

Institutional Investors: It's a Whole New World

Tuesday, April 28, 2009

4:00 PM - 5:15 PM

Moderator

Liam Kennedy, Editor, Investment & Pensions Europe

Speaker

Christopher Ailman, Chief Investment Officer, California State Teachers' Retirement System

Harold Bradley, Chief Investment Officer, Ewing Marion Kauffman Foundation

Joseph Dear, Chief Investment Officer, California Public Employees' Retirement System

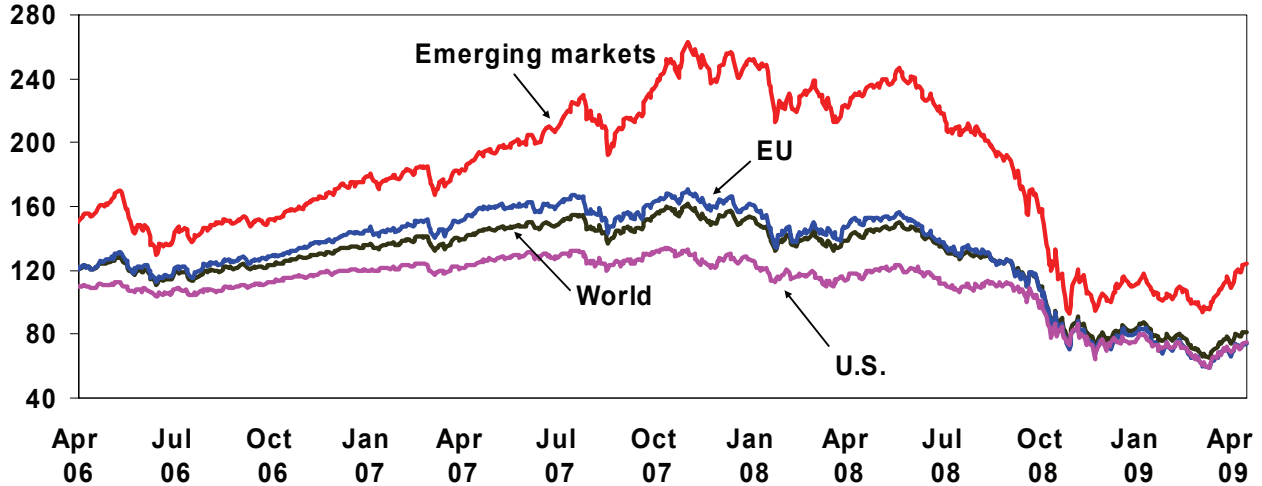
Catherine Lynch, CEO and Chief Investment Officer, National Railroad Retirement Investment Trust

Scott Miner, Managing Partner, Guggenheim Partners; CEO and Chief Investment Officer,
Guggenheim Partners Asset Management Inc.



Global equity index

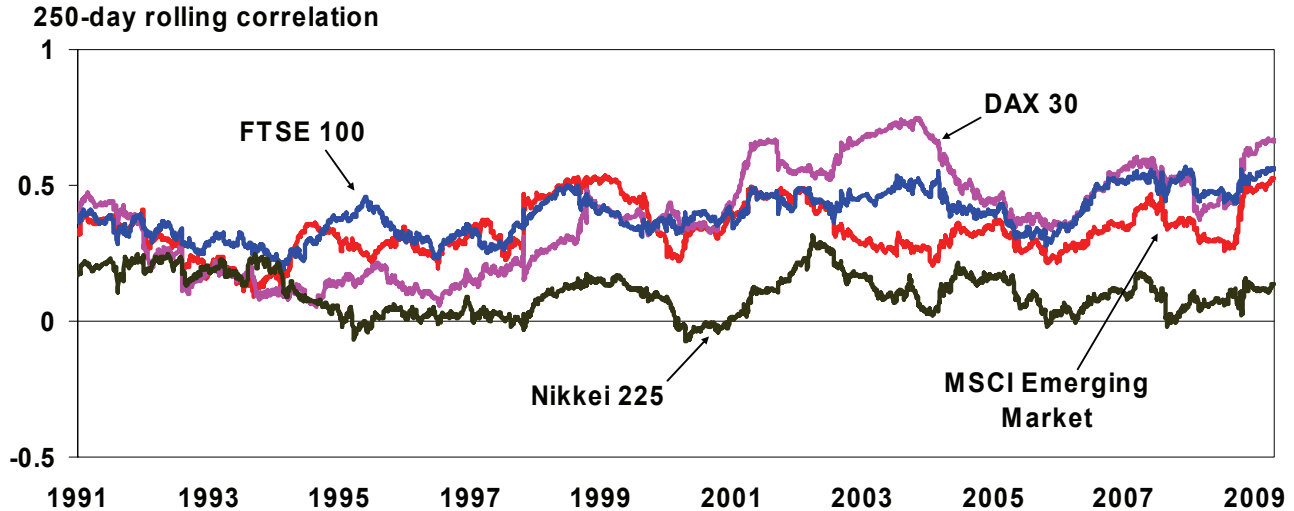
January 2005 = 100



Source: Datastream.



