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12 Co-Conservator of the Estate

13
14 **SUPERIOR COURT OF THE STATE OF CALIFORNIA**
15 **FOR THE COUNTY OF LOS ANGELES**
16

17 In re the Conservatorship of the Person and
Estate of

18 BRITNEY JEAN SPEARS,
19
20 Conservatee.

Case No. BP 108 870

NOTICE OF ERRATA RE *EX PARTE*
PETITION FOR ORDER MODIFYING
INVESTMENT STRATEGY

[Probate Code §§ 2403, 2570, 2328]

Date: March __, 2013


Time: 8:30 a.m.

Dept. 9 / Room 258

Assigned to Hon. Reva Goetz

FILED
Superior Court of California
County of Los Angeles

MAR 29 2013

John A. Clarke, Executive Officer/Clerk
By:  Deputy
Andrea Murdock

1 **TO ALL PARTIES AND THEIR COUNSEL OF RECORD:**

2 YOU ARE HEREBY NOTIFIED THAT Exhibits A and B to the Ex Parte Petition for
3 Order Modifying Investment Strategy were inadvertently omitted. Exhibit A to this Petition is a
4 true and correct copy of a recent article entitled "Portfolio Management: The New 60/40" by Art
5 Steinmetz, Chief Investment Officer of Oppenheimer Funds. Exhibit B is a true and correct copy
6 of the article "What Are Alternative Investments?" by Merrill Lynch Wealth Management. Both
7 Exhibits are attached to this Notice of Errata.
8

9 Dated: March 28, 2013

Respectfully submitted,

10 HOFFMAN, SABBAN & WATENMAKER
11 A Professional Corporation
12 Attorneys for James P. Spears, Conservator of the
13 Person and Co-Conservator of the Estate of Britney
14 Jean Spears

15 HINOJOSA & WALLET, LLP

16 Andrew M. Wallet, Co-Conservator of the Estate of
17 Britney Jean Spears

18 By: 

19 GERALDINE A. WYLE
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Focus On...

Portfolio Management
The New 60/40

Executive Summary

Structural changes in the global economy are gradually rendering traditional portfolio construction strategies obsolete. A typical asset allocation model of 60% domestic equities and 40% high grade bonds no longer reflects the breadth of opportunity in the world. Moreover, it is unlikely to provide many of the diversification benefits it once did.

We believe asset allocation models must evolve. The New 60/40 must be more globalized, more diversified and more nimble, to expand the growth opportunity set, generate real income and protect against specific risks.

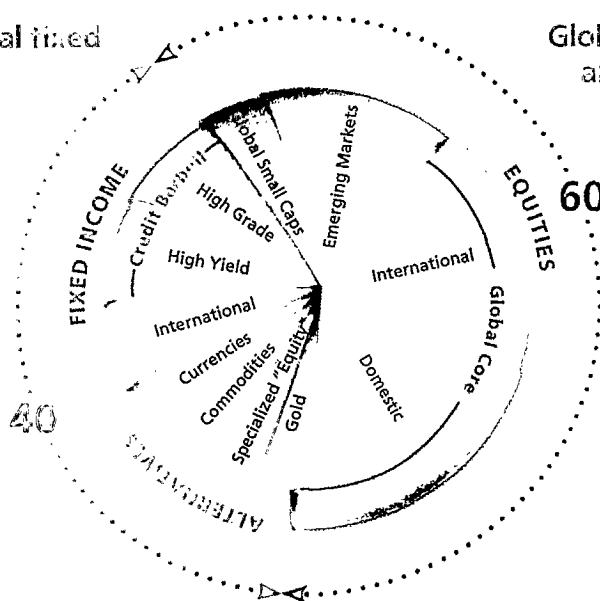


Art Steinmetz
Chief Investment
Officer

In brief, we believe that investors should

Think beyond traditional fixed
income allocations

- Own a core "credit barbell" of U.S. Government and domestic high yield bonds and/or senior loans
- Add exposure to developed and emerging market international bonds
- Use alternative assets and specialized equity exposure to help protect against inflation and other risks

Globalize their equity
allocations

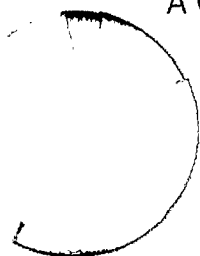
- Combine shares of large companies headquartered across developed markets
- Add positions in emerging market and global small-cap stocks



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Not FDIC Insured May Lose Value Not Bank Guaranteed

The New 60%: A Globalized Equity Portfolio



Almost 80% of the equity portion of a typical portfolio today (represented by the Lipper Mixed-Asset Target Allocation Growth Funds Category)¹ is allocated to U.S. stocks, with the remainder in international equities.²

Such allocations might have been more appropriate in the early 1970s, when American companies constituted nearly 70% of global market capitalization (see Chart 1). Today, however, U.S. companies represent less than half of global market cap, with the rest of the developed world comprising 41.38% and emerging markets contributing 12.58%.³

The world has changed—and so must investors' equity allocations. Having a more significant allocation to international equities is likely to become even more important in the future, considering that

- Foreign countries now contribute about four-fifths of world GDP⁴
- Among publicly traded companies with a market capitalization of over \$1 billion, fully three-quarters are headquartered outside of the U.S.
- U.S. firms constitute only one-third of the top 500 global companies by sales⁵

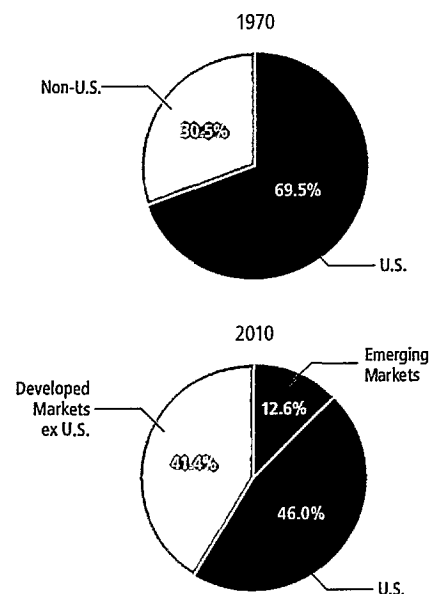
The fact is, not all of the world's best or fastest growing companies are domiciled in the U.S. anymore. Investors must be willing to pursue investment opportunities globally—or risk missing them altogether.

Combine shares of large companies headquartered across developed markets

The changing composition of the global economy implies that investors need greater international equity exposure. What's less clear, given the rising

CHART 1

Market Cap as a Percentage of the MSCI All-Country World Index*



*Note: Data for the U.S. represents the market-capitalization weight of the MSCI U.S. Index within the MSCI World Index through 1987, and its weight in the MSCI ACWI Index thereafter. Source: MSCI Barra, 12/31/10.

correlation between the S&P 500 Index and international stocks, is how best to get it.

The "Global Core" approach

We recommend that investors center their equity allocations on a "global core" holding, consisting mainly of shares in large companies headquartered across developed markets. This path should work best for investors who are funding a new portfolio or adding significant new assets to an existing portfolio. The idea is to gain comprehensive exposure to the world's prime corporate movers, and to evaluate companies against their competitors worldwide (not simply within regions).

1. Lipper defines this category as "Funds that, by portfolio practice, maintain a mix of between 60%–80% equity securities, with the remainder invested in bonds, cash and cash equivalents."

2. Source: Lipper, Inc. (fund data), Morningstar, Inc. (asset class data), 10/31/12.

3. Source: MSCI Barra, 12/31/10.

4. Source: International Monetary Fund, as of 10/31/12.

5. Source: Bloomberg, OppenheimerFunds research, *Fortune Magazine*, as of 10/31/12.

This flexible approach has demonstrated clear long-term advantages over simply combining U.S. and international mutual funds. On average, over the 10-year period ending October 31, 2012, active global managers outperformed both international (regional) managers and U.S. managers against the MSCI World Index, a common global benchmark.⁶

The traditional way: domestic plus international

For investors who already have significant domestic equity holdings and do not want to unwind them completely, a more traditional, regionally segmented approach—appending an international allocation to an existing diversified domestic allocation—may also prove viable. In this case, we favor adding incremental assets to international investments to bring the overall global exposure more in line with global market capitalizations and economic activity.

Add positions in emerging market and global small-cap stocks

Regardless of whether one adopts the “global core” or “traditional” (domestic plus international) approach, two other equity categories offer distinct enough characteristics to warrant inclusion in a globalized equity portfolio: emerging market and small-cap stocks.

Emerging market stocks

Broadly diversified global portfolios will, by definition, include exposure to emerging market stocks. Such stocks tend to be less correlated with developed market stocks than other asset classes. Moreover, emerging markets, while at times volatile, are undergoing powerful, long-term economic and demographic shifts. We expect these shifts to propel billions of people into the global middle class over the next several decades, revolutionizing growth and consumption patterns in the process.

Capitalizing on emerging market opportunities requires specialized portfolio management abilities, given the sheer number of countries in the category, each with different economic, political and regulatory characteristics. Other factors, such as generally low analyst coverage (which may render markets less efficient) and the abundance of tradable stocks also make a specialized approach advantageous.

Small-cap stocks

Because domestic and international small-cap stocks, like emerging market stocks, have relatively modest correlations to their large-cap counterparts, they also offer important potential diversification and growth benefits. However, they, too, may be relatively volatile.

The small-cap market is generally less efficient and liquid than the large- and mid-cap segments, and small-cap returns are often driven more by company-specific characteristics than large-cap returns are. With analyst coverage of small-cap stocks far thinner than for their larger counterparts, it is critical for small-cap managers to possess local, company-specific knowledge of a vast number of small-cap stocks in the country or region of their interest—in other words, to be specialists.

WHAT IT MEANS FOR INVESTORS

The globalization of financial markets and the explosion of opportunities beyond U.S. borders means that most U.S. investors’ equity allocations need a fresh approach. We recommend that

- ▣ Investors seeking an alternative, potentially more efficient approach employ a “global core” allocation and add exposure to emerging markets and domestic and international small caps
- ▣ Investors with an established portfolio built along “traditional” lines add meaningful exposure to international stocks—including emerging market equities—as well as domestic and international small-cap stocks

6. Source: FactSet, as of 10/31/12. **Past performance does not guarantee future results.**

The New 40%: Beyond Traditional Fixed Income



The loss of purchasing power—the amount of goods and services money can buy—is one of the most crucial risks to one's wealth. Americans' purchasing power faces threats as consumer needs get costlier while household incomes fail to keep pace.

Compounding the problem, interest rates on high quality U.S. bonds have fallen steadily for more than 30 years, reaching all-time lows in 2012. As a result, investors now face the obvious problem of finding little "income" in "fixed income." Moreover, as long as the rate of inflation exceeds yields on high quality bonds, (consumer inflation has averaged about 4.5% since 1970), real returns will be negative—virtually guaranteeing a loss of wealth over time.

During the past three equity bear markets, a standard 40% allocation to high quality bonds would have mitigated much of the loss on the stock portion of a portfolio via steady income and capital gains. But in a low or rising-rate environment, it is unlikely that the same 40% allocation would provide similar portfolio benefits.

Own a "credit barbell" of U.S. Government and domestic high yield bonds and/or senior loans

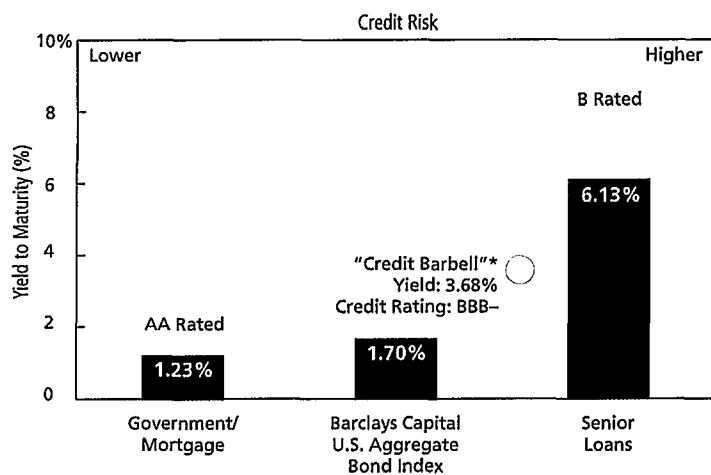
For the domestic fixed income allocation, we believe in using a "credit barbell" strategy that combines highly rated (but typically low yielding) government securities with lower rated, high yield bonds and/or senior floating rate bank loans. As of October 31, 2012, a barbell strategy with equal exposure to these two fixed income categories offered a significantly higher yield than the Barclays Capital U.S. Aggregate Bond Index, while keeping aggregate default risk moderate (see Chart 2).

Although there are risks associated with lending money to below-investment-grade companies, today's generous yields appear to be compensating investors adequately to do so, and the smaller government bond position may still serve as a counterweight in the event of market duress. In addition, today's low rate environment means that the upside to the Barclays Capital U.S. Aggregate Bond Index is capped, while the potential downside risk in a rising rate environment could be considerable.

Senior loans appear particularly well-suited to addressing the risk associated with rising interest rates, known as duration risk. Besides typically offering greater income than higher credit quality bonds of a comparable maturity, these loans' "floating" interest rates reset every 30 to 90 days, based on changes in common benchmarks such as the London Interbank Offered Rate (LIBOR). Unlike fixed rate bonds, these loans generate more income for investors if benchmark interest rates rise. Their relatively low sensitivity to interest rate changes also tends to keep their prices more stable than the prices on fixed coupon bonds. Keep in mind that senior loans are typically lower rated (more at risk of default) and may be illiquid investments (lacking a ready market).

