Diversified Alternatives
a new approach to alternative investing

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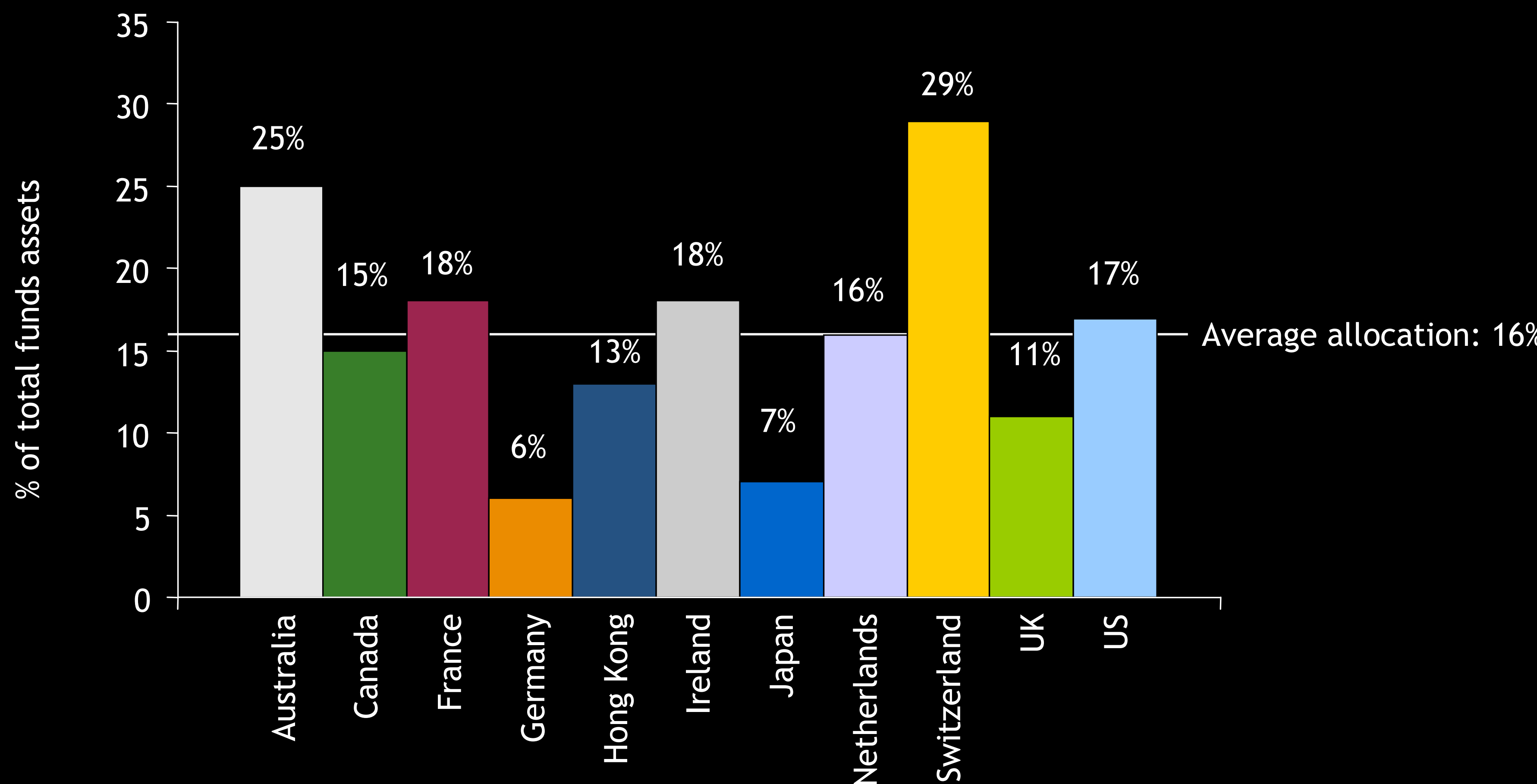
Allocations to alternatives

Global pension funds' allocation to alternatives (Total assets excl. Equities and Bonds)



Source: Watson Wyatt's Global Pension Asset Study 2008. Notes: Total assets of the 11 markets are $24,932bn, as of Dec 07.