Correlation of global stock markets with S&P 500

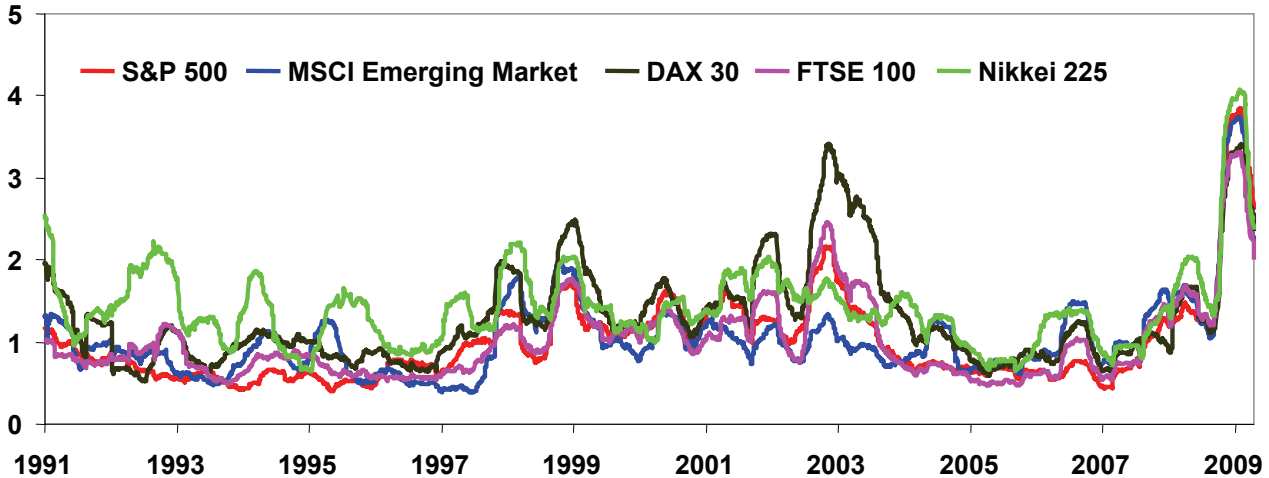


Source: Datastream.

Stock market volatility

Volatility is off its peak

A rolling 100-day standard deviation of equity prices



Note: The data is as of April 15, 2009; Source: Datastream.

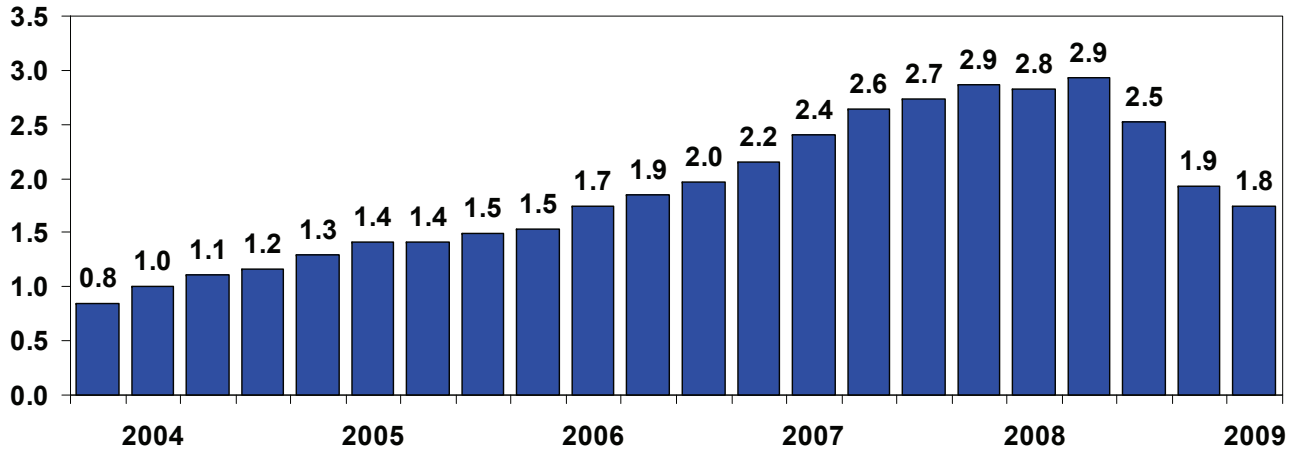
Private equity activities slow globally

	Deal value announced (US\$ millions)		Fund raised (US\$ millions)	
	2007	2008	2007	2008
United States	368,400	59,600	325,200	256,900
Western Europe	185,900	88,000	101,500	96,100
Asia	67,000	52,500	28,700	37,100
Middle East	898	1,700	5,000	6,400
Eastern Europe	27,900	8,000	14,600	5,400
Latin America	4,600	1,200	4,400	4,000
Africa	7,900	2,200	2,300	2,600
Total	662,598	213,200	481,700	408,500

Sources: Dow Jones, Dealogic.

Worldwide hedge fund assets drop by 40 percent since Q2 2008

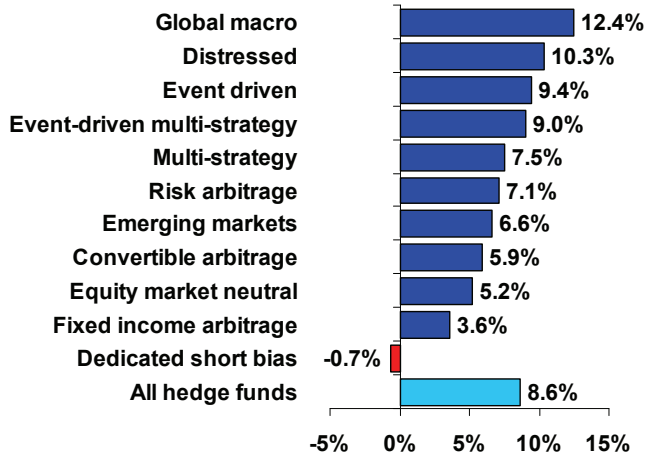
US\$ trillions



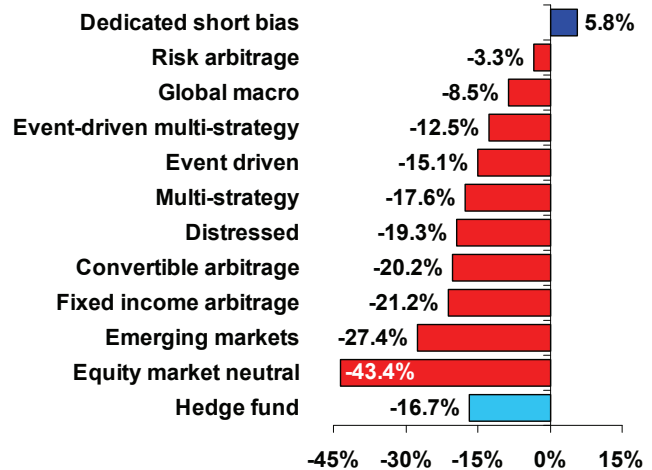
Sources: Hedgefund.net, The Milken Institute.

