PRIVATE EQUITY INVESTMENT PROGRAM STRATEGIC PLAN

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ARIZONA STATE RETIREMENT SYSTEM

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Introduction

The ASRS board has determined that a target allocation of seven percent, plus or minus two percent, shall be invested in private equity investments. The ASRS began deploying within this strategy in 2007 and by late 2010 investments of approximately 30% of the allocation have been made. This planning document sets forth the underlying philosophies and principles, which will be followed with the ongoing construction and maintenance of the portfolio. While the portfolio is being constructed to its target allocation, it will be a net absorber of capital. However, once the portfolio is mature it will be net contributor to cash flow.

Private equity is equity. It has the investment characteristics and risk factors of publicly traded equity with the additional risk factor of illiquidity. The returns for private equity are expected to be higher, and historically have been higher, than publicly traded equity. The historic returns in private have exceeded public markets by a spread of 2% to 5%. The source of excess return for private equity includes a liquidity premium but is more than that. Best in class private equity owners add value through an intensely attentive owner's footprint on the portfolio company. This takes the form of improved governance, operational support, improvements in financial and managerial systems, support in strategic marketing and in some cases growth or acquisition capital. In some cases, private equity managers add value through their global and local capital insights, providing liquidity to overlooked opportunities.

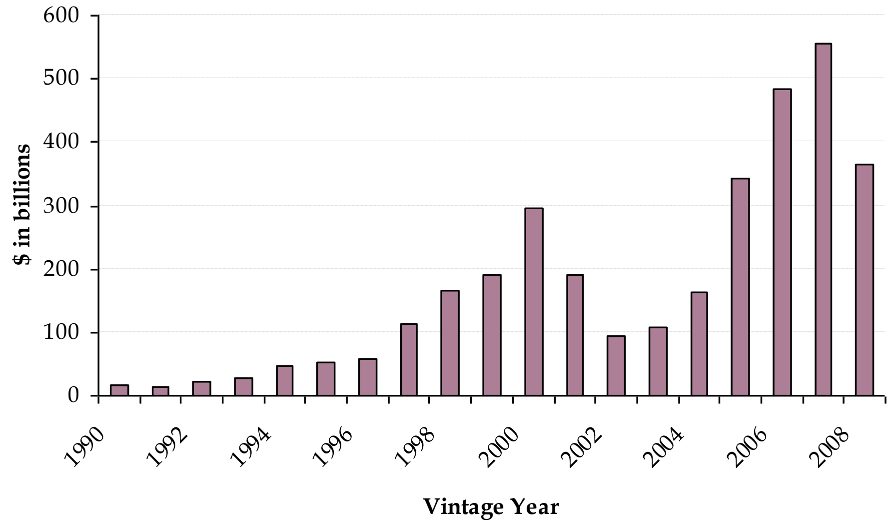
Unlike active managers in public space, research has shown persistence in returns of more successful private equity managers. Additionally, research has shown that smaller managers focusing on smaller capitalization companies have outperformed the largest funds. Thus, the program has focused on and will continue to focus on small to mid buyout funds with $1 billion or less total fund size. The ASRS private equity program will also invest in large buyout funds, venture capital, secondaries, co-investments, mezzanine and distressed debt funds where control or equity characteristics are expected to be a significant element in return generation. The program will be constructed bottom up, focusing on firms and management teams with proven performance capabilities in generating favorable returns.

The portfolio will be constructed with diversification goals in mind. The ASRS will monitor and limit exposure to strategies, manager, industries, and geographies. The program is being implemented gradually to ensure adequate diversification across "vintage years" and the business cycle. The pool of potential target companies is very large. It is believed that there are approximately 100 privately firms for every large public company. At full build out, the ASRS private equity investment program will involve investments in hundreds of portfolio company businesses not otherwise reflected in our investment universe.

Private Equity Market Evolution

The modern private equity market began to develop in the late 1970s, as the limited partnership structure was broadly adopted by private equity investors and industry-favorable regulatory and tax changes were adopted by the federal government. In the early 1980s, the levels of capital raised by funds dedicated to venture capital and buyout strategies were similar, but by the mid-1980s buyout, funds began to dominate the landscape due to the scalability of the buyout model and the increasing supply of debt financing for leveraged purchases of private companies. The supply of capital for private equity investments continued to grow through cycles of fundraising from approximately $18 billion in 1987 to over $500 billion in 2007, as indicated in the chart below.

Private Equity Commitments by Vintage Year[1]



Over the last two decades, the private equity market has become increasingly developed and sophisticated, attracting institutional investors of all types. The private equity marketplace has reached a size at which it cannot be ignored by institutional investors of sufficient size. It is widely believed that the market value of privately held companies is comparable to that of publicly traded company shares. However, there are many more private companies than public ones. Historical studies have shown that there are approximately 100 small, typically private companies for every larger public company[2]. Thus, the private equity market provides a large arena for investing.

The private equity markets have also offered a higher source of returns than the broad public equity markets. Over long periods of time, private equity has generally performed between 2% and 5% in excess of broad public equity indices, as indicated in the table below.

	Trailing 10-Year Annualized Return Ending June 30, 2010[3]	Trailing 20-Year Annualized Return Ending June 30, 2010[3]
Private Equity	**3.8%**	**10.9%**
Russell 3000	-0.9	7.9

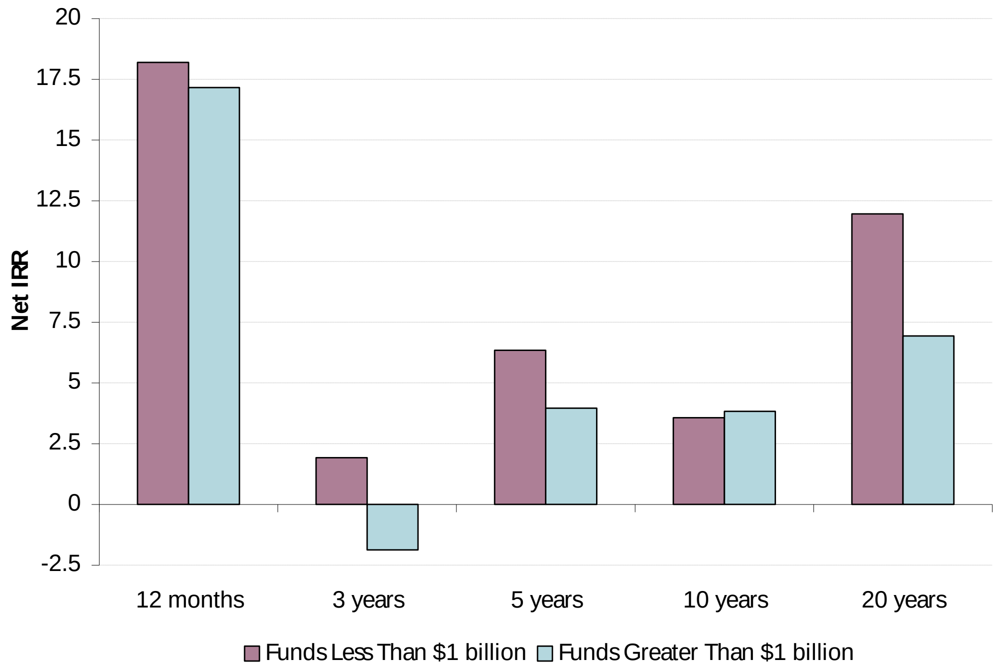
In recent years, allocations across institutional investors in private equity have tended to be dominated by buyout funds. This is primarily a reflection of the size of the buyout opportunity set relative to other private equity strategies, but is also partially a function of the positive performance experienced by many investors in the buyout market versus the venture capital market over the last ten years. Due to the relative stability and maturity of buyout-backed companies, buyout managers have historically been able to generate attractive returns through pricing inefficiencies, financial engineering, and participating in

[1] Source: Venture Economics, May 2010
[2] Small business Administration Office of Advocacy.
[3] Private Equity performance represents Venture Economics data for all private equity funds.

improvements of the operating performance of their investments. However, as buyout markets have become more competitive and sophisticated over time, some sources of return originally available to buyout managers have generally begun to diminish. As such, many buyout managers have sought to develop differentiated skill sets related to sourcing investments at attractive prices and various methods for enhancing the operating performance of portfolio companies.

Another trend seen in the buyout market over the last ten years is the dramatic increase in fund sizes and product offerings for certain successful managers. Many buyout managers who developed successful track records and reputations investing in small- and middle-market companies (enterprise values of $500 million and less) have capitalized on their success by accumulating multiple billions of dollars to invest in increasingly larger companies every few years (and in doing so increasing the basis for their fees) and leveraging their brand names to become asset managers with numerous products and strategies under management. Despite this shift, funds with $1 billion of commitments or less have continued to outperform larger funds by at least 2% per year over both short and long time periods, as detailed in the chart below.