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Why invest in alternatives?

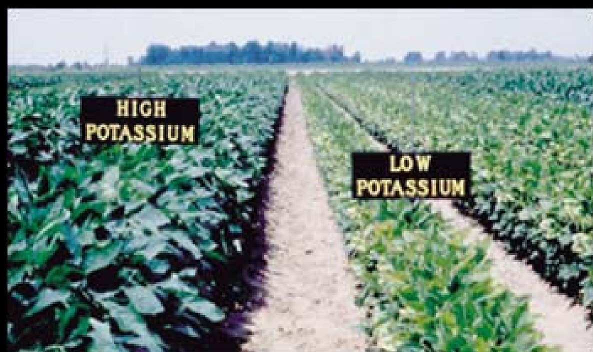
- Low correlation with traditional asset classes
- Improve diversification – can improve efficiency of total portfolio structure
- Can provide some protection against inflation surprises
- Illiquidity premium; return offered for providers of long term capital
  - Pension plans are natural providers of liquidity given investment time horizon

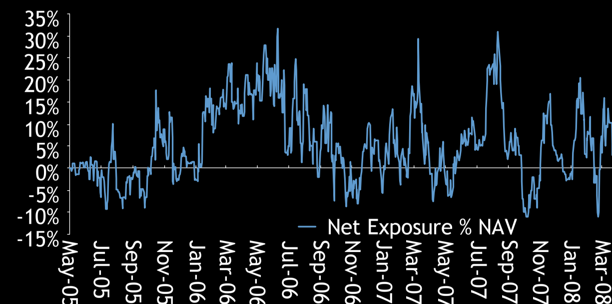
Characteristics of Alternative Assets

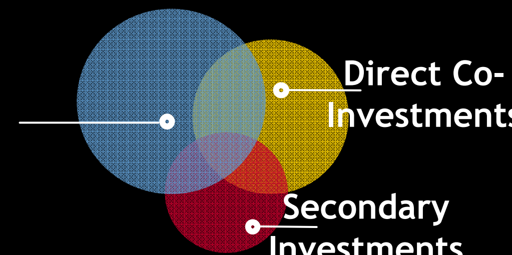
- Generally measured in terms of absolute return
- Some have a proportion of return from market exposure
- Return is primarily skill-based hence managers are subject to greater reputational scrutiny / assessment
- Often Illiquid
- Sometimes difficult to value

Allocations are growing fast

EIU / PWC Global Survey of investors:







35% to increase commodities

33% to increase hedge funds

40% to increase private equity

$200 billion waiting to go into infrastructure

41% to increase real estate

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Problems for Trustees

We know we need to diversify but…

- There is a growing range of investment types
- We don’t have the specialist knowledge
- Which should we invest in?
- How do we monitor risk?
- Is it the right time to invest?
- How do we measure success?
- Do we have the time to do this ourselves?

Solution: A Managed Portfolio of Alternatives

Benefits of outsourcing

Simple access - “one stop shop”

Full diversification

Low governance

Transparent fee structure

Cost efficient

Streamlined reporting

More scope for active management

Why active management is important

	2000*	2001	2002	2003	2004	2005	2006	2007
Hedge FoF	4.1	7.9	6.3	12.6	9.0	6.3	10.8	12.9
Private Equity	-28.9	-22.6	-25.6	35.3	15.6	35.6	11.1	-6.7
European Real Estate	12.6	-8.7	16.0	38.0	47.1	6.7	62.3	-26.8
Infrastructure	6.0	11.0	-4.8	29.4	32.3	22.1	26.7	15.2
Commodities	-2.2	-13.1	37.7	36.9	19.1	27.9	24.6	29.7
GTAA Futures	8.4	3.5	19.8	21.5	5.3	11.5	1.3	7.7
Cash	1.9	5.0	3.9	3.5	4.3	4.6	4.6	5.7

Best Return Worst Return

** 1/9 to 31/12 2000*
Source - BlackRock

Asset allocation matters

Asset class returns vary over time

Some asset classes display elements of market return

- Commodities
- Real Estate
- Debt Strategies

Others are more skill driven

- Hedge Funds
- Private Equity
- Real Assets

And all need effective implementation

How do we structure a portfolio?

