

**PRIVATE EQUITY OVERVIEW**

While the first three quarters of 2008 proved more challenging for private equity relative to the years just prior, it was primarily in the 4<sup>th</sup> quarter, after the collapse of Lehman Brothers, that private equity felt the full brunt of the financial and economic deterioration. The dramatic drop in the public markets in October and November had a direct and material impact on the private equity industry. Over that very short period of time, many LPs became overallocated to private equity relative to policy targets given the so-called “denominator effect”. Additionally, the declines across most asset classes created limited options to generate liquidity to fund new and existing capital commitments to private equity. These considerations caused at least some LPs to re-think, and to delay, commitment strategies so as not to exacerbate existing portfolio problems; as such, fundraising across most private equity strategies dramatically slowed relative to prior periods. In addition, some LPs, including some high-profile endowments, considered putting private equity assets up for sale on the secondary market. Notably, Harvard did so, but did not execute a sale; it is reported that Harvard considered the bids too low. Importantly, some other institutions may not have the luxury of deciding whether or not to sell – they may be “forced” to do so given liquidity or other portfolio problems. The relatively weaker fundraising environment is likely to continue while the markets and economy struggle; this is evident not only in the lesser amounts flowing into private equity, but also in the longer fundraising cycles for many managers.

However, private equity is a very viable asset class, and one which will adjust to the new environment, as has been the case in past downturns. Private equity is well-suited to manage through difficult environments: long-term lockups neutralize the redemption risk of hedge funds and other vehicles; asset-level leverage (as opposed to portfolio-level leverage) can protect the fund when individual investments sour; and economic structures, when properly constructed, help to align the interests of LPs and GPs. These are but some of the attributes of private equity which will help the industry to manage through this period. Other asset classes, notably hedge funds, may have a more difficult path to follow. Still, many private equity investments made over the past few years will struggle; the weak economy, lower valuations and tight debt markets may make it difficult to generate attractive returns from some investments made over that period. However, as the private equity industry adapts to the new reality, there will be new, attractive opportunities for investors to pursue.

US Private Equity Performance Index (PEPI)  
Investment Horizon Performance through 9/30/2008

Fund Type	1 Yr	3 Yr	5 Yr	10 Yr	20 Yr
Early/Seed	0.2	3.8	5.1	37.2	21.6
Balanced	(6.4)	7.4	11.5	14.9	14.7
Later Stage	8.6	12.0	10.5	8.9	14.7
<b>All Venture</b>	<b>(1.6)</b>	<b>6.6</b>	<b>8.6</b>	<b>17.3</b>	<b>17.1</b>
Medium	(1.1)	9.3	12.1	7.9	11.6
Large	8.9	6.4	12.6	7.0	11.7
<b>All Buyouts</b>	<b>(8.2)</b>	<b>7.2</b>	<b>12.2</b>	<b>7.3</b>	<b>11.2</b>
<b>All P.E.</b>	<b>(6.5)</b>	<b>7.8</b>	<b>11.2</b>	<b>9.4</b>	<b>12.9</b>
NASDAQ	(21.9)	(0.1)	3.9	2.7	9.6
S & P 500	(22.0)	0.2	5.2	3.1	9.9

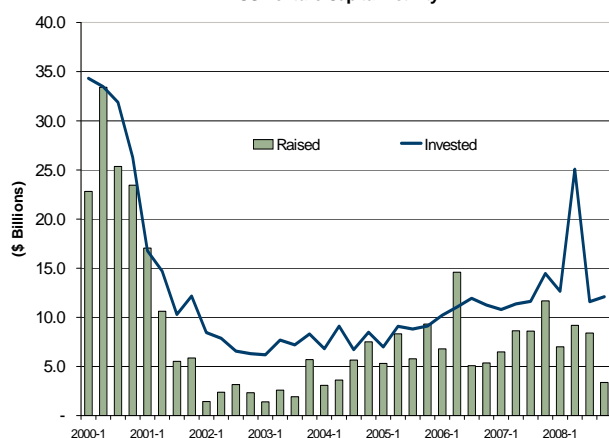
\*The PEPI is based on the latest quarterly statistics from Thomson Venture Economics. All returns are calculated by TVE from the underlying financial cash flows. Returns are net to investors after mgmt fees and carried interest.