Buyout Horizon Performance[1]



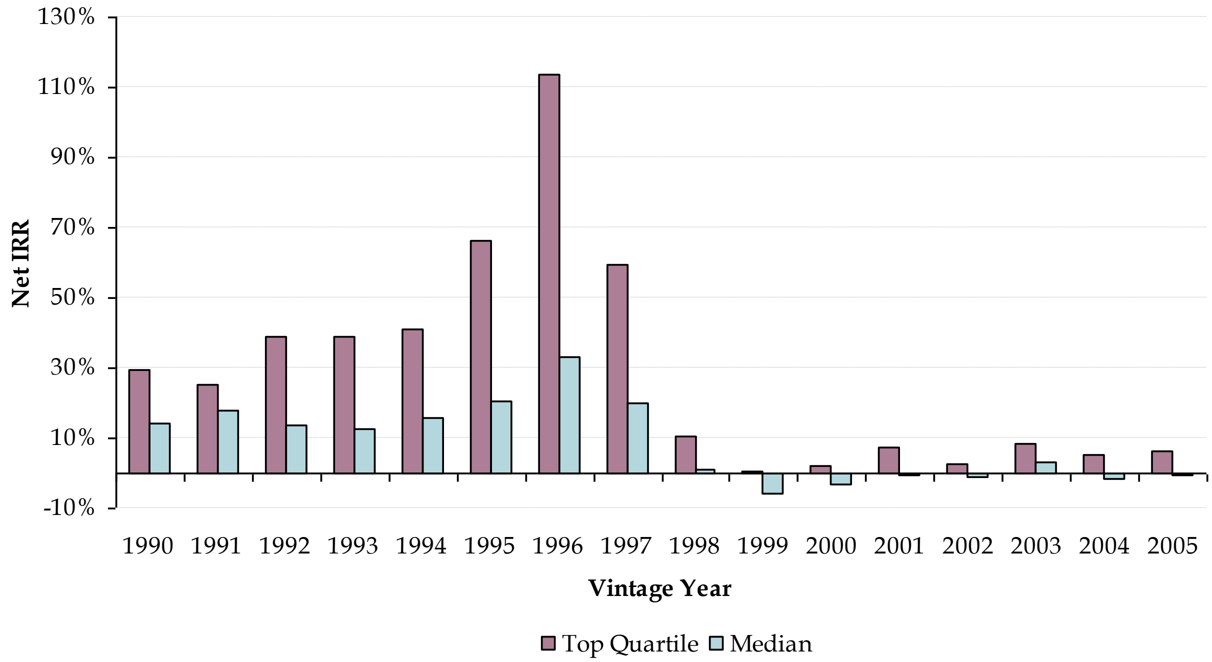
In addition, the types and sizes of transactions sought by many of the largest managers are not supported by the capital markets in all market conditions.

The development of the venture capital market over the last decade has been drastically different from that of the decade before it. Venture capital fundraising grew steadily for the final decades of the 1900s, and the market broadly produced compelling performance. However, the downturn in the economy in the early 2000s, which was driven by overvaluation of the technology industry, had a profoundly negative

1 Represents data for U.S. buyout funds from Venture Economics as of June 30, 2010.

impact on demand for new technologies and company valuations. As such, the performance of the aggregate venture capital market from 2000 through 2005 did not satisfy most investors, particularly given the risks associated with the strategy and a general increase in the length of holding periods for such investments, as shown in the chart below.

Venture Capital Vintage Year Performance[1]



While a select number of venture capital firms have continued to generate compelling performance during the 2000s, and many funds raised over the last five years have yet to mature, it remains unclear whether the venture capital market opportunity warrants the risks involved and the resources required to derive successful performance. Regardless, there continue to be new areas of expected innovation that present attractive investment opportunities for select investors. Further, periods of economic contraction tend to stimulate the introduction of new and "disruptive" technologies, and a fertile environment for developing them.

Managers focusing on the issuance and purchase of private debt have become an increasingly important component of the private market investment landscape. The two primary private debt strategies, mezzanine debt and distressed debt, have different characteristics that have caused them to be utilized by investors in varying market conditions. Mezzanine debt has been a relatively consistent part of alternative investment portfolios for many investors due to the relatively consistent risk/reward offered by such strategies, which only deteriorates during periods of abnormally high liquidity, and their attractive near-term cash flow characteristics. During periods of limited liquidity, such as the period starting in 2008, mezzanine debt can provide equity-like performance with debt-like protections. Distressed debt, on the other hand, tends to be a more opportunistic strategy with a market opportunity that generally expands and contracts inversely to the business cycle. Distressed debt funds encountered a large number of

1 Represents data for U.S. venture capital funds from Venture Economics as of September 30, 2009.

opportunities in the fall-out of the internet bubble, and similarly are identifying a large number of appealing investments in the economic contraction beginning in 2008.

Investment Philosophy

This section formalizes the mission statement of the ASRS Private Equity Investment Program, and addresses the top-down and bottom-up factors the ASRS will consider when allocating capital within the private equity asset class.

Mission Statement

The mission of the ASRS Private Equity Program is to build and maintain a diversified portfolio of private equity investments that meets the allocation targets and return and risk objectives detailed within this document.

The ASRS recognizes it must aim to commit capital to funds that significantly outperform the median to meet the program's long-term return objectives. The process of identifying high quality investment opportunities in the private equity market will require a combination of top-down research to understand the competitive landscape and to identify pockets of opportunity, and rigorous bottom-up vetting of individual managers to gauge experience and investment acumen.

Top-Down Considerations

Devising portfolio strategy solely around certain macro-economic expectations can increase the risk profile of a private equity program, as economic developments are difficult to forecast with a high degree of certainty. As such, a marriage of top-down considerations with opportunities identified in a continual bottom-up process of reviewing individual strategies, coupled with a steady pace of capital deployment in all market environments, allows the ASRS to best balance the risks and capitalize on the opportunities in the private equity market. To the extent that themes guide the investment process, they should be limited to areas in which there is high conviction. These should be regularly tested for validity, for how close or far they are from the consensus view, and for what risks they bring relative to a market portfolio. Refer to Appendix A for a detailed description of top-down investment themes currently considered by the ASRS Private Equity Investment Program.

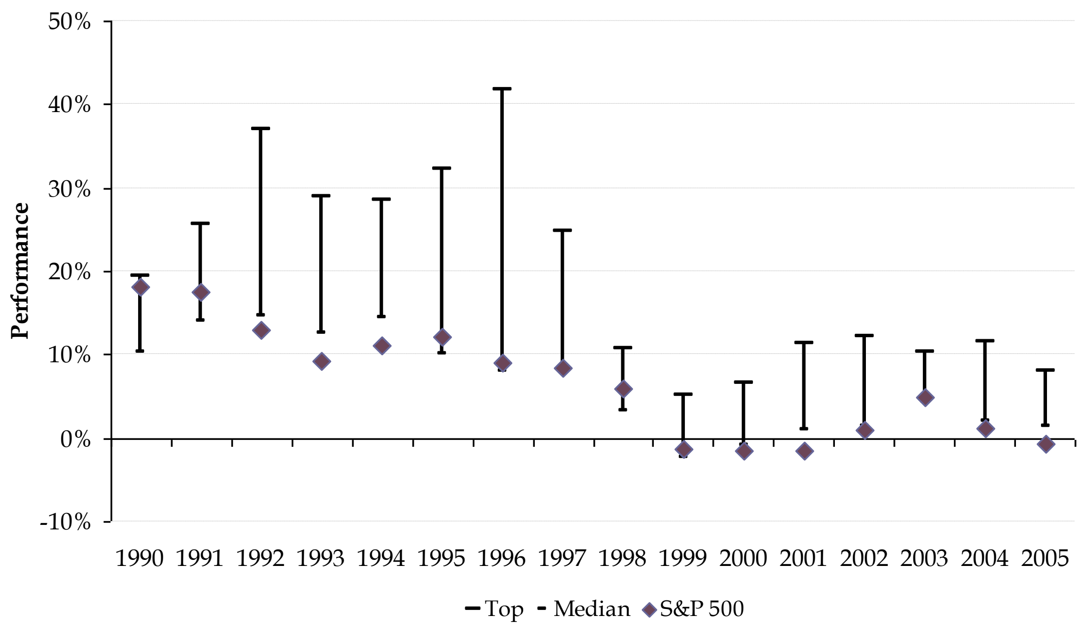
The manager selection process will provide diversification on factors such as geography, strategy, vintage year, industry, deal size, investment stage, and debt versus equity exposure. This ensures the program has the flexibility to respond to attractive market opportunities while maintaining adequate protections from unfavorable market forces through diversification.