Strategy
Private Equity
Property
Hedge Fund of Funds
Infrastructure
Hedge Funds
Commodities
Opportunistic Debt Strategies
Overlay & Cash Plus Strategies
Cash

Core

- Longer time investment horizon to achieve performance targets
- Attractive long term absolute returns
- Benefit from illiquidity premium

Rotational

- Shorter payback periods
- Provide additional diversification & liquidity
- Opportunities to invest in more cyclical ‘alternatives’ on an opportunistic basis
- Maximise returns on committed but un-drawn core investments by actively managing ‘frictional’ cash

Strong focus on portfolio construction to maximise risk adjusted returns

The importance of good manager selection

- Far, far more important than in traditional classes
- Requires detailed knowledge of manager & manager universe
- Best managers may be expensive: trade off is greater persistence than in traditional asset classes
- Organisational risk is a key concern
- Needs commitment to ongoing monitoring (not cheap)
- Access to market intelligence matters
- Effective portfolio construction and risk management

Analysing risk in alternatives

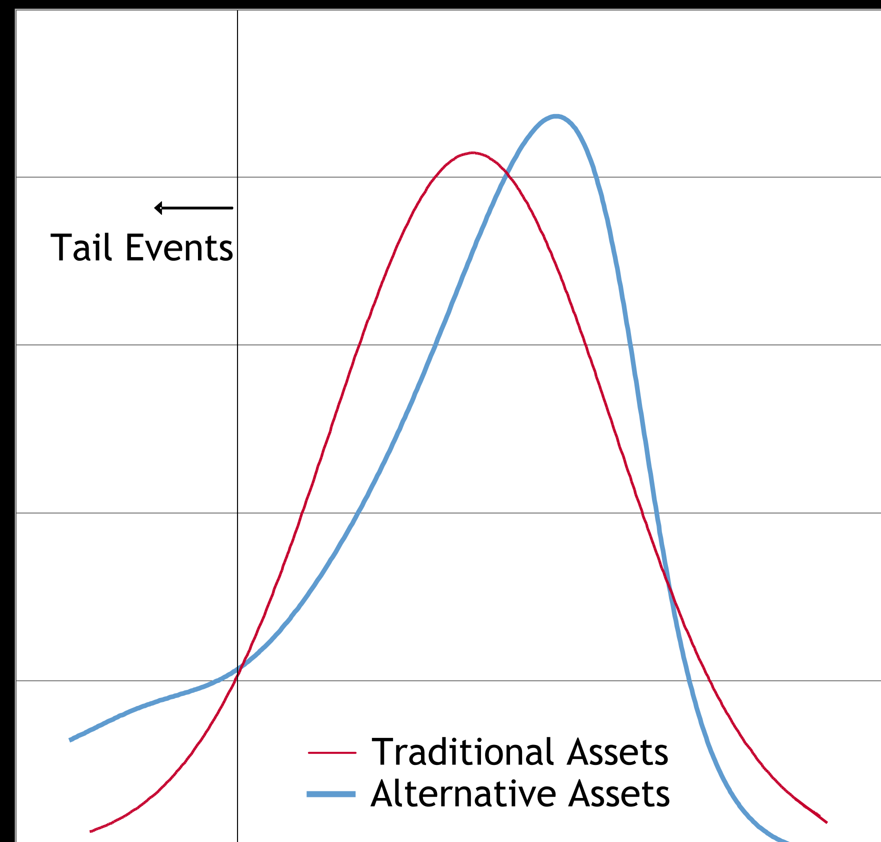
For Traditional assets the distribution of returns is well explained by the normal distribution.

