performance going forward.

Operator

Your next question comes from the line Richard Bove with Rochdale Securities.

Richard Bove - Punk Ziegel

I'd like to ask a minor question and a major question. The minor question is the principal transactions line in the standard balance sheet, how does that relate to the Lending and Investment line that you now have? In other words, is 100% of that part of the Lending and Investing line, or is there some difference between the two?

David Viniar

I'm sorry, which part?

Richard Bove - Punk Ziegel

Of the principal transactions.

David Viniar

Principal transactions. Dick, I'm sorry, I'm not sure where you're looking.

Richard Bove - Punk Ziegel

If you take a look at the income statement, you've broken principal transactions into market making, which is presumably your services for third parties and other principal transactions.

David Viniar

The other principal transactions line, that is primarily Investing and Lending.

Richard Bove - Punk Ziegel

The larger question is, I think what everybody's try to get at is, has there been a lack of customer conviction in the last six months in the marketplace, or has there been a structural change in the marketplace which has got nothing to do with invested conviction? And I would point to the commercial paper market for asset-backed securities, which at the peak was $1.2 trillion in size and now is 1/3 that in size. It is unlikely to get back to $1.2 trillion, because there isn't any major housing market out there. There isn't any major ferment in [ph] CDOs squared or CDOs cubed, et cetera. So where in the structure of the financial sector, as we see it, are there product lines that could in fact come back to replace what I would consider to be a structural decline in a market like that? And I'm applying that to all financial markets.

David Viniar

Clearly, there have been some structural changes in certain parts of the market. The real question is are they permanent? Are they temporary? I don't happen to believe most things are permanent. When you look over time at financial markets, things get created. Sometimes they stay, sometimes they get out of fashion and other things get created to replace them. There's going to be a housing market in the United States. In order to have a housing market in the United States, you need mortgages and you need financing for those mortgages. That's not going to go away. Is it going to be the same type of securitizations that we saw in 2006 and 2007? Probably not for some period of time. I wouldn't say not forever but certainly, not for some period of time. But is there going to be something to replace them to allow that market to go on? Yes, there's going to be something. I don't know what's going to be yet. So it's a really tough question to answer. Some products that were in favor are now out of favor, and are likely to stay out of favor for at least some period of time, but other products will be developed to replace them

Operator

Your next question comes from the line of David Trone with JMP Securities.

David Trone - JMP Securities LLC

On the FICC question, which I guess is getting a little old at this point, but if you look at the sequential declines since the first quarter of '10, it's been pretty steadily downward. And you mentioned there's a pickup here so far. Do you think it's just the seasonal factor? Or do you think there's really a -- like how robust do you think the client conviction recovery could be here in the first quarter?

David Viniar

I don't want to overstate it. We're two weeks into the quarter, so anything can happen. All I can tell you is there has been a pickup from the fourth quarter to the first quarter so far. It could change.

David Trone - JMP Securities LLC

How about in the European credit markets?

David Viniar

I think there's just been a pickup of activity everywhere but again, it's just two weeks. I don't want to overstate that.

David Trone - JMP Securities LLC

Do you think that area has the biggest potential -- that was particularly weak, I suppose, right?

David Viniar

I think there are still a lot of concerns about what the ultimate resolution is going to be in Europe. I think that's one of the things that's weighing on people's conviction. I think it's one of the things that weighed on activity throughout the entire 2010.

David Trone - JMP Securities LLC

Switching gears, the adjusted comp ratio, again, you're below 40% for the year. And I assume, given the increase in deferred comp over the last few years, you have some -- a wave of tranche vesting coming, which will impact the expense, the comp expense. How do you think about that going forward?

David Viniar

There's two things I would say. We don't target a ratio. You've heard me say this before. We pay our people fairly based on their performance, based on the firm's performance, the individual performance. And again, I'm going to say, some of you have heard me say before, we look at compensation based on our performance, the competitive environment, the external environment. We take all those things in consideration, and we paid what we paid this year, I can't tell you what it's going to be next year.

David Trone - JMP Securities LLC

Is it reasonable to assume that all else being equal, the vesting -- the increase in deferred comp, as it vests, would be an upward pressure?

David Viniar

I'm not sure there's going to be that much of an increase going forward versus where we've been. We've always used a lot of equity. It's always been pretty high.

Operator

Your next question comes from the line Steven Wharton with JP Morgan.

Steven Wharton - JP Morgan

It goes back to this question that everybody's wondering about, how much of this is just a temporary lull in activity due to client uncertainty and how much could be more structural? I guess my question is that when you gave your headcount outlook, I think you indicated you'd be up this year, assuming you budgeted for that. Yet historically, when you've gone into these periods of weak activity, you've seen the brokers cut back sometimes on headcount. So does this reflect your confidence, I guess, that this is temporary in nature? And at what point do you kind of think about, well, because of whether all these regulatory changes or other factors, we need to kind of re-evaluate the amount of heads that we have?

David Viniar

Two things I'd say, Steve: First of all, I talked about the fact that a reasonable amount of that is expected to be in the growth markets. That's investment for the long-term. We think it's important for the long-term success of the firm. It might not result in revenues very quickly, but we think over time, it will be the best thing for us and our returns and our shareholders. But the second thing I would say is if activity levels stayed where they were in the fourth quarter for a protracted period of time, we wouldn't be growing our headcount. We don't think that's going to happen. We think it was largely a seasonal fourth quarter event, but I can't tell you for sure. You know I don't like to make predictions, and so we'd have to see it. And remember, I said that -- I prefaced my comment on saying that I thought it would be mid-to-high single digits, with assuming there was no dramatic change in the economic environment. If there is, then I think that number will change.

Operator

I will now turn the call back to management for any closing remarks.

Dane Holmes

Thank you, everyone, for joining on our fourth quarter earnings call. If you have any additional questions, please feel free to contact the Investor Relations Department, and enjoy the rest of your day.