

**PRIVATE EQUITY AS AN  
INTEGRAL PART OF  
YOUR PORTFOLIO**

**WHAT IS PRIVATE EQUITY?**

**WHY SHOULD YOU CONSIDER INVESTING IN  
THE ASSET CLASS?**

**WHAT ARE THE MECHANISMS TO ACCESS  
THE ASSET CLASS?**

**WHAT ARE THE INDUSTRY'S PERSPECTIVES &  
BENCHMARKS?**

**WHO IS GRUPO GUAYACAN?**

**WHAT IS GRUPO GUAYACAN'S TRACK  
RECORD?**

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Alternative investments are a class of nontraditional, mostly illiquid investments that include private equity, oil and gas properties, timberland, precious metals and other investments. Private equity comprises the lion's share of the alternative investments market and is typically the first alternative investment strategy that an institution pursues. As a result, private equity has become synonymous with the term "alternative investments."<sup>4</sup> Because of private equity's dominance in the alternative investments market, it is the logical first step for an investor entering alternative investments.

<sup>4</sup> Gary Robertson, "An Introduction to Alternative Investment Strategies," *The Directory of Alternative Investment Programs*, 1999, p. 16.

- **Definition**
  - **Investment in the stock of a company that is privately owned**
- **Characteristics**
  - **Private ownership** (vs. publicly traded)
  - **Equity participation** (vs. fixed income)
  - **Long-term orientation** (vs. short-term trading)
  - **Active, value-added** (vs. passive stock market investing)
  - **Building businesses**
- **Segments**
  - **Venture capital** young companies
  - **Buyouts & Acquisitions** mature companies
  - **Mezzanine** subordinated debt

Venture Capital is the best known type of private equity investment. The venture capital investment strategy seeks to provide growth equity capital to companies in the early stages of development. Because venture capital is used for small companies, individual venture transactions are much smaller in dollar size but higher in frequency than buyout transactions that are used for much larger companies. This is why the majority of private equity dollars are used for buyouts but the majority of private equity partnerships focus on venture capital.

**Buyouts and acquisitions make up the majority of private equity investments on an amount of dollars invested basis. In a buyout or acquisition strategy, the investor seeks to make investments in established companies which have the potential to achieve greater value through strategic initiatives. The investor actively works to increase the company's value and then sells the company for more than its purchase price.**

**Mezzanine investing is much smaller than buyouts and venture on both an amount of dollars invested and partnerships formed basis. Mezzanine involves a loan or an equity investment with a company, usually in the form of subordinated debt or preferred stock. These investments typically earn a current coupon or dividend in addition to carrying an option for common stock conversion if the investor so chooses. Mezzanine investments are typically lower risk and lower return than other private equity strategies because they generate current income and have a more protected position in a company's capital structure.**

**THE RISKS OF PRIVATE EQUITY**

**ILLIQUIDITY RISK**

**VOLATILITY RISK**

**HISTORIC RISK & RETURN DATA**

**PRIVATE EQUITY MARKET DYNAMICS AND TRENDS RISK**

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## INVESTING IN THE ASSET CLASS

- **There are at least 75 public pension funds representing 37 states that have allocated public pension funds to private equity. Though their reasons for investing in private equity vary, most are seeking additional investment opportunities that increase investment returns and lower risk for their fund<sup>1</sup>;**
- **Goldman Sachs/Frank Russell<sup>2</sup> survey found that these funds allocated an average of 5.6% of their funds to private equity in 1999, up from 4.9% in 1996;**
- **Clearly private equity is a widely accepted investment alternative for public pension funds, the largest institutional investor.**

<sup>1</sup> **Indiana Pension Funds: Expanding the Impact of Equity; May 2000 by Indiana Fiscal Policy Institute**

<sup>2</sup> **Report on Alternative Investing by Tax-Exempt Organizations, Goldman Sachs & Co. and Frank Russell Capital, November 1999.**

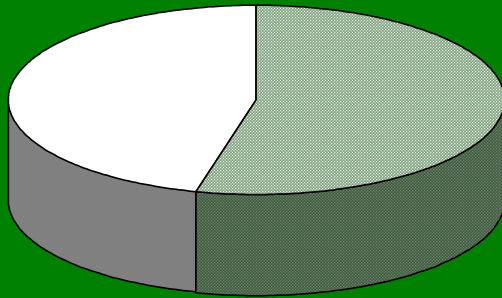
# INVESTING IN THE ASSET CLASS

Access to more opportunities...

