

**PRIVATE EQUITY OVERVIEW**

The credit crisis continues to take a toll on private equity, although the impact varies somewhat depending on the segment of the market. On the buyout side, the impact is relatively clear and visible in the data – fundraising is down materially from the prior quarter, which we would expect to continue relative to the very strong environment in 2007, investment activity has slowed, and exit activity is weak, given, among other things, poor investor sentiment. In the near-term, it will be interesting to see how much difficulty the large and mega buyout firms have in raising funds, as they should be most directly impacted by the market turmoil. Madison Dearborn and Blackstone are currently in the market, and are reportedly having to extend fundraising given the slow environment, although it is still too early to say whether they will have difficulty meeting their targets. However, against this backdrop, many institutional investors continue to enter private equity as an asset class, or to increase existing allocations, which will serve to buffer any weakness in fundraising due to market-related issues. Over the long-term, we continue to believe that private equity will grow over time. Also, quality private equity firms (buyout firms in particular) are often very creative and good at identifying opportunities in different and difficult market environments – this environment should not be fundamentally different. The difference is that manager selection is even more important in an uncertain environment.

While venture capital has not been materially impacted on the fundraising and investing side (which is not entirely surprising given the lack of leverage in venture deals), exit activity continues to be weak, with the IPO window for venture-backed companies entirely shut for the first time in 30 years. We are not as concerned as are some others, as there is no magic to zero IPOs in a quarter, and the situation will improve over time. If there were to be any reason for concern, it would relate to the pipeline of IPO candidates; venture capitalists must continue to invest in firms in order to maintain a robust pipeline of firms seeking a public listing.

More importantly for the asset class, however, is the question of when leveraged lending will return to more normal conditions, allowing private equity dealflow to resume a more typical pace than what we have seen in the past few months. While the investment banks have been able thus far to raise capital and clear a material amount of the hung inventory since last year, which should help them to get on better footing, questions remain: what risks remain hidden within the banks that could cause further losses; will there be a second wave of the credit crisis, driven by a recession and leading to higher consumer and/or corporate defaults? The risks are real that the financing market may take some time to come back in a meaningful way. However, that should not deter investors from continuing to invest in private equity.

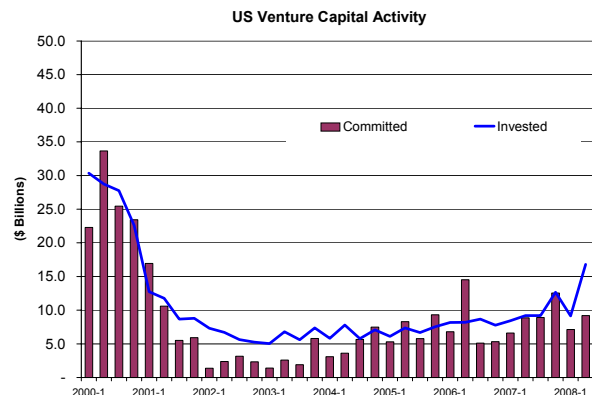
**VENTURE CAPITAL**

**US Private Equity Performance Index (PEPI)**  
**Investment Horizon Performance through 3/31/2008**

Fund Type	1 Yr	3 Yr	5 Yr	10 Yr	20 Yr
Early/Seed	10.6	4.9	4.8	34.0	21.2
Later Stage	30.4	13.1	11.1	8.6	14.4
<b>All Venture</b>	<b>13.3</b>	<b>9.5</b>	<b>9.1</b>	<b>17.2</b>	<b>16.8</b>
Medium	19.0	10.9	12.2	8.3	12.4
Large	16.8	8.5	14.1	6.7	12.3
<b>All Buyouts</b>	<b>10.8</b>	<b>13.0</b>	<b>15.6</b>	<b>7.9</b>	<b>12.1</b>
<b>All P.E.</b>	<b>12.9</b>	<b>12.3</b>	<b>13.5</b>	<b>9.9</b>	<b>13.5</b>
NASDAQ	5.1	5.9	11.3	3.5	10.9
S & P 500	5.1	5.3	11.9	2.7	10.3