Source: Thomson Venture Economics/NVCA, Stylus

**VENTURE CAPITAL**

- The 4<sup>th</sup> quarter of 2008 proved a challenging fundraising quarter, as the carnage in the public markets contributed to a meaningful slowdown in new commitment activity. Forty-three funds closed in the quarter, down 31% from the sixty-two funds that closed in the prior quarter and down 49% from the eighty-four funds that closed in the 4<sup>th</sup> quarter of 2007. The total raised (\$3.4 billion) was the lowest quarterly total since the 1<sup>st</sup> quarter of 2004, and was down 60% versus the prior quarter and down 71% relative to the 4<sup>th</sup> quarter of 2007.
- While fundraising was directly impacted by the market events, venture investment activity was not impacted to nearly the same extent. VCs invested \$12.1 billion in the 4<sup>th</sup> quarter, up from \$11.6 billion in the prior quarter, and very much in-line with investment activity over the past few years. However, looking ahead the pace of activity could slow, as the deteriorating economy may lead to more caution as VCs look to support existing companies and retain some dry powder given the aforementioned weak fundraising environment.
- The exit market for venture capital remained largely closed; for the second time in 2008, there were zero IPOs in a quarter (both the 2<sup>nd</sup> and 4<sup>th</sup> quarters hold that dubious distinction). For the year, only six venture-backed IPOs made it to market, a dramatic drop from the eighty-six venture-backed IPOs in 2007; this was the lowest number since 1977. The shallow pipeline of companies in registration for an IPO does not bode well in the near-term, either. Only twenty-eight venture-backed companies are in the pipeline, down from thirty-eight at the end of the prior quarter. Notably, forty companies withdrew from registration in 2008.
- M&A exit activity was also very weak, but not so much as was the IPO market. Forty-one venture-backed M&A transactions closed in the quarter, down from seventy-eight in the prior quarter. This was the lowest number of deals since the 3<sup>rd</sup> quarter of 1997.

US Venture Capital Activity



Source: Venture Economics

**BUYOUTS**

- The landscape for buyout fundraising changed dramatically over 2008. While the 1<sup>st</sup> quarter broke all records for fundraising, subsequent quarters were weaker, culminating in a very weak 4<sup>th</sup> quarter in which thirty-eight funds raised \$15.4 billion, down from the forty-five funds that raised \$47.2 billion in the prior quarter. This was down materially from the eighty-five funds that raised \$58.9 billion in the 4<sup>th</sup> quarter of 2007. The drop in the equity markets from September through November put a chill on fundraising, as many institutions sought to preserve liquidity and to defer or avoid new commitments as the so-called “denominator effect” skewed allocations to the asset class.

- While near-term private equity performance has been negative across virtually all sub-segments, it is likely to get worse as 4<sup>th</sup> quarter valuations get reflected in the data. As the worst of the declines across listed markets and the deteriorating economy happened in the 4<sup>th</sup> quarter thus far, this value destruction has not yet been entirely reflected in the private markets. Continued deterioration may take an additional toll on valuations and performance. Under FAS 157, portfolio values will more fully and quickly reflect such conditions; still, the valuations of individual funds could diverge materially, given the different strategies and timing of investments in various portfolios. For example, some of the highest-profile mega buyout investments of vintage 2006 and 2007 may be all-but wiped out, due to the high leverage and now-optimistic economic assumptions in some of those deals, while more conservatively leveraged deals may prove more successful.

- The investment opportunity for buyout managers looking ahead is challenging, as debt financing is less available and is less favorable; still, valuations of companies are also lower, which may present opportunities to make attractive investments over the long-term.

- Similar to venture capital, the exit market for buyouts remained weak in the 4<sup>th</sup> quarter. There was only one buyout-backed IPO in the quarter, and only six during the year. This is down from forty in 2007, and is the lowest number of buyout-backed IPOs since 1982.