Over \$250MM revenues

Public Companies

46%



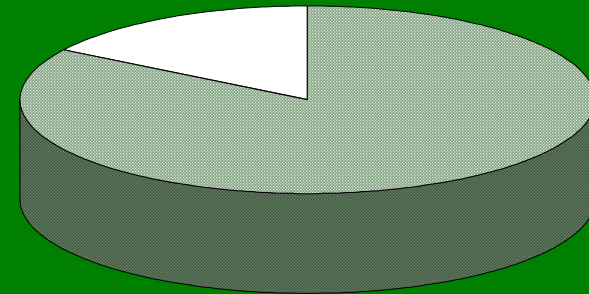
Private Companies

54%

Under \$250MM revenues

Public Companies

16%

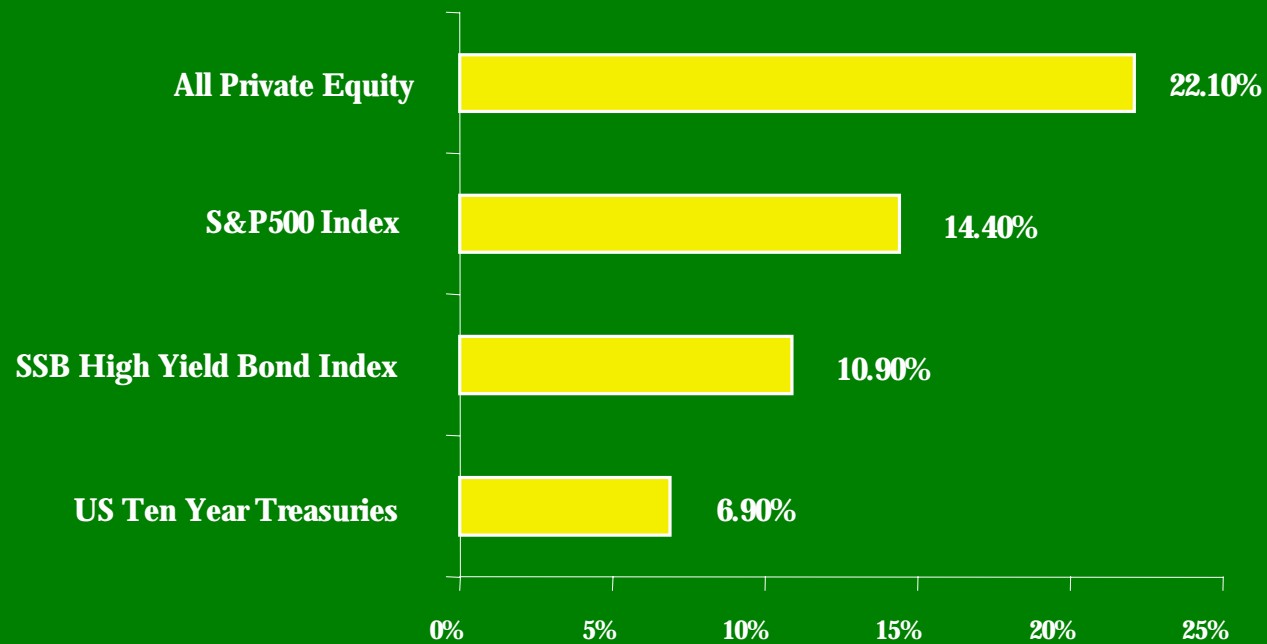


Private Companies

84%

## High Returns

Net IRR for the Ten years ending in 12/31/00



## Risk Reduction...

### Historical Correlation Statistics

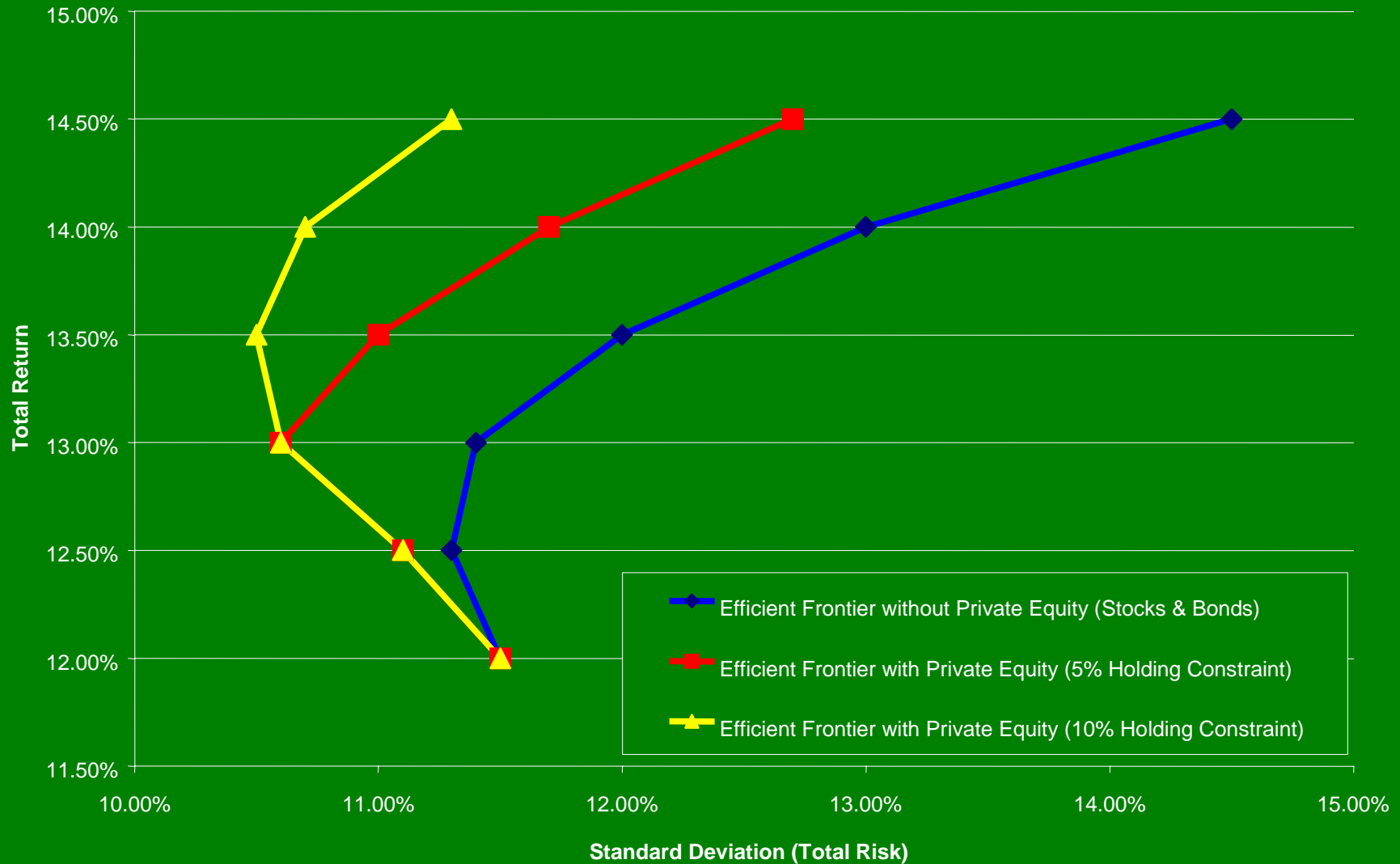
	Private Equity	Large Stocks	Small Stocks	Corp Bonds	Treasury Bonds
Private Equity	1.00	0.29	0.35	(0.08)	(0.11)
Large Stocks		1.00	0.75	0.35	0.33
Small Stocks			1.00	0.20	0.15
Corp Bonds				1.00	0.97
T-Bonds					1.00

