CALLAN INVESTMENTS INSTITUTE

# Capital Market Review

FOURTH QUARTER 2009

## Lingering Stench | U.S. ECONOMY

The Great Recession may be over, but the stench will linger for some time. GDP returned in the second half of 2009, rising 2.2% in the third quarter and 5.7% in the fourth quarter. However, private credit is still contracting and there are a lot of concerns about whether a recovery can be sustained once the stimuli fade and the inventory cycle runs its course. see page 16

## The Recession is Over! Now What? | U.S. EQUITY

The fourth quarter started unsteadily as October broke a seven-month streak of gains. However, November and December proved this was a temporary glitch. For the quarter, the **Russell 3000 Index** rose 5.90%. Growth strongly surpassed value for the quarter and year. see page 1

## Is Credit Here to Stay? | U.S. FIXED INCOME

The **Barclays Capital Aggregate** advanced 0.20% for the quarter, impacted by Treasurys (-1.30%). Investment-grade credit—aided by improving corporate profits and positive economic data—outpaced like-duration Treasurys by 2.67%. The **Barclays Corporate High Yield Index** (+6.19%) bested all sectors within the U.S. fixed income market. see page 4

## Real Estate Issues Remain; CMBS Issuances Emerge | REAL ESTATE

The **NAREIT Equity Index** (+9.39%) and **NCREIF Property Index** (-2.11%) sectors diverged for the fourth quarter. Three CMBS deals highlighted the prospects for returning sources of financing. Growth in the Americas was a substantial driver for the **FTSE EPRA/NAREIT Developed Index** (+4.40%). see page 12

## Emerging Markets Surge Past Developed | NON-U.S. EQUITY

After surging ahead in excess of 49% over the past two quarters, **MSCI EAFE** rose 2.18% for the fourth quarter. **MSCI EMF Index** (+8.58%) outpaced EAFE for the fourth consecutive quarter and **EAFE Small Cap** (-1.03%) failed to keep pace with the broader Index. see page 7

## Debt Markets Begin Weighing the Cost of Recovery | NON-U.S. FIXED INCOME

The **Citi Non-U.S. World Government Bond Index** rose 0.10% during the quarter. Most of Europe felt the impact of rating agencies' Greek debt downgrade. The repayment difficulties of Dubai World led to a brief hiccup in emerging markets debt performance. For the quarter, the **JPMorgan EMBI Global Index** gained 1.52%. see page 10

## Treading Water | PRIVATE EQUITY

In the fourth quarter, fundraising commitments totaled $19.5 billion with 75 new funds formed. Buyout-sponsored U.S. acquisitions with announced values totaled only $20.2 billion. Exit activity was $4.3 billion for the quarter. see page 14

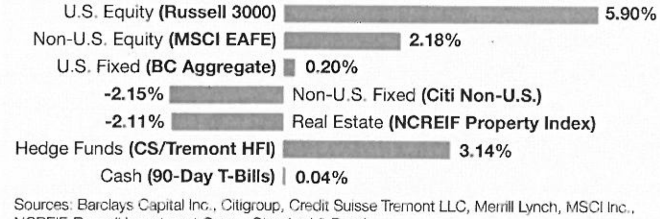
## Recovery Boosts Hedge Funds | HEDGE FUNDS

The median manager in the **Callan Hedge Fund-of-Funds Database** gained 2.40% net of fees in the fourth quarter. Despite strong support from convertibles and distressed securities, the *Callan Absolute Return FoF* manager (+1.81%) outpaced the *Callan Long-Short Equity FoF* (+2.64%). see page 15

## Ending on a Strong Note | DIVERSIFIED ACCOUNTS

After tying for last place in the third quarter, endowments/foundations (+3.59%) topped their institutional counterparts in the fourth quarter. Corporate plans (+3.31%) and public plans (+3.29%) were not far behind. Once again, Taft-Hartley plans took a back seat (+3.12%). see page 18

### Broad Market Returns




Sources: Barclays Capital Inc., Citigroup, Credit Suisse Tremont LLC, Merrill Lynch, MSCI Inc., NCREIF, Russell Investment Group, Standard & Poor's

The *Capital Market Review* is a quarterly macro-economic indicator newsletter that provides thoughtful insights on the economy and recent performance in the equity, fixed income, alternatives, international, real estate and other capital markets.

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### About the Callan Investments Institute

The Callan Investments Institute, established in 1980, is a source of continuing education for those in the institutional investment community. The Institute conducts conferences and workshops and provides published research, surveys and newsletters. The Institute strives to present the most timely and relevant research and education available so our clients and our associates stay abreast of important trends in the investments industry.

### About Callan Associates

Founded in 1973, Callan Associates Inc. is one of the largest independently owned investment consulting firms in the country. Headquartered in San Francisco, Calif., the firm provides research, education, decision support and advice to a broad array of institutional investors through five distinct lines of business: Fund Sponsor Consulting, Independent Adviser Group, Institutional Consulting Group, Callan Investments Institute and the Trust Advisory Group. Callan employs more than 170 people and maintains four regional offices located in Denver, Chicago, Atlanta and Florham Park, N.J.

U.S. EQUITY | Lauren M. Etcheverry, CFA

# THE RECESSION IS OVER! NOW WHAT?

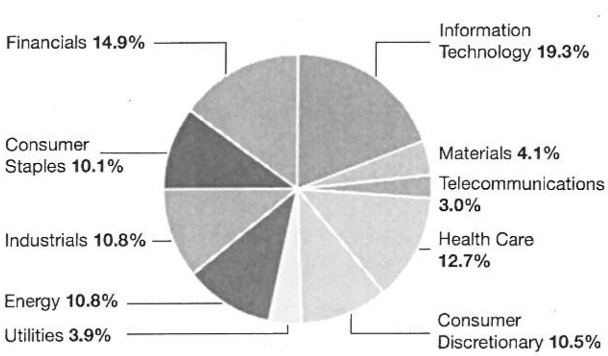
The quarter started unsteadily as October posted negative results, breaking a seven-month streak of gains. During the month, the unemployment rate hit 10.2% for the first time in 26 years. However, the downturn was not long lived as the economy showed signs of stabilizing and market data declared we are officially out of recession. GDP increased by 2.2% in the third quarter and 5.7% in the fourth, following four consecutive quarters of negative growth. The Conference Board Leading Economic Index increased for the eighth consecutive month in November and new home starts improved 8.9% during the quarter. The Federal Open Market Committee held the federal funds rate at 0% to 0.25%, stating that elevated unemployment and low core inflation expectations warranted low rates "for an extended period." Though the beginning of 2009 favored volatility, the CBOE Volatility Index—also known as the "fear gauge"—ended the fourth quarter 20% lower than it was in September. Is this an indicator that extreme market returns are behind us and, if so, the investor is wondering what lies ahead?

For the fourth quarter, all sectors except Financials, were in the black within the broad benchmark **Russell 3000** (+5.90%). By capitalization size, the **Russell Midcap** (+5.92%) led both the **Russell 2000** (+3.87%) and 3000 for the fourth quarter in a row. The largest stocks (**Russell Top 50:** +5.98%) experienced the biggest gains.

Within the Russell 3000 sectors, Financials fell hard—from the top sector in the third quarter (+24.18%) to the bottom in the fourth (-2.14%). In 2009, Financials had the lowest valuations and the most volatility. Commercial real estate woes, as well as continued credit losses, brought down shares of larger banks including Goldman Sachs (-8.22%) and Citigroup (-31.61%).

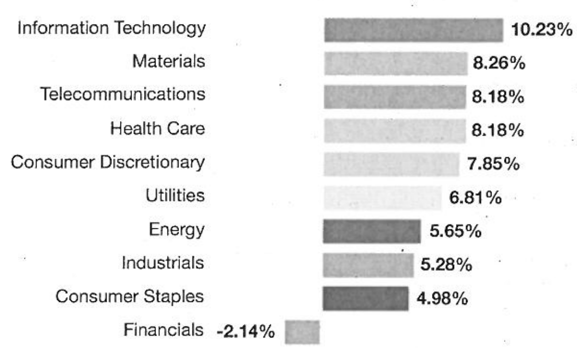
Other sectors trailing the benchmark included Energy (+5.65%), Industrials (+5.28%) and Consumer Staples (+4.98%). Energy suffered from businesses that depend on healthy refining margins, which are predicted to remain poor in 2010. Industrials advanced only moderately despite increased mergers and acquisitions activity. With markets moving upward, Consumer Staples remained weak, though less so than previous quarters. Some Food & Staples retailers (+2.77%) are suffering from deflationary pressures on the items they sell, as well as con-

## Economic Sector Exposure (Russell 3000)

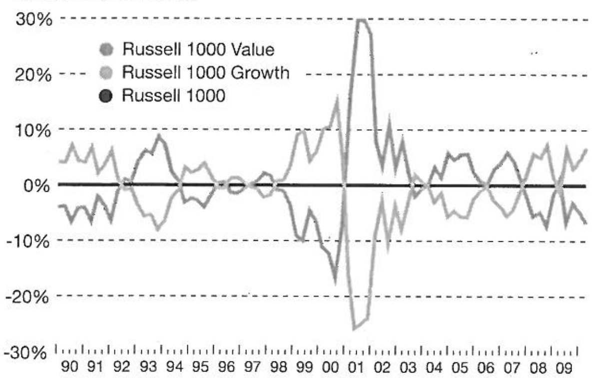



Source: Russell Investment Group

## Economic Sector Returns (Russell 3000)

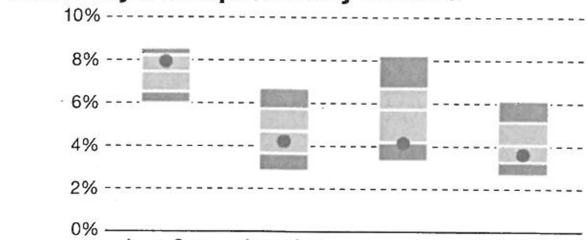


## Rolling One-Year Relative Returns
**versus Russell 1000**




Source: Russell Investment Group

## Callan Style Group Quarterly Returns




| | Large Cap Growth Style | Large Cap Value Style | Small Cap Growth Style | Small Cap Value Style |
|---|---|---|---|---|
| 10th Percentile | 8.56 | 6.70 | 8.24 | 6.15 |
| 25th Percentile | 8.22 | 5.73 | 6.70 | 5.13 |
| Median | 7.45 | 4.69 | 5.71 | 4.05 |
| 75th Percentile | 6.51 | 3.63 | 4.18 | 3.26 |
| 90th Percentile | 5.98 | 2.83 | 3.30 | 2.65 |
| | R1000 Growth | R1000 Value | R2000 Growth | R2000 Value |
| Benchmark ● | 7.94 | 4.22 | 4.14 | 3.63 |

Sources: Callan Associates Inc., Russell Investment Group

sumers' desire to save money by moving toward generic pharmaceuticals.

