

**PRIVATE EQUITY OVERVIEW**

The private equity industry has finally hit a rough patch after an extended period of what some have referred to as the “Golden Age” of private equity of huge capital inflows and easy financing which has driven investment activity to record levels. However, the environment is starting to become less accommodative, as investors are demanding better terms for the debt of private equity deals. In some cases, deals have been postponed, while in others, more attractive terms – higher interest rates, tighter covenants – have been necessary to attract investors. In others still, banks are having difficulty syndicating deals at all, and are “on the hook” for such debt. Yet, the pipeline of deals remains strong, meaning it may take a while to work all of this debt through the system, assuming all of these deals are completed.

At least partly due to the sub-prime crisis, investors are repricing risk, which will make it more difficult and less attractive to finance buyout deals. While this trend should help to cool the buyout market, it remains to be seen if the financing “spigot” has been effectively turned off, or whether it has been turned down to a more moderate pace. Given the reaction in the markets, it is possible that buyout deal making will slow significantly, particularly among the largest deals. Even if the financing environment stays slow for an extended period, there remains a large pool of committed capital waiting to be invested. Private equity firms will still have to find a place for this capital, despite the vagaries of the market. However, the credit issues are much less likely to impact venture capitalists, as they are not dependent on financing for their deals. Any economic downturn caused by the recent financial distress, however, would have a direct impact on venture portfolio companies.

In the regulatory arena, Blackstone’s IPO and the huge paydays enjoyed by top buyout professionals (highlighted by Steve Schwarzman’s 60<sup>th</sup> birthday extravaganza), have piqued the government’s interest with respect to re-evaluating the tax paid by both publicly-traded partnerships (i.e. Blackstone, Fortress, etc.) and GPs themselves on the carried interest they receive from investments. Were taxes to increase meaningfully on private equity in general (either publicly-traded private equity partnerships or general partners themselves) there may be material repercussions, which could impact Limited Partners. Some have suggested that private equity firms could (or would) raise fees and carried interest to offset such taxes, effectively reducing returns of LPs. While no one knows for certain how this will play itself out, it bears watching. The 2008 presidential election may be the key to the outcome of this debate.

**VENTURE CAPITAL**

- In the second quarter of 2007, 70 venture capital funds raised a total of \$7.25 billion, up significantly from the \$5.64 billion raised in the prior quarter, but still down 49% as compared to the second quarter of 2006, which was the strongest quarter since the first quarter of 2001 – the end of the bubble era. This level of fundraising is at the higher end of the range for the last few years (notwithstanding the 2<sup>nd</sup> quarter of 2006 results).
- Total volume of investment in venture capital was down slightly from the first quarter, with \$11.1 billion invested in the second quarter, versus \$12.0 billion invested in the prior quarter. However, the number of deals was the highest since the third quarter of 2001, as venture capitalists invested in 945 companies during the quarter. Seed- and early-stage investment activity was up over 30% from the prior quarter, driving the growth in the number of deals completed.
- While the number of deals increased or held steady across all segments – early-, expansion- and later-stages – only early-stage deals experienced higher volume.
- Venture capital investment activity by US venture capital firms in India and China picked up materially relative to the prior quarter. Firms invested \$119 million in 18 deals in India, up from \$83 million invested in 2 deals in the first quarter. In China, \$408 million was invested in 34 deals versus \$137 million invested in 18 firms in the prior quarter. These data exclude investment activity in these geographies by local and other non-US entities.
- The IPO market in the second quarter for venture-backed companies was the strongest by volume since the third quarter of 2000. Twenty-five companies went public in the quarter, raising a total of \$4.1 billion. This total is up 89% from the prior quarter, and up 106% from the second quarter of 2006. The increase in volume is generally due to larger amounts raised, as the number of IPOs during the quarter was up from prior quarters, but not as materially as was the volume. This is partly due to the IPO of MetroPCS Communications, the third-largest venture-backed IPO of all time, at \$1.15 billion.

