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PRESENTATION

Operator

Welcome, and thank you for joining the Oaktree Capital Group Fourth Quarter 2018 Conference Call. Today's conference call is being recorded. (Operator Instructions)

Now I would like to introduce Andrea Williams, Oaktree's Head of Corporate Communications and Investor Relations, who will host today's conference call. Ms. Williams, you may begin.

Andrea Williams ***Oaktree Capital Group, LLC - MD and Head of Corporate Communications & IR***

Thank you, Laura, and welcome to all of you have joined us for today's call to discuss Oaktree's fourth quarter and full year 2018 financial results. Our earnings release issued this morning detailing these results may be accessed through the Unitholders section of our website. Our speakers today are Chief Executive Officer, Jay Wintrob; Co-Chairman, Howard Marks; and Chief Financial Officer, Dan Levin. We'll be happy to take your questions following the prepared remarks.

Before we begin, I want to remind you that comments today include forward-looking statements reflecting our current views with respect to, among other things, our operations and financial performance. Important factors could cause actual results to differ possibly materially from those indicated in these statements. Please refer to our SEC filings for a discussion of these factors. We undertake no duty to update or revise any forward-looking statements.

I'd also like to remind you that nothing on this call constitutes offer to sell or a solicitation of an offer to purchase any interest in any Oaktree Fund. Investors and others should note that Oaktree uses the Unitholders section of its website to announce material information. Accordingly, Oaktree encourages investors,and the media and others to review the information that it shares on its corporate website at ir.oaktreecapital.com.

During our call today, we'll be making reference to certain non-GAAP financial measures, which exclude our consolidated funds. For a reconciliation of each non-GAAP financial measure to its mostly directly comparable GAAP financial measure, please refer to our earnings press release furnished to the SEC today on Form 8-K. This also may be accessed through the Unitholders section of our website.

Today, we announced a quarterly distribution of $0.75 per Class A unit payable on February 22 to holders of record as of the close of business on February 15. Finally, we plan to issue our 2018 Form 10-K by the end of February.

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

Jay Wintrob ***Oaktree Capital Group, LLC - CEO***

Thanks, Andrea, and welcome to everyone joining the call this morning. The fourth quarter was very challenging for credit and equity markets around the world. U.S. high yield bonds suffered their largest monthly decline in three years. U.S. senior loans had their worst month since August 2011, with the two largest weekly outflows on record for the asset class. And U.S. equities experienced their worst December since the Great Depression.

The market declines in the fourth quarter stood in sharp contrast to the optimistic market conditions that prevailed over the first three quarters of the year. Against this tale of two markets and fast-changing investor sentiment, Oaktree demonstrated solid closed-end fund investment performance of negative 1% for the fourth quarter and positive 9% gross for the full year, further validating our disciplined and risk-controlled investment approach.

Consistent with our focus on seeking value, we were able to take advantage of the market declines in the fourth quarter by investing $4 billion from our closed-end funds, shifting our posture from a net seller in the first half of 2018 to a net buyer in the back half of the year. Also, we feel good about our strong fundraising of $13 billion of gross capital in 2018. And our current balance of $19 billion of dry powder positions us well for any expansion of investment opportunities across our strategies. All in all, we're pleased with the progress in our business and the strength of our model.

Distributable earnings for full year 2018 were $613 million, down 15% from 2017 when we had record incentive income from our U.S. private equity strategy. Our solid 2018 investment performance produced strong full year incentive and investment income totals while generating $297 million of incentives created. And the distribution we announced today of $0.75 brought total distributions for 2018 to $2.96 per Class A unit.

Last year, we made progress in broadening our business, particularly in terms of attracting new clients and raising assets outside the United States. Of the nearly $7.5 billion we raised in closed-end funds, some larger commitments were from clients based in Japan, China, the Middle East and Latin America, all regions where we've dedicated additional marketing resources over the past few years. Capital from non-U.S. clients represented approximately half our closed-end and total gross capital raised in 2018.

We had a strong fundraising year from intermediary and high net worth channels, raising approximately $1.4 billion from global high net worth individuals, family offices and clients of financial advisory firms such as Morgan Stanley and Merrill Lynch. Together with an additional $2 billion of flows from our sub-advisory and SICAV platforms, we raised about $3.4 billion from these channels across a diverse slate of strategies such as Strategic Credit, Real Estate Debt, Special Situations and Emerging Markets Equities.