Bottom-Up Considerations

While top-down considerations will be taken into account when allocating assets across private equity opportunities, the ASRS believes that identifying the strongest managers utilizing bottom-up research is a richer, and more consistent, source of outperformance over time.

The chart below demonstrates that there is a consistently large gap between the performance of a median performing manager and a top quartile performing one. In addition, median private equity performance has not often typically provided enhanced returns relative to the public equity markets.

Private Equity Performance Quartile Spread[1]



Therefore, the ASRS will seek to identify private equity managers that have the skills and advantages to generate top quartile performance relative to the universe of managers available.

The ASRS also acknowledges that the private equity marketplace is becoming increasingly competitive over time, and the ASRS believes that the performance of individual managers is becoming increasingly dependent upon their ability to add tangible value to the companies in which it invests. Equally important to generating attractive fund-level performance is a manager's implementation of an effective risk-management process, including, when applicable, accessing and utilizing prudent levels of leverage. In addition, most private equity managers have flexible investment mandates and ultimately determine the composition of their portfolios. While the aforementioned top-down considerations provide guidance with respect to areas of relative opportunity, even greater considerations relate to an individual manager's expertise, acumen, and competitive advantages.

Of particular relevance to the consideration of an individual manager is the existence of a demonstrated track record of successfully investing in its target markets. Numerous academic studies have concluded that there is robust evidence of performance persistence across multiple funds raised over time by a single manager. [2] As such, a manager's demonstrated ability to generate attractive performance over time will be an important characteristic when the ASRS reviews investment opportunities. The ASRS may pursue Emerging Managers through both separate account mandates and through primary partnership commitments, consistent with the objectives of seeking enhanced returns or providing additional diversification to the Program.

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[1] Top Quartile and Median performance represents Venture Economics net IRRs for all private equity funds of corresponding vintage year as of December 31, 2009. S&P 500 performance represents annualized 10-year returns beginning in each corresponding year, or through December 31, 2009 for periods less than 10 years.

[2] "The Performance of Private Equity Funds", Philappou and Gottschalg (2005) and "Private Equity Performance: Returns, Persistence and Capital Flows", Kaplan and Schoar (2003).

To guide the determination of an individual manager's relative merits and weaknesses, the ASRS will utilize a multi-stage process for the evaluation and approval of private equity fund commitments, which will be implemented by the ASRS staff and consultants. The three stages of the process, which are detailed in Appendix B, are Initial Review, Final Review, and Legal Documentation.

An important element of the fund selection process is the careful review and negotiation of fund terms and conditions. While the aforementioned characteristics of fund managers will drive the selection criterion for funds, the ASRS has a strong preference for managers that adhere to the Institutional Limited Partner Association Private Equity Principles, have competitive fee structures, and espouse other terms and conditions that align the interests of the manager to those of its limited partners. The ASRS' staff and consultants will work closely with managers during the due diligence and legal documentation processes to ensure that the terms and conditions of each fund are the best available given the size of ASRS' interest in a fund and the supply and demand dynamics of the fund offering.

Objectives

This section outlines the broad return, risk, and liquidity objectives of the ASRS Private Equity Investment Program.

Return Objectives

The return objective for the Private Equity portfolio is to achieve the highest return possible, given the constraints and risk parameters set forth below.

To properly monitor and guide the portfolio, the following objective return goal has been established:

- Achieve an annualized investment return, net of all associated fees, over the long term (10 years or more) greater than the return of the Russell 2000 index.

The ASRS believes that a truly effective benchmark for private equity managers and programs does not exist. Numerous types of benchmarks have been adopted within the industry, including absolute returns, manager universes, and broad market equity indexes plus a premium. However, each of these approaches falls short of meeting the basic properties of an effective benchmark. As such, while the ASRS has established a long-term performance benchmark for the program, it will evaluate each Private Equity investment opportunity on its individual merits and risks and seek to partner only with managers that it believes can deliver attractive long-term risk-adjusted returns. To assess the efficacy of its manager selection process, it will compare fund and program performance to the pooled Venture Economics universe of all private equity funds of relative vintage years. The ASRS believes that a Private Equity portfolio constructed in this manner will result in an enhancement to the returns of the Retirement System's aggregate portfolio.

Liquidity Objectives

The following liquidity objectives have been established:

- Once the ASRS program is fully mature, generate annual income through realizations of portfolio investments that equal or exceed annual capital calls by managers to fund fees and investments.

- During the construction phase of the Private Equity Investment Program, emphasize strategies that have historically produced a more rapid return of capital (e.g., secondary strategies, mezzanine debt strategies, etc.), provided the use of those strategies does not adversely impact the long-term risk-adjusted return potential of the program.

However, the portfolio's liquidity objective shall be subject to the risk and return parameters set forth above. Based on the most recent commitment pacing study completed by ASRS staff and Meketa Investment Group in August 2010, the ASRS expects to meet the Private Equity Investment Program's liquidity objective beginning in 2014, once the early commitments of the program begin to mature.

Commitment Pacing

Relative to more liquid asset classes, gaining diversified exposure to private equity investments requires substantial time, resources, and planning. Private equity funds are blind pools in which investors do not buy interests in existing assets, but rather the fund managers slowly call capital to build portfolios of assets. Each private equity fund typically makes platform investments over a three- to five-year period, and may continue to add capital to those investments for years after the initial capital outlays. The timing of such platform and add-on investments is generally unpredictable. In addition, private equity funds typically self liquidate and generally begin to exit investments four or five years after a fund's inception. However, private equity funds may not exit their last holdings until 13 or more years into a fund's life.

Due to the unpredictable nature of the timing of private equity fund cash flows and the self liquidating fund structures, commitments to private equity funds must be made on a relatively consistent basis from year to year in order to meet and maintain a long-term target allocation. However, the Program must remain somewhat flexible with respect to the amount of capital committed to private equity from year to year in order to respond to forces that may impact the Private Equity portfolio and total pension assets over time, such as the pace of capital called and distributed by the existing Private Equity portfolio, and the performance of the Private Equity portfolio.

Despite prudent commitment pacing and implementation, the possibility remains for the Private Equity Investment Program's fair market value to exceed that of its target allocation. This situation may be caused by factors specific to the Private Equity Investment Program, or to changes in the market values of the ASRS' other assets. Should it become over-allocated to private equity, the ASRS' preference for rebalancing involves a long-term approach, such as reducing future commitments, rather than liquidating private equity investments in the secondary market. This preference is the result of secondary market sales typically being executed at prices that could represent significant discounts to intrinsic value.

No less frequently than once per year, the ASRS staff and consultants will perform a detailed study of the Private Equity Investment Program's existing assets and unfunded commitments relative to the pension's total assets. Utilizing a set of consultant-developed assumptions related to the future behavior of private equity funds and the pension's total assets, ASRS staff and consultants will determine the appropriate pace of capital commitments each year to meet and maintain the program's long-term target allocation.

Based on the most recent commitment pacing study completed by ASRS staff and Meketa Investment Group in August 2010, the ASRS expects to commit an average of approximately $500 million per year for the five years beginning in 2011. Based on this pace of capital commitment, and existing commitments made by the program, the ASRS is expected to reach its target Private Equity allocation of 7% in 2013. Such expectations assume net annual growth in total pension assets of 6% per annum.

See Appendix C for additional information related to the commitment pacing study completed in August 2010.

Diversification

Diversification within the private equity asset class, like within other asset classes, represents the primary measure of risk mitigation. Because of the structure of most private equity vehicles (illiquid and concentrated blind pools with finite investment horizons), ensuring diversification is somewhat more complex. This section highlights the important dimensions of diversification within a private equity program.

Strategy

The allocation across private equity sectors both diversifies overall exposure to private equity investment strategies, and helps determine the risk and return attributes of the Private Equity portfolio.

While the selection of funds will result primarily from bottom-up strategy analysis, the ASRS does intend to diversify investments across sectors. Once the program reaches its target level, the strategy allocation targets and ranges below shall apply:

Strategy	Target Allocation Range
Buyout (Corporate Finance)	50% - 80%
Infrastructure	*0 - 20*
Natural Resources	*0 - 20*
Venture Capital	0 - 20
Private Debt	0 - 30
Special Situations	0 - 20

The target strategy allocations and allocation ranges listed above are based on the Private Equity Investment Program's fair market value. See Appendix D for descriptions of each of the strategies listed above and additional information related to the current allocation of the program across these strategies.

Vintage Year

Private equity funds typically take three to six years to deploy capital. Deals are executed at the manager’s discretion and the performance of these investments is driven only in part by the manager’s investment acumen, and in part by larger business cycle considerations. Given it is difficult to predict business cycles, it is imperative to diversify across multiple years.

The ASRS will diversify its commitments across vintage years, in accordance with the process detailed in the Commitment Pacing section of this document, to ensure diversification through business cycles.