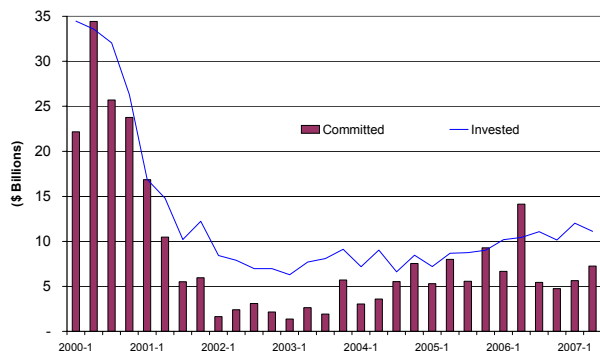
**US Private Equity Performance Index (PEPI)**  
Investment Horizon Performance through 3/31/2007

Fund Type	1 Yr	3 Yr	5 Yr	10 Yr	20 Yr
Early/Seed	8.0	6.9	(1.4)	37.7	20.6
Later Stage	23.5	9.6	5.2	10.0	13.8
<b>All Venture</b>	<b>18.1</b>	<b>9.6</b>	<b>2.7</b>	<b>21.0</b>	<b>16.4</b>
Medium	26.0	13.6	8.5	11.0	13.8
Large	22.1	11.0	11.0	8.1	12.5
<b>All Buyouts</b>	<b>22.3</b>	<b>15.0</b>	<b>11.4</b>	<b>8.9</b>	<b>13.1</b>
Mezzanine	10.8	4.9	4.5	5.9	8.5
<b>All P.E.</b>	<b>21.5</b>	<b>13.1</b>	<b>8.7</b>	<b>11.3</b>	<b>14.0</b>
NASDAQ	4.2	7.4	6.2	7.6	9.9
S & P 500	11.8	10.1	6.3	8.2	10.8

\*The PEPI is based on the latest quarterly statistics from Thomson Venture Economics. All returns are calculated by TVE from the underlying financial cash flows. Returns are net to investors after mgmt fees and carried interest.

Source: Thomson Venture Economics/NVCA, Stylus

**US Venture Capital Activity**



Source: Venture Economics

**VENTURE CAPITAL (Con't)**

- There are currently 40 companies “in registration” for an IPO, down from the 44 companies at the end of the first quarter of 2007, and from the 41 companies at the end of the second quarter of 2006.
- Venture-backed M&A volume was the slowest since the fourth quarter of 2003. Only 70 companies were acquired during the quarter, for a disclosed \$2.7 billion, down 40% from the prior quarter, and down 34% from the comparable quarter of 2006. The number of deals was at the low end of the range of the past few years, but was not down as dramatically as was disclosed deal volume.

