

THE 2007-2008

Russell Investments Survey on Alternative Investing

A SURVEY OF ORGANIZATIONS IN
NORTH AMERICA, EUROPE, AUSTRALIA, AND JAPAN

EXECUTIVE SUMMARY OF KEY FINDINGS

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Introduction

As interest in alternative investments has grown, and as such investments have become more mainstream, the phrase “alternative investments” itself is beginning to sound like a contradiction in terms. What were once considered fringe investments are now deemed essential components of many institutional investors’ portfolios.

Russell Investments began studying alternative investments back in 1992, to fill a void in the useful information available about private equity investment practices. Our survey has now become an indispensable tool for many investors, who look forward to receiving it biennially. With 15 years of accumulated data, Russell is able to offer insights and perspectives not available elsewhere.

About the survey

- For the eighth edition of the *Russell Investments Survey on Alternative Investing*, we asked pension funds, endowments and foundations about their use of private equity, hedge funds and real estate.
- In all, 326 large organizations responsible for managing tax-exempt assets responded, representing Australia, Europe, Japan and North America.
- The survey asked in-depth questions designed to extract useful information and insights.

On page 3, subject matter experts from Russell’s Alternative Investments practice highlight the key findings of the report. The executive summary that follows provides more detail on the various and numerous alternatives across the regions.

Thanks to the respondents

Russell gratefully acknowledges the valuable input we received from those who responded to this edition of the survey. In a world where there is competition for every moment’s attention, we appreciate that so many took the time to make this report possible. We intend to continue providing a report that holds value for you and your organization. Toward that end, we welcome your comments and any suggestions for further refinement of this research.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Jon Bailie', with a stylized flourish extending to the right.

Jon Bailie, Managing Director
Alternative Investments

Methodology

A total of 326 surveys of institutional investors were completed by phone, mail, e-mail and Internet during the first half of 2007 and represented organizations that utilize at least one form of alternative investment. The respondents were selected from a broad-based, global list of institutions that manage tax-exempt assets, and those interviewed were qualified to represent the investment activities, decisions and views of their organizations. The list included large institutions located in the United States, Canada, Britain, Continental Europe, Australia and Japan. Russell Investments was assisted in the research by Riverside Associates, Inc.—The Markets Group.

Note that since the topic of alternative investments includes a considerable subjective component and the sample sizes are typically small (or in some cases limited), the results of this survey, or others like it, should not be considered projectable to a larger population. Changes observed between two surveys may be affected by differences in the composition of the samples, such as the mix of types of organizations, or by changes in the investment behavior of one or two very large institutions. The reader is advised to take a qualitative approach to the data, with a focus on the long-term trends and implications that are suggested.

The total sample was divided into smaller segments for reporting on the basis of geography and major types of alternative investments (i.e., private equity, hedge funds, real estate and “other”). The complete sample was asked about types of “other” investments, whereas for the other three categories, private equity, hedge funds, and real estate categories only those who indicated using investments in each area were asked the detail questions for each type of investment. In this study, sub-groups that represent less than three respondents are not reported graphically, and a footnote is used when only three to five respondents are represented.

Recent Sample Sizes (i.e., completed interviews) by Geography and Type

	2001	2003	2005	2007		2001	2003	2005	2007
North America					Australia				
Private Equity	112	116	100	95	Private Equity	21	27	16	11
Hedge Funds	30	39	47	54	Hedge Funds	1	7	7	10
Real Estate	N/A	93	96	102	Real Estate	N/A	28	19	17
Other	N/A	166	176	167	Other	N/A	39	22	18
Europe					Japan				
Private Equity	51	41	41	37	Private Equity	3	6	9	14
Hedge Funds	14	15	23	20	Hedge Funds	13	20	38	51
Real Estate	N/A	47	43	49	Real Estate	N/A	N/A	14	28
Other	N/A	71	65	69	Other	N/A	N/A	64	72

Note: Real Estate and Other were included starting in 2003 (in 2005 in Japan).

