Convergence in Alternatives

November 29, 2004

Freeman & Co. LLC

Introduction

As alternative investments become mainstream and the overall industry growth continues, we see a number of trends developing as alternative firms become more sophisticated, and increasingly diversified. Product classes are beginning to converge and a number of alternative investment firms are becoming multi-product, multi-strategy, diversified alternative investment platforms that offer hedge funds, private equity and real estate or other asset classes. Market share concentration in the fund of funds sector of hedge funds and private equity has accelerated and we believe that a next generation of successful businesses will develop as multi-product, diversified alternative investment platforms.

Index Returns as of September 30, 2004

Index	Total Return YTD	Total Return Trailing 12 Mos	Total Return Annualized 3 Yr	Total Return Annualized 5 Yr
S&P 500	1.5%	13.9%	4.0%	-1.3%
NASDAQ	-5.3%	6.2%	8.2%	-7.1%
Lehman Brothers Govt/Credit	3.4%	3.4%	6.3%	7.7%
Dow Jones Hedge Strategy Benchmarks	2.2%	4.9%	na	na
S&P Hedge Fund Index	0.4%	3.7%	na	na
MSCI Hedge Fund Index	2.0%	6.6%	7.6%	na
HFRI Funds of Funds Index	1.9%	5.8%	5.6%	6.9%
CSFB/Tremont Hedge Fund Index	3.8%	8.4%	8.1%	9.5%

Note: Composites are used for each of the hedge fund indexes above. Dow Jones Composite calculated using the simple average of each of the underlying strategy benchmarks

Summary

- The total amounts invested in the "traditional" alternative asset classes of real estate, private equity and hedge funds are sizable, totaling over $3 trillion in 2004 with strong growth rates, particularly in hedge funds
- Institutional assets continue to drive alternative asset growth. When we look broadly at the top 200 US institutional Defined Benefit ("DB") plans, we see that their total alternative asset exposure is over $250 billion, consisting of $117 billion in real estate, $14 billion directly in hedge funds (ex. FOFs), $98.7 billion in private equity and venture capital, and $9.0 billion in other strategies
- We believe alternatives account for 8.4% of investment assets in the US, totaling $1.9 trillion. This is led by private equity with 3.9% or $876 billion and hedge funds at 2.8% or $640 billion
- The overall hedge fund industry should exceed $1 trillion in AUM by the end of 2004, which would be more than twice the estimated total at the end of 2000. The vast majority of net new assets have come through hedge funds of funds, which account for as much as 40% of the overall hedge fund industry
- Although private equity has lagged since the dot-com fallout, the strong economy has provided numerous successful "old-economy" investments: Overall, private equity represents $1.5 trillion of committed capital

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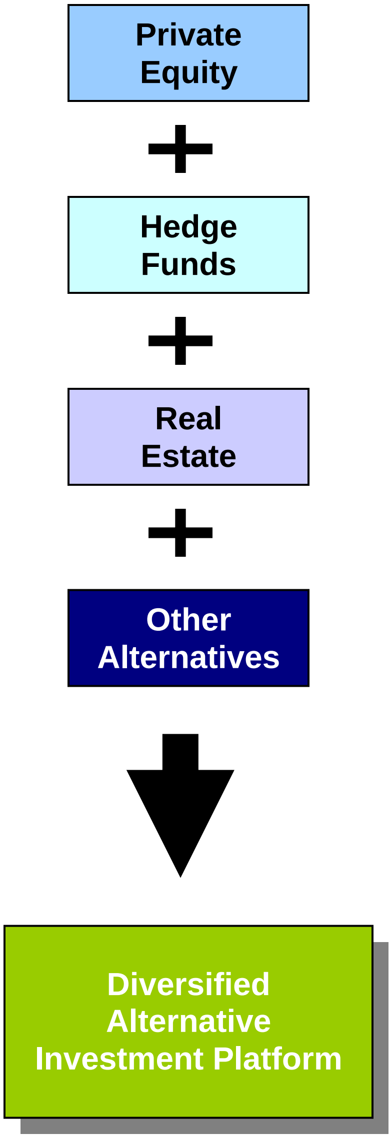


Executive Summary

We believe that there is a coming convergence within alternative asset management and that this general convergence will develop through two separate themes (see below). The purpose of this research report is to:

1. highlight where alternatives are today,
2. review the drivers of growth in alternatives and how they might change,
3. develop a framework for the future of alternatives, and
4. identify themes upon which firms can profitably capitalize

In addition to providing comprehensive data and analysis of current events, we hope this report develops themes and provides concrete examples of the convergence in alternatives that are relevant to the many participants in the alternative arena.

Product Convergence
First, we believe that the near-term future (18-36 months) will see alternative firms build out their product spectrum. We expect the main asset classes in which this theme will develop to include hedge funds, private equity, and real estate, both at the direct and the fund of funds level. Our bias is that more activity will be concentrated at the fund of funds level than at the underlying direct manager level, although we do expect to see some creative expansion by some firms. The types of developments we would expect to see include combinations, mergers, product expansions, team lift-outs, etc. including:

- hedge fund of funds adding private equity fund of funds;
- private equity fund of funds adding real estate funds;
- mezzanine funds launching collateralized debt products

This product expansion provides a number of advantages to a firm that can successfully execute this strategy, including increased scale, recognition and marketing leverage. We see advantages in areas such as establishing a global presence, marketing reach, product diversification (for those inevitable poor performance years), infrastructure support, compliance and general management.

Securities Convergence
Second, many alternative firms will expand the securities or deals in which they are comfortable investing. The most notable example is that hedge funds will continue to press into the private equity arena. Also, we expect to see hedge funds continue to broaden their investing spectrum to new securities and new styles, with a general push towards multi-product / multi-style.

Some examples of "securities convergence" might include:

- sector focused hedge funds adding sector focused private equity capabilities
- high yield and distressed hedge funds will expand further into private equity
- Event driven hedge funds will invest in new securities that track their investment themes (options, futures, bonds, credit default swaps, etc.)

ALTERNATIVES
Mainstream
• Private Equity • Hedge Fund • Real Estate
Natural Resources
• Timber • Pipelines • Other Oil & Gas MLPs • Commodities • Other Natural Resources
Financial
• Currencies • Interest Rates • Other Structured Products and Derivatives

A great deal of this securities convergence will be driven by the search for strong risk-adjusted returns and the continuing flow of capital into the hedge fund marketplace. As such, hedge funds will become more opportunistic and will look at investments that traditionally would not have the best liquidity, including syndicated loans, distressed debt, controlling (or near controlling) equity positions, mezzanine, etc.

Mainstreaming of Alternatives

As a result of the surge in alternative asset management products, particularly hedge funds, alternatives are moving more mainstream. We believe that this trend will be focused on the "traditional" alternative asset classes such as hedge funds, private equity and real estate. These trends will continue to escalate as the factors leading to mainstreaming continue to develop:

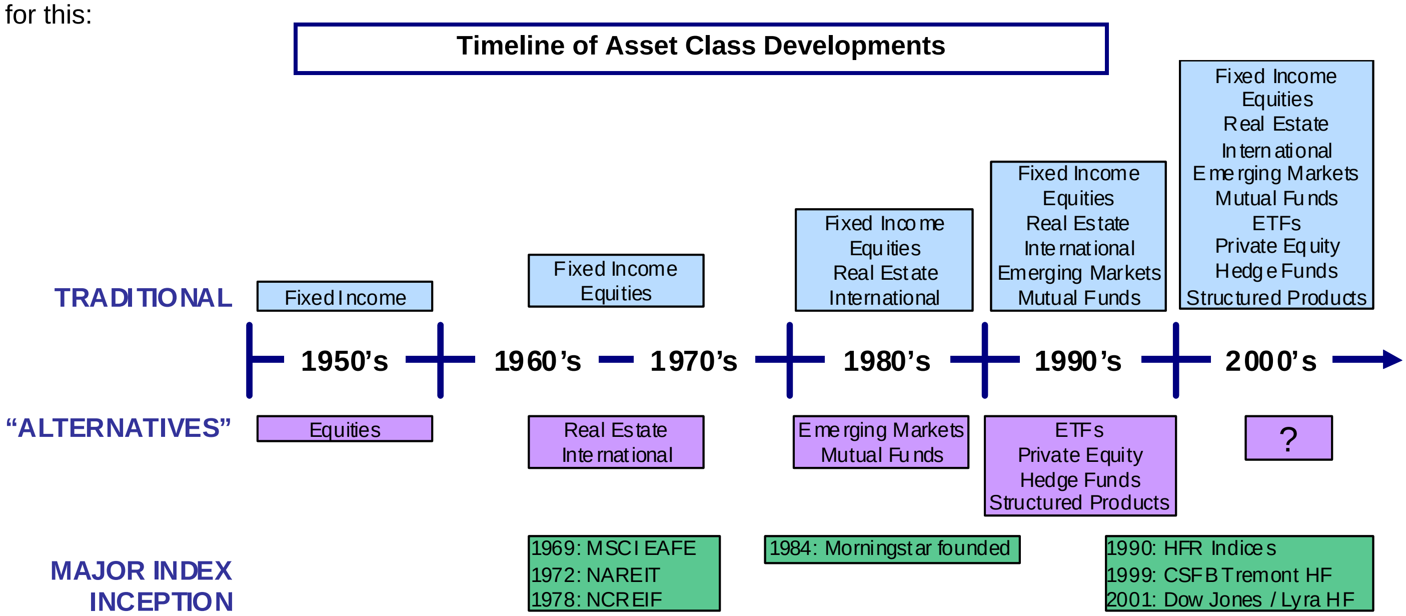
- increased education
- better access to data and information
- development of benchmarks, standards and indices
- advancements in information technology and support systems

The other two alternative areas that continue to develop are, broadly, natural resources and financial derivatives. Within these are products as basic as gold-based mutual funds and as complex as commodity-driven managed futures programs. Many of these products, such as currency or option overlay, have had niche status among traditional investors, while others such as interest rate-driven managed futures programs are more esoteric.

While we believe that many of these alternative asset classes will move towards becoming more mainstream, most will fail to gain the prevalence of the "mainstream alternative" groups.

CONVERGENCE IN ALTERNATIVES

In trying to make estimates of where the alternative asset management industry is headed, we think that it is necessary to review the development of the asset allocation process and those asset classes that get introduced to the process. We believe that a number of underlying characteristics are necessary for an asset class to become "acceptable" to the majority of investors. These include: access to reliable data, an understandable investment thesis, performance measurement standards and the introduction of benchmarks and indices, to name a few. Our view is that the "traditional" alternative asset classes of hedge funds, private equity and real estate are well developed, with private equity and real estate leading the path and hedge funds quickly closing the gap. The timetable below provides a brief historical context for this:



Source: HVB/Frank Russell

We expect the acceptance of alternative asset classes to continue to broaden such that they will eventually be accepted as "traditional." Having laid some historical context, let us consider the development of three other financial products over the past decade (see table below). Our view is that most financial products follow a similar pattern as the infrastructures to support them are developed, including key steps of product introduction, evolution and adoption. With alternatives, we believe that hedge funds have reached a particular tipping point in their evolution (widespread use of fund of funds) and adoption (increased allocations). This has helped to push their use close to the allocation levels seen in private equity and real estate. As these asset classes mature, we would expect firms to capitalize on their "alternative" branding to expand into other alternative classes outside of their original core focus.