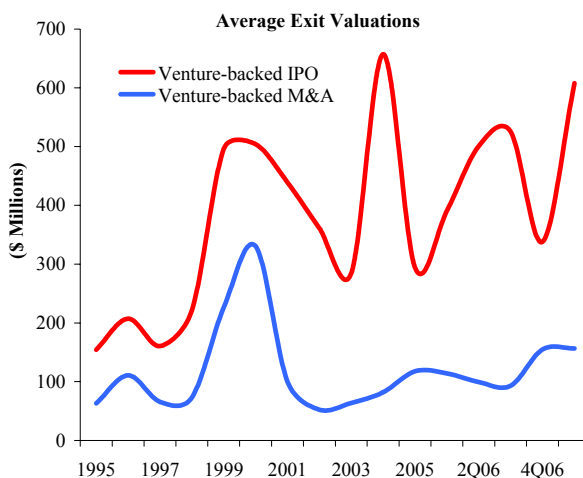
**BUYOUTS**

- Buyout fundraising in the second quarter was strong, as expected. A total of \$40.4 billion was raised in the quarter, down marginally from the past few quarters, but still one of the strongest showings on record.
- From an investment standpoint, the recent credit issues may make it much more difficult for buyout firms to do deals. There are estimates that investment banks have between \$200 billion and \$300 billion in inventory of leveraged loans that are waiting to be sold to investors. In addition, several recent deals have been delayed or had other issues, including perhaps the most high-profile and anticipated deal, Chrysler. Other deals currently stuck in the pipeline include First Data, Alltel, and Sallie Mae, among others.
- As long as active deals in the pipeline are delayed, buyout firms may have trouble getting new deals, particularly large deals, financed unless they are willing to acquiesce to more generous terms (financial and covenants) for investors. While it is widely reported that “covenant-lite” and other aggressive loan packages were no longer “de rigeur” even before the recent credit market issues, anecdotally private equity firms are having to offer higher interest payments to attract buyers to finance deals.
- The exit market for buyout-backed deals remained weak, continuing the trend from last quarter. There were only ten buyout-backed IPOs during the second quarter, which raised an aggregate \$2.1 billion, up 35% from the prior quarter, but still down 51% from the comparable quarter of 2006. While this performance is at the low end of the range of activity over the past few years, it is not worse than other weak quarters. However, as some of the mega-buyouts mature, a likely exit will be to take these companies public again. As such, if the markets cannot absorb at least some of these large buyouts in the next few years, the mega funds may struggle to generate good performance.
- The M&A market for buyout-backed companies was not much better; there were only 12 M&A deals in the second quarter for a disclosed deal value of \$2.2 billion. This was down 33% from the prior quarter’s \$3.3 billion of disclosed value, and down 64% from the 2<sup>nd</sup> quarter of 2006. This was the weakest quarter for buyout-backed M&A since late 2004/early 2005. However, this data does not include sponsor-to-sponsor activity, which is likely taking up meaningful slack in the exit environment, meaning the data likely understates, and possibly meaningfully so, the actual buyout-backed M&A activity.

**Venture Exit Analysis:**

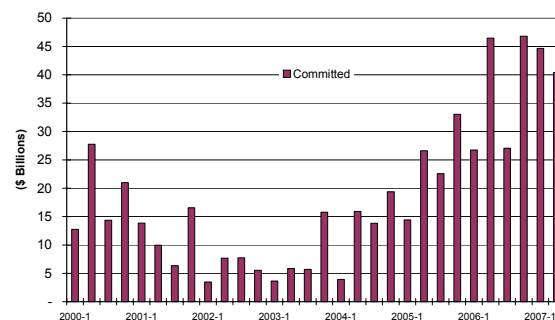
	# of Venture-Backed IPO's	Offer Amt (\$MM)	# of Venture-Backed M&A	Deal Value (\$MM)
<b>2002</b>	22	2,109	341	8,372
<b>2003</b>	29	2,023	306	7,796
<b>2004</b>	93	11,015	345	15,486
<b>2005</b>	56	4,461	365	20,638
<b>2006</b>	57	5,117	365	17,350
<b>3Q06</b>	8	934	89	3,729
<b>4Q06</b>	20	1,631	60	3,867
<b>1Q07</b>	18	2,191	80	4,540
<b>2Q07</b>	25	4,147	70	2,702