Overview

Private Equity: Allocations expected to increase in all regions

Private equity remains a popular alternative investment, with strategic allocations up in Europe, Australia and Japan, and down slightly in North America. However, all locations forecast allocations to increase through 2009. Investors may have come to the conclusion that the best and biggest Leveraged Buyouts (LBOs) have already occurred, as they forecast more growth in popularity for venture capital and secondaries over the next three years. Mean return expectations worldwide with the exception of Japanese respondents' expectations for 2007 and 2008, remain in double digits with North American and European respondents expressing the greatest optimism.

Jay Pierrepont
Managing Partner
Pantheon Ventures—Russell Investments

Hedge Funds: Allocations expected to increase in nearly all regions

Worldwide, hedge funds have matured as an investment tool for diversifying portfolios and reducing risk. Asked to project their usage of hedge funds over the next three years, investors predict that strategic allocations will increase in nearly all global markets. Of the various hedge fund structures, funds of funds appears to be the most popular method of accessing this investment strategy. As more and more players enter the hedge fund marketplace, investors are increasingly turning to consultants to help them select hedge fund providers. Consultant use rose by 25 percentage points in North America, 32 in Australia, and 20 in Japan, while remaining stable in Europe.

Victor Leverett
Director—Hedge Funds
Russell Investments

Real Estate: Use as investment strategy increasing worldwide

Real estate continues to play an integral role in institutional portfolios. The percent of respondents utilizing real estate as an investment strategy increased over 2005, especially in Japan, which posted a 77% increase over 2005. Strategic allocations to real estate remain relatively high, with slight declines in Europe and Australia. The consensus is for increased allocations worldwide through 2009. Investors are increasingly interested in global investments with growing allocations to non-domestic markets.

Karl Smith
Director—Real Estate
Russell Investments

Executive Summary

Summary of Regional Findings

NORTH AMERICA

- » Private equity and real estate are top alternatives choices of North American respondents
- » Respondents' commitments to hedge funds jump \$15 billion from 2005 level
- » Respondents expect strategic allocations to increase in all categories
 - Among the three alternative investment categories, private equity and real estate are the most widely used by respondents (57% and 61% of North American survey respondents, respectively), with hedge funds less widely used (32%) but growing in popularity.
 - The total commitment by North American survey respondents to private equity is \$132 billion, down slightly from \$137 billion in 2005; to real estate, \$68 billion, down from \$81 billion in 2005; and to hedge funds, \$40 billion, a significant increase over the \$25 billion in 2005.
 - In all three categories, North American respondents expect allocations to increase in the next two years. For example, the current mean strategic allocation to hedge funds of 7.5% of total fund assets is forecast to rise to 8.9%. The allocations to private equity and real estate (6.5% and 6.7% respectively) are also forecast to rise (to 7.0% and 7.3% respectively).
 - Return expectations over a 1–3 year horizon are highest for private equity, with an average expected return of 13.2%, while real estate and hedge funds are expected to return on average 9.8% and 9.2%, respectively.
 - Private equity and real estate—traditionally categories regarded as domestic in nature—are both showing signs of evolving into global investment opportunities. According to survey respondents, 27% of private equity allocations now go to global mandates (the corresponding figure was 8% in 2005), and 48% of respondents indicate that they expect to invest in a global real estate mandate in the next three years.