Manager

The performance of the ASRS Private Equity portfolio will be closely linked to the prudence and diligence of the investment managers to which it commits capital. In addition, private equity funds are highly illiquid and have life cycles of typically thirteen years or more. As such, manager specific risks exist, such as strategy drift, personnel turnover, etc., for which timely, adequate protections may not be available. To manage such risks, the ASRS will limit commitments to a single fund to 10% of the ASRS Private Equity target allocation, and to any single manager 20% of the ASRS Private Equity target allocation.

Industry

As with business cycles, it is difficult to predict the relative performance of industries, and investors are well served with diversified exposure to them. Still, themes discussed above may emphasize certain favorable industries, within boundaries.
The ASRS intends to diversify the Private Equity portfolio across numerous industries.

Geography

The allocation across geographic regions is both an important diversification criterion, and a determinant of the overall risk profile of the ASRS Private Equity portfolio. The ASRS Private Equity portfolio may be constructed to identify opportunities in the global economy.

Investment Vehicles

The ASRS may utilize a variety of investment structures to access private equity opportunities. The following investment vehicles are the most commonly used structures to build diversified portfolios of private securities. The primary benefits of, and differences between, each of the five types of vehicles lie in the types of strategies they pursue, the amount and types of fees charged, and the extent to which the terms and strategies are customizable.

Primary Partnerships

Primary partnerships are typically closed-ended investment vehicles that buy, hold, and sell interests in privately held companies. Due to the illiquid nature of private investments, primary partnerships are generally formed with a fixed term of between 10 and 13 years, during which time the partnerships are expected to make investments and harvest their returns. Many primary partnerships ultimately represent relatively concentrated portfolios, particularly for active or control strategies, of between 8 and 12 platform investments. Some partnerships with more passive strategies may have more diversified portfolios that contain up to several dozen discrete investments.

Primary partnerships, and their underlying portfolio company investments, are managed by a general partner. The general partner controls the process of identifying investment opportunities, monitoring their progress during the holding periods, and ultimately managing their sales to other buyers. Partnerships also include limited partners, which are passive investors that provide most of the capital used to fund portfolio company investments, but individually have limited influence on the terms of the partnerships and strategies they will pursue. Similar to the other four types of investment vehicles below, at the formation of a primary partnership, limited partners typically do not know in which specific holdings the partnership will ultimately invest.

Secondary Partnerships

Secondary partnerships are typically closed-ended investment vehicles that buy, hold, and sell limited partner interests in existing primary partnerships. Interests purchased by a secondary partnership generally include pro-rata ownership in the portfolio company investments held by the primary partnership, and all of the rights and obligations of other limited partners in the primary partnership, including the funding of future portfolio investments. While secondary partnerships generally have similar terms as primary partnerships of between 10 and 13 years, they typically generate more liquidity earlier in the lives of the partnerships due to the more mature nature of the underlying holdings. Secondary partnerships also tend to be much more diversified than primary partnerships, as they typically invest in dozens of primary partnership interests that in turn represent hundreds of portfolio company positions.
Secondary partnerships generally have a similar legal structure as primary partnerships, with a general partner that controls the partnerships' investment process and passive limited partners that provide capital for investment. The fees charged by a secondary partnership are typically lower than those of a single primary partnership, but are additive to the fees charged by the underlying managers within a secondary partnership's portfolio.

Funds of Funds

Funds of funds are partnerships that make a series of capital commitments to a number of primary partnerships. The legal structure of funds of funds is similar to that of primary partnerships and secondary partnerships, with a general partner that manages the funds' investment activities and several limited partners that provide capital for investment. Funds of funds are typically utilized by investors that do not have the resources or capabilities to identify high quality primary partnerships. The term of a fund of funds may be longer than that of a typical primary partnership, as a fund of fund's liquidity is driven by the liquidity of the underlying primary partnerships to which it has committed capital. Funds of funds are also typically much more diversified than a single primary partnership.

Similar to secondary partnerships, the fees charged by a fund of fund are typically lower than those of a single primary partnership, but are additive to the fees charged by the underlying managers within a fund of fund's portfolio.

Separate Accounts

Separate accounts are customized private equity investment vehicles formed by a single investor and an investment manager. Separate accounts can have mandates that span the private equity opportunity set, including various primary, secondary, co-investment, or direct investment strategies, or a combination thereof. As with the investment mandate, the terms and parameters of a separate account are negotiated between the investor and the account manager. Some large investors utilize separate accounts in lieu of secondary partnerships, funds of funds, and even primary partnerships, due to their customizable nature and the potential for lower fees. However, separate account managers typically require that an investor make a very large capital commitment.

Joint Ventures

Opportunities may also exist to partner with other institutions, organizations, companies, or other entities to gain exposure to private equity investments in ways that are unavailable under typical limited partnership and separate account legal structures. Examples of such joint partnerships include purchasing ownership positions in investment manager entities, establishment of operating companies for investment purposes, and strategic partnerships with investment managers or other institutional investors to execute specific investment strategies, among others. The scope and scale of joint ventures are variable, provide additional flexibility in the implementation of the Private Equity Investment Program and the fulfillment of its return, and risk objectives.

Co-Investments, Direct Investments, and Direct Secondaries

Some institutional investors also make investments directly into companies outside of a pooled partnership structure. Similarly, some institutional investors purchase secondary positions directly into existing primary partnerships outside of a pooled partnership structure. Co-investments, direct investments, and direct secondaries typically require significant resources to adequately review each investment opportunity, and direct investments also require resources and capabilities to carefully monitor the investment over time. As such, many institutional investors utilize consultants or separate account managers to bolster their capabilities and execute such investments on their behalf. Additionally, the ASRS may directly implement direct and co-investment strategies. Co-investments, direct investments, and purchases of secondary interests may allow for access to private investments with lower fees than through a partnership structure, yet may provide less diversification due to the concentrated nature of the invested capital. Diversification issues may be managed through investing in various sectors at different cyclical points.

Treatment of In-Kind Distributions

The process of disposing of in-kind distributions from private equity funds will be managed by the ASRS staff. Generally, the ASRS will seek to dispose of all distributions of in-kind securities as prudently as possible so as to not materially dilute value, but will have the flexibility to hold securities received in-kind at the discretion of the ASRS staff. The ASRS may use its internal brokerage capabilities or a third-party broker to execute dispositions. The ASRS will not typically seek to hedge securities received through in-kind distributions due to the short expected hold period and the relatively low financial risk to the total portfolio.

Defined Roles for Decision-Making Bodies

The ASRS Private Equity Investment Program shall be planned, implemented, and monitored through the coordinated efforts of the Board, Investment Committee (IC), Private Equity Committee (PEC), Director, Chief Investment Officer (CIO), Private Equity Staff (staff), and ASRS' private equity consultants (consultants). Below are the four primary functions of the ASRS Private Equity Investment Program, and the individuals and entities charged with carrying out each of the functions:

1. **Determination of the Target Private Equity Allocation:** Review and approval by the Board.
2. **Formulation of the Strategic Plan**: Formulation and modification of the Private Equity Investment Program Strategic Plan will be a collaborative process among staff, the PEC, and the IC and the Board shall be the authorizing body for approval of the Strategic Plan and changes thereto.
3. **Investment Selection Process:** Executed through the collaborative efforts of the ASRS staff and consultants, with review and approval by the PEC, and insight and perspective provided by the IC.

4. **Back Office Administration and Reporting:** Currently out-sourced with ASRS staff oversight.

The investment manager selection process is described in greater detail in Appendix B.

The back office reporting and accounting process has been outsourced to a third party, and the ASRS continues to develop its accounting and finance capabilities. The ASRS believes that this is an appropriate method to allow the ASRS to pursue alternative investments and maintain an effective fiduciary compliance process. As the Program expands, the ASRS will consider the creation of an internal capability for asset management, including back office functions.

The roles of the Board, IC, executive staff, staff, and consultants are defined in detail in Appendix E.

Appendix A - 2010 Market and Economic Outlook

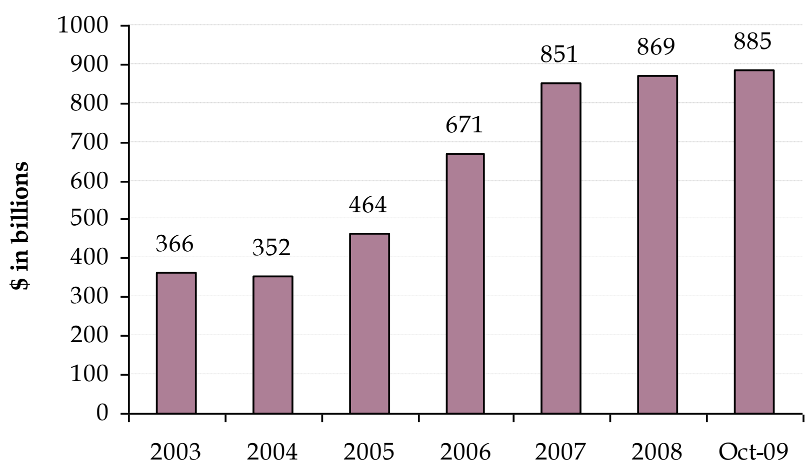
This Appendix provides an outlook for the private equity market and the broader economy. While the private equity asset class is structured to be long term in nature, an investor should be aware of the environment in which they are committing capital, and open to the specific risks and opportunities presented by the broader environment.

