

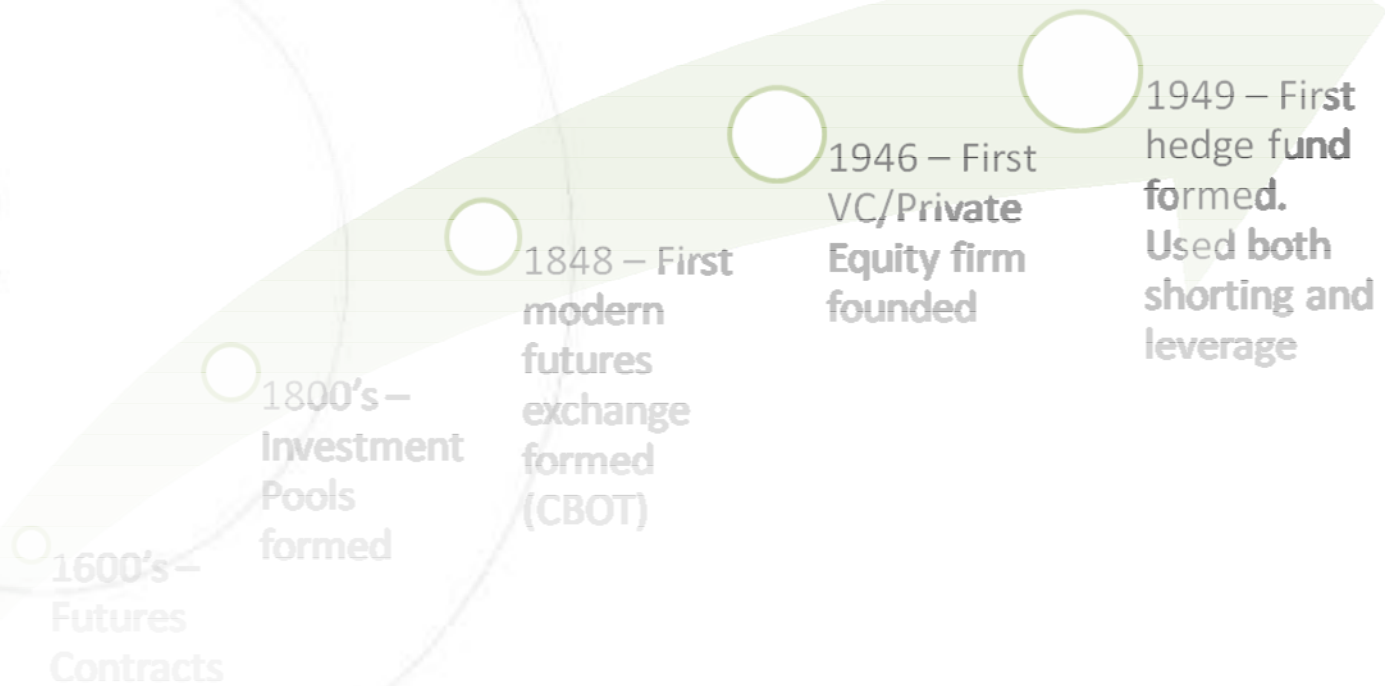
Alternative Investing

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Alternative Investments?

- Google Search for “Alternative Investments” yielded: *About 1,500,000 results (in 0.26 seconds)*.
- Anything outside of traditional investments (stocks, bonds, cash) is an alternative?
- Hedge funds, private equity/venture capital, commodities, real estate, etc...
- Is our collective definition of traditional investments incomplete?

Alternative Investments Timeline



Hedge Fund Evolution

1990s – Hedge funds were mostly boutiques. Owner/manager controlled. Performance and innovation coupled with creativity, flexibility and lifestyle choices typified most funds.

2010 – Hedge funds are being **institutionalized**. Focus on asset gathering, strong governance/control, liquidity and transparency. **Will superior returns be sustained?**

Hedge Fund Flows

- Inflows into hedge funds likely will quadruple in 2011 to **\$210 billion**.
- Increase industry assets should increase to **\$2.5 trillion** at year-end. By comparison: total U.S. equity market capitalization = **\$ 14.2 trillion**.
- 72% of pension fund executives intend to increase the size of their internal hedge fund teams in 2011.

Source: Pensions and Investments, March 8, 2011, Deutsche Bank Alternative Investment Survey.

Characteristics

- Low correlations with traditional investments
- Illiquid
- Difficult to value
- A high degree of investment analysis may be required before buying
- Costs of purchase and sale may be relatively high
- Management fees are usually high
- Potential **alpha generation** is high
- Portfolios are often **more creative** than traditional investments
- Managers are **incentivized** to perform

Investments

- Private Equity
- Venture Capital
- Hedge Funds
- Commodities
- Mezzanine Debt
- Private Debt
- Distressed Debt
- Real Estate
- Currency Overlay
- Long/Short
- Timberland
- Infrastructure
- Agriculture
- Green Investing
- Real/Absolute Return
- MLPs

Allocation Profile of SCTR Member Systems

	Average Allocation	Minimum Allocation	Maximum Allocation
Alternative Investments	5%	0%	11%
Cash & Short Term	3%	0%	15%
Commodities	2%	1%	2%
Equities	42%	18%	63%
Fixed Income	30%	15%	52%
International Equities	18%	11%	24%
Limited Partnerships	4%	4%	4%
Other	5%	1%	12%
Private Equity	6%	0%	13%
Real Estate	5%	1%	9%

*Alternative Investments include the following; Absolute Return Investments and Hedge Funds.

What Caused the Explosion of Alternative Investments?

- Low interest rates, borrowing costs and yields.
- Quest for adequate returns.
- Self interest – alternative investments charge premium fees.
- Excessive boundaries placed on portfolio managers.
- Proprietary desks – training ground for aggressive investors.

New Alternative Asset Class?

- **Master Limited Partnerships.**
- Income producing pass-through institutions engaged primarily in energy infrastructure.
- Asset class is a creation of tax code. Partnership units trade like equities.
- Exposure to different types of energy stocks is available – oil shale, gas shale, coal, pipelines, shipping, etc.

Attractive Correlations

Ten Years ended March 31, 2011

	Alerian MLP Index	BarCap Aggregate	MSCI ACWI ex-US	Russell 1000	Russell 2000	S&P 500
Alerian MLP Index		-0.03	0.49	0.46	0.42	0.45
BarCap Aggregate	-0.03		0.02	-0.09	-0.13	-0.09
MSCI ACWI ex-US	0.49	0.02		0.90	0.82	0.89
Russell 1000	0.46	-0.09	0.90		0.90	1.00
Russell 2000	0.42	-0.13	0.82	0.90		0.89
S&P 500	0.45	-0.09	0.89	1.00	0.89	

Risk/Return Scatterplot

Ten Years Ended March 31, 2011