Hedge fund returns, different strategy

Annualized return, January 1994–March 2009



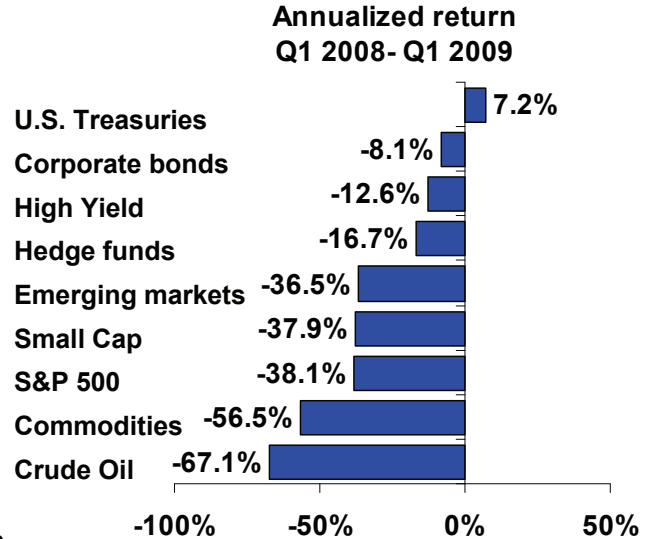
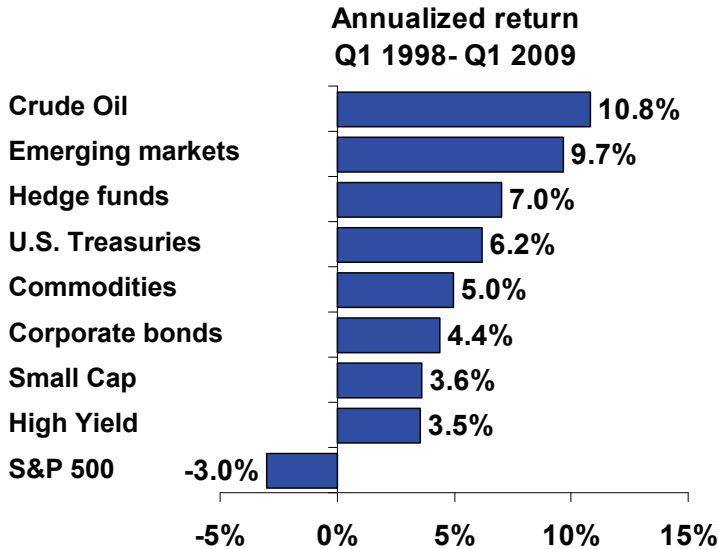
Annualized return, March 2008–March 2009



Sources: Bloomberg, The Milken Institute.



Total returns of selected asset classes



Sources: Bloomberg, Datastream, The Milken Institute.



Liam Kennedy's Slides

81% of (European) pension plans surveyed had raised risk management issues at board level in the 6-9 months to March 2009



What were the outcomes of your risk management discussions?

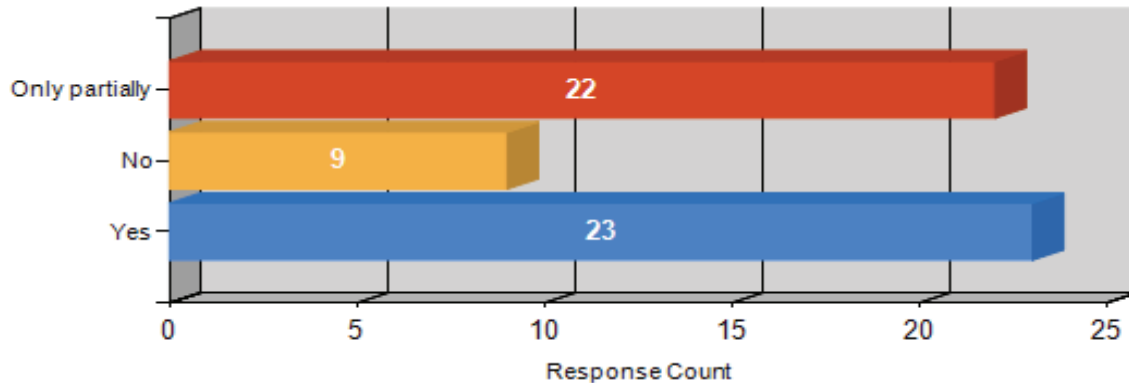
“Undertake asset allocation review; longevity risk management and real interest risk management reviews.”

“Operational risk management procedures became more relevant. These were found to be adequate.”

“We performed an ALM study that confirmed the current asset allocation.”

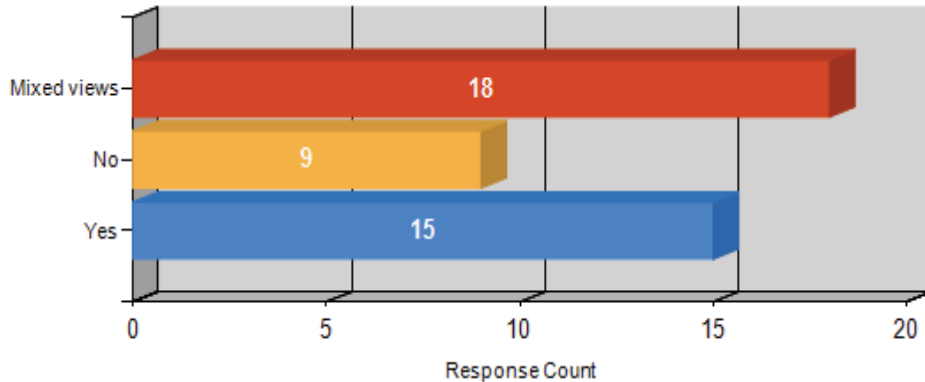


Are you confident that the models used by your asset and liability modeling (ALM) provider take into account current economic and financial market conditions?



