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Hedge Fund Market Overview

Equity markets rallied feverishly in March, with the S&P 500 Index up 6.0% and the MSCI EAFE Index up 6.3%. In contrast to earlier in the year, investors appeared only minimally concerned that a sovereign debt crisis could emerge and stall economic progress. An overview of performance across markets is shown in Exhibit 1.

Exhibit 1: 2010 Market Performance

Index	March	YTD 2010	FYTD*	Calendar 2009	Calendar 2008
Equity					
Dow Jones 5000	6.2%	6.2%	30.7%	28.6%	-37.2%
S&P 500	6.0%	5.4%	29.2%	26.5%	-37.0%
Russell 2000	8.1%	8.9%	34.9%	27.2%	-33.8%
MSCI EAFE	6.3%	0.9%	23.3%	32.5%	-43.1%
MSCI Emerging Mkts	8.1%	2.4%	34.5%	78.3%	-53.5%
DJ REIT	10.2%	9.8%	62.4%	28.5%	-39.2%
S&P 500 Financials	8.9%	11.2%	34.9%	17.2%	-56.6%
Fixed Income					
Barclays Aggregate	-0.1%	1.8%	5.8%	5.9%	5.2%
Barclays Treasuries	-0.9%	1.1%	1.9%	-3.6%	20.1%
Barclays TIPS	0.1%	0.6%	5.5%	11.4%	-2.4%
Barclays High Yield	3.1%	4.6%	26.9%	58.2%	-26.2%
Barclays Bank Loan	2.4%	4.8%	19.8%	53.8%	-29.5%
AAA ABX (Subprime)	7.3%	10.5%	52.3%	-7.8%	-43.2%
Barclays Municipals	-0.2%	1.3%	7.4%	12.9%	-2.5%
3 mo.Libor	0.0%	0.1%	0.2%	0.7%	3.1%
Alternative					
DJ UBS Commodity	2.4%	-5.0%	7.9%	18.9%	-35.7%
Hedge Funds					
HFRI Fund of Funds**	1.7%	1.5%	7.6%	11.5%	-21.4%
HFRI Fund Weighted**	2.7%	2.6%	12.3%	20.0%	-19.0%
CS/Tremont	2.2%	3.1%	14.1%	18.6%	-19.1%

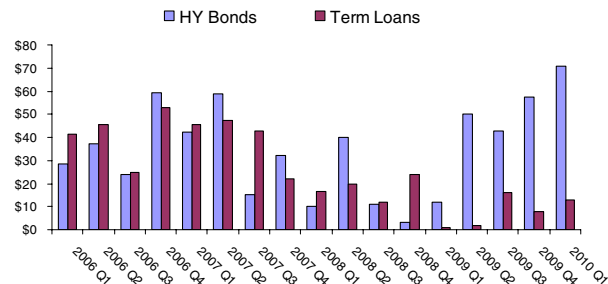
* Fiscal YTD from June 30, 2009

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The improving economic outlook has been a large contributor to the market rally, but the technical factors have also been prominent. With Treasury yields

remaining low, the demand for risky assets has been brisk. One example of this is the strength of the new issue high yield market. Last July we commented on the dramatic rebound in high yield issuance, and how it has helped alleviate debt management issues for many companies, and reinforce the rally in credit. Exhibit 2 shows how the trend has continued, with the dollar amount of high yield issuance in the first quarter of 2010 reaching a record high.

Exhibit 2: High Yield and Leverage Loan Issuance (in \$billions)



Strong demand has more than absorbed this new supply, with spreads continuing to come down, in turn making it easier for companies to issue new debt. The net new supply is considerably less than the gross supply, as many companies have been using the proceeds from high yield bond issuance to repay bank debt with nearer-term maturities. Looking backward, the impact of this phenomenon on credit-focused hedge funds has been to boost returns. Looking forward, the new issuance is extending the opportunity set for distressed credit funds, as many companies have postponed their financial troubles to a later date. Thus, while default rates are lower than had been predicted last year, they will likely stay above average for a longer period of time.

Hedge funds enjoyed a very good March after a modest start to the year. The HFRI Fund Weighted Index and HFRI Fund of Funds Index were up 2.7% and 1.7%, respectively, while the CS/Tremont Index was up 2.2%. Exhibit 3 shows the performance of different hedge fund strategies, as defined by HFRI and CS/Tremont.

