CORPORATE DISTRESSED INVESTING

Private Markets Team

Executive Summary:

Distressed investment managers will most likely have an attractive multi-year opportunity set in which to invest as a result of the macroeconomic slowdown and global deleveraging process that has accelerated since the Spring of 2008. Many market participants have moved away from a multi-year period of embracing increasing levels of risk to a more cautious approach. With increasing levels of defaults expected over the next few years due to deteriorating fundamentals, over-leveraged balance sheets and debt maturity schedules, a supply-demand imbalance of capital is likely to continue for a significant period creating market inefficiencies which can be exploited by focused and experienced investment teams.

Consequently, both the sheer number of situations and the potential for unlevered returns across the distressed opportunity set are among the highest they have been in many years. Current rates of return vary depending on the level of risk being assumed: the most senior securities, debtor-in-possession (DIP) loans, are yielding high single/low double digit returns while many illiquid credits are being priced to yield significantly higher rates. Individual security selection as well as market timing will play key roles in developing successful investment portfolios.

Driver of Success = Fundamental & Credit Analysis + Timing

Distressed Opportunities Characteristics:

Generally, distressed investment opportunities are the result of financially troubled companies who may have difficulty in meeting their financial obligations and may ultimately file for bankruptcy protection. To compensate investors for the risks associated with this investment strategy, the debt of the company usually trades significantly below par, the current yield is significantly higher than other debt instruments and the market value of the equity is negligible. In certain strategies, the manager will buy distressed hard assets (i.e. real estate, aircraft) at deep discounts to their intrinsic values.

MANY ILLIQUID CREDITS ARE BEING PRICED TO YIELD ATTRACTIVE, RISK-ADJUSTED RATES OF RETURN

Distressed Investment Strategy Definitions:

Debtor-in-Possession Financing ("DIP Financing"):

DIP financing is a special form of working capital financing provided for companies in financial distress or under the Chapter 11 bankruptcy process. Most often, DIP securities are more senior than any other debt or equity securities issued by the company. These loans have traditionally been regarded as interim, short term instruments with a duration of 12-24 months that allow company management to remain in control of the bankrupt estate, as opposed to a court appointed Trustee. This process gives the troubled company a new start, albeit under strict conditions, until the DIP loans are retired by first lien bank debt. Thus, DIP financings are usually one component of a distressed investment manager's strategic arsenal.

Distressed Debt Trading Strategy:

Distressed debt trading involves the purchase of debt obligations trading at a distressed level – for example at 40% of par value – in anticipation of reselling those securities over a relatively short period of time at a higher level, generating a trading profit.

For managers pursuing a trading strategy, the investment decisions are based primarily on technical and credit analysis rather than fundamental analysis, and sell decisions are usually triggered by short term price appreciation. Distressed debt is often very illiquid and generally trades at well below par value, in most instances because there is some perceived risk that all or a portion of the debt may not be repaid. Distressed debt focused investors fall along a continuum that has, at one end traders who focus on buying and selling distressed debt, and at the other, managers who acquire debt with the intent of converting it to equity in a restructuring and taking control of the company. In practice most managers employ a combination of these strategies.

DISTRESSED DEBT IS OFTEN VERY ILLIQUID AND GENERALLY TRADES AT WELL BELOW PAR VALUE

Non-Control (Significant Influence) Strategy:

The distressed for non-control strategy involves the attempt by managers to own a significant position of a particular class of debt in a distressed company in order to sit on its creditor's committee during a restructuring or bankruptcy proceeding. Active non-control managers typically do not hold positions much beyond the reorganization process and aim to capture the value generated as a byproduct of the restructuring process.

For investment managers pursuing an active restructuring strategy, in addition to technical and credit analysis, the Fund will do a great deal of fundamental analysis, looking at the company's business lines and related industries. Investment managers are looking to gain a position of influence in the restructuring process in which the value of securities – and indeed the nature of the end securities exchanged – is negotiated in bankruptcy in order to maximize returns. Often times, the investment manager will gain influence over a company by participating in ad hoc or formal creditors' committees, or as a board observer or member.