\*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



Source: Venture Economics

- In the 2<sup>nd</sup> quarter of 2008, seventy-six venture funds raised \$9.2 billion, up 29% from the prior quarter and up 4% from the 2<sup>nd</sup> quarter of 2007 in terms of volume; the number of funds that closed in the quarter was up from the seventy-one that closed in the prior quarter, but down slightly from the eighty-three in the 2<sup>nd</sup> quarter of last year. Fundraising held up relatively well despite the market and credit-related turmoil; however, it remains to be seen whether potential future investors will be put off by the weak exit market recently, which is described below. Unlike in some periods, when very large single funds can skew the data, the largest funds raised in the quarter included Lightspeed Venture Partners VIII (\$800 million) and Foundation Capital VI (\$750 million).
- Venture investment activity was strong in the second quarter, up 83% from the prior quarter, at \$16.8 billion. This was up a similar amount from the 2<sup>nd</sup> quarter of 2007 as well. According to the NVCA, the Clean Tech sector reached an all-time high in investment activity during the quarter; this is not surprising given the preponderance of such funds in the market, both dedicated to the sector, and more generalist funds. While Clean Tech represents a diverse and potentially large opportunity, it is unclear whether it will be as large or as profitable as some project given some of the unique challenges in the sector, including dealing with potential regulatory, environmental and other considerations. Internet-specific companies also experienced the highest quarterly investment activity since the end of the technology bubble in 2001.
- While fundraising and investment activity remained solid, the exit market for venture-backed companies again disappointed in the 2<sup>nd</sup> quarter, continuing a pattern of weakness from earlier in 2008. There were only five venture-backed IPOs in the 1<sup>st</sup> quarter, and none in the 2<sup>nd</sup> quarter – this is the first time since 1978 that there have been no venture-backed IPOs in a quarter. This reflects a material drop-off from the pace of 2007, when there were eighteen and twenty-five IPOs in the 1<sup>st</sup> and 2<sup>nd</sup> quarters, respectively.

**VENTURE CAPITAL (Con't)**

- There are currently forty-two venture-backed companies “in registration” for an IPO. This is down 40% from the three-year high in the 3<sup>rd</sup> quarter of 2007, and does not bode particularly well for a recovery in venture IPOs in the near future.
- M&A exit activity for venture-backed companies was slower relative to recent history, but not nearly to the same extent as the IPO market. Seventy-three venture-backed companies were acquired in the 2<sup>nd</sup> quarter, up from seventy in the prior quarter. However, this was down from the eighty-seven M&A exits in the 2<sup>nd</sup> quarter of 2007. Venture-backed M&A volume for the quarter was \$5.2 billion, which is more in the middle of the range on a quarterly basis for the past few years.

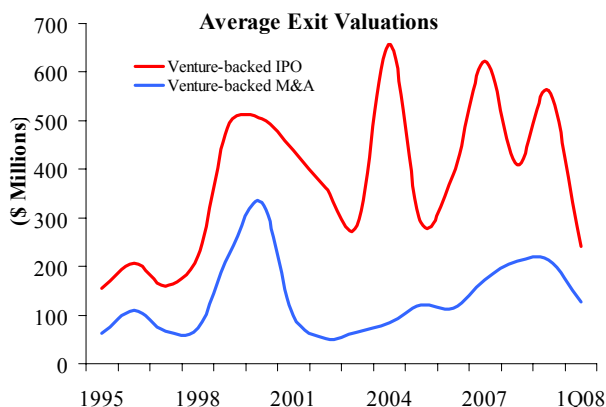
**Venture Exit Analysis:**

	# of Venture-Backed IPO's	Offer Amt (\$MM)	# of Venture-Backed M&A	Deal Value (\$MM)
<b>2003</b>	29	2,023	299	7,535
<b>2004</b>	94	11,378	350	15,942
<b>2005</b>	57	4,485	371	22,179
<b>2006</b>	57	5,117	387	19,316
<b>2007</b>	86	10,326	357	28,457
<b>3Q07</b>	12	945	100	10,810
<b>4Q07</b>	31	3,044	88	9,084
<b>1Q08</b>	5	283	70	3,602
<b>2Q08</b>	0	0	73	5,246