Source: Venture Economics



Source: Venture Economics

**US Buyouts & Mezzanine Activity**

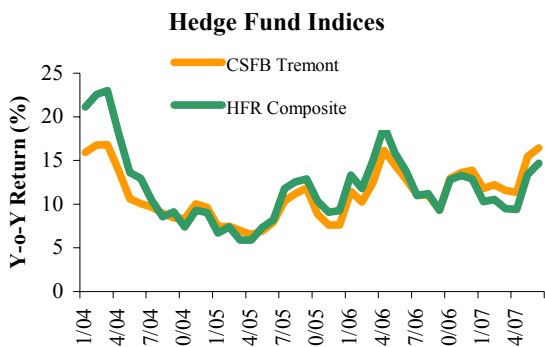


Source: Venture Economics

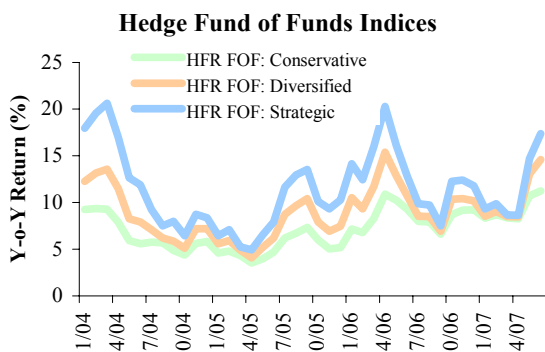
**Buyout Exit Analysis:**

	# of Buyout-Backed IPO's	Offer Amt (\$MM)	# of Buyout-Backed M&A	Deal Value (\$MM)
<b>2002</b>	21	4,366	32	7,681
<b>2003</b>	NA	NA	16	4,913
<b>2004</b>	58	11,407	48	10,699
<b>2005</b>	67	15,764	70	17,718
<b>2006</b>	66	17,451	153	30,150
<b>3Q06</b>	10	2,553	24	5,195
<b>4Q06</b>	22	6,163	15	2,699
<b>1Q07</b>	6	1,568	16	3,320
<b>2Q07</b>	10	2,123	12	2,229

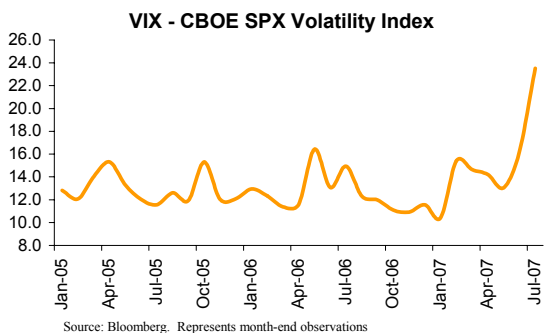
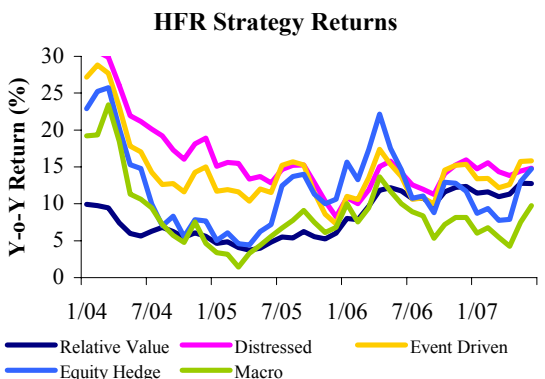
Source: Venture Economics



Source: Hedge Fund Research, CSFB Tremont



Source: Hedge Fund Research, CSFB Tremont



Source: Bloomberg. Represents month-end observations

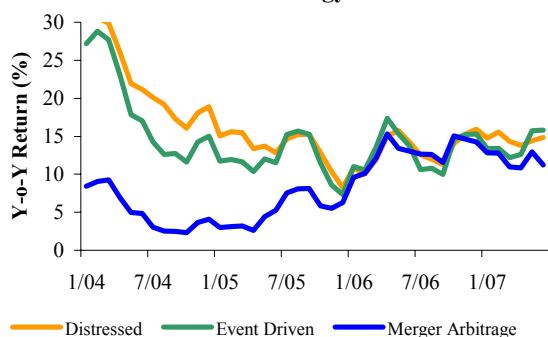
**HEDGE FUND OVERVIEW**

- Despite headlines of large hedge funds shutting their doors due to subprime mortgage problems, hedge fund performance was quite strong in the 2<sup>nd</sup> quarter. The Hedge Fund Research (HFR) Weighted Composite Index gained 1.78% in April, 2.03% in May and finished the quarter with a 0.89% gain in June. While not well publicized, many managers benefited initially from the blow out in subprime due to short positioning. This was particularly true during the 2<sup>nd</sup> quarter, when credit spreads had yet to widen materially and equity markets continued to rally. But the 2<sup>nd</sup> quarter may well be remembered as the calm before the storm. The start of the 3<sup>rd</sup> quarter was a different story, as subprime loans proved not to be an isolated problem, and the subsequent uncertainty leading to wider credit spreads, falling equity markets in the U.S. and Europe, poor liquidity, a spike in volatility and a decrease in investors' appetite for risk.
- Prior to July, the HFR Weighted Composite had produced eleven consecutive positive months, with the last losses coming in May, June and July of 2006, a period that saw the index decline a total of 1.97%. For the quarter, the HFR Weighted Composite gained 4.77% while the CSFB Tremont Hedge Fund index gained 5.19%. For the trailing 12-months, the CSFB Tremont index (+16.45%) has a modest advantage over the HFR Weighted Composite (+14.67%).
- Hedge fund of funds, as represented by the HFR Fund of Funds Index, gained 4.76% during the quarter, slightly lower than the return of the HFR Weighted Composite. There was a noticeable performance differential between conservative funds of funds (HFR FOF Conservative; +3.31%) and more directional funds of funds (HFR FOF Strategic; +5.79%) fueled by the strong equity market performance, especially in Asia and the emerging markets, during the quarter.

