

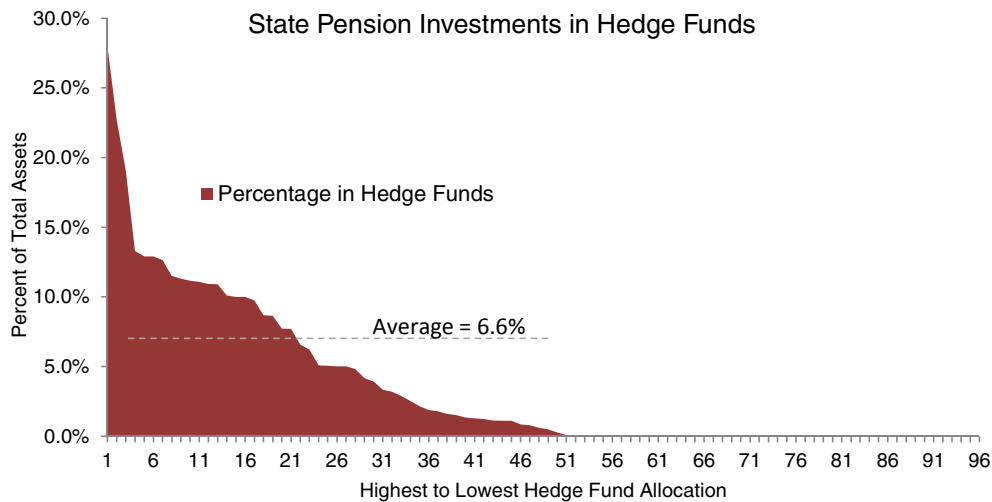
Survey of State Pension Fund Investments in Hedge Funds

January 24, 2011

U.S. public pension plans are allocating significant assets to hedge funds, many for the first time. This survey measures hedge fund allocations for 96 state-wide pension systems at fiscal year-end 2010.<sup>1</sup> Data comes from Comprehensive Annual Financial Reports (CAFRs) published by the pension systems and, in some instances, supplemental investment reports found on system websites.

Public pension systems generally make their hedge fund investments through a separate “absolute return” asset class. However, in a few instances hedge fund investments are part of more traditional stock and bond asset classes, or as part of a portable alpha pool. We include all hedge fund assets in our survey, whether they are designated as a separate asset class or included in other asset classes.

In the exhibit below we show hedge fund allocations for all 96 systems surveyed, ranked from left to right by the size of their percentage allocation from highest to lowest. This is followed by a summary of our findings, some of which reference our earlier 2006 survey for comparison.



Findings:

1. The 96 state pension systems collectively invest \$63 billion in hedge funds at fiscal end 2010, double the \$28 billion invested in hedge funds in fiscal 2006.
2. Over one-half – 52 out of 96 – pension systems invest in hedge funds, up from 21 systems in 2006.

<sup>1</sup> June 30, 2010 is the most frequent fiscal year end.

*The views expressed herein are the views of Cliffwater only through the date of this report and are subject to change based on market or other conditions. All information has been obtained from sources believed to be reliable, but its accuracy is not guaranteed. This report is being distributed for informational purposes only and should not be considered investment advice. The information we provide does not take into account any investor's particular investment objectives, strategies, tax status or investment horizon. Past performance does not guarantee future performance.*

3. Including the 52 pension systems that invest in hedge funds, the average hedge fund allocation equals 6.6% of total assets and the median is 5.0% of total assets.
4. Hedge fund assets equal 3.0% of all total assets (\$2.1 trillion) when all 96 pension systems are included.
5. The average policy allocation to hedge funds is 7.3% of total assets and the median policy allocation is 6.0% of total assets. The difference between actual and policy allocations suggests an additional \$20 billion will likely be invested in hedge funds by state pension systems.
6. Pension systems with hedge fund allocations at 10% or higher total 16, up from 4 in fiscal 2006.
7. Five pension systems have hedge fund policy allocations equal to 15% of total assets.
8. More state pension systems now invest directly in hedge funds than through fund-of-funds, a turnaround from 2006 when the majority of systems invested in hedge funds through fund-of-funds. Of the 49 state systems where we can determine the asset split between direct hedge funds and fund-of-funds:
  - a. 24 systems (49%) only invest directly in hedge funds,
  - b. 16 systems (33%) only invest through hedge fund-of-funds,
  - c. 9 systems (18%) invest both directly in hedge funds and through fund-of-funds,
  - d. On an asset weighted basis, 64% of hedge fund investments are invested directly and 36% are invested through fund-of-funds.
9. The change from fund-of-funds to direct hedge fund investing has come about from new direct allocations. Only one pension system (of the 11 investing only in fund-of-funds in 2006) subsequently fully switched from fund-of-funds to direct investments.
10. The 3 funds investing in both fund-of-funds and direct hedge fund investments in 2006 greatly increased their direct percentages over the last four years. The seven systems investing only directly in hedge funds in 2006 continue to do so.

Cliffwater expects that persistent low bond yields and modest expected equity returns<sup>2</sup> will likely drive pension systems to further increase their allocations to hedge funds. Increased institutional familiarity with hedge funds should cause most new hedge fund investments to be direct rather than through fund-of-funds.

Stephen L. Nesbitt  
Cliffwater LLC  
310-448-5020  
snesbitt@cliffwater.com

*Cliffwater is a service mark of Cliffwater LLC.*

---

<sup>2</sup> Most long term equity return forecasts range between 7.50% and 7.75%.