AUM from intermediary and high net worth channels comprised about 16% of total Oaktree AUM at year-end.

We're particularly encouraged by the growth of several Oaktree strategies last year. First, we continue to make progress in broadening and scaling our real estate platform, which now comprises three strategies. We successfully completed our second Real Estate Debt fund, which closed on over $2 billion. We also laid a terrific foundation for future growth in our newest Real Estate Income fund by generating a very strong first year investment return of 27% before fees. We're currently leveraging our Real Estate Income team by launching Oaktree REIT. And finally, this year we'll be raising our eighth Real Estate Opportunities fund.

Second, we successfully increased the scale of and diversified our direct lending platform, raising $800 million for our Middle-Market Direct Lending fund for institutional clients and over $300 million for a private BDC for high net worth clients. Our Private/Alternative Credit strategies now total nearly $8 billion.

Third, we grew our assets for Power Opportunities significantly by raising our largest fund ever for that strategy, $1.4 billion in a single close. This strategy continues to generate outstanding investment performance, holding the enviable position of Oaktree's highest-performing closed-end strategy since its inception in 1999. This is a great testament to the positive impact of discipline in setting the size of funds.

Fourth, our Emerging Market Debt platform made good progress last year, raising almost $900 million in our Emerging Markets Opportunities and Emerging Markets Debt Total Return strategies.

Fifth, our value-based approach to Emerging Market Equities delivered strong outperformance versus the benchmark in 2018, and we were able to attract over $1.2 billion in gross capital during the year with a solid pipeline for additional flows in the next couple of quarters.

And finally, we continue to see strong investment performance from the Global Credit strategy. Over its nearly two-year life, the Global Credit strategy has outperformed its benchmark on an annual basis by 1.5% gross. And in 2018, we raised $650 million for the strategy and are continuing to see a lot of interest from new and existing clients.

Looking ahead to this year, we have momentum from the growth in our strategies and distribution organization and from the continuation of fundraising efforts for Special Situations Fund II, Emerging Markets Debt and Equity funds, the Real Estate Income Fund and the Global Credit Fund. And this year, we anticipate launching, in addition to the Real Estate Opportunities Fund VIII, our fifth European Principal fund, our second European Capital Solutions Direct Lending fund, Mezzanine Fund V, Oaktree REIT and various structured credit vehicles; as well as engaging in ongoing fundraising for our evergreen strategies, in particular, the Value Opportunities Fund and Strategic Credit.

Turning to our open-end strategies, we were not immune to the industry fund outflows that took place throughout last year, including record redemptions in the high yield bond and senior loan asset classes during the fourth quarter. Within our open-end strategies, Oaktree experienced about $4 billion in net outflows last year, primarily from our high yield bond and convertible securities strategies. However, we're encouraged by strong investment track records for our European High Yield Bond and U.S. Senior Loan products and increased investor demand for our Emerging Markets Equities strategy.

Looking back on 2018, I'm very proud of our Oaktree team of remarkably talented, dedicated and hardworking professionals. Viewing things from a high level, I think we achieved success on three fronts: first, investing well while adhering to our focus on the primacy of risk control; second, raising $13 billion of gross capital through a broad range of Oaktree strategies and products; and third, continuing to expand the investment strategies that have been most important to the growth of our diversified platform in recent years, namely real estate, infrastructure, Emerging Markets Debt and Equity and direct lending. Right now, I believe our best opportunities for future growth will come from continuing to scale many of these strategies, successfully deploying an increasing amount of capital across the globe in our flagship Distressed Debt strategy and capitalizing on the strong performance track records of our private equity strategies and several of our open-end and evergreen strategies.

And with that, let me turn the call over to Howard to discuss our investment performance and the market environment.

Howard Marks ***Oaktree Capital Group, LLC - Co-Chairman & Co-Founder***

Thanks, Jay, and hello, everyone. What an interesting year 2018 was. The market psychology proved to be incredibly volatile as a broad sell-off took hold of the markets in the first week of October and continued nearly unabated through year-end. This was driven by no new real concerns as the withdrawal of central bank liquidity, increase in interest rates, slower global growth, all had been foretold well in advance as had the geopolitical tensions regarding trade.