- The M&A market was somewhat better, but continues to be weak relative to recent history. In the 4<sup>th</sup> quarter, there were twenty-eight buyout-backed M&A deals, roughly flat with the twenty-nine deals in the prior quarter. Over 2008, there were 112 deals, down from 170 in 2007. Still, in only 2006 and 2007 were there more buyout-backed M&A deals. Disclosed deal volume for 2008, at \$10.8 billion, was well down from 2007 levels, at \$43.8 billion.

**OTHER**

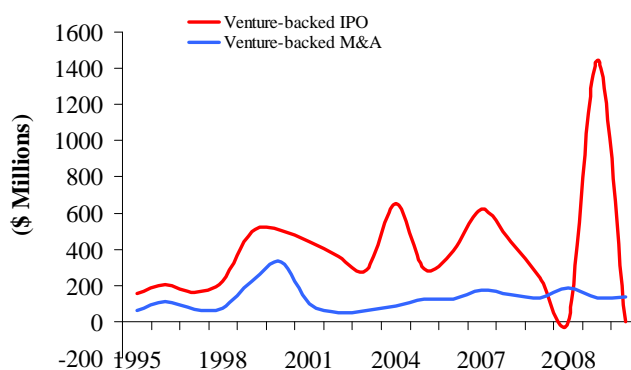
- While there is anecdotal evidence of broad interest in distressed debt, secondaries, and other fixed income-related strategies, virtually all funds are having difficulty raising capital in the current environment. Even where the investment opportunity may be compelling, the hesitation among LPs to commit is proving a headwind for virtually all private investment funds.

**Venture Exit Analysis:**

	# of Venture-Backed IPO's	Offer Amt (\$MM)	# of Venture-Backed M&A	Deal Value (\$MM)
<b>2004</b>	94	11,378	351	15,942
<b>2005</b>	57	4,485	371	22,179
<b>2006</b>	56	5,075	387	19,316
<b>2007</b>	86	10,326	362	28,457
<b>2008</b>	6	470	271	13,915
<b>1Q08</b>	5	283	77	3,929
<b>2Q08</b>	0	0	75	4,154
<b>3Q08</b>	1	188	78	3,741
<b>4Q08</b>	0	0	41	2,091

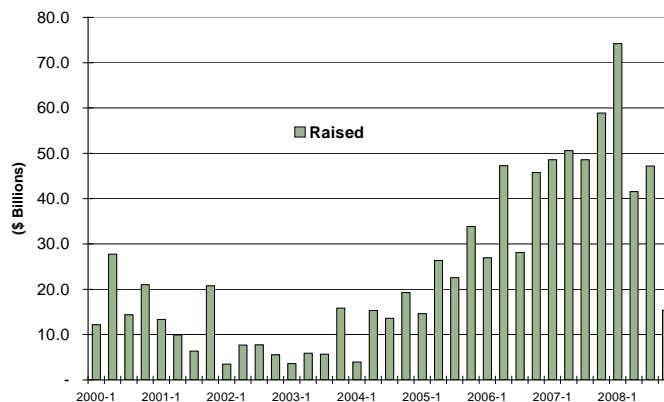
Source: Venture Economics

**Average Exit Valuations**



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>2004</b>	57	11,293	39	9,251
<b>2005</b>	67	15,764	97	22,672
<b>2006</b>	66	17,451	146	30,538
<b>2007</b>	40	9,627	170	43,845
<b>2008</b>	6	1,250	112	10,800
<b>1Q08</b>	2	267	26	3,690
<b>2Q08</b>	2	357	29	1,773
<b>3Q08</b>	1	500	29	3,315
<b>4Q08</b>	1	126	28	2,023