Source: Venture Economics 1999

**Private Equity is a very different type of investment than stocks and bonds, and its diversification benefits with existing asset classes held by typical portfolios make it an attractive addition to any pension fund.**

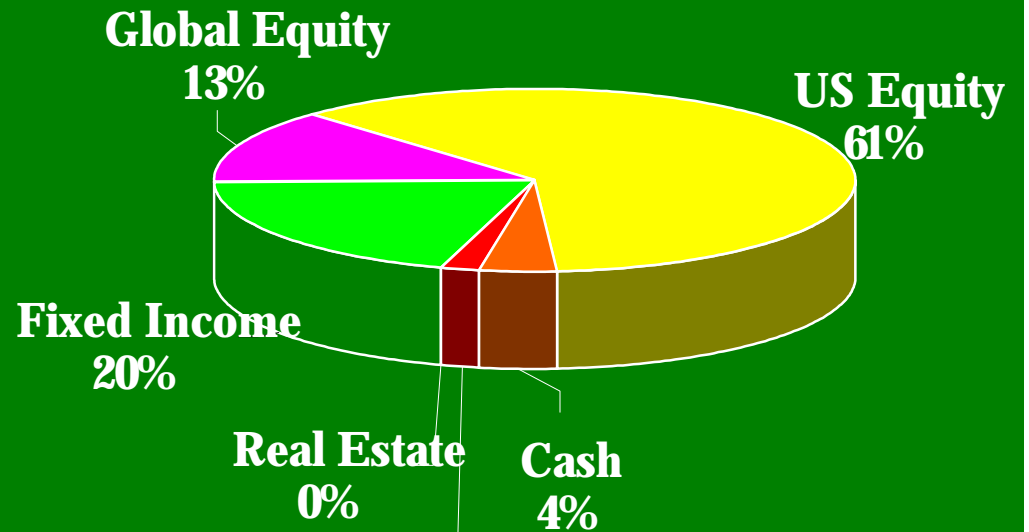
# INVESTING IN THE ASSET CLASS

## Diversification: Modern Portfolio Theory

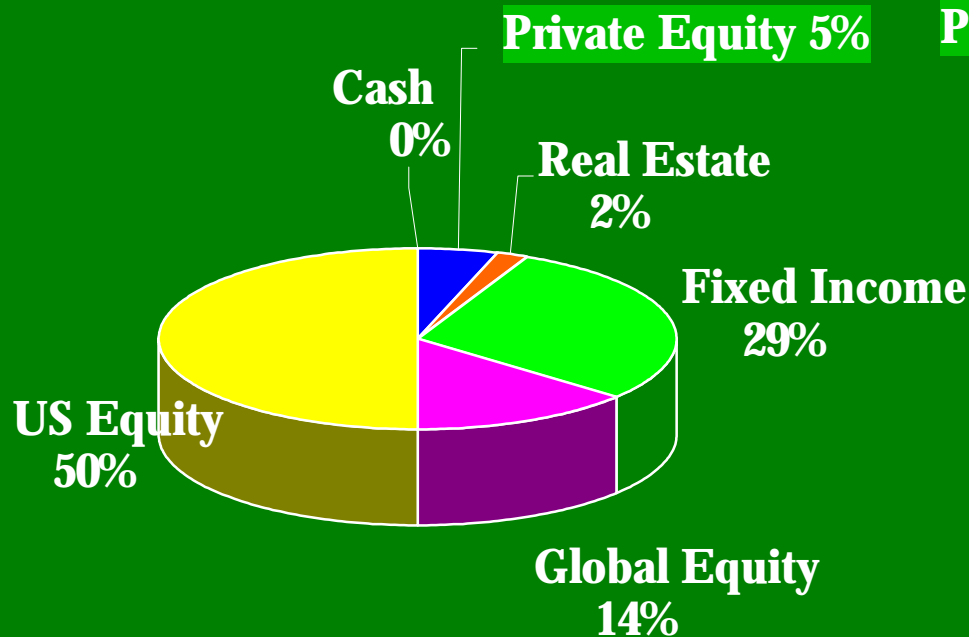


Source: Merrill Lynch Quantitative and Equity Derivatives Research

# INVESTING IN THE ASSET CLASS



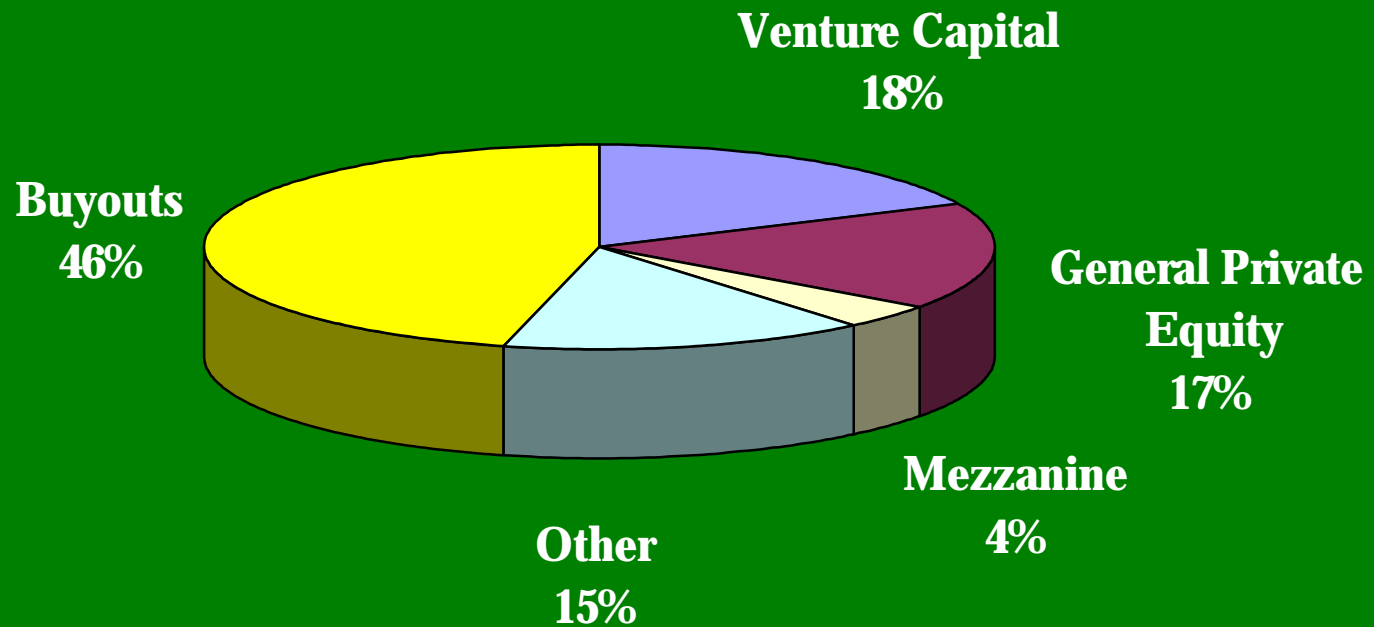
## New York State Common Retirement Fund



Private Equity 2%

## PR Employees & Judiciary Retirement Fund

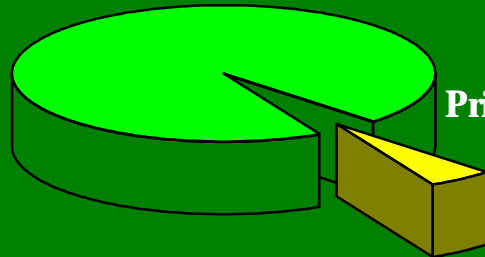
**Public Pension Funds  
1999 Private Equity Allocation**



Report on Alternative Investing by Tax-Exempt Organizations, Goldman Sachs & Co. and Frank Russell Capital, November 1999

# INVESTING IN THE ASSET CLASS

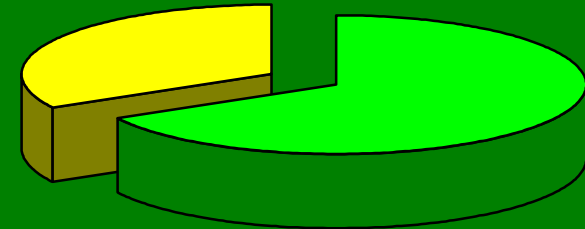
**Other Assets**  
95% - 90%



**Private Equity**  
5% - 10%

**Targeted Funds**  
33%

**Diversified Funds**  
67%



## Targeted Funds

- Funds that are constrained either by geography, industry or stage
- Economically targeted funds

## Diversified Funds

- Funds that are diversified by stage, geography, industry and time
- Most likely Fund of Funds