For Alternative assets the distribution of returns is skewed and has “fat tails”

Need to focus on tail risk

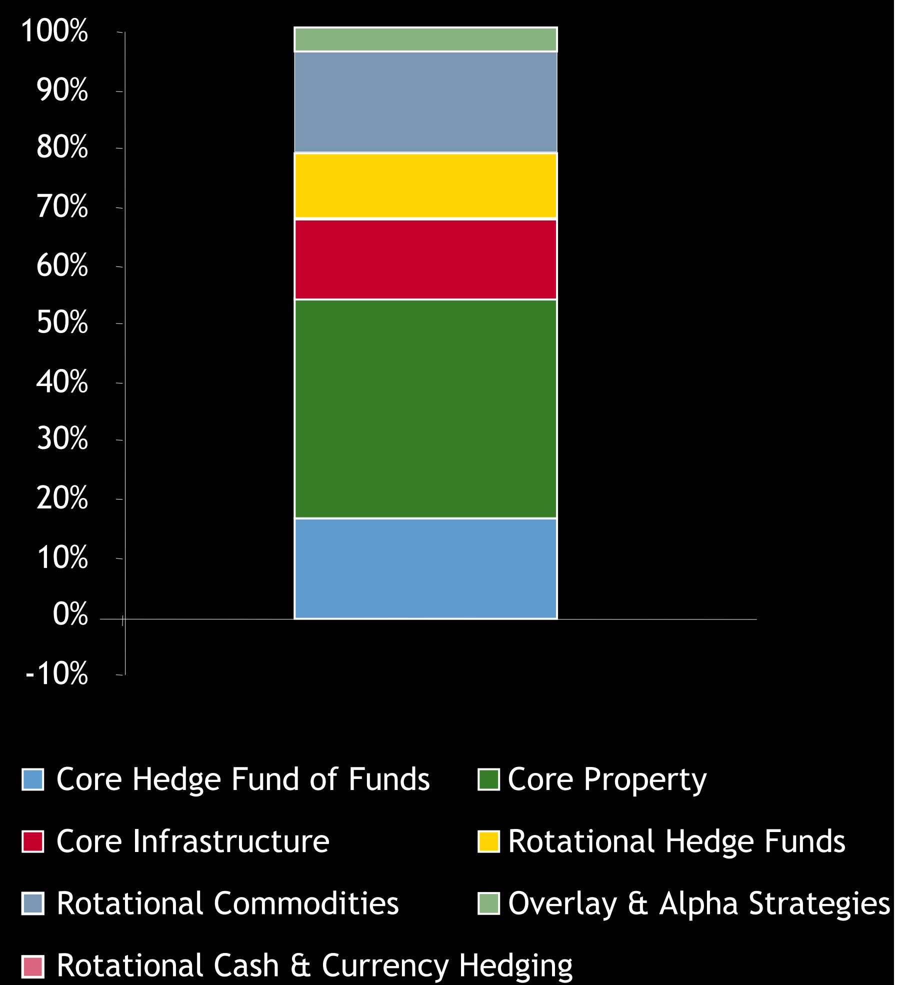
- The exposure of the overall fund and individual assets to tail events
- The contribution of each asset to the tail risk of the overall fund
- The trade off between an asset’s contribution to tail risk and it’s expected return

Distribution of returns



Using risk intelligently

Portfolio Characteristics*	Estimates**
Volatility (annualised)	4.0%
95% Quarterly Loss	-3.5%
Maximum Drawdown	-7.1%
Worst Quarter	-2.4%
Correlation (FTSE 100)	0.3



* Inception 31 July 07
** sample client account as at 30 June 08
Source - BlackRock

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Why opt for a managed approach?

Fee structure aligned to client experience

Overall risk management

Less governance required

Active asset allocation

Consolidated reporting

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