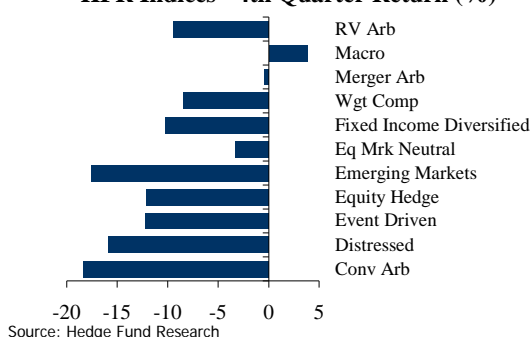
Source: Venture Economics

**HEDGE FUND OVERVIEW**

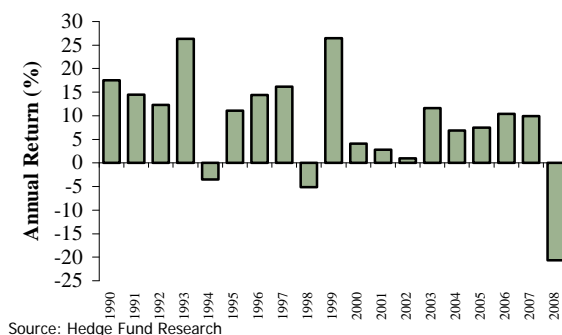
Throughout the fourth quarter financial markets were under highly “stressed” conditions as widespread risk reduction and de-leveraging continued to impact virtually all asset classes; the Lehman Brothers bankruptcy in particular caused significant uncertainty leading into the 4<sup>th</sup> quarter. Under these conditions, even hedge funds were not immune to the market declines; the HFR Weighted Composite Index dropped 8.47% during the fourth quarter, and was down 18.36% on the year. This marked one of the most difficult years for the hedge fund industry, and the worst annual performance since the inception of the HFR index in 1990. Many managers in the third and fourth quarters were forced to sell into illiquid markets in order to raise cash for redemptions or in some cases margins calls. This led to more hedge fund managers either gating or suspending redemptions in their funds in order to preserve their NAVs or in some cases their businesses. The hedge fund industry may experience consolidation going forward as assets have declined 38% to \$1.25 trillion from \$2 trillion throughout 2008.

Hedge Funds of Funds also had a difficult year, with the HFR FOF Diversified Index, the collection of broadly diversified funds of funds, down 8.98% during the quarter and down 20.12% for the year. Funds included in the HFR FOF Conservative Index were down 9.93% for the quarter and down 18.36% for the year, while the more aggressive mixture of funds, those that typically emphasize equity long/short strategies and are included in the HFR FOF Strategic Index, fell in value even more, down 10.58% for the quarter and down 25.15% for the year. The differential in performance of hedge fund of funds largely relates to how much exposure managers have to relative value and macro type strategies.