On October 3, everything was fine with the markets. On October 4, the equity market began one of the biggest declines ever seen over such a short period of time, leading to the worst December since the Great Depression. But as I wrote in "On the Couch" in early 2016, when the markets got off to one of their worst starts in history, "In the real world, things tend to fluctuate between 'pretty good' and 'not so hot,' but in the markets, things swing between flawless and hopeless." And that's what happened in the fourth quarter.

Against this turbulent backdrop, the composite full year returns for our closed-end funds and evergreen strategies were largely outstanding and well above the public securities indices. The composite gross return for the Distressed Debt strategy was 10%; Power Opportunities, 13%, European Principal, 11%, Real Estate Opportunities, 15%; and U.S. Private Debt, 12%. As an aside, I believe we had a particularly good year relative to our competition in our very important Distressed Debt strategy, with a fourth quarter gross return of negative 1.5% and a full year return of 10%. As a result, Opps X, which already has seen its committed capital invested more than once against the very lackluster background for opportunities in distress over the last 2.5 years, shows an attractive absolute return and adds further to Oaktree's luster. The Emerging Markets Opportunities Debt strategy came in at 8% and Special Situations Private Equity at 1% for the year due to its exposure to certain public equities in the tech sector.

Among our evergreen strategies, the two largest, Strategic Credit and Value Opportunities, had 2018 full year gross returns of 4% and 11%, respectively. While our open-end strategies generally performed in line with their benchmarks, some did better, of course, and some did worse. The conspicuous outperformers were U.S. Senior Loans, European High Yield and Emerging Markets Equities. And in a difficult fourth quarter, six of the nine open-end strategies beat their benchmarks.

So where do we stand today? I see the fourth quarter price action as a dash of cold water that cooled off some unwarranted enthusiasm. All of a sudden, credit spreads widened, and it was hard to raise money or refinance debt. I take these as signs of helpful prudence. That said, those losses now have been recovered to a large degree, so I'd say investors were chastened but back to being optimistic, especially with developments with the Fed and trade with China now perceived as positive.

I continue to believe that asset prices are relatively high, and as the fourth quarter proved, investor psychology is fragile. As we begin 2019, the outlook for defaults in corporate credit remains quite benign, with strategists projecting high yield bond and leveraged loan defaults about 1.5%, well below the long-term averages in the areas of 3%. Thus, a supply of U.S. distressed, tradeable investment opportunities may continue to be modest. We saw in the fourth quarter the ability of our teams to deploy capital into some high-quality traded credit opportunities in weak times. As 2019 has started off with a relief rally, the focus of the distressed debt teams active pipeline has reverted to private deals in Europe and Asia and attractive opportunities in sectors such as telecom, healthcare and retail.

Now is a good time to have dry powder, and we do, given the outstanding amounts of low-quality debt and fallen angel candidates, BB debt that could be downgraded. They are significantly greater than they were prior to past times of expanded opportunity.

Now I'd like to turn the call over to Dan to discuss the financials in detail.

Dan Levin *Oaktree Capital Group, LLC - CFO*

Thank you, Howard. Reflecting upon the year as a whole, we are pleased with our financial performance. For the full year, we generated adjusted net income and distributable earnings per Class A unit of $2.63 and $3.61, respectively, and we distributed $2.96 per unit to our Class A unitholders. Management fees declined $24 million or 3% to $790 million. As I've mentioned on prior calls, the elevated pace of realizations, especially in the first half of the year, has reduced our management fee-generating AUM for our closed-end funds, and net outflows have had a similar impact on our open-end funds. This decline was partially offset by fees from our BDC acquisitions in late 2017.

Turning to expenses, compensation and benefits increased $18 million in 2018, primarily resulting from expenses related to the Highstar infrastructure team, as I've mentioned before. This amount reflects existing expenses of the infrastructure business that were previously paid for by a legacy Highstar fund that, as scheduled, stopped paying management fees in the fourth quarter of 2017.

