CLIFFWATER LLC

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Hedge Fund Market Overview

Hedge funds returns were generally flat for March. The HFRI Fund of Funds Index, a more reliable index of institutional hedge fund performance, returned -0.01% for the month. The HFRI Fund Weighted Index reported a 1.8% return for the month. This equal weighted index of all hedge funds has an almost 60% weighting to equity long/short managers, which were up 3.4% as a group in March. The HFRI Fund Weighted Index return is often revised downward as lower return funds tend to report with a lag.

After revisiting 12 year lows, the markets surged in the final three weeks of March, responding positively to a number of events. A combination of multiple government programs designed to ease the housing crisis and restore liquidity contributed to the optimism. So too did the slowdown in some of the negative economic trends witnessed in the 4th quarter of 2008. Capital flowed into multiple markets, with equity and credit securities moving up in price. Financials benefitted disproportionately, climbing 18%, following the easing of fears that more major banks, including Citibank, would collapse.

The HFRI Fund of Funds Index returned 0.5% and equity long/short funds returned 0.4% for the first quarter, far better than the -11.0% return for the S&P 500 Index. The capital protection characteristic expected from hedge funds has apparently returned after many missteps in 2008. Much of this improved risk control is attributable to a general reduction in hedge fund leverage – 45% of hedge funds are now unlevered – and larger cash positions.

The exhibit below provides returns to major asset classes.

Exhibit 1: 2009 Market Performance

Index	March	YTD 2009	FYTD*	Calendar 2008
Equity				
DJ Wilshire 5000	8.7%	-10.6%	-37.0%	-37.2%
S&P 500	8.8%	-11.0%	-36.4%	-37.0%
Russell 2000	8.9%	-14.9%	-37.9%	-33.8%
MSCI EAFE	6.4%	-13.9%	-45.4%	-43.1%
MSCI Emerging Mkts	14.3%	0.7%	-46.9%	-53.5%
DJ Wilshire REIT	3.2%	-33.9%	-52.6%	-39.2%
S&P 500 Financials	17.9%	-28.8%	-56.0%	-56.6%
Fixed Income				
Barclays Aggregate	1.4%	0.1%	4.2%	5.2%
Barclays Treasuries	2.2%	-1.3%	15.9%	20.1%
Barclays TIPS	5.8%	5.5%	15.7%	-2.4%
Barclays High Yield	3.2%	4.9%	-21.5%	-26.2%
Barclays Bank Loan	2.0%	9.5%	-22.4%	-29.5%
AAA ABX (Subprime)	-24.1%	-25.5%	-57.9%	-43.2%
Barclays Municipals	0.0%	4.2%	1.6%	-2.5%
3 mo.Libor	0.1%	0.3%	1.8%	3.1%
Alternative				
DJ AIG Commodity	3.6%	-6.3%	-52.6%	-35.7%
HFRI Fund of Funds**	0.0%	0.5%	-19.1%	-21.4%
HFRI Fund Weighted**	1.8%	0.5%	-17.5%	-19.0%

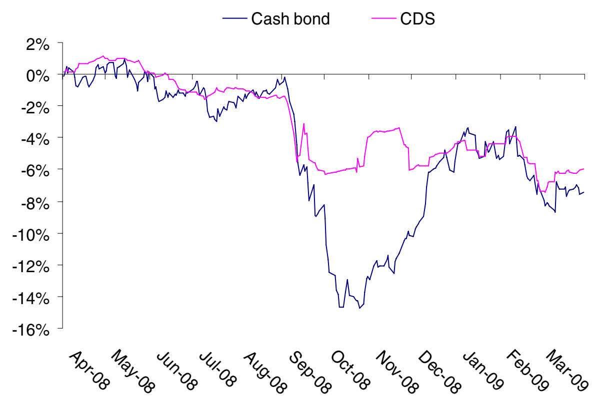
* Fiscal YTD from June 30, 2008
** Hedge Fund Research, Inc. ("HFR") is the source and owner of the HFR data contained or reflected in this report and all trademarks related thereto.

One of the better performing hedge fund strategies in 2009 has been "relative value," which is up 4.7% for the year. Many of the funds in this category invest in credit markets, attempting to earn returns that are independent of market direction. Among the tactics they employ is to invest long in one bond and short in another from the same issuer, where the bonds have different priority in the capital structure or maturity dates. Another tactic involves targeting mispricing in bonds that have embedded options.

A key component to fixed income relative value strategies is the use of credit default swaps ("CDS") to gain short exposure to bonds. This market operates differently than the cash bond market, as it is contractually based rather than dependent on an exchange of cash for securities. The underlying economics and payout profiles differ between the cash bond market and the CDS market. However, they are designed to closely track each other under normal conditions. A deleveraging event, such as the one in the 4th quarter of 2008, can cause significant distortions in the cash bond-CDS relationship, particularly because most of the strategies that invest in both markets have historically used significant leverage.

Exhibit 2 shows the performance of the cash and CDS markets for investment grade corporate bonds since April of 2008. Beginning in September of 2008, amidst the collapse of Lehman Brothers and the subsequent rush to reduce credit risk, the investment grade cash bond market significantly underperformed the CDS market, as the unwinding of relative value positions put opposite pressures on the two markets.

Exhibit 2: Relative Performance of Investment Grade Corporate Bonds and CDS



Source: Barclays

A more pronounced effect took place in the high yield and convertible bond markets, where most of the leverage was being deployed. In 2009, much of the mispricing reversed. The so-called “basis trade,” which involves the purchase of a bond and the shorting of that bond through the CDS market, has become very profitable for fixed income relative value funds, particularly those that focus on convertible bonds.