## CHALLENGES FACED BY TAXABLE INVESTORS

**Over 90% of Private Equity LP returns are capital gains.**

**Puerto Rico Taxable investors that invest in Delaware LP and receive capital gains distributions are taxed as if received dividend from foreign corporation, thus bearing a penalty equal to the spread from the capital gains rate to the ordinary income rate [this varies if corporation or individual].**

**The Asset Class is penalized for other than tax exempt investors [tax wise].**

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**Investors can make private equity investments directly with companies, however most investors access the private equity market through professionally managed private equity partnerships.**

**A partnership gathers funds from investors, and then seeks out, analyzes, negotiates and monitors private equity investments on behalf of its investors.**

**Due to the structure of this process, investors are effectively investing in blind pools of assets since the investors give the partnership their money before the partnership makes any investments.**

# SNAPSHOT OF THE PRIVATE EQUITY MARKET

<u>Target Sectors</u>	1999 Total Assets or Retained Earnings	5% OF THE TOTAL	10% OF THE TOTAL
		ASSETS	ASSETS
I Public Pension Plans	7,907	395	790
II ERISA and tax-exempt investors	1,174	59	117
III Local Taxable Institutions [Retained Earnings]	1,941	97	194
IV Taft-Harley (unions)	281	14	28
V Endowments	181	9	18
VI Life & Disability Insurance	946	47	94
VII Property and Casualty Insurance	1,612	80	161
VIII Multinational Corporation's Pension Plan	267	13	26
<b>TOTALS</b>	<b>14,309</b>	<b>714</b>	<b>1,431</b>

Source: Grupo Guayacán, Inc.