Financial Product	**Evolution**
401(k) Plans	• Circa 1990: generally only four choices including one GIC, money market, bond and equity fund each • Now plans generally have multiple bond and equity funds segmented by style, capitalization, duration, etc. as well as other specialty products
Mutual Funds	• In 1990, there were approximately 3,000 funds • Today, there are nearly 9,000 funds
ETFs	• Did not exist in 1990 • Growing rapidly, and estimated to total over 160 today

Source: ICI

Pension Fund Assets & Alternative Investment Allocations

	Hedge Funds	Private Equity	Real Estate
Total AUM $Bn 2004	$1,063	$1,500	n.a.
Fund of Fund AUM $Bn 2004	$478	$225	$300
Fund of Fund % of AUM	45.0%	15.0%	n.a.
Top 10 DB Plan AUM $Bn	$14.0	$49.1	$54.1

The total amounts invested in the "traditional" alternative asset classes of real estate, private equity and hedge funds are sizable, totaling over $3 trillion in 2004 with strong growth rates, particularly in hedge funds. In addition, the funds of funds have reached critical mass with total assets exceeding $1 trillion. As both direct and FOF allocations have increased, the top 10 US DB plans have allocated approximately $117 billion to these asset classes.

When we look more broadly at the top 200 US institutional DB plans, we see that their total broad alternative asset exposure is over $250 billion, consisting of $117 billion in real estate, $14 billion in hedge funds, $98.7 billion in private equity and venture capital, and $9.0 billion in other strategies. The total allocation to these assets is 8.7%, with the majority in real estate at 4.0%; private equity 2.8%; venture capital 0.6%; and hedge funds 0.5%.

Top 200 US Defined Benefit Plans' Alternative Allocations*

Alternative Asset Class	Allocations ($ billions)		% of Total Assets
Hedge Funds			
Direct Investments	6.1		0.2%
Fund of Funds	8.3		0.3%
Total Hedge Funds	**$ 14.4**		0.5%
Venture Capital	16.3		0.6%
Oil & Gas	1.5		0.1%
Private Debt	1.7		0.1%
Private Equity	82.4		2.8%
Distressed Debt	5.8		0.2%
Total Alternative Investments**		**$ 134.9**	**4.7%**
Real Estate Equity	102.1		3.5%
REITS	14.9		0.5%
Total Real Estate		**$ 117.0**	**4.0%**
Total Assets**		**$ 2,899.9**	**100%**

*As of January 26, 2004

** Total is greater because some plans did not provide breakouts

Source: Pensions & Investments

Although many of these alternative classes are small individually, when combined they reach critical mass of almost 10% total AUM for large investors. For many endowments and foundations, the allocations to alternatives are higher than this. We would expect that these figures should continue to rise as all institutional investors seek additional diversification, yield and alpha generation capabilities.

One place to look for alternatives' trends is at some of the largest investors. In the chart at the bottom of the page, we see that the average allocation to all alternatives (alternatives and real estate) is 10.6%, with a high of 16.0% and a low of 2.6%. As usual, CalPERS leads the way in this area. However, it is notable that the 10.6% average compares favorably with international equities (18.2%) and is closer to fixed income (27.0%) than many would expect. If alternatives were compared to fixed income on a revenue basis, instead of AUM, we would expect them to be revenue-equivalent due to the higher fees in alternatives. Although many alternative asset classes require more resources to manage due to their illiquidity and sourcing requirements, we believe that many traditional asset management firms need to evaluate the revenue opportunity in these asset classes.

Public Plan Target Asset Allocations

Asset Class	CalPERS	State of Wisconsin	New York State Retirement[1]	CalSTRS	FL State Board of Admin[2]	Texas State Teachers[3]	Average
Cash Equivalents	**0.0%**	**0.0%**	**na**	**1.0%**	**1.0%**	**0.8%**	**0.6%**
Global Fixed Income	**26.0%**	**31.0%**	**30.0%**	**26.0%**	**21.0%**	**27.8%**	**27.0%**
U.S. Equities	39.0%	39.0%	43.0%	41.0%	50.0%	na	42.4%
International Equities	19.0%	20.0%	13.0%	20.0%	19.0%	na	18.2%
Total Equities	**58.0%**	**59.0%**	**56.0%**	**61.0%**	**69.0%**	**68.8%**	**62.0%**
Alternatives	**7.0%**	**6.0%**	**9.0%**	**6.0%**	**3.0%**	**2.6%**	**5.6%**
Real Estate	**9.0%**	**4.0%**	**5.0%**	**6.0%**	**6.0%**	**0.0%**	**5.0%**
Total Fund	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Source: Respective websites

Alternatives includes private equity, venture capital and hedge fund products

[1] Actual allocation as of 3/31/04. Fixed Income contains cash, fixed income & mortgages.

[2] Actual allocation as of 7/31/04. 4% of International Equities is Global Equities.

[3] Actual Allocation as of 8/31/03

Alternative Asset Demand—Present

Current US Demand for Alternative Investment Products

Client Type	Current AUM ($bil.)	% Allocations Hedge Funds	Private Equity	Real Estate	Total Alts
HNW Individuals	$ 8,500.0	4.0%	3.8%	2.0%	9.8%
Endowments	328.0	8.0%	6.0%	3.0%	17.0%
Foundations	435.2	8.0%	5.9%	1.0%	14.9%
Corporate	4,839.7	2.5%	2.9%	1.0%	6.4%
Public Funds	3,228.9	3.0%	8.0%	3.0%	14.0%
Life Insurance	3,770.0	0.4%	2.0%	0.8%	3.2%
Other Insurance	1,045.0	0.5%	2.0%	0.2%	2.7%
Taft-Hartley	420.0	0.3%	2.5%	2.0%	4.8%
Total	**$ 22,566.8**	2.8%	3.9%	1.6%	8.4%

Source: Freeman & Co. estimates, Nelson's, Merrill Lynch/Cap Gemini, Fed Reserve, P&I, AIP, GS/Russell, NABUCO, AM Best Aggregates & Averages

Note: Real estate includes equity real estate investments, real estate equity funds, and direct investments, etc but excludes REITs, CMBS, mortgages and other fixed income-type products

While it is difficult to estimate the entire size of the US alternative asset management industry, we have reviewed our original 2002 projections of hedge fund allocations and updated this, along with estimates of private equity and real estate. We have drawn on a wide variety of sources and made our own estimates, where appropriate.

We believe alternatives account for 8.4% of investment assets in the US, totaling $1.9 trillion. This is led by private equity with 3.9% or $876 billion and hedge funds at 2.8% or $640 billion. The growth has largely been driven by hedge funds in recent years, but an increase in interest in absolute returns has helped benefit the entire industry.

High net worth individuals account for $833 billion of alternative assets, representing 44.2% of total alternative assets, either directly or through intermediaries. Public funds and corporations represent the next largest allocations at an estimated $452 billion and $311 billion, respectively. Combined, foundations and endowments represent $120 billion, or 6.4% of the overall alternative investment industry, however their allocation percentage is among the highest and should continue to increase as many of the larger university endowments (Harvard, Yale, Univ. of Texas) have raised their allocations to as much as 22% (University of Texas).

Current US Demand for Alternative Investment Products

Client Type	Current AUM ($bil.)	Amounts ($bil.) Hedge Funds	Private Equity	Real Estate	Total Alts
HNW Individuals	$ 8,500.0	340	$ 322.9	170.0	$ 832.9
Endowments	328.0	26	19.8	9.8	55.8
Foundations	435.2	35	25.8	4.4	64.9
Corporate	4,839.7	121	142.0	48.4	311.4
Public Funds	3,228.9	97	258.2	96.9	452.0
Life Insurance	3,770.0	15	75.8	28.3	119.2
Other Insurance	1,045.0	5	21.0	2.1	28.3
Taft-Hartley	420.0	1	10.6	8.4	20.3
Total	**$ 22,566.8**	$ 640.5	$ 876.1	$ 368.2	$ 1,884.8

Source: Freeman & Co. estimates, Nelson's, Merrill Lynch/Cap Gemini, Fed Reserve, P&I, AIP, GS/Russell, NABUCO, AM Best Aggregates & Averages
Note: Real estate includes equity real estate investments, real estate equity funds, and direct investments, etc but excludes REITs, CMBS, mortgages and other fixed income-type products

Alternative Asset Demand—2010

2010 US Demand for Alternative Investment Products

		% Allocations			
Client Type	**2010 AUM ($bil.)**	**Hedge Funds**	**Private Equity**	**Real Estate**	**Total Alts**
HNW Individuals	$ 11,390.8	3.4%	5.3%	2.5%	11.2%
Endowments	465.3	10.0%	7.5%	3.5%	21.0%
Foundations	617.3	10.0%	7.5%	1.3%	18.8%
Corporate	6,485.7	5.0%	5.0%	1.0%	11.0%
Public Funds	4,327.0	5.0%	9.5%	3.0%	17.5%
Life Insurance	5,052.2	0.6%	2.6%	1.0%	4.2%
Other Insurance	1,400.4	0.8%	2.6%	0.4%	3.8%
Taft-Hartley	531.4	0.5%	4.3%	2.5%	7.3%
Total	**$ 30,270.1**	3.6%	5.3%	1.9%	10.8%

Source: Freeman & Co. estimates, Nelson's, Merrill Lynch/Cap Gemini, Fed Reserve, P&I, AIP, GS/Russell, NABUCO, AM Best Aggregates & Averages
Note: Real estate includes equity real estate investments, real estate equity funds, and direct investments, etc but excludes REITs, CMBS, mortgages and other fixed income-type products

Using our estimates of the current size of the alternative investment industry we projected the size of the market for 2010. We began by making estimates of the size of the investable asset pool in 2010 and predicted allocations using historical growth projections and general trends in investor appetites.

We expect to see allocations to alternatives reach double-digit percentages at 10.8%, driven largely by increased allocations from corporations, public funds, foundations and endowments and a continued, though subdued, interest from the high net worth client segment. We project that allocations to alternatives from corporate investors and public funds could reach $745 billion and $791 billion respectively. Amongst public funds we are already seeing large allocations to alternatives from funds like CalPERS, State of Wisconsin Investment Board and New York State Retirement Fund, all of which have targeted allocations that exceed 5%. These are three of the largest public funds in the country and some of the most closely watched. We suspect that other public funds will continue to follow suit leading to significant asset flows to the broader alternative investment industry.

2010 US Demand for Alternative Investment Products

		Amounts ($bil.)			
Client Type	**2010 AUM ($bil.)**	**Hedge Funds**	**Private Equity**	**Real Estate**	**Total Alts**
HNW Individuals	$ 11,390.8	387	$ 603.7	$ 284.8	$ 1,275.8
Endowments	465.3	47	34.9	16.3	97.7
Foundations	617.3	62	46.3	7.7	115.8
Corporate	6,485.7	324	324.3	64.9	713.4
Public Funds	4,327.0	216	411.1	129.8	757.2
Life Insurance	5,052.2	30	131.4	50.5	212.2
Other Insurance	1,400.4	11	36.4	5.6	53.2
Taft-Hartley	531.4	3	22.6	13.3	38.5
Total	**$ 30,270.1**	$ 1,080.4	$ 1,610.6	$ 572.8	$ 3,263.8

Source: Freeman & Co. estimates, Nelson's, Merrill Lynch/Cap Gemini, Fed Reserve, P&I, AIP, GS/Russell, NABUCO, AM Best Aggregates & Averages
Note: Real estate includes equity real estate investments, real estate equity funds, and direct investments, etc but excludes REITs, CMBS, mortgages and other fixed income-type products

Convergence in Action

We believe one of the best examples of capitalizing on the product convergence trend by a company is The Blackstone Group. It offers hedge fund of funds, private equity, senior debt and mezzanine financing and real estate products to its investors. It has done an excellent job at marketing, capital raising and cross-selling its products. With over $9 billion in hedge fund of funds assets, Blackstone is one of the world's largest alternative investment managers. Additionally, the company has committed over $14 billion in private equity investments, raised nearly $6 billion for real estate investments, raised another $1.1 billion for a mezzanine investment fund and has more than $2 billion in CDOs. Using some public asset managers and their AUM as a guide, it is a fair estimate that these businesses of The Blackstone Group could have a market value greatly in excess of $1.5 billion.