Exhibit 3: Hedge Fund Performance by Major Strategy Category

Strategy Indexes	March	YTD 2010	FYTD*	Calendar 2009	Calendar 2008
Arbitrage/Relative Value					
HFRI**	1.5%	3.6%	15.6%	25.8%	-18.0%
CS/Tremont-Convert	2.1%	3.5%	23.1%	47.3%	-31.6%
CS/Tremont-Fixed Income	1.4%	3.6%	18.0%	27.4%	-28.8%
Event Driven					
HFRI	3.2%	4.7%	19.0%	25.0%	-21.8%
CS/Tremont	2.9%	4.8%	18.3%	20.4%	-17.7%
Equity Long/Short					
HFRI	3.4%	3.0%	14.4%	24.6%	-26.7%
CS/Tremont	3.0%	2.8%	13.5%	19.5%	-19.8%
Global Macro/CTA					
HFRI	2.0%	0.2%	3.2%	4.3%	4.8%
CS/Tremont-Macro	0.4%	2.6%	10.7%	11.6%	-4.6%
CS/Tremont-Managed Future	4.3%	2.1%	3.0%	-6.6%	18.3%
Multi-Strategy					
HFRI	2.1%	5.1%	16.8%	24.6%	-20.3%
CS/Tremont	1.4%	2.6%	13.9%	24.6%	-23.6%

* Fiscal YTD from June 30, 2009

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All strategies were positive for the month. Not surprisingly, equity long/short funds were among the best performers, up over 3% amidst gains of over 6% in global developed equity markets, and 8% in emerging market equities. Credit funds also posted significant gains, with high yield bonds and loans up 3.1% and 2.4%, respectively. The strong correlation between market returns and hedge fund returns which has persisted for many months suggests that hedge funds may not be well positioned to absorb a sudden and sharp downturn in markets. Indeed, Cliffwater believes that, as represented by the indices, the hedge fund industry, and in particular equity long/short funds, are highly exposed to a market retraction. However, institutional absolute return portfolios, which generally have lower betas than the indices, should fare relatively better should such a situation occur.

Private Equity Market Overview

Private equity continued to show signs of improvement in 2010. Private equity investment activity is stabilizing, leverage multiples are increasing as banks relax restrictions, and exit activity has increased, particularly for venture-backed companies. Fundraising, on the other hand, remains slow, as limited partners continue to make smaller commitments to fewer groups. Market participants are hopeful that planned liquidity events over the remainder of the year will help stimulate fundraising activity.

Private equity fundraising continued to be sluggish in the first quarter of 2010. According to Thomson Venture Economics, 155 funds raised \$22 billion, representing a decline of 48% compared to the first quarter of 2009 and 15% compared to the fourth quarter of 2009. Both U.S. and Europe fundraising

incurred declines compared to 2009. In the U.S., 79 funds raised \$13.8 billion, a decline of 51% from the same period last year and 17% compared to the fourth quarter of 2009. In Europe, 22 funds raised \$1.9 billion, a decline of 79% from the same period last year and 36% compared to the fourth quarter of 2009. Notably, 45 Asia-focused funds raised \$5.2 billion in the first quarter, an increase of 27% compared to the same quarter in 2009 and a 48% increase from the fourth quarter of 2009. According to Asia Private Equity Review, China-focused funds accounted for 84% of capital, of which 66% were RMB funds.

Global private equity disbursements totaled \$37 billion in the first quarter of 2010, relatively flat compared to the fourth quarter of 2009, but significantly more than the \$13 billion deployed in the first quarter of 2009. The 10% decline in investment activity during the first quarter was primarily driven by a drop in venture capital investment, which decreased from \$23 billion in the fourth quarter to \$14 billion in the first quarter. Buyout investment activity remained stable during the quarter with \$24 billion deployed in both the first quarter of 2010 and the fourth quarter of 2009. Other private equity deal activity, which includes distressed debt and energy, helped to offset the decline in venture investment by deploying \$11 billion in the first quarter of 2010 compared to \$6 billion in the fourth quarter of 2009 (Source: Thomson Venture Economics). During the quarter, there was an increase in secondary buyouts. Notable deals include KKR's acquisition of Pets at Home for £955 million from Bridgepoint Capital and Triton's purchase of Ambea from 3i and GIC for €850 million (Source: Preqin).