Control Strategy:

The distressed for control strategy combines elements of both private equity and hedge funds. Distressed for control managers make a profit from companies that are on the brink of bankruptcy. Managers employing this strategy gain equity control, augment or replace the management team, implement new strategies and renegotiate labor and supplier contracts.

Managers pursuing a distressed for control strategy build a controlling position in the fulcrum security in a bankruptcy proceeding in order to effectively gain control of the target company through the bankruptcy process, either alone or as part of a syndicate. With this strategy, the acquisition of the distressed debt position is in many respects the start of a much longer process. Once in control of the target company, the distressed manager takes the company through a multi-step process similar to that of a buyout manager: right-sizing the company through a combination of cost cuts and incorporating operational industry best practices, installing new management, and maximizing profitability through a combination of strategic growth initiatives and operating efficiencies.

The main risks associated with this strategy involve the inability of a company to survive the time it takes to execute a turnaround strategy and a further deterioration of asset values.

Turnaround Strategy:

The distressed – turnaround strategy primarily involves control equity and equity-related investments, bridge financings, and other similar investments in companies that are under-performing their potential. Managers who employ this strategy only do so if they; a) can become comfortable that the company can be turned around; b) can control the process; and c) have a viable exit strategy.

Turnaround focused managers are a subset of distressed managers that focus on under-performing companies. Funds managed by these managers often acquire the equity of distressed companies, in certain cases out of bankruptcy or emerging from bankruptcy proceedings, and to effect operational turnarounds or financial restructurings. The best turnaround focused managers often have talented in-house operational expertise, a detailed understanding of the bankruptcy process, and financial restructuring capabilities. These turnaround specialists generally acquire companies that are experiencing poor operating performance or that are inappropriately capitalized for low multiples of depressed cash flow.

DISTRESSED OPPORTUNITIES HAVE A LOW CORRELATION TO EQUITY MARKETS AND ALTERNATIVE ASSET CLASSES

Typical sellers include corporations that are undergoing restructuring and selling non-core or under-performing divisions, founding entrepreneurs or family business owners whose businesses have outgrown them, and other private equity managers without operational expertise. Once they have acquired a suitable company, turnaround managers often put that company through a three stage process that involves stemming losses by right-sizing the business, re-aligning strategy and pursuing expansion and growth.

Analysis Performed in the Evaluation of Distressed Investment Opportunities:

Technical Analysis:

Technical analysis is used to forecast the future direction of prices of securities through the study of past market data, primarily price and volume. It is widely used among traders and financial professionals. Technical analysis ignores the actual nature of the company, market or industry segment and is based solely on the chart, which conveys price and volume information.

Credit Analysis:

Credit analysis is a method by which one calculates the creditworthiness of a business. Credit analysis involves a variety of financial analysis techniques, including ratio and trend analysis as well as the creation of projections and a detailed analysis of cash flows. It also includes the examination of collateral and other sources of repayment as well as credit history and management ability.

Fundamental Analysis:

Fundamental analysis is the most comprehensive study of a business that builds upon credit analysis techniques and considers both quantitative and qualitative factors. Fundamental analysis involves an analysis of a company's financial statements, management, competitive advantages and its competitors and markets with the goal of making financial forecasts and determining current intrinsic and potential future value.

Portfolio Construction:

Distressed opportunities should be included in a private equity program. These investment strategies provide: (i) strategy diversification to a private equity program; (ii) reduced risk via the use of debt securities, which offer downside protection to default by residing higher in the capital structure, and (iii) low correlation to the equity markets and other alternative asset classes.

Portfolio Structure:

In making a recommendation for including a distressed opportunity allocation, we consider the need to mitigate manager, strategy and vintage year risk associated with the private equity program. These risks are addressed by appropriately sizing the commitment to each manager, pursuing a diversified allocation effort and by committing to an investing program over a multi-year period.