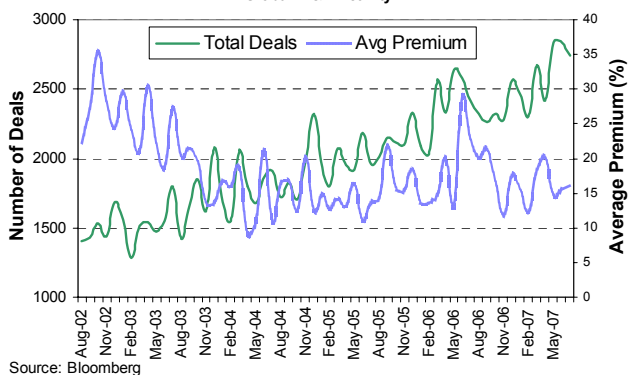
**NON-DIRECTIONAL STRATEGIES**

- Arbitrage and Relative Value strategies were positive for the 2<sup>nd</sup> quarter. The HFR Relative Value Arbitrage Index gained 3.52%, and is up 12.76% for the one-year period ending June.
- The two lagging strategies in the relative value space were Fixed Income (+1.88%) and Convertible Arbitrage (+1.76%). Spread widening was ubiquitous late in the 2<sup>nd</sup> quarter, and accelerated into July. Hedge fund managers that were generally long credit got hurt, while those that had removed credit bets from their portfolio, or implemented short credit positions, performed well. Problems within Bear Stearns subprime-focused hedge funds became evident during the 3<sup>rd</sup> week of June, sending shock waves through the hedge fund community. What resulted was a dramatic sell off in subprime issues, and a knock on to other asset backed securities. The brunt of the hit was taken in July, although this contributed to fixed income managers lagging during the quarter. The question now is whether weakness in the housing market, and the rising default rates in the residential mortgage market, will impact consumer spending, and more importantly, hamper U.S. economic growth.
- Equity Market Neutral gained 2.65% for the quarter, but is only up 7.41% for the one-year period. This ranks as the worst one-year return among the primary hedge fund strategies tracked by HFR. Up until the end of June, equity market volatility has been muted, thus retarding the ability of market neutral strategies to take advantage of mispricing opportunities. This changed in July, as the VIX index shot above 24, the highest observed level since March 2003.