Private Equity Market Outlook

The private equity markets are presently adapting to the economic realities presented by the broader economy. The Financial Crisis of 2008 shook the foundations of the capital markets in ways that may have a lasting impact on many asset classes, including private equity. The impact of the Financial Crisis and the related prolonged recession may significantly change the sectors in which growth opportunities exist, the ways in which private equity transactions are structured, the timeframe in which exits occur, and the types of strategies that will be successful in the future.

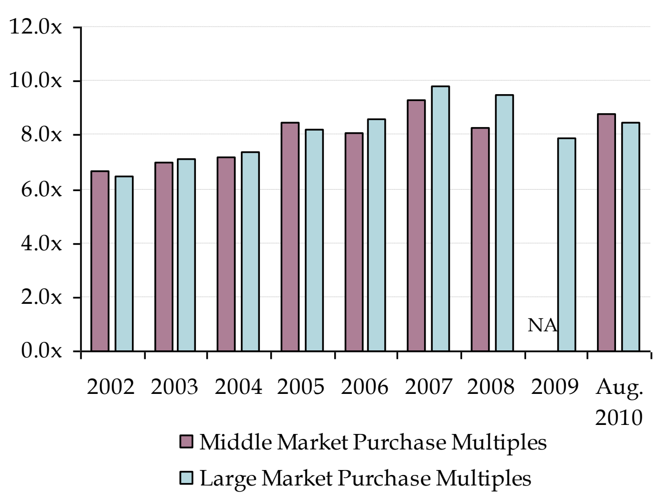
Over long periods of time, the performance of the private equity market has been driven largely by the secular growth of the global economy, intermittent business cycles, and related economic and regulatory policies. Historically, the best performance has been generated during recession or post-recession vintage years, particularly for buyouts, as interest rates have tended to be low during difficult economic periods, and valuations depressed. Based on the performance of the global economy, particularly that of the U.S., over the last 12 to 24 months (as detailed in the Economic Outlook section below), commitments to current and near-term vintage funds could be expected to perform well. However, some room for caution remains as uncertainty regarding unemployment and earnings growth continues. In addition, an excess in supply of capital for private equity transactions, known as a "capital overhang," has reached record levels based on an existing supply of $900 billion of unfunded commitments, which may prevent or delay a true capitulation in company valuations.

Aggregate Unfunded Commitments

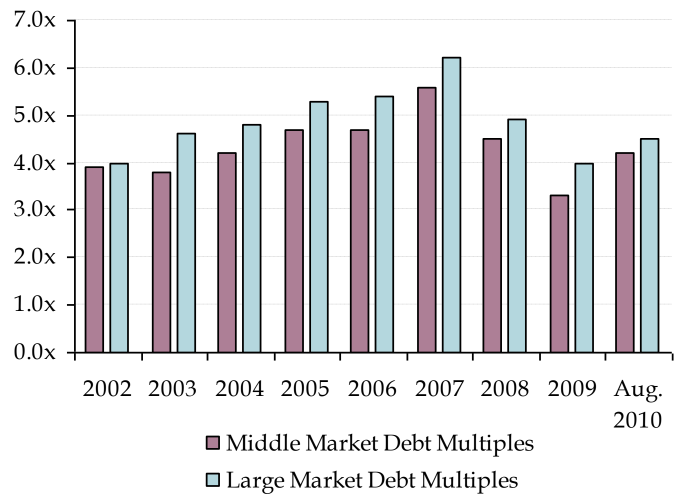


The buyout market has recently declined from a cyclical peak that saw fundraising, transaction sizes and volume, use of leverage, and purchase prices at their highest in history. While many of these trends began to reverse in 2009, the capital overhang described in the prior paragraph, combined with a significant increase in bank lending in 2010, have led to a resurgence of private equity deal activity. A primary result of this has been resilience in prices for private companies, with prices remaining near cyclical highs for both large and small transactions, as indicated in the chart below. As such, the ASRS believes that the past three-to-four years have been a unique opportunity to gauge the acumen and discipline of managers during a heated market. Further, the recent market activity has demonstrated the need to partner with disciplined managers that deploy capital prudently throughout market cycles.

Enterprise Value to EBITDA Multiples[1]



Buyout Net Debt to EBITDA Multiples[1]



Due to the large number of companies in the small- to mid-size markets relative to large market, and the relative levels of sophistication of their constituents, the ASRS believes that the small- to middle-market is likely to present significantly more opportunities for investing in companies at attractive valuations and with potential for adding tangible value to the companies through operational enhancements, particularly in an expanding economy. While small- to middle-market managers generally possess less internal resources and require higher per-unit fees, the ASRS believes that many such managers have the ability to enhance the operations of their portfolio investments to an extent that more than justifies the costs. The ASRS believe that for small- and middle-market managers to be successful on a relative an absolute basis, the managers will need to be highly experienced, well-resourced, differentiated in key areas, such as deal sourcing, industry expertise, or operating capabilities, and disciplined with respect to deal structures and prices.

Other attractive areas of opportunity in the near- to mid-term related to the buyout markets include turnaround and distressed strategies, and specific industries that are either defensive or expected to experience growth. Distressed and turnaround investors have recently identified numerous opportunities to invest at attractive valuations in companies experiencing financial or operational challenges where value can be created through stabilizing the businesses. This investment opportunity may continue further if the economic recovery stalls, as most distressed managers thrive in periods of uncertainty, though with significant volatility. In addition, other areas of particular appeal in an uncertain economic climate include assets and businesses related to “critical services” and expanding government spending, such as basic infrastructure, energy, government services, and healthcare.

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1 Source: Standard & Poor's "M&A Stats" report, August 2010.

In the venture capital sector, recessions and higher unemployment rates have been associated with higher levels of innovation. Examples of this are Microsoft and Intel, which were each founded in late 1970s, and AOL, which was launched in the early 1990s. Cost cutting, "disruptive technologies" are more likely to find fertile ground during times of economic difficulty, and entrepreneurs are more likely to face less opportunity cost in driving them. In addition, there has been a significant decline in the amount of commitments to venture capital funds, and the corresponding number of venture capital firms deploying capital, over the last ten years. A decrease in the supply of capital to emerging companies may ensure that invested capital is more productively utilized.

However, there are several reasons to approach investing in the venture capital space with skepticism and caution. First, many experienced and historically successful venture capital firms are undergoing generational transitions in which the investment professionals who made successful pre-bubble investments are reducing time commitments to their firms, and younger professionals with limited track records are beginning to lead investment activities. Also, as most venture capital firms have not generated substantial proceeds over the last ten years, the ability of individual firms to retain talented investment professionals and generate attractive deal flow may become increasingly challenged. Finally, while venture capital returns tend to be driven by innovation and the creation of new industries, many venture capital firms continue to focus on certain sectors that have matured significantly over the last 20 years, such as computer software and hardware. There continue to be new areas of expected innovation, including cloud computing, and clean and renewable materials and energy sources, among others. However, there is little certainty that these opportunities will develop into profitable drivers of the economy.

Over long periods of time, private equity has generated returns higher than those of the public markets, and this relationship is likely to continue in the current cycle. Steady deployment of capital to the asset class remains important, along with a focus on strategies best suited for the current macroeconomic environment. The ASRS believes the themes below may be well-suited to the current market environment, and will consider them as it implements the Program:

- Small- and middle-market buyouts,
- Operationally and financially distressed businesses, with an emphasis on control-oriented strategies,
- Economically defensive, and consequently more resilient, sectors like healthcare, niche infrastructure[1], defense, government products and services, and education,
- Preferred, mezzanine, and senior positions in capital structures,
- Growth opportunities, such as energy, natural resources, and emerging markets.
- Businesses that would benefit from increasing global demand for energy, such as companies that extract, transmit, or generate power from fossil fuels or renewable sources, and businesses that provide services to such companies, and
- Geographies outside of North America that we expect to experience high rates of growth, stability, and other conditions that would foster local business expansion.