CHART 2

Domestic Fixed Income Approach: "Credit Barbell"
Potential Income Advantage Over Investment Grade Bonds



Source: Barclays Capital and JPMorgan, as of 10/31/12.

Government/Mortgage is represented by 70% Barclays Capital U.S. Aggregate Government Bond Index and 30% Barclays Capital MBS Index.

Senior loans are represented by the Credit Suisse Leveraged Loan Index.

*Credit Barbell is a blend of 50% Government/Mortgage and 50% Senior Loans. The credit rating of the credit barbell is assigned based on historical average default trends of similarly rated securities.

Senior loan yield is calculated by adding discount margin to maturity to 3-Month LIBOR.

Indices are unmanaged and cannot be purchased directly by investors. Index performance is shown for illustrative purposes only and does not predict or depict the performance of any Oppenheimer fund.

Past performance does not guarantee future results.

Add exposure to developed and emerging market international bonds

We also strongly advocate including international exposure in a core fixed income allocation. International bonds offer potentially profound diversification benefits, given their low correlations to the Barclays Capital U.S. Aggregate Bond Index.

Additionally, international bonds offer

- A larger opportunity set than U.S. markets alone provide
 - Access to higher yields than are available domestically (see Chart 3)
 - Foreign exchange exposure, which can help offset swings in the value of the U.S. dollar versus other currencies
- A potential hedge against the effects of import-price inflation

Total of the Top: Fixed Income Barbell versus Aggregate Index

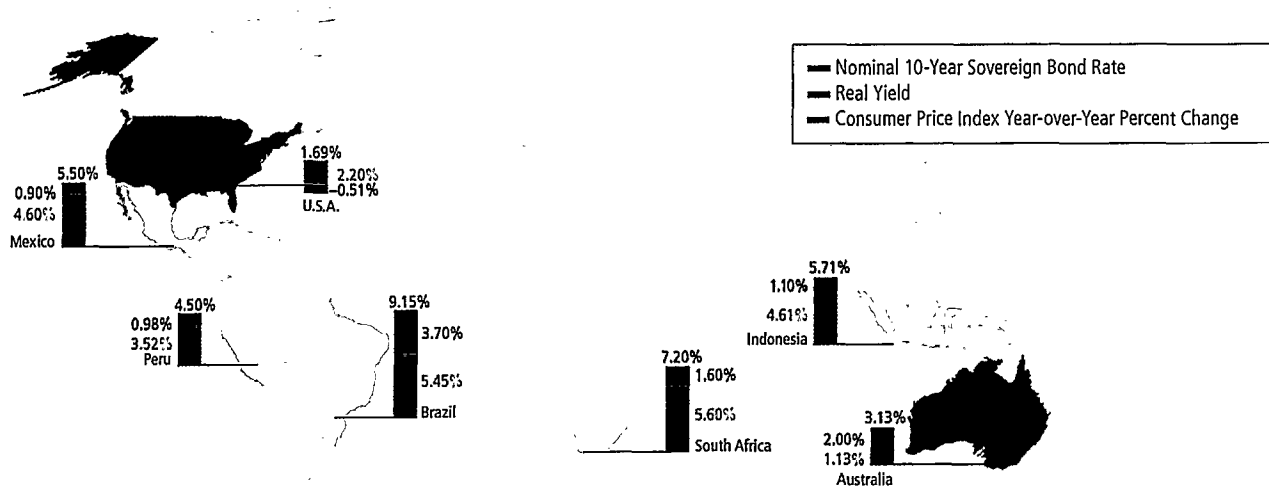
In periods of rising treasury rates dating back to 1990, the government securities/high yield barbell approach would have outperformed the aggregate bond portfolio by an average of 950 basis points.⁷ If interest rates hypothetically were to rise by 100 basis points from November 1, 2012, to October 31, 2013, with all else held equal, the government securities/senior loan barbell (with a 3.68% yield and 1.62 years duration) would return 2.06%.⁸ In comparison, the Barclays Capital U.S. Aggregate Bond Index (1.70% yield, 5.02 years duration) would decline by 3.32%. Investors expecting a "traditional" core bond holding to provide ballast in all market environments are likely to be disappointed.

Exposure to both developed and emerging market debt is critical, in our view, given that the global business cycle affects each area of the world differently. The full extent to which developed and emerging economies have "decoupled" is as yet unknown. It's worth noting, however, that while emerging markets suffered to some degree along with developed markets in the 2008 global financial crisis, their increasingly domestically oriented

As long as the rate of inflation exceeds yields on high quality bonds, real returns will be negative—virtually guaranteeing a loss of wealth over time.

CHART 3

Developing Markets May Be More Attractive than U.S.



Diversification does not guarantee profit or protect against loss.

Source: Bloomberg, 10/31/12. CPI data is most recent available, as of 10/31/12 for all countries except Australia, which is as of 9/30/12. Nominal yields are that of each country's "on-the-run" (most recently issued) 10-year government bond. Real yield is equal to the country's 10-year sovereign bond rate minus the year-over-year change in the country's consumer price index. Past performance does not guarantee future results.

7. Source: Bloomberg, as of 10/31/12. This is a hypothetical illustration and does not predict or depict the performance of any fund. **Past performance does not guarantee future results.**

8. Duration measures a bond's sensitivity to a 1.00% change in interest rates, expressed in years. If a bond has a duration of 4.50, for example, and interest rates rise 1.00%, the bond will lose 4.50% in value. Adding back in the bond's yield provides the total return for the period. This is a hypothetical illustration and does not predict or depict the performance of any fund.

economies proved very resilient. Emerging market growth rebounded quickly, while many developed economies still remain burdened by high debt levels, slow-to-negative growth and high unemployment. Strategic exposure to both developed and emerging market bonds (and currencies) is an effective way, in our view, to seek to take advantage of the decoupling of the global economy.

Use alternative assets and specialized equity exposure to help protect against inflation and other risks

The “traditional” companion to a portfolio’s equity allocation generally consists entirely of fixed income investments but, as we’ve seen, such a narrow approach faces increasing limitations. While fixed income will continue to play a dominant role in the New 40%, it is essential that investors incorporate a mix of alternative assets and specialized equities, like real estate investment trusts and master limited partnerships, to help address inflation and other risks.

Alternative investments

Like “traditional” fixed income investments, many alternative asset classes have low historical correlations to equities. While there are times when some alternatives lag the broader market, small allocations have the potential to benefit a portfolio during periods of market stress. For example, modest allocations to gold and commodities would have helped investors during the past decade and provided substantial diversification benefits during the credit crisis, in particular. Diversification does not guarantee profit or protect against loss.

Currencies—Investors concerned about protecting their purchasing power often focus on the effects of consumer inflation and higher interest rates. But what if inflation comes from a different source?

For several decades now, plentiful overseas labor, particularly in emerging countries such as China, has kept prices low for a range of goods imported into America. With wages rising in many of those economies and demand for commodities increasing, however, the era of importing deflation into the U.S. may be coming to an end, setting the stage for higher prices.

Historically, exposure to foreign currencies—either directly, or through locally denominated international bonds—has served as an effective way to offset import price inflation, and thus to help preserve purchasing power in dollar terms.

Commodities—Exposure to commodities or commodity-linked investments is another potential way to diversify a stock and bond portfolio and help protect purchasing power. Commodities represent an ownership claim on real assets, such as a barrel of oil or a bushel of wheat, and historically they have outperformed U.S. and international equities in environments of rising inflation. Despite their high correlation to consumer inflation over the past two decades, they have been poorly correlated to both U.S. stocks and investment-grade bonds, making them valuable diversifiers. Finally, commodities may help protect an investor against the effects of U.S. dollar weakness, since most commodities trade in dollars.

Gold—The yellow metal serves as a potential hedge against numerous tail risks, including geopolitical turmoil and the loss of purchasing power that can come from a weakening currency. The price of gold has historically been negatively correlated to U.S. equity indices, making it a potentially valuable diversifier.

Among the possible downsides to owning gold is that it has no yield, so it may carry an opportunity cost. But in an era of very low interest rates across the developed world and with central banks seemingly committed to keeping them that way for an extended period, this cost appears minimal.

Specialized “Equity”

Investors may also diversify some of their fixed income allocations into specialized “equity” exposures like real estate investment trusts and master limited partnerships that currently provide an attractive income and may help manage future inflation.

REITs—Real estate investment trusts provide a potential hedge against rising prices through the inflation-sensitive cash flow stream inherent in the asset class. Costs for land, labor and materials are passed through to tenants in the form of more

expensive leases—and therefore potentially higher dividends for investors.

Historically, the FTSE NAREIT Equity REITs Index has tended to offer a higher yield than the Barclays Capital U.S. Aggregate Bond Index⁹ and dividend growth that has outpaced the Consumer Price Index (CPI)¹⁰—characteristics that have led to nearly zero correlation between the performance of REITs and high quality bonds. Investors should note that investments in real estate companies, including REITs, are subject to volatility and risk, including loss in value due to poor management, lowered credit ratings and other factors. Smaller real estate companies may also be subject to liquidity risk.

MLPs—Master limited partnerships (MLPs) have historically generated cash flows (and therefore distributions) that outpace inflation over time.¹¹ The energy infrastructure MLP sector consists of companies that own and operate long-lived, high value physical assets such as pipelines and terminals for the storage and transportation of oil and natural gas along the supply chain. MLPs are akin to toll roads, earning fees for the service of shipping such commodities, the demand for which is generally so high that rising prices tend not to diminish it. MLPs provide a potential hedge against rising prices because the government determines these fees in accordance with changes in the Producer Price Index, a measure of wholesale inflation.

Historically, the Alerian MLP Index has offered a higher yield than the Barclays Capital U.S. Aggregate Bond Index, and its income growth has outpaced the Consumer Price Index¹¹—characteristics that have led to nearly zero correlation with asset categories like equities and high quality bonds. Energy infrastructure companies are subject to risks specific to the industry, such as reduced volumes of natural gas or other energy commodities, environmental hazards, changes in the regulatory environment and extreme weather.

WHAT IT MEANS FOR INVESTORS

Traditional fixed income allocations consisting mainly of high quality domestic bonds increasingly appear ill-suited to the challenges of today's markets. We believe investors should consider

- ▣ Using a “credit barbell” of U.S. Government bonds and domestic high yield bonds as a core fixed income position
- ▣ Supplementing this with exposure to developed and emerging market international bonds
- ▣ Addressing inflation and other risks via exposure to select alternative investments and specialized “equity” instruments

Index Definitions

The Alerian MLP Index is a composite of the 50 most prominent energy Master Limited Partnerships (MLPs) that provides investors with an unbiased, comprehensive benchmark for this emerging asset class.

The Barclays Capital U.S. Aggregate Bond Index is an investment-grade domestic bond index.

The Barclays Capital U.S. Credit/Corporate/Investment Grade Bond Index represents primarily investment-grade corporate bonds within the Barclays Capital U.S. Aggregate Bond Index.

The Barclays Capital U.S. Aggregate Government Bond Index is composed of all publicly issued non-convertible, domestic debt of the U.S. Government or any agency thereof, quasi-federal corporation or corporate debt guaranteed.

The Barclays Capital MBS Index represents the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA) and Freddie Mac (FHLMC).

The Consumer Price Index (CPI) program produces monthly data on changes in the prices paid by urban consumers for a representative basket of goods and services.

The Credit Suisse Leveraged Loan Index tracks the performance of senior loans.

The FTSE National Association of Real Estate Investment Trusts (NAREIT) Equity REITs Index consists of certain companies that own and operate income-producing real estate that have 75% or more of their respective gross invested assets in the equity or mortgage debt of commercial properties.

The Morgan Stanley Capital International (MSCI) All Country World Index (ACWI) is designed to measure the equity market performance of developed and emerging markets.

The MSCI EAFE (Europe, Australasia, Far East) Index is designed to measure developed market equity performance, excluding the U.S. and Canada.

The MSCI Emerging Markets (EM) Index is designed to measure global emerging market equity performance.

The MSCI U.S. Index is designed to measure U.S. equity market performance.

The MSCI World Index is designed to measure global developed market equity performance.

The S&P 500 Index is a broad-based measure of domestic stock market performance.

Each index is unmanaged and cannot be purchased directly by investors. Index performance is shown for illustrative purposes only and does not predict or depict the performance of any Oppenheimer fund. **Past performance does not guarantee future results.**

9. Source: FactSet, 7/25/12. **Past performance does not guarantee future results.**

10. Source: Cornerstone Research, NAREIT, Bloomberg, 12/31/11. **Past performance does not guarantee future results.**

11. Source: Alerian, Bloomberg, 10/31/12. **Past performance does not guarantee future results.**

A typical asset allocation model of 60% domestic equities and 40% high grade bonds no longer reflects the breadth of opportunity in the world and is unlikely to provide many of the diversification benefits it once did.

The New 60/40 is a more globalized, diversified and nimble approach that seeks to help investors:

- Find growth *Page 2*
- Generate income *Page 4*
- Protect against inflation and other risks *Page 6*

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A fund's performance depends largely upon the portfolio managers' skill in selecting the best mix of investments. The portfolio managers' evaluations and assumptions regarding the prospects of the global financial markets may be incorrect and a fund's performance may be adversely affected by their asset allocation decisions.

Foreign investments may be volatile and involve additional expenses and special risks including currency fluctuations, foreign taxes and political and economic uncertainties. Emerging and developing market investments may be especially volatile.

Derivative instruments, investments whose values depend on the performance of an underlying security, asset, interest rate, index or currency, entail potentially higher volatility and risk of loss compared to traditional stock or bond investments. Currency derivative instruments may be particularly volatile and involve significant risks.

Short selling may increase volatility and risk of loss and is considered a speculative investment practice.

