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## Russell Investments Global Survey: Alternatives become mainstream

- Investors worldwide plan to increase portfolio allocations to alternatives
- Institutions believe private equity returns to increase, with hedge funds and real estate returns remaining steady

LONDON – December 3, 2007 – Pension funds, endowments and foundations that responded to a recent survey across the world are forecasting that over the next two years they will dedicate an even larger slice of their total investment portfolio to private equity, hedge funds and real estate, according to the eighth global report on alternative investing released today by Russell Investments.

As a percentage of total fund assets, institutional investors in North America, Europe, Japan and Australia expect increases in all of these alternative investments, with the one exception of Australian institutional investors keeping their mean strategic asset allocation to hedge funds steady.

Since 1992, Russell has surveyed large tax-exempt institutions (public and corporate pension funds, endowments and foundations generally with assets of \$1 billion or more) in North America, Europe, Japan and Australia to gauge their participation in and expectations for core alternative investing strategies. The results, based on responses from 326 organizations worldwide, are published in a detailed report, *2007-2008 Russell Investments Survey on Alternative Investing*. The report presents data by region, investment category and type of institution and includes detailed analysis of use of investment strategies, investment types, geographic allocation and expected returns.

### Headline global findings:

- Institutional respondents around the globe predict that their strategic allocations to hedge funds will increase by 2009, except in Australia where the hedge fund allocation is anticipated to remain steady at 4.1 percent. European respondents expect allocations to hedge funds to rise from 7.4 percent to 8.4 percent while Japanese respondents predict it will increase from 9.3 percent to 9.9 percent. The biggest jump is expected in North America, where allocations to hedge funds are forecast to rise from 7.5 percent to 8.9 percent over the next two years.
- Strategic allocations to private equity by respondents increased in Europe, Australia and Japan and fell slightly in North America. However, all geographic areas forecast allocation increases through 2009.

- Across the globe, respondent's return expectations are strongest for private equity, with expectations for hedge funds and real estate remaining steady. Median return expectations for private equity worldwide vary between 8 percent and 13 percent, with North American and European respondents expressing the greatest optimism for performance of this asset class.
- The utilization of real estate as an investment strategy climbed worldwide over the past two years, particularly in Japan where utilization rose from only one in five respondents in 2005 to nearly 40 percent this year.

"Describing the use of private equity, hedge funds and real estate as 'alternative' is increasingly a misnomer in today's sophisticated investment environment. Russell's survey highlights systematic use of these strategies to enhance returns, reduce volatility and improve fund governance through diversification," said Jon Bailie, Managing Director, Alternative Investments. "Fund of funds remain the preferred route to access both private equity and hedge funds, with limited in-house investment resources dedicated to these strategies by even the world's largest institutions. With outsourcing gaining traction across the globe, consultants continue to have an important role to play."

#### *Strategy overview:*

- **Hedge fund allocations expected to rise in nearly all regions.** Hedge fund use among the respondents is most widespread in Japan – the percentage of respondents investing in hedge funds increased from 59 percent in 2005 to 71 percent in 2007. Hedge funds now make up more than 9 percent of the mean strategic allocation for institutional investors surveyed in Japan. Conversely, Japanese expect hedge funds to return only 4.6 percent on average through 2009, while institutional investors in United States, Europe and Australia all expect hedge funds to return about 9 percent.  
  
"Worldwide, hedge funds have matured as an investment tool for diversifying portfolios and reducing risk," said Victor Leverett, Director, Hedge Funds, Russell Investments. "As more and more players enter the hedge fund marketplace, institutional investors are turning to consultants to help them select hedge fund providers and better understand the esoteric strategies they often employ. Consultant use rose by 25 percentage points from the last survey in North America, 32 in Australia and 20 in Japan while remaining stable in Europe."
- **Leveraged buyouts remained the most popular private equity strategy across the world among survey respondents and increased in commitments across all regions, except for a slight decline in Europe.** The strategy dominates in North America, representing 71 percent of private equity commitments in 2007 and a substantial increase from 57 percent in 2005. Australia and Japan saw similar leaps in commitments to leveraged buyouts, rising from 26 percent to 41 percent and from 47 percent to 63 percent, respectively, over the same time. In Europe, commitments to expansion capital increased from 6 percent to 12 percent, while commitments to mezzanine financing and other types of private equity investment, including secondaries and special situations, fell from 15 percent to 11 percent.