NORTH AMERICA*

Exhibit 1: Mean Strategic Allocation to Alternative Investments

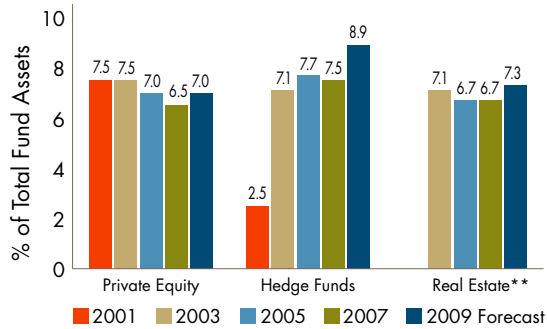
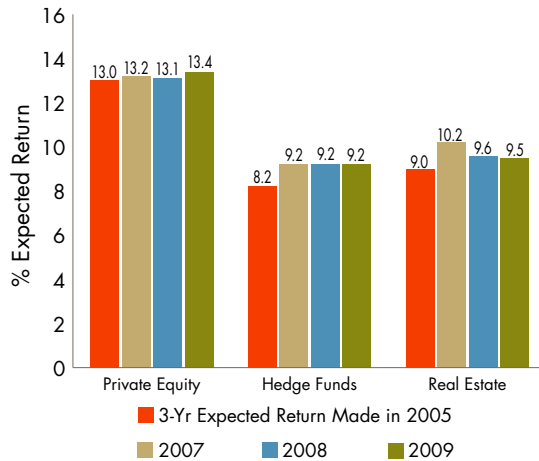
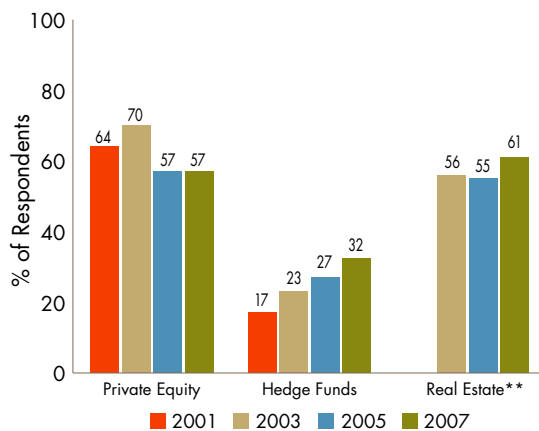


Exhibit 2: Mean Expected Return of Alternative Investments



Note: In the 2007 survey, respondents were asked their 1-year expected return for 2007, 2008 and 2009, respectively.

Exhibit 3: Alternative Investments Used as Percent of Respondents



* All data based on survey responses, in North America n=167

** 2003 was the first year for which information on use of real estate was collected.

Executive Summary

Summary of Regional Findings

EUROPE

- » Funds of funds grow in popularity for private equity and hedge funds among European respondents
- » Demand among respondents increasing for global real estate investments
- » Respondents expect strategic allocations to increase in all categories
 - Funds of funds are increasingly being used by European respondents to access private equity and hedge fund investments.
 - European respondents expect to increase their strategic allocations to alternatives over the next two years. For example, the current mean strategic allocation to private equity of 4.6% is forecast to rise to 5.5%. Allocations to hedge funds and real estate are forecast to rise from 7.4% to 8.4% and from 8.9% to 9.7%, respectively.
 - While most real estate portfolios of European respondents are still heavily invested in Western Europe, demand for global investments is increasing.
 - Although private equity commitments to other regions around the world are on the increase, one in five respondents limits private equity exposure to Europe, while two out of three respondents have little or no exposure to Asia.
 - Nearly one in three European respondents maintains direct real estate investments. Those who do, hold all, or nearly all, their real estate assets in direct investments. However, allocations to listed real estate securities and funds continue to increase, as more respondents gain exposure via indirect vehicles.
 - European respondents are either using or considering other forms of alternative investing. Among strategies reported as currently in use, currency overlay, absolute return and infrastructure were mentioned most frequently. The most frequently mentioned strategies under consideration are Currency Overlay, Tactical Asset Allocation Overlay, Portable Alpha and Infrastructure.
 - The majority of European respondents do not have even one full-time employee dedicated to alternatives. Those that do are most likely to employ someone to focus primarily on real estate.