Source: Investment & Pensions Europe survey of pension funds, March/April 2009.

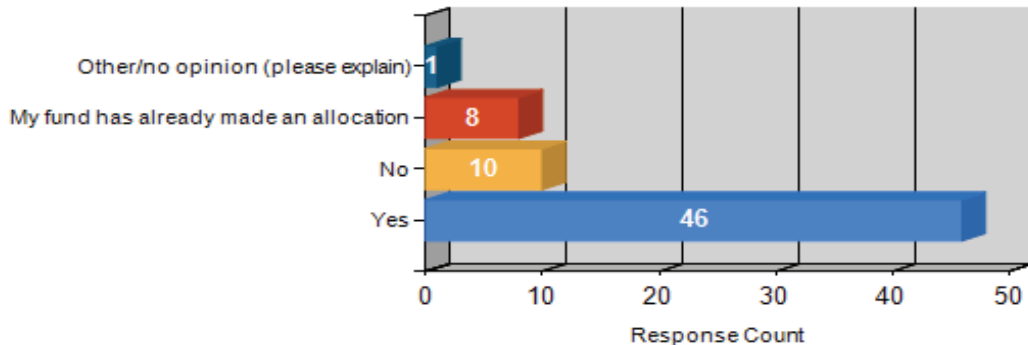
Overall, have consultants added value to your investment portfolio, taking their fees into account?



“Especially with manager searches they bring up external managers based on reputation and size. Like ‘who gets fired for buying IBM?’. We prefer boutiques.”

Source: Investment & Pensions Europe survey of pension funds, January 2009.

I expect my fund to invest in undervalued assets or investment classes in 2009



Source: Investment & Pensions Europe survey of pension funds, December 2008.



Over the four-year market cycle 2004-08...

- *S&P 500 outperformed 71.9% of actively managed large cap funds*
- *S&P MidCap 400 outperformed 75.9% of mid cap funds*
- *S&P SmallCap 600 outperformed 85.5% of small cap funds*

Source: Standard & Poor's Index Versus Active Fund Scorecard (SPIVA), April 2009.

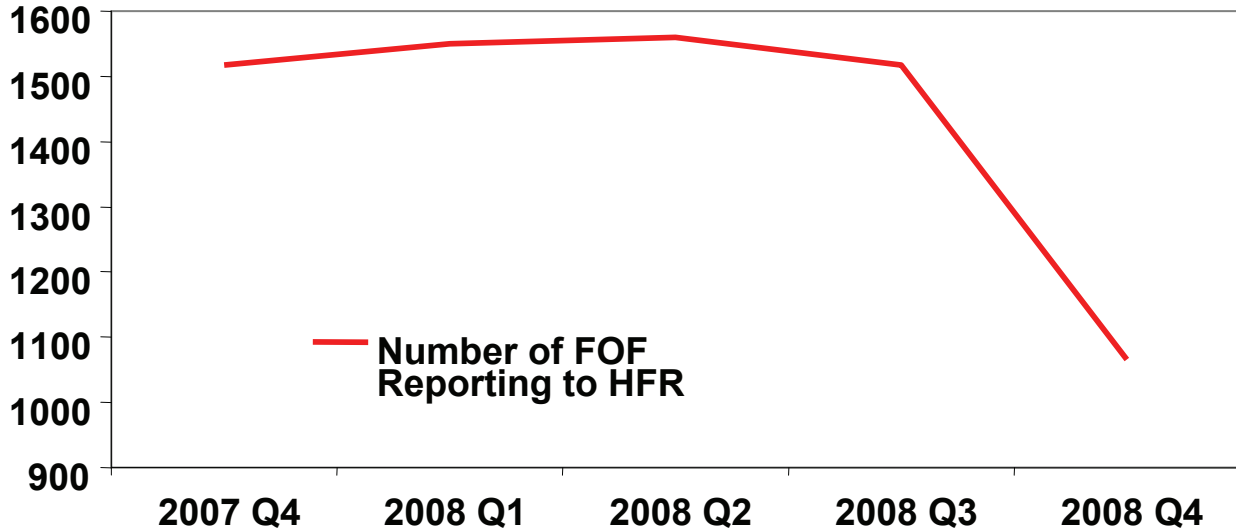


Harold Bradley's Slides

Hedge funds as an asset class survivorship bias:



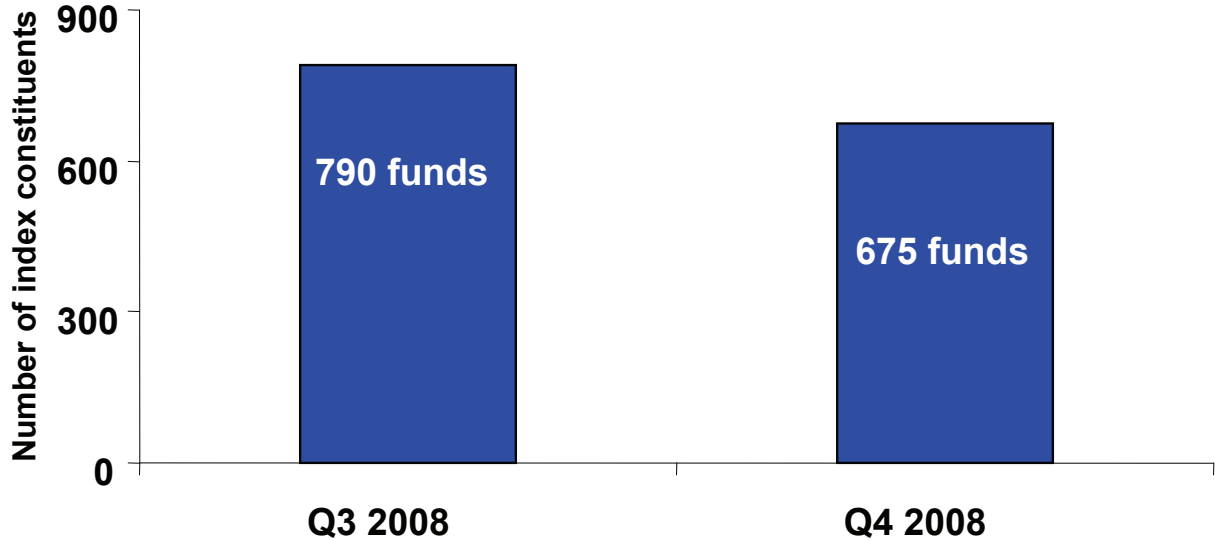
Many fund-of-funds stopped reporting in Q4 2008