Examples of Convergence (as of Sept. 30, 2004)

Company	Products	Assets ($MM)
The Blackstone Group	Hedge Fund of Funds	$ 9,000.0
	Private Equity	14,000.0
	Real Estate	6,000.0
	Sr. Debt / Mezz. Financing	3,100.0
	Total	**$ 32,100**
Mesirow Financial	Hedge Fund of Funds	$ 6,000.0
	Private Equity	800.0
	Total	**$ 6,800**
Auda Advisors	PE Fund of Funds	$ 1,800.0
	Hedge Fund of Funds	1,000.0
	Total	**$ 2,800**
Hamilton Lane (1)	PE Fund of Funds	$ 5,000.0
Richcourt Advisors (1)	Hedge Fund of Funds	1,400.0
	Total	**$ 6,400**

(1) Announced November 18, 2004. Freeman & Co. acted as financial advisor to Hamilton Lane
Source: Company websites

Although Blackstone has few competitors on its scale (excluding the Bulge bracket investment banks as their efforts are typically separated into different silos) a small number of firms have begun to emulate the Blackstone business model. Mesirow Financial, based in Chicago, can be viewed in this model, with $6 billion in hedge fund of funds and nearly $1 billion in private equity. Although Mesirow is not as large or as concentrated in alternative investments as Blackstone, its investment management activities accounted for $64 million in revenues in its most recent fiscal year, which represented 24% of the firm's total revenues.

More specialized firms are following the convergence trend as well, particularly fund of funds managers. Auda Advisors, began as a private equity fund of funds and has since added approximately $1 billion in hedge fund of fund assets. On November 18, 2004, Hamilton Lane Advisors, one of the world's largest private equity fund of funds, announced its intent to acquire a controlling interest of Citco's hedge fund of funds subsidiary, Richcourt Advisors. The combination of these two firms creates a sizable competitor in the alternative investments industry as Hamilton Lane has over $5 billion in discretionary assets and oversees approximately $34 billion in private equity commitments by institutional investors. Meanwhile Richcourt appeared on Institutional Investor's 2003 ranking of the top 50 hedge fund of funds with $1.4 billion in assets. This cross-border transaction could have several synergies: Richcourt's client base is primarily European individuals, while Hamilton Lane focuses on the institutional market, with clients such as CalPERS and the New York State Common Retirement Fund. The cross-selling opportunities for firms that follow this business strategy may be sizable – many firms believe establishing a relationship and winning the first sale is the largest investment (we would agree) and that thereafter introducing new products becomes easier. Of course, this requires that the investment management firm establish itself as a product provider of excellence.

Blackstone - Public Company AUM Comparisons (as of Sept. 30, 2004)

Company	Ticker	Assets ($MM)	Market Cap ($MM)
The Blackstone Group	N/A	$ 32,100.0	N/A
Gabelli	GBL	27,200.0	1,375.8
Waddell & Reed	WDR	35,600.0	1,756.8
Boston Private Finl	BPFH	16,700.0	694.1
Wilmington Trust	WL	33,300.0	2,389.7

Source: SEC filings; Bloomberg; company websites

In order to successfully target the institutional and pension fund market and its ever-changing investment needs, alternative investment managers are realizing the added value of having multiple products and skill sets. Within product sets (such as a hedge fund of funds firm), we have seen firms continue to diversify by offering more specialized products. Often they disaggregate a product into its building blocks to allow investors to custom-tune the product. We believe that some firms will also choose to broaden the product line like The Blackstone Group model; for example a firm may move from a credit-driven hedge fund origin and then add CDOs or a mezzanine product.

Alternative Investment Consolidation

One outcome of significant growth in an industry is that financial and strategic partnerships generally increase. Acquisition activity in the alternative investment space has remained strong during the last year and we have seen a number of large transactions. The types of firms being acquired have varied with a high number of private equity funds of funds being acquired as well as some surprising hedge fund manager deals.

Largest Alternative Investment Acquisitions (2002 - 2004)

Target	Acquirer	Total Deal AUM ($MM)
RMF Investment Group	Man Group Plc	$ 8,500.0
Aberdeen Property Investors Intl Ltd	Arlington Securities Limited	7,830.0
Highbridge Capital Management	JP Morgan Chase	7,000.0
Pantheon Ventures Ltd.	Frank Russell Co	7,000.0
WestInvest Gesellschaft fuer Investment	DekaBank Deutsche Gironzen	6,046.5
Multi-manager business of m Cubed	Momentum	4,500.0
Evaluation Associates Capital Markets	Mellon Financial Corp.	4,500.0
Security Capital Research & Managemer	Bank One Corp	3,500.0
Bluecrest Capital Management	Man Group	3,100.0
The Crossroads Group	Lehman Brothers	2,000.0

Source: Freeman & Co.

The most notable transaction of the year was JP Morgan's recent majority interest acquisition in Highbridge Capital Management, which the Wall Street Journal valued at nearly $1 billion. Until recently, it was uncommon to see acquirers pay premiums for hedge fund businesses because of the key man risk, the variability of performance fees and the potential for "blow-ups". Despite these concerns several hedge fund managers have been able to execute strategic transactions. For example, Man Group Plc acquired a 25% interest in Bluecrest Capital Management, which reportedly valued the $3.1 billion manager at over $700 million, and Mellon previously acquired HBV Capital Management with $500 million. Although it may appear that JP Morgan paid a rich price for Highbridge, if one assumes a 2% management fee for Highbridge then it is generating $140 million in recurring revenues and could generate $160 million in performance fees in a modest year – under this case the rumored $1 billion price for a $300 million revenue firm does not seem entirely unreasonable.

While most of the strategic activity has been centered on large firms plugging gaps in their product line-up, we believe this may shift in the near future. We believe a number of firms may begin to consolidate their alternative asset management activities under one banner. We would expect to see hedge funds making multiple acquisitions or team hires to build multi-style / multi-product hedge fund platforms and for large companies to consolidate hedge fund, private equity, real estate and other alternative products into one area. The goal for these firms would be to leverage their brand name, resources and geographic reach to achieve what some competitors have successfully accomplished.

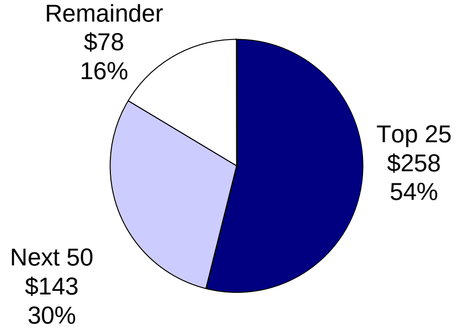
Illustrative Alternative Investment Acquisitions (2003-2004)

Qtr.	Yr.	Target	Country 1	Product	Acquirer	Country 2	Ownership %	Entity Value ($MM)	Total Deal AUM ($MM)
3	2004	Highbridge Capital Management	US	Hedge Funds	JP Morgan Chase	US	55	$ 1,000.0	$ 7,000.0
3	2004	Harmonic Investment Management	US	Hedge Funds	R.J. O'Brien & Associates Inc.	US	100		220.0
3	2004	Green Park Investment Limited	UK	Hedge Funds	Libertas Capital Group PLC	UK	70	3.6	0.2
3	2004	Pescara Partners Inc.	Canada	HFoF	Jovian Capital Corporation	Canada	50		
2	2004	Evaluation Associates Capital Markets	US	HFoF	Mellon Financial Corp.	US	100		4,500.0
2	2004	Javelin Fund of Hedge Funds*	US	HFoF	BNP Paribas	France	100	5.5	890.0
2	2004	MidOcean Partners LLP	US	Private Equity	Ripplewood Holdings LLC	US	N/A		
2	2004	Aberdeen Property Investors Intl Ltd	Scotland	Real Estate	Arlington Securities Limited	UK	100	91.1	7,830.0
1	2004	Baring Capital Partners	China	Private Equity	ING Real Estate	Netherlands	100		
1	2004	Yorkville Advisors Management	US	Private Equity	Hudson Street Investments, LLC	US	N/A		
4	2003	Pantheon Ventures Ltd.	UK	PE FoF	Frank Russell Co	US	100		7,000.0
4	2003	Bluecrest Capital Management	UK	Hedge Fund	Man Group	UK	25	712.0	3,100.0
4	2003	Sal Oppenheim Private Equity FoF	Germany	Private Equity	CAM Private Equity	Germany	100		120.0
3	2003	Security Capital Research & Mgmt Co.	US	Real Estate	Bank One Corp	US	100		3,500.0
3	2003	The Crossroads Group	US	PE FoF	Lehman Brothers	US	100		2,000.0
2	2003	HPB Management LLC	US	HFoF	BlackRock Inc	US	80	4.0	150.0
2	2003	Euroventures	Sweden	Private Equity	Nordico	Sweden	100		
1	2003	Parkway Capital	US	Hedge Funds	The Real Return Holdings	US	N/A		25.0

Source: Freeman & Co.
*Freeman & Co. acted as Financial Advisor to Zurich Capital Markets in its sale of the Javelin Fund

Manager Concentration

Hedge Fund of Fund Concentration
(Total $479 billion)



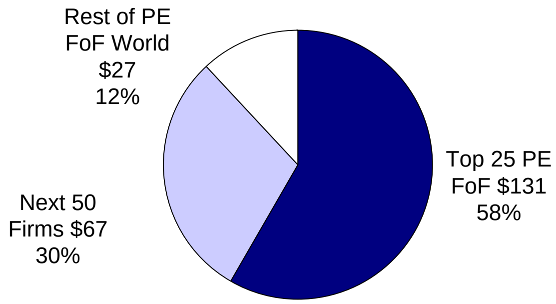
Source: Institutional Investor, HFR, HedgeFund Intelligence, Freeman & Co. estimates

Much of the assets currently flowing into both private equity and hedge funds are coming through investments in fund of funds products. As more institutional investors are making forays into alternative investments, particularly hedge funds, they are treading carefully by using fund of fund vehicles. The diversification of funds of funds provides a level of comfort for investors who are acting in a fiduciary role and the due diligence required monitoring for blow-ups or fraud with single managers can be transferred to outside specialists.

The concentration of assets amongst the top funds of funds managers is high. The top 25 hedge fund and private equity funds of funds managers each control over 50% of the assets in their respective product/asset classes. While private equity funds of funds do not represent as large a percentage of the overall private equity market (15%) when compared to hedge funds of funds (>40%), the general consolidation trend is present in both asset classes. Aside from the obvious diversification benefits of funds of funds, there is an added benefit of brand name recognition. Several of the largest funds of funds have established themselves as household names within the alternative investment industry. Names such as Ivy Asset Management, Blackstone and Grosvenor in the hedge fund space and Frank Russell and Hamilton Lane in the private equity space appear on many consultant search lists. In addition to getting many invitations to pitch their products, these firms have the added benefit of being the “safe” decision for fiduciaries to make when allocating assets to a perceived “risky” asset class.

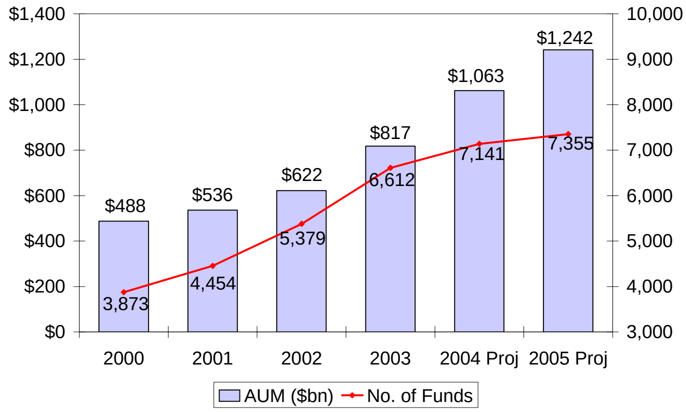
Compared to funds of funds products, direct investments are skewed in the opposite direction, with the majority of assets falling outside the top 75 managers. This is not surprising as many of the top managers are constrained by investment opportunities and too much capital pouring into the same strategies. Additionally, many of the single strategy managers will close funds to new investments once they have reached much smaller levels since performance may suffer if they grow too large.