Portfolio company risk can be addressed by investing in managers that build well diversified portfolios or investing in multiple managers with different target markets. When compared to other strategies in a private equity portfolio, the distressed opportunities strategy is expected to generate distributions within a shorter time period either through a manager's trading strategy or a rapid restructuring. Managers will typically exit their positions within 24-36 months.

Market Opportunity:

The current opportunity set in distressed securities is a direct result of a number of factors that have transformed the credit markets over the last few years. These include:

THE U.S LOST 7.6 MILLION JOBS IN THE 24 MONTHS ENDING DEC. 2009, RAISING THE UNEMPLOYMENT TO 20 YEAR HIGHS

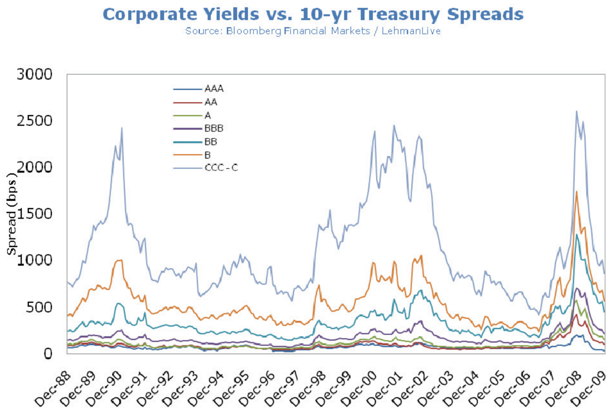
- Massive global liquidity spurred by petrodollars, financial institutions, foreign governments, global money expansion, etc.;
- Tremendous growth in participation by levered players including hedge funds, collateralized loan obligations, structured products, etc.;
- "Golden Age" in the Private Equity/LBO market characterized by unprecedented activity and size of transactions;
- Growth of the institutional loan market, especially leveraged loans to finance the M&A activity;
- Easy credit standards by both bank and non-bank lenders; and
- Record low yield spreads in credit that culminated in June 2007.

Over the past number of years, the average U.S. consumer had been seduced by the proliferation of financial products and less stringent lending standards across all segments of the economy from housing to automobiles to consumer credit and consequently, had been accustomed to living beyond its means. Since the consumer economy represents two-thirds of the overall spending in the US economy, the central underpinning of this crisis has been the rapidly declining employment statistics. The Bureau of Labor Statistics reported the U.S. has lost 7.6 million jobs from December 2007, when the recession began, through December 2009, swelling the unemployment rolls to 10.0%, levels not seen for over twenty years. This figure does not include an additional 2.5 million people who have been looking for work for over twelve months and a further 9.2 million part-time workers who are looking for full-time work. As the jobs market began to crack, consumer bad debt levels began to rise across large areas of the economy:

- Housing: Mortgages, especially Multi-Family Housing
- Consumer Finance: Credit Cards and Consumer Durables
- Automobile Financing: Car Loans

This has had a ripple effect through the rest of the economy as many retail chains are either reducing their real estate footprint by reducing their store count or going out of business completely. Declining household income has a dramatic effect on discretionary purchases such as travel and entertainment. The travel and entertainment industry affects numerous components of the economy including the airline, hotel, casino, restaurant, car rental and state and local municipalities heavily dependent on tourism and tax dollars. This cycle culminates with the industrial and corporate complexes. These organizations are forced to rationalize their costs and operations which results in giving up non-essential real estate and pursuing rental rate reductions on remaining leases.