Source: HFRI database.

Constituents for HFR fund of funds index

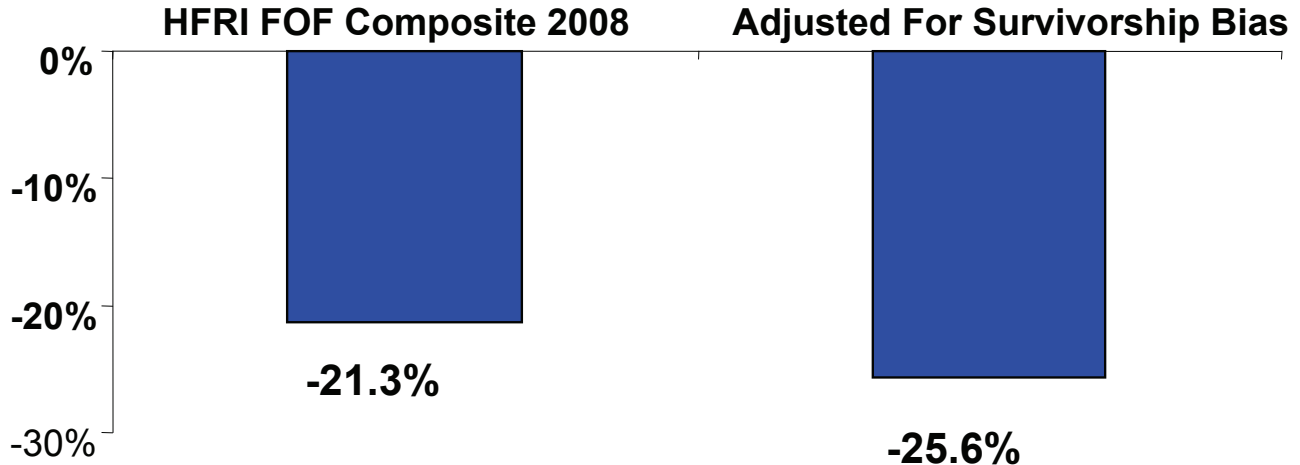
Does anybody know the real returns and volatility?



Source: HFRI.

Hedge funds as an asset class:

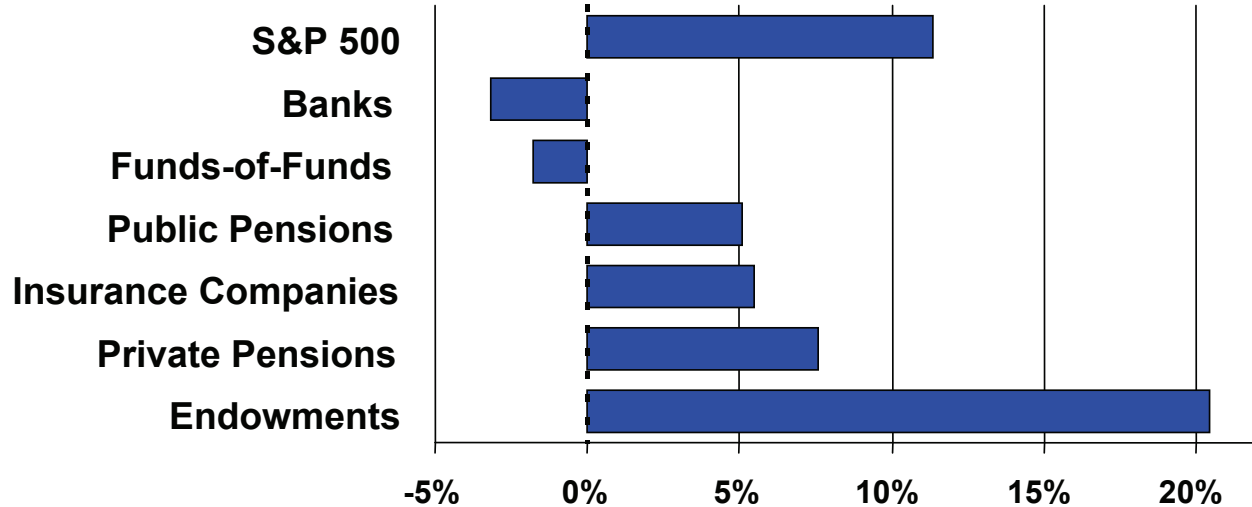
How did they perform?



Assumption: funds that stopped reporting lost half their value on average.