**Private equity investing requires more time and expertise than public equity investing. Analysis of and legal negotiations with a private company requires months of work. Private equity partnerships are experts in business analysis and legal negotiations and therefore good partners for funds wishing to invest in private equity but lacking the time and expertise.**

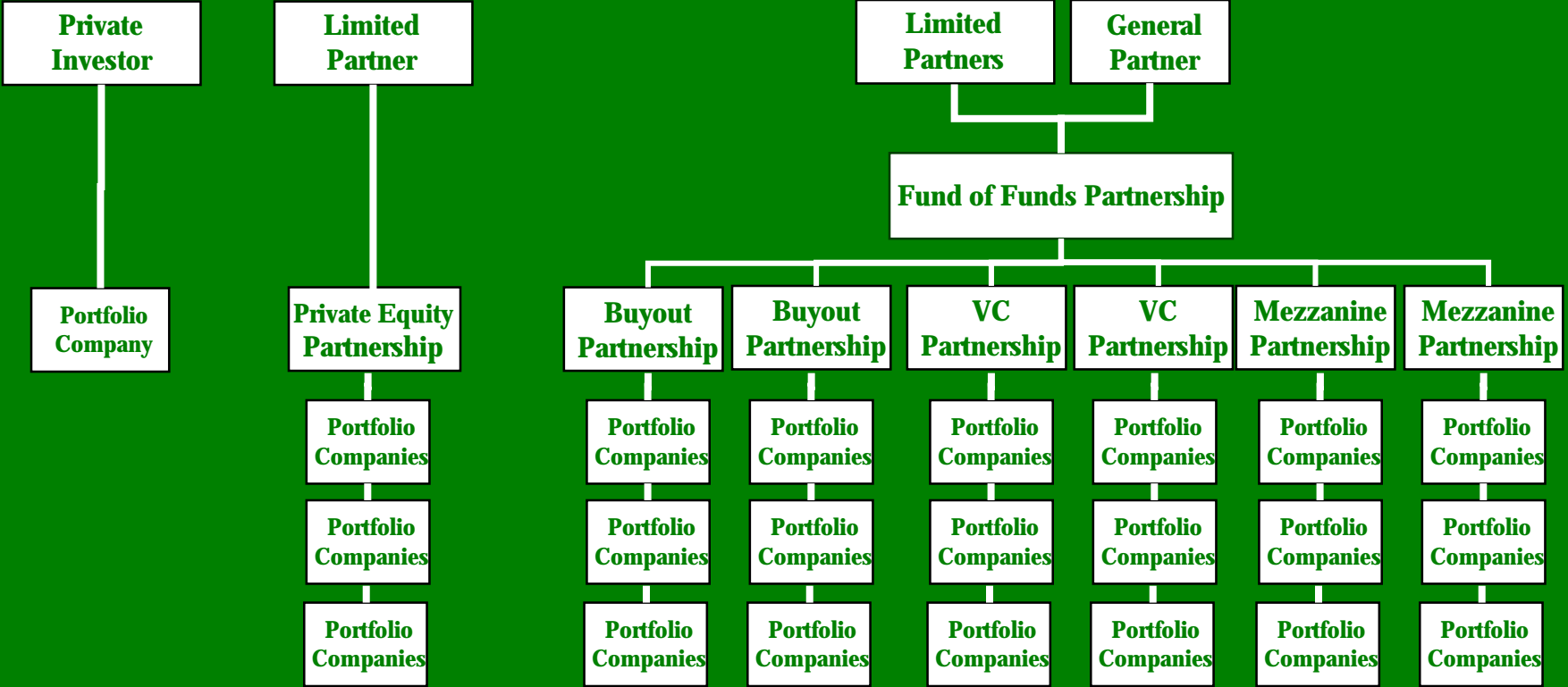
**Sourcing and selection of partnerships can be very difficult primarily because of the wide range of quality. Investors need to have an intimate knowledge of the marketplace as well as sound investment judgement. Furthermore, partnerships tend to report on a quarterly basis and, as a portfolio builds, the reporting burden can become onerous. Investors entering the market may not have the experience and/or access to find good quality partnerships.**

**The Fund of Funds vehicle gathers funds from investors, and then seeks out, analyzes, negotiates and monitors investments in private equity partnerships on behalf of its investors.**

**This method offers investors, particularly those who are new to the asset class, a means of gaining exposure to a broad spectrum of private equity assets within a reasonable time frame and with a reasonable amount of capital.**

**The key skills a Fund of Funds manager should possess include an in-depth knowledge of the private equity markets globally; access to high-quality partnerships; tried and tested selection processes; ability to negotiate limited partnership terms and conditions; sufficient resources to manage and monitor commitments; and fully functional, accurate and timely reporting systems.**