Source: Venture Economics

**BUYOUTS**

- Not surprisingly, the credit crisis continues to impact the buyout market. Buyout fundraising fell by 41% quarter-over-quarter, to \$36.4 billion. This is down a more modest 13% versus the 2<sup>nd</sup> quarter of 2007. However, while traditional buyouts are much more difficult now given the financing environment, several private equity firms have been raising more “opportunistic” pools of capital to take advantage of specific market dislocations. For example, some firms have raised funds to buy pools of hung loan inventory from the banks, acquiring some of the same loans that had previously financed private equity buyouts.
- The overall exit market for buyouts was equally poor to that for venture capital; however, buyouts were not entirely shut out of the IPO market. There were two buyout-backed IPOs in the quarter accounting for \$357 million, the same number as in the prior quarter, where deal value was only \$267 million. This is the slowest pace since the 1<sup>st</sup> quarter of 2003. As for buyout-backed M&A, there were twenty-eight deals accounting for \$1.8 billion in disclosed value. While the disclosed value is the lowest quarterly total since the 4<sup>th</sup> quarter of 2004, this may not reflect the actual value of transactions in the quarter.
- Overall, the impact of the credit crisis is to be expected in the buyout market, as it impacts the ability of firms to invest capital (with leverage less readily available, it is more difficult to invest capital productively), and it also impacts the market for buyers of these assets. These effects feed back into fundraising, making it more difficult to raise capital.



Source: Venture Economics

**Buyout Exit Analysis:**

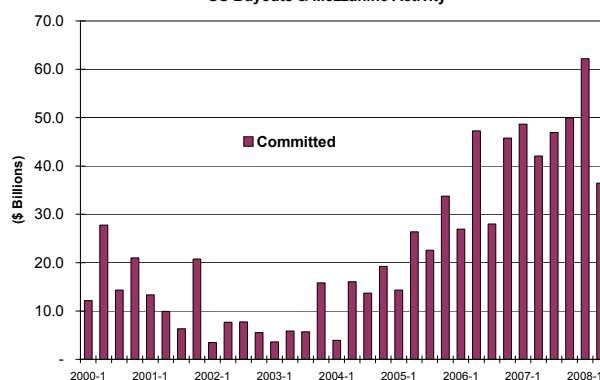
	# of Buyout-Backed IPO's	Offer Amt (\$MM)	# of Buyout-Backed M&A	Deal Value (\$MM)
<b>2003</b>	22	5,038	39	8,572
<b>2004</b>	57	11,293	37	9,251
<b>2005</b>	67	15,764	96	22,672
<b>2006</b>	55	17,451	139	26,144
<b>2007</b>	40	9,627	142	43,065
<b>3Q07</b>	14	3,344	38	11,094
<b>4Q07</b>	10	2,593	35	7,800
<b>1Q08</b>	2	267	26	3,690
<b>2Q08</b>	2	357	28	1,773

Source: Venture Economics

**OTHER**

- Given the credit turmoil in the markets, distressed debt funds have come back into vogue over the past few quarters. In the 2<sup>nd</sup> quarter, distressed debt funds raised \$14.7 billion, up from \$3.3 billion in the prior quarter, according to Venture Economics. However, the data set includes a limited number of funds, and likely does not fully represent the state of that market, even while the trend may be indicative.
- Energy funds have also been popular more recently, and while the 2<sup>nd</sup> quarter was relatively slow (\$2.1 billion raised), fundraising activity over the past year has been relatively strong. Venture Economics estimates that \$18.2 billion has been raised by such funds over the past year.