Private Equity Fund of Funds Concentration
(Total $225 billion)



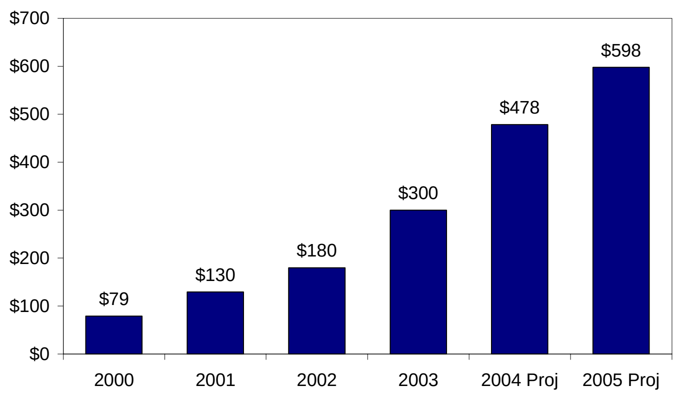
Source: Alternative Investor and Freeman & Co. estimates

Hedge Fund Industry Assets and No. of Funds



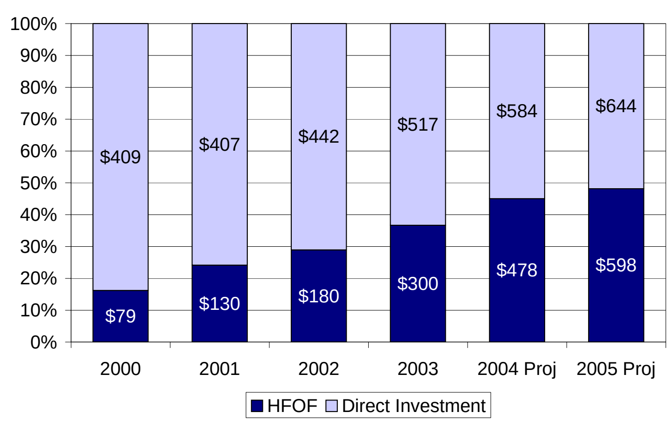
Source: HFR, Freeman & Co. estimates

Hedge Fund of Funds Industry Assets (US $billions)



Source: Institutional Investor, HedgeFund Intelligence, Freeman & Co. estimates

HFOF Assets as a % of Total Hedge Fund Assets



Source: HFR, Freeman & Co. estimates. Institutional Investor, HedgeFund Intelligence

Hedge Funds

Size of the Hedge Fund Market

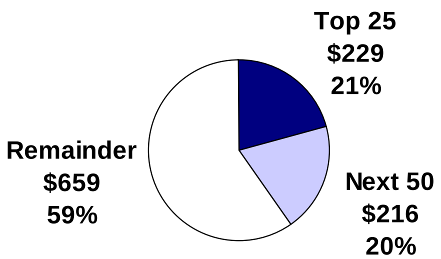
Hedge funds are the first focus of our report and have been the dominant driver of alternative asset management growth. The overall hedge fund industry should exceed $1 trillion in AUM by the end of the year, which would be more than twice the estimated total at the end of 2000. In just four years this market has increased 21.5% per annum. Initially fueled by increased demand due to declines in the equity markets, assets have continued to pour into the industry as institutions, pensions, foundations and endowments seek to diversify their portfolios into absolute return investments.

The majority of net new assets have come through hedge fund of funds, which may account for more than 40% of the overall hedge fund industry. According to rankings by HedgeFund Intelligence, there are now over 100 fund of funds with over $1 billion in AUM. Fund of funds are often seen as an investor's first step into hedge funds as they diversify idiosyncratic manager risk. Many first time hedge fund investors choose fund of funds as a way to gain exposure to absolute returns and multi-strategy products. Hedge fund of funds have been particularly popular with pension funds, foundations and endowments since they may not have the expertise in house to select hedge fund managers and/or the resources to stay on top of the necessary ongoing due diligence. According to Pensions & Investments, the top 200 US defined benefit plans had invested $14.4 billion in hedge funds by 2003 with $6.1 billion, or 42%, as direct investments with the remaining 58% through fund of funds.

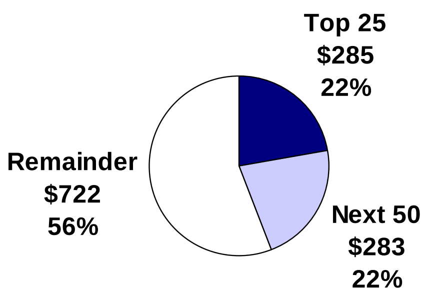
Fund of funds should remain the preferred means of investment for pension fund and endowment money in the near term, however, as these investors become more comfortable with the asset class they may look to direct investments to eliminate the extra layer of fees and any lack of transparency. Going forward, investors that are big enough may develop capabilities to select hedge funds in-house, squeeze fund of fund fees or use lower cost pension consultants to select individual hedge funds. Meanwhile, direct hedge fund managers are creating multi-strategy platforms to compete head-to-head with the fund of funds. By having the ability to allocate money in-house across several teams with different styles, hedge fund managers can position themselves as multi-strategy with one fee layer. However, this approach lacks true "best of breed" objectivity and some products may have style gaps that are not easily filled.

Hedge Fund Asset Concentration

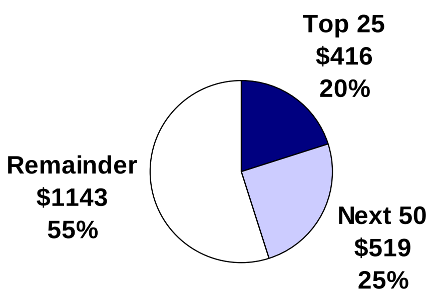
2004 Hedge Fund Concentration ($ billion)



2005 Hedge Fund Concentration ($ billion)



2010 Hedge Fund Concentration ($ billion)



Source: Institutional Investor, HFR, HedgeFund Intelligence, Freeman & Co. estimates

Compared to the hedge fund of funds industry, the assets invested amongst hedge fund managers are much less concentrated, with the top 25 managers controlling only 22% of the overall assets compared to 56% amongst fund of funds. Making the comparison between hedge fund managers and hedge fund of funds managers is naturally biased, as the number of hedge funds drastically exceeds the number of fund of funds with over 6,000 different hedge funds in existence. However, the top 25 hedge fund managers have, on average, $9.2 billion AUM; the next 50 largest firms average $4.3 billion AUM. This compares to $10.3 billion AUM for the top 25 hedge fund of funds and $2.9 billion for the next 50 largest hedge fund of funds.

The largest hedge funds need to manage their size: trading volume and market liquidity can impact many strategies. Since they can generate the vast majority of their fees from performance fees, size and the ability to nimbly execute trading strategies is critical for the largest funds. Comparably, fund of funds, which allocate money across a wide variety of hedge fund managers and strategies do not have direct impact on security selection, but the largest do have constraints on which managers they can allocate to, particularly with small managers.

We expect to see larger hedge fund managers continue to grow. We estimate that the largest 25 firms might average $11.4 billion in 2005, up 24% in size, and $16.6 billion in 2010, up 80% or 10.3% per annum. It may be difficult to imagine a large group of firms all of this size, but consolidation and critical mass themes have been prevalent in financial services.

By building multi-strategy platforms, these hedge funds will be able to invest much larger sums of money, as well as attract more money from investors who seek diversification, and in some cases feel more comfortable with large institutional quality firms. Specific examples include FrontPoint Partners and Highbridge Capital Management. FrontPoint was created with the purpose of combining investment professionals with expertise in several different strategies. The firm's goal was to offer 15-20 different strategies. Since its formation in 2001, FrontPoint has grown to over $3 billion in AUM. Alternatively, Highbridge, which has $7 billion AUM, originally specialized in convertible arbitrage, and later expanded into several different strategies as the founders focused on creating a diversified, institutional quality platform.

Strong hedge fund initiatives by global financial institutions (i.e. Citigroup and JP Morgan Chase) should lead to more concentration amongst the largest hedge fund managers. Although asset concentration should not reach hedge fund of funds level, we would expect to see a slight, but noticeable increase over the next few years.

Hedge Fund of Funds Concentration

As we highlighted previously in our Asset Management Focus report dated March, 31, 2004, the big just keep getting bigger in the hedge fund of funds space with the top 25 firms representing over 50% of the industry's overall assets. Although the accuracy of the AUM reporting in the industry may be questionable at times, the table below demonstrates how much certain firms have grown over the past six months based on Hedge Fund Intelligence's year end rankings versus June 30th estimates: this particular group added $16.0 billion AUM.

Firm Name	Jan 1, 2004	Jun 30, 2004	% Change
GAM	$19.1 bn	$23.2 bn	+21.5%
UBP	$10.9 bn	$15.9 bn	+45.8%
Ivy Asset Mgmt	$10.0 bn	$13.3 bn	+33.3%
Grosvenor	$7.9 bn	$11.5 bn	+45.6%
Total	**$47.9 bn**	**$63.9 bn**	**+33.4%**

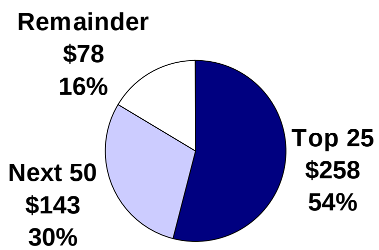
Source: HedgeFund Intelligence

According to HedgeFund Intelligence's data, the top 25 hedge fund of funds raised nearly $60 billion in assets during the first six months of the year, representing $400 million per month per firm and an average of $2.4 billion per firm during this period. This example is likely to prove discouraging to many of the small hedge fund of fund firms with long track records that have not gained the asset raising traction they desire, many having taken an unsuccessful *Field of Dreams* approach of "if you build it, they will come". The next 50 firms raised almost half the amount, $30 billion, of their larger brethren.

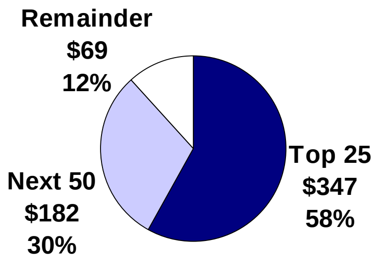
We believe that the trend of the largest firms receiving the largest allocations will continue. Anecdotally, our discussions with investment committee members lead us to believe that large institutional investors are generally picking three hedge fund of fund mangers. The largest allocation, representing 60-80%, generally goes to one of the top 25 firms. The remaining allocation is often split between two smaller firms for 10-20% each. The large firm tends to remove reputational risk issues (read: no one ever got fired for buying IBM), and the smaller firms add diversity and an added learning point for the trustees.

These allocation trends do raise two issues of capacity and specialization. If the largest hedge fund of funds continue to raise $400 million per month, how will this money be allocated? Some may chose to close temporarily: UBS recently announced that certain of its funds are closed to investors. For many of the mid-sized and smaller firms, we expect to see increased trends towards specialization — in either products or services — to differentiate and profitably position themselves versus their larger competitors.

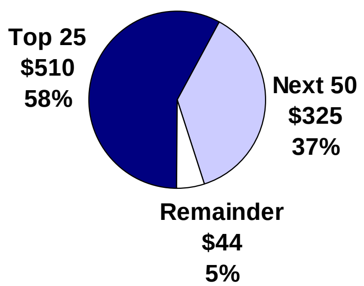
2004 HFOF Concentration ($ billion)



2005 HFOF Concentration ($ billion)



2010 HFOF Concentration ($ billion)



Source: Institutional Investor, HFR, HedgeFund Intelligence, Freeman & Co. estimates

Drivers of Hedge Fund & HFOF Growth: Institutional Demand

Historically hedge funds were the investment toys of the ultra affluent and private bankers in Zurich, Geneva, Hong Kong and Bermuda. Today, the drive in demand has clearly shifted to institutional investors, which should be a continuing theme for the coming 24-48 months. In this section we examine where, how and how much they are using hedge funds as a part of their asset allocation.