With the credit markets continuing to open up, both purchase multiples and leverage multiples increased for leveraged buyout transactions in 2010. In the U.S., the leverage multiple of buyout transactions increased to 4.4 times EBITDA from 3.7 times EBITDA in 2009. Purchase price multiples also increased to 8.8 times EBITDA from 7.7 times EBITDA in 2009. In Europe, leverage multiples increased modestly to 4.2 times EBITDA from 4.0 times EBITDA in 2009. Similarly, purchase price multiples increased slightly to 9.3 times EBITDA from 8.9 times in 2009. Despite the increase in leverage multiples in 2010, debt financing as a percent of total deal value remains conservative compared to the high level achieved from 2005 to 2007. In the U.S., the average equity contribution in the first quarter was 51%, the same as in 2009, but still markedly higher than any of the preceding years. In Europe, the average equity contribution declined by 1% to 52% compared to 2009 (Source: Standard & Poor's LCD).

Venture capital exit activity showed signs of life in the

first quarter with the highest number of M&A exits since records began in 1975 (Source: NVCA). During the quarter, 113 M&A transactions were reported compared to 73 in the fourth quarter (Source: Thomson Venture Economics). The largest deals include Johnson & Johnson's purchase of Acclarent (\$785 million), whose backers include New Enterprise Associates and Versant Ventures, and the sale of NuVox (\$643 million), whose backers include Columbia Capital and M/C Venture Partners (Source: Dow Jones Private Equity Analyst). Additionally, venture-backed IPOs increased with nine venture-backed IPOs valued at \$936 million, compared to four valued at \$349 million in the fourth quarter of 2009. Technology and biotechnology companies represented \$698 million of total value for the quarter. Buyout-backed exits were primarily driven by M&A transactions. During the first quarter, U.S. buyout M&A activity remained flat at 22 deals (Source: Thomson Venture Economics). The largest reported U.S. deal was Oak Hill's sale of Duane Reade to Walgreen Company for \$1.1 billion. However, outside the U.S., there were several large exits, including Apax Partner's \$3.2 billion sale of Tommy Hilfiger to Phillips-Van Heusen and the \$1.2 billion public offering of Kabel Deutschland, a Providence Equity Partners company.

Performance in the public and private equity markets finished the year strong. Private equity funds (buyouts, energy, growth equity and mezzanine) generated a return of 4.7% during the fourth quarter, bringing the full year 2009 return to 10.4%. Venture capital continued its upward trend generating a return of 3.1% during the quarter, bringing the full year 2009 return to 4.3%. (Source: Thomson Venture Economics). Similarly, the Dow Jones Wilshire 5000 was up 6.0% during the quarter and 29.4% over the year.

Cliffwater believes that growth equity and select venture capital opportunities are compelling. These strategies do not rely on leverage and are well positioned to invest in growing companies that are unable to access the capital markets. Similarly, operationally focused buyouts and distressed debt funds have a pipeline of overleveraged or mismanaged companies that are trading at depressed valuations. Additionally there are opportunities to invest in emerging markets, particularly in Asia, where companies have rebounded more quickly from the global economic crisis.

Real Estate Market Overview

The US economy is still in a fragile recovery and will continue to face significant headwinds, including high unemployment, tight lending standards and a housing sector struggling to recover. Sustained growth will likely not be seen until the financial sector, companies and households have meaningfully

repaired their respective balance sheets. The commercial real estate market will likely lag the broader economy by 6 to 9 months. The unprecedented amount of troubled real estate debt maturing over the next several years will also put additional pressure on the already fragile capital markets.

While supply is not a near to mid-term risk, vacancy rates are at cyclical highs. Effective rents also remain between 20% and 35% off peak rates. Net operating income growth is expected to remain weak in 2010 for most property sectors due to the roll-down of leases, in particular those with above-market rents. For the first quarter of 2010, the National Council of Real Estate Investment Fiduciaries (NCREIF) Property Index produced a total return of 0.76% (1.66% from net income, -0.90% from capital losses). The index's performance has been steadily improving over the past several quarters and is in the positive territory for the first time since second quarter 2008. The primary driver of the index's lackluster performance continues to be the unprecedented pace of write-downs. Within property types, the Retail sector led with a 1.13% return. The Office, Industrial and Apartment sectors returned 0.86%, 0.64% and 0.42%, respectively, while the Hotel sector trailed with a return of -0.42%.

The most notable changes in commercial real estate continue to occur in the debt market. The secured financing market remains significantly constrained as it is dominated by outstanding loans that can not be refinanced at their current balances. Financial institutions continue to favor loan extensions over foreclosures; putting pressure on the already limited transaction market. However, there has been significant improvement in the availability of mortgages and pricing as lenders are re-entering the market. Life insurers were more active in originating new loans in the first quarter; primarily targeting stabilized assets while maintaining tighter underwriting standards such as lower loan-to-value (LTV) ratios. For example, on a stabilized asset, a borrower can obtain debt with 65% to 70% LTV at an interest rate between 6.25% and 7%. The commercial mortgage-backed securities (CMBS) market, which was effectively closed for the past 18 months, witnessed three single-issuer offerings totaling \$1.4 billion in fourth quarter 2009. It is expected that several multi-issuer CMBS offerings will be marketed in 2010. We continue to favor managers who are opportunistically allocating capital to debt investments, in particular loan-to-own and non- and sub-performing strategies.