**US Buyouts & Mezzanine Activity**



Source: Venture Economics

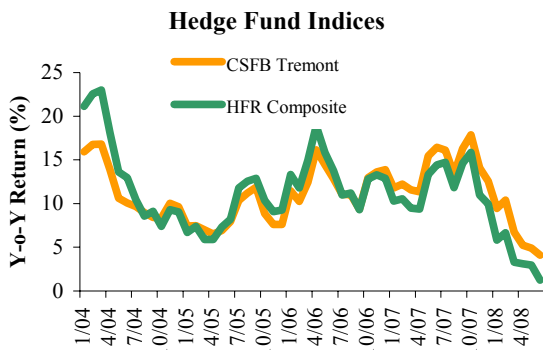
**HEDGE FUND OVERVIEW**

Equity and credit markets rallied early in the quarter following the orchestrated bail-out of Bear Stearns in late March and the Federal Reserve’s 75 basis point rate cut on March 18<sup>th</sup>, and a follow on 25 basis point cut on April 30<sup>th</sup>. Investors reacted by buying into depressed share prices across a variety of equity and fixed income markets in April, with the equity rally continuing into May. Fixed income markets stalled in May as a result of sharp increases in inflation, brought on by surging commodity prices, including crude oil, which surpassed \$140 per barrel during the quarter. Sentiment soured quickly in June, resulting in sharp declines in equity prices globally, and renewed weakness in corporate debt markets, asset-backed securities and other structured financial instruments.

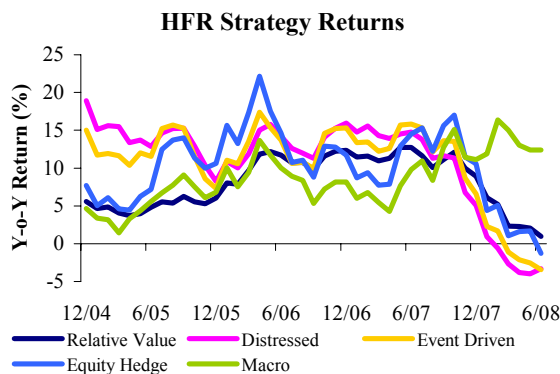
Hedge fund strategies performed well in April and May, before slipping in June. For the quarter, most strategies posted gains, which is a reversal from the 1<sup>st</sup> quarter when almost all hedged strategies posted losses. The 2<sup>nd</sup> quarter gains were not enough to move hedged strategies into positive territory for the year, however, as many remain in the red as a result of the poor start to the year. The HFR Weighted Composite (+2.51%) made back most of the first quarter’s 3.06% loss, with solid gains in April and May. Despite sharp downward moves in June for equity markets (S&P 500: -8.4%, MSCI EAFE(\$): -8.2% and MSCI Emerging Markets(\$): -10.0%), the Composite index was down only 0.95% for the month, highlighting the reduced equity market exposure for the broader hedge fund community. By comparison, the index captured nearly 250% more of the downward movement in equity prices in January, when the same indices fell by a similar magnitude as in June. Most strategies tracked by HFR were up for the quarter, with Convertible Arbitrage (-0.56%) the notable exception. The quarter’s modest results, though, moved many hedge fund strategies into negative territory for the one-year period. Of the major hedge fund strategies tracked by HFR, the range of one-year returns was +12.37% (Macro) to -6.26% (Convertible Arbitrage), with an equal number of strategies straddling the zero mark.

Hedge Funds of Funds also generated positive results during the 2<sup>nd</sup> quarter, with the HFR FOF Diversified Index, the collection of broadly diversified funds of funds, up 2.04%. More conservative funds included in the HFR FOF Conservative Index were up on average 1.56%, while the more aggressive mixture of funds, those that typically emphasize equity long/short strategies and are included in the HFR FOF Strategic Index, were up 1.66%. As with the prior quarter, funds of funds performance was influenced by the level of equity long/short exposure and the inclusion of, or omission of, macro and CTA managers.