“The private equity community witnessed enormous volumes of LBO activity over the past two years, but investors may have come to the conclusion that the best and biggest buyouts have already occurred,” said Jay Pierrepont, Managing Partner, Pantheon Ventures-Russell Investments. “Institutional investors still have high expectations for private equity and are forecasting, with the exception of Japanese respondents’ expectations for 2007 and 2008, double digit returns, for the next two years derived predominately from venture capital and secondary opportunities.”

- **Strategic allocations to real estate are forecast to increase in all regions over the next two years.** In North America, institutional investors anticipate their strategic allocation will increase from 6.7 percent in 2007 to 7.3 percent in 2009, led by an uplift in endowment and foundation allocations from 5.9 percent to 7.1 percent. European respondents expect strategic allocation to real estate to rise from 8.9 percent to 9.7 percent, led by respondents from the United Kingdom, who foresee that their allocation will rise from 9.1 percent to 10.2 percent over the same period. Australian respondents anticipate a similar rise from 9.6 percent to 10.5 percent, while Japanese respondents mean strategic asset allocation to real estate is expected to increase from 4.7 percent to 5.7 percent.
- **Real estate investing in 2007 exhibited a gradual decrease in home bias as institutional respondents across the world seek to diversify their commitments outside of their local region.** Institutional respondents in Australia and Japan each experienced dramatic increases in geographic diversification: Australian and Japanese respondents have historically invested in the developed areas of the Asia Pacific region, which accounted for 97 percent of both countries real estate allocations in 2005. These figures dropped to 68 percent and 78 percent respectively in 2007, as investors reallocated toward a more diverse portfolio of real estate assets. European investors on the other hand remain highly concentrated with 92 percent of real estate commitments located in Western Europe. North American respondents exhibit similar bias, with 85 percent of their real estate investments located in North America, although this number represents a decrease from 89 percent two years ago.

“Real estate continues to play an integral role in institutional portfolios,” said Karl Smith, Director, Real Estate, Russell Investments. “Respondents around the world plan to increase allocations through 2009, with many respondents expressing interest in globally diversified real estate investments with access through private real estate funds and more liquid publicly traded real estate securities (REITs).”

- **Worldwide, respondents continue to explore new strategies to add to the alternative investment mix beyond hedge funds, private equity and real estate.** Many European respondents are either using or considering other forms of alternative investing. Among strategies currently being employed, currency overlay, absolute return and infrastructure were mentioned most frequently. Among strategies actively being considered, currency overlay, tactical asset allocation, portable alpha and infrastructure were most frequently mentioned.

In North America, the strategy most widely used – as well as the most widely considered – is portable alpha (currently used by 22 percent of survey respondents and under consideration by a further 45 percent). Currency overlays ranked highest in Europe, Japan and Australia with 41 percent, 38 percent and 53 percent respectively, of institutional respondents currently using this strategy.

In Australia, infrastructure investments tied currency overlay also with 53 percent of survey respondents.

### **About the Survey on Alternative Investing**

Since its inception in 1992, the Russell Investments Survey on Alternative Investing has been an important tool for institutional respondents in alternative investments - becoming a barometer for industry standards and investment levels. Published biennially, the report is intended to help institutions and respondents broaden their knowledge about industry best practices, stay abreast of trends and structure their alternative investment commitments intelligently. The 2007 report focuses on determining, on a percentage basis, the types of alternative investments that are being used by respondents, particularly the growth and composition of these investments, as well as geographic diversification.

The survey, which targets the largest pension funds, foundations and endowments, is given in an objective format and respondents are asked about their views and methodologies concerning alternative investments. The 2007 survey results are based on the detailed information provided by 326 organizations in North America, Europe, Australia and Japan. Information from other surveys represented here are views from respondents at that point in time.

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Russell Investments provides strategic advice, world-class implementation, state-of-the-art performance benchmarks and a range of institutional-quality investment products. With nearly \$231 billion in assets under management (as of 9/30/07), Russell serves individual, institutional and advisor clients in more than 40 countries. Russell provides access to some of the world's best money managers. It helps investors put this access to work in corporate defined benefit and defined contribution plans, and in the life savings of individual investors. Founded in 1936, Russell is a subsidiary of Northwestern Mutual Life Insurance Company and headquartered in Tacoma, Wash. Russell has principal offices in Amsterdam, Auckland, Hong Kong, Johannesburg, London, Melbourne, New York, Paris, San Francisco, Singapore, Sydney, Tokyo and Toronto.

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