Looking at the top 10 US-based defined benefits plans currently invested in hedge fund products there is a preference for hedge fund of funds rather than direct hedge fund investments. Of the $14 billion invested in hedge fund products by the 20 investors listed on the left, 57% has been allocated to fund of funds. Among this group, the weighted average asset allocations to these products have been: direct at 1.8% and fund of funds at 2.7% - a full 50% higher. This makes sense considering fund of funds offer a well-diversified product with very low "blow up" risk. Furthermore, the amounts allocated to direct investment vs. fund of funds vary widely — the 10th largest investor in direct hedge funds committed only $23 million, while the 10th largest investor in hedge fund of funds committed $225 million. Based on this information, we estimate that 65-80% of US defined benefit institutional allocations to hedge funds are being made through fund of fund intermediaries.

Top 10 Defined Benefit Plans Invested in Hedge Funds
($ millions)

Pension Fund	Total Assets	Hedge Fund Assets	% HF Allocation
General Dynamics	$ 9,581.0	$ 2,008.0	21.0%
General Electric	61,622.0	1,275.0	2.1%
Texas Teachers	77,836.0	996.0	1.3%
CalPERS	148,840.0	641.0	0.4%
World Bank	9,667.0	594.0	6.1%
Episcopal Church	6,389.0	424.0	6.6%
Eli Lilly	6,045.0	56.0	0.9%
UMWA Health & Retirement	6,264.0	52.0	0.8%
Cook County Employees	5,500.0	34.0	0.6%
Target	4,949.0	23.0	0.5%
Total / Average	**$ 336,693.0**	**$ 6,103.0**	**1.8%**

Top 10 Defined Benefit Plans Invested in HFOF
($ millions)

Pension Fund	Total Assets	HFOF Assets	% HFOF Allocation
Pennsylvania Employees	$ 23,831.0	$ 3,000.0	12.6%
General Motors	89,738.0	808.0	0.9%
Deere	8,360.0	665.0	8.0%
SBC Communications	36,540.0	624.0	1.7%
Eli Lilly	6,045.0	618.0	10.2%
Missouri State Employees	5,398.0	597.0	11.1%
Citigroup	18,449.0	589.0	3.2%
North Carolina	56,300.0	505.0	0.9%
Illinois Municipal	15,136.0	253.0	1.7%
Lockheed Martin	32,940.0	225.0	0.7%
Total / Average	**$ 292,737.0**	**$ 7,884.0**	**2.7%**

Source: Pensions & Investments January 26, 2004 issue

In addition to the current investments in hedge funds made by large institutions, we continue to track new allocations. The sampling of announcements from pension funds, foundations and endowments below shows percentage allocations to fund of funds ranging from a high of 10% to a low of 3%, with a dollar allocation high of $575 million and low of $6 million. The asset-weighted average allocation is 4.6% - in-line with many of the announcements by investors and our past research reports.

Recent Hedge Fund of Funds Allocations

Name of Institution	Country	Product Type	Total Assets (US $MM)	Amount (US $MM)	% of Portfolio	Date Announced
New Mexico State Investment Council	US	HFOF	$ 11,600.0	$ 350.0	3.0%	3/29/2004
P&O Nedlloyd	Netherlands	HFOF, PEFOF	1,300.0	39.0	3.0%	3/22/2004
Illinois State Board of Investment	US	HFOF	10,200.0	510.0	5.0%	3/7/2004
Jack Kent Cooke Foundation	US	HFOF, Real Estate	500.0	50.0	10.0%	2/19/2004
University of Texas System	US	Hedge Funds, HFOF	11,500.0	575.0	5.0%	1/11/2004
Burroughs Welcome Fund	US	HFOF	550.0	50.0	9.1%	12/29/2003
PNM Resources	US	HFOF	400.0	40.0	10.0%	11/14/2003
Commonwealth of MA Health Care Security Trust	US	HFOF	500.0	50.0	10.0%	11/2/2003
University of New Hampshire System	US	HFOF	500.0	25.0	5.0%	10/28/2003
University of the Pacific	US	HFOF	136.0	6.0	4.4%	10/28/2003
Total Allocations & Average % of Portfolio			**$ 37,186**	**$ 1,695**	**4.6%**	

Source: II Alternatives, HF Alert, Hedgeworld

Drivers of Hedge Fund Growth: Derivatives & Indexes

Leading Structured Products Providers
(listed alphabetically)

Company	Country
Banc of America	U.S.
Barclays	United Kingdom
BNP Paribas	France
CALYON Securities	France
Deutsche Bank	Germany
KBC	Belgium
RBC Capital Markets	Canada
Societe Generale	France
UBS	Switzerland

Source: Freeman & Co.

The rapid growth of the hedge fund industry has Wall Street equity derivative and structured product desks generating new products. These groups generally offer two products for hedge fund investors: capital guarantees and leverage. Although often discussed interchangeably (and sometimes used together), the two basic derivative products function quite differently.

Leverage products come in a wide variety of flavors and function. The majority of leveraged deals are in the 2:1 to 3:1 debt:equty range, but we have seen leverage ratios as high as 4:1. The benefit to the investor is a potential higher return and the investment bank owns highly over-collateralized loans with relatively liquid underlying assets. Also, the mechanics of these loans can vary — fixed interest rate spreads with the maximum leverage varying based on risk measures; constant leverage deals with floating spreads that expand or contract based on the risk being taken; and we have seen open architecture and closed architecture deals. Open architecture deals allow fund of fund managers to invest in any hedge fund, but provide for large (or 100%) haircuts if the fund is not on the lender's approved list; closed platforms only allow investments in pre-approved managers. Given that these loans have large over-collateralization levels and that the rest of financial services has moved to open architecture models, we believe there will be a continued shift to the open architecture leverage models.

The capital guarantee products are simple to understand — a guarantee on principal in 5, 7 or 10 years — but can work in a variety of ways. Some buy a zero coupon bond to hedge the guarantee and invest the remaining assets on a leveraged basis to get the equivalent return on 100% of assets; others will dynamically shift from hedge funds to riskless assets based on a spread over the zero coupon bond price. We have also seen the odd combination of both leverage and capital guarantee wrapped into the same product — for the risk taker that also wants to buy insurance.

Although the overall size of the hedge fund structured products market is difficult to determine, the leaders are relatively easy to pinpoint. European players dominate the market due to their historical experience in structuring hedge fund products to circumvent accounting, regulatory and capital charge restrictions. BNP Paribas bolstered its group through the acquisition in 2003 of Zurich Capital Markets. Meanwhile, Societe Generale, through its Lyxor managed account platform, has also built a robust business.

Investable Hedge Fund Index Providers
(US $ millions)

Index	Product Provider	Est. Assets Linked to Index
S&P Hedge Fund Index	PlusFunds	$ 2,500.0
Dow Jones Hedge Benchmarks	Lyra Capital	1,500.0
MSCI Hedge Invest Index	Lyxor Asset Management	2,100.0
FTSEhx Hedge Index	MSS Capital	N/A
HFR Hedge Fund Indices	HFR Asset Management	500.0
CSFB/Tremont Hedge Fund Index	Tremont Capital Management	1,200.0
Van Hedge Index	Van Advisors	100.0
Estimated Total Assets Invested in Hedge Fund Indices		**$ 7,900.0**

Source: Press releases; Freeman & Co. estimates

One development that has drastically increased structuring opportunities for Wall Street firms are investable hedge fund indices. The majority of these indices are built on managed account platforms (i.e. Lyxor or Lyra) which address the transparency issue that has traditionally been one of the biggest risks in hedge fund lending. The managed account platform allows product providers to see every underlying position, to obtain information on risks and exposures and to calculate daily pricing estimates. As a result of increased transparency and the direct ownership of the accounts, from which they can seize the securities to prevent a credit loss, these have become popular structures for Wall Street firms. Additionally, as it lowers the providers' risks it should allow for more innovative products and lower fees over time.

These products have experienced tremendous inflows in a very short amount of time with as much as $8 billion of direct investments now invested in hedge fund index products. In particular, the traditional index providers (S&P, Dow Jones, MSCI) have experienced the most rapid inflows, due in large part to their globally recognized brand names. In addition, these products have had success in multiple distribution channels:

- direct selling by the underlying index manager
- wholesale distribution by the equity derivate desks that structure the product to meet demand needs by geographic region
- through licenses or sub-advisory agreements with other distributors such as private banks and life insurers

While a number of industry observers have debated the definition of hedge fund indices and what they are replicating; the products provide an exposure mechanism for investors in an easy to understand format that is often well branded by a name they trust. As such, we expect index hedge fund products to increase in popularity.

PRIVATE EQUITY

Size of the Private Equity Market

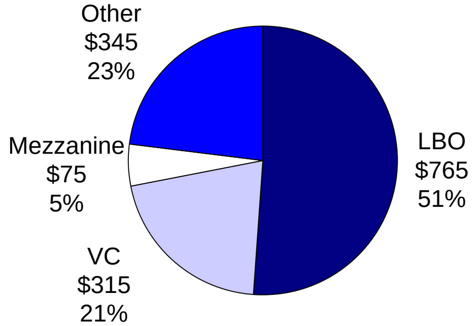
Private equity is the second focus of our report. Although it has suffered recently from the dot-com fallout, it represents $1.5 trillion as per our latest research. The majority of assets in private equity are allocated to LBO transactions, representing $765 billion, or 51% of the total. These are the equivalent of large capital stocks– well-developed companies with stable cash flows that can support a large debt load.

The next largest single strategy is venture capital, representing commitments of $315 billion, or 21% of total. This sector was the hardest hit from the NASDAQ collapse in late 2000 and 2001, but the recent IPO's of firms with venture capital backing, such as Google and Blue Nile, should help to revive this sector. The mezzanine sector has commitments of $75 billion, or 5% of total. These funds target returns of 14-22% through a combination of debt and equity, filling a niche in the balance sheet of companies. The "Other" category, with $345 billion and 23% of commitments is comprised of a variety of styles including distressed debt, restructurings, project finance, bridge financing, financial leasing and other special situations.

Of the $1.5 trillion invested in private equity, approximately half of the capital comes from public plans and family offices. Corporate pension plans contribute approximately $250 billion while insurance companies provide 10% of total industry capital or about $130 billion. PE FOF make up about 15% of the capital sources and endowments, foundations and others round out the remaining investors.

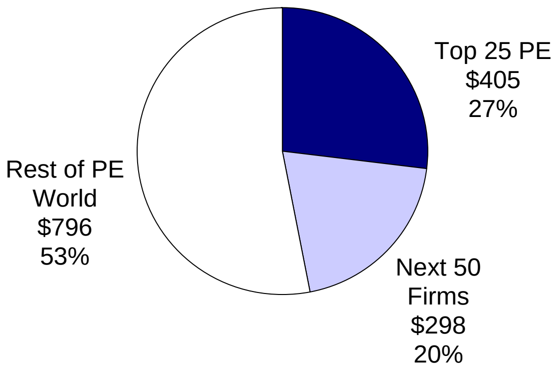
The direct private equity industry is much more fragmented than the hedge fund of fund or even the private equity fund of fund sector. The top 25 private equity firms accounted for just over $400 billion of capital, averaging $16 billion each, and representing 27% of industry assets in total. The next 50 firms accounted for $300 billion of capital, averaging $6 billion each, and 20% of the industry total. Meanwhile, the rest of the private equity firms comprise 53% of total assets with about $800 billion.