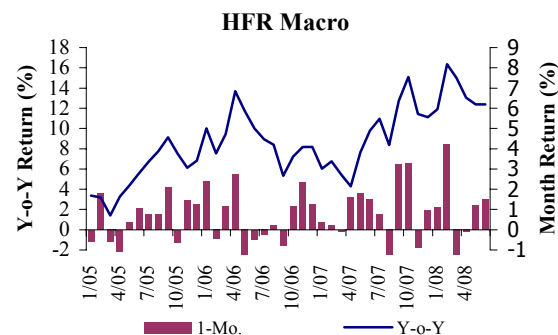
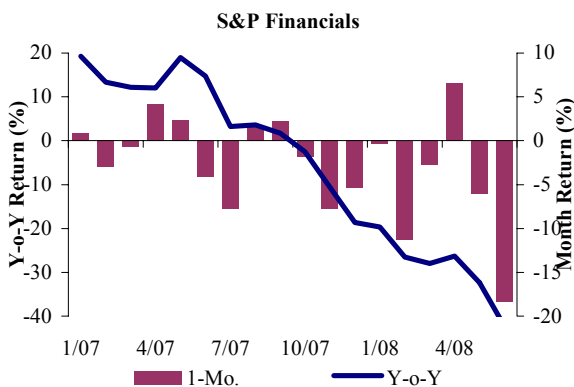
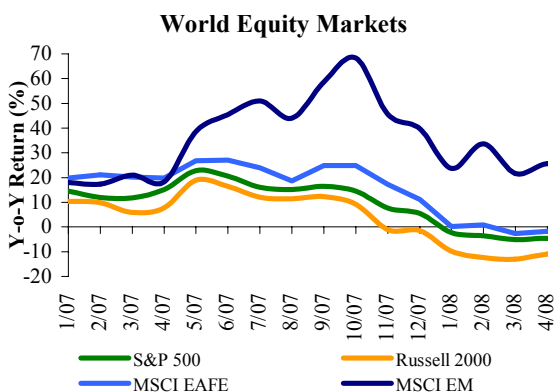
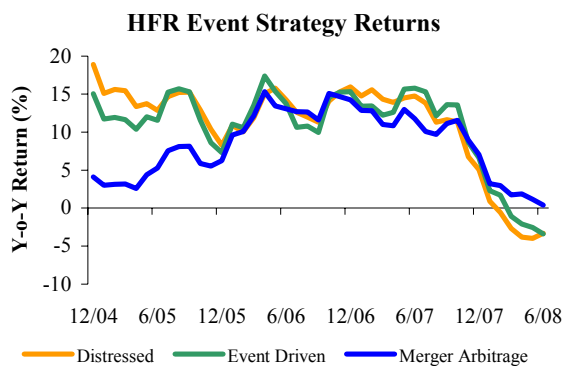
**NON-DIRECTIONAL STRATEGIES**



Source: Hedge Fund Research, CSFB Tremont



- Equity Market Neutral was one of the few strategies to generate gains every month during the quarter, resulting in a 2.97% climb for the HFR index. This is the largest quarterly gain for the strategy since the 3<sup>rd</sup> quarter of 2001, when the category climbed 3.53%. This result is in sharp contrast to the recent past, as the strategy has posted losses in two of the prior three quarters. The performance results are somewhat surprising given the stark performance differential between growth and value stocks during the quarter. Russell 1000 Growth (+1.26%) outperformed Russell 1000 Value (-5.32%) significantly for the quarter, which typically would be problematic for managers that utilize fundamental factors and favor value stocks in their portfolio construction.
- Convertible arbitrage, as represented by the HFR Convertible Arbitrage Index (-0.56%), was among the worst performing strategies for the quarter, and is competing with the HFR Emerging Markets index as one of the worst performing categories for the year-to-date period with a near 7% decline. The good news behind the numbers is the fact that convertibles have cheapened considerably over the past year. We have heard from many managers that they see greater return potential in this space, but are proceeding with caution given the prospects for further credit erosion. Issuance has been strong, and with the prospect of continued elevated volatility, this may prove to be a winning strategy over the near term.
- The HFR Relative Value Arbitrage Index was up 2.14% for the quarter.
- The HFR Fixed Income Index finished the quarter up 1.68%. While risk aversion was the theme of the month in June, spread sectors generally performed better during the quarter.