EUROPE*

Exhibit 4: Mean Strategic Allocation to Alternative Investments

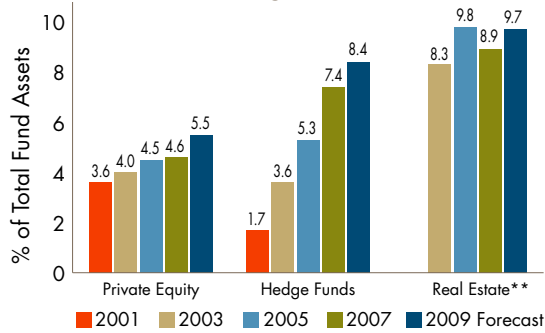
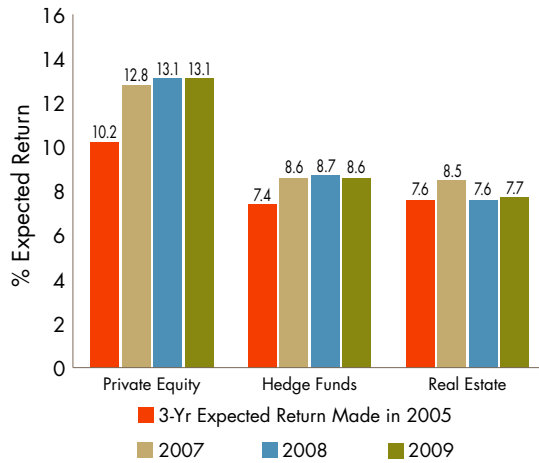
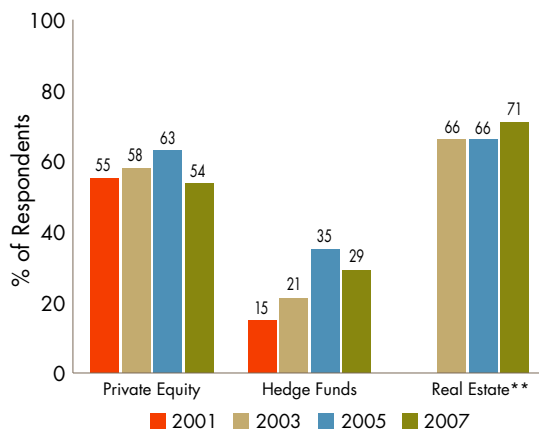


Exhibit 5: Mean Expected Return of Alternative Investments



Note: In the 2007 survey, respondents were asked their 1-year expected return for 2007, 2008 and 2009, respectively.

Exhibit 6: Alternative Investments Used as Percent of Respondents



* All data based on survey responses, for Europe n=69

** 2003 was the first year for which information on use of real estate was collected.

Executive Summary

Summary of Regional Findings

AUSTRALIA

- » Use of real estate investment strategy by Australian respondents is widespread
- » Return expectations among respondents highest for private equity
- » Respondents expect private equity and real estate strategic allocations to increase
 - Among the three alternative investment categories, real estate was the most widely used (94%), with private equity and hedge funds less widely used (61% and 56% respectively) by Australian respondents.
 - Mean return expectations over a 1–3 year horizon are highest for private equity, with an average expected return of 11.1%, while respondents expect real estate and hedge funds to return on average 9.8% and 9.4%, respectively.
 - Australian respondents expect to increase their strategic asset allocations to two alternatives categories over the next two years. The current mean strategic allocation as a percent of total fund assets to private equity of 6.3% is forecast to rise to 7.6%, and the allocation to real estate of 9.6% is forecast to rise to 10.5%.
 - Real estate—traditionally a category regarded as domestic in nature—is evolving into a global investment opportunity for Australian respondents. 18% of real estate allocations are now to Global and Other (the corresponding figure was less than 2% in 2005). 55% of respondents indicate that they expect to invest in a global real estate mandate in the next three years, with North America and Asia Pacific Developed also cited as favored regions.
 - Funds of Funds are becoming a preferred investment structure for private equity and hedge funds. The reported use of funds of funds as a percent of private equity commitments by Australian respondents has risen significantly from 29% in 2005 to 47% in 2007 and for hedge funds as a percent of hedge fund commitments—from 38% in 2005 to 87% in 2007.
 - A number of Australian respondents are using, or considering, other forms of alternative investing. The most prevalent strategies currently reported in use are Infrastructure and Currency Overlay. The most frequently mentioned strategies under consideration are Portable Alpha, Active and Passive Commodities, and Collateralized Debt Obligations, and Tactical Asset Allocation.