Transaction volume, particularly in distressed assets, remained muted during the first quarter. For the

most part, high quality stabilized core properties, predominately located in and around Washington, D.C., have come to market and been countered by a large number of bids; pushing pricing upward. The FDIC has been selling pools of commercial mortgages to opportunity funds and special servicers of debt have also been selling selected portfolios of loans and foreclosed properties. We believe that experienced managers who are able to underwrite and acquire high quality properties at significant discounts to replacement cost, using moderate or no leverage, will benefit in the coming year. During the first quarter of 2010, 67 properties were sold for \$1.6 billion with an average sales price of \$24 million per transaction. This compares to the 102 properties sold for \$2.2 billion with an average sales price of \$22 million per transaction in the fourth quarter of 2009. The NCREIF current value capitalization rates for the four major property types for the first quarter were: Apartment (5.8%), Retail (6.9%), Industrial (6.5%) and Office (7.3%). The average NCREIF transaction cap rate was 8.0% during the quarter, a decrease of 38 basis points from the prior quarter.

After gaining 28.0% for the full year 2009, shares within the U.S. REIT market continued to rally in the first quarter, gaining 10.0%. Movements in REIT share prices were primarily impacted by improvements in the outlook for the economy and in the capital markets. During the quarter, more than \$6 billion of unsecured corporate debt was issued at attractive financing rates. \$2.5 billion of equity was also issued during the quarter, primarily through follow-on equity issuance from existing REITs and also from three successful IPOs. Due to the dearth of distressed sales in the private real estate markets, it is difficult to assess net asset value. However, there are estimates that the REIT sector is trading at an approximate 20 to 30% premium to downward adjusted asset values. We favor a measured pace of dollar cost averaging when considering new allocations into the REIT sector.

Similar to the U.S., economic prospects have improved across Europe while labor markets remain weak. The central banks also kept rates low in order to minimize the effects of the Greece sovereign credit concerns. Negative net absorption and declining rental rates continued to plague the office markets during the quarter while supply remained modest. The U.K. office market was the exception as leasing and rental rates improved and development activity is beginning to emerge. European retail sales growth was negative during the quarter, and the supply of new retail space is expected to put downward pressure on occupancy and rental rates in the coming quarters.

Overall economic conditions continued to improve

across Asia during the first quarter, helped by improving employment and consumer confidence. Office vacancy rates rose in Japan driven by new supply and weaker tenant demand while leasing activity in Hong Kong and Singapore increased due to corporate expansion. Rental rates on prime grade A assets have also edged higher due to improved tenant demand. The retail sector remained strong in most Asian markets and transaction volume in the residential sector continued to increase in the quarter.

Real Asset Market Overview

Despite the lack of inflation in the current economy, mitigating its effects is still a hot topic among institutional investors. Investors have a choice between public and private implementation strategies. Structuring a new private real asset portfolio will take time and investors may end up paying higher prices for private real assets in an inflationary environment. Public assets on the other hand can be quickly implemented into a real asset portfolio though are more highly correlated to the equity markets. A simple strategy of investing in a portfolio of liquid real assets up front will allow an investor to benefit from the inflation sensitivity of the public real assets while allowing the investor to allocate to a portfolio of private real assets over a reasonable amount of time.

It appears that the new reality of infrastructure fund raising is starting to be accepted by GPs. Several large infrastructure funds closed well short of their original fund raising targets. However, the fact that these large funds were able to close on the amounts they did is testament to the viability of the asset class. Large state pension plans such as CalPERS and CalSTRS are making and implementing plans for significant investment in infrastructure. Notwithstanding, there still remains a significant amount of un-called commitments in infrastructure funds around the globe (\$60 billion). In the U.S., state and local governments are further opening the doors to Private Public Partnerships (PPPs). PPPs have been used in the U.S. for many years, though are now being utilized for larger projects and assets. As government budgets continue to fall deeper into the red, government leaders are being forced to look for alternative means to raising capital. The PPP structure has been successfully used in Australia, the United Kingdom, Canada, and many other developed and developing nations. Under these structures, a private party will be responsible for constructing and managing an asset over a pre-negotiated period of time (up to 100 years) and will be compensated by the government through concession payments. In the U.S., several states are getting a lot of press with their proposed deals,

legislation, and willingness to use the structure in as short a time frame as possible. While all this is positive and should lead to more available transactions for infrastructure funds to participate in, the process is still new and will take time to firmly gain traction in the U.S. In the meantime, infrastructure funds continue to focus on assets already in private hands including water utilities, waste water treatment plants, and energy assets.