**HFR Event Strategy Returns**

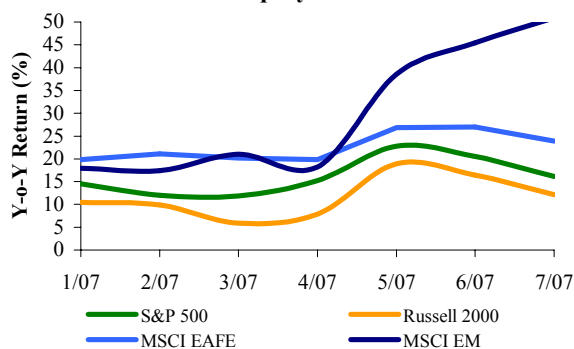


**Global M&A Activity**

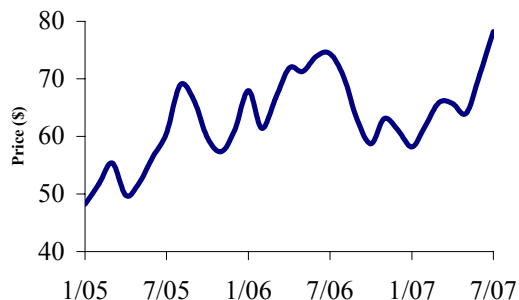


Source: Bloomberg

**World Equity Markets**



**Crude Oil**



**EVENT DRIVEN STRATEGIES**

- Corporate event activity remained robust, helping the HFR Event Driven index (+4.20%) to another strong quarterly performance. Event Driven is one of the best performing hedge fund strategies with a gain of 15.8% for the one-year period.
- The HFR Merger Arbitrage Index (+2.40%) lagged within the event driven arena, as deal arbitrage spreads widened in June on fears that announced deals would fall through. Investors demanded greater return (wider spreads) for taking the risk of deals closing in a timely manner. The big concern has been the fallout from the subprime mortgages, which has resulted in the market making risk capital much harder to access. If announced deals are dependent on lots of debt, and that debt is no longer accessible, the deal potentially does not get done. Another concern is that major borrowers, such as private equity investors engaging in leveraged buy outs of public companies, will not be able to get capital to finance these transactions. If that happens, transaction volume will decrease, cutting into the merger & acquisition opportunity set.
- Distressed managers performed well relative to merger arbitrage, but failed to keep pace with the strength seen in the broad hedge fund index. The HFR Distressed Index posted a 3.28% gain for the quarter, but remains one of the more attractive strategies for the one-year period (+14.84%).

**DIRECTIONAL STRATEGIES**

- While the 2<sup>nd</sup> quarter was generally seen as a challenging period for directional long/short equity managers due to higher levels of volatility and sharp swings in market performance, most managers produced decent returns for the period. The HFR Equity Hedge Index gained 5.30% during the second quarter, resulting in a 14.75% gain for the one-year period.
- Managers benefited from a strong upward move in U.S. and European equity markets in April, buoyed by generally higher than expected 1<sup>st</sup> quarter corporate earnings. By late May, the upward move stalled as inflation concerns, housing troubles in the U.S. and subprime uncertainty took center stage. U.S. and European equities were hit hard, while Asia and the Emerging Markets remained positive. U.S. equities briefly posted new highs in early June before being spooked by risk aversion brought on by renewed sub-prime mortgage market concerns and revelations about hedge fund losses. Equity markets have since reversed course, giving back much, if not all, of the quarter's gain in July. Throughout the time period financial stocks have taken it on the chin, so anyone with long exposure has been hurt.
- Emerging markets hedge fund managers rebounded strongly after a mediocre first quarter. The MSCI Emerging Markets Index experienced a 2% to 3% gain every month of the quarter, resulting in an 8.85% gain in the second quarter.
- Macro traders performed well for the quarter, helped by some strong moves in currency, bonds and commodities. The HFR Macro Index was up 4.98% for the quarter, but remains a sub par performer for the one-year period (+9.74%). A common theme across macro books was the short dollar positioning, which proved a successful trade for the quarter. Other price trends that developed during the period were a sharp rise in oil, and the previously mentioned strength in Asia and emerging market equities. Short term trading strategies performed better than longer term trend strategies given the increase in volatility and the sharp swings of many prices within the quarter.

**REAL ASSET OVERVIEW**

The housing market, which has been a major contributor to the current expansion of the U.S. economy over the past few years, may prove to be a drag on future growth as that market continues to struggle. Part of the problem relates to the distress in the well publicized sub-prime single family mortgage market. However, the commercial real estate market remains robust as each sector continues to perform relatively well, and although the housing market (residential ownership) is not particularly connected to or correlated with commercial (income producing) real estate, some commercial property sectors may be impacted by the sub-prime mortgage market fiasco. For example, occupancy in the apartment sector may trend higher as more renters enter the market by “default”, although this is less likely to be the case in markets with higher exposure to condo conversions, which will add supply as condos revert back to apartments. In contrast, select office markets may be adversely impacted as some sub-prime lenders go out of business essentially vacating office space; likewise, the retail markets may experience a less exuberant consumer should these issues lead to slower economic growth.