AUSTRALIA*

Exhibit 7: Mean Strategic Allocation to Alternative Investments

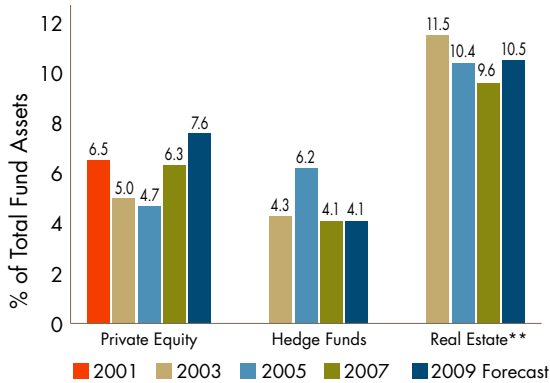
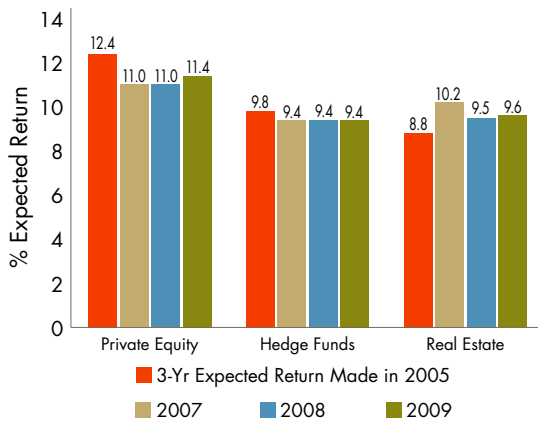
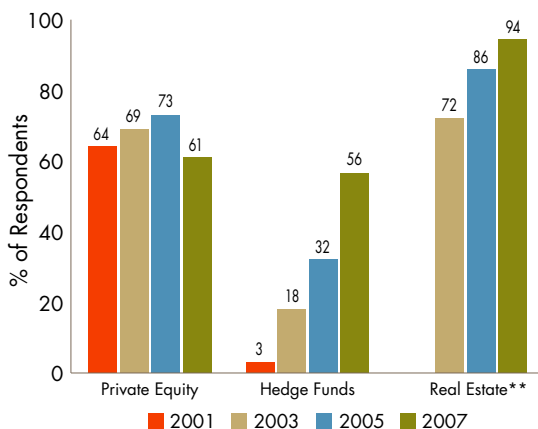


Exhibit 8: Mean Expected Return of Alternative Investments



Note: In the 2007 survey, respondents were asked their 1-year expected return for 2007, 2008 and 2009, respectively.

Exhibit 9: Alternative Investments Used as Percent of Respondents



* All data based on survey responses, for Australia n=18

** 2003 was the first year for which information on use of real estate was collected.

Executive Summary

Summary of Regional Findings

JAPAN

- » Hedge fund use continues to be strong among Japanese respondents
 - » Use of real estate investment strategy by respondents up 77% from 2005
 - » Respondents expect to increase strategic allocations in real estate
- Among the three alternative investment categories, hedge funds are the most widely used, as was the case in the previous survey. The percentage of respondents investing in hedge funds increased from 59% in 2005 to 71% in 2007 though the rate of growth appears to be slowing. The mean strategic allocation to hedge funds also increased, from 8.1% to 9.3%. The total commitment reported was ¥967 billion in 2007.
 - The ratio of Japanese respondents who invest in real estate has increased significantly, from 22% in 2005 to 39% in 2007. The total commitment of ¥322.5 billion reported by respondents in 2007 is nearly triple the ¥112 billion reported in 2005. However, both figures are low relative to other regions.
 - According to respondents the mean strategic allocation to real estate in 2007 was 4.7%, an increase of 1.3 percentage points from 2005 (3.4%). Nearly three out of ten respondents plan to increase their strategic allocations to real estate over the next three years.
 - Respondents commit the highest percentage of their real estate commitments to Public Real Estate Securities (45%) and Core Commingled Funds (30%). The majority of respondents' real estate portfolios is geographically concentrated in the developed area of the Asia Pacific sector, although some are indicating an interest in other regions around the world.
 - The percentage of respondents who invest in private equity is relatively low at 19%, and the growth since 2005 as a share of total fund assets (0.9 percentage points) is slightly below that of hedge funds and real estate, 1.2 and 1.3 percentage points, respectively. Total commitment to private equity among Japanese respondents in 2007 was ¥207.4 billion, up more than 100% from 2005. The mean allocation to private equity has grown steadily since 2003 to reach 3.3% in 2007.
 - Respondents continue to buy into the established North American private equities market—38% of their allocation is to this region. Regarding investment type, 63% of the capital commitment goes to leveraged buyouts.
 - Respondents expect a mean 4.6% annual return for hedge funds through 2009, in line with 2005 projections. Given that the short term rate in Japan is a little less than 1.0%, the implied return expectation of respondents is around 3.6 percentage points over Yen LIBOR.