Timberland prices continued their slow decline reflecting a lingering depressed housing market. Paper markets have remained stable, and in some areas shortages of pulp have emerged. However, these shortages are mostly the result of mill closures and bad weather, not macro supply and demand fundamentals. Like infrastructure GPs, timberland fund GPs, also known as TIMOs, have been settling into a new reality of fund raising. Some funds have successfully closed new offerings, while others continue to hope to close funds. Some of these funds have been open for more than two years. It is unlikely that the U.S. housing market will return to its heights of the mid 2000's, though most agree that there is a shortage of housing that may provide a stable source of demand for timber. Until a stable market for new housing re-emerges in the U.S., the timber market will remain weak and is unlikely to support current pricing for timberland acreage. There is a lot of speculation about potential alternate uses of timber such as biomass. However, it is unlikely that biomass and other energy related uses will create enough demand to support the supply available in the U.S. Despite the poor fundamentals in the U.S., demand for timber in Asian markets has remained strong. China, India, and Japan are forced to import much of their timber. Australia, New Zealand, South America, and to a lesser extent the Pacific Northwest of the U.S. are the sources for this demand. In response, most TIMOs are now offering Non-U.S. funds to take advantage of the better timberland economics in these countries.

MLPs investing in energy assets, specifically midstream energy assets, have continued to produce strong performance. For the three month and one year periods ending March 31, 2010, MLPs returned 6.4% and 58.8% respectively. Despite the meteoric performance of MLPs over the last 12 months, yield spreads between MLPs and treasuries remain at their 10 year average of 330 basis points. The high yielding publicly traded securities have been active in the acquisition of accretive energy assets which in turn have continued to grow distributions to unit holders. MLPs focusing on the midstream space have been successful at raising both debt and equity from the capital markets. The low cost of capital built into the MLP structure (due to the tax pass through to unit holders) has allowed them to out bid on assets in

the midstream space. Many private energy funds searching for assets in the midstream space have noted their inability to compete with MLPs, although infrastructure funds with their lower target returns are providing some competition to MLPs.

Commodity futures posted a +20.53% one year and -5.03% quarterly total return ending March 2010 as measured by the Dow Jones UBS Commodity Total Return Index. During the quarter, agriculture commodities and softs were severely negative, while industrial metals and livestock were positive, and energy and precious metals were basically flat. Many commodity futures curves remain in contango where the cost of a future delivery of a commodity is lower than the present delivery price, though on average, the curves are beginning to move back to a normal backwardated position and is unchanged from the prior quarter. The outlook for commodity demand has been tempered as global economies continue to move slowly toward recovery. Monetary policies and the strengthening U.S. dollar haven't helped commodity prices either. The Chinese demand for commodities that increased prices last year has stabilized and cannot be expected to continue to be the sole factor in commodity demand.

The Barclays Capital U.S. TIPS Index returned +0.56% for the quarter, underperforming Treasuries (+1.12%). During the first quarter, break-even inflation rates rose in the front part of the curve (+81 basis points in the 1 year) but fell in the 5-30 year portion of the curve. Break-even rates are now 2.16% at the five year maturity and 2.26% at the ten year maturity. There has been increased investor interest in TIPS, as evidenced by publicly announced TIPS searches and funded mandates. The Treasury reintroduced the 30-year tenor of TIP in the first quarter, and we expect TIPS issuance to increase in 2010, but at a slower pace than the increase of nominal Treasuries' issuance.

Cliffwater Research

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Alternative Investments: Are They Worth the Price?	April 2010
2010 Asset Allocation Report: The Re-Engagement of Risk	Jan 2010
Asset Allocation Update	Oct 2009
Update on TALF and PPIP Investment Opportunities	Aug 2009
Private Equity Secondary Market	Mar 2009

Update on Cliffwater

Elina Ploskin joined us in January as an Analyst in our New York office and as a member of our hedge fund research team. Prior to joining Cliffwater in 2010, Elina was an Investment Banking Analyst at Fox-Pitt Kelton Cochran Caronia Waller.

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