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[1] Infrastructure, in this case, refers to investment opportunities related to the underlying foundation of basic services, facilities, and institutions upon which a community depends, but that also have investment characteristics, including an expected return profile, similar to those of private equity buyout investments. For a more detailed definition of infrastructure, as it relates to the Private Equity Program, please refer to Appendix D.

Other opportunistic, non-traditional investment strategies will also be considered within the context of the objectives and constraints outlined in this Strategic Plan. Examples of such strategies include royalty streams, catastrophe insurance, carbon credits, life insurance viatical settlements, and tax liens, among others.

While the prior paragraphs identify specific areas of current interest to the ASRS, it will not be constrained in its review of all available private equity opportunities, and may select managers across a variety of strategies based on their individual merits and risks. Keen manager selection likely remains the paramount factor in returns as skills that differentiate managers will face a greater test when deal flow is lower, exit opportunities more scarce, leverage less available, and economic uncertainty continues.

Economic Outlook

At the beginning of 2010, the world economy has seemingly stabilized after its first recession since World War II. The developed world (U.S., Western Europe, and Japan) faced the sharpest decline in economic activity since the Great Depression. In response, governments and central banks have acted in a concerted way to provide an unprecedented level of stimulus to the world economy, through both more relaxed monetary policy and increased government deficit spending.

While the global economy has, for the moment, stabilized, largely due to the stimulus described, there remain significant imbalances in the global economy. Such imbalances include a large trade imbalance between the U.S. and China, U.S. consumer debt at record levels, "negative equity" in U.S. real estate markets, global government budget deficits, bank balance sheet concerns, and double-digit unemployment in the U.S. In addition, it is not clear that if, or when, this stimulus is removed, the global economy will recede once again.

While the "deflationary" risks are evident, so are potentially inflationary ones. The U.S. Federal Reserve has taken approximately $2 trillion in securities onto its balance sheet. Interest rates in the U.S. have been maintained at effectively 0% for well over a year. The amount of liquidity being provided to the global economy is unprecedented in scale and, therefore, its consequences are quite unpredictable. While it may not guarantee that inflation occurs, the monetary policy being enacted certainly increases the risk of inflation in the future.

As a consequence of this point in time, the general outcomes for the economy and the capital markets over the next five to ten years are much more variable than during periods that are more normal. In addition, drivers of growth for the global economy, and sources of return for private equity investors, are likely to be different during the next business cycle than during the last. Future pockets of global economic growth are likely to be tied to the continued development of emerging economies and fiscal stimulus from the governments of developed countries.

Appendix B - Investment Opportunity Review Process

The process designed by the ASRS for selecting private equity funds and executing commitments to them is designed to provide ample time and resources to thoroughly evaluate each opportunity presented to, or identified by, the ASRS, while providing adequate flexibility to respond to certain time-sensitive opportunities. The process involves the three following steps:

Initial Review: The first stage of the process involves the preliminary evaluation of private equity funds based on marketing materials provided by the fund managers, supplemental materials requested of the managers as needed, and in-person meetings with the managers' key investment professionals. During the Initial Review stage, the ASRS will seek to determine the quality of an individual investment opportunity based on an assessment of the manager's strategy, historical performance, experience and resources, and the terms and conditions of the offering.

Final Review: Investment opportunities that the PEC approves to advance beyond the Initial Review stage enter a second stage of review. This stage of the process involves the in-depth evaluation of an investment opportunity, including requests for detailed information from a manager related to its background, resources, governance, policies, strategy, philosophy, process, and performance, among other topics, conducting reference calls and background checks on the manager, and conducting additional meetings with the manager, including at its offices. In conjunction with an approval from the PEC to commit capital to a fund following a Final Review, the PEC will determine the appropriate categorization of the fund within the six Strategy and Sub-Strategy groups identified and defined within t2his Strategic Plan.

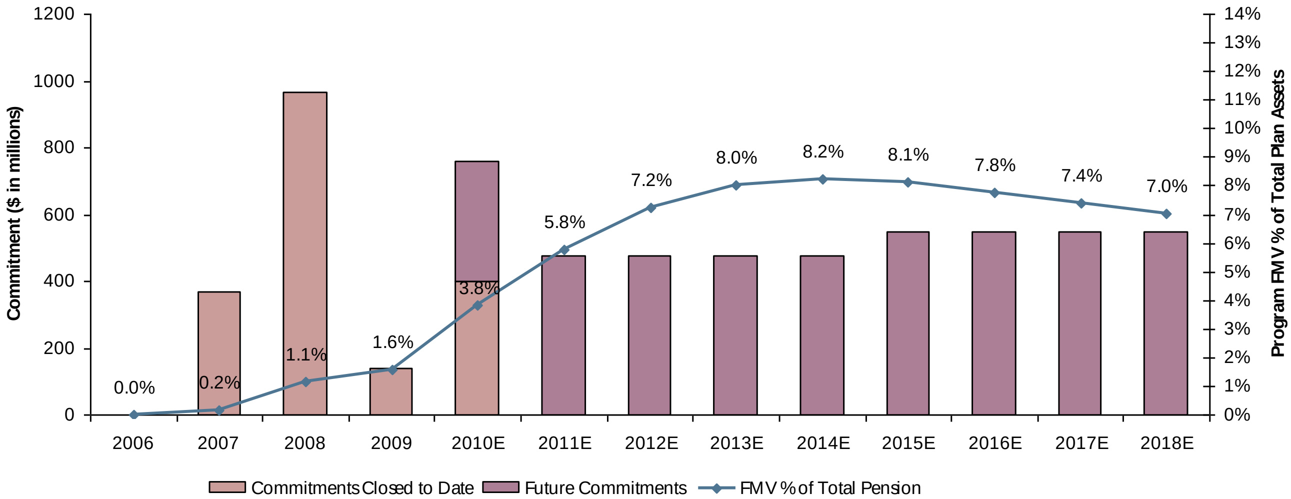
Legal Documentation: Investment opportunities that the PEC approves to advance beyond Final Review enter the final stage of the evaluation process which is the negotiation and documentation of the terms and conditions governing the investment vehicles. Specific issues raised by the PEC related to terms and conditions of the offering must be satisfactorily addressed prior to the execution of a commitment.

In certain cases when an investment opportunity is time sensitive, the Initial Review and Final Review processes may be combined for purposes of approval by the PEC, provided all of the underlying manager evaluation has been satisfactorily completed. Similarly, the PEC may, in certain instances of time sensitive opportunities, approve a fund for Legal Documentation subject to the satisfactory completion of a few Final Review evaluation steps that are in process.

The process for reviewing follow-on funds from managers to which the ASRS has previously committed capital (Follow-On Fund) will be the same as that outlined above, with exceptions as detailed in the paragraph below. While the ASRS gains a degree of familiarity with a manager during the due diligence and monitoring processes, a significant amount of time typically passes between fund offerings (usually three to four years). During this time, various important developments might occur at a manager, such as changes in staffing, firm ownership, strategy, portfolio health, and other items that could impact the ability of a manager to successfully implement its strategy, but that may not be readily apparent to investors.

However, in certain cases when the ASRS has closely monitored, particularly through advisory board membership, a manager of a Follow-On Fund, the ASRS staff may lead the review process for such a Follow-On Fund. The review process for such a Follow-On Fund will address updates to many critical areas reviewed during initial due diligence, including i) performance of the manager's prior investments, ii) staffing and team cohesion, iii) investment strategy, including any changes over time thereto and relevance in current market environment, iv) financial sustainability of the firm, and v) terms of the offering. The investment recommendation formulated by the ASRS staff regarding a Follow-On Fund, based on the findings described above, will be supplemented by a researched opinion from an ASRS consultant, Separate Account manager, or Fund of Funds manager that has completed due diligence on such Follow-On Fund.

Appendix C - 2010 Commitment Pacing Study



($ mm)	2007	2008	2009	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E
Commitments by Close Date	370	967	140	760	475	475	475	475	550	550	550	550
FMV % of Total Pension	0.2%	1.1%	1.6%	3.8%	5.8%	7.2%	8.0%	8.2%	8.1%	7.8%	7.4%	7.0%
Total Plan Assets	28,000	20,500	24,009	23,768	25,194	26,706	28,308	30,006	31,807	33,715	35,738	37,882

Total Pension Asset Assumptions:

- Total assets as of June 2010 of $23.1 billion.
- Net asset growth rate of 6% per annum (asset growth rate of 8.0% per annum, reduced by net benefit payments of 2% of assets per year).

Private Equity Assumptions:

- Target Private Equity allocation of 7.0% (target range minimum of 5% and maximum of 9%).
- Various private equity fund performance and cash flow assumptions based on Meketa Investment Group's proprietary research.

Appendix D - Strategy Definitions and Information

The following are definitions for each of the primary private equity strategies and sub-strategies targeted by the ASRS.

