

BHA Quarterly Research Report | Q1, 2008

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BHA Alternative Investor Research | Overview

Since its inception in 2006, Brighton House Associates (BHA) has become the definitive leader in alternative investor research. BHA works with a diverse group of alternative investment managers and acts as an unbiased research liaison between these managers and its global network of accredited investors. This work includes collecting and analyzing the most comprehensive data available on global investor's alternative investment mandates and searches. The quarterly report highlights the insights from this research that are most pertinent to industry professionals.

Research & Process

Each week BHA analysts speak with hundreds of investors from across the globe who are actively making investments in Hedge Funds, Fund of Funds, Real Estate, Venture Capital, Private Equity, and Structured Products. These analysts profile 17 major categories of investors ranging from small foundations all the way to major global financial institutions. In these profiles they collect detailed information from investors about their current preferences regarding alternative strategies, manager requirements, investment processes, due diligence, allocations, and current areas of exposure.

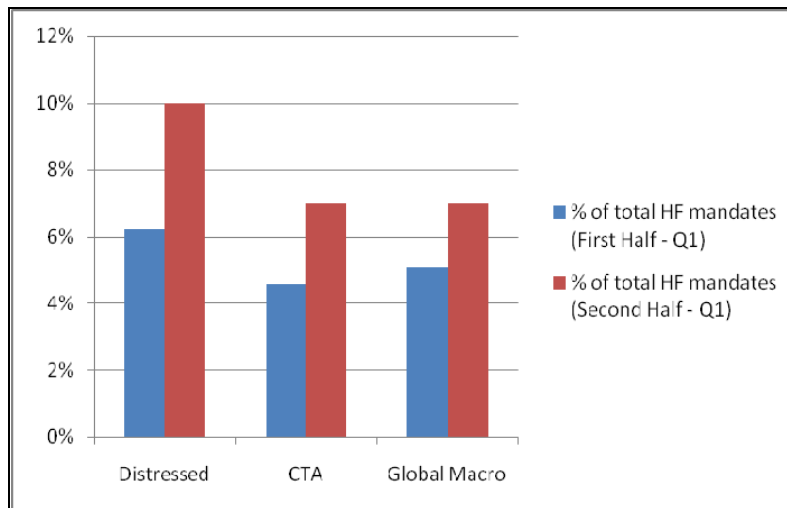
The team then conducts analysis of the data to explore trends and developments within the alternative investment space. For the purposes of the study, each indication of interest in an alternative investment that has its own criteria and qualifiers is considered a unique mandate. This results in more total mandates than total investors, but better allows us to study the demand for certain investment vehicles and strategies relative to others. The following analysis uses this system to account for our conclusions about investor interests.

Strategy Analysis | Q1 2008

The first quarter of 2008 was a volatile period for financial institutions and investors alike. While the turbulence in the market forced some investors to seek the safety of more diversified multi-strategy funds, others sought funds whose strategies could take advantage of the volatility in the market to achieve higher than average returns.

During each week of the first quarter, analysts recorded the total number of investor mandates received and then broke the number down by the individual strategies represented. They then converted the number of mandates by strategy into percentages of the total number of mandates received that week. This data was then used to compare the average strategy search percentages of the first half of the quarter, to that of the second half in order to determine shifts in the demand of investors for specific strategies.

Based on this data, the most significant changes in interest were increases in demand for distressed debt, CTA strategies, and global macro funds. All managers who are uniquely set to capitalize on faltering or highly volatile markets were of increasing interest to investors of all types during the quarter. Accordingly, our research suggests these managers in distressed equity and debt, CTAs, and global macro strategies could reap fund raising benefits in this new environment.



Distressed Debt

During the 1st half of Q1, 6% of hedge fund investor mandates mentioned distressed strategies. That percentage grew to 10% during the second half of the quarter. Recent economic conditions including widening credit spreads and the drying up of the bank loan market seem to have helped shift investors' interests towards these distressed opportunities.

In a recent poll conducted by Debtwire, 43% of institutional investors expect the economy to fall into a recession in 2008. These receding economic conditions create lucrative opportunities in the distressed debt markets, as distressed fund managers have historically been able to post their best returns during weaker periods in the markets. In tandem, our data suggests that investors have begun to increase their research and due diligence on any and all distressed opportunities.

On March 15, 2008 JP Morgan made an offer to purchase failed investment bank Bear Stearns for \$2.00 per share. The week following this event, analysts at Brighton House Associates observed a remarkable spike in interest in distressed funds. During the week of March 17, 2008 25 investors mentioned an interest in hearing from and potentially allocating to distressed hedge fund managers, up from 16 the week before.