**HFR Indices - 4th Quarter Return (%)**



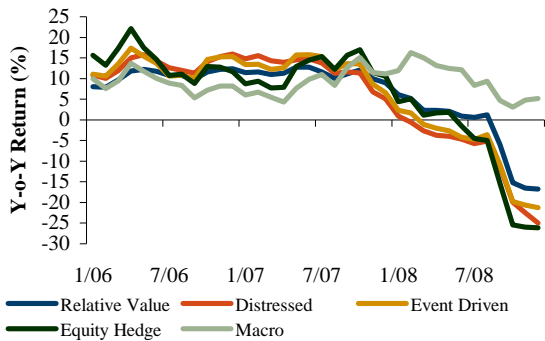
**HFR Funds of Funds**



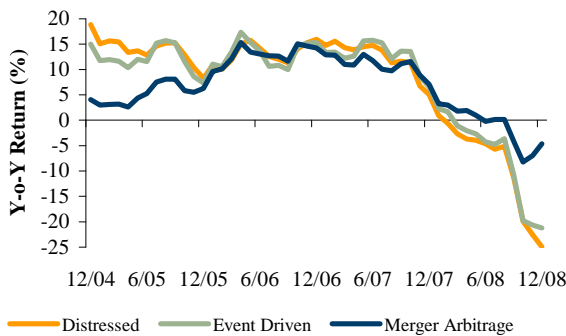
**NON-DIRECTIONAL STRATEGIES**

- The HFR Equity Market Neutral Index was down for the quarter, dropping 3.30%, but remains a top performing strategy over the full-year period, falling just 6.19%. Market neutral managers were affected by the volatile markets, which created difficult trading conditions during the quarter; still, the low or no beta profile of these portfolios proved beneficial relative to other managers and strategies.
- Convertible arbitrage, as represented by the HFR Convertible Arbitrage Index, was the worst performing strategy for the quarter (-18.38%) and the year (-34.74%). After dropping 12.04% in September, partly due to the short-sale ban instituted by the government following the bankruptcy of Lehman Brothers, the index dropped a record 16.70% in October. This was due to a number of factors, including credit spread widening, elevated funding costs, restrictive margin requirements, forced selling, and de-leveraging. Convertible arbitrage managers saw a slight up tick in performance in December (+0.78%) due partly to the fact that several large companies began repurchasing convertibles at distressed levels. At this juncture, convertibles are viewed as trading at extremely cheap valuations based on volatility and credit conditions.
- The HFR Relative Value Arbitrage Index was down 9.48% for the quarter and finished down 16.75% for the year. The period continued to present problems for those seeking to exploit mis-pricings between securities. Fundamentals clearly did not matter during the year, and many relationships continued to remain “disconnected” due to technical factors.
- The HFR Fixed Income Index sustained back to back quarters of record negative performance with a loss of 8.64% in the third quarter and a 10.20% decline in the fourth quarter. The fourth quarter’s performance stemmed from a horrible October (-8.73%), where de-leveraging and sharply widening spreads hurt returns. The unprecedented moves in credit spreads on a global basis continued to hamper this strategy. U.S. High Yield, as measured by the Merrill Lynch High Yield Cash Pay Index, fell 17.47% for the quarter, and finished the year down 26.19%. Meanwhile, investment grade corporate credits rebounded significantly during the quarter, with the Barclays Capital Long Credit Index up 13.41%, producing a 2008 return of -3.92%.

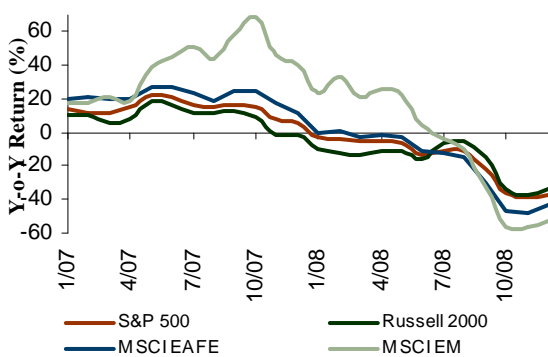
**HFR Strategy Returns**



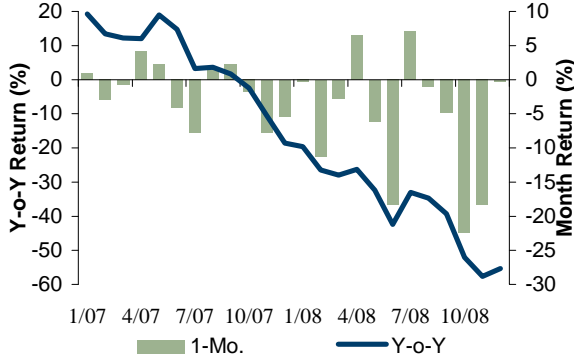
**HFR Event Strategy Returns**



**World Equity Markets**



**S&P Financials**



**EVENT DRIVEN STRATEGIES**

- The HFR Event Driven Index delivered its worst quarterly loss (-12.25%) since the inception of the index in 1990 and finished the year down 21.24%. Continued risk aversion coupled with deal specific issues plagued most managers.
- The HFR Distressed Index was down dramatically (-15.88%) during the quarter, the strategy's worst loss since the inception of the index in 1990. Distressed was also one of the worst performing strategies for the year (-24.95%). Managers in this space continue to suggest that there are increasing opportunities for distressed trades, particularly after the massive sell-off and economic deterioration experienced during the fourth quarter. In November, credit spreads widened to record highs, translating to significant unrealized losses for managers that have opted to allocate to bank loans while waiting for better opportunities in subordinated corporate debt. The general consensus is that there are huge dislocations within the leveraged loan market as high quality bank loans are being sold in the secondary market at substantial discounts to face value.
- The HFR Merger Arbitrage Index declined 0.38% in the fourth quarter, and was down 4.64% for the year. The index was one of the top performers during the quarter and the year, despite the sharp slow down in global M&A activity. Despite a difficult environment that saw nearly \$1 trillion, or 28% of all announced deals (as a percent of announced transactions), fall through, managers benefited from significant deal spreads on several key transactions. Additionally, gains were extracted from trading in GMAC securities which became a bank holding company and saw an injection of capital from the U.S. government. The opportunity set remains limited, though, as North American M&A volume fell to \$100 billion, or roughly half that of the previous quarter.