Fixed income investing entails credit risks and interest rate risks. When interest rates rise, bond prices generally fall, and the Fund's share prices can fall.

Commodity-linked investments are considered speculative and have substantial risks, including the risk of loss of a significant portion of their principal value.

Small company stock is typically more volatile than that of larger, more established businesses, as these stocks tend to be more sensitive to changes in earnings expectations and tend to have lower trading volumes than large-cap securities, creating potential for more erratic price movements. It may take a substantial period of time to realize a gain on an investment in a small company, if any gain is realized at all. Investments in securities of real estate companies may be especially volatile. Because they do not have an active trading market, shares of Real Estate Investment Trusts (REITs) may be illiquid. The lack of an active trading market may make it difficult to value or sell shares of REITs promptly at an acceptable price.

When interest rates rise, bond prices generally fall, and the Fund's share prices can fall. Invests in below-investment-grade ("high yield" or "junk") bonds, which are more at risk of default and are subject to liquidity risk. Senior loans are typically lower rated (more at risk of default) and may be illiquid investments (which may not have a ready market).

There is no guarantee that the issuers of stocks held by mutual funds will declare dividends in the future, or that if dividends are declared, they will remain at their current levels or increase over time.

Inflation-indexed debt securities (including TIPS) are bonds structured to seek to provide protection against inflation. If inflation declines, the principal amount or the interest rate of an inflation-indexed bond will be adjusted downward. This will result in reduced income and may result in a decline in the bond's price, which could cause losses. Interest payments on inflation-protected debt securities can be unpredictable and will vary as the principal or interest rate is adjusted for inflation. Inflation-indexed debt securities are also subject to the risks associated with investments in fixed income securities.

Investing in MLPs involves additional risks as compared to the risks of investing in common stock, including risks related to cash flow, dilution, and voting rights. Energy infrastructure companies are subject to risks specific to the industry such as fluctuations in commodity prices, reduced volumes of natural gas or other energy commodities, environmental hazards, changes in the macroeconomic or the regulatory environment or extreme weather. MLPs may trade less frequently than larger companies due to their smaller capitalizations which may result in erratic price movement or difficulty in buying or selling. MLPs are subject to significant regulation and may be adversely affected by changes in the regulatory environment including the risk that an MLP could lose its tax status as a partnership.

Shares of Oppenheimer funds are not deposits or obligations of any bank, are not guaranteed by any bank, are not insured by the FDIC or any other agency, and involve investment risks, including the possible loss of the principal amount invested.

Before investing in any of the Oppenheimer funds, investors should carefully consider a fund's investment objectives, risks, charges and expenses. Fund prospectuses and summary prospectuses contain this and other information about the funds, and may be obtained by asking your financial advisor, visiting oppenheimerfunds.com or calling 1.800.CALL OPP (225.5677). Read prospectuses and summary prospectuses carefully before investing.

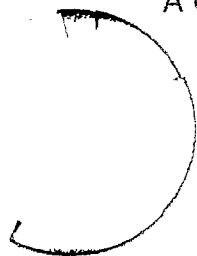
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DS0001.186.1112 December 7, 2012



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The New 60%: A Globalized Equity Portfolio



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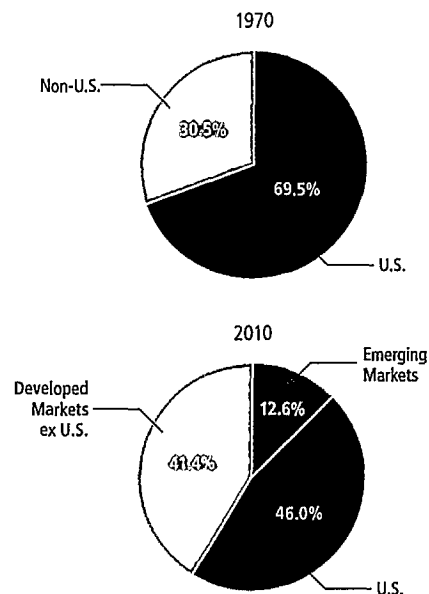
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The "Global Core" approach

We recommend that investors center their equity allocations on a "global core" holding, consisting mainly of shares in large companies headquartered across developed markets. This path should work best for investors who are funding a new portfolio or adding significant new assets to an existing portfolio. The idea is to gain comprehensive exposure to the world's prime corporate movers, and to evaluate companies against their competitors worldwide (not simply within regions).

1. Lipper defines this category as "Funds that, by portfolio practice, maintain a mix of between 60%–80% equity securities, with the remainder invested in bonds, cash and cash equivalents."

2. Source: Lipper, Inc. (fund data), Morningstar, Inc. (asset class data), 10/31/12.

3. Source: MSCI Barra, 12/31/10.

4. Source: International Monetary Fund, as of 10/31/12.

5. Source: Bloomberg, OppenheimerFunds research, *Fortune Magazine*, as of 10/31/12.

This flexible approach has demonstrated clear long-term advantages over simply combining U.S. and international mutual funds. On average, over the 10-year period ending October 31, 2012, active global managers outperformed both international (regional) managers and U.S. managers against the MSCI World Index, a common global benchmark.⁶

The traditional way: domestic plus international

For investors who already have significant domestic equity holdings and do not want to unwind them completely, a more traditional, regionally segmented approach—appending an international allocation to an existing diversified domestic allocation—may also prove viable. In this case, we favor adding incremental assets to international investments to bring the overall global exposure more in line with global market capitalizations and economic activity.

Add positions in emerging market and global small-cap stocks

Regardless of whether one adopts the “global core” or “traditional” (domestic plus international) approach, two other equity categories offer distinct enough characteristics to warrant inclusion in a globalized equity portfolio: emerging market and small-cap stocks.

Emerging market stocks

Broadly diversified global portfolios will, by definition, include exposure to emerging market stocks. Such stocks tend to be less correlated with developed market stocks than other asset classes. Moreover, emerging markets, while at times volatile, are undergoing powerful, long-term economic and demographic shifts. We expect these shifts to propel billions of people into the global middle class over the next several decades, revolutionizing growth and consumption patterns in the process.

Capitalizing on emerging market opportunities requires specialized portfolio management abilities, given the sheer number of countries in the category, each with different economic, political and regulatory characteristics. Other factors, such as generally low analyst coverage (which may render markets less efficient) and the abundance of tradable stocks also make a specialized approach advantageous.

Small-cap stocks

Because domestic and international small-cap stocks, like emerging market stocks, have relatively modest correlations to their large-cap counterparts, they also offer important potential diversification and growth benefits. However, they, too, may be relatively volatile.

The small-cap market is generally less efficient and liquid than the large- and mid-cap segments, and small-cap returns are often driven more by company-specific characteristics than large-cap returns are. With analyst coverage of small-cap stocks far thinner than for their larger counterparts, it is critical for small-cap managers to possess local, company-specific knowledge of a vast number of small-cap stocks in the country or region of their interest—in other words, to be specialists.

WHAT IT MEANS FOR INVESTORS

The globalization of financial markets and the explosion of opportunities beyond U.S. borders means that most U.S. investors’ equity allocations need a fresh approach. We recommend that

- ▣ Investors seeking an alternative, potentially more efficient approach employ a “global core” allocation and add exposure to emerging markets and domestic and international small caps
- ▣ Investors with an established portfolio built along “traditional” lines add meaningful exposure to international stocks—including emerging market equities—as well as domestic and international small-cap stocks

6. Source: FactSet, as of 10/31/12. **Past performance does not guarantee future results.**

The New 40%: Beyond Traditional Fixed Income



The loss of purchasing power—the amount of goods and services money can buy—is one of the most crucial risks to one's wealth. Americans' purchasing power faces threats as consumer needs get costlier while household incomes fail to keep pace.

Compounding the problem, interest rates on high quality U.S. bonds have fallen steadily for more than 30 years, reaching all-time lows in 2012. As a result, investors now face the obvious problem of finding little "income" in "fixed income." Moreover, as long as the rate of inflation exceeds yields on high quality bonds, (consumer inflation has averaged about 4.5% since 1970), real returns will be negative—virtually guaranteeing a loss of wealth over time.

During the past three equity bear markets, a standard 40% allocation to high quality bonds would have mitigated much of the loss on the stock portion of a portfolio via steady income and capital gains. But in a low or rising-rate environment, it is unlikely that the same 40% allocation would provide similar portfolio benefits.

Own a "credit barbell" of U.S. Government and domestic high yield bonds and/or senior loans

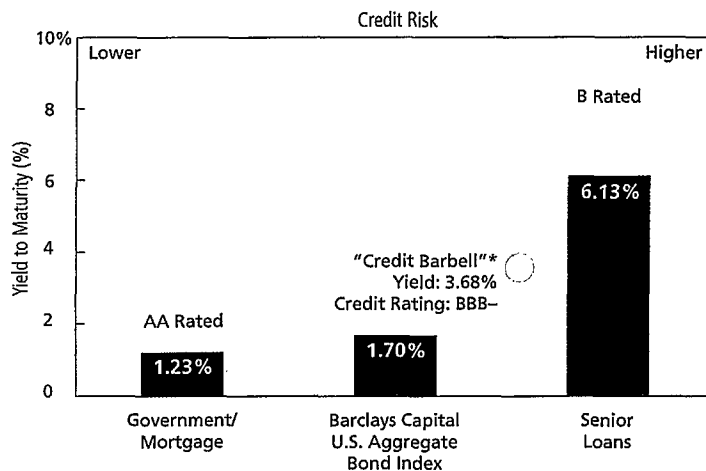
For the domestic fixed income allocation, we believe in using a "credit barbell" strategy that combines highly rated (but typically low yielding) government securities with lower rated, high yield bonds and/or senior floating rate bank loans. As of October 31, 2012, a barbell strategy with equal exposure to these two fixed income categories offered a significantly higher yield than the Barclays Capital U.S. Aggregate Bond Index, while keeping aggregate default risk moderate (see Chart 2).

Although there are risks associated with lending money to below-investment-grade companies, today's generous yields appear to be compensating investors adequately to do so, and the smaller government bond position may still serve as a counterweight in the event of market duress. In addition, today's low rate environment means that the upside to the Barclays Capital U.S. Aggregate Bond Index is capped, while the potential downside risk in a rising rate environment could be considerable.

Senior loans appear particularly well-suited to addressing the risk associated with rising interest rates, known as duration risk. Besides typically offering greater income than higher credit quality bonds of a comparable maturity, these loans' "floating" interest rates reset every 30 to 90 days, based on changes in common benchmarks such as the London Interbank Offered Rate (LIBOR). Unlike fixed rate bonds, these loans generate more income for investors if benchmark interest rates rise. Their relatively low sensitivity to interest rate changes also tends to keep their prices more stable than the prices on fixed coupon bonds. Keep in mind that senior loans are typically lower rated (more at risk of default) and may be illiquid investments (lacking a ready market).

CHART 2

Domestic Fixed Income Approach: "Credit Barbell" Potential Income Advantage Over Investment-Grade Bonds



Source: Barclays Capital and JPMorgan, as of 10/31/12.

Government/Mortgage is represented by 70% Barclays Capital U.S. Aggregate Government Bond Index and 30% Barclays Capital MBS Index.

Senior loans are represented by the Credit Suisse Leveraged Loan Index.

*Credit Barbell is a blend of 50% Government/Mortgage and 50% Senior Loans. The credit rating of the credit barbell is assigned based on historical average default trends of similarly rated securities.

Senior loan yield is calculated by adding discount margin to maturity to 3-Month LIBOR.

Indices are unmanaged and cannot be purchased directly by investors. Index performance is shown for illustrative purposes only and does not predict or depict the performance of any Oppenheimer fund.

Past performance does not guarantee future results.

Add exposure to developed and emerging market international bonds

We also strongly advocate including international exposure in a core fixed income allocation. International bonds offer potentially profound diversification benefits, given their low correlations to the Barclays Capital U.S. Aggregate Bond Index.

Additionally, international bonds offer

- A larger opportunity set than U.S. markets alone provide
- Access to higher yields than are available domestically (see Chart 3)
- Foreign exchange exposure, which can help offset swings in the value of the U.S. dollar versus other currencies
- A potential hedge against the effects of import-price inflation

Role of the Target Fixed Income Barbell versus Aggregate Index

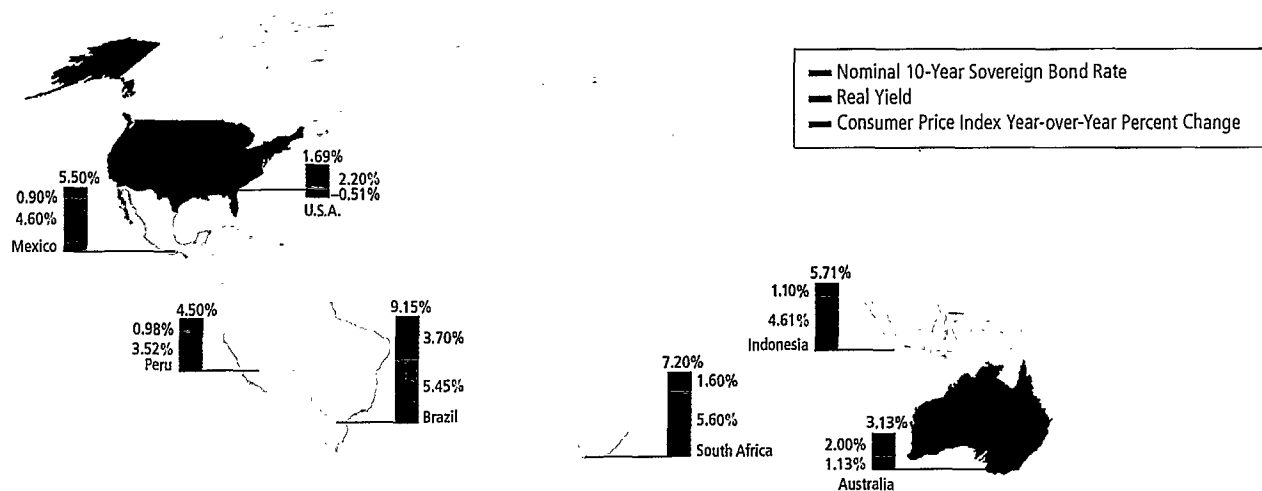
In periods of rising treasury rates dating back to 1990, the government securities/high yield barbell approach would have outperformed the aggregate bond portfolio by an average of 950 basis points.⁷ If interest rates hypothetically were to rise by 100 basis points from November 1, 2012, to October 31, 2013, with all else held equal, the government securities/senior loan barbell (with a 3.68% yield and 1.62 years duration) would return 2.06%.⁸ In comparison, the Barclays Capital U.S. Aggregate Bond Index (1.70% yield, 5.02 years duration) would decline by 3.32%. Investors expecting a "traditional" core bond holding to provide ballast in all market environments are likely to be disappointed.

