

Russell Research

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# Russell Investments' 2010 Global Survey on Alternative Investing

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Evaluation and re-commitment: The next phase for alternatives

## Survey highlights in brief

### Most investors are staying the course.

- › Most institutional investors are “staying the course” with alternative strategies and expecting increases in overall alternative allocations over the next few years. Few say they are cutting back.
- › The survey found that institutional investors are expecting to increase their allocation to alternative investments from 14% in 2009 to 19% over the next two to three years.
- › The anticipated increase in allocations to alternatives is expected to come from equities, as institutions continue efforts to mitigate total portfolio risk.

### Institutions are placing significant emphasis on improving risk management and governance processes.

- › 84% of respondents have made or plan to make changes in their risk management approach, and nearly two-thirds are increasing the sophistication of their internal decision making and governance processes.
- › Alternatives remain attractive for potential risk-adjusted returns and reducing overall portfolio volatility; however, high costs and illiquidity continue to be viewed as obstacles.
- › Investors want more transparency. While larger institutions are trending towards separate accounts, virtually all who participate in alternatives will demand greater accountability from providers.

### Expectations for new investments over the next two years.

- › **Private equity** allocations are expected to increase, especially in North America, based on a combination of valuation improvements and new commitments.
- › **Hedge funds** have survived the “stress test” of the financial crisis, and allocations are expected to rebound in most regions, although recovery may be slow in Europe.
- › **Real estate** allocations are expected to grow through 2012, partly due to rebalancing to policy weights, perceived opportunities due to the current stage of the economic cycle, and attractive inflation features.
- › **Infrastructure and commodities** are becoming more important to institutions around the globe. They are expected to represent an important share of overall growth in allocations to alternatives through 2012, though from a very low base.

## Introduction

We can now divide the growth of alternative investing into three phases:

1. The initial era of increasing acceptance among institutional investors, culminating in 2007;
2. The global financial crisis of 2008 and early 2009, which heavily impacted alternatives; and
3. The recovery and evaluation period now underway, which we believe is leading to a re-commitment to alternatives for the future.

Russell Investments' 2010 Global Survey on Alternative Investing offers one of the first comprehensive evaluations of trends and themes that will emerge in this third phase and beyond. It captures—in quantitative data and qualitative interviews—the experiences of individuals who are “on the front lines” of institutional investment decisions. It also documents the evolving changes in philosophies, policies, allocations and attitudes among diverse global institutions that participate in alternatives.

In normal economic environments, institutional asset management is a business that seeks to mitigate the risks associated with sudden changes or personal emotions, yet it is also susceptible to the market's trends and moods. The cataclysms of 2008-09 shook this industry in many ways—from Lehman to Madoff, from large-scale layoffs to record low interest rates. The professionals who are responsible for prudently investing billions of dollars today, to provide benefits such as pension payments or foundation grants tomorrow, were personally involved in this epic event. They have had to re-evaluate much of what they do and re-think a number of concepts, including alternative investing.

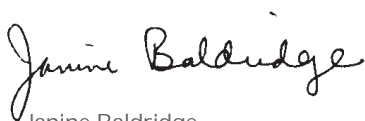
Our 2010 global survey offers a window into this process. In this report, we have summarised key survey findings in a way that allows readers to interpret data and commentary in the context of their own organisations and mandates. We believe you will find the nuances of the interview comments as revealing, and perhaps as useful, as the “headline data.” Together, the comments and data suggest a variety of ways institutional investors are changing their expectations, needs and requirements in this space.

We have deliberately chosen interview comments to help you understand the diversity of ideas uncovered by the survey, rather than to reinforce any generalisations and conclusions. To protect the confidentiality of respondents, all interview comments are anonymous.

We believe this survey confirms that alternative investments have survived the storm and are on the way to recovery. Although the financial crisis raised the bar for alternative providers in specific areas such as liquidity and transparency, awareness of alternatives' role in portfolio diversification and risk management has increased. Institutional investors around the globe remain committed to alternatives, and the majority view increased allocations to alternatives as probable in the years ahead.

Russell wishes to thank the many institutional investment executives who contributed time, efforts and insights to this survey. We hope you will find the results and our analysis valuable to your firm and useful in your work and decisions. Collectively, the results summarised herein are valuable to us as we continue to have conversations with global investors and offer thought leadership as well as innovative strategies and solutions.

Yours sincerely,



Janine Baldrige  
Global Head of Consulting &  
Advisory Services



Vic Leverett  
Managing Director  
Alternative Investments



Julia Cormier  
Director  
Alternative Investments



JANINE BALDRIDGE



VIC LEVERETT



JULIA CORMIER

## Methodology

During the first month of 2010, 119 firms with a total of \$1.3 trillion of assets under management completed surveys by phone, e-mail and internet. Each represented organisations that utilise at least one form of alternative investment. For survey purposes, "alternative investments" comprise the following types of investments: hedge funds, private equity, real estate, infrastructure, commodities, and "other." Other includes: green investing, carbon investing, timber, portfolio catastrophic insurance, and non-specified alternatives. (Note: We will refer to these consistently as "types" in this report.)

Respondents were selected among broadly based, global organisations that manage institutional assets. In all cases, the individuals surveyed or interviewed were qualified to represent the investment activities, decisions and views of their organisations. The list included large institutions located in North America, Europe, Australia/New Zealand and Japan/Asia and the interview comments you will see throughout this report stem from our interviews with a sampling of these institutions. Live interviews were conducted with institutional investors in each region, mainly focused on those who sponsor defined benefit pension plans. You can see a

breakdown of the full survey participant list, by type, in the chart below.

Russell Investments was assisted in this endeavor by our research partner McKinsey & Company.

Note that the topic of alternative investments includes a considerable subjective component and, in some cases, is measurable only through limited samples. Therefore, the results of this survey should not necessarily be considered projectable to a larger population. Changes observed between two surveys may be affected by differences in the composition of the samples, such as the mix of types of organisations, or by changes in the investment behaviour of one or two very large institutions. The reader is advised to take a qualitative approach to the data, with a focus on the long-term trends and implications suggested.

The total sample was divided into smaller segments for reporting purposes on the basis of geography, firm size, firm types and major types of alternative investments. Readers are advised that data for relatively small segments may not be statistically significant. The tables below summarise each segment as a percentage of total completed interviews (119) and total respondent assets under management (\$1.3 trillion).

Survey respondent composition	Number of respondents % of total	Respondent assets % of total
<b>By GEOGRAPHY</b>		
North America	52%	17%
Europe	18%	55%
Japan/Asia	24%	26%
Australia/New Zealand	6%	2%
<b>By INSTITUTION SIZE</b>		
More than \$25 billion	9%	71%
\$5–25 billion	26%	21%
\$1–5 billion	43%	7%
Less than \$1 billion	22%	1%
<b>By TYPE OF FIRM</b>		
Corporate pension/DC plan	50%	12%
Public pension	16%	51%
Endowment & foundation	17%	2%
Insurance/other	17%	34%

**NOTE:** We believe it is important to note that endowments and foundations represented 17% of survey respondents but only 2% of total respondent assets reported. Based on other surveys and studies, including our own, we believe it is probable that endowments and foundations may have somewhat larger overall allocations to alternatives than most other investor types surveyed.