G&A expenses increased by $22 million, primarily a result of increases of $10 million in placement fees and $5 million related to the Highstar infrastructure team. The higher placement fees were driven largely by the $5 billion increase in closed-end capital raised versus 2017, with closed-end funds representing 59% of the year's total capital raised compared to 28% a year ago.

As Jay mentioned, we have grown intermediary and high net worth distribution and have offered an increasing number of products through these channels, which represents a nice diversification of our client mix and comes with incremental G&A expenses. As a result of lower closed-end and open-end management fees and increased expenses, fee-related earnings in 2018 declined 22% to $228 million.

Incentive income for the year totaled $496 million driven by strong realizations in our Distressed Debt, Special Situations and Real Estate strategies. The largest contributor was Distressed Debt at $262 million.

Investment income was $49 million in 2018. We recognized a $38 million investment income loss in the fourth quarter, primarily driven by mark-to-market declines in public equity positions across various strategies. Not surprisingly, many of these declines are proving temporary.

Moving to DoubleLine, we continue to be impressed with the company's investment and operating performance, especially in light of the market declines in mutual fund outflows witnessed in the fourth quarter. AUM grew 2% in 2018 as the firm continued to diversify from core fixed income products into an increasing array of equity, real estate and commodity-related funds. Over the last year, DoubleLine contributed $74 million to Oaktree's distributable earnings, up 4% from 2017.

In terms of capital structure, over the past year, we strengthened our balance sheet to maximize operational flexibility and increase dry powder at the corporate level. We extended the maturity of our $150 million term loan and $500 million revolver, both now maturing in March 2023; and issued two perpetual preferred securities, raising $400 million in net proceeds. As a result, we are well positioned to take advantage of opportunities to invest in new strategies and potentially, for an inorganic strategic growth.

Net incentives created in 2018 were $148 million, bringing our net accrued incentives balance for the year to $812 million or $5.17 per Operating Group Unit. 39% of our net accrued incentives is represented by private equity strategies, 31% by Distressed Debt and 24% by Real Assets. Of our net accrued incentives balance, 29% is in funds that are currently paying incentives.

Turning to the outlook for 2019. We reiterate prior comments that we do not expect management fees to grow until the start of investment period of Opps Xb, which we still estimate will be in the second half of 2019. While we're off to a good start in deploying capital on Opps Xb with 19% invested as of year-end, given the size of the fund, we are going to be patient in starting the investment period and, thus, the time when the fund will pay management fees on committed capital.

With respect to the first quarter of 2019, at this point, our known fund-related investment income proceeds are $5 million, and we have no known net incentive income, thus far. As we generally do in the first quarter, we expect to recognize incentive income from tax-related incentive distributions paid by funds that generate taxable income in 2018 but aren't yet paying regular incentives.

Current indications are that net incentive income from tax-related incentive distributions will be approximately $130 million in the first quarter. The meaningful increase of tax-related incentive income relative to the first quarter of 2018 is driven by European Principal Fund III and Opps X paying tax distributions for the first time.

Before I wrap up, I'd like to address the recent decisions by several of our peers to report distributable earnings as their primary earnings metric. We think this is a positive development for the industry, and it aligns well with how we have always thought about our business. In order to simplify our disclosure and enhance comparability, starting with the first quarter of 2019, we will report distributable earnings as our primary earnings measurement and will no longer report adjusted net income or economic net income.

In conclusion, 2018 was a strong year for fundraising and deployment and a solid one for investment performance against a challenging market backdrop. Looking ahead, we are well positioned to capitalize if market volatility continues, with $19 billion of dry powder at our funds and $1 billion of cash and equivalents on our balance sheet.

With that, we're delighted to take your questions. So Laura, please open up the lines.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question today comes from Jerry O'Hara of Jefferies.

Jerry O'Hara ***Jefferies LLC, Research Division - Equity Analyst***

You touched on a little bit there in prepared remarks about how the marks, I guess, were largely temporary on some of the public positions. But could you perhaps talk a little bit about the puts and takes between 4Q and what sounds like a little bit of a bounce back here year-to-date with respect to exposures or just kind of general market rebound and how that's impacted portfolios, thus far? I know it's still early, but any sense would be helpful.