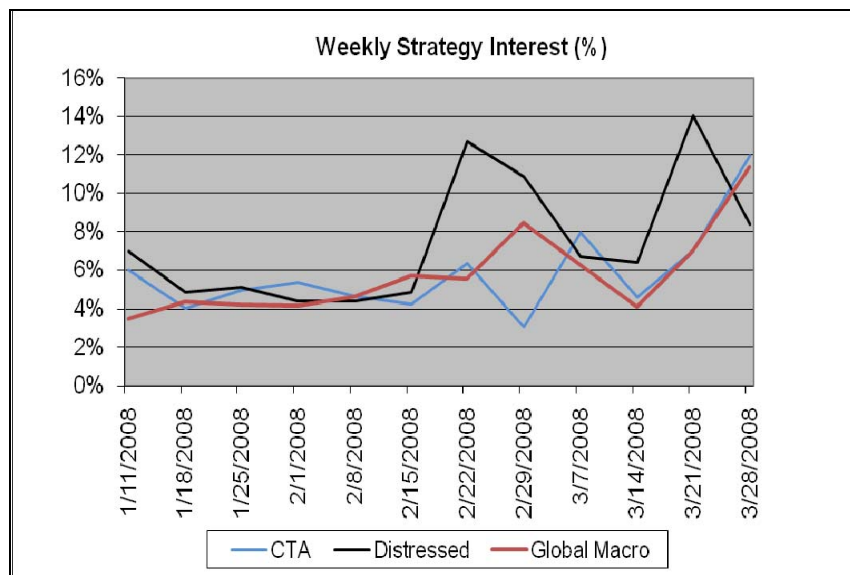
While directly purchasing this debt is too risky and complicated for most investors, many have said that managers who specialize in distressed investing can create value for them in through their focused experience in distressed situations.

Commodity Trading Advisors

CTA's are another area that hedge fund investors have taken a strong interest in throughout Q1. In the first half of Q1, CTAs represented 5% of investor mandates, and that number grew to 7% during the second half of the quarter. There appears to be many factors that are contributing to this increased interest in CTA's. The most obvious reason is the major price increases in oil, gold and wheat. As more and more investors continue to realize that commodities are an important asset class providing investors with returns uncorrelated to equities, this sentiment feeds back into the secular bull market, which in turn supports prices. Many investors also communicate that they are finding that CTA's are a helpful way to reduce overall portfolio volatility.

Although CTA's can be highly volatile, investors have communicated that they feel they can control risk more effectively than an indexed commodities approach. There has also been a concurrent increase in interest in Fund of CTA approaches. Many investors interested in CTA's are looking for traders employing a long/short approach, with good liquidity terms. While some have said they want CTA's who trend follow, many are now starting to specify the opposite. As commodities prices continue to rise, managers who are prepared to profit during both rising and falling markets stand to benefit.

The majority of investors expressing interest in CTA's have been funds of hedge funds, foreign institutions and private banks. The data also shows that these investors continue to have interest in both hard and soft commodities, despite media attention being devoted primarily towards the soft commodities in recent months.



Global Macro

BHA also observed an increased demand for global macro strategies. During the first half of Q1, global macro represented 4% of hedge fund mandates. The second half saw that representation increase to 7% of mandates received.

This increase may be tied to a number of factors; the foremost of which investors mentioned was the remarkable increase in currency volatility throughout the quarter. Rising concerns about global imbalances, national debt levels, and central banking policy have helped fuel this sentiment. Investor worries about real interest rates looking increasingly negative have also returned attention to the latent prisoner's dilemma in Asia and the Middle East relating to dollar denominated debt. Combined with the credit crisis and the breakdown of other funding sources like the Yen carry-trade, investors are increasingly seeking managers who can navigate this turbulent macro environment profitably.

Many of the small to midsized endowments and family offices that BHA analysts spoke with expressed trepidation about the current economic situation. Several of these smaller investors mentioned they are specifically looking for global macro managers because they feel an established manager with a proven track record in this strategy should be able to successfully navigate the upcoming year and provide consistent returns for a conservative portfolio that would historically suffer during this part of the economic cycle. This information also illustrates the unique ability of Brighton House to gain insight and

access to the interests and philosophies of smaller and lesser known asset pools as well as the larger institutional investors.

Vehicle Analysis / Q1 2008

Brighton House's quarterly investor data also offers uncommon insights into investor demand for various alternative vehicles and structures. In this, the inaugural report, focus has been applied to information we have received about current portfolio structuring norms. Future reports will offer more insight into relative change to these conditions.

Hedge Funds

The hedge fund industry has built its reputation on providing positive absolute performance in all types of market and economic conditions. This feature, combined with unique correlations or lack thereof, are helping managers increasingly appeal to institutional investors. While large inflows into hedge funds have dominated headlines for a number of years, BHA's data suggests that in the recent quarter, hedge funds lagged behind both Private Equity and Real Estate in terms of investor demand. While the market penetration of Private Equity and Real Estate is generally known to be wider than that of hedge funds historically, there may also be some additional factors at work in the recent quarter's results.