JAPAN*

Exhibit 10: Mean Strategic Allocation to Alternative Investments

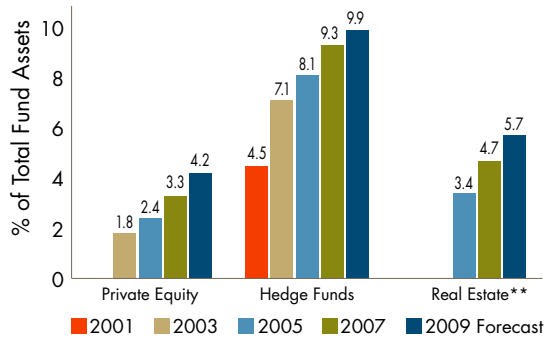
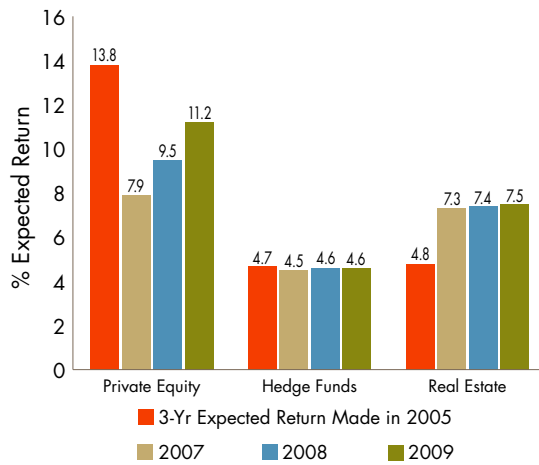
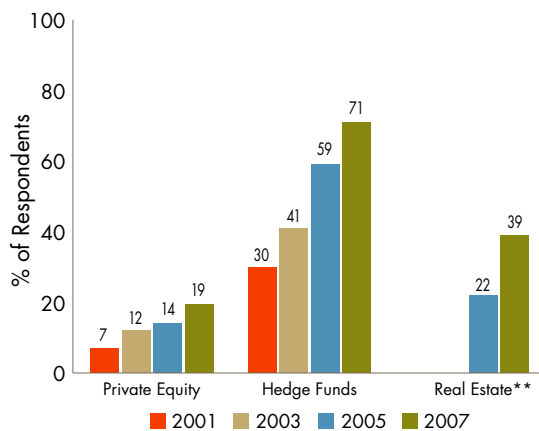


Exhibit 11: Mean Expected Return of Alternative Investments



Note: In the 2007 survey, respondents were asked their 1-year expected return for 2007, 2008 and 2009, respectively.

Exhibit 12: Alternative Investments Used as Percent of Respondents



* All data based on survey responses, for Japan n=72

** 2005 was the first year for which information on use of real estate was collected.

This executive summary sets out the main points of the *2007–2008 Russell Investments Survey on Alternative Investing*. Copies of the full survey can be requested by including name, title, organization, and country of domicile by email request to altsurvey@russell.com.

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