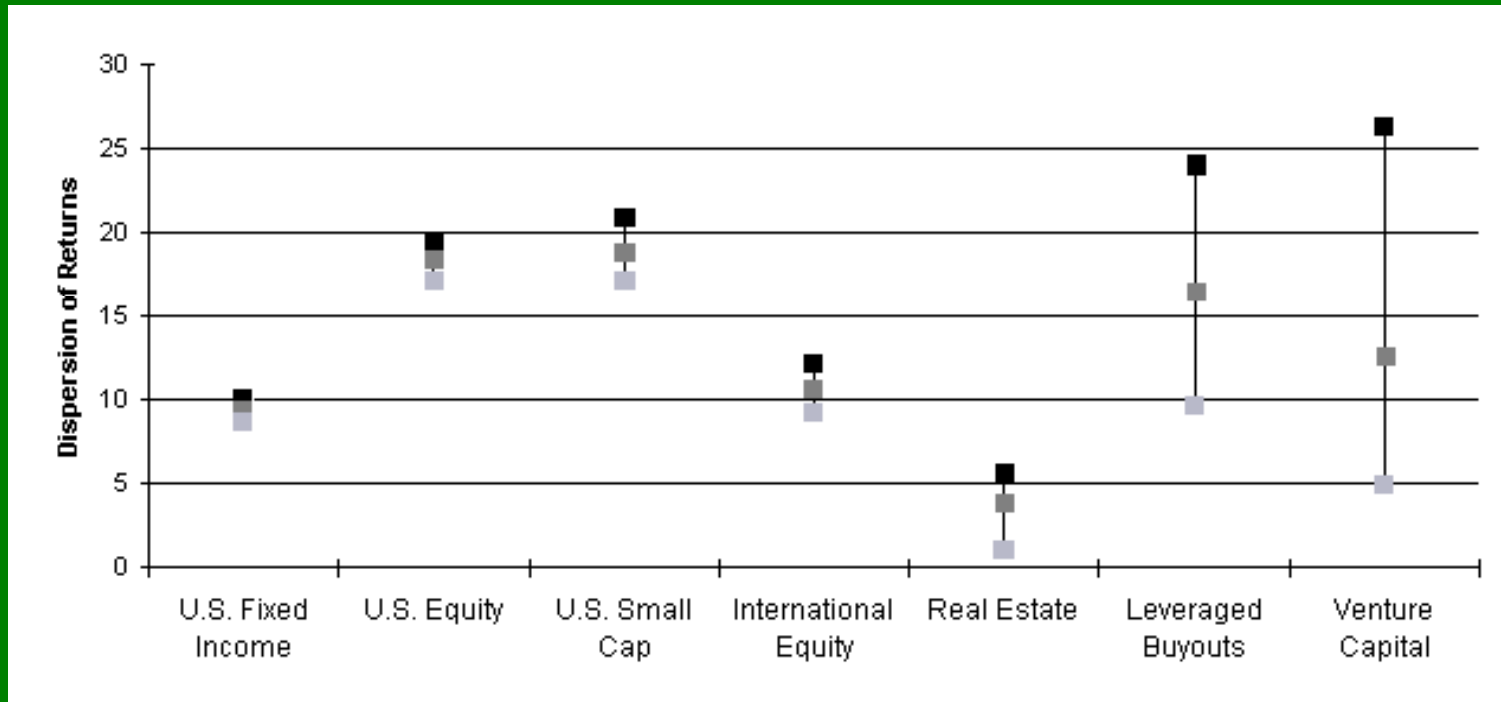
SUMMARY



THE \$5 MILLION DOLLAR QUESTION?

# IMPORTANCE OF ACCESING THE BEST MANAGERS

## Asset Returns by Quartile Ten Years Ending December 31, 1997



■ First Quartile

■ Median

■ Third Quartile

From the Yale Endowment 1999 Update Report

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## INDUSTRY PERSPECTIVES

- **A robust economy and the increasing appetite of pension funds for private equity contributed for the industry's capital under management to increase ten times during the 1990-2000 decade (from \$34 billion to \$356 billion)**
- **The numbers thru September 2001 indicate that 2001 will be the third highest year in PE history in terms of venture capital dollars invested and the fourth in terms of dollars fundraised for all Private Equity Partnerships.**
- **Investment in Seed and First round financings declined steeply in the 2Q 2001 vs 1Q 2001, attracting only 13% of investment dollars. Traditionally early rounds of financing constitute roughly one-half of total deals. During the 2Q 2001 for the first time, less than one-third of the deals were Seed or First round financings. Second round financings dropped as well. The majority of venture capitalists time and money in been spent in existing portfolio companies, as demonstrated by the fact that approximately 81% of total venture investment in the second quarter of 2001 went to follow-on investments.**

- **Venture capitalists are facing the challenge of keeping portfolio companies for longer periods than expected due to the limited exit options available**
- **Venture Backed M&A Activity continued to be stable in Q3 2001. While VCs have not been able to sell portfolio companies at valuations they had hoped for, the current condition of M&A market is allowing for liquidity**
- **“Overhang” is the amount of money that has been fundraised but not invested yet. Venture Economics estimates that there were approximately \$45 billion at the end of 2Q 2001. While a large percentage of these funds will likely serve as reserves for existing portfolio companies, this amount shows that there is plenty of money to invest in the next years.**
- **History shows that some very successful companies were funded during down cycles. For example, companies such as Palm, Intuit, McAfee and Starbucks received VC during the last downturn—in the early 1990’s.**

- **Given the tremendous performance of the information technology sector in recent years, the Communications and Internet Specific sectors experienced the greatest returns when looking at the three-year and five-year time frames. In the short run, the new promise of the industry appears to be the Life Science sectors, particularly Biotechnology, which showed the only positive return in the last twelve months. In the intermediate term, these funds have showed strong returns.**
- **An economic impact study released in October by the National Venture Capital Association (NVCA) revealed that venture capital invested in the United States during the period of 1970-2000 created 7.6 million new jobs and more than \$1.3 trillion in revenue in the year 2000**
- **\$273.3 billion of venture capital created companies that were responsible for 5.9% of US jobs and 13.1% of the U.S. Gross Domestic Product in 2000.**

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**Private, local , tax-exempt corporation established in 1996**

- to familiarize local investors with Private Equity;
- to help increase the availability of capital for entrepreneurial high-growth companies;
- to strengthen the entrepreneurial culture in Puerto Rico.

**The only registered investment advisor in Puerto Rico that specializes in private equity investment programs. Grupo Guayacan currently manages approximately \$117.5 million of investments through two distinct diversified investment vehicles:**

**Guayacán Fund of Funds, L.P. - is a Delaware limited partnership created in 1996 with an initial closing of \$55.5 million from public pension funds.**

**Guayacán Fund of Funds II, L.P. - is a Delaware limited partnership created in 1999 with an initial closing of \$62.0 million from public and private pension funds.**

**Both funds invest in U.S. based and international venture partnerships and have familiarized local pension funds with the private equity asset class without the risks inherent in geographically constrained investments.**

**Grupo Guayacan was also chartered to pursue initiatives that would increase the availability of capital for entrepreneurial high-growth companies and strengthen the entrepreneurial culture in Puerto Rico.**

**Puerto Rico Venture Forum—established by Grupo Guayacan—is an entrepreneurial support group whose goal is to help the development of local entrepreneurial ventures by offering expert counsel on the equity raising process through a series of educational forums [over 260 attendees] and once a year showcasing companies looking for equity to an audience of potential investors [two conferences, 25 companies presented, 375 participants, over \$7MM raised].**

**BOARD OF DIRECTORS**

**William Lockwood, Principal of Lockwood Financial Advisors, former GDB Vice President, EDB Vice President and Adviser to the Chief of Staff.**