Strategies

Buyout (Corporate Finance): Funds that make investments in, or acquisitions of, relatively mature private companies with developed products and/or services. Such companies typically have significant and relatively stable annual revenues and are profitable. Buyout funds typically employ leverage, or company-level debt, to facilitate acquisitions.

Venture Capital: Funds that make investments in relatively immature private companies that are in the process of developing products and revenue bases. Such companies have not typically reached profitability and are related to certain high growth industries, such as technology, health care, and energy. Venture capital funds vary with respect to the amount of market and technology risk assumed in their strategies.

Private Debt: Funds that make investments in debt securities of privately held companies. The two primary private debt strategies are mezzanine debt and distressed debt. Mezzanine debt strategies purchase or issue junior unsecured debt in relatively mature, typically buyout-sponsored, companies. Mezzanine debt typically has high coupon payments and some equity participation. Distressed debt funds typically invest in relatively senior debt in companies undergoing financial or operational distress, in anticipation of gaining significant equity interests through restructuring and bankruptcy processes.

Special Situations: Funds that target a limited market opportunity or that are expected to provide a limited portfolio management benefit. Such strategies may vary broadly, but generally include secondary strategies, due to their cash flow and diversification characteristics, funds focused on specific sectors undergoing significant change, and other cyclical specialty strategies.

Sub Strategies

Infrastructure: Buyout funds that target companies related to the underlying foundation of basic services, facilities, and institutions upon which a community depends (civil infrastructure, municipal infrastructure, or public works). Such companies possess many characteristics of those targeted by buyout funds, and typically provide materials and services to, or leverage the market opportunities created by, infrastructure assets.

Natural Resources: Buyout funds that target companies related to the aggregation, extraction, processing, or distribution of natural resources assets. Such companies possess many characteristics of those targeted by buyout funds, and typically leverage the increasing demand for, and evolving market dynamics around, natural resources assets.

The following table details the ASRS' target allocations and target ranges across each of the primary private equity strategies, and the program's current allocation across these strategies by commitments and fair market value:

	Target Range	Current Commitment Allocation[1]	Current FMV Allocation[1]
Buyout (Corporate Finance)	50% - 80%	82%	70%
Infrastructure	0 - 20	3	4
Natural Resources	0 - 20	10	5
Private Debt	0 - 30	9	17
Special Situations	0 - 20	6	9
Venture Capital	0 - 20	4	5

1 Based on commitments executed as of June 30, 2010 and fair market value as of June 30, 2010.

Appendix E - Roles and Duties of Participants

The following section is a summary of information contained in the ASRS Board Governance Policy Handbook, which is the definitive source of the authority of, definitions related to, and roles and duties of the Private Equity Investment Program's participants.

Duties of the Board

- Establish the allocation to, and role of Private Equity to the ASRS.
- Approve the Private Equity Investment Program Strategic Plan and changes and modifications to it.
- Approve macro-level strategic investment policies that guide the strategic vision for the ASRS investments.
- Formally review the Private Equity asset class on an annual basis.

Duties of the IC

- Recommend to the Board the Private Equity Investment Program Strategic Plan and changes and modifications to it.
- Act as a knowledge base resource to the Private Equity Committee (PEC).

Duties of the PEC

- Develop the Private Equity Investment Program Strategic Plan.
- Implement the Private Equity Program from deal identification through monitoring and reporting activities.
- Recommend to the Director the hiring and termination of ASRS Private Equity Consultants. [1]
- Final decision-making authority for investments made pursuant to the Private Equity strategic plan.[1]
- Final decision-making authority for private equity related investments referred to the PEC pursuant to the opportunistic private investments strategic plan.[1]
- Approve the hiring and termination of legal counsel for the Private Equity Program.1
- Review and, as appropriate, approve tactical variances to the objectives and policies of the Private Equity Program targets/ranges during the implementation period.

Duties of the Director

- Select, retain, and terminate ASRS investment managers/partners and manage the day-to-day activities of the PEC.
- Approve the selection, retention and termination of asset class committee consultants and staff-extension consultants. The IC must consent to the Director's recommendation before the primary Consultant for an asset class committee is hired or terminated.
- Review and approve the Investment Standard Operating Procedures.

Duties of the CIO

- Reporting the activities of the PEC to the IC and full Board.
- Execute the decisions made by the PEC.
- Review and approve the Investment Standard Operating Procedures.
- Approve the selection, hiring, and termination of staff-extension consultants.

Duties of the Staff

[1] Decisions require the consensus of the Director and CIO.

- Prepare in consultation with the Consultant the private equity strategic plan and updates thereto for presentation to the PEC, IC and board.
- Review potential investments and recommend investments to the CIO, Director and PEC.
- Oversee the day-to-day operational activities of the Private Equity Program, including manager selection, due diligence, deal terms, consultant activities, legal counsel activities, investment cash flows and other private equity activities, and review their compliance with policy.
- Coordinate PEC meetings.
- Develop private equity investment Standard Operating Procedures.

Duties of the Consultant(s)

- Act in an advisory role to the PEC on all program matters, including:
  - Advise on the establishment and maintenance of the Private Equity Investment Program Strategic Plan.
  - Advise on the implementation of the policy and management of the Private Equity Program.
  - Conduct, as requested by the ASRS, due diligence activities with full fiduciary responsibilities.
- Bring any non-conforming items or significant issues to the attention of the PEC, and as applicable, to the IC and/or Board.
- Ensure compliance with approved Private Equity Strategic Plan.
- Perform other duties and responsibilities as defined by contract relationship.

Duties of the "Back Office"

- Prepare quarterly performance reports.
- Collect data and manage the data flow to and from private equity managers.
- Execute capital calls and distributions from private equity vehicles.

Appendix F - Glossary of Private Equity Terms

Private equity investors have developed a number of unique terms to describe their investment work. The following glossary of private equity terms is intended to help make sense of these terms.

Advisory Board: Private equity partnerships often establish an advisory board comprised of representatives of the Limited Partners to oversee the on-going work of the General Partners.

Advisory boards typically meet once each year to review the partnership's investments. It is important to note that unlike the Board of Directors of a public company, the advisory board has very little power to control the activities of the General Partners.

Angel Investor: Angel investors are individuals who invest their own capital directly in small, early stage companies. Angels are an alternative source of funding for entrepreneurs. Such investments are characterized by high levels of risk and potentially a large return on investment.

Blind Pool: Most private equity partnerships are organized as blind pools, meaning that Limited Partners commit capital to the partnership before any actual investments are made. At the point of commitment, the Limited Partners do not know specifically how their money will be used (hence the term blind pool), and must therefore rely entirely upon the track record and experience of the General Partner.

Capital Call (Contribution): Once a partnership has declared its first close, the General Partners will begin to make portfolio investments. As each investment is made, the capital necessary to fund the investment is "called" from the Limited Partners.

Carried Interest: The share of profits that the fund manager is due once it has returned the cost of investment to investors. Carried interest is normally expressed as a percentage of the total profits of the fund. The industry norm is 20%. The fund manager will normally therefore receive 20% of the profits generated by the fund and distribute the remaining 80% of the profits to investors.

Carrying Value (Fair Market Value): The General Partner must list on the partnership's balance sheet a value for every investment held. These valuations are called carrying values, and in most cases are simply the original cost of the investment. Note that carrying values in most cases are not audited and do not represent actual market values.

Cash Flow Positive: When a company generates more free cash than it consumes in normal operations, it is deemed to be cash flow positive. Such companies may not need extra financing or debt in order to grow.

Cash on Cash Return: The simple gross total return earned by the Limited Partners, calculated as the total distributions received divided by the total contributions made. Thus, if an investor supplied a total of $100 in cash calls and contributions, and received over the life of the partnership $200 in distributions, the cash on cash return would be 100%. The cash on cash return is typically reported as a multiple. In the example above, the investment returned 2x (two times).

Claw-Back Provision: A claw-back provision ensures that a General Partner does not receive more than its agreed percentage of carried interest over the life of the fund. So, for example, if a General Partner receives 21% of the partnership's profits instead of the agreed 20%, Limited Partners can claw back the extra one percent.

Closings and Closing Dates: Every partnership must specify the date upon which the General Partners will cease fundraising and begin making investments with the Limited Partners' committed capital. That date is called the closing date, and defines the vintage year of the partnership. Most partnerships, however, have several closing dates, and all partnerships must eventually have a final closing. In most cases, the final closing lags six to nine months after the first closing. If a majority of the original Limited Partners consent, a partnership can remain open to new investors after the final closing and while early, investments are being made, in order to have time to attract additional investors.

Consolidation (Roll Up): Many industries in America are highly fragmented, as the market space is serviced by a large number of locally owned businesses. By consolidating fragmented industries (i.e., purchasing many local businesses), private equity firms can create a single larger company with greater market control, more attractive financial characteristics, and potentially, better pricing flexibility and lower costs.