Private Equity Commitments by Investment Type (Total $1,500 billion)



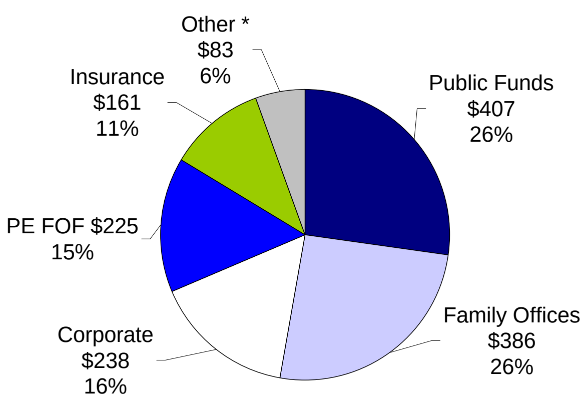
Source: 2003 Goldman Sachs & Frank Russell Report on Alternative Investments, Freeman & Co.

Private Equity Funds Concentration (Total $1,500 billion)



Source: Alternative Investor and Freeman & Co.

Private Equity Capital Sources (Total $1,500 billion)



Source: Alternative Investor and Freeman & Co.

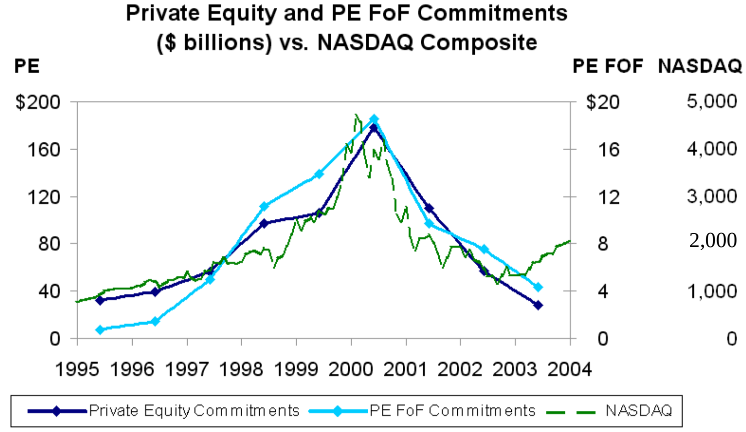
Size of the Private Equity Fund of Funds Market

Capital raising in the private equity industry is still recovering from the excesses of the tech bubble with new private equity commitments down for the third straight year in 2003. When we impose a graph of the NASDAQ Composite on top of the private equity and private equity fund of funds ("PE FOF") commitment trends we see that the ramp-up of inflows closely corresponds to the NASDAQ's performance.

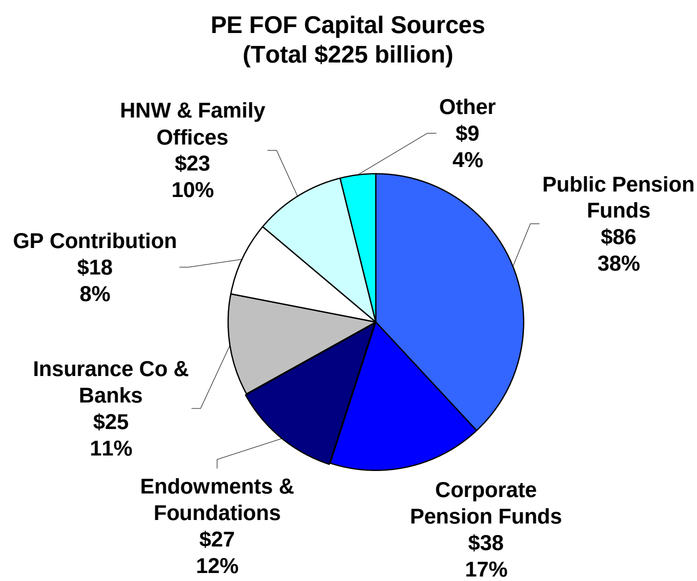
Although private equity is a fairly well developed asset class, the private equity fund of funds industry is a growing segment that has helped to increase access to private equity. Recently it has not garnered as much attention as the hedge fund of fund marketplace, in part due to the latter's recent surge of asset flows. Funds of funds provided approximately 15%, or $225 billion, of the capital raised by private equity firms – a percentage that has been steadily increasing. The PE FOF space will continue to grow rapidly as it is fueled by a continued interest in alternative investments and increased access to information and transparency of the market.

PE FOF firms source their investors from the same pool as the direct private equity firms. Pension funds, both public and corporate, are the leading investors in PE FOF, accounting for over 50% of all sources of PE FOF capital. It is worth noting that within this investor group, general partners have contributed 8% or $18 billion of the total capital in PE FOF. This distribution of PE FOF capital sources is similar to that of direct private equity funds, as discussed earlier.

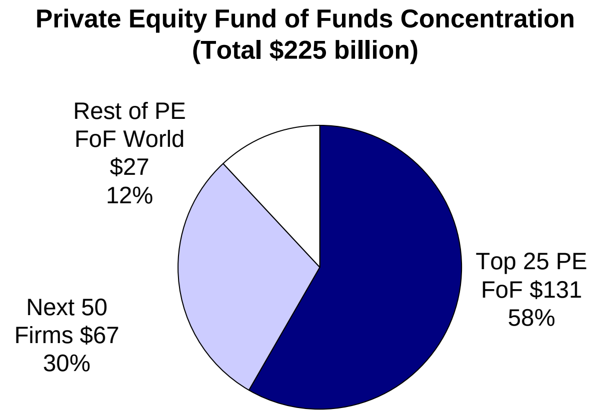
The PE FOF industry is fairly concentrated and more closely resembles the hedge fund of fund industry in that regard. The largest 25 PE FOFs account for 58% of total assets, averaging $5.2 billion, while the next 50 private equity firms account for 30% of total assets and average $1.3 billion each; over 125 private equity fund of funds account for the remaining 12% of total assets. This industry segmentation (88% controlled by the largest 75 firms) stands in stark contrast to the fragmentation of the direct private equity industry in which the top 75 firms control approximately 47% of total private equity assets.



Source: Private Equity Funds-of-Funds State of the Market, 2004, Bloomberg and Freeman & Co.



Source: Private Equity Funds-of-Funds State of the Market, 2004 and Freeman & Co.



Source: Alternative Investor and Freeman & Co.

Institutional Demand for Private Equity

Private equity investing has historically been the domain of institutional investors, primarily the larger public funds, insurance companies, foundations, endowments and corporate pensions plans. Later in this report we examine the increasing accessibility of private equity to other investors, primarily the public and smaller institutional investors. Here, we analyze the top institutions and their private equity and venture capital allocations.

A brief examination of the top 10 US-based defined benefit plans investing in private equity reveals a stark contrast between the investments allocated to private equity and venture capital. Of the $49 billion invested in the asset class, more than $40 billion is committed to private equity, leaving a significantly smaller 17%, or $8.6 billion, committed to venture capital. Similarly, the weighted average commitment amongst pensions to private equity is over four times larger than that to venture capital at 5.4% and 1.2% respectively. This is not to suggest venture capital has not been an attractive asset class for pension funds. Venture capital fundraising was up 60% from 2003 with $2.9 billion committed in the first three months of 2004, while buyout fundraising was up only 19%. It is crucial, however, to acknowledge the 21% decrease in the number of companies receiving venture funding in 2004 when compared to 2003.

Top 10 Defined Benefit Plans Invested in Private Equity
($ millions)

Pension Fund	Total Assets	Private Equity Assets	% PE Allocation
New York State Common	$ 106,843.0	$ 6,232.0	5.8%
CalPERS	148,840.0	5,519.0	3.7%
Michigan Retirement	46,878.0	5,216.0	11.1%
Washington State Board	42,461.0	4,260.0	10.0%
Oregon Public Employees	38,689.0	3,883.0	10.0%
CalSTERS	103,277.0	3,746.0	3.6%
Florida State Board	92,310.0	3,044.0	3.3%
IBM	60,119.0	3,002.0	5.0%
General Electric	61,622.0	2,929.0	4.8%
Verizon	54,591.0	2,726.0	5.0%
Total / Weighted Average	**$ 755,630.0**	**$ 40,557.0**	**5.4%**

Top 10 Defined Benefit Plans Invested in Venture Capital
($ millions)

Pension Fund	Total Assets	Venture Capital Assets	% PE Allocation
CalPERS	$ 148,840.0	$ 1,338.0	0.9%
CalSTERS	103,277.0	996.0	1.0%
Verizon	54,591.0	935.0	1.7%
Michigan Retirement	46,878.0	926.0	2.0%
Lucent Technologies	36,684.0	851.0	2.3%
Washington State Board	42,461.0	769.0	1.8%
General Motors	89,738.0	751.0	0.8%
SBC Communications	36,540.0	719.0	2.0%
Pennsylvania Employees	23,831.0	691.0	2.9%
New York State Common	106,843.0	583.0	0.5%
Total / Weighted Average	**$ 689,683.0**	**$ 8,559.0**	**1.2%**

Source: Pensions & Investments January 26, 2004 issue

To understand the future of private equity we have tracked private equity fund of fund allocations. Within the past 18 months, there has been over $6 billion in new PE FOF commitments from institutional investors. While alternative asset interest would lead smaller investor to the PE FOF product, there are a number of larger investors that have chosen this approach. PE FOFs, by nature diversify risk and have worked to increase investor transparency. A pension fund such as San Bernardino County Employees' Retirement System, which allocated 12.2% of assets to PE FOF, is a prime example of institutions' newfound comfort level with private equity. Pension funds, in fact, have been very active in the private equity fund of funds arena and now account for 38% of capital for this product class.

Recent Private Equity and PE FOF Allocations

Name of Institution	Product Type	Date of Announcement	Total Assets (US $MM)	Amount (US $MM)	% of Portfolio
Kuntien Eläkevakuutus (Helsinki local gov.)	Private Equity	3/7/2004	14,000.0	300.0	2.1%
Doris Duke Charitable Foundation	Private Equity	4/4/2004	$ 1,500.0	$ 135.0	9.0%
Indiana Public Employees' Retirement Fund	Private Equity	5/3/2004	10,000.0	520.0	5.2%
Lumina Foundation for Education	Private Equity	5/31/2004	1,100.0	55.0	5.0%
Falkirk Council Pension Fund	PEFOF	5/31/2004	1,100.0	55.0	5.0%
San Bernardino County Employees' Retirement	PEFOF	6/1/2004	3,600.0	185.0	5.1%
Los Angeles Fire & Police Pension System	Private Equity	8/1/2004	11,000.0	550.0	5.0%
North Carolina State Treasury	Private Equity	10/1/2004	55,000.0	2,200.0	4.0%
Swamscott Contributory Retirement System	PEFOF	10/4/2004	27.0	1.0	3.7%
San Bernardino County Employees' Retirement	Private Equity	10/4/2004	3,600.0	440.0	12.2%
Total Allocations & Average %			**$ 100,927.0**	**$ 4,441.0**	**4.4%**

Source: Pensions & Investments

Private Equity & PE FOF Industry Trends and Dynamics

The private equity and PE FOF industries are in the midst of a transition period highlighted by several notable trends:

Private Equity Trends
• Recovering from tech bust; more prudent investing
• More capital chasing fewer investments
• Decreasing use of leverage due to fewer large deals
• Mid-size firms having difficulty raising capital

As with hedge funds, size, brand name, reputation and track record are crucial in a private equity firm's capital raising, especially for the small- and mid-sized firms. The result is that the large, brand name firms have been rewarded with consistent capital in-flows, while the smaller and lesser-known firms have had more difficulty raising capital. Recently for example, Industri Kapital, a Scandinavian private equity manager with a reputable business model, was able to raise less than a third of its most recent $3.1 billion fund target. Also, Hutton Collins received less than 50% of expected commitments for its mezzanine fund (Source: Financial News, 11/04).