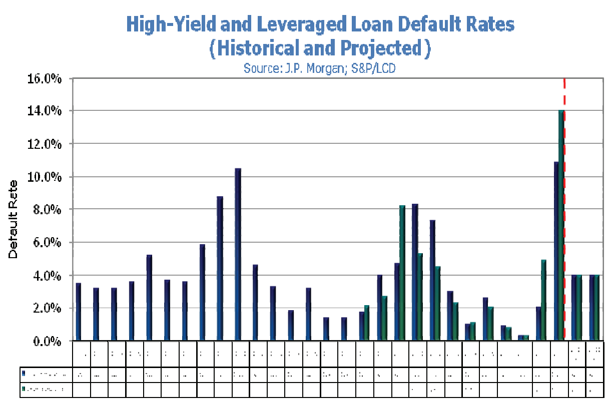
As depicted in the following two charts, the credit markets began to deteriorate in the Spring of 2008 as high yield bond spreads began to widen-historically an ominous sign for future default rates. The world quickly moved away from a multi-year period of embracing increasing risk levels to a systematic avoidance of risk during the Winter of 2009, followed by the more recent thawing out process whereby investors who were able to establish or hold on to their credit positions profited handsomely from credit spreads tightening.



WHAT HAPPENS TO THE $1.3 TRILLION IN LOANS THAT MATURE IN THE 2011-2014 TIME FRAME?

However, we expect default rates for high yield bonds and leveraged loans over the next few years will likely be higher than average due to:

- The volume of the maturity schedule for High Yield Bonds and Leveraged Loans; and
- A diminished set of buyers willing to take on this type of risk.

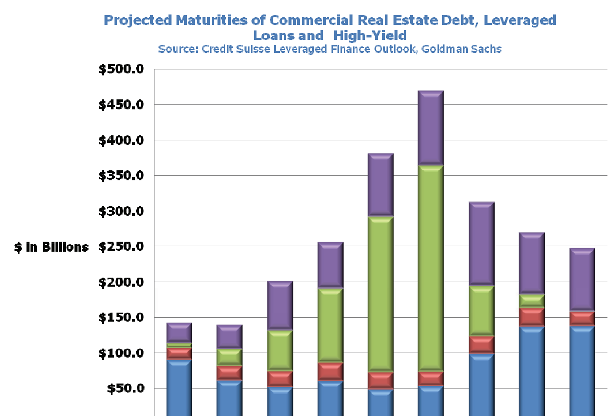


The collapse of Lehman Brothers in September 2008 signaled a new phase in the deleveraging process and sparked a complete reversal of the trends in the credit markets. Many lenders have exited a wide spectrum of the loan market permanently or for at least the foreseeable future, causing some dislocations. This "Great Deleveraging Process" that has been working its way through the global credit markets can be broken down into three segments or phases:

- *First Phase: Subprime Credit:* Residential real estate and consumer credit specifically the Residential Mortgage Backed Securities Market, ("RMBS") and the consumer portion of the Asset Backed Securities market, ("ABS");
- *Second Phase: Structured Credit:* High Yield Debt and Leveraged Loan Market; and
- *Third Phase: Commercial Real Estate:* Commercial Mortgage Backed Securities Market

As we begin 2010, we are in the third phase of this process. Due to the record new issuance volumes in 2006-2007, upcoming maturity volumes are significantly larger than can be expected to be financed by the remaining set of loan buyers. The big question is what happens to the $1.3 trillion in loans that mature in the 2011-2014 time frame? For the time being, many large borrowers and banks are delaying the pain by extending maturities further into the future, "kicking the can," hoping for a better economic and financing environment in the years ahead.

The following chart shows the expected maturities by year for Commercial Real Estate Debt, Leveraged Loans and High Yield Bonds for 2009 through 2017.