Private Equity Market Overview

As expected, the private equity market downturn continued in the 1st quarter of 2009. Just about all metrics, fundraising, investing, realizations, and performance showed deterioration during the quarter. Part of the downturn reflects the lagging impact of the horrific performance of public markets in the second half of 2008 and part of the downturn reflects a continuation of the slump in economic and capital market performance in the 1st quarter of 2009. We expect the metrics for the private equity market to show deterioration throughout the first three quarters of 2009. An improvement in the private equity market in the 4th quarter will likely depend on stabilization of economic and capital market conditions and an increase in activity among value-oriented private equity strategies, namely distressed investing.

Compared to the frothy days of 2006 and 2007, private equity fundraising came to a halt in the 1st quarter. According to Dow Jones Private Equity Analyst, only 56 private equity funds raised capital and they raised only $15.5 billion, a five year low. In the 1st quarter of 2008, 134 funds raised $82.7 billion. During the quarter, 26 buyout funds raised $22.1 billion versus 52 funds and $49.0 billion of capital in the prior year’s quarter. It is worthy of note that one buyout fund, Hellman Friedman, accounted for almost half of the buyout capital raised during the quarter. Twenty-three venture capital funds raised $2.4 billion during the quarter versus 57 funds and $6.7 billion in the same period a year ago. The pace of fundraising will continue to be slow as existing funds still have significant amounts of dry powder and investors are restrained by the denominator effect on their private equity allocations. We also expect that much of the capital raised during the remainder of 2009 will be from distressed and turnaround funds.

Private equity investing was also down during the quarter due to the lack of credit and general partners’ concern over declining EBITDA of target companies. According to Reuters, buyout activity during the 1st quarter of 2009 was down 80% from the same quarter a year ago. Final data on venture capital investments during the quarter is not yet available. However, we expect a slowdown from the $3.4 billion that was invested during the 4th quarter of 2008. Venture capital firms are responding to the economic downturn by being more selective about new and follow-on investments.

Realizations were few during the 1st quarter. After a long stretch of distributions from buyout funds resulting from recapitalizations, trade sales, and IPOs, distributions were practically nowhere to be found. The same was true for venture capital funds. In the 1st quarter of 2009, there were no IPOs of venture capital backed companies. Exits by trade sales were also stunted during the quarter as only 68 venture capital companies were merged or acquired in during the 1st quarter, down from a 104 companies in the 1st quarter of 2008. We expect distributions to remain at a trickle level throughout 2009 with no recovery until there is a marked improvement in public equity valuations, flows of capital into equity mutual funds, and credit availability.

Private equity valuations and returns experienced one of their worst quarters on record during the 4th quarter of 2008. Public data on buyout fund returns for the 4th quarter showed returns negative returns of 20-30%. Private equity valuations correlate with EBITDA and

EBITDA multiples of public companies. Both of these metrics declined in the 4th quarter of 2008 and continued to decline in the 1st quarter of 2009. Thus, we expect returns to be negative during the 1st quarter. If the economy and public market stabilize during the next two quarters, we would expect private valuations to bottom in the 3rd quarter. However, private equity returns in coming quarters may be worse than public markets due to the asymmetric outcomes (e.g. bankruptcy) of leveraged buyouts. Moody's expects default rates on corporate credit to accelerate during 2009 and to peak at 15% in early 2010. We expect a similar acceleration in the number of bankruptcies of private equity sponsored deals particularly of highly leveraged and high priced deals. We further caution that bankruptcies of private equity sponsored deals may continue longer than the overall corporate trend as deals done with few or no covenants may postpone bankruptcy until they require a refinancing.

The news is bad, especially for vintage year 2005-2007 buyout funds. Funds of those vintage years who will weather the storm are those that have significant amounts of dry powder, did not use excessive leverage, had early realizations, and/or have companies and general partners with the ability to reduce costs and reduce leverage in this difficult environment.

Beyond the bad news of legacy deals, we believe that the current environment is creating an attractive environment for new investments. Fewer dollars, fewer private equity funds, and fewer acquisitive trade buyers mean less competition for new investments. Value-oriented strategies like distressed investing and strategies that do not require debt are particularly attractive today as number of investment opportunities are increasing and are likely to reach historic levels.

Real Asset Market Overview

Real estate, energy, natural resources, and infrastructure investments are experiencing many of the negative trends experienced by private equity. A downturn in public market valuations, a shortage of real estate debt, project finance, and general corporate credit have negatively impacted the real asset sector. Real estate and energy investments will also experience a lag in their fundamentals relative to the overall economy. Real estate vacancies generally lag the overall economy and are now expected to peak in 2010. Energy investments, which correlate with capital expenditures of the large energy companies, will also likely lag the economy as long term projects are completed and new projects are put off or cancelled.

Cliffwater Research

To obtain copies of Cliffwater research papers, including those listed below, please visit our website: www.cliffwater.com.

Overview of Infrastructure Investing	Jan 2009
Impact of the Credit Crisis on Wealth	Oct 2008
Navigating the Credit Crisis: Where Do Investors Go From Here?	Sept 2008

Update on Cliffwater

Cliffwater's New York office has moved and our contact information has changed to the following:

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Recent hires include Kevin Lenaghan and Yane Hsu. Kevin joined our hedge fund research group in New York as a Senior Associate. Prior to joining Cliffwater, Kevin was a Director at FTI Consulting, where he performed various financial and econometric analyses for clients including hedge funds, investment banks and law firms. Yane joins our real asset research group in Los Angeles as a Director. Prior to joining Cliffwater Yane was a Director of Accounts Management at BlackRock's Financial Institutions Group. Previous experience includes managing general account assets at MetLife Investments.

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