Dan Levin ***Oaktree Capital Group, LLC - CFO***

Yes. So Jerry, to address the publicly traded securities, as we think about them kind of Level 1 and Level 2 securities in our portfolio, we've seen a recovery so far this quarter of a little bit over 50% of the kind of write-downs that we saw in the fourth quarter. So we're off to a good start in terms of the portfolio and the performance in the first quarter. Harder to give you much insight or color on the Level 3 assets, but clearly, market movements this quarter should be helpful there as well because part of the valuation methodology is based on comparable companies.

Howard Marks ***Oaktree Capital Group, LLC - Co-Chairman & Co-Founder***

Dan, I would you just add that in the marketable securities categories where we have benchmarks, we beat the benchmarks in most of them in the fourth quarter, meaning to say we went down less, and yet our participation in the recovery in the month of January, which is a very strong month, was -- we were right in there with the indices. So I would say that those four months taken together demonstrated the kind of performance pattern that we and our clients look for.

Operator

And the next question will come from Mike Carrier of Bank of America Merrill Lynch.

Michael Needham ***BofA Merrill Lynch, Research Division - Associate***

This is Mike Needham, in for Mike Carrier. Howard, I was hoping you might expand on the comments you made about a larger addressable market for your distressed business. There does seem to be a lot more debt out there, both high yield and low-rated investment grade. Thinking there could be some offsets, things like companies paying lower tax rates and covenants that are harder to trip. Just wondering if you can drill down on that assessment and whether in the fourth quarter, you kind of start to see more debt in the public markets, at least, that was trading at distressed levels.

Howard Marks ***Oaktree Capital Group, LLC - Co-Chairman & Co-Founder***

Yes. Well, Mike, as you mentioned, there are considerable crosscurrents. On the one hand, the issuance of low-grade debt has been very strong, plus the issuance of BBBs, which has the potential to become low-rated, and the -- it may or may not be synonymous, but the standards for credit issuance has been very loose. I put out a memo on September 26 entitled "The Seven Worst Words in the World, Too Much Money Chasing Too Few Deals". The consequence of that condition is always a weakening in the strength of deals, in addition to an increase in the pricing, so more issuance, lower quality and, obviously, some fragility in investor attitudes. Some things did get cheap in the fourth quarter, and we were able to put $4 billion to work, which I think is a good plus. Not merely the existence of the opportunities, but the fact that despite the crumbling -- seemingly crumbling environment around us, our people were able to gut it out and put money to work. And that's what we should do, but it's always nice to see it happen. On the other hand, as you indicate, part of the weakening of deal structures over the last several years has been the disappearance of covenants. And when there are no covenants, it means everything else being equal that any distress that does arise, defaults, I should say, that does arise, tends to happen later. It can't happen for technical reasons, breach of covenant, and it can only happen for money reasons. So all things being equal, the defaults will come later than they otherwise would have. But they'll probably be worse because by the time companies default having been able to go on for -- and do business for a long time in breach of covenants, they would tend to dissipate more of their assets. So the rating agencies, for example, have estimated that recoveries will be considerably less from this round of financing than at the historic levels. So many crosscurrents. I think that I would sum up by saying that the stage has been set through what we call around here the unwise extension of credit and in particular, the heavy reliance on adjusted EBITDA for an elevated -- for our fourth occasion of elevated opportunities. We had great opportunities in the funds that were formed in 1991, '01/'02, '06/'07, great opportunities. And we think that the pieces are in place for the fourth such opportunity, but we need an igniter. And that will probably require a recession because, especially given the absence of covenants, you're unlikely to get much of a pickup in defaults and, thus, in opportunities for us until you get a recession.

Jay Wintrob ***Oaktree Capital Group, LLC - CEO***

Howard, if I could just add a couple of comments specific to Oaktree that I think the fourth quarter reflected. I think that for several years now, we've been methodically and intentionally growing our global platform for distressed debt. And several of the transactions in the fourth quarter included investments in Asia, China, India, for example, as well as we still have a very large presence in EMEA. I think for the full year, about 40% of the deployment in our distressed debt strategy was outside the United States, and we continue to have a bigger group of investment professionals located around the globe than we do inside the United States. So I think that, in addition to the big macro, I think we are positioned globally better than we've ever been.

