WHEN OPPORTUNITY KNOCKS

NEPC Asset Allocation Committee

Introduction

At the start of this year we indicated in our annual letter that the current market volatility would create investment opportunities. Today, we believe severe dislocations in the credit markets have created the potential for compelling risk adjusted returns. As a result, we recommend that clients consider increasing their credit market exposure in the near future.

This recommendation is consistent with key themes we have emphasized over the years. These themes represent attributes we find among the best investors, including:

– Broad diversification and reduced dependency on any one asset class;

– Willingness to invest in undervalued asset classes and to rebalance out of overvalued asset classes;

– Willingness to add money to talented but out of favor managers;

– Ability to withstand some short term volatility for longer term payoffs;

– Willingness to lead; and,

– Willingness to be flexible and to take advantage of timely opportunities

Our message for this letter focuses on opportunities. Historically we've recommended timely increases to international equity, high yield bonds, global asset allocation, and numerous other types of diversifying asset classes. As part of our recommendation to invest in the credit markets at this time, we also want to suggest a broader consideration of opportunistic investing.

Is Opportunistic Investing Appropriate for Your Portfolio?

For most long-term investment portfolios we believe that some form of opportunistic investing is appropriate. We recognize that taking advantage of near-term opportunities can be outside the more traditional asset allocation process. Therefore, we will be asking you to consider adjusting your investment policy to include an "Opportunistic Investment" category as part of your strategic allocation. We understand that great opportunities won't always exist and will structure the policy accordingly. For example, you might create a target range of 0 - 10% for these strategies. Because each plan has specific needs, your consultant will work with you to determine what is appropriate for your circumstances.

SEVERE DISLOCATIONS IN THE CREDIT MARKETS HAVE CREATED THE POTENTIAL FOR COMPELLING RISK-ADJUSTED RETURNS.

The Credit Markets

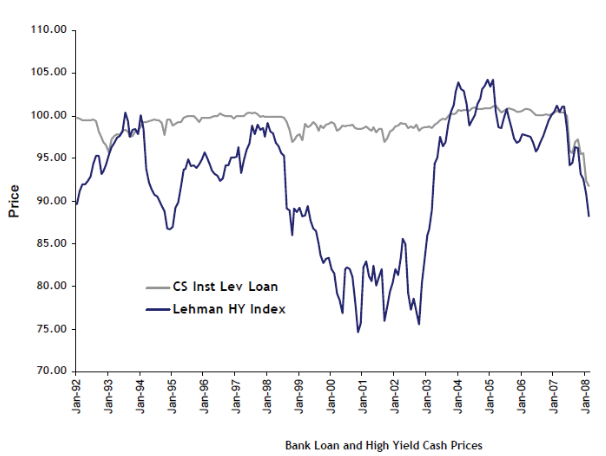
As mentioned above, we believe there are attractive opportunities in the credit markets. Over the past nine months we've seen the sub-prime meltdown, the credit contagion, and a broad-based repricing of risk for all asset classes. Indeed, much of the crisis seems warranted; a direct reaction to a housing and lending bubble. As a result, the times of easy money and lax lending practices came to an abrupt end. Most recently, credit standards have tightened as over $250 billion in write-downs and losses have been realized due to bad loans.

While we may not have seen the bottom yet, we do know that numerous niches of the credit markets have sold off to seemingly irrational levels. "Throwing the baby out with the bath water" is an idiom that applies in the investment world following virtually every short-term crisis. Eventually, fundamentals do return to the market and those willing to act quickly reap the rewards.

CONSIDER ADJUSTING YOUR INVESTMENT POLICY TO INCLUDE AN 'OPPORTUNISTIC INVESTMENT' CATEGORY.

In our opinion, there are many areas in the credit market that have been thrown out with the proverbial bath water, including: bank loans, areas of distressed debt and structured credit, and segments of mezzanine financing. As an example of an extreme in valuation, we include a graphic showing Bank Loan prices, which are now priced at levels approaching high yield, despite their superior position in the capital structure. This unusual relationship should not be sustainable.

NEW TECHNICAL RELATIONSHIP BETWEEN BANK LOANS AND HIGH YIELD



Data source: Credit Suisse & Lehman Brothers, through February 29, 2008

Building Exposure to Credit Markets

There are many investment products available in the credit space structured to take advantage of this current dislocation. Some products capture diversified exposure to the credit markets while others focus on a specific niche. These products range from very liquid, long-only investments to private equity-type investments with lockup periods of 6 years or greater. We recommend that clients gain access to credit opportunities with a diversified approach and with products that are consistent with the risk tolerance, liquidity needs, and time horizon of their specific investment program.

We have asked members of our research group to focus specifically on the products in their area that are designed to capitalize on the current market environment. We have created a special research task force to identify opportunistic credit investments across traditional fixed income strategies, hedge funds, and private markets. This team will be working directly with client consulting teams to present the most relevant strategy and products to address individual client needs.

For those clients considering an allocation to these strategies, we think that it is important to highlight the following:

1. It will be difficult to follow the "standard" due diligence process. Many of the products are relatively new or in the process of being launched. This means that investors may not have the benefits of a long, product specific track record to reinforce the investment decision. Instead, investors will need to understand the manager's underlying skill sets and how those skills are applicable for the new opportunity they are trying to exploit.
2. Because products in this area vary widely, it may be hard to do an "apples-to-apples" comparison of different managers, strategies, and structures. Many of the investments will need to be made based on their own merits and not relative to other comparable managers. This highlights the need for diversification.
3. The opportunity may improve after you invest. In other words, prices may still decline

after you begin to deploy capital. Investors should be prepared for this and can take steps to mitigate the risk. We suggest building smaller initial positions and being prepared to add to the position if the markets continue to slide.

4. Timing may be important. We are always cautious when providers say that you have to hurry to get in or you will miss your chance. We do, however, anticipate that the investment window may be short as markets may correct quickly and many manager fund-raising cycles may be compressed. We don't think that investors should forego appropriate due diligence, but we do encourage them to act as quickly as their process and structure allows.

EVENTUALLY, FUNDAMENTALS DO RETURN TO THE MARKET AND THOSE WILLING TO ACT QUICKLY REAP THE REWARDS.

Conclusions

We have tried to highlight three major points. First, we feel that investors benefit from being willing to deploy assets opportunistically to take advantage of market dislocations. Second, we recommend that you consider adjusting your investment policy to allow for more effective capitalization on future opportunities. Finally, we believe that segments of the credit markets currently present investors with compelling risk/return characteristics and that you should consider increasing your exposure to those areas.

We look forward to discussing these ideas at our next meeting with you. Opportunities in the credit markets will also be a presentation topic at our Client Conference in Boston on May 14th and 15th. If you would like to speak about this sooner, please give your consultant a call.

ONE MAIN STREET, CAMBRIDGE, MA 02142 | TEL: 617.374.1300 | FAX: 617.374.1313 | www.nepc.com

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