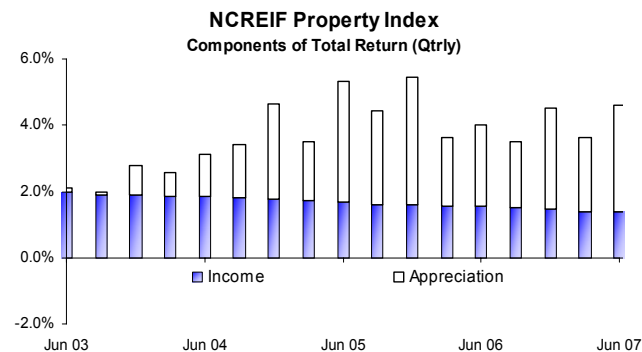
The primary impact of the sub-prime meltdown with respect to commercial real estate has been within the securitized debt markets, causing short-term volatility in both Commercial Mortgage Backed Securities (CMBS) and commercial real estate collateralized debt obligations (CDOs) as material re-underwriting, re-sizing and re-pricing has occurred. Many in the industry consider the sub-prime problems a wake up call for the commercial real estate market, as it may lead to more prudent underwriting and investing as the strength in the commercial real estate markets continues. Despite sub-prime issues and turbulence in U.S. REIT performance, investment in commercial real estate remains healthy with strong underlying fundamentals and demand continuing to outpace supply in most sectors of the market. During the first half of the year direct U.S. real estate investments totaled \$163 billion (\$382 billion globally).

The housing market has affected some parts of the timber markets as a reduction in starts has reduced the demand for lumber for residential homes; as a result, in this segment current conditions are expected to lead to price weakness for lumber without reduced production capacity to balance supply with the lower demand. However, housing starts is just one component of timberland total return as pulp and paper products demand as well as land values have been particularly strong. In addition, the market has experienced healthy repair and remodeling activities and strong non-residential and industrial construction, somewhat mitigating the residential housing effect.

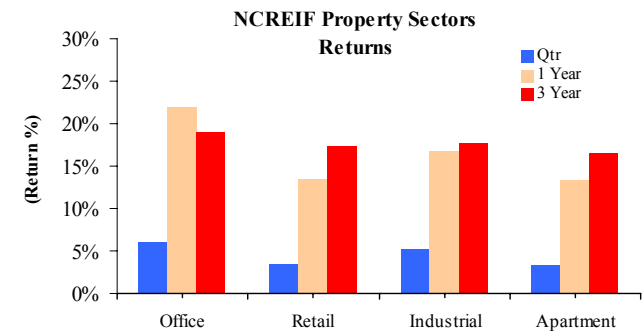
**Asset Class Performance (% Annualized Returns)**

As of 3/31/07	1 Year	3 Years	5 Years	10 Years
NAREIT (US)	12.6	21.1	18.6	13.2
EPRA/NAREIT (Global)	25.4	27.7	24.2	NA
NCREIF Property	17.2	18.0	14.4	13.1
NCREIF Timberland	11.9	15.2	11.4	8.4