**Carlos J. Nido, President of Virtual, Inc., former General Manager of Primera Hora, Treasurer of El Nuevo Dia, Special Assistant to GDB's President and Investment Banker at First Boston.**

**Clotilde Pérez, Corporate Development Officer at V. Suárez, former Senior Investment Banker at Citibank, N.A., Executive Director at Grupo Guayacan, Inc., EDB Vice President and Associate Dean for UPR's Business School.**

**David H. Chafey, Jr., Senior Executive Vice President of Banco Popular de Puerto Rico & Popular, Inc. [\$4.7B mkt cap], Board Member of Popular, Inc.**

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**Norman Dann, Co-Founder of Pathfinder Venture Capital in Minneapolis, former Senior Vice President for Corporate Development at Medtronic and founder of The Dann Company**

**Juan Agosto Alicea, GDB President, former Treasury Secretary and Managing Partner at Peat Marwick**

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# GUAYACAN PERFORMANCE 6/30/01

## GUAYACAN FUND OF FUNDS I, L.P.

<b>Inception</b>	<b>Sep-96</b>
<b>Contributed Capital</b>	<b>48,849,048</b>
<b>Distributed to Partners</b>	<b>38,498,673</b>
<b>Net Investment Value</b>	<b>39,143,077</b>
<b>Distributed Securities Held for Trade</b>	<b>1,050,646</b>
<b>Cash or Cash Equivalents</b>	<b>2,506,795</b>
<b>Total Value</b>	<b>81,199,192</b>
<b>Total Value / Contributed Capital</b>	<b>1.66 X</b>
<b>Fund Net IRR</b>	<b>31.50%</b>

## GUAYACAN FUND OF FUNDS II, L.P.

<b>Inception</b>	<b>Aug-99</b>
<b>Contributed Capital</b>	<b>23,715,000</b>
<b>Distributed to Partners</b>	<b>1,095,468</b>
<b>Net Investment Value</b>	<b>21,400,189</b>
<b>Distributed Securities Held for Trade</b>	<b>-</b>
<b>Cash or Cash Equivalents</b>	<b>1,987,439</b>
<b>Total Value</b>	<b>24,483,096</b>
<b>Total Value / Contributed Capital</b>	<b>1.03 X</b>
<b>Fund Net IRR</b>	<b>2.76%</b>

## GUAYACAN PERFORMANCE 6/30/01

The performance of the previous Guayacán Funds of Funds where Abbott has acted as the investment adviser Fund I and Fund II as of June 30, 2001 is as follows:

(\$ Million)

Fund	Year Formed	Committed Capital	Number of Investments	Capital Called	Distributions	FMV <sup>1</sup>	Total Value <sup>2</sup>	Net IRR <sup>3</sup>
I	1996	\$55.5	15	\$48.8	\$38.5	\$42.7	\$81.2	31.5%
II	1999	\$62.0	16	\$23.8	\$1.1	\$23.4	\$24.5	N.A.

**Notes:**

1. FMV = fair market value as reported to limited partners from audited June 30, 2001 financial data based upon information provided by the Fund I and Fund II general partner and general partners of funds in which Fund I and Fund II have invested.
2. Total Value = amounts distributed to investors plus the fair market value of Portfolio Funds
3. Industry practice deems fund investments less than four years of age to be too young to be indicative of long term performance.
4. Returns will vary in the future.

### **Guayacan Select Private Equity, Inc.**

**80% assets in Guayacan Fund of Funds III & 20% assets in local taxable fixed income investments**

### **BENEFITS**

- **Dividends not subject to Federal Tax**
- **Company exempt if distributes 90% NOI**
- **No Property Tax; No Patente Tax**
- **Tax Rate of 10% Individuals**
- **85% Dividend Received Credit for Corporations**

# NEW FUND STRUCTURE

\$5 - \$10 MM



\$1 - \$2 MM



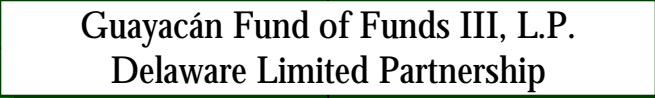
\$55 - \$90 MM



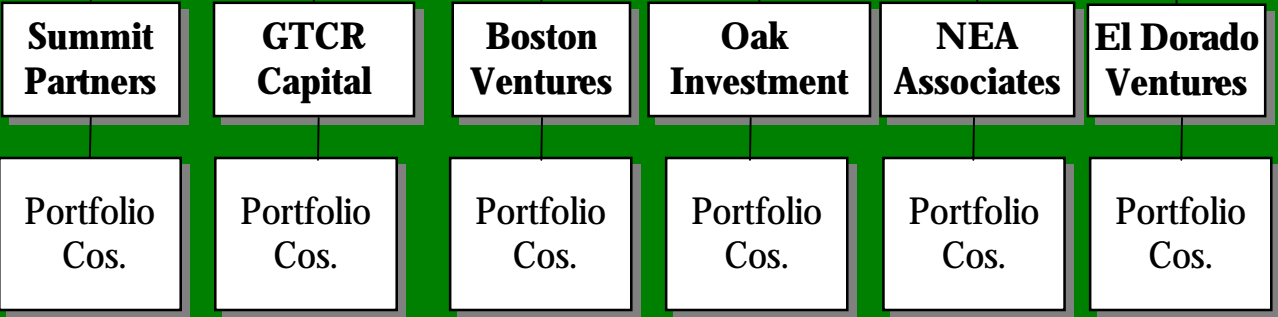
20%



80%



10-12 Partnerships



## RETURN COMPARISSON UPR PENSION FUNDS

**GUAYACAN INVESTMENTS WHICH ARE 0.70% OF UPR'S INVESTMENT PORTFOLIO, REPRESENTED 2.67% OF THE TOTAL INVESTMENT INCOME OF THE PENSION FUND TRUST FOR FISCAL YEAR 2000 [3.8 X MULTIPLE]**