Exposure to both developed and emerging market debt is critical, in our view, given that the global business cycle affects each area of the world differently. The full extent to which developed and emerging economies have "decoupled" is as yet unknown. It's worth noting, however, that while emerging markets suffered to some degree along with developed markets in the 2008 global financial crisis, their increasingly domestically oriented

As long as the rate of inflation exceeds yields on high quality bonds, real returns will be negative—virtually guaranteeing a loss of wealth over time.

CHART 3

10 Yields Ahead May Be More Attractive As of 10/31/12



Diversification does not guarantee profit or protect against loss.

Source: Bloomberg, 10/31/12. CPI data is most recent available, as of 10/31/12 for all countries except Australia, which is as of 9/30/12. Nominal yields are that of each country's "on-the-run" (most recently issued) 10-year government bond. Real yield is equal to the country's 10-year sovereign bond rate minus the year-over-year change in the country's consumer price index. Past performance does not guarantee future results.

7. Source: Bloomberg, as of 10/31/12. This is a hypothetical illustration and does not predict or depict the performance of any fund. **Past performance does not guarantee future results.**

8. Duration measures a bond's sensitivity to a 1.00% change in interest rates, expressed in years. If a bond has a duration of 4.50, for example, and interest rates rise 1.00%, the bond will lose 4.50% in value. Adding back in the bond's yield provides the total return for the period. This is a hypothetical illustration and does not predict or depict the performance of any fund.

economies proved very resilient. Emerging market growth rebounded quickly, while many developed economies still remain burdened by high debt levels, slow-to-negative growth and high unemployment. Strategic exposure to both developed and emerging market bonds (and currencies) is an effective way, in our view, to seek to take advantage of the decoupling of the global economy.

Use alternative assets and specialized equity exposure to help protect against inflation and other risks

The “traditional” companion to a portfolio’s equity allocation generally consists entirely of fixed income investments but, as we’ve seen, such a narrow approach faces increasing limitations. While fixed income will continue to play a dominant role in the New 40%, it is essential that investors incorporate a mix of alternative assets and specialized equities, like real estate investment trusts and master limited partnerships, to help address inflation and other risks.

Alternative investments

Like “traditional” fixed income investments, many alternative asset classes have low historical correlations to equities. While there are times when some alternatives lag the broader market, small allocations have the potential to benefit a portfolio during periods of market stress. For example, modest allocations to gold and commodities would have helped investors during the past decade and provided substantial diversification benefits during the credit crisis, in particular. Diversification does not guarantee profit or protect against loss.

Currencies—Investors concerned about protecting their purchasing power often focus on the effects of consumer inflation and higher interest rates. But what if inflation comes from a different source?

For several decades now, plentiful overseas labor, particularly in emerging countries such as China, has kept prices low for a range of goods imported into America. With wages rising in many of those economies and demand for commodities increasing, however, the era of importing deflation into the U.S. may be coming to an end, setting the stage for higher prices.

Historically, exposure to foreign currencies—either directly, or through locally denominated international bonds—has served as an effective way to offset import price inflation, and thus to help preserve purchasing power in dollar terms.

Commodities—Exposure to commodities or commodity-linked investments is another potential way to diversify a stock and bond portfolio and help protect purchasing power. Commodities represent an ownership claim on real assets, such as a barrel of oil or a bushel of wheat, and historically they have outperformed U.S. and international equities in environments of rising inflation. Despite their high correlation to consumer inflation over the past two decades, they have been poorly correlated to both U.S. stocks and investment-grade bonds, making them valuable diversifiers. Finally, commodities may help protect an investor against the effects of U.S. dollar weakness, since most commodities trade in dollars.

Gold—The yellow metal serves as a potential hedge against numerous tail risks, including geopolitical turmoil and the loss of purchasing power that can come from a weakening currency. The price of gold has historically been negatively correlated to U.S. equity indices, making it a potentially valuable diversifier.

Among the possible downsides to owning gold is that it has no yield, so it may carry an opportunity cost. But in an era of very low interest rates across the developed world and with central banks seemingly committed to keeping them that way for an extended period, this cost appears minimal.

Specialized “Equity”

Investors may also diversify some of their fixed income allocations into specialized “equity” exposures like real estate investment trusts and master limited partnerships that currently provide an attractive income and may help manage future inflation.

REITs—Real estate investment trusts provide a potential hedge against rising prices through the inflation-sensitive cash flow stream inherent in the asset class. Costs for land, labor and materials are passed through to tenants in the form of more

expensive leases—and therefore potentially higher dividends for investors.

Historically, the FTSE NAREIT Equity REITs Index has tended to offer a higher yield than the Barclays Capital U.S. Aggregate Bond Index⁹ and dividend growth that has outpaced the Consumer Price Index (CPI)¹⁰—characteristics that have led to nearly zero correlation between the performance of REITs and high quality bonds. Investors should note that investments in real estate companies, including REITs, are subject to volatility and risk, including loss in value due to poor management, lowered credit ratings and other factors. Smaller real estate companies may also be subject to liquidity risk.

MLPs—Master limited partnerships (MLPs) have historically generated cash flows (and therefore distributions) that outpace inflation over time.¹¹ The energy infrastructure MLP sector consists of companies that own and operate long-lived, high value physical assets such as pipelines and terminals for the storage and transportation of oil and natural gas along the supply chain. MLPs are akin to toll roads, earning fees for the service of shipping such commodities, the demand for which is generally so high that rising prices tend not to diminish it. MLPs provide a potential hedge against rising prices because the government determines these fees in accordance with changes in the Producer Price Index, a measure of wholesale inflation.

Historically, the Alerian MLP Index has offered a higher yield than the Barclays Capital U.S. Aggregate Bond Index, and its income growth has outpaced the Consumer Price Index¹¹—characteristics that have led to nearly zero correlation with asset categories like equities and high quality bonds. Energy infrastructure companies are subject to risks specific to the industry, such as reduced volumes of natural gas or other energy commodities, environmental hazards, changes in the regulatory environment and extreme weather.

WHAT IT MEANS FOR INVESTORS

Traditional fixed income allocations consisting mainly of high quality domestic bonds increasingly appear ill-suited to the challenges of today's markets. We believe investors should consider

- Using a “credit barbell” of U.S. Government bonds and domestic high yield bonds as a core fixed income position
- Supplementing this with exposure to developed and emerging market international bonds
- Addressing inflation and other risks via exposure to select alternative investments and specialized “equity” instruments

Index Definitions

The Alerian MLP Index is a composite of the 50 most prominent energy Master Limited Partnerships (MLPs) that provides investors with an unbiased, comprehensive benchmark for this emerging asset class.

The Barclays Capital U.S. Aggregate Bond Index is an investment-grade domestic bond index.

The Barclays Capital U.S. Credit/Corporate/Investment Grade Bond Index represents primarily investment-grade corporate bonds within the Barclays Capital U.S. Aggregate Bond Index.

The Barclays Capital U.S. Aggregate Government Bond Index is composed of all publicly issued non-convertible, domestic debt of the U.S. Government or any agency thereof, quasi-federal corporation or corporate debt guaranteed.

The Barclays Capital MBS Index represents the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA) and Freddie Mac (FHLMC).

The Consumer Price Index (CPI) program produces monthly data on changes in the prices paid by urban consumers for a representative basket of goods and services.

The Credit Suisse Leveraged Loan Index tracks the performance of senior loans.

The FTSE National Association of Real Estate Investment Trusts (NAREIT) Equity REITs Index consists of certain companies that own and operate income-producing real estate that have 75% or more of their respective gross invested assets in the equity or mortgage debt of commercial properties.

The Morgan Stanley Capital International (MSCI) All Country World Index (ACWI) is designed to measure the equity market performance of developed and emerging markets.

The MSCI EAFE (Europe, Australasia, Far East) Index is designed to measure developed market equity performance, excluding the U.S. and Canada.

The MSCI Emerging Markets (EM) Index is designed to measure global emerging market equity performance.

The MSCI U.S. Index is designed to measure U.S. equity market performance.

The MSCI World Index is designed to measure global developed market equity performance.

The S&P 500 Index is a broad-based measure of domestic stock market performance.

Each index is unmanaged and cannot be purchased directly by investors. Index performance is shown for illustrative purposes only and does not predict or depict the performance of any Oppenheimer fund. **Past performance does not guarantee future results.**

9. Source: FactSet, 7/25/12. **Past performance does not guarantee future results.**

10. Source: Cornerstone Research, NAREIT, Bloomberg, 12/31/11. **Past performance does not guarantee future results.**

11. Source: Alerian, Bloomberg, 10/31/12. **Past performance does not guarantee future results.**

A typical asset allocation model of 60% domestic equities and 40% high grade bonds no longer reflects the breadth of opportunity in the world and is unlikely to provide many of the diversification benefits it once did.

The New 60/40 is a more globalized, diversified and nimble approach that seeks to help investors:

- Find growth *Page 2*
- Generate income *Page 4*
- Protect against inflation and other risks *Page 6*

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A fund's performance depends largely upon the portfolio managers' skill in selecting the best mix of investments. The portfolio managers' evaluations and assumptions regarding the prospects of the global financial markets may be incorrect and a fund's performance may be adversely affected by their asset allocation decisions.

Foreign investments may be volatile and involve additional expenses and special risks including currency fluctuations, foreign taxes and political and economic uncertainties. Emerging and developing market investments may be especially volatile.

Derivative instruments, investments whose values depend on the performance of an underlying security, asset, interest rate, index or currency, entail potentially higher volatility and risk of loss compared to traditional stock or bond investments. Currency derivative instruments may be particularly volatile and involve significant risks.

Short selling may increase volatility and risk of loss and is considered a speculative investment practice.

Fixed income investing entails credit risks and interest rate risks. When interest rates rise, bond prices generally fall, and the Fund's share prices can fall.

Commodity-linked investments are considered speculative and have substantial risks, including the risk of loss of a significant portion of their principal value.

Small company stock is typically more volatile than that of larger, more established businesses, as these stocks tend to be more sensitive to changes in earnings expectations and tend to have lower trading volumes than large-cap securities, creating potential for more erratic price movements. It may take a substantial period of time to realize a gain on an investment in a small company, if any gain is realized at all. Investments in securities of real estate companies may be especially volatile. Because they do not have an active trading market, shares of Real Estate Investment Trusts (REITs) may be illiquid. The lack of an active trading market may make it difficult to value or sell shares of REITs promptly at an acceptable price.

When interest rates rise, bond prices generally fall, and the Fund's share prices can fall. Invests in below-investment-grade ("high yield" or "junk") bonds, which are more at risk of default and are subject to liquidity risk. Senior loans are typically lower rated (more at risk of default) and may be illiquid investments (which may not have a ready market).

There is no guarantee that the issuers of stocks held by mutual funds will declare dividends in the future, or that if dividends are declared, they will remain at their current levels or increase over time.

Inflation-indexed debt securities (including TIPS) are bonds structured to seek to provide protection against inflation. If inflation declines, the principal amount or the interest rate of an inflation-indexed bond will be adjusted downward. This will result in reduced income and may result in a decline in the bond's price, which could cause losses. Interest payments on inflation-protected debt securities can be unpredictable and will vary as the principal or interest rate is adjusted for inflation. Inflation-indexed debt securities are also subject to the risks associated with investments in fixed income securities.

Investing in MLPs involves additional risks as compared to the risks of investing in common stock, including risks related to cash flow, dilution, and voting rights. Energy infrastructure companies are subject to risks specific to the industry such as fluctuations in commodity prices, reduced volumes of natural gas or other energy commodities, environmental hazards, changes in the macroeconomic or the regulatory environment or extreme weather. MLPs may trade less frequently than larger companies due to their smaller capitalizations which may result in erratic price movement or difficulty in buying or selling. MLPs are subject to significant regulation and may be adversely affected by changes in the regulatory environment including the risk that an MLP could lose its tax status as a partnership.

Shares of Oppenheimer funds are not deposits or obligations of any bank, are not guaranteed by any bank, are not insured by the FDIC or any other agency, and involve investment risks, including the possible loss of the principal amount invested.

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EXHIBIT B

WHAT ARE ALTERNATIVE INVESTMENTS?