Convertible Bonds: Some private equity partnerships, generally those that provide mezzanine financing, may take convertible bonds as part of their compensation for providing investment capital. The convertible bond pays interest like other bonds, but can be exchanged for shares of the company stock at a favorable price if certain conditions are met, hence the term convertible.

EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization): The "top line" profits of a private company are the monies earned before paying interest and taxes, and adding back depreciation and amortization. Unlike public companies, which are valued as the multiple of bottom line earnings to the stock price (P/E or price to earnings), private companies are valued as the multiple of EBITDA to the price of the stock.

There is no simple conversion factor that will convert an EBITDA multiple to a P/E for all companies, but in general, a factor of 2 is appropriate. Thus, a private company selling for an EBITDA multiple of 6 is priced about as richly as a public company with a P/E of 12.

EBITDA Multiples: The ratio of a private company's top line earnings to the price of its shares. See EBITDA above.

Enterprise Value: A measure of a company's value, often used as an alternative to straightforward market capitalization. Enterprise Value is calculated as market cap plus debt, minority interest and preferred shares, minus total cash and cash equivalents.

Fee Income: The General Partners in a private equity partnership generally receive three types of compensation: fee income from Limited Partners as payment for their portfolio management services, a share of any profits (carried interest) as incentive compensation, and transaction and advisory fees from portfolio companies for services provided to those companies. Typically, a portfolio of fees charged to portfolio companies offset the fees paid by Limited Partners.

General Partner: The control partner in private equity partnerships, analogous to the portfolio manager in a public stock portfolio. Under the IRS code, the General Partner must commit some personal capital to the partnership (a minimum of 1% of the partnership's committed capital), and unlike the Limited Partners, is liable for leverage and other losses generated by the partnership.

Growth (Expansion Capital): A strategy that entails providing capital to a private company with the intention that the capital be used to expand operations. Generally, expansion capital strategies result in minority equity positions in companies, but with some degree of control over how the expansion capital is spent.

In-Kind Distribution: Most distributions from private equity partnerships are in cash. However, in some cases, a private deal will be taken public through an initial public offering (IPO), or through a trade sale for stock to a public company. In these cases, the Limited Partners will receive their distributions in the form of publicly traded common stocks and/or rights and warrants.

Investment Period: The period of time after the first closing during which the General Partner will call capital from the Limited Partners and make partnership investments. Legally, the investment period is usually five or six years. Practically, it is three to four years. Not to be confused with the term of the partnership, generally ten to thirteen years.

IPO (Initial Public Offering): When a private company issues publicly traded stock, it becomes known as a public company. The initial sale of publicly available stock is called the initial public offering, or IPO.

IRR (Internal Rate of Return): The annualized rate of return on capital that is generated or capable of being generated within an investment or portfolio over a period of time, assuming all cash flows can be reinvested at the same rate. Mathematically, the IRR of an investment is the discount rate applied to that investment such that the net present value of the investment is zero. IRR is commonly used to measure profitability by applying the calculation to the after tax cash flows to arrive at an after tax equity yield rate.

J-Curve: Some private equity partnerships have significant negative returns in the early periods of operation as capital is invested and fees are called. Such negative returns result because the partnership's investments have not matured and turned a profit, but the partnership has nevertheless experienced various operating costs. When early deals begin to mature and are liquidated at a profit, the partnership's returns should become positive. Thus, the graph of the partnership's returns versus time can resemble the capital letter "J."

Later Stage Fund: A venture capital partnership that specializes in investing in startup companies that have already achieved at least some actual revenues, or a venture fund that provides subsequent rounds of venture financing after all of the capital provided in the first rounds has been consumed.

Lead Investor: Describes a General Partner who is the "lead" investor in a deal, as opposed to co-investors or follow-on investors. The term implies that the lead investor has taken the lead in sourcing, evaluating, and executing the deal.

Leverage: Many General Partners use both equity capital provided by the Limited Partners and money borrowed from banks or other lenders to finance their investments. Any borrowed money is called leverage. If a deal is successful, leverage can often enhance the returns of the Limited Partners substantially. On the other hand, too much leverage can negatively impact an investment with interest and financing costs. It is important to note that the Limited Partners are not responsible for the repayment of any borrowed money.

Leveraged Buyouts: The purchase of a private or public company wherein a significant amount of the purchase price is paid using borrowed money.

Limited Partner: All investors in a Limited Partnership other than the named General Partner are defined under the IRS code as Limited Partners. Limited Partners have only the control rights defined for them in the Limited Partnership Agreement, and are generally passive investors in the partnership's deals. Importantly, Limited Partner's total liability for all deals made by the partnership are limited strictly by law to the Limited Partner's committed capital. Thus, even if the General Partners borrow a great deal of money (leverage), and lose it all, the lenders have no recourse to the assets of the Limited Partners. In effect, a Limited Partner can lose no more than the amount of money invested.

Look-Back Provision: See Claw-Back Provision above.

Mezzanine Financing: An additional level of financing provided to a private company to expand sales, market share, or develop new products. Most mezzanine financing is structured as a package of high coupon bonds with equity "kickers," i.e., rights to acquire the company's stock at a favorable price at a future point. Companies seeking mezzanine financing often have substantial revenues, and if not actual profits, the expectation of imminent profitability.

Multiples and Multiple Expansion: Managers purchasing public common stocks often buy companies with low price to earnings multiples when they believe some factor will induce other investors to bid up the price of the stock without an increase in actual earnings, thus causing the price multiple to expand. In the same fashion, a General Partner may purchase a private company with a low EBITDA multiple, expecting to profit through an expansion of that multiple. A typical example of a multiple expansion plan is consolidation. Many small companies, operating independently, may each be priced at relatively low multiples. But if purchased and combined into a larger, cohesive entity, investors might be willing to pay a higher multiple for the aggregate than for any individual component.

Placement Agent: Unlike public stock management companies, most of which utilize an in-house sales force to market their services, private equity partnerships are generally marketed by third-party placement agents. These outside marketing firms and individuals are typically paid a commission by the General Partner.

Platform Company: Some private equity buyout funds attempt to add value by merging companies into larger, more cost-efficient enterprises. This strategy generally begins with the acquisition of a platform company, often a market leader, to which other companies are added.

PPM (Private Placement Memorandum): Because Limited Partnership interests are not registered with the SEC, private equity managers must distribute a comprehensive document to prospective investors that describes the broad investment thesis of the partnership, and highlights any risks involved in the partnership. This document is called a Private Placement Memorandum.

Preferred Return: The minimum rate of return that the Limited Partners must receive before the General Partners have a right to a share of any additional profits (carried interest) produced by the partnership's investments. For example, the partnership may specify that once the Limited Partners have received distributions representing an 8% total return on their commitment (the hurdle rate), the General Partner will share in all future distributions until they have been allocated 80% to the Limited Partners, and 20% to the General Partners (their carried interest).

Public to Private: If a private partnership (or group of private partnerships) purchases all of the outstanding shares of a publicly traded company, the company's shares may be de-listed from a stock exchange. The company is then said to have been "taken private."

Take Down/Draw Down: See Capital Call above.

Term: The term of a private equity partnership is its expected lifetime, and is specified in the Private Placement Memorandum. Most partnerships have a term of ten years, with the option to extend by up to two or three additional years if the Limited Partners approve.

The term of a partnership consists of several phases. After the final closing, no new commitments are accepted and the partnership enters the investment phase, legally lasting up to five or six years, but generally lasting three to four years, during which the individual investments are made. A distribution phase follows, during which mature investments are realized and profits are distributed to the partners. The final phase is the liquidation phase, during which all remaining properties and assets are sold in order to terminate the partnership.

Trade Sale: The most prevalent exit strategy for many private equity managers involves selling a company in the private markets, usually through an auction process, to other private equity investors or to larger companies. This type of exit is termed a trade sale.

Turnaround: A turnaround strategy involves buying a troubled company, usually for a relatively low price, and making significant managerial or organizational changes to better the company's operations and enhance profitability.

VCOC (Venture Capital Operating Company): The IRS code defines one category of private partnerships to be venture capital operating companies for tax purposes. The General Partners of VCOCs are not required to register with the SEC as investment advisors. The name venture capital operating company relates only to the partnership's legal and tax structure, and does not imply that the partnership will invest in venture capital deals. For example, a middle market buyout fund, which invests only in mature companies with enterprise values of between $200 million and $1 billion, may be structured as a venture capital operating company.

Warrants: Just like publicly traded companies, private companies may issue warrants to their shareholders or to other groups providing some form of financing. A warrant is the right to purchase shares of the company's stock at a future date at a predetermined price, called the exercise price. Warrants become valuable if the exercise price is below the market price of the stock.