Howard Marks ***Oaktree Capital Group, LLC - Co-Chairman & Co-Founder***

I can't let Jay have the last word. And I just want to add, as I said in my prepared remarks, I'm enormously proud of the distressed debt group's behavior over the last three years. They activated Fund X, which was $3.8 billion, I think, in the middle of '15. They got it more than 100% invested despite the paucity of distressed opportunities, despite the rosy environment, and it's showing very good returns to date in a period when most people in distressed debt were, I would say, not able to accomplish anything. So we did a lot on the investing side and a lot on the performance side. Very proud.

Operator

The next question will come from Michael Cyprys of Morgan Stanley.

Michael Cyprys ***Morgan Stanley, Research Division - Executive Director and Senior Research Analyst***

Just wanted to ask about the Opps Xb 19% invested here, seems like that -- the pace is picking up. I guess, if you roll the clock forward from here at this current pace could be, call it, 40% invested by the time you get to the middle of 2019. So just curious at what sort of level are you looking to before you start activating fees, maybe how that differs versus what you've done in the past in terms of practice. And then just thoughts around raising another distressed fund, how you're thinking about sizing that, and what the timeframe might be because at the current pace, this fund could be meaningfully deployed by the end of '19.

Dan Levin ***Oaktree Capital Group, LLC - CFO***

So let me take the first part of that. So in terms of how we're thinking about activating the investment period and, therefore, fees on committed capital, this is a larger fund that we sized up because of some of the things that Howard already mentioned, both in the prepared remarks and some of the responses. And so what we do is we really look at two things. We look at how much has been deployed, which you pointed to, 19%, and that should grow as we get into this year. And we also look at the opportunity set ahead and how do we think about the pace of deployment. And so I think, we will be patient in terms of turning on the investment period given the greater size of this fund relative to our last fund. So as Howard mentioned, our last fund was $3.6 billion. This is $8.9 billion. And so we may be willing to deploy more of it than we did of the last fund before we start the investment period. So there's no magic number. We use our best judgment of what we think is in the best interest of our clients, and it will be based on our impressions of how much we've deployed but as importantly, what do we think the prospects for future deployment are.

Howard Marks ***Oaktree Capital Group, LLC - Co-Chairman & Co-Founder***

And I'd like to add that you asked something about how this squares with past practice. We don't have a lot of experience in this. The idea of delaying the onset of the investment period for fee purposes is a pretty new thing. It happened to the first time sometime within our last few funds. And as you know, the purpose is to avoid having heavy fees on a fund in the early years when it is only fractionally invested, which fees on the whole thing returns on just a little bit, creates a bad dynamic in the beginning that we decided to spare our clients. So as Dan says, we're going to do it. You said, if you extrapolate the pace last year, that takes us to 40% by mid-'19. We can't really comment on whether 40% is enough or whether that's a fair extrapolation. Then you also talked about the outlook for being substantially invested by the end of '19. And if you take those two comments together, what it says is second half of '19, which is what we have always said lately, and I think that's the wise thing to say. Just one reminder, if anybody is listening on the call and has the impression that we're not charging fees in Xb, that's wrong. We're charging fees based on invested capital. The only thing under discussion is when we switch to charging fees on committed capital for a 3-year period.

Jay Wintrob ***Oaktree Capital Group, LLC - CEO***

And on that period, I just want there to be no uncertainty. We expect that to be in the back half of this year.

Howard Marks ***Oaktree Capital Group, LLC - Co-Chairman & Co-Founder***

Jay, you can have the last word on that.

Jay Wintrob ***Oaktree Capital Group, LLC - CEO***

No, you got it.

Dan Levin ***Oaktree Capital Group, LLC - CFO***

And then, Mike, I think, you did ask about the next fund. So it's a little -- it's hard to say exactly when the next fund will come. We're obviously making some good progress. If we continue to make good progress we would certainly start thinking about that in 2020.

Howard Marks ***Oaktree Capital Group, LLC - Co-Chairman & Co-Founder***

And I'll throw in that in the fourth quarter, in December, when things were cascading down, I was starting to salivate. I mean, we were seeing debt prices plummet, spreads widen out very substantially by a couple hundred basis points, total inability to issue a high yield bond in December for the first time in many years. We had a month without any issuance. So at that moment, we were optimistic both as to the timing and the size of Opps XI and, of course, with the recovery. We're a counter-indicator, so with the recovery, now we're less optimistic. But these things will change a lot between now and then.