AI STRATEGY & MARKETING

INVESTMENT MANAGEMENT & GUIDANCE



ALTERNATIVE INVESTMENTS EDUCATION SERIES

PAPER 1 OF 3

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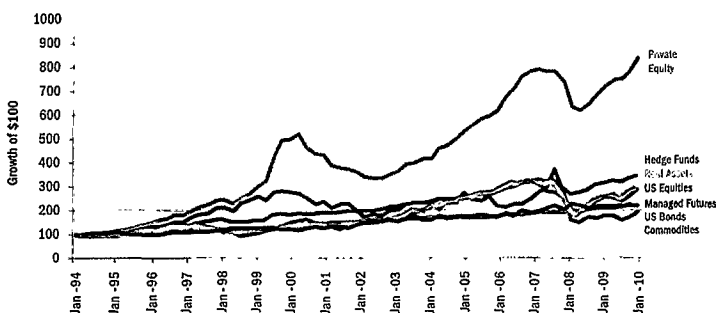
Alternative investments (AI) have received a great deal of media coverage in recent years. The significant use of alternatives by high-profile endowments, such as Yale and Harvard, has helped generate substantial interest among a broader group of investors. And while alternative investments were not immune to the events of 2008, their appeal has endured beyond the crisis. A 2010 joint survey by Morningstar and Barron's found that nearly 70% of institutional investors and financial advisors believe alternative investments will be as, or more, important than traditional investments over the next five years.¹ Yet for all the attention given to alternative investments, they remain somewhat of an enigma to many investors. In the same survey, almost 40% of advisors cited "lack of understanding" as one of the main reasons clients may hesitate to invest in alternatives. No doubt, to effectively utilize these investments, investors need to understand the benefits and risks involved. The aim of this series of papers is to demystify this rapidly growing segment of the investment management industry by addressing three basic questions:

1. What are alternative investments?
2. Why are alternative investments important?
3. How can alternative investments be incorporated into a portfolio?

Defining Alternative Investments

Historically, financial portfolios have consisted primarily of stocks and bonds; however, growing risk and weakening performance among traditional assets have prompted investors to seek a broader mix of asset classes that increasingly include alternative strategies. Alternative investments include hedge funds, managed futures, private equity and real assets. These investments have produced impressive returns for much of the last two decades, as shown below.

Chart 1: Historical performance of alternative investments (1994-2010) ^{2,3}



Source: GWIM AI Group. For illustrative purposes only.
Past performance is no guarantee of future results.

So what exactly do we mean by alternative investments? While there is no universal definition, these alternatives generally refer

¹ Morningstar/Barron's, "2010 Alternative Investment Survey of Institutions and Financial Advisors", January 11, 2011.

² Based on the total returns of the S&P 500 Index and Barclays US Aggregate Bond Index, and the net returns of the CS-Tremont Hedge Fund Index, Cambridge Associates US PE Index, and MLAI Real Assets Composite. See disclosure page for complete definitions.

³ The alternative investment indexes shown do not represent benchmarks or proxies for the return of any particular investable AI product and fund selection interjects a significant element of "survivor bias" into the reported levels of the indexes. Please see the back of this paper for additional disclosure.

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Please refer to the last page of this document for additional important disclosure and risk information.

04-04-2010

to investments that pursue strategies and utilize financial products often not available through more traditional investment vehicles. Most alternative strategies are implemented through fund structures that pool capital from multiple investors. As with traditional mutual funds, alternative funds also invest in stocks and bonds, and employ derivatives, whose value is derived, again, from underlying equity and fixed-income assets. But, whereas traditional portfolios generally limit themselves to publicly traded stocks, bonds, and certain derivative instruments, alternative strategies broaden the available investment opportunity set to also include private companies, commodities, currencies and a wider variety of over-the-counter derivatives. (Please note, derivatives often involve a high degree of financial risk and are not suitable for all investors.) Broadly, alternative investments engage in some, or all, of the following:

- Investing in multiple markets, including equities, fixed-income, commodities, currencies, emerging markets, volatility, etc.
- Carrying illiquid assets
- Employing leverage
- Using derivatives
- Short-selling of securities

Legal Structure and Operations of AI Funds

Alternative investment strategies typically operate under legal structures and regulatory frameworks that are meaningfully different from those applicable to traditional investment companies. In fact, it is their distinct governance structure that makes possible many of the strategies alternative managers undertake.

Alternative investment funds are generally organized as limited partnerships, with two categories of partners: limited partners and the general partner. Limited partners are the investors in a fund; they contribute capital, are not

usually liable for the fund's debt and typically do not participate in management decisions. The general partner of a fund is responsible for all aspects of the fund's business, including managing its investment portfolio. A fund's general partner is typically organized as a limited liability company (LLC), because unlike the limited partners, the general partner bears liability for the partnership's debts. The general partner will often manage multiple funds under its operations representing different investment themes.

Regulatory Framework of Alternative Investments

Unlike traditional funds, many alternative funds are not registered with the Securities and Exchange Commission (SEC) as investment companies under the Investment Company Act of 1940, as amended, ("1940 Act"), and the securities they issue are often not registered under the Securities Act of 1933 ("1933 Act"). Funds offered to non-U.S. clients are often not registered with the relevant regulatory authority in the jurisdiction in which they are sold and the securities that they issue are not listed on a regulated exchange.

Companies registered under the 1940 Act, or with the relevant international authority, are subject to regulations intended to protect the financial interests of unsophisticated investors, but which can also limit the flexibility of an alternative fund in pursuing its investment objectives.⁴ Many alternative funds are exempted from registration because they are sold as private placements to a qualified set of investors. Briefly, the exemptions provide alternative funds with additional flexibility (relative to registered funds) with regard to investments in certain financial instruments, the use of leverage, reporting, and the use of incentive fees, to name a few. Nevertheless, unregistered funds in the U.S. are still subject to the antifraud provisions of the 1933 Act and the SEC maintains jurisdiction over them and their managers.

Table 1: Alternative investment investor qualification requirements

Investor Type	Qualifications
Accredited Investors	Individual investor with a net worth in excess of \$1m (either alone or jointly with a spouse), excluding the value of such individual's primary residence or income above \$200k in each of the last two years (or joint income above \$300k) and with reasonable expectation of the same income for the current year.
Qualified Clients (QCs)	Individual investor or entity with net worth of more than \$2m at the time of investment.
Qualified Purchasers (QPs)	Individual investor owning at least \$5m in investments (excluding residence) either alone or jointly with a spouse. This requirement also applies to eligible family entities and trusts.

Source: GWIM AI Group. For more complete definitions of client eligibility, please consult your Financial Advisor or financial representative.

⁴ The Investment Company Act of 1940, as amended, was passed by Congress in response to the 1929 stock market crash that was a precursor to the Great Depression.

As exempt funds, alternative investments are only marketable to a limited pool of sophisticated, high-net-worth individuals and institutions.⁵ For most alternative funds, potential investors must meet the criteria of an accredited investor, qualified client (QC), or qualified purchaser (QP), depending on the type of fund. The table on the prior page summarizes the key requirements of each eligibility level. Depending on the nature and structure of the fund and the client's jurisdiction of residence, clients may have to meet additional eligibility requirements or product-specific suitability requirements.

Organizational Features of Alternative Investments

From an operational and regulatory standpoint, alternative investments typically require larger investment minimums, can have extended lockup periods, may have limited transparency and often compensate the fund manager with incentive fees. Typically, funds have a "2 & 20" fee structure whereby investors are charged a management fee of 2% based on assets under management (AUM) and 20% of profits. However, managers themselves usually have a significant stake in the funds, which helps align manager and investor interests. Moreover, managers generally have certain performance thresholds they must cross before collecting the 20% incentive fee; for example, investors' equity position in hedge funds needs to be positive or above their "high-water mark", or performance of a private equity fund must exceed a pre-negotiated 'hurdle' rate of return.

The potentially lucrative reward structure of alternative investment firms, along with the allure of an entrepreneurial

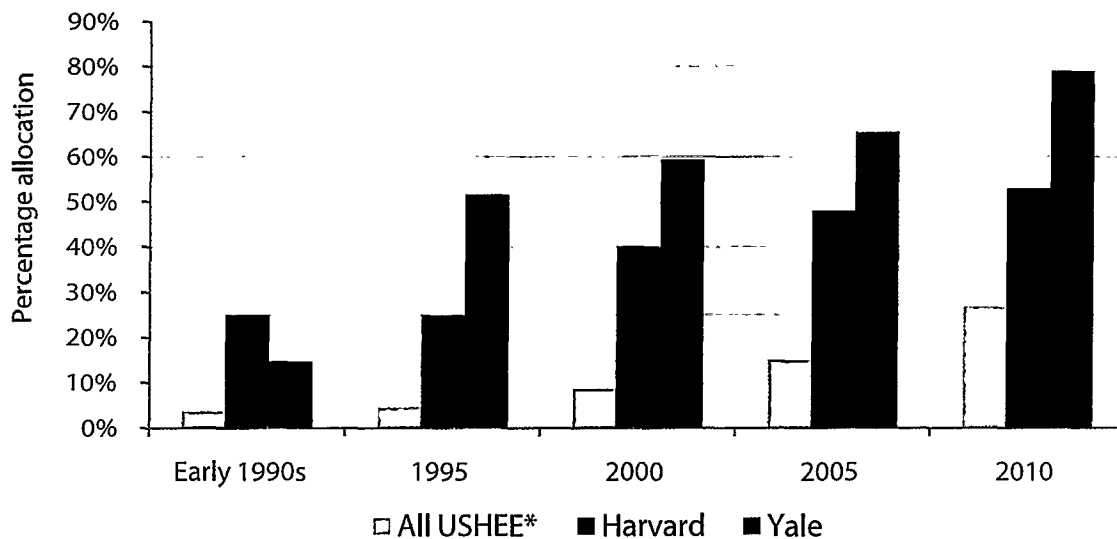
environment, helps draw some of the best investment talent to the industry — undoubtedly a key element of the success of alternative investments. Not surprisingly, many of Wall Street's elite traders have opened or moved to hedge funds in the last decade. Similarly, top deal makers and exceptional managers of public companies have migrated to private equity firms.

Who Invests in Alternative Investments?

Over the years, the success of alternative investments has drawn an established and varied investor base to these products, not least of which has been the pioneering use of alternatives by Harvard and Yale, which has spurred other endowments and foundations to adopt alternative investments. Chart 2, below, plots the increasing use of alternative investments by the two institutions over the last 20 years. Correspondingly, over the same period the size of Harvard's and Yale's endowments grew from around \$5 billion and \$3 billion to \$26 billion and \$16 billion, respectively.

In recent years even very traditional institutional investors, such as pension funds, have been raising their allocations to alternative investments in an effort to more closely match assets to growing liabilities. They consider hedge funds and private equity firms as sources of enhanced returns and a means to diversify into additional asset classes. Both the aforementioned Morningstar/Barron's survey and BofA - Merrill Lynch Global Research have identified diversification and absolute returns as the main reasons for institutions to consider investing in alternative products.⁶ At the same time, in order to attract more

Chart 2: Increasing use of alternative investments by top U.S. endowments



Source: Annual reports of Harvard University and Yale University (1997-2010), NACUBO (2009), *U.S. Higher Education Endowments. For illustrative purposes only.

⁵ Under Regulation D of the "1933 Act", a "sophisticated investor" is one who "either alone or with the investor's purchaser representative(s) has such knowledge and experience in financial and business matters that the investor is capable of evaluating the merits and risks" of an investment in the fund.

institutional assets, many hedge funds and private equity firms have improved transparency, liquidity provisions and reporting related to investment approach and risk. These changes can benefit not just institutional but individual investors as well.

Wealthy individuals are also an important segment of the industry's investor base. According to the 2010 Merrill Lynch Capgemini World Wealth Report, approximately 15% of high-net-worth individuals' (HNWIs)⁷ assets are invested in alternatives. Moreover, HNWIs make up a large segment of the client base for alternatives. A 2009 study by Casey Quirk & Associates and Bank of New York Mellon found that HNWIs constituted 57% of the hedge fund industry's total asset base at the end of 2008.

Size of the Alternative Investment Industry

Alternative investments have grown significantly in the last two decades to become an important part of the asset management industry. According to Hedge Fund Research (HFR), hedge funds have grown from approximately \$40 billion of AUM in 1990 to nearly \$1.92 trillion at the end of 2010. Over that period hedge fund assets grew at an annualized rate of 20.4%.⁸ Chart 3, below, displays the impressive growth of hedge funds over the past 20 years. Similarly, the private equity space grew from an estimated \$100 billion in AUM in 1994 to \$2.4 trillion in 2010, representing an annual growth rate of 20.6%.⁹

Alternative investments now play a significant role in global capital markets, and even the real economy. Hedge funds are responsible for a large portion of daily trading volume in the

equity and fixed-income markets and can serve as important providers of liquidity.¹⁰ Private equity firms today account for nearly 20% of all M&A activities.¹¹ And large-scale studies have found that sectors where private equity firms are active grow more rapidly than the rest of the economy in terms of productivity, total output, and employment.¹²

In the years ahead, we believe the alternative investment industry will continue to evolve and experience robust growth. Having begun with a broad overview of the industry, in the next section we delve more deeply into the specific types of alternative investment strategies available to investors and how they work.