**EVENT DRIVEN STRATEGIES**

- The HFR Event Driven Index followed the performance pattern of most other hedge fund strategies, with a modest gain in April (+0.94%), a more significant move in May (+1.72%) and a modest loss in June (-0.90%), to finish with a 1.75% gain for the quarter. The quarter's performance was unique from the recent past in that much of the positive contribution came from the distressed area, which was one of the better performing strategies for the quarter. The HFR Distressed Index gained 2.58%, the strategy's first gain since the 2<sup>nd</sup> quarter of 2007. Many managers appear to agree that there are increasing opportunities for distressed trades, although the definition might not be typical. For example, many managers are allocating to what they would term "stressed" securities, that may not actually be in a default, or near default, situation. Technical selling on the part of investment banks has led to tremendous selling pressure on bank loans, driving prices to levels not commonly seen. Even when factoring in an increase in potential defaults from current levels, distressed managers believe these credits are significantly mispriced. We anticipate we will see steady investing in these stressed securities if prices weaken further. Additionally, interest has been expressed for mispriced RMBS, although most managers have so far proceeded with caution.
- Merger spreads remained wide during the quarter, as investors continued to be concerned about deals getting done in the context of falling equity values and the ability of buyout groups to finance debt loads. In addition, merger activity on a global basis has slowed, contributing to generally lower returns in the merger arbitrage arena. The HFR Merger Arbitrage Index gained 1.51% in the 1<sup>st</sup> quarter, and is up only 0.39% on a year-over-year basis. Despite more attractive spreads, many funds of funds are not actively looking to add merger arbitrage exposure, instead relying on multi-strategy managers with such a capability to allocate capital on an opportunistic basis for them. Notable deals during the quarter included several giant transactions, including Verizon Wireless/Alltel and InBev/Anheuser-Busch. Meanwhile, there continues to be private equity groups that had initiated LBO transactions, but have since attempted to back away from the deals. One notable situation where a deal did fall through was the Penn National Gaming LBO, which saw Fortress and others back away from the transaction.

**DIRECTIONAL STRATEGIES**

- As with the prior four quarters, Macro managers were among the biggest winners for the quarter, with the HFR Macro Index posting a 2.63% gain. This makes the strategy one of the best performers over the past year, with a 12.37% rise. The next closest major hedge fund category over that time period is Equity Market Neutral (+3.27%). Performance is being generated both by trend followers and discretionary traders in this category. The main trades continue to be shorts in select industries in the U.S., namely financials and consumer discretionary, offset by longs in energy. Additional positions include short dollar and long a variety of commodities.
- Equity long/short managers actually performed well in the 2<sup>nd</sup> quarter despite the decline in the global equity markets. The HFR Equity Hedge index was up 2.64%, a sharp contrast to the 2.73% loss for the S&P 500, the 2.25% loss for MSCI EAFE (\$) and the 0.80% decline for the MSCI Emerging Markets (\$) index. Meanwhile, the HFR Emerging Markets Index was up 0.42% for the quarter.

**REAL ASSET OVERVIEW**

Amidst the storm of surging commodity prices, swelling inflation fears and a crippling credit crisis rippling through the economy and markets, the various commercial real estate (“CRE”) markets are navigating these issues somewhat differently. Having already impacted public REITs (NAREIT Equity Index), which are down 13.6% for the trailing one-year period as of June 30, 2008, the private market as measured by the NCREIF Property Index gained 9.20% over the same period, but remained largely directionless during the first half of 2008 as the lack of transactions has made it difficult to determine direct property values (the appraisal-based NCREIF index generally lags public counterparts, and may not fully reflect current market valuations). Experts have estimated that values have already fallen by 10% and perhaps as much as 15%-20% from peak to trough. Deal activity on all levels has been limited, with buyers and sellers at a stalemate on values causing wide bid/ask spreads in the transaction market. Sellers are using past (cap rate) expectations for valuations whereas buyers are looking forward. The deadlock persists as sellers appear willing to hold-out for a “market recovery” while buyers are anticipating a further correction. Further exacerbating this issue is the lack of debt financing, with the CMBS market running aground and banks enforcing strict lending policies, the tide has turned on the highly-levered investor who is now less able to participate in the market.