As the private equity market emerges from its trough and as the asset class, along with the broader alternatives asset class, gains more visibility, we expect many smaller institutional investors to utilize funds of funds to obtain access to funds, gain expertise and achieve diversification.

Another trend is the marketing positioning of the independently owned PE FOF firms. As the industry is split between these firms and units of the large investment banks, the independents have sought to promote their lack of conflicts as a significant asset. The current regulatory and enforcement environment will encourage firms to position themselves favorably with respect to this issue.

PE FOF Trends
• Smaller investors using PE FOF to obtain access, expertise and diversification
• Perceived independence issues of independents vs. large investment banks
• Increasing importance of critical mass and brand recognition
• Recent caution of investing in private equity funds through the public markets
• European regulatory changes

Critical mass for PE FOF firms has become important– at a minimum firms need to reach $500 million in AUM to be competitive institutionally. In fact, the $2 billion mark is increasingly becoming the new critical point in winning business from institutional clients. Developing and maintaining a brand name is of particular importance as independent consultants tend to favor well-known funds and are more comfortable recommending them to clients.

In Europe the private equity asset class is less developed than the hedge fund asset class, but interest in private equity is beginning to accelerate. European investors now account for more than 50% of new private equity capital raised. More significantly, European governments are redefining guidelines and raising limits on institutional private equity exposure. We estimate that approximately 60% of all private equity capital commitments originate from the United States, pegging the domestic private equity industry size at about $900 billion and the international private equity industry at about $600 billion.

European Business & Regulatory Changes
• UK: public pension funds now permitted to invest up to 15% of assets in private equity
• France: 2004 budget amendment requires life insurance companies to invest 5% in private equity, up from 1.5%
• Greece: government launced TANEO, a $150 million VC FOF
• European Investment Bank: sponsored European Investment Fund, a VC FOF

Increasing Public Access to Private Equity

In the first half of 2004, over a dozen private equity firms filed for or announced their intent to file for IPO's of their funds, including industry leaders such as KKR, Blackstone and Thomas H. Lee. Two were successful:

- Apollo raised $930 million in a public offering of their latest BDC fund in April of 2004
- Prospect Capital Management raised a $105 million publicly-traded fund focused on the energy industry in July 2004 after reducing the offering size by over 40%.

However, this trend of raising private equity funds via publicly-traded closed-end funds (using Business Development Company "BDC" vehicles) has cooled. as investor appetite waned. As a result, a number of firms have postponed or altered their plans including Blackstone (indefinite postponement) and Evercore (delayed IPO three times and reduced management fees). Even the successful ones have not always fared well in the capital markets: Apollo's (NASD: AINV) share price dipped over 15% in the weeks following its debut.

The BDC funds seem to suffer from a number of drawbacks that have inhibited new funds from launching. First, the ability to invest quickly is crucial in maximizing return as they will sit on cash for a substantial period of time. Second, investors have difficulty with the high fee structures, which can include 2% management fees and a 20% incentive fee with an underwriting commission of approximately 7% for the lucky investors on first day. Third, the financial press has been liberal in pointing out these issues. Despite the setbacks, the private equity asset class continues to generate interest as creative structures are further developed, even if there is a temporary hiatus.

We believe that demand for a publicly-traded private equity-like vehicle will be strong in the long-term since it is an attractive vehicle for small institutions and retail investors that seek access to this asset class. Allied Capital (NYSE: ALD), which provides long-term debt and equity investment capital to companies in a variety of industries, and other similar BDCs provide capital via a range of instruments including equity, mezzanine and long-term debt. Private financing of this kind is generally used to fund growth, acquisitions, buyouts, recapitalizations, note purchases, bridge financings, and other types of financings. BDCs, however, generally invest in private companies. Though, from time to time, they invest in public companies that lack access to public markets. These features make BDCs and their competitors, attractive alternatives for investors.

Summary of Publicly Traded Business Development Companies*

Company Name	Ticker	Stock Price	Market Cap ($MM)	Price / Sales	Price / Cash	PE	Est. PE	LT Growth Rate	5 Yr Avg ROE
Allied Capital Corp	ALD	$ 27.5	$ 3,667.9	8.4x	14.2x	12.8x	18.1x	5.0%	15.5%
American Capital Strategies	ACAS	31.5	2,693.9	9.5x	12.9x	11.6x	11.5x	7.7%	12.0%
Apollo Investment Corp	AINV	14.4	903.3	N/A	N/A	N/A	47.4x	10.0%	N/A
MCG Capital Corp	MCGC	17.8	807.4	9.4x	13.2x	14.2x	11.7x	9.0%	N/A
Capital Southwest Corp	CSWC	78.8	303.7	5.5x	32.7x	5.8x	N/A	N/A	3.3%
Harris & Harris Group Inc	TINY	14.2	249.3	N/A	N/A	N/A	N/A	N/A	3.3%
Ares Capital Corp	ARCC	18.1	199.2	N/A	N/A	N/A	N/A	N/A	N/A
MVC Capital Inc	MVC	9.3	113.0	13.8x	4.7x	28.7x	N/A	N/A	N/A
Prospect Energy Corp	PSEC	14.0	99.8	N/A	N/A	N/A	N/M	13.5%	N/A
High				13.8x	32.7x	28.7x	47.4x	13.5%	15.5%
Average				9.3x	15.5x	14.6x	22.2x	9.0%	8.5%
Median				9.4x	13.2x	12.8x	14.9x	9.0%	7.7%
Low				5.5x	4.7x	5.8x	11.5x	5.0%	3.3%

*Date: 11/24/2004
Source: Bloomberg

REAL ESTATE

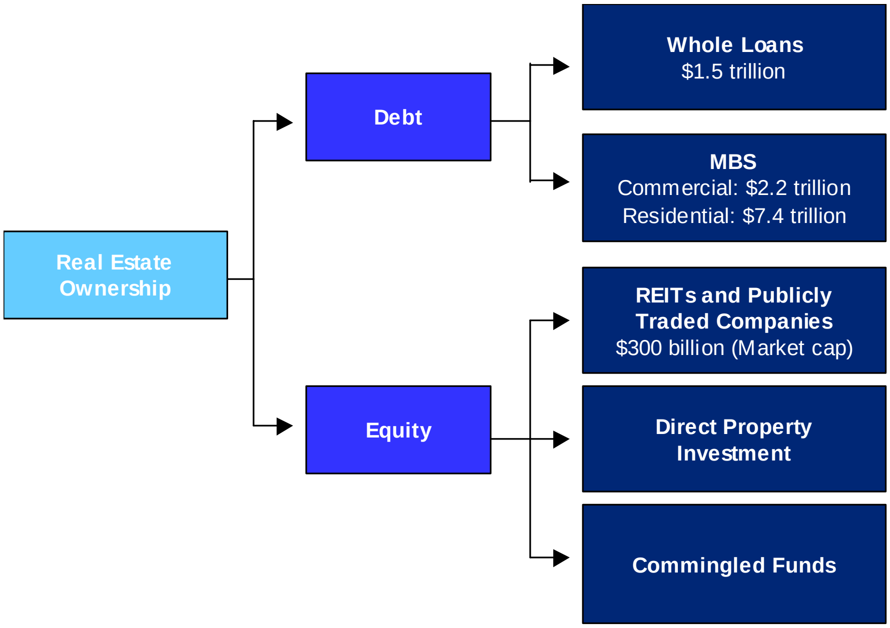
Size of the Real Estate Market

Real estate is the third focus of our report. Real estate is quickly becoming a mainstream asset class as pension plans, endowments, foundations, charities and foreign investors continue to announce additional alternative asset allocations. In support, we note that tax-exempt real estate assets have increased by approximately 10% per annum over the past 10 years and institutional, tax-exempt assets managed internally increased by 15% during 2002 (Source: Pension & Investments).

The tangibility of real estate, and the reputation of higher security than other assets, could be one driver of this growth. While these perceptions may be accurate, it does lose sight of some shortcomings. Opaque pricing data, high transaction costs, poor liquidity and refinancing risks all erode the comfort of a real estate allocation. Notwithstanding these issues, the expected return profile is attractive. Investors can expect 5% to 7% returns in the short term and 8% to 10% in the medium term. The lower end of this range also boasts low volatility and minor correlation to other assets. In conjunction with 13% to 15% returns driven by falling interest rates over the last five years, real estate is an attractive investment.

Real estate also continues to attract capital globally, as foreign investors in US real estate are benefiting from prolonged favorable exchange rates. Foreign investment in US real estate rose by 59% in 2003 and is expected to increase by another 12% in 2004. This supports the suggestion that foreign investors are targeting 56% of their cross-border allocations for US real estate (Source: AFIRE). At the same time, global real estate remains strong with 60% of new real estate investments being made outside the US. In addition, growth looks to be further supplemented by European and Asian demand of transparent and liquid products. Their adaptation to the US REIT structure seems likely and would boost real estate growth tremendously.

The real estate market and its investment opportunities are varied depending on investors' preferences. Illustrated below, we have segmented the market into the products and vehicles in demand:



Source: Federal Reserve, Institute for Fiduciary Education, Freeman & Co. estimates

Within the product segmentation on the preceding page, an investor can invest in real estate debt directly or through collateralized pools. Direct whole loans, such as primary and secondary mortgages are estimated to total approximately $1.5 trillion. However, investors typically choose to invest via residential and commercial mortgage-backed securities, and according to the Federal Reserve, are estimated at $10 trillion (Sept. 2004). Most of these collateralized products are classified as fixed income securities by investors.

On the equity side, investing is accomplished directly or via real estate investment trusts (REITs). REITs in the US, providing a variety of investment strategies, have become popular vehicles with total market capitalization reaching $300 billion. While the size of the direct real estate equity market is difficult to estimate, when compared to the debt it has secured, the equity value is over $3 trillion. Our focus for direct real estate equity in this report will be on institutional demand.

Size and Segmentation of the Real Estate Market

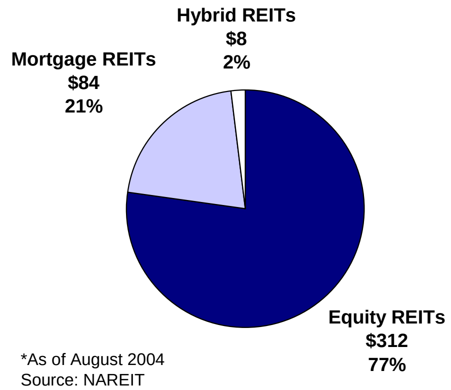
In this section we focus on characteristics of mortgage-backed and REIT securities, including: underlying collateral and investors. For REITs, the underlying collateral is well-diversified across various property types: office property (17%), diversified property (15%), apartments (14%), regional malls (13%) and shopping centers (13%) lead the mix. The total REIT market cap totals $300 billion and has purchasing power of approximately $1.5 trillion with leverage. The REIT market is dominated by equity REITs, totaling $312 billion or 77%, while mortgage-focused vehicles account for 21%. Small institutional and individual investors, seeking to gain REIT exposure, will continue to grow the market as equity REITs continue to address their liquidity, diversification, and pricing needs.