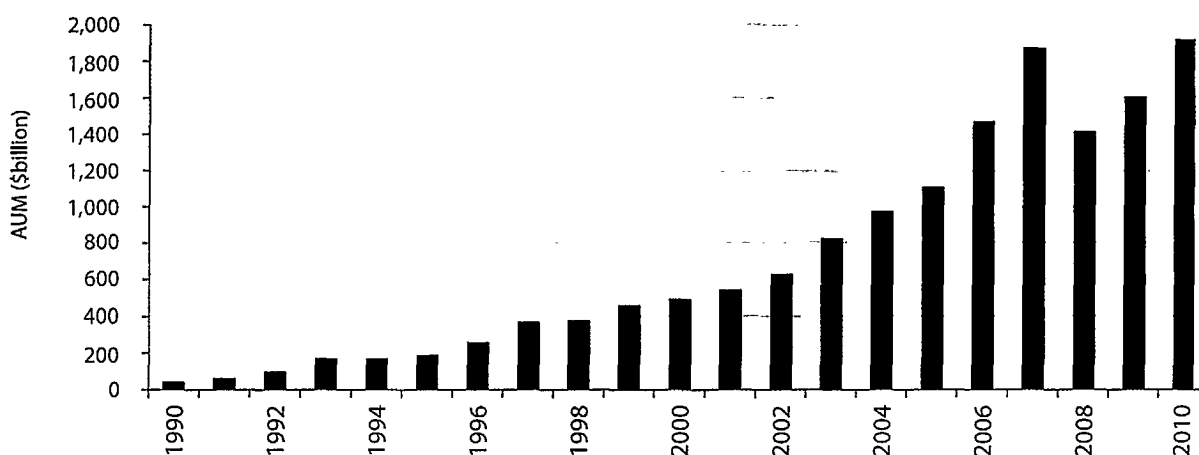
TYPES OF ALTERNATIVE INVESTMENTS

HEDGE FUNDS

Hedge funds are prime examples of active management. As these private investment pools, have fewer portfolio management constraints than do traditional funds. Hedge funds are free to invest in a wide array of assets in almost any market, short-sell securities and use leverage to enhance returns. They may utilize derivatives to increase efficiency and undertake complex and dynamic strategies. As comparatively illiquid investments, hedge funds are often able to keep relatively lower levels of liquid assets on hand, enabling them to hold contrarian positions that may take time to yield the desired outcome.

At the same time, many hedge funds are under no regulatory obligation to report trading activities to investors. This lack

Chart 3: Growth of the hedge fund industry (1990-2010)



Source: HFR Research Inc. (HFR) as of December 2010. For illustrative purposes only.

⁶ Bank of America Merrill Lynch (March 2010), "The New Hedge Fund Environment: Attracting Institutional Capital in a Post-Crisis World."

⁷ HNWIs are defined as those having investable assets of US \$1 million or more, excluding primary residence, collectibles, consumables, and consumer durables. The 15% figure excludes residential real estate assets.

⁸ Based on the compounded annual growth rate (CAGR). CAGR is the year-on-year growth rate of an investment over a specified period of time.

⁹ Based on calculations from the Federal Reserve Bank (1995) and data from TheCityUK (2010).

¹⁰ In 2006, the SEC estimated hedge funds were responsible for 30% of all U.S. equity trading. A 2007 survey by Greenwich Associates found hedge funds generated 30% of all daily fixed-income trading volume, including 80% of trading volume in high-yield derivatives and distressed debt.

¹¹ According to Dealogic, as of Sept 30, 2009.

¹² World Economic Forum, "The Globalization of Alternative Investments (2010)."

of transparency has both benefits and drawbacks. On one hand, hedge funds are better able to preserve and devote resources to proprietary strategies that generate returns. On the other hand, it can also lead to widespread misconceptions about hedge funds and their workings. Outlier events such as the demise of several prominent funds, including Long-Term Capital Management and Amaranth Advisors, and other instances of excessive risk-taking, are easily generalized and used to define an industry shrouded in mystery. In reality, not all hedge funds are highly levered; most use varying degrees of leverage depending on their strategies, and some none at all. And while many hedge funds use derivatives in some form, in many cases it is for hedging rather than speculative purposes. Even the term "hedge" is often misinterpreted, as not all funds are market neutral, with many of them maintaining partial or even full exposure to market risks.

Hedge Fund Managers vs. Traditional Fund Managers

Hedge fund managers can differ from traditional investment fund managers in numerous ways, but the two most basic ways are their approach to risk and return. Traditional investment fund managers define risk as the deviation from a stated benchmark (tracking error), whereas hedge fund managers generally define risk in terms of potential loss of invested capital (total risk). Thus while traditional managers can choose the extent to which they want to "hug" their benchmarks, they are less able to manage the risks associated with a broad decline in the benchmark. Hedge fund managers, on the other hand, have the flexibility to hedge away unwanted broader market

risks (which is the actual basis for the term "hedge" funds). Consequently, they are often able to better preserve investor capital during downturns. In fact, managing risk is considered to be as important a function for successful hedge fund managers as selecting good investments.

Similarly, when it comes to returns, traditional managers normally seek to deliver a *relative* return that is above a designated benchmark (e.g., the S&P 500); whether *actual* returns are positive or negative is of secondary concern. Hedge fund managers, on the other hand, commonly seek to generate positive returns regardless of the conditions in the stock and bond markets. Table 2 below provides a list of comparative features of hedge funds and traditional investment funds.

A Brief History of Hedge Funds

While hedge funds have grown to become an important part of the global financial industry in recent years, their story began over 60 years ago. In 1949, Alfred W. Jones, a sociologist and financial journalist, started what is considered to be the first hedge fund, A. W. Jones & Co. (the actual term "hedge fund" was coined later by a reporter). Jones recognized that there were two distinct sources of risk for equity investments: the risk that is specific to individual stocks and the general market risk that affects all stocks. He then married two investment tools — shorting and leverage — to capitalize on this insight. Shorting is the practice of selling borrowed securities, in anticipation of a decline in value, with the intention of replacing the securities for a lower price at a later date.¹³ Leverage is the process of using borrowed funds to magnify returns. Jones' innovative method

Table 2: Characteristics of traditional investment funds and hedge funds

Features	Traditional Funds	Hedge Funds
Return objective	Market-based strategy	Skill-based strategy
Benchmark	Constrained by benchmark indexes	Seek positive returns regardless of market conditions (absolute returns)
Investment strategies	<ul style="list-style-type: none"> Limited investment strategies Primarily take long positions only Limited use of leverage 	<ul style="list-style-type: none"> Flexible investment strategies Take long and short positions May use significant leverage
Market correlation	High correlation to traditional markets	Seek low to moderate correlation to traditional markets
Liquidity	Highly liquid	<ul style="list-style-type: none"> Liquidity restrictions May have initial lockup periods and redemption penalties
Agency-principal relationship	Manager may or may not invest alongside investors	Manager generally has significant investment alongside investors
Investment size	Small minimum investment	Larger minimum investment
Structure	<ul style="list-style-type: none"> Typically set up as trust or investment company Registered with the SEC 	<ul style="list-style-type: none"> Typically set up as private investment, limited partnership or trust Typically sold on a private placement basis Investors generally subject to eligibility requirements
Regulation	<ul style="list-style-type: none"> Highly regulated High level of transparency Can be publicly marketed 	<ul style="list-style-type: none"> Less regulated Less mandated disclosure Marketing restrictions typically apply

Source: GWIM AI Group. These are typical characteristics - individual funds may vary. Hedge funds generally use more aggressive strategies than traditional funds and entail a higher level of risk.

was to hold a short basket of stocks to hedge against a fall in the market while leveraging those stocks he felt would do well. His fund gained over 1,000% between 1958 and 1968.¹⁴ Despite the interest generated by Jones' performance in the late 1960s, hedge funds did not capture the attention of the wider investment community and the media until the late 1980s and early 1990s. Then, star fund managers such as Julian Robertson and George Soros started to consistently post impressive returns and became associated with significant political and economic events. For example, Soros' Quantum Fund famously "broke the Bank of England" in 1992, by successfully betting that Britain would leave the European Exchange Rate Mechanism (ERM) and be forced to devalue its currency. Almost overnight, Soros pocketed \$1 billion in profits shorting the pound. Hedge funds were also linked to the 1994 bond market turmoil and also came under blame for the 1997 Asian currency crisis. These episodes had the effect of portraying all hedge funds as speculators. However, just a few years later, hedge funds proved to be prudent managers of risk following the bursting of the technology bubble in 2000. During the ensuing bear market the broader equity market lost 44% of its value between April 2000 and September 2002. In contrast, hedge funds gained 6% over the same period—reinforcing their diversification benefits and confirming their place in investors' portfolios (*past performance is no guarantee of future results*).¹⁵ The number of hedge funds quickly grew from about 3,000 at the beginning of the decade to over 7,600 by the end of 2007.¹⁶

Hedge funds did lose some of their luster during the credit crisis of 2008. Caught in a spiral of redemptions, forced selling, and

margin calls, they lost 19% in what was their first annual loss since 1998 and experienced a 25% reduction in AUM.¹⁷ However, even with these losses, they still significantly outperformed the S&P 500, which fell 37%. And while many hedge fund strategies suffered in late 2008, a few, such as dedicated short bias, global macro and managed futures posted healthy gains, reflecting the diversity of fund styles.¹⁸ In addition, 2008 provided a shakeout for the hedge fund industry—with the more adaptable and better managed funds emerging from the crisis with reduced competition. The industry promptly rebounded in 2009, gaining 18.6%, their best performance in a decade.¹⁹

Hedge Funds Strategies

Hedge fund strategies can vary enormously in terms of style, risk and investment returns. But, while there are many different types of hedge funds, most can be grouped around several core strategies: relative value, event-driven, equity hedge, and global macro²⁰ (see Chart 4 below).

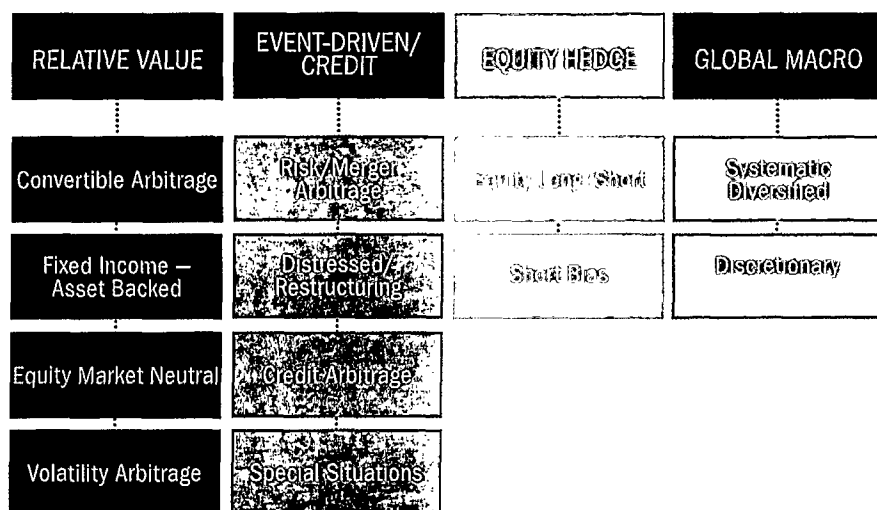
- **Relative value** strategies attempt to capitalize on valuation discrepancies between multiple securities using fundamental, quantitative and/or technical analysis. Typically, it involves simultaneously buying and selling two or more different securities to realize the pricing anomalies between them. Examples include convertible arbitrage, fixed-income arbitrage, volatility arbitrage, and equity market neutral. These strategies tend to have low to moderate volatility and typically use higher levels of leverage.

- **Event-driven/credit** strategies seek to profit from corporate activities, such as merger & acquisitions, restructurings, share issuances and buybacks, debt exchanges, etc. Investment theses are typically based on fundamental analysis of companies and involve managing exposure to the equity and credit markets. Examples include merger arbitrage, credit arbitrage, distressed credit, and special situations. Event-driven/credit strategies have moderate volatility and use relatively little leverage.

- **Equity hedge** strategies maintain long and short positions in equity and equity-linked securities. Managers may use a wide variety of investment processes, involving both fundamental and quantitative techniques and ranging broadly in terms of leverage, holding period, security universe, etc. Equity hedge managers typically maintain around a 50%

net long exposure, but levels can change significantly depending on market conditions. For

Chart 4: Hedge fund core strategies and sub-strategies



Source: GWIM AI Group. Utilizing these strategies involves investment risks, including the possible loss of principal.

¹³ The profit (loss) to the short seller is the difference between the selling pricing of the security today and the future replacement price minus (plus) the lending fee.

¹⁴ Russell, John (1989), *New York Times*

¹⁵ Based on the performances of the S&P 500 Total Return Index and the Credit Suisse-Tremont Hedge Fund Index. Please see disclosure page for complete index definitions.

¹⁶ Hedge Fund Research Inc. (HFR), July 2010.

¹⁷ Based on net returns of the CS-Tremont Hedge Fund Index and AUM figures from Hedge Fund Research Inc. (HFR), July 2010.

¹⁸ Bartels, Mary Ann and Shan Hasnat (January 2009), "Goodbye 2008," BofA-ML Global Research.

²⁰ Different sources have different classification schemes, in part due to overlapping of characteristics among strategies. Depending on granularity and focus, groupings can vary.

example, during the height of the credit crisis, equity hedge funds were flat to net short; while in the years preceding the crisis, it was not uncommon to see net long exposure levels as high as 60-70%. Examples include equity long/short and short bias. Equity hedge strategies typically have lower volatility than the market and use moderate leverage.

- *Global macro* strategies seek to exploit macroeconomic trends impacting equities, fixed income, commodities and currencies. Managers employ a variety of techniques, quantitative and fundamental, with long- and short-term holding periods. Global macro strategies generally fall into two major categories: discretionary thematic and systematic diversified.

Discretionary managers use their knowledge and judgment of macroeconomic fundamentals to forecast market behavior. They generally seek out directional movements in price (e.g., going long crude oil or gold) or attempt to exploit relative mispricings within major asset classes (e.g., being long the Australian dollar and short the Japanese yen). Systematic traders, on the other hand, are commonly described as using a 'black-box' approach. Trade ideas are typically generated based on advanced statistical analyses of historical data, supported by powerful computer systems. Global macro funds can experience high levels of volatility and may use significant leverage.