Utilities (+6.81%) accelerated 10% since November, benefiting from reinvigorated investor appetite for dividends from sector firms such as Provident Energy (+6.74%), whose dividend yields over 6%. Telecommunication Services (+6.63%) was buoyed by Wireless Telecommunication Services (+10.61%) companies like SBA Communications (+26.38%), which profited from increased demand for wireless traffic.

Internet Retail (+11.81%) was the winner within Consumer Discretionary (+7.85%) due to rising consumer demand, but more specifically from a shift toward online purchases. Following the passage of the Senate Committee's health care reform plan, less uncertainty provided a boost to Health Care (+8.18%) stocks in the fourth quarter. Materials (+8.26%) was a surprising leader, buoyed by a surge in metal prices. Information Technology (+10.23%) repeated double-digit quarterly returns riding on a positive 2010 outlook.

Based upon the Russell style indices, growth regained the lead. To compare value and growth, Russell divides the capitalization indices to create subsectors of growth- and value-oriented stocks. Among smaller stocks, the **Russell 2000 Small Cap Value Index** (+3.63%) trailed its growth counterpart (+4.14%). The same held true for larger stocks; the **Russell 1000 Value Index** (+4.22%) lagged the **Russell 1000 Growth Index** (+7.94%).

## U.S. Equity Index Characteristics as of December 31, 2009

| | S&P 1500 | S&P 500 | S&P 400 | S&P 600 | Rus 3000 | Rus 1000 | Rus Midcap | Rus 2000 |
|---|---|---|---|---|---|---|---|---|
| Cap Range Min ($MM) | 42 | 1059 | 259 | 42 | 10 | 75 | 75 | 10 |
| Cap Range Max ($B) | 323.72 | 323.72 | 8.26 | 2.80 | 332.25 | 332.75 | 15.46 | 5.60 |
| Number of Issues | 1,500 | 500 | 400 | 600 | 2,968 | 965 | 773 | 2,007 |
| % of S&P 1500 | 100% | 88% | 8% | 4% | 100% | 92% | 26% | 8% |
| Wtd Avg Mkt Cap ($B) | 71.62 | 80.73 | 2.95 | 1.01 | 66.96 | 72.56 | 6.21 | 1 |
| Price/Book Ratio | 2.1 | 2.2 | 1.8 | 1.7 | 2.1 | 2.2 | 1.9 | 1.6 |
| P/E Ratio (forecasted) | 14.8 | 14.5 | 17.3 | 18.6 | 15.1 | 14.8 | 17.0 | 21.4 |
| Dividend Yield | 1.9% | 1.9% | 1.5% | 1.2% | 1.8% | 1.9% | 1.6% | 1.3% |
| 5-Yr Earnings (forecasted) | 9.9% | 9.7% | 11.2% | 11.8% | 10.1% | 10.0% | 11.0% | 11.9% |

Sources: Russell Investment Group, Standard & Poor's

## Style Median and Index Returns* for Periods ended December 31, 2009

| Large Cap Equity | Quarter | Year | 3 Years | 5 Years | 10 Years | 15 Years |
|---|---|---|---|---|---|---|
| Large Cap–Broad Style | 5.99 | 26.69 | -4.86 | 1.35 | 1.45 | 9.22 |
| Large Cap–Growth Style | 7.45 | 33.95 | -1.78 | 1.63 | -2.50 | 8.73 |
| Large Cap–Value Style | 4.69 | 22.29 | -7.46 | 0.66 | 3.86 | 9.40 |
| Aggressive Growth Style | 7.09 | 44.43 | 0.48 | 3.86 | -1.40 | 8.88 |
| Contrarian Style | 5.11 | 26.68 | -5.78 | 1.35 | 6.18 | 10.66 |
| Core Style | 6.09 | 25.38 | -4.78 | 1.60 | 0.77 | 9.31 |
| Yield-Oriented Style | 6.02 | 21.85 | -5.55 | 1.59 | 5.02 | 9.77 |
| Russell 3000 | 5.90 | 28.34 | -5.42 | 0.76 | -0.20 | 8.13 |
| Russell 1000 | 6.07 | 28.43 | -5.36 | 0.79 | -0.49 | 8.23 |
| Russell 1000 Growth | 7.94 | 37.21 | -1.89 | 1.63 | -3.99 | 6.87 |
| Russell 1000 Value | 4.22 | 19.69 | -8.96 | -0.25 | 2.47 | 8.93 |
| S&P Composite 1500 | 5.96 | 27.25 | -5.30 | 0.69 | -0.20 | 8.29 |
| S&P 500 | 6.04 | 26.47 | -5.63 | 0.42 | -0.95 | 8.04 |
| NYSE | 4.56 | 28.46 | -5.14 | 2.41 | 2.63 | 9.15 |
| Dow Jones Industrials | 8.10 | 22.68 | -3.12 | 1.95 | 1.30 | 9.24 |
| **Mid Cap Equity** | **Quarter** | **Year** | **3 Years** | **5 Years** | **10 Years** | **15 Years** |
| Mid Cap–Broad Style | 5.95 | 37.15 | -3.33 | 3.23 | 6.33 | 11.29 |
| Mid Cap–Growth Style | 6.24 | 42.14 | -0.83 | 3.58 | 2.66 | 11.52 |
| Mid Cap–Value Style | 5.76 | 34.15 | -4.53 | 2.87 | 9.30 | 11.90 |
| Russell Midcap | 5.92 | 40.48 | -4.59 | 2.43 | 4.98 | 10.33 |
| S&P MidCap 400 | 5.56 | 37.38 | -1.83 | 3.27 | 6.36 | 11.66 |
| **Small Cap Equity** | **Quarter** | **Year** | **3 Years** | **5 Years** | **10 Years** | **15 Years** |
| Small Cap–Broad Style | 4.77 | 33.87 | -5.22 | 0.94 | 6.16 | 10.28 |
| Small Cap–Growth Style | 5.71 | 37.74 | -3.08 | 1.51 | 1.09 | 9.29 |
| Small Cap–Value Style | 4.05 | 31.44 | -5.32 | 1.00 | 10.26 | 11.75 |
| Small Cap–Core Style | 4.49 | 28.20 | -6.24 | 0.41 | 6.50 | 10.78 |
| Russell 2000 | 3.87 | 27.17 | -6.07 | 0.51 | 3.51 | 7.73 |
| S&P SmallCap 600 | 5.12 | 25.57 | -4.80 | 1.36 | 6.35 | 9.80 |
| NASDAQ | 7.19 | 45.28 | -1.17 | 1.70 | -5.09 | 8.26 |
| **Russell 3000 Sectors** | **Quarter** | **Year** | **3 Years** | **5 Years** | **10 Years** | **15 Years** |
| Consumer Staples | 4.98 | 15.70 | 3.30 | 5.81 | 5.92 | 9.83 |
| Consumer Discretionary | 7.85 | 46.64 | -7.40 | -2.39 | -1.49 | 6.06 |
| Industrials | 5.28 | 21.81 | -6.24 | 0.11 | 2.15 | 8.67 |
| Energy | 5.65 | 17.91 | -0.76 | 9.60 | 10.46 | 12.92 |
| Materials | 8.26 | 53.22 | 1.04 | 5.42 | 5.89 | 7.33 |
| Information Technology | 10.23 | 61.79 | 2.10 | 3.45 | -6.64 | 8.59 |
| Utilities | 6.81 | 12.51 | -1.83 | 5.82 | 5.79 | 8.26 |
| Financials | -2.14 | 14.44 | -22.15 | -9.69 | -0.45 | 8.22 |
| Telecommunications | 8.18 | 12.72 | -6.14 | 1.98 | -7.38 | - |
| Health Care | 8.18 | 21.83 | 0.22 | 3.08 | 3.22 | - |

*Returns less than one year are not annualized.

Sources: Callan Associates Inc., Dow Jones & Company Inc., **GICS, Russell Investment Group, Standard & Poor's, The NASDAQ Stock Market Inc.

U.S. FIXED INCOME | Maria Bautista

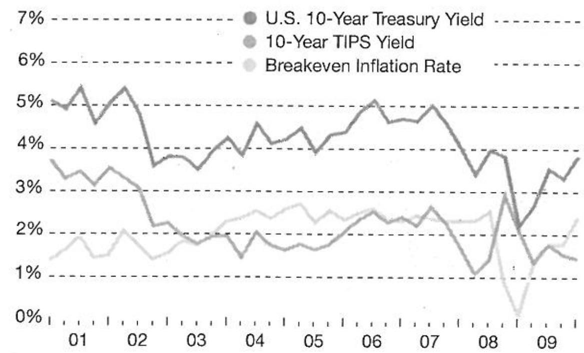
# IS CREDIT HERE TO STAY?

The credit markets rallied through year end from their low in March as investors' risk appetite remained. 2008 saw a flight to quality but 2009 reversed the trend as investors fled Treasurys. Treasurys suffered in the fourth quarter (-1.30%) and fell 3.57% for the year. With Treasurys comprising over 25% of the **Barclays Capital Aggregate Index**, the broad-market fixed income benchmark finished flat for the quarter (+0.20%) but advanced for the year (+5.93%).

The Federal Open Market Committee (FOMC) kept rates unchanged in the fourth quarter at 0% to 0.25%. The FOMC also announced plans to reduce quantitative easing efforts and let special liquidity programs expire. During the quarter, Treasury yields rose across all maturities pushing prices down and returns negative while the yield curve steepened to an all time high. The spread between two-year and 10-year Treasurys reached 2.70% at year end. Despite the selloff in Treasurys, real yields remained low. The breakeven rate (the difference between nominal and real yields) on the 10-year Treasury was 2.40%.

During the fourth quarter, the U.S. fixed income market maintained its momentum from the third quarter across all sectors and finished 2009 with record returns. The investment-grade credit market—aided by improving corporate profits and positive economic data—outpaced like-duration Treasurys by 2.67% for the quarter and 19.90% for the year. Financials and Utilities led the charge finishing the year with 21.40% and 23.12% of excess returns, respectively. Asset-backed securities maintained its positive run with healthy new issuance and lower default rate expectations, surpassing like-duration Treasurys by 1.68% for the quarter and 24.96% year to date.