**DIRECTIONAL STRATEGIES**

- The HFR Macro Index posted a 3.85% gain for the quarter, and represents the only strategy with a positive return over the past year (+5.18%). Gains were achieved in currency markets as all major currencies experienced substantial, sustained moves. Short commodity positions also proved popular with a number of managers as prices fell sharply on global recessionary worries. Performance in the fourth quarter was hampered by losses in emerging market equity and sovereign bonds where investors continued to sell-off "risky" assets amid growing fears over the future prospects for global growth.
- Equity long/short managers were hit hard in the fourth quarter as global markets plummeted and market volatility, as measured by the VIX index, peaked in October (59.89), and remained at similar levels through November (55.28). The HFR Equity Hedge Index was down 12.12% for the quarter, which was considerably less than the S&P 500 (-21.94%), MSCI EAFE (\$) Index (-19.95%) or the MSCI Emerging Markets (\$) Index (-27.56%). Over the year, equity long/short managers looked even better on a relative basis, posting a -26.15% decline, as opposed to the S&P 500 (-37.00%), MSCI EAFE (\$) Index (-43.38%) and the MSCI Emerging Markets (\$) Index (-53.18%). At this juncture, net exposure has collapsed and cash levels in portfolios have increased dramatically.

**REAL ASSET OVERVIEW**

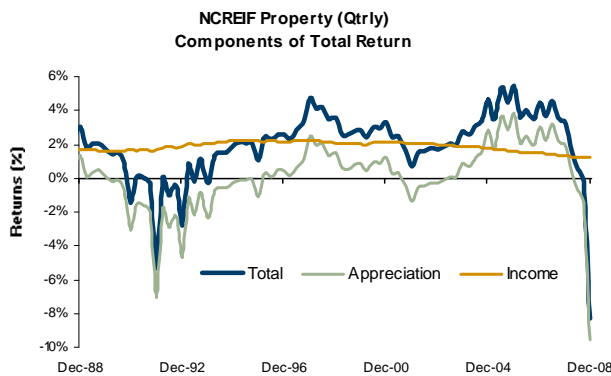
The NCREIF Property Index (“NPI”) suffered its worst quarterly decline (-8.3%) as well as its worst one-year total return (-6.5%) since its inception in 1978. The decline was broad-based within the asset class, as all property types were impacted. The deleveraging process for CRE is just getting underway and the 4<sup>th</sup> quarter may have only marked the beginning of a period of expected write-downs in direct real estate asset values. With prices for core properties peaking around early 2007, some industry experts have predicted a re-pricing decline of roughly 20% - 30% (peak-to-trough). As such, further erosion in appreciation is expected in the first half of 2009. Until recently, CRE has held up relatively well early in the down cycle compared to other asset classes, largely driven by solid demand and healthy property fundamentals. However, the CRE market may be facing its most difficult year since the early 1990’s, as the prospects for real estate in 2009 include the dual impacts of deteriorating fundamentals and higher cap rates.

Although transaction activity overall remained quiet through 2008, with buyers and sellers largely at an impasse over price, volume may increase in 2009 as more distressed properties are forced to market. With the CMBS market frozen, and life companies and commercial banks in capital preservation mode, there are limited sources of credit to refinance maturing debt and to support new sale transactions. As such, many assets with debt maturing in the coming months may struggle to refinance on reasonable terms. While lenders may consider extending loans or other means to avoid foreclosures, defaults are expected to rise significantly. Furthermore, it remains uncertain what, if any, impact the U.S. government’s efforts (TARP, stimulus package, etc.) will have on CRE lenders. However, with dislocation comes opportunity; the market has become increasingly concentrated with private equity real estate funds focused on debt, distressed debt or distressed property.