MANAGED FUTURES/CTAs

Managed futures are investment funds traded by commodity trading advisors (CTAs) or commodity pool operators (CPOs) that trade futures and forward contracts on commodities as well as financial assets such as currencies, interest rates, and bond and stock indexes.²¹ Though they resemble hedge funds, we consider them separately due to differences in operational structure. Futures were originally designed in the 1850s to hedge price risks related to the harvesting and sale of agricultural crops and grew to a wide variety of commodities, such as energy and metals. The industry operated largely unregulated until 1974, when the U.S. Commodity Futures Trading Commission (CFTC) was established. Soon after, futures intended to hedge financial risk on currencies and interest rates were introduced, quickly followed by bond and stock index futures.

Today, managed futures can be accessed in one of three ways: investors can buy shares in public commodity pools that operate like mutual funds and are registered with the SEC, or they can invest in unregistered private commodity pools that are set up more like hedge funds. For both approaches, a commodity pool operator (CPO) allocates the money raised to one or more

CTAs to manage. Finally, wealthy individuals or institutions can invest directly with a CTA in separate managed accounts (SMAs). Typically, CTAs will charge a "2 & 20" fee structure, similar to that of other alternative investments funds.

How Managed Futures/CTAs Work

Managed futures employ both discretionary and trend-following trading strategies, similar to global macro though among CTAs, the latter tends to be the more dominant style. Using sophisticated algorithms to identify trends, CTAs buy and sell futures and forwards. They can have a wide range of holding periods, from as little as a few seconds to one year, and can experience high volatility.

Managed futures have historically performed well in trending markets (up and down) and on average, make money when market volatility rises. The latter half of 2008 is a good example; while the S&P 500 fell 35% between May 31 and December 31, CTAs gained 8%.²² However, CTAs can struggle when markets reverse quickly and sharply, and more generally can underperform in range-bound markets where persistent trends fail to materialize.

Managed futures have several appealing attributes. As most of the contracts they trade are exchange listed, CTAs rarely suffer liquidity problems, have limited counterparty risk and can often make asset allocation changes more quickly than other investment managers. In addition, they are generally highly transparent, with most investments having easily accessible up-to-date market prices. Finally, CTAs are not as vulnerable to sudden credit restrictions by lenders as they typically operate on a margin basis. That is to say, a CTA manager will deposit a specified amount of money or collateral with their broker as security every time a futures position is established in order to serve as a guarantee for the fulfillment of the contract. For example, if a fund manager wishes to invest \$100 in gold futures, she will post, say, \$10 in a margin account and invest the remaining \$90 in an overnight cash deposit. In this way, at any given time, a typical CTA is significantly in cash.

PRIVATE EQUITY

Companies commonly raise capital by either issuing debt or new shares in the public markets, but for reasons of size and cost, they may also look to the private market for funds. Private equity firms are pools of actively managed capital organized to invest in privately held and, in certain cases, public companies and securities. Essentially, private equity groups identify promising or underperforming firms and try to create value

²¹ Futures are standardized contracts, traded on public exchanges, in which one party agrees to buy or sell a specified amount of a commodity at a specified future date at a particular price. Futures contracts were created to allow investors to lock in prices ahead of the actual production or harvesting. The counterparty purchasing these contracts generally pays a premium to lock in a price for physical delivery of these commodities at a future date. Forward contracts have the same economic function as futures; however, unlike futures, they are tailored to specific transactions and are not traded publicly.

²² Past performance is no guarantee of future results. Based on the total returns of the S&P 500 and the net returns of the CS-Tremont HFI Managed Futures Index.

Table 3: The largest private equity deals as of September 2010

Target	Sector	Buyer	Year	Value (\$bn)
TXU Corp.	Utilities	KKR, TPG Capital	2007	\$43.8
Equity Office Property Trust	Real Estate	Blackstone Group LP	2007	\$38.9
Hospital Corp. of America	Health Care	Bain Capital LLC, ML Global Private Equity	2006	\$32.7
RJR Nabisco	Consumer Staples	KKR	1989	\$31.1
Harrah's Entertainment Inc.	Consumer Discretionary	Apollo Management LP, TPG Capital	2008	\$29.9

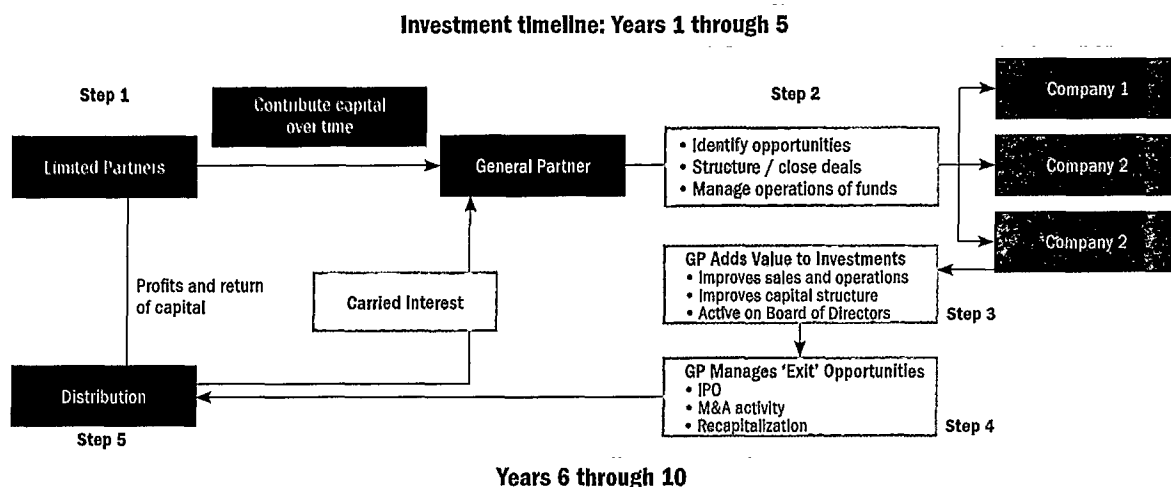
Source: TheCityUK (2010)

by improving the operations, governance, and finances of the selected companies. Targeted companies can range from start-ups to large, mature enterprises. Gains on investments are realized by the outright sale of the interest, floating of stock through an initial public offering (IPO) or by merger with another firm. Private equity funds typically have investment horizons of 7-10 years, after which the specific partnership is liquidated.

The roots of the private equity industry can be traced back as far as the industrial revolution when wealthy individuals began to finance fledgling enterprises. The first modern private equity firm was a venture capital (VC) company called the American Research and Development Corp., established in 1946. For the next few decades, the private equity industry saw steady, but not spectacular growth. Then in the 1980s with the backdrop of deregulation, falling interest rates, and innovations in the high-yield debt market, a boom in leverage buyouts (LBOs) took place. Thousands of LBOs were completed between 1980 and 1990—the most famous of which was the \$31 billion takeover of RJR Nabisco by Kohlberg Kravis Roberts & Co. in 1989. The buyout frenzy brought about not only a financial change, but

also a cultural one. The exploits of financiers, such as Michael Milken of Drexel Burnham Lambert, who pioneered junk-bond financing, and Jerome Kohlberg Jr., Henry Kravis, and George Roberts of the eponymous firm KKR were lionized in print and cinema *Barbarians at the Gate*, *Wall Street*, *Pretty Woman*, etc. The LBO cycle began to lose steam with the collapse of Drexel Burnham Lambert in 1990 and came to a close with the onset of the 1991 recession.

It was followed a few years later, however, with the resurgence of the venture capital business as the Internet changed the global economy. There was a flurry of VC activity during the 1980s in the biotech industry, but nothing compared to the dot-com wave of the late 1990s as equity valuations reached sky-high levels. In the painful bust that followed, several important companies emerged, among them Amazon, AOL, Cisco Systems, eBay, and Yahoo!.²³ The market cycle shifted again a few years later as the low interest-rate environment which followed the post tech-bubble recession gave rise to a new period of LBOs in the mid-2000s, culminating in the \$44 billion takeover of TXU Corp. by KKR and the Texas Pacific Group (TPG).

Chart 5: The mechanics of a private equity partnership

Source: GWIM AI Group. For illustrative purposes only.

²³ References to a specific company or security does not constitute a recommendation to buy, sell, hold or directly invest in the company or its securities.

The Mechanics of Private Equity Investments

Private equity funds have a few unique characteristics. For example, individual funds typically have finite life spans, and the capital that they raise for deals is not invested all at once. Instead, capital is generally committed up front by the limited partners (investors) and is called, invested, and distributed over time by the general partner (manager). The year in which a fund makes its first capital call is known as its vintage year. Capital calls are generally required in the first five years of a fund's life cycle. Failure to respond to capital calls can lead to stiff penalties for limited partners, including the forfeiture of their interest in the fund. The liquidity needs of investors are thus a very important consideration.

Cash and stock returned to investors after a fund has exited from an investment are part of the capital distribution process. Here, on top of the management fee, the general partner receives a performance-based reward called carried interest. Typically, it is 20% of capital gains after committed capital is returned to the limited partners. Often, the investors must receive the preferred return or hurdle rate on the investment (usually 7-10%) before the general partner can collect carried interest. Chart 5 on the prior page illustrates the different steps in a typical private equity investment.

Different Types of Private Equity

The private equity space, like hedge funds, has distinct subclasses, each with its own risk/return characteristics. They include venture capital, growth capital, mezzanine financing, leverage buyouts (LBOs), restructuring, and distressed debt (see Chart 6 below).

- *Venture capital* aims to provide cash financing to promising start-ups and companies in early stages of growth in return for an equity stake. It is the riskiest private equity subclass and often focuses on the technology and life sciences industries. Companies such as Amgen, Apple, Federal Express, Genentech, Intel, and Microsoft were all recipients of venture capital early on.

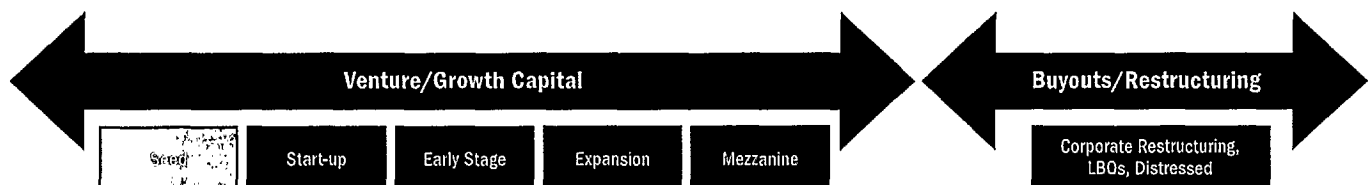
- *Growth capital* offers financing to companies seeking to expand, usually in exchange for common or preferred equity.
- *Mezzanine financing* refers to private placements of unsecured, subordinated debt. Due to higher risk relative to senior debt, investors receive higher interest payments and in many cases "equity kickers" in the form of equity warrants.
- *Leveraged buyouts (LBOs)* use debt rather extensively in order to take a majority equity stake in companies. Cash flow from the acquired company is used to pay off the debt and is enhanced by operational and capital structure improvements. The LBO space is further divided into segments based on transaction size, such as, micro-cap buyout, middle-market buyout, and large buyout.
- *Distressed debt* strategies invest in the debt securities of companies in default. Distressed debt funds will purchase securities they feel will increase in value once the company is turned around. Typically, a distressed debt manager will become a major creditor of the company and use that position to play a leading role in reorganizing and restructuring the company. Turnaround time on distressed debt investments is generally shorter than LBOs and little leverage is used.

Investment Cycle and the J-Curve Effect

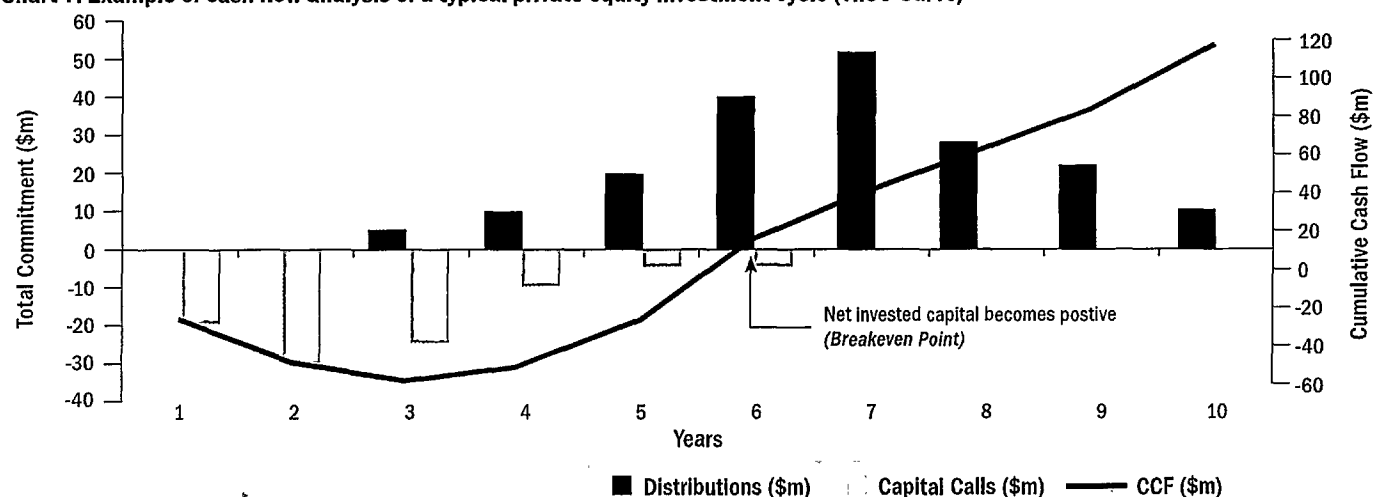
As mentioned earlier, most private equity funds have long investment horizons and therefore, liquidity can become a very important issue for potential investors. Private equity investors will generally contribute capital into a fund for the first three to five years and only begin to recoup their investment in the second half of a typical 7-10 year investment life cycle. This payout pattern gives rise to the "J-Curve", as shown in Chart 7 on the following page, with many private equity investments experiencing negative cash flows in their early years.