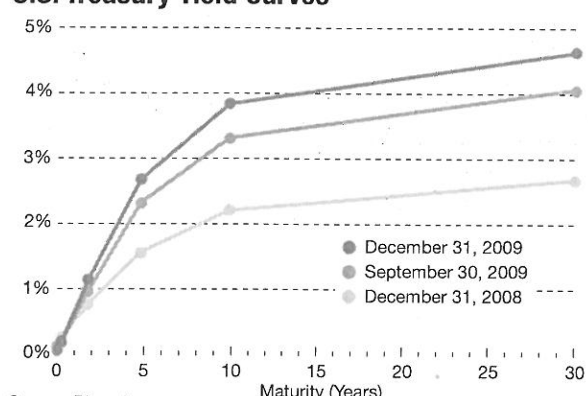
## Historical 10-Year Yields




Source: Bloomberg

Government stimulus programs have continued to benefit mortgage-backed securities (MBS) and commercial-backed securities (CMBS)—although not as substantially as in earlier quarters. MBS outperformed like-duration Treasurys by 0.75% for the quarter and 4.95% for the year. In addition to the Term Asset-Backed Securities Loan Facility, the Public-Private Investment Fund helped increase demand and narrow spreads for the CMBS sector. CMBS exceeded like-duration Treasurys by 3.74% for the quarter and 29.60% for the year.

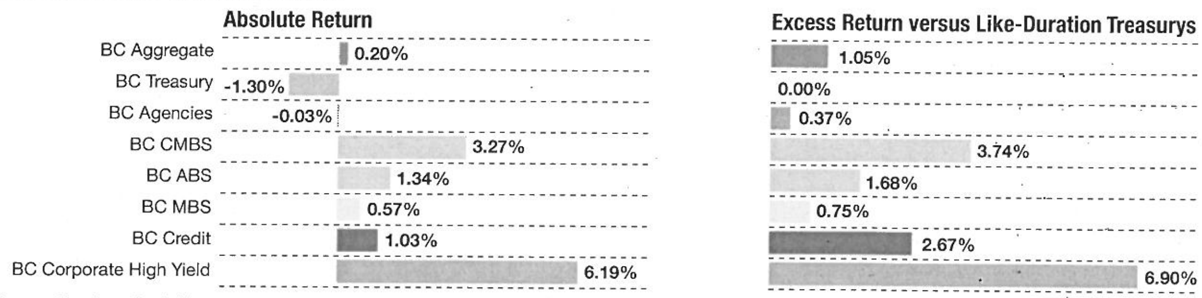
## U.S. Treasury Yield Curves




Source: Bloomberg

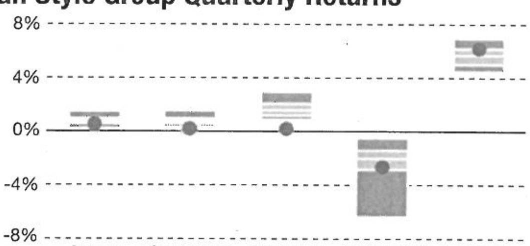
The non-investment grade market, as measured by the **Barclays Corporate High Yield Index**, bested all sectors within the U.S. fixed income market, finishing up 6.19% for the quarter and 58.21% for the year. Lower-quality securities dominated, with CCCs surpassing like-duration Treasurys by 9.27% for the quarter and a staggering 96.66% for the year. During the quarter, spreads narrowed by 1.60% and new issuances totaled $57.4 billion.

## Fixed Income Index Returns




Source: Barclays Capital Inc.

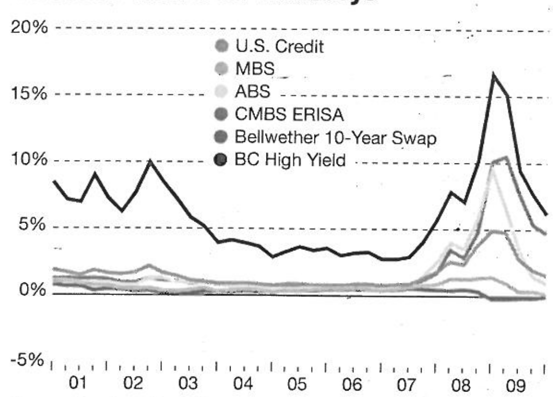
## Callan Style Group Quarterly Returns




| | Interm Style | Core Bond Style | Core Plus Style | Ext Maturity Style | High Yld Style |
|---|---|---|---|---|---|
| 10th Percentile | 1.49 | 1.54 | 2.96 | -0.49 | 6.96 |
| 25th Percentile | 0.93 | 0.95 | 2.06 | -1.42 | 6.18 |
| Median | 0.73 | 0.76 | 1.59 | -2.03 | 5.67 |
| 75th Percentile | 0.55 | 0.55 | 1.19 | -2.83 | 5.02 |
| 90th Percentile | 0.20 | 0.31 | 0.87 | -6.38 | 4.46 |
| | BC Interm Agg | BC Agg | BC Agg | BC G/C Long | BC High Yld |
| Benchmark ● | 0.53 | 0.20 | 0.20 | -2.64 | 6.19 |

Sources: Barclays Capital Inc., Callan Associates Inc.

## Effective Yield Over Treasurys




Source: Barclays Capital Inc.

## U.S. Fixed Income Index Characteristics as of December 31, 2009

| BC Indices | Yield to Worst | Modified Adj Duration | Avg Maturity | % of BC G/C | % of BC Agg |
|---|---|---|---|---|---|
| BC Aggregate | 3.68 | 4.57 | 6.84 | 100.00% | 100.00% |
| BC Govt/Credit | 3.21 | 5.23 | 7.45 | 100.00% | 59.67% |
| Intermediate | 2.76 | 3.85 | 4.40 | 83.23% | 49.66% |
| Long-Term | 5.46 | 12.08 | 22.60 | 16.77% | 10.01% |
| BC Govt | 2.40 | 4.64 | 5.97 | 61.35% | 36.61% |
| BC Credit | 4.51 | 6.16 | 9.81 | 38.65% | 23.06% |
| BC Mortgage | 4.15 | 3.57 | 6.05 | - | 36.78% |
| BC Asset-Backed | 2.88 | 3.31 | 3.93 | - | 0.36% |
| BC Commercial Mortgage | 7.12 | 3.95 | 4.74 | - | 3.19% |
| BC Corp High Yield | 9.06 | 4.30 | 6.83 | - | - |

Source: Barclays Capital Inc.

## U.S. FIXED INCOME | continued

### Style Median and Index Returns* for Periods ended December 31, 2009

| Broad Fixed Income | Quarter | Year | 3 Years | 5 Years | 10 Years | 15 Years |
|---|---|---|---|---|---|---|
| Core Bond Style | 0.76 | 10.68 | 6.13 | 5.17 | 6.58 | 7.03 |
| Core Bond Plus Style | 1.59 | 17.55 | 6.19 | 5.25 | 6.91 | 7.30 |
| BC Aggregate | 0.20 | 5.93 | 6.04 | 4.97 | 6.33 | 6.79 |
| BC Govt/Credit | -0.21 | 4.52 | 5.81 | 4.71 | 6.34 | 6.76 |
| BC Govt | -1.00 | -2.20 | 6.10 | 4.87 | 6.17 | 6.59 |
| BC Credit | 1.03 | 16.04 | 5.74 | 4.67 | 6.63 | 7.15 |
| Citi Broad Investment Grade | 0.02 | 5.04 | 6.43 | 5.23 | 6.47 | 6.89 |
| **Long-Term** | **Quarter** | **Year** | **3 Years** | **5 Years** | **10 Years** | **15 Years** |
| Extended Maturity Style | -2.03 | 7.75 | 6.37 | 5.94 | 8.25 | 9.03 |
| BC Gov/Credit Long | -2.64 | 1.92 | 5.62 | 4.97 | 7.68 | 8.12 |
| BC Gov Long | -5.07 | -12.19 | 5.71 | 5.15 | 7.65 | 8.11 |
| BC Credit Long | -0.73 | 16.80 | 5.15 | 4.53 | 7.53 | 7.95 |
| **Intermediate-Term** | **Quarter** | **Year** | **3 Years** | **5 Years** | **10 Years** | **15 Years** |
| Intermediate Style | 0.73 | 8.59 | 6.50 | 5.25 | 6.27 | 6.64 |
| BC Intermediate Aggregate | 0.53 | 6.46 | 6.11 | 4.97 | 6.09 | 6.53 |
| BC Gov/Credit Intermediate | 0.31 | 5.24 | 5.90 | 4.66 | 5.93 | 6.32 |
| BC Gov Intermediate | -0.42 | -0.32 | 6.09 | 4.74 | 5.65 | 6.08 |
| BC Credit Intermediate | 1.61 | 15.93 | 5.98 | 4.76 | 6.39 | 6.85 |
| **Short-Term** | **Quarter** | **Year** | **3 Years** | **5 Years** | **10 Years** | **15 Years** |
| Defensive Style | 0.78 | 5.81 | 5.09 | 4.32 | 4.83 | 5.45 |
| Active Cash Style | 0.75 | 4.49 | 3.71 | 3.74 | 3.70 | 4.35 |
| Money Market Funds (net of fees) | 0.01 | 0.12 | 2.29 | 2.82 | 2.64 | 3.49 |
| ML Treasury 1–3-Year | 0.03 | 0.78 | 4.86 | 4.04 | 4.48 | 5.15 |
| 90-Day Treasury Bills | 0.04 | 0.21 | 2.40 | 3.02 | 2.99 | 3.74 |
| **High Yield** | **Quarter** | **Year** | **3 Years** | **5 Years** | **10 Years** | **15 Years** |
| High Yield Style | 5.67 | 44.95 | 5.59 | 6.22 | 6.84 | 8.17 |
| BC Corporate High Yield | 6.19 | 58.21 | 5.97 | 6.46 | 6.71 | 7.57 |
| ML High Yield Master | 5.83 | 56.28 | 5.62 | 6.23 | 6.77 | 7.71 |
| **Mortgage/Asset-Backed** | **Quarter** | **Year** | **3 Years** | **5 Years** | **10 Years** | **15 Years** |
| Mortgages Style | 1.05 | 9.02 | 6.64 | 5.56 | 6.56 | 7.10 |
| BC MBS | 0.57 | 5.89 | 7.04 | 5.78 | 6.46 | 6.96 |
| BC ABS | 1.34 | 24.72 | 3.62 | 3.53 | 5.34 | 5.90 |
| BC CMBS | 3.27 | 28.45 | 2.53 | 2.82 | 6.01 | - |
| **Municipal** | **Quarter** | **Year** | **3 Years** | **5 Years** | **10 Years** | **15 Years** |
| BC Muni | -0.96 | 12.91 | 4.41 | 4.32 | 5.75 | 6.13 |
| BC Muni 1–10-Year | -0.09 | 7.18 | 5.39 | 4.31 | 5.10 | 5.47 |
| BC Muni 3-Year | 0.80 | 5.78 | 5.44 | 4.03 | 4.40 | 4.66 |

*Returns less than one year are not annualized.