Private equity performance by investor type

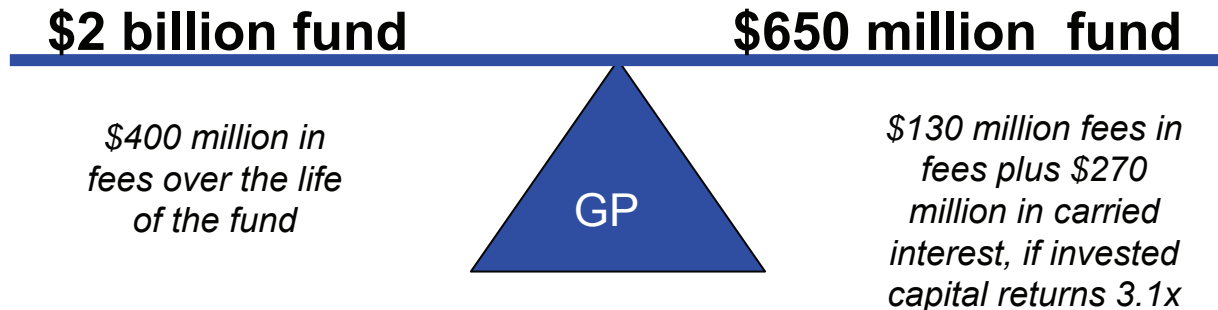
(Funds between 1992 and 2001)



Source: Lerner, Schoar and Wang [2007].

Courtesy of Josh Lerner, HBS

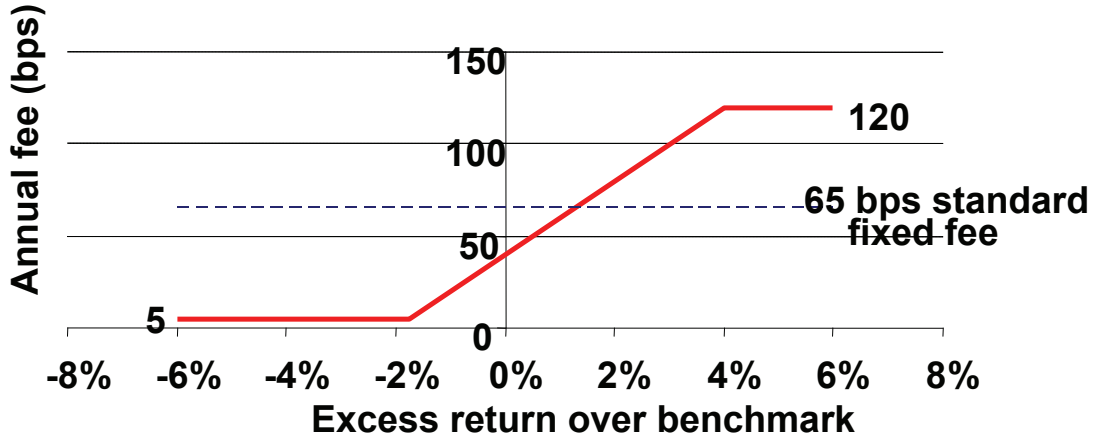
Why do we pay GPs to get huge...



Source: Andrew Metrick and Ayako Yasuda, "The Economics of Private Equity Funds," the Wharton School, University of Pennsylvania, 2007

Using variable fee schedules for equity accounts

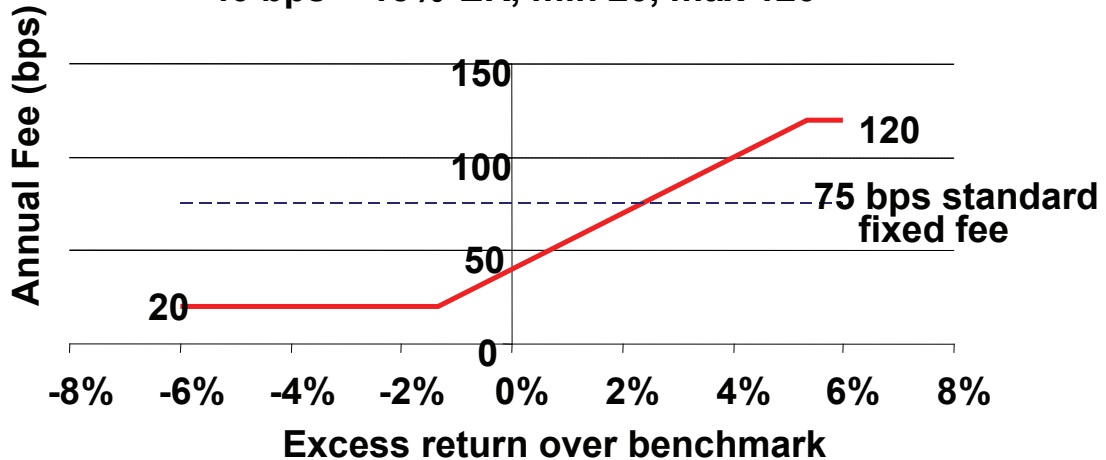
Fund A variable fee schedule
 40 bps + 20%*ER, min 5, max 120