Operator

And next, we have a question from Brian Bedell of Deutsche Bank.

Melinda Roy ***Deutsche Bank AG, Research Division - Research Associate***

This is Melinda Roy, on for Brian Bedell. Maybe just one on FRE. How should we think about FRE growth and margins in 2019 and into 2020, given your management fee guidance on Opps Xb and any other fundraising efforts?

Dan Levin ***Oaktree Capital Group, LLC - CFO***

Thanks, Melinda. So the biggest driver of FRE margin is going to be the trajectory of our management fees. And so in the first part of the year, we don't expect management fees to grow. As I think about expenses for 2019, expect G&A to be roughly similar to what we saw this year, noting that placement fees can vary quarter-to-quarter as well as year-to-year. In terms of comp and benefits, I do expect there to be kind of mid- to high single-digit percent growth in comp and benefits next year, reflecting some of the investments we've made, particularly in building out our Asia investment capabilities as well as distribution capabilities. So add that all up, you could see a little bit of FRE pressure in the first part of the year. When Opps Xb starts its investment period, we would expect management fees to step up and our FRE margins to step up into the 30s as a result. As we look into 2020, I think, we could see continued FRE margins in the kind of low to mid-30s, and it will partially depend on the timing -- the pace of deployment and the timing of turning on some of the other funds that we're raising such as some of the ones that Jay mentioned, including Real Estate Fund VIII, European Principal Fund V, among others.

Operator

And the next question comes from Alex Blostein of Goldman Sachs.

Alexander Blostein ***Goldman Sachs Group Inc., Research Division - Lead Capital Markets Analyst***

Howard, wanted to start with a question around fundraising and sort of the LP's response to the events in December and the volatility and, obviously, the subsequent improvement we saw in January. So is that, in any way, accelerating or, in the other hand, delaying some of the fundraising initiatives you have in place? And really, just, again, hoping to get a better check on the pulse of how LPs have responded to this brief period.

Howard Marks ***Oaktree Capital Group, LLC - Co-Chairman & Co-Founder***

I think, it's too soon to say, Alex. We're only one month into the new year. We're only a few days past the end of that highly volatile recovery month. I think that, if I'm not mistaken, the resurrection of what I would call prudence in the fourth quarter, whenever prudence is rewarded, Oaktree does better in client reception because they say, "Oh yes, now I remember why we like Oaktree because they don't go down as much and because they swing into action in tough times." So -- and I think that that's all going on now. And we had nine years in which there were very few reminders of the need for prudence. So I think that our receptivity is very good. And by the way, people give me credit for being cautionary in my last memo, and they let me off the hook for having been cautionary over several memos well before that.

Alexander Blostein ***Goldman Sachs Group Inc., Research Division - Lead Capital Markets Analyst***

Great. Fair enough. And then Dan, can I just sneak one more in, in your comments around the balance sheet and the fact that you guys, obviously, have a lot of dry powder in the funds as well as on the balance sheet, and you did highlight inorganic opportunities. Could you guys expand on that a bit more and what you could find interesting right now?

Dan Levin ***Oaktree Capital Group, LLC - CFO***

So currently, it's consistent with our prior comments, not unlike our general view of the investment environment. There's lots of capital. Prices are high. There are minority stake investors that are active in the market. So as a general comment, I'd say, we're pretty cautious on M&A in this environment. But we certainly understand and appreciate the prudence of having capital available when times change, when sentiment in psychology evolve and when the opportunity set gets larger. So to sum it up, I think we're going to be quite cautious in the current environment, but we think it's prudent to have available capital for a different environment.

Operator

And our next question comes from Chris Harris of Wells Fargo.

Christopher Harris ***Wells Fargo Securities, LLC, Research Division - Director and Senior Equity Research Analyst***

So your investment performance in the fourth quarter better than our expectations, better than benchmarks, better than your peers. Might be a little hard to generalize, but what do you attribute that outperformance to specifically in the quarter? Is it just that, perhaps, you're a little bit higher up on the quality spectrum and that kind of drove it? Or was it something more broad than that?