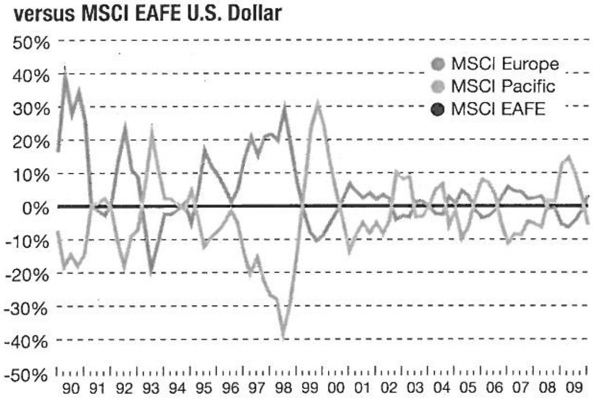
Sources: Barclays Capital Inc., Callan Associates Inc., Citigroup, Merrill Lynch

NON-U.S. EQUITY | Matthew Schmelzer, CFA

# EMERGING MARKETS SURGE PAST DEVELOPED

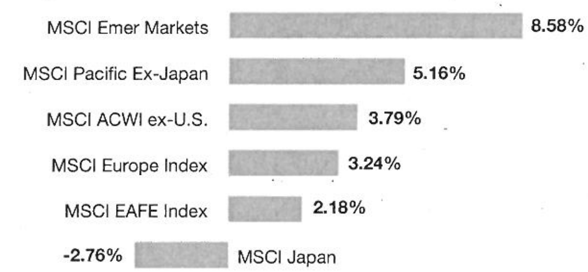
The global equities swell that originated during the first half of 2009 strengthened during the fourth quarter ensuring robust gains for the year. Optimistic investors welcomed expansionary government monetary and fiscal policies, coupled with better-than-expected earnings at attractive valuations. As the market began to reward earnings growth during the quarter, sector leadership was mixed. Energy, Staples and Materials drove the Index while Utilities, Financials and Technology lagged. After surging ahead in excess of 49% over the past two quarters, **MSCI EAFE** rose 2.18% for the fourth quarter. **EAFE Growth** (+4.17%) overtook **EAFE Value** (+0.28%), **MSCI EMF Index** (+8.58%) outpaced EAFE for the fourth consecutive quarter and **EAFE Small Cap** (-1.03%) failed to keep pace with the broader Index. The U.S. dollar appreciated against most major currencies.

### Rolling One-Year Relative Returns
**versus MSCI EAFE U.S. Dollar**




Source: MSCI Inc.

### Regional Performance (U.S. Dollar)




Source: MSCI Inc.

## Europe

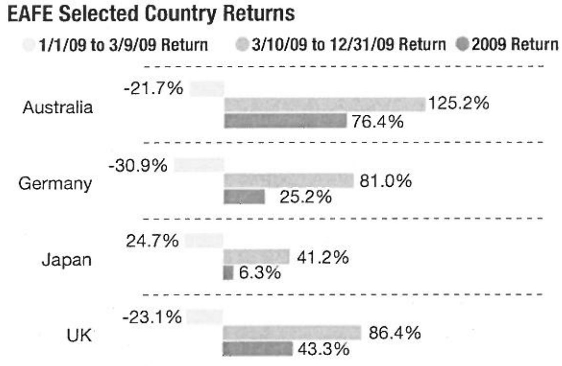
Leading all developed markets for the fourth quarter, the **MSCI Europe Index** reported a modest advance (+3.24%). Sector leadership came from Materials where rising commodity prices and increased demand fueled gains. Consumer Staples soared, buoyed by an improving global economy and better-than-expected reported earnings. Financials lagged as investors became concerned that the European Central Bank (ECB) would begin phasing out stimulus policies along with credit concerns over Dubai World's debt restructuring. Performance across the region was mixed for the quarter. After outpacing all countries during the third quarter, Greece (-22.43%) faltered after three rating agencies downgraded the country's credit rating. Conversely, growth in consumption and relatively low unemployment led Norway (+14.88%) to become the first European nation to raise interest rates. The euro zone emerged from recession during the quarter despite achieving an 11-year high in unemployment. The ECB and the Bank of England held rates steady at 1.0% and 0.5%, respectively.

## Asia

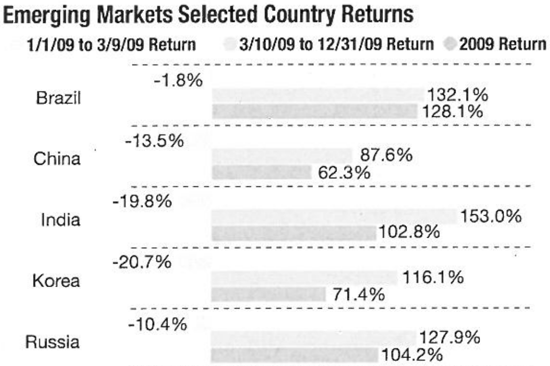
The **MSCI Pacific Basin Index** eked out a slight gain of 0.07%. Despite the tempered performance, Australia (+4.92%) and Singapore (+9.76%) topped the region. Signs of an improving economy, lower-than-expected unemployment and economic growth among trading partners convinced the Reserve Bank of Australia to become the first central bank to begin tightening monetary policy, raising rates three times during the quarter to 3.75%. Singapore was bolstered by increased real estate activity as well as a resurgence of initial public offerings. Notwithstanding a weakened yen, Japan's outlook remained muted, falling 2.76% for the quarter. Investor still worry about an aging population, fear of deflation and the uncertainty of the Democratic Party of Japan's renewed focus on domestic growth.

### "Digging Out of a Deep Hole"

**EAFE Selected Country Returns**




**Emerging Markets Selected Country Returns**




## Emerging Markets

Despite uncertainty caused by Dubai World's debt restructuring in November, emerging markets maintained their feverish pace in the fourth quarter as measured by the **MSCI EM Index** (+8.58%). While all 10 sectors increased, sector leadership came from Consumer Staples, Health Care and Materials. The Asian region continued to underperform all emerging regions during the quarter despite China surging 9.56%. China's economic growth led to positive repercussions across emerging markets as trade partners benefited from the increased appetite for commodities. The Latin American region (+12.43%) remained the pacesetter, attributed largely to resource-rich Brazil (+12.93%) and Chile (+15.29%). Rising demand for steel as well as better growth prospects within the banking industry lifted Brazil. Within the EMEA (Europe, the Middle East and Africa), commodity-driven Russia (+10.46%) was propelled by higher oil prices.

### Return Attribution for EAFE Countries

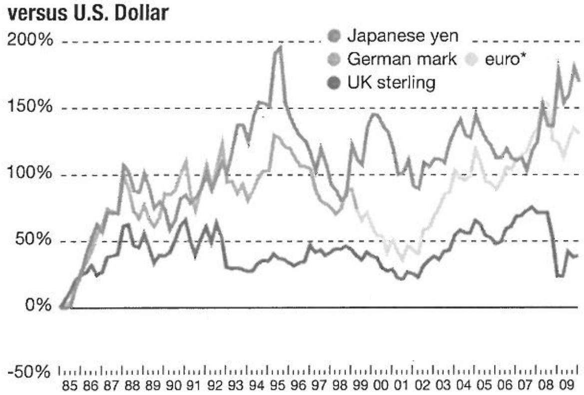
**(U.S. Dollar)**

| Country | Total | Local | Currency | Wtg |
|---|---|---|---|---|
| Australia | 4.92% | 2.96% | 1.90% | 8.43% |
| Austria | -9.82% | -8.12% | -1.84% | 0.32% |
| Belgium | 1.58% | 3.48% | -1.84% | 0.97% |
| Denmark | -2.80% | -1.02% | -1.80% | 0.87% |
| Finland | -3.49% | -1.68% | -1.84% | 1.12% |
| France | 2.08% | 4.00% | -1.84% | 11.06% |
| Germany | 2.18% | 4.10% | -1.84% | 8.10% |
| Greece | -22.43% | -20.97% | -1.84% | 0.51% |
| Hong Kong | 3.58% | 3.63% | -0.05% | 2.34% |
| Ireland | -2.67% | -0.84% | -1.84% | 0.27% |
| Italy | -2.67% | -0.84% | -1.84% | 3.47% |
| Japan | -2.76% | 1.10% | -3.82% | 20.68% |
| Netherlands | 3.75% | 5.70% | -1.84% | 2.69% |
| New Zealand | -0.05% | -0.63% | 0.59% | 0.11% |
| Norway | 14.88% | 14.38% | 0.44% | 0.80% |
| Portugal | 0.44% | 2.33% | -1.84% | 0.32% |
| Singapore | 9.76% | 9.36% | 0.36% | 7.70% |
| Spain | 1.29% | 3.19% | -1.84% | 1.48% |
| Sweden | 3.64% | 5.82% | -2.06% | 4.60% |
| Switzerland | 3.83% | 3.44% | 0.38% | 2.53% |
| UK | 6.96% | 5.94% | 0.97% | 21.63% |

Source: MSCI Inc.

## Major Curencies Cumulative Returns

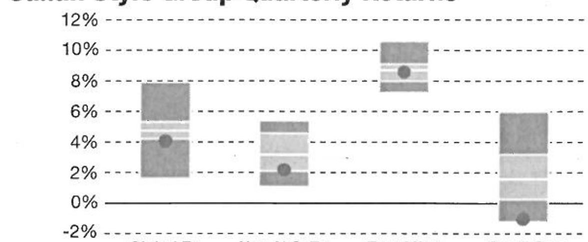
**versus U.S. Dollar**




*euro returns from 1Q99

Source: MSCI Inc.

## Callan Style Group Quarterly Returns




| | Global Eq Style | Non-U.S. Eq Style | Emg Mkts Style | Small Cap Style |
|---|---|---|---|---|
| 10th Percentile | 7.92 | 5.39 | 10.59 | 5.98 |
| 25th Percentile | 5.32 | 4.56 | 9.08 | 3.18 |
| Median | 4.72 | 3.15 | 8.68 | 1.56 |
| 75th Percentile | 4.21 | 2.08 | 7.97 | 0.24 |
| 90th Percentile | 1.60 | 1.06 | 7.21 | -1.21 |
| | MSCI World | MSCI EAFE | MSCI Emg Mkts | MSCI Small Cap |
| Benchmark ● | 4.07 | 2.18 | 8.58 | -1.03 |

Sources: Callan Associates Inc., MSCI Inc.