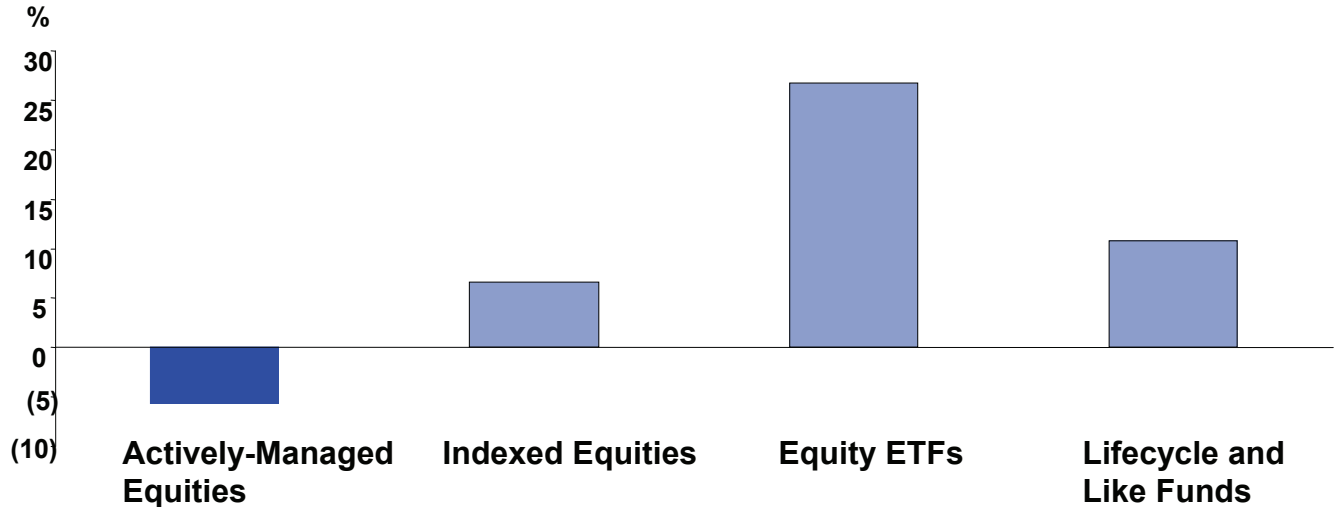


Using variable fee schedules for equity accounts

Fund B variable fee schedule
40 bps + 15%*ER, min 20, max 120



Equity-oriented mutual funds net Inflows as a share average assets 2008



Source: Strategic Insight Simfund.

Courtesy: Empirical Research



Further threats to street research – the dependability of investor behavior...

S&P 500 Earnings Yield vs. 10-year Treasury Yield

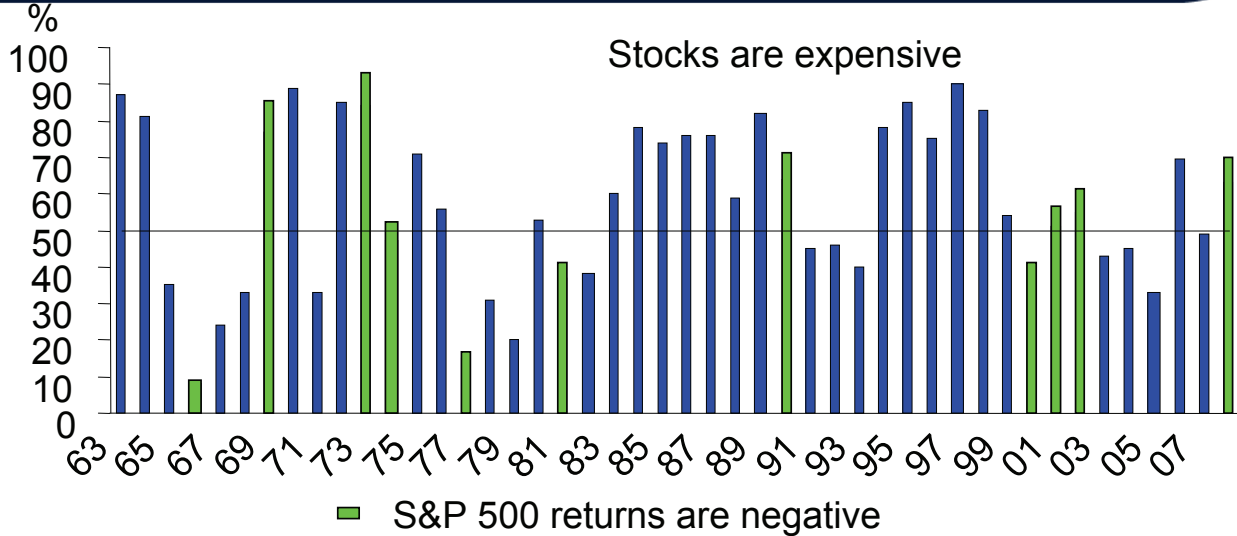


Q-Ratio: Stock Price Relative to Company Assets



Sources: Standard & Poor's, Compustat, EcoWin, FactSet, JPMorgan Asset Management.

Share of general equity funds underperforming the S&P500 (1963 through 2008)



Source: The Vanguard Group, Empirical Research Partners Analysis.



Joseph Dear's Slides

Risk managed absolute return strategies

- \$5.9 Billion as of March 1, 2009
- 26 direct hedge fund investments - \$4.6B (78%)
- 9 FoHFs with a niche focus - \$1.3B (22%)
- FoHFs invest in Asian-focused hedge funds, European-focused hedge funds and emerging hedge funds
- Invest in funds that actively seek to add value in both the long & short portfolios
- Avoid “beta” funds, activists, acronym funds (ABL, ABS, CLO, CDO, etc.)
- Allocation to a maximum of 8% of total Global Equity portfolio



The three pillars of hedge fund governance

Pillar 1: Alignment of Interests

- Fee structures that reward long-term performance, deter asset-gathering and encourage the development of institutional caliber businesses
“When our beneficiaries win, you win”

Pillar 2: Control of Assets

- Removes “game theory” of fund redemptions; eliminates gates, suspensions and side pockets; allows immediate termination of trading authority
“Without the return of capital there is no return on capital”

Pillar 3: Transparency of Risks and Exposures

- Builds on existing security-level transparency received from 90% of current hedge funds; improves ability to tailor portfolio-wide risk exposures; provides valuable “trust but verify” capability
“If you do not trust us with information, we cannot trust you with our capital”



Risk management measures

- **Leverage** – Determine aggregate debt across asset classes. For public equities aggregate at the benchmark level and for private assets at the investment company level
- **Concentration** – Determine aggregate industry/factor exposures across asset classes
- **Credit Risk** – Evaluate counterparty risk by monitoring trends in credit default swap spreads
- **Liquidity Risk** – Assess by aggregating portfolios into liquidity categories. Bid/ask spread is one measure of liquidity
- **Stress Testing** – Use the quantitative risk system to evaluate extreme market conditions
- **Reputation Risk** – Safeguarding our reputation through disciplined communications, rigorous codes of conduct and thorough compliance monitoring.