	2009	2010	2011	2012	2013	2014	2015	2016	2017
High Yield Bonds	$28.1	$33.8	$68.8	$64.3	$89.3	$105.1	$118.6	$87.6	$87.6
Leveraged Loans	$7.3	$23.9	$57.2	$104.4	$218.7	$290.2	$70.1	$18.6	$1.0
Life Insurance - CRE Loans	$16.8	$19.8	$23.1	$26.1	$24.8	$20.6	$25.7	$27.3	$21.4
CMBS, CDO, ABS	$90.5	$61.9	$51.5	$60.4	$48.0	$53.0	$98.2	$136.6	$137.1

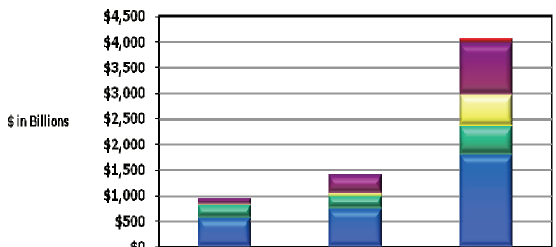
The estimate of market losses for loans and securities is a rapidly changing target as illustrated in the figure below. The International Monetary Fund, IMF, has tried to estimate mark to market losses for the components of the credit market. In just the last 18 months, the revised estimate has ballooned to $3.4 trillion, a change of nearly 3.5

times the April 2008 estimate of $0.945 trillion and nearly 2.5 times the October 2008 figure of $1.4 trillion. The projected losses related to consumers continue to grow at a rapid pace. The takeaway from this analysis is that only a small portion of these losses is currently realized, suggesting a large volume of defaults/losses is still to come.

DRIVER OF SUCCESS = FUNDAMENTAL & CREDIT ANALYSIS + TIMING

The following chart compares the IMF projections of mark to market losses from April 2008 through October 2009.

IMF's Estimate of Mark to Market Losses for Loans & Securities
Source: International Monetary Fund



	April, 2008	October, 2008	October, 2009
Municipal Loans	$0	$0	$80
Corporate Loans	$120	$360	$994
Consumer Loans	$20	$45	$626
Commercial Real Estate Mortgages	$240	$250	$546
Residential Real Estate Mortgages	$565	$750	$1,808

In the near-term, lenders have little choice but to extend maturities or experience tremendous waves of default. The rising volume of DIP loans, shown on the next page, is expected to continue. Under more normal conditions, high credit spreads increase lending by existing lenders and induce new competitors to enter the market. Historically, the largest DIP lenders by volume have been many of the major commercial and investment banks as well as some specialty finance firms such as GE and CIT Group. Many of the mid -large distressed debt control investors also maintain a presence in this market. However, this has not been the case recently, as many of the large DIP lenders including the large investment banks and specialty finance institutions have been relegated to the sidelines due to their own issues with overly leveraged balance sheets. Two of the largest DIP lenders in 2009 were governments, The US Department of Treasury and the Export Development of Canada.

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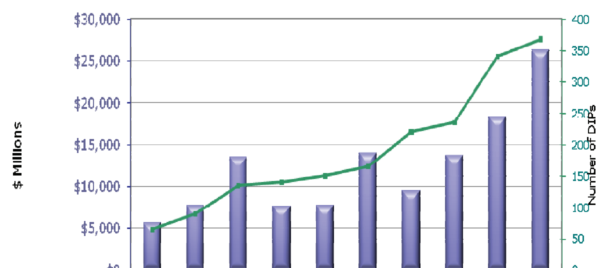
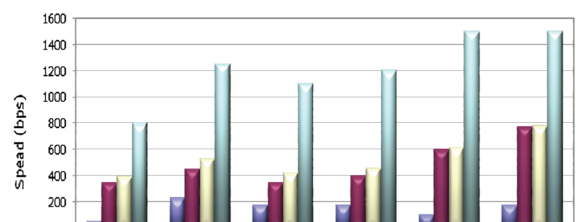
To illustrate this point, lenders in the DIP market, the safest portion of the capital structure, are now earning double digit unlevered returns due to the absence of normal market participants and the spike in volume of bankruptcies. A few dedicated DIP funds were raised in 2009 to take advantage of this supply-demand imbalance, the key risk being how long this anomaly exists as opposed to the risk of loss of principal capital loss.