## Style Median and Index Returns* for Periods ended December 31, 2009

| International Equity | Quarter | Year | 3 Years | 5 Years | 10 Years | 15 Years |
|---|---|---|---|---|---|---|
| Global Style | 4.72 | 31.56 | -5.19 | 2.90 | 1.22 | 8.12 |
| Non-U.S. Style | 3.15 | 32.75 | -4.33 | 4.82 | 3.20 | 7.48 |
| Core Style | 2.67 | 30.43 | -5.19 | 4.21 | 3.20 | 7.48 |
| MSCI EAFE–Unhedged | 2.18 | 31.78 | -6.04 | 3.54 | 1.17 | 4.92 |
| MSCI EAFE–Local | 3.33 | 24.72 | -8.31 | 2.98 | -1.05 | 4.24 |
| MSCI EAFE Growth–Unhedged | 4.17 | 29.36 | -4.78 | 3.65 | -1.31 | 3.32 |
| MSCI EAFE Value–Unhedged | 0.28 | 34.23 | -7.35 | 3.36 | 3.53 | 6.41 |
| MSCI World–Unhedged | 4.07 | 29.99 | -5.63 | 2.01 | -0.24 | 6.02 |
| MSCI World–Local | 4.50 | 25.73 | -6.90 | 1.54 | -1.26 | 5.75 |
| MSCI AC World ex-U.S.–Unhedged | 3.79 | 42.14 | -3.04 | 6.31 | 3.12 | 6.12 |
| MSCI AC World–Unhedged | 4.72 | 35.41 | -4.05 | 3.64 | 0.89 | 6.65 |
| **Pacific Equity** | **Quarter** | **Year** | **3 Years** | **5 Years** | **10 Years** | **15 Years** |
| Pacific Basin Style | 3.47 | 28.88 | -3.38 | 6.95 | 1.68 | 2.90 |
| Japan Style | -4.28 | 5.80 | -11.95 | -0.78 | -3.28 | 1.11 |
| Pacific Rim Style | 7.30 | 65.76 | 4.82 | 14.19 | 9.37 | 7.76 |
| MSCI Pacific–Unhedged | 0.07 | 24.18 | -5.97 | 2.73 | -0.55 | 0.45 |
| MSCI Pacific–Local | 2.10 | 19.63 | -12.21 | 0.74 | -1.95 | -0.21 |
| MSCI Japan–Unhedged | -2.76 | 6.25 | -10.36 | -0.80 | -3.67 | -1.83 |
| MSCI Japan–Local | 1.10 | 9.12 | -17.44 | -2.69 | -4.58 | -2.28 |
| **Europe Equity** | **Quarter** | **Year** | **3 Years** | **5 Years** | **10 Years** | **15 Years** |
| Europe Style | 3.09 | 35.78 | -5.33 | 5.00 | 3.90 | 10.13 |
| MSCI Europe–Unhedged | 3.24 | 35.83 | -6.07 | 3.93 | 1.97 | 8.29 |
| MSCI Europe–Local | 3.96 | 27.70 | -6.12 | 4.23 | -0.45 | 7.51 |
| **Emerging Markets** | **Quarter** | **Year** | **3 Years** | **5 Years** | **10 Years** | **15 Years** |
| Emerging Markets Style | 8.68 | 77.52 | 4.72 | 15.70 | 11.28 | 10.03 |
| MSCI EMF–Unhedged | 8.58 | 79.02 | 5.42 | 15.88 | 10.11 | 7.34 |
| MSCI EMF–Local | 7.20 | 62.76 | 5.65 | 15.60 | 10.20 | 10.57 |
| **International Small Cap Equity** | **Quarter** | **Year** | **3 Years** | **5 Years** | **10 Years** | **15 Years** |
| Small Cap Style | 1.56 | 47.99 | -5.37 | 5.80 | 7.22 | 8.98 |
| MSCI EAFE Small Cap–Unhedged | -1.03 | 46.78 | -7.59 | 3.51 | 6.45 | - |

*Returns less than one year are not annualized.

Sources: Callan Associates Inc., MSCI Inc.

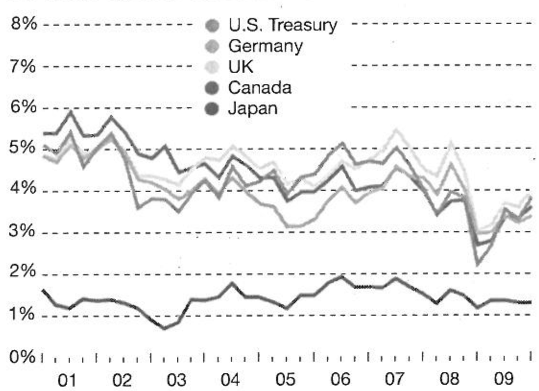
NON-U.S. FIXED INCOME | Matthew Routh

# DEBT MARKETS BEGIN WEIGHING THE COST OF RECOVERY

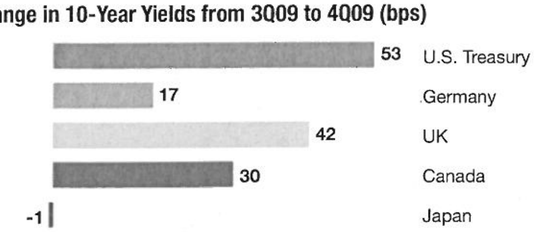
Non-U.S. and emerging fixed income markets were anything but boring during the final quarter of 2009. Negative headlines, such as the Greek bond downgrade and the Dubai World multi-billion dollar debt restructure, caused markets to question which issuers might face similar crises in the near future. As economies around the world continued to recover, many investors ended the year wondering if the cost of averting an economic catastrophe has become too much to bear for some governments. These sentiments, coupled with steady net asset flows toward equities, had a detrimental effect on global fixed income markets during the fourth quarter.

Contrary to previous global downturns, fiscal and monetary issues in developed nations—not emerging—have faced the scrutiny of debt markets. The Bank of England maintained its quantitative easing program and kept rates at record lows despite the pound sterling remaining at its pre-crisis exchange rate. UK gilts fared the worst during the quarter and year, becoming the largest drag on the **Citi Non-U.S. World Government Bond Index,** which rose 0.10% during the quarter and 2.36% for the year. Australia was the Index's best performer for the second straight quarter (+2.62%) and year (+24.85%); a reward for its firm stance on supporting its currency with three rate increases in the fourth quarter.

### 10-Year Global Government Bond Yields




### Change in 10-Year Yields from 3Q09 to 4Q09 (bps)




Source: Citigroup

### Return Attribution for Non-U.S. Gov't Indices
**(U.S. Dollar)**

| Country | Total | Local | Currency | Wtg |
|---|---|---|---|---|
| Australia | 2.62% | 0.70% | 1.90% | 0.71% |
| Austria | -1.47% | 0.38% | -1.84% | 1.80% |
| Belgium | -1.28% | 0.58% | -1.84% | 2.87% |
| Canada | 1.58% | -0.78% | 2.38% | 2.50% |
| Denmark | -1.89% | -0.10% | -1.80% | 0.83% |
| Finland | -1.06% | 0.80% | -1.84% | 0.57% |
| France | -1.39% | 0.46% | -1.84% | 9.58% |
| Germany | -1.65% | 0.19% | -1.84% | 10.21% |
| Greece | -8.26% | -6.54% | -1.84% | 2.39% |
| Ireland | -1.93% | -0.09% | -1.84% | 0.90% |
| Italy | -0.89% | 0.97% | -1.84% | 10.94% |
| Japan | -3.35% | 0.49% | -3.82% | 38.20% |
| Malaysia | 1.64% | 0.55% | 1.08% | 0.51% |
| Netherlands | -1.28% | 0.58% | -1.84% | 2.52% |
| Norway | 1.80% | 1.35% | 0.44% | 0.30% |
| Poland | 2.59% | 1.29% | 1.28% | 0.83% |
| Portugal | -2.36% | -0.53% | -1.84% | 1.12% |
| Singapore | 0.31% | -0.05% | 0.36% | 0.35% |
| Spain | -2.15% | -0.31% | -1.84% | 4.49% |
| Sweden | -0.73% | 1.36% | -2.06% | 0.67% |
| Switzerland | 1.50% | 1.12% | 0.38% | 0.58% |
| UK | -1.10% | -2.05% | 0.97% | 7.10% |

Source: Citigroup

Most of Europe felt the impact of rating agencies' Greek debt downgrade during the fourth quarter in response to a fiscal situation that was deemed unsustainable. As a member of the euro zone, Greece (-8.26%) also hampered the quarterly performance of Spain (-2.15%), Italy (-0.89%) and Ireland (-1.93%), whose investors sought higher yields in compensation for holding seemingly riskier government debt. Japanese bonds reversed their previous downward trend in U.S. dollar terms, revived in part from a shift toward the safety of government bonds by domestic investors.

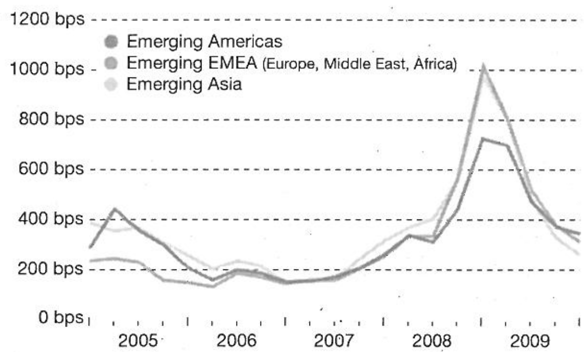
The repayment difficulties of the quasi-sovereign group, Dubai World, led to a brief hiccup in emerging markets debt performance. In spite of this, yields continued to narrow versus developed debt. For the quarter, the **JPMorgan GBI EM Global Composite Index** gained 3.20% for the quarter and surged ahead 21.01% for the year. Argentina led the way, benefiting from investors' preference for riskier issuers and the country's end-of-quarter announcement that it will use foreign reserves for the settlement of earlier debts. Local currency debt performed even better due to the rise of most emerging currencies versus the U.S. dollar.

## Callan Style Group Quarterly Returns


| | Global Fixed Style | Non-U.S. Fixed Style |
|---|---|---|
| 10th Percentile | 0.83 | -1.18 |
| 25th Percentile | -0.02 | -1.34 |
| Median | -0.75 | -1.43 |
| 75th Percentile | -1.60 | -1.70 |
| 90th Percentile | -1.69 | -1.89 |
| | Citi World Govt Unhedged | Citi Non-U.S. Govt Unhedged |
| Benchmark ● | -1.93 | -2.15 |

Sources: Callan Associates Inc., Citigroup

## Emerging Spreads by Region




Source: Barclays Capital Inc.