Source: NCREIF, NAREIT (Equity Only), Bloomberg



Source: NCREIF



Source: NCREIF

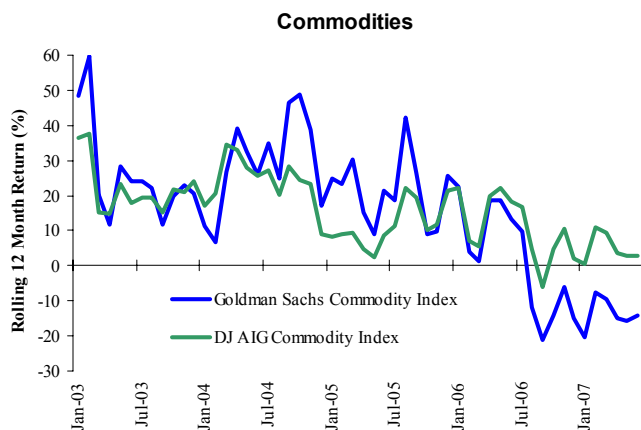
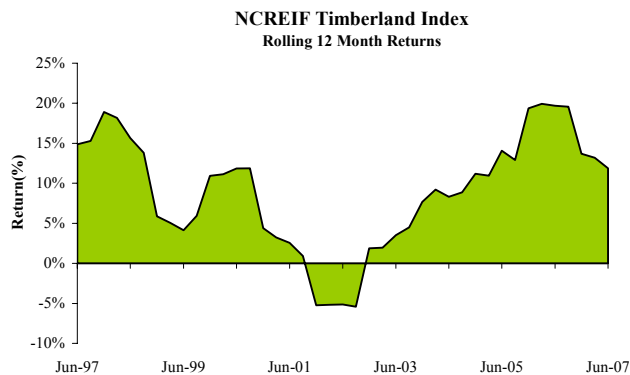
**PRIVATE REAL ESTATE**

- As mentioned above, private real estate, as represented by the NCREIF Property Index (“NPI”), continues to perform well, notching its 3rd best first-half performance since inception with a total return of 8.21% YTD as of June 30, 2007. The Index built on its first quarter gain (+3.62%) with a second quarter total return of 4.59% which was the strongest quarterly performance since the 4<sup>th</sup> quarter of 2005. The NPI is up 17.24% for the trailing one-year period.

- The office sector remains strong, and continues to drive the NPI performance posting a 5.93% return for the quarter and a 10.80% return year-to-date as of June 30, 2007. However, if the economy begins to slow meaningfully, the office market would likely struggle as job growth is highly correlated with office rental growth. The industrial sector remained strong as well with a 5.14% total return for the quarter. This sector continues to have sound fundamentals, especially in the major U.S. port markets.

- Meanwhile, apartment sector performance has been relatively weaker compared to its sub-sector counterparts. Although up from its first quarter return (+2.87%), the 3.26% second quarter total return was the worst performing sector of the index. The apartment sector also trails all other sectors over the one-year period (+13.30%) as well. However, retail is the only sector currently exhibiting signs of weakness in fundamentals with decreased demand for new space; as such, rising vacancy rates are expected. For the quarter the sector was up 3.42% with a one-year total return of 13.60%.

- Similar factors contributing to U.S. real estate market conditions generally hold true abroad, with strong fundamentals, macro-economic support and robust capital flows. Given the continued adoption of REIT structures (offering liquidity) abroad and with fundamentals lagging the U.S. market in specific markets, certain non-U.S. markets may present more compelling investment opportunities.



**TIMBER**

- The NCREIF Timberland Property Index returned 2.31% during the second quarter, up from the 2007 first quarter return of 1.86%. For the one-year ending June 30, 2007, the Index was up 11.88%, but still off meaningfully from the strong performance (+19.69%) for the same time period last year.
- Although timber prices have yet to fall significantly in response to weak conditions in some manufactured product markets, some erosion may be likely over the near term. However, as timber prices are subject to multiple markets and factors, the longer-term trend is less clear.
- Demand in the U.S. for lumber and panels experienced an increase during the quarter despite falling housing starts. Pulp and paper prices continued their steady rise for the year, up considerably over last year's levels. Overall demand for pulp is still strong and is leading to tighter supply in that segment.

**COMMODITIES**

- While intra-month volatility was high during the quarter, commodity indices produced relatively flat returns. The Dow Jones-AIG Commodity Index declined -0.12% during the second quarter, while the Goldman Sachs Commodity Index (GSCI) gained 1.4%. While Crude Oil was a big mover for the quarter, other commodities experienced sharp pullbacks. Crude climbed 7.3%, to end the quarter above \$70 as concerns over global supply intensified. On the flip side, Gold fell 1.8%, Silver declined 8.2% and Natural Gas collapsed 12.4%. All had experienced dramatic gains in prior periods.

Data Sources: Hedge Fund Research, CSFB Tremont, Venture Economics, NCREIF, NAREIT, Citigroup, GSCI, DJ-AIG, Bloomberg