Although the “distress” is working its way through the capital markets, already affecting over-levered investors who either bought at the peak or need to refinance, it has yet to show up in the transaction market in terms of deep discounts. For example, during the second quarter Macklowe Properties sold its stake in the GM building in Manhattan to Boston Properties, in order to pay down debt for other properties bought in 2007. The trophy property sold for \$2.9 billion, making the transaction a record sale for an office building. Despite the current market turmoil, fundamentals for CRE remain mostly balanced for the time being (less so in suburban areas) and investor demand for real assets and yield (particularly non-US) remain healthy. Although an economic downturn will impact all property types to some extent, the relative lack of new supply and an abundance of capital waiting to invest (estimated at \$50 billion), may provide a tailwind for the CRE market’s recovery.

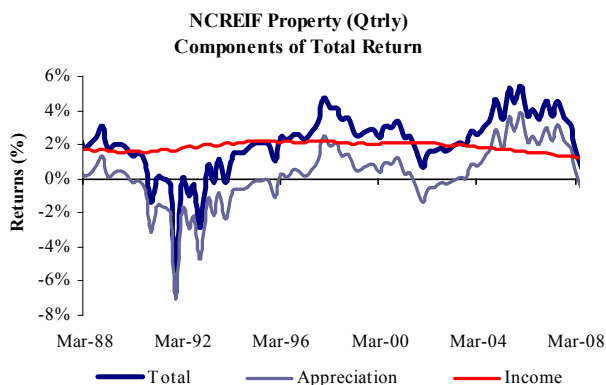
**Asset Class Performance (% Annualized Returns)**

As of 6/30/08	1 Year	3 Years	5 Years	10 Years
NAREIT (US)	(13.6)	5.0	14.3	10.7
EPRA/NAREIT (Global)	(19.7)	8.3	17.9	NA
NCREIF Property	9.2	15.0	14.7	12.2
NCREIF Timberland	20.0	17.1	14.7	8.8

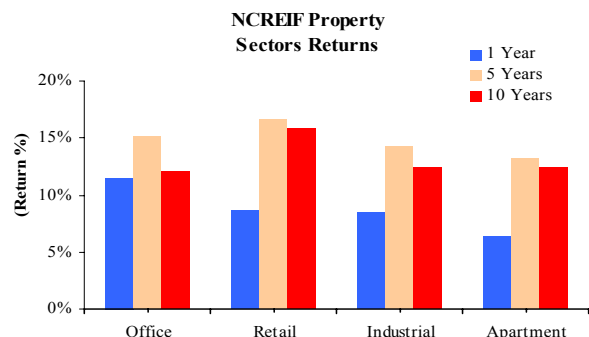
Source: NCREIF, NAREIT (Equity Only), Bloomberg

**PRIVATE REAL ESTATE**

- Private real estate, as represented by the NCREIF Property Index (“NPI”), generated a mere 0.56% total return during the second quarter; the Index is up 9.20% for the trailing one-year period. The second quarter return is the worst performance in almost 15 years (Q4:93, -0.25%) when the Resolution Trust Corporation (RTC) was winding down its activities.
- Office fundamentals remain relatively healthy, although vacancy rates have ticked up slightly. There are pockets of concern in some regions with higher exposure to job losses, but the lack of new construction may keep rates from spiking too quickly. For the quarter, office properties generated a 0.52% total return, and lead all property types over the one-year period with an 11.5% total return.
- As the global economy softens, so has the demand for industrial properties. Imports have slowed along with retail sales weakening demand at ports and distribution hubs. In addition, due to the weak dollar, many U.S. companies are exporting more which generates less demand for space. However, occupancy rates are still above historical averages. Industrial properties led the Index for the quarter, generating a 0.94% total return.
- The retail sector is finally starting to feel the negative wealth effect from consumers, as confidence hit a 30 year low in June. Retailers have already announced closings of stores or slowing expansion plans as consumers pull back on spending. Non-discretionary focused retailers (Shopping Centers) should hold up better than their discretionary brethren (Regional Malls) during this down cycle. However, the retail sector still outpaced the broader Index during the quarter, up 0.69%.
- The apartment sector was again the weakest performer compared to other property types during the quarter with a 0.29% total return. This sector’s property fundamentals have a mixed outlook, as would-be homeowners spurned by the credit crisis come back to the rental market creating additional demand, while condo conversions due to overbuilding increase supply. However, the long-term outlook for this sector remains positive, as the coming of age of the “echo boomer” should spur demand and fuel rent growth.