## Style Median and Index Returns* for Periods ended December 31, 2009

| Global Fixed | Quarter | Year | 3 Years | 5 Years | 10 Years | 15 Years |
|---|---|---|---|---|---|---|
| Global Style | -0.75 | 6.87 | 8.17 | 4.87 | 7.24 | 7.43 |
| Citi World Govt–Unhedged | -1.93 | 2.56 | 8.06 | 4.51 | 6.63 | 6.56 |
| Citi World Govt–Local | -0.22 | 0.99 | 4.48 | 3.56 | 4.58 | 5.78 |
| **Non-U.S. Fixed** | **Quarter** | **Year** | **3 Years** | **5 Years** | **10 Years** | **15 Years** |
| Non-U.S. Style | -1.43 | 6.08 | 8.34 | 4.44 | 6.89 | 7.03 |
| Citi Non-U.S. World Govt–Unhedged | -2.15 | 4.38 | 8.60 | 4.46 | 6.60 | 6.37 |
| Citi Non-U.S. World Govt–Local | 0.10 | 2.36 | 4.09 | 3.24 | 4.09 | 5.58 |
| **Europe** | **Quarter** | **Year** | **3 Years** | **5 Years** | **10 Years** | **15 Years** |
| Citi Euro Govt Bond–Unhedged | -1.79 | 7.70 | 8.11 | 5.18 | 9.32 | - |
| Citi Euro Govt Bond–Local | 0.05 | 4.34 | 5.11 | 4.05 | 5.46 | - |
| **Emerging Markets Fixed** | **Quarter** | **Year** | **3 Years** | **5 Years** | **10 Years** | **15 Years** |
| JPM Emerg Mkts Bond Plus | 1.37 | 25.95 | 6.58 | 8.39 | 10.94 | 12.79 |
| JPM Emerg Local Mkts Plus | 1.04 | 11.69 | 7.57 | 7.61 | 8.44 | 8.50 |
| JPM GBI EM Global Composite | 3.20 | 21.01 | 9.74 | 9.25 | - | - |

*Returns less than one year are not annualized.

Sources: Callan Associates Inc., Citigroup, JPMorgan Chase & Co.

REAL ESTATE | Jay Nayak

# REAL ESTATE ISSUES REMAIN; CMBS ISSUANCES EMERGE

The commercial real estate markets welcomed three new commercial mortgage-backed (CMBS) offerings during the fourth quarter. While total issuances for the three-month period fell below $2 billion, the deals served as an early signal of the gradual return of the primary CMBS market.

As indicated by the Federal Reserve Bank of New York, approximately $72 million in Term Asset-Backed Securities Loan Facility (TALF) financing for newly-issued CMBS was utilized during the quarter. Approximately $4.5 billion in TALF financing for legacy securities was extended over the same period.

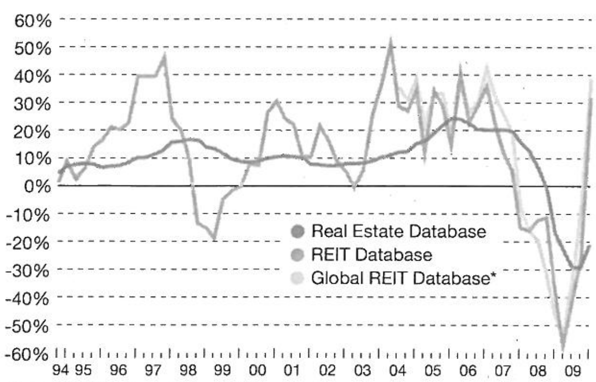
Public real estate securities, as measured by the **NAREIT Equity Index** (+9.39%), advanced over the fourth quarter. REITs gained 6.91% in November, boosted by new CMBS issuances and news of positive GDP growth. Regional Malls (+14.75%) topped all sectors alongside expectations for a successful restructuring by General Growth Properties, a prominent casualty of the liquidity crisis. The Mixed (+0.92%) sector trailed behind.

While capital raising activity slowed during the fourth quarter, domestic REITs managed to raise $6.0 billion across 24 offerings. Over $1.9 billion of secondary equity was raised and unsecured debt offerings totaled $3.7 billion. Dupont Fabros Technology, Inc., a non-investment grade REIT, completed a noteworthy unsecured debt offering priced at 8.5%.

Growth in the Americas was a substantial driver of global REIT performance as measured by the **FTSE EPRA/NAREIT Developed Index** (+4.40%). On opposite ends of the return spectrum were the EPRA/NAREIT North America Index (+8.94%) and the EPRA/NAREIT Australia Index (-3.24%). European REIT performance returned market focus on company and asset quality while policy and regulatory concerns curbed performance in Asia.

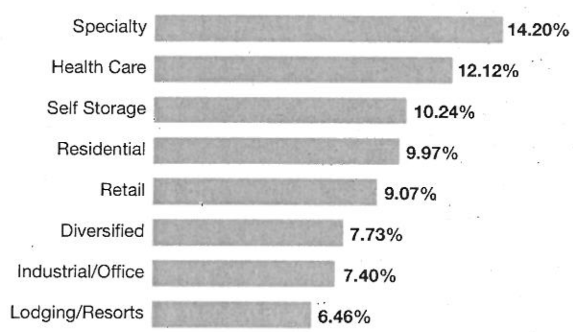
In the direct property markets, the **NCREIF Property Index** shed 2.11% over the fourth quarter, comprising of a 1.60% income return and a -3.71% capital return. The leading sectors were Retail (-0.92%) and Apartments (-1.81%). Hotels (-3.63%) and Office (-2.75%) fell behind.

## Rolling One-Year Returns




*Global REIT returns from 2Q04
Source: Callan Associates Inc.

## NAREIT Equity Sector Performance




Source: NAREIT

**NCREIF Open-End Diversified Core Equity Index** fell 3.40% during the fourth quarter. While the pace of writedowns has largely subsided, the fund universe remains in the red for the sixth consecutive quarter, representing a peak-to-current decline of 37.78%. The quarter saw further redemption rescissions from investors thereby trimming redemption queues.

Lastly, the Federal Deposit Insurance Corporation (FDIC) completed its first notable sale of assets held in receivership. Starwood Capital headed a consortium to buy a $2.77 billion portfolio of assets from the bankrupt Corus Bank. The sale was a public-private partnership where the FDIC retained an equity interest in the acquiring entity and provided debt financing for the transaction. This is the anticipated structure for subsequent FDIC auctions. A periodic and orderly sale of failed bank assets is expected to prevent a flood of assets from entering the marketplace.

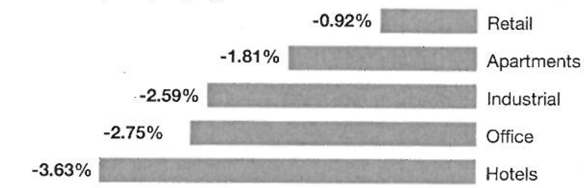
## Overall Capitalization Rates

| Sector | 4Q09 | 3Q09 | 4Q08 |
|---|---|---|---|
| Industrial | 7.32% | 7.31% | 6.20% |
| Apartment | 5.75% | 5.71% | 4.89% |
| Office | 6.91% | 6.90% | 5.33% |
| Retail | 7.03% | 6.79% | 6.35% |

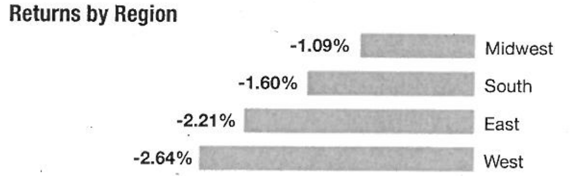
Rates based on unleveraged, value-weighted, appraisal capitalization rate data.
Source: NCREIF

## NCREIF Property Index

### Returns by Property Type

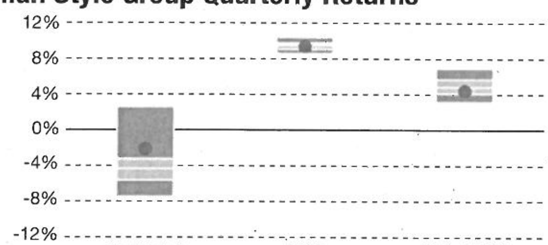



### Returns by Region




Source: NCREIF

## Callan Style Group Quarterly Returns




| | Real Estate Database | REIT Database | Global REIT Database |
|---|---|---|---|
| 10th Percentile | 2.61 | 10.38 | 6.96 |
| 25th Percentile | -3.24 | 9.74 | 5.70 |
| Median | -4.36 | 9.52 | 4.82 |
| 75th Percentile | -5.66 | 9.05 | 4.10 |
| 90th Percentile | -7.48 | 8.57 | 3.15 |
| | NCREIF Property | NAREIT Equity | EPRA/NAREIT Global |
| Benchmark ● | -2.11 | 9.39 | 4.40 |

Sources: Callan Associates Inc., NAREIT, NCREIF, The FTSE Group

## Style Median and Index Returns* for Periods ended December 31, 2009

| Private Real Estate | Quarter | Year | 3 Years | 5 Years | 10 Years | 15 Years |
|---|---|---|---|---|---|---|
| Real Estate Database (net of fees) | -4.36 | -28.53 | -10.17 | -0.33 | 4.55 | 6.72 |
| NCREIF Property* | -2.11 | -16.86 | -3.42 | 4.75 | 7.30 | 8.79 |
| **Public Real Estate** | **Quarter** | **Year** | **3 Years** | **5 Years** | **10 Years** | **15 Years** |
| REIT Database | 9.52 | 30.21 | -11.11 | 1.76 | 12.17 | 11.55 |
| NAREIT Equity | 9.39 | 27.99 | -12.41 | 0.36 | 10.63 | 9.77 |
| **Global Real Estate** | **Quarter** | **Year** | **3 Years** | **5 Years** | **10 Years** | **15 Years** |
| REIT Global Database | 4.82 | 37.47 | -11.55 | 3.99 | 12.77 | - |
| EPRA/NAREIT Global | 4.40 | 38.26 | -12.39 | 2.00 | 9.21 | 8.71 |

*Returns less than one year are not annualized.
**Represents data available as of publication date.
Sources: Callan Associates Inc., NAREIT, NCREIF, The FTSE Group

All real estate returns are reported gross in USD.

PRIVATE EQUITY | Gary Robertson

# TREADING WATER

As expected, 2009's fundraising total dropped precipitously from last year. The $95.9 billion in commitments is only 36% of last year's total of $267 billion, with 28 fewer funds formed. This is the lowest fundraising total since 2003's $70 billion. In the fourth quarter, fundraising increased modestly with $19.5 billion in commitments and 75 new funds formed. This represents a $3.8 billion (17%) increase over the third quarter, with six additional funds. Similar to 2008, the fourth quarter of 2009 was not the largest, which is unusual as there is normally a rush to finish year-end business.

Callan anticipates that fundraising will continue to be slow in 2010. Most well-established general partners have raised funds in recent years that are undeployed and will be invested slowly. Although many institutions are feeling better about their liquidity position after the second-half rally in public securities, there will be fewer tenured partnerships in which to invest. Also, commitment amounts and fund sizes will remain smaller given the still cautious market environment.