DIP Loans - Volume by Year
Source: William Blair & Co M&A Market Analysis, Citi



	2000	2001	2002	2003	2004	2005	2006	2007	2008	Nov-09
Volume of DIPs	$5,628	$7,692	$13,555	$7,647	$7,733	$13,963	$9,485	$13,683	$18,268	$26,300
Number of DIPs	65	90	135	140	150	165	220	235	340	368

DIP Loan Pricing: Spread Above LIBOR by Year
Source: William Blair & Co M&A Market Analysis, Citi



	2004	2005	2006	2007	2008	Nov-09
Min	50	225	175	175	100	175
Median	350	450	350	400	600	775
Mean	390	528	416	454	611	780
Max	800	1250	1100	1200	1500	1500

J.P. Morgan put it plainly in fourth quarter of 2008, "the opportunity to acquire greater downside protection with the upside of equity-like returns un-leveraged should lead high yield bonds and loans to outperform equities..." Since March 2009 through year end, this statement proved to be prescient as the high yield index rocketed 60.4%, the best performance in its history, rivaling the broader based S&P equity rally which earned 67.8% during this time period. The question ***is whether this opportunity for outperformance still exists going forward?***

Strategy Risks:

Distressed debt managers will most likely have an attractive multi-year opportunity set in which to invest. However, the excess leverage and liquidity which characterized the 2006-2007 vintage loans

BANKRUPTCY LAW: THE INTERESTS OF THE SHAREHOLDERS ARE SUBORDINATE TO THE INTERESTS OF THE CREDITORS

(which make up 80% of loans available for purchase in today's market) created loan-heavy capital structures. Senior secured leverage levels reached all-time highs. Therefore, the best distressed investors will selectively pick from among possibly the most borrower friendly leveraged loans ever arranged and not be overly seduced by the attractive pricing levels of the overall index. Individual security selection as well as market timing will play key roles in developing successful investment portfolios.

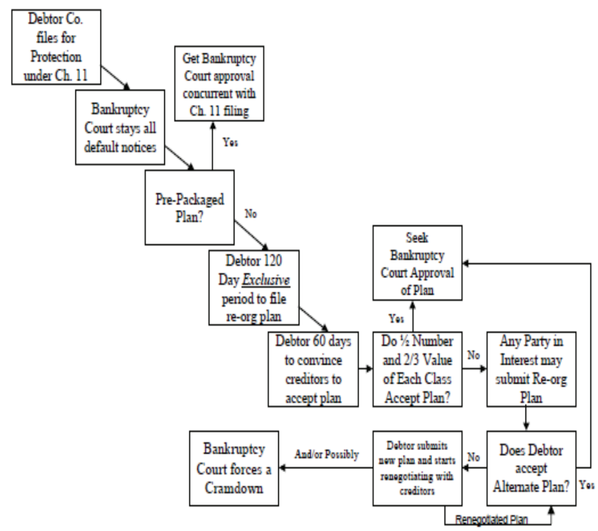
Driver of Success = Fundamental & Credit Analysis + Timing

A key unpredictable variable affecting security selection and overall strategy in the distressed area is the involvement of the US Government in the bankruptcy process. For the credit market to function properly, market participants must feel confident that the rules of contract law will prevail. In the most recent Chrysler bankruptcy case, the company's senior creditors' rights were compromised by the Government out of a perceived national interest in keeping Chrysler operating. Chrysler shareholders much further down the capital structure were given large equity stakes in the pro-forma enterprise before the senior creditors' claims were fulfilled. To help explain this issue, it is useful to review the basics of a bankruptcy process.