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

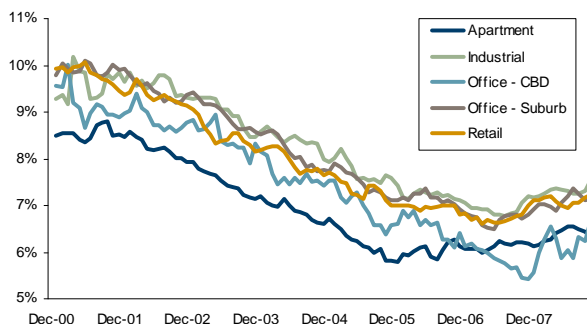
As of 12/31/08	1 Year	3 Years	5 Years	10 Years
NAREIT (US)	(37.7)	(10.8)	0.9	7.4
EPRA/NAREIT (Global)	(47.7)	(11.5)	2.0	NA
NCREIF Property	(6.5)	8.1	11.7	10.5
NCREIF Timberland	9.5	13.8	14.4	9.0

Source: NCREIF, NAREIT (Equity Only), Bloomberg



Source: NCREIF

**U.S. Capitalization Rates by Property Type**

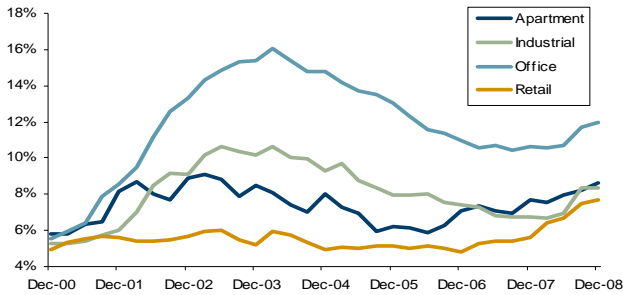


Source: Real Capital Analytics, CB Richard Ellis

**PRIVATE REAL ESTATE**

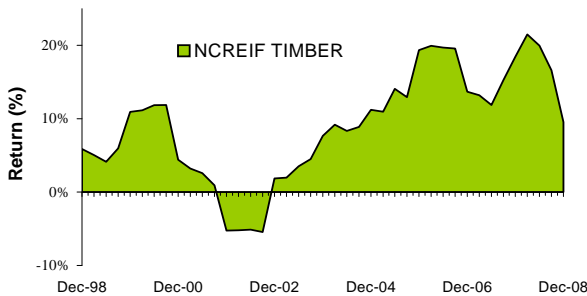
- As mentioned above, the NPI declined 6.5% in 2008, which marks only the third year in the Index’s history to record a negative annual total return. The only other negative years were in 1991 and 1992, a similarly challenging time for CRE. During the 4<sup>th</sup> quarter, the total return for the NPI was -8.3%; appreciation was -9.5%.
- As the U.S. unemployment rate rose to 7.2% at year-end according to the Labor Department, vacancy rates increased and net absorption declined, negatively impacting rental growth in office space. Although the slowdown is broad-based, with office vacancies rising in 71 of the 79 markets according to Reis, core, globally-linked markets with stronger fundamentals may fare better than peripheral or suburban markets. During the 4<sup>th</sup> quarter, the total return for the office sector was -9.3%, ending the year down 7.3%.
- Although financing is generally difficult to obtain, Fannie Mae and Freddie Mac continue to be active debt providers in the apartment space. The long-term prospects for this sector remain positive, however over the short-term a bifurcation exists between strong, steady markets and those that are experiencing excess supply. The sector declined 8.4% for the 4<sup>th</sup> quarter, and was down 7.3% for the year.
- Weak demand for imports due to the global recession has reduced demand for industrial space, although vacancy rates remained flat during the quarter. The industrial sector outperformed the broader NPI albeit only marginally, declining 8.0% during the 4<sup>th</sup> quarter, and 5.8% for the year.
- The retail sector led the NPI during the quarter (-6.3%) as well as over the year (-4.1%). However, prospects for this sector going forward are poor. Weak consumer spending is putting pressure on retailers, and vacancy rates are expected to move higher as layoffs and store closings continue into 2009.