(Expressed in Thousand's)	UPR Retirement System	%	Guayacan Funds of Funds <sup>*</sup>	%
Investments	630,643		4,731	
Investment Income				
Interest	22,783	<b>3.61%</b>	46	<b>0.97%</b>
Dividends	3,401	<b>0.54%</b>	-	<b>0.00%</b>
Net Appreciation Gain	82,697	<b>13.11%</b>	2,898	<b>61.26%</b>
Investment Expense	(2,673)	<b>-0.42%</b>	(110)	<b>-2.33%</b>
<b>Total Investment Income</b>	<b>106,208</b>	<b>16.84%</b>	<b>2,834</b>	<b>59.91%</b>

Information gathered from the Combined Statement of Changes in Plan Net Assets Available for Pension Benefits - Pension Trust Fund Types and Similarly Discretely Presented Component Units Year Ended June 30, 2000 & Grupo Guayacan, Inc. information regarding Guayacan Fund of Funds I, L.P. & Guayacan Fund of Funds II, L.P. performance June 30, 2000

\* Participation by UPR Pension Plan in both Funds

# RETURN COMPARISSON PUBLIC PENSION FUND TRUSTS

**GUAYACAN INVESTMENTS WHICH ARE 1.04% OF THE INVESTMENT PORTFOLIO, REPRESENTED 4.43% OF THE TOTAL INVESTMENT INCOME OF THE PENSION FUND TRUSTS FOR FISCAL YEAR 2000 [4.2 X MULTIPLE]**

	Employees Retirement System	%	Teachers Retirement System	%	Judiciary Retirement System	%	Guayacan Funds of Funds*	%
Investments	1,692,363		2,232,963		80,074		41,796	
Investment Income								
Interest	39,700	2.35%	90,361	4.05%	1,473	1.84%	402	0.96%
Dividends	9,648	0.57%	15,051	0.67%	303	0.38%	-	0.00%
Net Appreciation	236,218	13.96%	186,842	8.37%	9,299	11.61%	26,091	62.42%
Investment Expense	(5,930)	-0.35%	(5,747)	-0.26%	(413)	-0.52%	(959)	-2.29%
Total Investment Income	279,636	16.52%	286,507	12.83%	10,662	13.32%	25,535	61.09%

Information gathered from the Combining Statement of Plan Assets Available for Pension Benefits - Pension Trust Funds & Grupo Guayacan, Inc. information regarding Guayacan Fund of Funds I, L.P. & Guayacan Fund of Funds II, L.P. performance June 30, 2000

\* Participation by Public Pension Plans in both Funds

# PUBLIC PENSION FUNDS RETURN COMPARISSON

	Total Assets (in billions)	P.E. Since	Actual Allocation	Target Allocation	Annualized Return <sup>1</sup>	Fund of Funds
<b>Puerto Rico PERF<sup>2</sup></b>	<b>2.1</b>	<b>1996</b>	<b>3.7%</b>	<b>10.0%</b>	<b>54.3%</b>	<b>yes</b>
<b>Puerto Rico TRF<sup>2</sup></b>	<b>2.6</b>	<b>1996</b>	<b>2.1%</b>	<b>10.0%</b>	<b>54.3%</b>	<b>yes</b>
<b>UPR Pension Fund<sup>2</sup></b>	<b>0.6</b>	<b>1996</b>	<b>3.2%</b>	<b>10.0%</b>	<b>54.3%</b>	<b>yes</b>
<b>Illinois TRF</b>	<b>22.0</b>	<b>1983</b>	<b>2.7%</b>	<b>n/a</b>	<b>42.5%</b>	<b>no</b>
<b>Kansas PERF</b>	<b>9.6</b>	<b>1985</b>	<b>1.8%</b>	<b>5.0%</b>	<b>34.1%</b>	<b>no</b>
<b>Illinois SIB</b>	<b>5.3</b>	<b>1984</b>	<b>4.0%</b>	<b>5.0%</b>	<b>29.5%</b>	<b>yes</b>
<b>Minnesota SIB</b>	<b>45.2</b>	<b>1981</b>	<b>5.7%</b>	<b>15.0%</b>	<b>26.0%</b>	<b>no</b>
<b>New Hampshire SIB</b>	<b>4.3</b>	<b>1986</b>	<b>5.1%</b>	<b>5.0%</b>	<b>24.4%</b>	<b>no</b>
<b>Washington SIB</b>	<b>33.2</b>	<b>1982</b>	<b>8.5%</b>	<b>15.0%</b>	<b>23.0%</b>	<b>yes</b>
<b>Pennsylvania TRF</b>	<b>34.5</b>	<b>1985</b>	<b>2.0%</b>	<b>5.0%</b>	<b>21.7%</b>	<b>no</b>
<b>Colorado PERF</b>	<b>26.3</b>	<b>1982</b>	<b>7.2%</b>	<b>n/a</b>	<b>17.4%</b>	<b>yes</b>
<b>Connecticut SIB</b>	<b>16.0</b>	<b>1987</b>	<b>3.4%</b>	<b>12.0%</b>	<b>15.6%</b>	<b>yes</b>
<b>Colorado Fire &amp; Police</b>	<b>2.2</b>	<b>1986</b>	<b>2.6%</b>	<b>5.0%</b>	<b>13.3%</b>	<b>no</b>

<sup>1</sup> 5 year annualized returns

<sup>2</sup> Figures only for investment in Guayacan Fund of Funds I, L.P.

From "Indiana Pension Funds: Expanding the Impact of Equity", report published by the Indiana Fiscal Policy Institute

PERF = Public Employees Retirement Fund

TRF = Teachers Retirement Fund

SIB = State Investment Board