Commercial Breakdown (by REIT Market Cap)

Property Type	Market Cap ($ billions)	Total Market Cap
Office Property	$ 50.2	16.7%
Diversified	44.1	14.7%
Apartments	41.9	14.0%
Regional Malls	40.5	13.5%
Shopping Centers	40.4	13.5%
Mortgage	21.0	7.0%
Industrial	19.0	6.3%
Health Care	15.7	5.2%
Hotels	13.7	4.6%
Storage	10.9	3.6%
Manufactured Homes	2.7	0.9%
Total REIT Market Cap	**$ 300.0**	**100.0%**

Source: Bloomberg as of 9/30/04

Total Assets Breakdown of REITs by Financing Product (Total $400 billion)*



*As of August 2004
Source: NAREIT

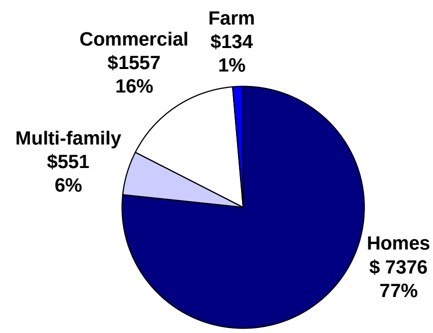
The mortgage-backed security (MBS) market is also attractive and has surged to nearly $10 trillion with $7.4 trillion backed residentially. Commercial properties (such as office buildings and warehouses) represent $1.6 trillion or 16%, and multi-family dwellings comprise $0.6 trillion or 6% of the MBS market. The purchasers of MBS are heavily dominated by the government and quasi-government entities (state & local governments, government sponsored enterprises, agencies, etc.), which purchase nearly 50%, or $4.2 trillion, of all outstanding mortgages. Within this amount are Agency and GSE-backed Mortgage Pools of which Fannie Mae, Freddie Mac and others acquire over $3.5 trillion. Banks, commercial banks, savings institutions and credit unions are the second largest investors in real estate mortgages, with over 36% of the investments at $3.4 trillion.

Breakdown of Mortgages by Investor Type

Investors	Capital Invested ($ billions)	% of Total
Banks	$ 3,442.4	35.8%
Insurance	263.6	2.7%
Other Finance	290.0	3.0%
Govt/Quasi-Govt	4,201.6	43.7%
ABS	1,127.2	11.7%
Other	229.8	2.4%
Retirement	62.9	0.7%
Total Invested in Mortgages	**$ 9,617.5**	100.0%

Source: Federal Reserve Statistical Release, Flow of Funds Accounts of the United States: Flows and Outstandings First Quarter 2004, p 93, L217, Total Mortgages

Breakdown of Mortgages by Underlying Property Type (Total $9.618 billion)*



*As of August 2004
Source: Federal Reserve Statistical Release, Flow of Funds Accounts of the United States: Flows and Outstandings First Quarter 2004

Institutional Demand for Real Estate

Institutional demand for real estate equity has been consistently strong. The top 10 US-based defined benefit plans have invested $54.1 billion in real estate equity and REITs, which is comparable to the $49.1 billion in private equity and $14.0 billion in hedge funds. What separates the overall real estate asset class from hedge funds and private equity is the debt component. Via either direct loans or MBS, there would be an additional $26.3 billion of real estate exposure to these investors. Another key observation is that many of these investors use both direct and REIT strategies. The allocation among the top 10 DB plans is 5.7% direct equity and 1.4% REIT, which compares to 5.4% in private equity and 1.8% in hedge funds. However, the allocation to hedge fund of funds is 2.7%, slightly higher than the REIT allocation.

The annual NACUBO Endowment Study shows weighted average allocations to real estate, private equity, and venture capital have increased over the past nine years, although there have been some shifts among these assets. According to the *Yale Daily News*, the University's $11 billion endowment has increased its target real estate allocation to 20% and decreased its target for private equity to 17.5%, but endowments are not alone in increasing their allocations. The table below illustrates that large institutional investors such as NYC Retirement Systems and Arizona State Retirement System, both recently announced an additional 5% to 6% of their portfolio into real estate. The average of this sample in the chart below is $9.743 million and 3.8% of total assets for each.

Real estate allocations are poised for growth in the near term as institutions continue to increase their exposure to alternatives. REITs will be a main component of this trend as investors are constrained by liquidity, diversification and investment size. Lower volatility at lower returns may also attract tepid investors and provide a steady stream of new investors. Specifically, managers with smaller AUM and possibly less aggressive investment styles could be drawn into the asset class.

Top 10 Defined Benefit Plans Invested in Real Estate
($ millions)

Pension Fund	Total Assets	Real Estate Assets	% RE Allocation
CalPERS	$ 148,840.0	$ 10,384.0	7.0%
CalSTERS	103,277.0	4,685.0	4.5%
General Motors	89,738.0	4,481.0	5.0%
Ohio State Teachers	48,463.0	4,445.0	9.2%
New York State Teachers	73,481.0	4,017.0	5.5%
Michigan Retirement	46,878.0	3,900.0	8.3%
Washington State Board	42,461.0	3,639.0	8.6%
Ohio Public Employees	53,691.0	3,584.0	6.7%
Florida State Board	92,310.0	3,333.0	3.6%
New York State Common	106,843.0	3,276.0	3.1%
Total / Weighted Average	**$ 805,982.0**	**$ 45,744.0**	**5.7%**

Top 10 Defined Benefit Plans Invested in Mortgages
($ millions)

Pension Fund	Total Assets	Mortgage Assets	% Mortgage Allocation
CalPERS	$ 148,840.0	$ 5,451.0	3.7%
Florida State Board	92,310.0	5,345.0	5.8%
New York State Teachers	73,481.0	4,559.0	6.2%
Washington State Board	42,461.0	2,776.0	6.5%
University of California	42,951.0	2,579.0	6.0%
New York State Common	106,843.0	1,683.0	1.6%
South Carolina Retirement	22,950.0	1,207.0	5.3%
DuPont	22,871.0	952.0	4.2%
New Jersey	63,591.0	897.0	1.4%
Illinois Teachers	27,987.0	894.0	3.2%
Total / Weighted Average	**$ 644,285.0**	**$ 26,343.0**	**4.1%**

Top 10 Defined Benefit Plans Invested in REITs
($ millions)

Pension Fund	Total Assets	REITs Assets	% REITs Allocation
Florida State Board	$ 92,310.0	$ 1,421.0	1.5%
General Motors	89,738.0	1,251.0	1.4%
New York State Teachers	73,481.0	978.0	1.3%
Maryland State Retirement	27,360.0	904.0	3.3%
IBM	60,119.0	777.0	1.3%
Pa. School Employees	43,525.0	668.0	1.5%
New York City Teachers	36,675.0	655.0	1.8%
CalPERS	148,840.0	616.0	0.4%
Texas County & District	10,002.0	602.0	6.0%
Oregon Public Employees	38,689.0	562.0	1.5%
Total / Weighted Average	**$ 620,739.0**	**$ 8,434.0**	**1.4%**

Source: Pensions & Investments January 26, 2004 issue

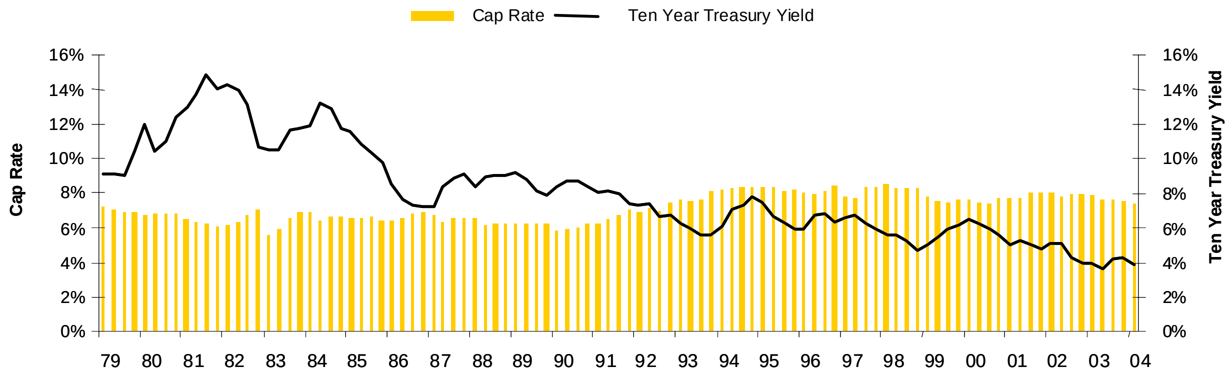
Recent Real Estate Allocations

Name of Institution	Product Type	Date of Announcement	Total Assets (US $MM)	Amount (US $MM)	% of Portfolio
Cambridge Regional Retirement Board	Real Estate	10/4/2004	534	27	5.0%
New York City Retirement Systems	Real Estate	8/1/2004	85,000	4,250	5.0%
Jacksonville Fire & Police Pension Fund	Real Estate	6/28/2004	900	45	5.0%
Illinois State Universities Retirement System	Real Estate	4/5/2004	12,700	635	5.0%
Jack Kent Cooke Foundation	HFOF, REFOF	2/19/2004	$ 500	$ 50	10.0%
CalSTERS	Real Estate	11/4/2003	103,277	2,066	2.0%
Massachusetts PRIM	Real Estate	11/4/2003	32,600	1,304	4.0%
Arizona State Retirement System	Real Estate	11/4/2003	18,700	1,122	6.0%
Employees' Retirement System of Rhode Island	Real Estate	11/4/2003	4,800	221	4.6%
Knoxville (Tenn.) City Employees' Pension Fund	Real Estate	11/4/2003	414	24	5.8%
Total Allocations & Average % of Portfolio			**$ 259,425**	**$ 9,743**	**3.8%**

Source: Pensions & Investments

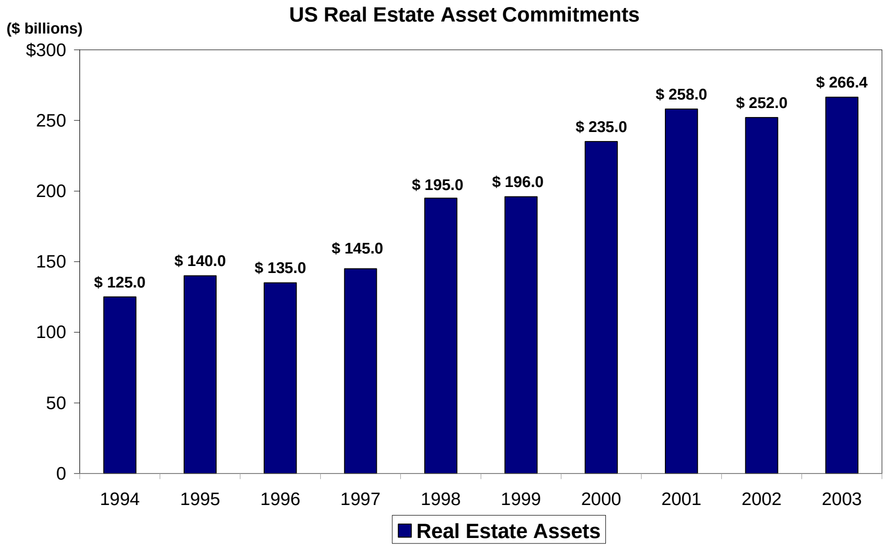
Growth of the Real Estate Market and Drivers of Demand

Real estate investment has generated attractive returns for some time, drawing capital from institutional investors in the US and abroad. The industry has been driven recently by historically low interest rates and expectations of increasing rents. As a result, the spread between cap rates and treasuries has been increasing since 2000 and now stands at nearly 400 bps:



Source: CPI, National Council of Real Estate Investment Fiduciaries (NCREIF), Economy.com

The charts above and below help highlight some of the similarities and differences in short-term and long-term expectations of real estate investing. In the short-term, the greatest influences have been the low level of interest rates and the slow recovery of the economy, which has put pressure on some aspects of commercial properties. However, over the long-term investors have continued to increase their allocations to the real estate sector -- inflows of tax-exempt assets have increased by 10% per annum over the past 10 years and were up 15% in 2002. Some of these allocations have been driven by the long-slow fall in interest rates to the historical lows we have today. The demand has also been driven by investment decisions to increase allocations to alternative assets overall. And finally, some of the increase in demand is attributable to structural changes such as increased access to data and information on industry and property trends, as well as the development of the REIT industry.



Source: Pensions & Investments

Note: U.S. Institutional tax-exempt real estate assets for years ended June 30.
Reported net of leverage, including contributions committed or received, but not yet invested.

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