Overview of the Bankruptcy Process:

Chapter 11:

Chapter 11 of the U.S. Bankruptcy Code recognizes the corporation as a ***going concern.*** This allows the troubled company to be protected from its creditors while attempting to work through its operational issues. The company, working under Chapter 11 proceedings, will propose ***a plan of re-organization*** that describes how creditors and shareholders are to be treated under the new business plan. ***Claimants in each class*** of creditors are entitled to review and vote on the plan. This process is show in chart below:



Under the bankruptcy code, the re-organization plan places the various claims in particular *classes;* to be in a class, each claim must be *substantially* similar to other claims in that class. The ranking of the various classes of securities in order of seniority follows:

- ***DIP Loans*** - loans provided post declaration of bankruptcy
- ***Secured bank loans*** - most senior loans pre-bankruptcy
- ***Subordinated debt*** - junior in the debt structure
- ***Preferred stock*** - most senior equity tranche
- ***Common equity*** - most vulnerable position in the capital structure

Thus, one of the tenets of bankruptcy law is that the interests of the shareholders are subordinate to the interests of the creditors.

During the first 120 days of the company seeking Chapter 11 protection, the company or debtor has the *exclusive* right to file a plan of reorganization. If filed during this time period, the company then has a further 60 days to lobby its creditors to accept the plan. No other party during this 180 day exclusive period may file a plan of reorganization. As shown in the chart above, the plan is ***accepted*** when ***all classes of claimants*** vote in favor of the plan (hence, any one class of creditors can block a reorganization plan-a key strategy among distressed debt holders).

THERE IS AN OPPORTUNITY TO TAKE ADVANTAGE OF THE ILLIQUIDITY PREMIUM PRICED INTO THE MARKET

To constitute an acceptance of a plan or reorganization, either :

1. Class must be ***completely unimpaired*** (paid back in full) by the plan or;

2. In number and 2/3 in value of claims in class vote in favor of the plan.

   Thus, importantly for a distressed debt investor, a single creditor can block a plan of reorganization if it holds 1/3 of the dollar amount of any class of claimants. This blocking position will force the company to negotiate with the blocking investor.

Importantly, all claims within a class must receive the *same treatment.*

<u>Other Options to Filing Chapter 11:</u>

- **Pre-Packaged Bankruptcy Filing:**

  Sometimes, the debtor company agrees in advance with its creditors on a plan of reorganization before it files for protection under Chapter 11. Creditors may take concessions up front in exchange for equity in the reorganized company (another commonly exercised **distressed debt investor option).** In this instance, the debtor company quickly files with the court, submits a pre-negotiated reorganization plan and quickly emerges with a new structure.

Chapter 7 – Liquidation:

Under a Chapter 7 Liquidation filing, the troubled company is not considered a *going concern.* In this case, the bankruptcy oversees a process whereby the company auctions off its assets to satisfy the claims of its creditors in order of priority. This is generally viewed as the least desirable option by creditors and shareholders alike in terms of maximizing value.

Comparison of Corporate Distressed Strategies:

Matching the Distressed Strategy with the Market Opportunity:

<u>DIP Lending:</u> Usually the lowest return strategy due to its position of seniority in the capital structure. Attractive in times of extreme financial distress and capital dislocation, where access to capital is paramount and hence, the providers of capital earn outsized returns. Usually this period is short-lived; hence this is most opportunistic of distressed debt strategies.

<u>Trading Strategies:</u> These strategies prosper during times of extreme volatility and dislocation in the market where trading acumen can exploit short term inefficiencies and reap outsized returns on senior paper that trades at depressed levels due to poor market sentiment, systematic risk, or temporary supply-demand imbalances in the buyer universe for distressed debt.