U.S. Vacancy Rates by Property Type



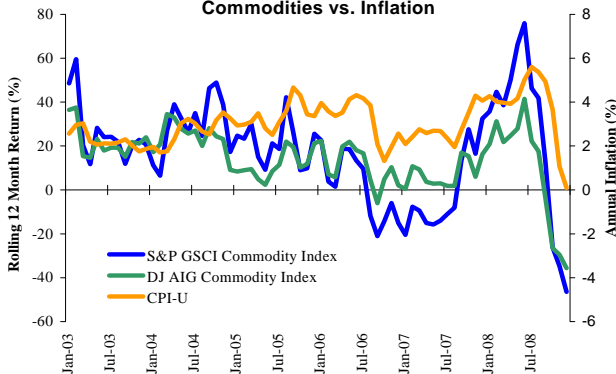
Source: NCREIF, Morgan Stanley

NCREIF Timberland Index Rolling 12 Month Return

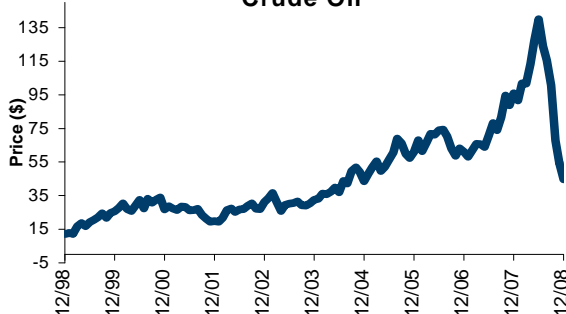


Source: NCREIF

Commodities vs. Inflation



Crude Oil



Source: Bloomberg; Linked spot month futures contract price

**TIMBER**

- The NCREIF Timberland Property Index was among the few asset classes in positive territory over the year, returning 9.5% for the trailing one-year period ending December 31, 2008. For the fourth quarter, the Index was up 2.7%.
- Similar to the CRE market, transaction activity within the timberland market has slowed, as cautious buyers and patient sellers assess the broader economy. However, small to medium size deals continue to sell at strong values, while larger deals remain mostly stagnant with several prospective timberland sales being pulled from the market.
- The significant drop in U.S. housing starts (38%) over the past year has impacted the lumber market, with prices down 20% for the year. The pulp and paper market has weathered the storm fairly well to-date, largely driven by the strength in U.S. news print (up over 30% for the year). However, this trend may change as global demand continues to soften, which will also put pressure on pulp-consuming mills, some of which have already extended seasonal downtime, if not closed down.

**OTHER**

- Fundraising for private equity infrastructure funds in 2008 decreased by 28% in aggregate relative to 2007 according to Private Equity Intelligence. Future prospects for the space are positive however, as the opportunities for private investors to finance infrastructure projects should increase, given the spotlight placed on the sector by the Obama Administration, which has made a strong commitment to the space going forward.

**COMMODITIES**

- During the quarter, commodities were among the worst performing asset classes, suffering their worst quarterly loss in history, and giving back all of the gains from the first half of the year. The Dow Jones-AIG Commodity Index was down 30.04% and the S&P GSCI plummeted 47.00% during the quarter. On a year-over-year basis, the Dow Jones-AIG was down 35.65% while the S&P GSCI was down 46.49%. The performance differential among the indices is caused by their relative allocations to oil and energy. The S&P GSCI has a high exposure to oil and energy, at 54.6% and 73.9%, respectively while the Dow Jones-AIG is more balanced with 12.1% and 30.9% allocated to oil and energy, respectively. Throughout the quarter, oil prices deteriorated rapidly, falling 55.68% to end the year down 53.53%.
- Inflation, as measured by the Consumer Price Index (CPI-U) dropped significantly over the 4<sup>th</sup> quarter; inflation peaked in July at a 5.60% annual rate but fell to 0.10% by the end of December which is the lowest reported increase since January 1967. With financial markets still in turmoil, and weak global growth, lower commodity prices have helped alleviate concerns about inflationary pressures over the near-term.

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