### Funds Closed 1/1/09 to 12/31/09

| Strategy | # of Funds | Amt ($MM) | % |
|---|---|---|---|
| Venture Capital | 123 | 13,162 | 14% |
| Acquisition/Buyouts | 113 | 43,958 | 46% |
| Subordinated Debt | 20 | 3,262 | 3% |
| Distressed Debt | 21 | 9,800 | 10% |
| Other | 21 | 17,451 | 18% |
| Fund-of-funds | 37 | 8,282 | 9% |
| **Totals** | **335** | **95,915** | **100%** |

Source: The *Private Equity Analyst*

For the year, the investment pace by funds into companies fell precipitously by both dollar amount and number of transactions. The disclosed total for buyouts was $34.7 billion, with 530 investments closing in 2009. Dollar volume dropped 75% from the $137 billion in 2008, which had 872 transactions. For the quarter, the investment pace by funds into companies fell by the number of deals, but increased by dollar amount. According to *Buyouts* newsletter, buyout-sponsored U.S. acquisitions with announced values totaled only $20.2 billion during the quarter, with total transactions closed numbering 98. The fourth quarter's dollar volume was a step up from the $3.8 billion in the third quarter, but a drop from the previous quarter's 144 transactions. Half the dollar volume in the fourth quarter was the $11 billion purchase of the bankrupt automotive parts company Delphi Corp. Three other buyout transactions over $1 billion occurred during the fourth quarter.

Exit activity was similarly mixed for the fourth quarter and the year, although the fourth quarter was particularly strong for buyout-backed IPOs. Thomson Reuters reports that 64 M&A exits occurred during 2009, with 31 announcing values totaling $39 billion. The fourth quarter had 21 of the private exits, with 13 announcing values totaling $4.3 billion. There were 20 buyout-backed IPOs in 2009 valued at $6 billion, of which 17 totaling $4.9 billion were in the fourth quarter.

Please see our upcoming issue of *Private Markets Trends* for more in-depth coverage.

### Index Returns* for Periods ended December 31, 2009

| Private Equity Proxy | Quarter | Year | 3 Years | 5 Years | 10 Years | 15 Years |
|---|---|---|---|---|---|---|
| WP/VE Post-Venture Cap | 11.30 | 88.25 | -0.80 | 1.13 | -6.61 | 6.11 |

*Returns less than one year are not annualized.
Source: NVCA

HEDGE FUNDS | Jim McKee

# RECOVERY BOOSTS HEDGE FUNDS

In the fourth quarter, the capital markets continued to mend, yielding healthy returns for equity and credit investors. Notwithstanding high unemployment and restrained consumers, the U.S. economy benefited from cheap financing for creditworthy borrowers and higher worker productivity. The unanswerable question is how the U.S. government will now gracefully withdraw its stimulus of low rates and deficit spending without spooking investors in risky assets.

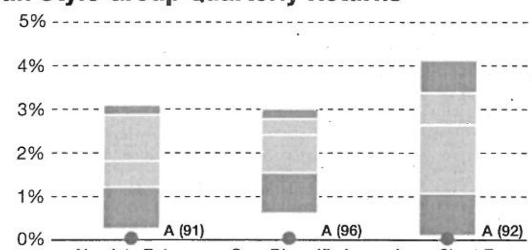
In this environment of improving liquidity and rising markets, most hedge funds made money. The median manager in the **Callan Hedge Fund-of-Funds Database** gained 2.40% net of fees in the fourth quarter.

Given the divergent views surrounding today's inflection point in the U.S. recovery, performance across the spectrum of hedge fund strategies was diverse. Although the **Credit Suisse/Tremont Hedge Fund Index,** an unmanaged index of hedge funds, rose a solid 3.14% last quarter, the returns of the underlying strategies ranged from -2.69% *(Short Bias)* to 5.38% *(Distressed).* As expected in a bullish market, the average *Long-Short Equity* manager (+2.39%) fell behind the S&P 500 (+6.04%). Struggling with indiscernible market twists in the fourth quarter, including a dollar snapback, *Managed Futures* declined 2.47%.

Despite strong support from convertibles and distressed securities, the *Callan Absolute Return FoF* manager (+1.81%) lagged the *Callan Long-Short Equity FoF* (+2.64%). More exposed across all strategies, the *Core Diversified FoF* advanced 2.41%.

Please see our upcoming issue of *Hedge Fund Monitor* for more in-depth coverage.

## Callan Style Group Quarterly Returns




| | Absolute Return FoF Style | Core Diversified FoF Style | Long-Short Eq FoF Style |
|---|---|---|---|
| 10th Percentile | 3.10 | 3.01 | 4.13 |
| 25th Percentile | 2.87 | 2.77 | 3.38 |
| Median | 1.81 | 2.41 | 2.64 |
| 75th Percentile | 1.21 | 1.54 | 1.07 |
| 90th Percentile | 0.25 | 0.61 | 0.10 |
| T-Bills ● | 0.04 | 0.04 | 0.04 |

Sources: Callan Associates Inc., Merrill Lynch

## Style Median and Index Returns* for Periods ended December 31, 2009

| Diversified Hedge Fund Strategies | Quarter | Year | 3 Years | 5 Years | 10 Years | 15 Years |
|---|---|---|---|---|---|---|
| Hedge Fund-of-Funds Database | 2.40 | 12.86 | 0.81 | 3.82 | 5.92 | 8.92 |
| CS/Tremont Hedge Fund Index | 3.14 | 18.57 | 2.60 | 5.76 | 6.57 | 10.30 |
| CS/Tremont Investable Blue Chip Index | 8.30 | 15.90 | -2.84 | 0.83 | - | - |
| **CS/Tremont Subindices** | **Quarter** | **Year** | **3 Years** | **5 Years** | **10 Years** | **15 Years** |
| Market Neutral | -1.15 | 4.05 | -12.12 | -4.35 | 2.11 | 5.99 |
| Convertible Arb | 5.27 | 47.35 | 1.96 | 3.38 | 7.37 | 8.82 |
| Fixed Income Arb | 4.47 | 27.41 | -1.98 | 0.59 | 3.73 | 5.13 |
| Multi-Strategy | 3.29 | 24.62 | 1.57 | 5.24 | 7.13 | 8.79 |
| Distressed | 5.38 | 20.95 | 1.39 | 6.12 | 8.99 | 11.94 |
| Risk Arb | 1.58 | 12.00 | 5.62 | 5.61 | 5.85 | 7.49 |
| Event-Driven Multi-Strategy | 4.65 | 19.94 | 5.48 | 7.92 | 8.99 | 10.42 |
| Long-Short Equity | 2.39 | 19.47 | 2.90 | 6.45 | 5.64 | 11.65 |
| Short Bias | -2.69 | -25.03 | -2.98 | -0.04 | -1.98 | -3.56 |
| Global Macro | 2.26 | 11.55 | 7.68 | 9.14 | 11.63 | 13.74 |
| Managed Futures | -2.47 | -6.57 | 5.43 | 4.81 | 6.76 | 5.93 |

*Returns less than one year are not annualized.
Sources: Callan Associates Inc., Credit Suisse Tremont LLC

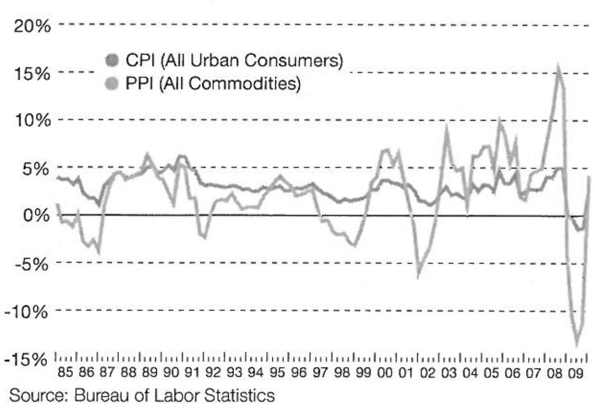
U.S. ECONOMY | Jay Kloepfer

# LINGERING STENCH

The Great Recession may be over, but the stench will linger for some time. We won't feel like we're breathing the fresh air of economic recovery until well into 2010 or perhaps even next year. Sharp recoveries usually follow steep recessions, but the experience in the U.S. and around the globe has been that recoveries after financial crises are slow. Financial stress has been greatly reduced, thanks in no small part to massive intervention by governments here and abroad. However, private credit is still contracting as banks are reluctant to lend and households and businesses are reluctant to borrow. The prospects for a V-shaped recovery are weak—we are mostly likely looking at it being U-shaped. Growth returned to the U.S economy in the second half of 2009, rising 2.2% in the third quarter and 5.7% in the fourth quarter. Fiscal and monetary stimuli drove these gains, along with the approaching turn in the inventory cycle. Aggregate demand is weak and concerns are high about whether a recovery can be sustained once the stimuli fade and the inventory cycle runs its course.

The fiscal stimulus added an estimated 1% to GDP growth in 2009 and is projected to add another 1.5% to growth in 2010. The stimulus included everything from government purchases, to infrastructure spending, direct transfers to state and local governments, tax cuts and credits, "Cash for Clunkers" and first-time home buyer credits. The monetary stimulus from the Fed is harder to gauge in GDP terms; clearly the Fed actions have helped to stabilize the financial system and prevent a downward spiral into depression and deflation. Interest rates are remarkably low, although rates alone can't spur borrowing. The Fed has aggressively purchased mortgages from financial institutions, which in turn have purchased Treasury debt. Both of these actions have held down interest rates. The scheduled conclusion to the mortgage purchase program at the end of March 2010 could signal higher rates, which may not be kind to a budding recovery.

**Inflation Year-Over-Year**

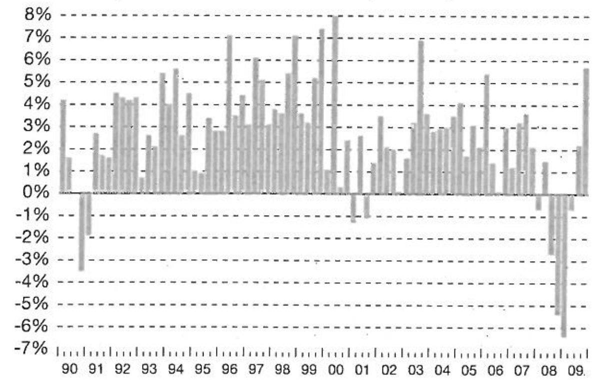



Source: Bureau of Labor Statistics

Inventories were drawn down dramatically as the economy went into a free fall in 2008. The contribution to GDP in the second half of 2009 did not come from an actual increase in inventories, but rather from a slowdown in the rate of decline as the inventory cycle approached bottom. Inventories are still falling, but they subtracted 0.75% less from GDP growth in the second half of the year. Going forward, the inventory cycle should provide a healthy push to the economy. Aggressive cost-cutting has sent one measure of productivity—output per worker—skyrocketing, advancing 7%, 8.5% and 6.5% in the last three quarters of 2009. Productivity gains and depleted inventories are two of the bright spots in the outlook for the economy.