For the most part, managers focused on trading do not buy distressed debt with the intention of holding for an extended period of time. The best of these managers are accomplished at identifying mispriced debt securities in a very illiquid market and at being able to deliver control or blocking positions to investor groups that become involved in the actual restructuring. Certain managers distinguish themselves by investing in only the most senior debt securities, while others consider the full spectrum of available debt. This strategy was well suited for the initial recovery phase of the market in the back half of 2009. The most liquid

Characteristics	Debtor In Possession " DIP"	Trading	Significant Influence	Control/Turnaround
Targeted Investments	Private and OTC/Publicly-traded securities	OTC/Publicly- traded securities	Private and OTC/Publicly-traded securities	Private and OTC/Publicly-traded securities
Investment Position	Most senior security	High Yield Debt	Senior debt, second lien debt, equity	Senior debt, second lien debt, equity
Primary Source of Return	Current Income-Short Duration	Current Income and Short-Term Capital Appreciation	Current Income and Capital Appreciation	Current Income and Long-Term Capital Appreciation
Timing of Entry/Exit	Entry: During restructuring Exit: Immediately Post restructuring	Entry: Pre-restructuring Exit: Pre-restructuring	Entry: Pre-restructuring Exit: Immediately Post restructuring	Entry: Pre and during restructuring Exit: After business transformation
Competitive Landscape	Large commercial/investment banks Control oriented distressed investors	Hedge Funds High Yield Bond Managers Proprietary Trading Desks	Distressed Managers: Hedge Funds and Private Equity	Distressed Managers Buyout Funds
Manager Value Add	Legal/bankruptcy process expertise	Trading abilities as well as network and research capabilities	Knowledge of legal and bankruptcy proceedings and industry expertise	Knowledge of legal/ bankruptcy proceedings, operational and industry expertise
Follow-on Capital Investment Required	Limited	Usually to build a position/manage portfolio	Usually to build a position in the fulcrum security	Often during business transformation process
Risk Mitigation	-Super Priority Security -Duration - Legal contract governed by U.S. Bankruptcy Code	Senior debt offers downside protection as holders are contractually first to get paid (exception: Chrysler). Liquidity.	Senior debt protection and potential receipt of equity. Optionality via pursuing liquidity.	Senior debt protection and potential receipt of equity
Board Member or Observer	No	No	No, but may serve on creditors' committee or as BOD observer	Yes

situations really ran in 2009 and are not nearly as attractive today.

Non-Control/Significant Influence: Rising default rates and market distress are environmental characteristics that typically signal attractive opportunities in this segment of the distressed marketplace. Relying more on fundamental analysis these managers often focus on event driven or more illiquid situations than do trading orienting strategies which are shorter in duration. As the current macroeconomic situation shows signs of stabilization, this may be an opportune time to practice this strategy.

Control/Turnaround: The key elements of success to this strategy are:

- Time: an ability of the troubled company to survive the time it takes to execute a turnaround strategy and a possible further deterioration of asset values
- Going Concern: a strong belief by the distressed investor that the company is fundamentally a good company and is underearning its potential or is being hampered by its over-levered balance sheet.

Therefore, this strategy is dependent on the distressed investor's ability to assess current value and perform fundamental analysis to project financial forecasts of cash flows. During periods of severe macro-economic distress, it may be more difficult for these managers to time the purchase of their positions and/or have confidence in predicting future financial performance. During stabilization periods or early periods of recovery, this strategy has often yielded very attractive risk-return options.

Recommendations for Present Conditions:

The last two years have been marked by dramatic swings in the credit markets due to broad global macroeconomic forces. In 2008, with the markets awash with systemic risk, credit participants were penalized for taking on any form of risk and returns suffered greatly. The pendulum swung in the opposite direction in final three quarters of 2009 and every segment of the credit market rebounded strongly with the riskiest credits performing the best. In short, the last two years have been an exposure call; in 2008 no exposure was ideal and for the majority of 2009, full exposure was rewarded.

Looking forward, there is an opportunity to take advantage of the illiquidity premium priced into the market. Due to the shocks to the system over the last two years, most investors and investment managers have a strong preference for liquidity. Thus, there are attractive risk-reward opportunities for strong fundamental managers with flexible investment mandates to pursue inefficiencies in less liquid markets such as small/midcap corporate credits and longer duration non-control and control distressed situations. We expect security selection to play a greater role in generating returns in the years ahead.