It has been forecast that some hedge funds may suffer record losses due to a global economy that has experienced recession-like performance throughout the first quarter. Given the economic outlook for the year, it is not necessarily a question of whether hedge funds will experience losses, but rather how many of them will and how big those losses will be.

Also, as the market becomes more volatile, managers of hedge funds have found themselves searching for ways to keep investors satisfied, and most importantly, keep them invested in their products and focused on long-term investment results. As a result, some managers are beginning to change their strategies away from the high equity correlations that worked recently. Some have even gone to the extent of altering their liquidity terms to ensure their investors will not all leave at once jeopardizing long-term returns from less-liquid holdings. These changes seem to be increasing investor uncertainty about the investment class.

The media has also reported that hedge funds have begun to see a decrease in growth of total capital inflows. February of this year saw \$8.4 billion of investor dollars move into hedge funds while in November of 2007, fund managers brought in up to 3 times that amount (Reuters 2008). Furthermore, hedge funds expenses continue to increase to support two important aspects of the industry. Funds must retain and attract the best personnel to manage and analyze for the funds, while simultaneously institutional investors are demanding better infrastructure for monitoring and accounting for fund activity. This more robust infrastructure is expensive and could potentially impact net returns as observed by previous non-institutional investors who placed less stringent demands on managers, offering them more resources and time to focus on idea generation rather than operational issues.

Though many managers themselves maintain optimistic views of the hedge fund market, investors have recently been more circumspect regarding the near-term performance of the investment class.

Private Equity and Real Estate

Private Equity and Real Estate saw stronger demand relative to hedge funds in the recent quarter. While this result is likely being impacted by the historical tendency of major investors to have larger

allocations to these classes, it also communicates some information about the alternatives market when combined with the analyst's qualitative observations

Market conditions have created a "perfect storm" for the Real Estate sector. As the credit situation continues to negatively impact the major developed Real Estate markets, lower property costs have begun to offer Real Estate managers better opportunities and valuation ratios than in the past few years. Based on discussions with investors, the recent pullback in prices is being increasingly seen as a buying opportunity. Spiraling construction costs also are a contributing factor, as Real Estate managers are starting to uncover assets that can be purchased at a discount to replacement cost.

In addition, investors are becoming increasingly skeptical of traditional equity correlated strategies in their alternative portfolios. This has caused many investors to search for new uncorrelated investments. Real Estate funds have proven over time to offer this uncorrelated exposure, making them a "core" alternative for most major investors. As evidenced by contracting due diligence time-frame estimates, investors are rapidly searching for Real Estate managers who can capitalize on current opportunities.

The strong interest in Private Equity is also related to the recent market volatility. Many investors who were negatively impacted by Q1's events, who are now focused on the preservation of capital, realize they must redeploy at some stage. The outsized long-term returns achieved by some Private Equity groups are attracting both a new generation and the old generation of Private Equity investors. Many of them see the credit crunch as a circumstance that will not impact the ultimate viability of Private Equity as a central investment class.

Investors are also increasingly interested in managers who are looking to apply traditional Private Equity strategies in new markets and geographies. For those investors that experienced superior results in their old Private Equity portfolio, this dislocation hopefully presents the beginning of a new, more global, era of growth for the industry.

Finally, another factor that seems to be impacting investor behavior is the growth of the secondary market for Private Equity. As the efficiency of this market increases and Private Equity portfolios become more liquid and adjustable, some of the hesitancy of investors due to the long lock-up periods has subsided. Increased liquidity is often self-reinforcing, and will likely be a driver of continued growth for the industry. This is a trend that BHA plans to give additional attention to in the coming quarters.

Conclusions

By speaking globally with thousands of institutions, family offices, wealth advisors, and private banks, BHA is able to analyze investor trends in an original and objective fashion. The data collected is largely from investors that do not use consultants, and therefore provides a unique window into the market for alternatives with firms that conduct their own research. Through the careful analysis of these unique conversations in the first quarter of 2008, a number of interesting trends emerged.

While it appears that most investors look at alternative allocations holistically in light of their complete portfolio, many investors also look at these investment classes opportunistically attempting to employ shrewd timing. This was reaffirmed as data suggested that investor interest migrated into strategies like Global Macro, CTAs, and Distressed Debt and Equity as economic developments highlighted those opportunities.

Finally, while Private Equity and Real Estate remain strong relative to Hedge Funds, this strength also has underpinnings that go beyond the historically broader market for those vehicles. Investors are taking cues from a number of market related factors to explore allocating new capital to these strategies on a more global basis.