There are a few key reasons for this. Foremost, even the most successful investments will usually take 5-10 years to see gains as businesses mature and the actions taken by the manager begin to increase the value of the enterprise. Private equity

Chart 6: The different types of private equity firms



Source: GWIM AI Group

Chart 7: Example of cash flow analysis of a typical private equity investment cycle (The J-Curve)

Source: GWIM AI Group. For illustrative purposes only. There can be no assurance that actual fund cash flows will be similar to the model set forth as cash flow patterns will vary depending on the activities of the underlying private equity partnerships. This is a simplified example and may not represent the performance of an actual company or fund.

managers will typically hold investments at cost until there is an exit event (e.g., sale, IPO, M&A, etc). Hence, even as the underlying investments may be appreciating, the value of the portfolio remains understated until sold.²⁴

Conversely, lackluster investments are usually identifiable early on, and consequently, most of a fund's write-downs are usually taken in the first years of operation. Furthermore, firms tend to charge the management fee (calculated on the entire committed capital) up front even though the capital called in the early years is only a small portion of the total committed. Consequently, early and interim performance data and valuation can vary significantly from ultimate realized gains and may not be particularly meaningful. The practical implication for investors is that potential gains will usually materialize only after a lengthy

incubation period.

REAL ASSETS

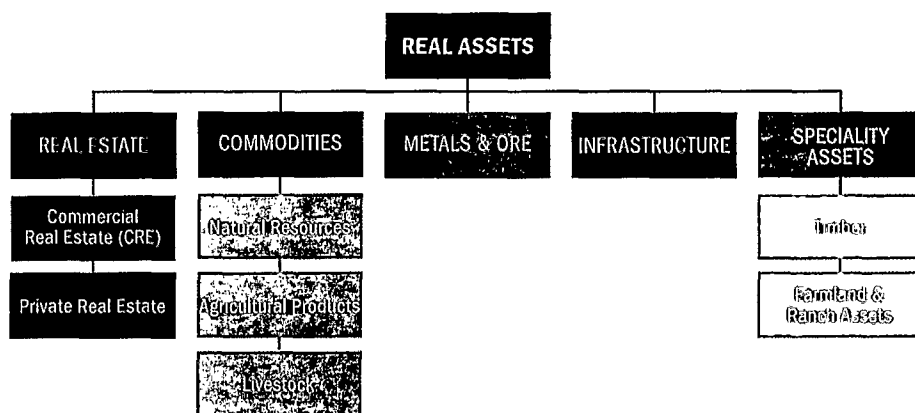
A significant portion of a nation's ultimate wealth and productive capacity rests on its stock of real assets. These are physical or identifiable assets such as commodities, infrastructure, plant and equipment, and real estate as well as human capital (see Chart 8 below). Real assets are primarily inputs for activities that generate income for the economy. In contrast, financial assets are claims to the income generated by real assets.

For investment purposes, real assets also include securities that represent ownership in physical commodities, such as oil, agriculture products, or gold. In addition, real assets can also include direct investments in natural resources and properties, such as timberland, or farm and ranch assets. We believe real assets can provide income, protect against inflation and provide additional portfolio diversification.

Real Estate

Real estate represents the largest segment of the real asset class, encompassing both personal residences and commercial real estate properties (CREs). For purposes of investment portfolios, though, real estate generally refers to ownership in commercial real estate.

For much of history, real estate was the pre-eminent asset class and primary measure of wealth. Even today, after a substantial

Chart 8: The wide range of real asset investment markets

Source: GWIM AI Group

²⁴ In September 2006, FASB issued the authoritative guidance on the fair value measurement of illiquid investments (FASB #157). It represents a broad set of asset valuation guidelines required under GAAP for financial statements. The new guidance was introduced to help provide more consistent and transparent financial reporting of asset values on a more current basis. For most firms the FASB #157 came into effect for fiscal years beginning after November 2007.

correction, real estate remains a very important asset class. The value of the commercial-grade global real estate market at the end of 2010 was estimated at \$23.9 trillion.²⁵ It may seem odd, then, to refer to real estate as an 'alternative' asset class, but it is typically classified as so, because they provide additional diversification beyond the 'traditional' asset classes of stocks and bonds. Commercial real estate investments also provide regular income in the form of rent, that can be reset on a periodic basis, providing a partial hedge against inflation.

Commercial real estate includes apartments, office buildings, industrial and retail properties. They can be accessed either through publicly traded real estate securities, such as real estate investment trusts (REITs) and collateralized mortgage-backed securities, or via investment in privately placed real estate funds.

There are essentially three strategies in the commercial real estate investment market: core, value-added, and opportunistic. The significant characteristics of each are given in Table 4 below.

Commodities

Commodities represent physical assets that can be consumed or used as economic inputs. The major commodity groups are energy (e.g., crude oil, natural gas, heating oil, and gasoline); agricultural crops (e.g., corn, soybean, and wheat); precious and industrial metals (e.g., gold, silver, copper, platinum, palladium and nickel); soft commodities (e.g., sugar, coffee, and cotton); and livestock (e.g., cattle and hogs). Commodities

are primarily traded on an exchange and their prices are determined by global supply and demand. They can be traded either for immediate, physical delivery (spot market), or future delivery (futures market). Most individual commodity investments take place in the futures market (described earlier in the section on managed futures). In most cases, only producers of commodities and those who make direct use of these commodities trade in the spot market.

Infrastructure

Infrastructure investments have become increasingly attractive in the last two decades. Rapid urbanization in developing countries and aging infrastructure in the mature economies have created a demand for highways, bridges, seaports, airports, pipelines, water and sewage systems, utilities, hospitals, schools, and the like. According to the Organization for Economic Co-operation and Development, global infrastructure requirements will average approximately \$2 trillion annually until 2030 or the equivalent of 3.5% of the global GDP.²⁶ Infrastructure projects typically have high development costs (barriers to entry), inelastic demand, and long lives; furthermore they generate regular, predictable earnings that have historically been independent of short-term market trends. These types of projects are particularly useful for investors seeking to match income streams with long-term liabilities. Infrastructure funds are typically in the form of private equity and can range from diversified, multi-asset funds with only a portion of their portfolio invested in infrastructure to fully dedicated funds that invest exclusively in infrastructure projects.

Table 4: Types of commercial real estate strategies

Strategy	Description	Investment Characteristics	Relative Risk
Core	Conservative strategy. Typically invests in well-leased office, industrial, retail, and apartment buildings with credit-worthy tenants.	<ul style="list-style-type: none"> Secure income streams. Current income constitutes a high proportion of total returns Less potential for significant capital appreciation Relatively low volatility of returns Well diversified by property type and geography Low use of leverage (0%-50%) Typical holding period is 8-12 years 	Moderate
Value-added	Similar types of investments as core real estate strategies, but typically in buildings of lower qualities that require enhancements. Most value-added funds pursue targeted investment strategies designed to buy, improve, and sell properties over a predetermined period.	<ul style="list-style-type: none"> Opportunity to improve cash flow and potential returns through physical and operational improvements Total return in the form of current income from operating cash flow and capital gains through planned sales Moderately leveraged (50%-65%) Typical holding period is 3-6 years 	Moderate to higher
Opportunistic	Riskiest of the three strategies. Typically involves the restructuring, redevelopment, and/or operating improvements of underperforming properties.	<ul style="list-style-type: none"> Highest potential returns. Focus on value creation and capital gains rather than income Initial cash flow may be negative Involves systematic risk as general market conditions may significantly affect expected returns High use of leverage (in excess of 65%) Typical holding period is 3-6 years 	Highest

Source: GWIM AI Group. Use of these strategies involves investment risks, including the possible loss of principal.

²⁵ Manidipa and Liang (2010), "A Bird's Eye View of Global Real Estate Markets: 2011 update", Pramerica Real Estate Investors.

²⁶ Inderst, G. (2009), "Pension Fund Investment in Infrastructure", OECD.

Most funds carry diversified portfolios that include different types of infrastructure spread over multiple regions.

Conclusion

Having covered the history, characteristics and styles of alternative investments, we conclude with a few thoughts regarding recent developments in the industry. In the aftermath of the financial crisis of 2008, alternative fund managers have seen significant requests from investors and regulators for additional transparency, enhanced liquidity terms, and better alignment of managers' and investors' interests. In response, many funds have taken a proactive approach to address these issues.

Alternative investment funds that weathered the crisis have and will likely continue to face reduced competition, which we believe will provide significant opportunities for them in the future. Moreover, returns are once again likely to be driven more by manager skill than leverage. Hedge fund leverage, for example, is far below its 2007 peak and, given increased funding constraints, it is unlikely that it will return to that level soon.²⁷ In the private equity space, Bain & Co. sees a trend toward greater geographic and industry diversity.²⁸ Asia-Pacific is now a growing area of interest for private equity funds, along with less mined sectors such as energy and health care.

From a strategy perspective, some of the best investment opportunities will continue to be in the distressed debt area. According to BofA - Merrill Lynch Global Research, approximately \$1 trillion in corporate high-yield and leveraged loan debt will likely need to be refinanced over the next six years.²⁹ It is likely, given the projections for a tepid economic recovery, that some firms will face difficulty refinancing, thereby creating opportunities for both hedge and private equity funds to trade this debt as well as profitably restructure certain companies. In particular, we feel that significant opportunities are likely to continue in the more complex areas of the credit market where specialized manager skills are necessary to extract value.

Interested and eligible investors can find some of the most successful and innovative managers in the alternatives industry here at BofA - Merrill Lynch. In addition, we strive to provide resources, such as this educational paper, that are designed to make the complex topic of alternative investments more accessible to our investors.

The next paper in this educational series, "Why Alternative Investments?", explores in detail the potential advantages of adding alternative investments to a traditional investment portfolio.

It is important to note that while there are significant advantages to alternative investments, they are also complex strategies that carry risks above and beyond those associated with traditional assets. Alternative products are therefore not suitable for all investors. Certain strategies and techniques used by alternative funds to enhance returns (e.g., short selling, leverage, investing in illiquid assets and securities, etc.) can also potentially increase investment risks, including the loss of principal. For more information, please consult your financial advisor or representative.

²⁷ Hasnat and Bartels (April 2010), "Quarterly hedge fund hold 'em and fold 'em report", BofA-Merrill Lynch Global Research.

²⁸ Bain & Company (2010), "Global Private Equity Report 2010".

²⁹ BofA-Merrill Lynch High Yield Research, Bloomberg as of 9/30/2010.

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Index Definitions

The indexes defined below are unmanaged, include the reinvestment of dividends when applicable, do not reflect the impact of transaction fees, management fees, or incentive compensation and are not available for investment. They are included here for illustrative purposes.

CS-Tremont Index: The CS-Tremont Index tracks more than 4,500 funds with a minimum of US \$50.0 MM AUM, minimum one-year track record, and current audited financial statements. Funds are separated into 10 primary subcategories based on investment style. The index is calculated and balanced monthly. Funds are reselected on a quarterly basis as necessary. Performance data used in the index is net of all fees. Funds of funds are not included. (Source: CS Tremont Hedge Fund website)

Credit Suisse - Tremont Managed Futures Index: An asset-weighted index, which includes only funds, as opposed to separate accounts. The index uses the Credit Suisse - Tremont database and consists only of Managed Futures funds with a minimum of US \$50 million AUM, a 12-month track record, and audited financial statements. It is calculated and rebalanced monthly, and shown net of all fees and expenses. Managed Futures funds (often referred to as CTAs or Commodity Trading Advisors) focus on investing in listed bond, equity, commodity, futures, and currency markets globally. Managers tend to employ systematic trading programs that largely rely upon historical price data and market trends.

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Some or all alternative investment programs may not be suitable for certain investors. No assurance can be given that any alternative investment's investment objectives will be achieved. Many alternative investment products are sold pursuant to exemptions from regulation and, for example, may not be subject to the same regulatory requirements as mutual funds. In addition to certain general risks identified below which are not exclusive, each product will be subject to its own specific risks, including strategy and market risk. Certain alternative investments require tax reports on Schedule K-1 to be prepared and filed. As a result, investors will likely be required to obtain extensions for filing federal, state, and local income tax returns each year.

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In the recent past, the alternative investment industry experienced a period of rapid change due to dislocations occurring in the global equity and fixed-income markets, which resulted in a number of market participants experiencing significant losses, substantial redemption requests and decreased liquidity. Due to contractions in market liquidity and the availability of financing, many alternative investment funds deleveraged their portfolios and raised cash to take a more conservative stance and meet potential future redemptions, and a number of others imposed limitations on the terms on which investors may redeem (for example, increasing the notice period for redemptions, instituting gates limiting the amount of capital that can be redeemed as of any redemption date, imposing lockup periods and suspending redemptions entirely) to avoid the forced liquidation of positions into a distressed market. While these actions may have been in the best interests of such funds overall, investors should carefully consider the implications of these events on their own investment portfolios, including their investment horizon, liquidity needs and ability to sustain losses, and the possibility that such events may occur in the future.

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