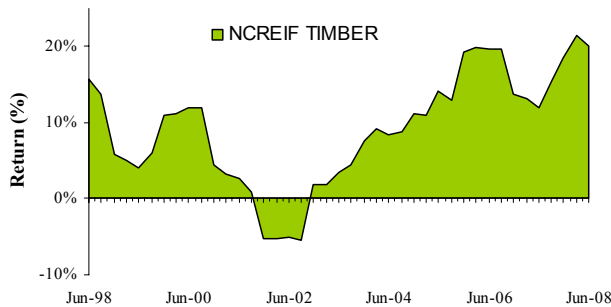


Source: NCREIF (Data as of 6/30/08)



Source: NCREIF (Data as of 6/30/08)

**NCREIF Timberland Index**  
Rolling 12 Month Return

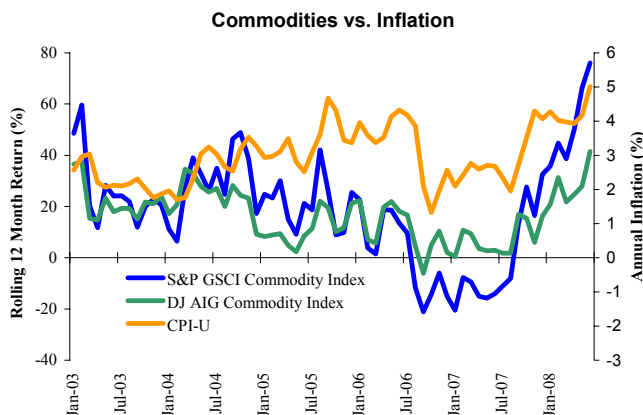


Source: NCREIF (Data as of 6/30/08)

**TIMBER**

- The distress in the U.S. housing market has caused a slowdown in lumber production, as reduced demand and full (mill) inventories drove timber prices lower across each region and product type during the quarter. The Southeast (pine) and Northeast (hardwoods) regions experienced the largest declines in timber prices, with the Pacific Northwest region faring much better due to the strong demand in exports to the Pacific Rim markets. However, the NCREIF Timberland Property Index eked out a 1.01% return during the first quarter, and is up 19.96% for the trailing one-year period ending June 30, 2008.
- The pulp and paper market remained essentially flat during the quarter, largely due to buyers' hesitancy to pay higher prices, although newsprint experienced a gain. Surprisingly, the lumber and panels market fared well during the quarter as seasonal buying and a modest recovery in housing starts occurred. According to the U.S. Census Bureau, building permits and housing starts for June showed increases of 11.6% and 9.1%, respectively, with Northeast multifamily showing the largest gain. Confirming this shift, the Random Lengths Framing Lumber Composite Price increased 10% during the quarter.

**COMMODITIES**



- Commodities were far and away the largest gaining asset class during the quarter, with the Dow Jones-AIG Commodity Index climbing 16.07% and the S&P GSCI soaring 28.67%. On a year-over-year basis, these commodity indices are up 41.56% and 76.01%, respectively. The differential between the two is a reflection of the higher energy allocation in the S&P GSCI. This overweight has generated considerable excess return given the nearly 100% increase in crude oil prices over that time period.
- Inflation, as measured by the Consumer Price Index (CPI-U) eclipsed the 5% annual rate, the highest reported increase in prices since May 1991, the period of the first gulf war. In reality, the CPI-U index likely understates the true level of price inflation, as many consumers will attest to when buying gas, groceries, or paying college tuition bills.
- Sharp increases in the cost of fuel and food has already started to impact consumption habits. This is most noticeable in the gasoline market, where supplies have increased as summer driving levels have been reduced. The term "Stay-cation" has come to symbolize the growing trend of vacationing at home as a result of these elevated fuel prices. Meanwhile, rising raw material costs for food manufacturers are being passed on to consumers through higher prices for goods derived from wheat, corn and soybeans. All have seen prices increase dramatically over the past several quarters.

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

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