Higher productivity certainly helps the bottom line but this particular path to productivity growth does nothing in the short term for the job market. The best thing to say about the job market at the end of 2009 is that we are losing jobs at a slower rate. After reaching a monthly loss of close to 700,000 jobs in January 2009, the decline in December came in just under 100,000. The national unemployment rate rose steadily during 2009, crossing 10% in the fourth quarter, and is unlikely to improve during the coming year. Unemployment is always a seriously lagging indicator, trailing measures like GDP that indicate recovery often a year before the unemployment rate starts to fall. The number of initial unemployment claims is a better leading indicator of the job market, and that measure has fallen from its April 2009 peak of around 650,000 to just north of 450,000 at the end of the year. Claims need to fall below 400,000 for employment to stabilize. Layoffs may be ending but hiring has yet to begin.

**Quarterly Real GDP Growth* (20 Years)**




Source: U.S. Department of Labor

The housing market remains a source of hope and consternation. A bottom to the housing market is often seen as the necessary condition for a sustained recovery in the economy and the financial system. Home prices appear to be stabilizing in some areas, yet sales remain weak. The first time home-buyer credit expired November 30, and sales dropped sharply in December, by over 15%. Credit has since been extended and broadened to current homeowners. Much is unknown about the condition and quality of the vast quantity of mortgage loans purchased by the Fed; the default and subsequent release of another round of houses on the market could send housing back down, dragging the financial system and the economy with it.

Inflation rose 2.7% during 2009, although that number compares December 2009 prices against the plunging prices of December 2008. Core inflation remains below 2%. Weak aggregate demand is holding back commodity prices and with unemployment at 10%, wage pressures are nonexistent.

## Recent Quarterly Indicators

| Economic Indicators (seasonally adjusted) | 1Q08 | 2Q08 | 3Q08 | 4Q08 | 1Q09 | 2Q09 | 3Q09 | 4Q09 |
|---|---|---|---|---|---|---|---|---|
| CPI–All Urban Consumers (year-over-year) | 4.0% | 5.0% | 4.9% | 0.1% | -0.4% | -1.4% | -1.3% | 2.7% |
| PPI–All Commodities (year-over-year) | 11.0% | 15.4% | 13.7% | -4.1% | -10.5% | -13.2% | -11.3% | 4.2% |
| Employment Cost–Total Compensation Growth | 3.0% | 2.7% | 2.6% | 1.9% | 0.7% | 0.7% | 1.8% | 1.2% |
| Non-farm Business–Productivity Growth | -0.1% | 3.1% | -0.1% | 0.8% | 0.3% | 6.9% | 8.1% | 6.5% |
| GDP Growth* | -0.7% | 1.5% | -2.7% | -5.4% | -6.4% | -0.7% | 2.2% | 5.7% |
| Manufacturing Capacity Utilization (level%) | 78.7 | 77.5 | 74.6 | 70.9 | 66.7 | 65.4 | 67.0 | 68.3 |
| Consumer Sentiment Index (1966=1.000) | 0.729 | 0.596 | 0.648 | 0.577 | 0.583 | 0.682 | 0.684 | 0.702 |

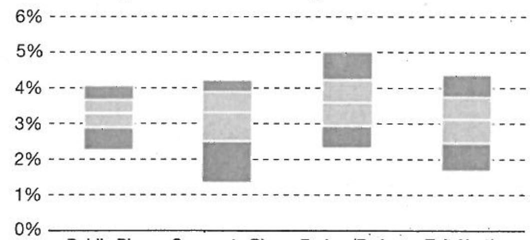
*The GDP estimates released on July 31, 2009 reflect the results of the comprehensive (or benchmark) revision of the national income and product accounts, according to the Bureau of Economic Analysis (BEA) Web site. More information on the revision is available at www.bea.gov/national/an1.htm.
Sources: Bureau of Economic Analysis, Bureau of Labor Statistics, Federal Reserve, Reuters/University of Michigan

DIVERSIFIED ACCOUNTS | Molly Jenkins

# ENDING ON A STRONG NOTE

Despite stumbling in October, the year ended with the broad equity market posting solid gains for the fourth quarter. A deceleration in job losses combined with increases in housing prices, consumer confidence and manufacturing are all signals that the economy is recovering. The equity markets, both at home and abroad, (Russell 3000: +5.9% and MSCI EAFE: +2.18%) ended the year on a positive note. Meanwhile, the domestic fixed income market stayed relatively flat for the quarter, but its international counterpart suffered a loss (Barclays Capital Aggregate: +0.20% and Citigroup Non-U.S. World Government Bond: -2.15%).

### Callan Fund Sponsor Quarterly Returns




| | Public Plan Database | Corporate Plan Database | Endow/Fndn Database | Taft-Hartley Database |
|---|---|---|---|---|
| 10th Percentile | 4.06 | 4.22 | 5.02 | 4.38 |
| 25th Percentile | 3.66 | 3.88 | 4.22 | 3.74 |
| Median | 3.29 | 3.31 | 3.59 | 3.12 |
| 75th Percentile | 2.89 | 2.50 | 2.93 | 2.46 |
| 90th Percentile | 2.25 | 1.33 | 2.31 | 1.67 |

Source: Callan Associates Inc.

Using the median manager returns from the current quarter and ending asset allocations from the prior quarter, Callan estimates the recent total returns of the institutional investor community.

The "Callan Fund Sponsor Returns" chart—illustrating the range of returns for the public, corporate and Taft-Hartley pension plans, as well as endowments/foundations—shows gains across every plan type for the third quarter in a row. As the markets settled and became more stable, the dispersion between the asset class returns became narrower. This allowed all of the fund sponsors to advance between 3.12% and 3.59%. After tying for last place in the third quarter, endowments/foundations (+3.59%) topped their institutional counterparts in the fourth quarter. Corporate plans (+3.31%) and public plans (+3.29%) were not far behind. Once again, Taft-Hartley plans took a back seat (+3.12%).

The table below compares the returns of the four types of institutional fund sponsors to several benchmarks over longer time periods. After a lackluster start to 2009, all of the plan sponsors were able to recover and end the year with strong double digit-gains. Corporate plans led the way (+21.04%). Public

### Style Median and Index Returns* for Periods ended December 31, 2009

| Plan Sponsor | Quarter | Year | 3 Years | 5 Years | 10 Years | 15 Years |
|---|---|---|---|---|---|---|
| Public Database | 3.29 | 19.88 | -1.13 | 3.41 | 3.88 | 8.02 |
| Corporate Database | 3.31 | 21.04 | -0.65 | 3.74 | 3.91 | 8.65 |
| Endowments/Foundations Database | 3.59 | 18.28 | -1.21 | 3.79 | 3.67 | 8.53 |
| Taft-Hartley Database | 3.12 | 18.12 | -0.99 | 3.02 | 3.54 | 7.46 |
| **Diversified Manager** | **Quarter** | **Year** | **3 Years** | **5 Years** | **10 Years** | **15 Years** |
| Asset Allocator Style | 5.47 | 33.26 | -4.96 | 0.99 | 2.45 | 7.41 |
| Domestic Balanced Database | 3.92 | 24.32 | -0.49 | 3.35 | 4.06 | 8.46 |
| Global Balanced Database | 2.15 | 19.31 | 2.37 | 4.16 | 4.87 | 9.10 |
| 60% Russell 3000 + 40% BC Aggregate | 3.62 | 19.55 | -0.31 | 2.87 | 2.89 | 8.08 |
| 60% MSCI World + 40% BC Global Agg | 2.10 | 20.81 | -0.03 | 3.51 | 2.91 | 6.76 |

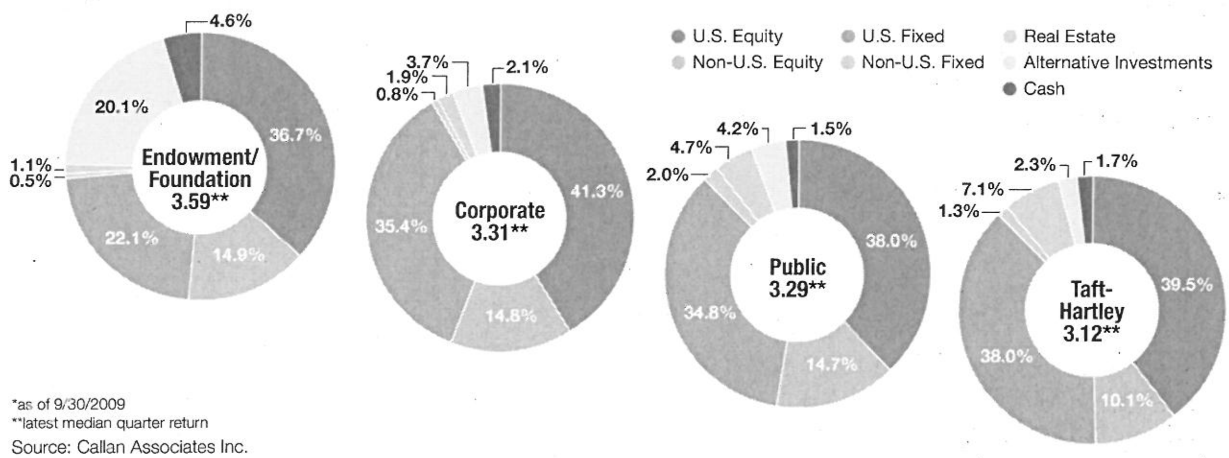
*Returns less than one year are not annualized.

Sources: Callan Associates Inc., Barclays Capital Inc., MSCI Inc., Russell Investment Group plans, endowment/ foundations and Taft-Hartley plans were not far behind, all up nearly 20% for the year.

Choices in asset allocation, as seen in the charts below, explain much of the difference in performance. Overall, the asset allocation percentages shifted very little from the previous quarter. While endowments/ foundations have a lower equity allocation (51.6%) than public plans (52.7%) and corporate plans (56.1%), they were able to benefit from having the lowest fixed income allocation, both domestically (22.1%) and abroad (0.5%). They also continue to have a much higher alternative investment allocation (20.1%) than the other fund sponsors (2.3% to 4.2%). Taft-Hartley plans were hurt by the fact that they have the highest fixed income allocation (39.3%) and the lowest equity allocation (49.6%).

Callan's balanced manager groups generally maintain well-diversified portfolios and attempt to add value by underweighting or overweighting asset classes, as well as through stock selection. During the quarter, global balanced managers (+2.15%) were able to narrowly outperform their 60% equity and 40% fixed income benchmark (+2.10%). As has been the case every quarter this year, domestic balanced managers (+3.92%) were able to best their benchmark (+3.62%). This is evident in the one year returns as the domestic balanced managers climbed 24.32% compared to 19.55% for the benchmark.

## Average Asset Allocation*




*as of 9/30/2009
**latest median quarter return
Source: Callan Associates Inc.