Howard Marks ***Oaktree Capital Group, LLC - Co-Chairman & Co-Founder***

We'll, I'd love to say we're smarter. But most of it is that our approach to investing emphasizes good participation in benchmark returns when they're good and protection against declines when there are declines. And so we really get to show our stuff in tough quarters, and I think we did, as a result. I think that's most of it. There's nothing specific. For many years, we've been fully invested but cautiously. And the fourth quarter was a period when it paid off extremely well, and there haven't been many such periods. But I'm proud of having remained fully invested. That's really the key. Our caution has permitted us the confidence to remain fully invested over this period. And that means that we have participated in most or all or sometimes even more than the benchmark returns. And then, when the stuff hits the fan to outperform on the way down, that's really our ideal.

Operator

Our next question comes from Patrick Davitt of Autonomous Research.

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

Howard, you mentioned the fourth big opportunity as emerging and the potential salivation in the fourth quarter. So with that in mind and the view that there's probably a lot more paper this time around out there than in '07, '08 and how quickly you raised VIIb when that opportunity became clear, have you guys done some work around how much bigger the addressable market when that opportunity comes and what percentage of that you think becomes a good Oaktree investment?

Howard Marks ***Oaktree Capital Group, LLC - Co-Chairman & Co-Founder***

I would say we don't generally do that kind of speculative thinking. These markets have doubled in size in the last 10 years. That's the most important thing. The quality is lower, which implies that one of these days there is going to be a high default rate once we cleared the requirement for a recession. And given the fact that recoveries are likely to be low, that means purchase prices may cascade downward. So it's all good for a good-sized Opps XI. But still, we need an entry point to make that decision as seemed to be foreshadowed in the fourth quarter but now seems to have disappeared. So we don't take a scientific approach to this. We used the judgment from having been in the distressed business over 30 years, and I'm sure we'll continue to use that judgment.

Jay Wintrob ***Oaktree Capital Group, LLC - CEO***

Howard, if I may just add, and then you'll comment.

Howard Marks ***Oaktree Capital Group, LLC - Co-Chairman & Co-Founder***

Yes, Jay.

Jay Wintrob ***Oaktree Capital Group, LLC - CEO***

To put in a word for -- and I completely concur with Howard's comments about the accomplishments of our distressed debt team and the potential. But I also want to put in a strong word for so many other Oaktree strategies that, during these past years, including '18, have continued to expand. And so when you get into the numbers, we've seen increased deployment both in our European Principal group and our European Private Debt group. We've seen meaningful increased deployment across all three strategies for Real Estate, the Power Opportunities strategy and the Infrastructure strategy, greater deployment this year than in prior, and both Emerging Markets Debt and Equity. And that's not even to speak about other aspects of our direct lending platform like the BDCs and Strategic Credit. So I just wanted to make sure that we didn't paint an imbalanced picture about the growth and expansion across Oaktree and what's really been driving it leading up to this very interesting period that we're heading into for distressed debt.

Howard Marks ***Oaktree Capital Group, LLC - Co-Chairman & Co-Founder***

Well, good point, Jay. And everybody tends to think of us as being dominated by the Opportunities funds. And they are important to us. But as Jay says, they're not everything. The Opportunities Fund, I noted in Jay's remarks, the Opportunities funds are not even the biggest factor anymore in our accrued incentives. They are 31, I think, versus 39 for the private equity. When I look at our performance summary for the year, which Andrea Williams was good enough to furnish me to get me going on my annual review, it's really exciting to look down the list and see so many of the closed-end, are you allowed to say exciting? Okay. To see so many of the closed-end strategies with double-digit returns for 2018, which was not a great year by most accounts.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Andrea Williams for any closing remarks.

Andrea Williams ***Oaktree Capital Group, LLC - MD and Head of Corporate Communications & IR***

Thank you, everyone, for joining us for the fourth quarter 2018 earnings conference call. The replay for this conference call will be available approximately one hour after this broadcast on Oaktree's website in the Unitholders section. You may also access the replay by dialing (877) 344-7529 in the U.S. or 1 (412) 317-0088 outside of the U.S. The replay access code is 10127530. Thank you very much.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.