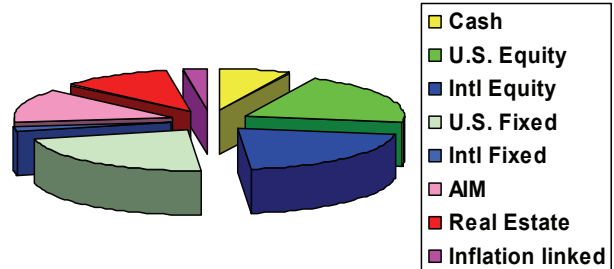
Five principles for financial regulation reform: *a model for change*

- Transparency
 - Greater disclosure and transparency
- Independence
 - True regulatory independence
- Corporate Governance
 - An increased and effective shareowner voice in the capital markets
- Investment Opportunities
 - The preservation of institutional investors' freedom to invest in the full range of investment opportunities
- Systemic Risk
 - Earlier identification by regulators of issues that give rise to overall market risk that threaten global markets



CalPERS investment portfolio (as of April 14, 2009)

Asset Class	Market Value (\$ in Billions)	Actual (%)	Target (%)
Cash Equivalents	\$12.6	7.2%	0%
Fixed Income			
Domestic	39.3	22.5	17
International	4.0	2.3	2
Equities			
Domestic	35.0	20.0	28
International	37.4	21.4	28
AIM (Private Equity)	22.9	13.1	10
Real Estate	19.5	11.1	10
Inflation Linked	4.3	2.4	5
Total Fund	\$175.0	100%	100%





Only the desperate are selling?

- 19 venture partnerships
- Raised between 1995 and 2004
- Cap weighted age of 10 years old (1999 vintage)
- Written down by 8% from cost to “comply” with FASB 157
- Recently received a bid for 45 cents
- It’s crazy to take a 55% loss...right?

55% discount is consistent with public market

RUO ↓ 260.97 +6.97 i
 At 14:21 Op 254.00 Hi 261.51 Lo 254.00 Prev 254.00

Index **GP**

RUO INDEX

GP - Line Chart

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Range **01/30/98 - 04/24/09** Upper **Line Chart** Mov. Avgs **20 55 200** Currency **USD**

Period **Weekly** Lower **None** Mov. Avg **15** # Events



Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
 Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000
 Copyright 2009 Bloomberg Finance L.P.
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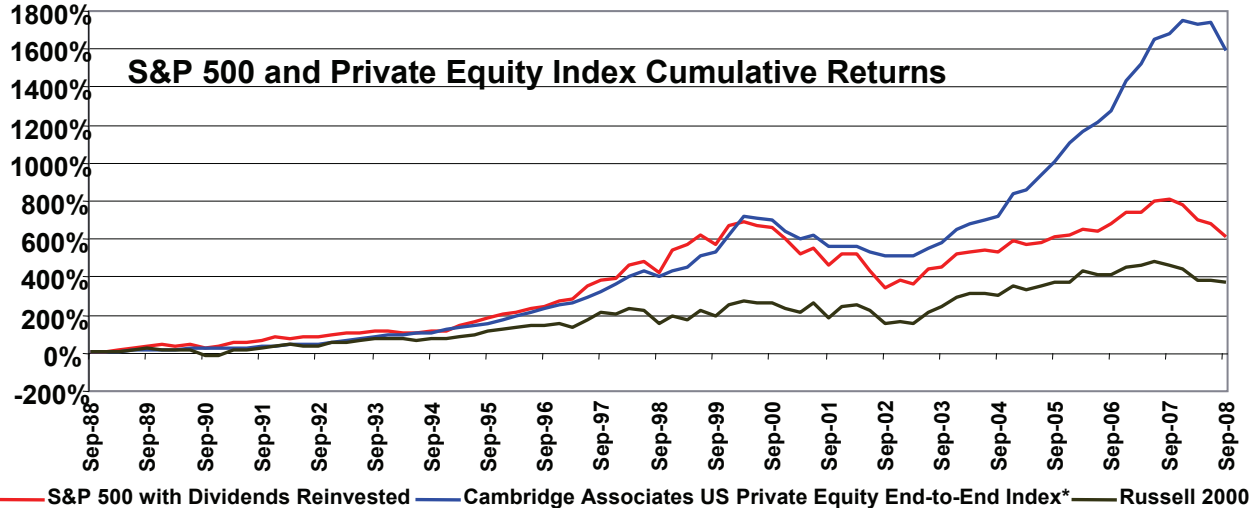


Selling might make sense

- Illiquidity in private equity is poorly understood
- New accounting rules still are not fully capturing true value
- Everything is an opportunity cost trade
 - Sell old venture capital at 45 cents
 - Buy distressed real estate and credits at 20 cents?



Cumulative Index Returns



* Excludes venture capital finds.
Source: Cambridge Associates, Bloomberg

Index Comparison

	Russell 2000	S&P 500	Private Equity*
Average Annual Returns	9.78%	11.60%	15.86%
Standard Deviation of Returns	20.08%	18.72%	13.92%
Sharpe Ratio	0.34	0.46	0.91

Note: Risk free rate assumed to be 10 Year Treasury Note as of 4/23/09.

* Excludes venture capital finds.

Source: Cambridge Associates, Bloomberg

Build America Infrastructure Bonds

Issuer	Pricing Date	Amount (\$ in millions)	Rating Category	Spread to 30-Year	Indicative Rate
University of Minnesota	4/15	\$37.5	AA	255	6.35%
University of Virginia	4/15	\$250	AAA	255	6.35%
NJ Turnpike Authority	4/20	\$1,300	A-Plus/A3	370	7.50%
California	4/22	\$5,000	A	365	7.45%
NY MTA	4/23	\$750	AA / A-Plus	350	7.30%

Source: Thompson Reuters, The Bond Buyer, Guggenheim Partners