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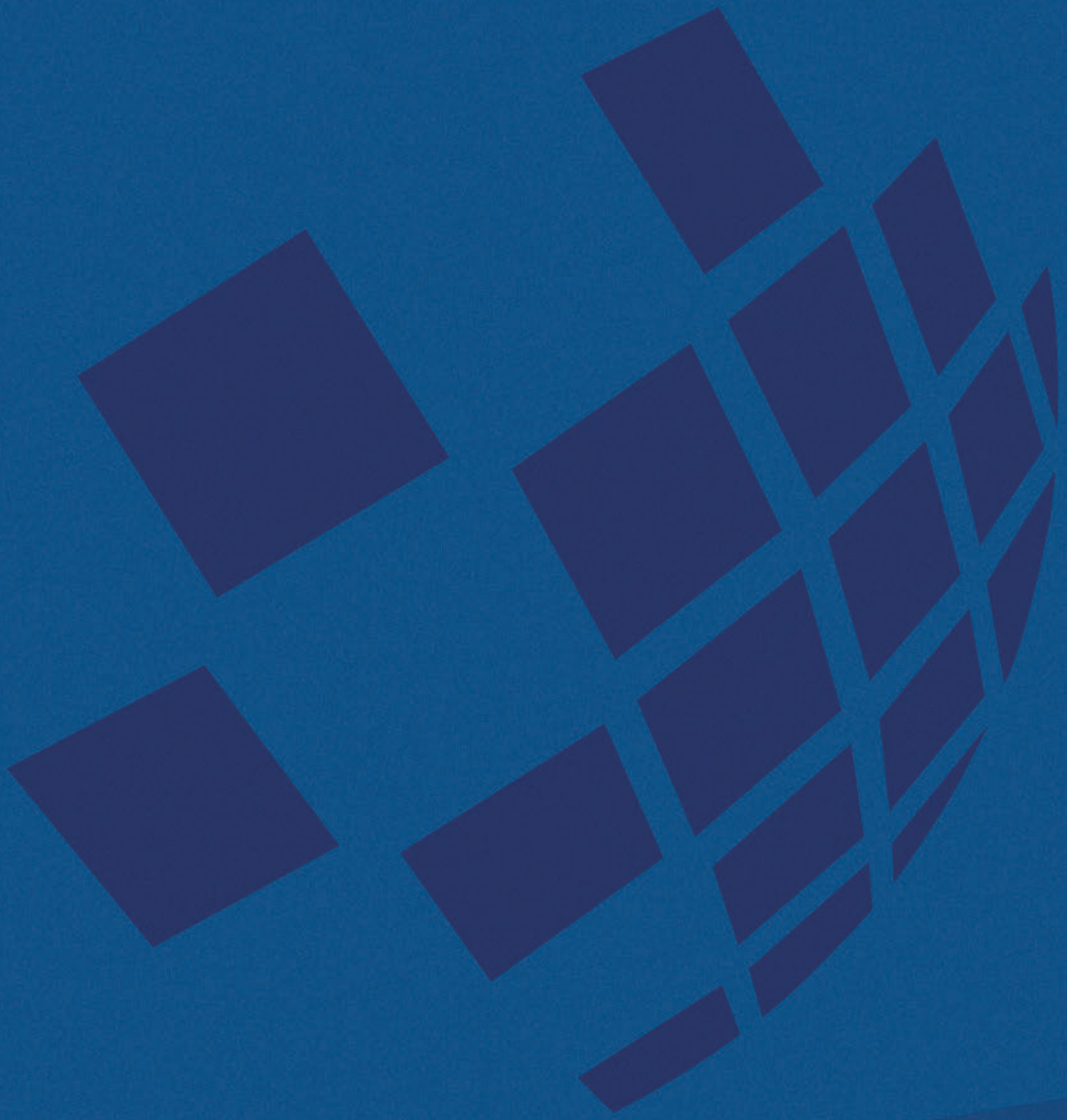

Hamilton Lane®

Market Overview

Keeping Clients in Sight

"It's better to keep your mouth shut and appear stupid than open it and remove all doubt."

- Mark Twain

That's always the risk when presenting a Market Overview, isn't it? It's particularly risky when that overview takes firm positions and offers specific, and occasionally controversial, opinions. Then again, who wants to read something that showcases data that can be found anywhere and then proffers such startling advice as "we recommend investing prudently and carefully"?

We don't, and we assume you don't either.

So – and at the risk of removing all doubt about whether or not we know our stuff – we are quite proud to present our annual Market Overview, which includes our thoughts, observations and analyses of the current market environment for alternative assets globally and, in particular, for private equity. This overview contains two unique elements that we believe will be of great interest to you. First, there is the sheer amount and quality of data we present. Second, there is the way in which we connect the data and draw upon it to make predictions and recommendations.

Let's use something else that Mark Twain said to frame the data discussion: "Get your facts first, and then you can distort them as much as you please." We have long complained that private equity, in general, is an asset class long on anecdote and short on facts. One culprit is data, which has simply not been available in any meaningful or reliable way. If we may brag here a moment, this is not Hamilton Lane's issue. Our database is as robust, and real-time, as any that private equity has to offer; we would actually argue it is more comprehensive than most. You will see a huge amount of that data incorporated throughout this overview. We have it, and it's our view that the entire industry benefits when we share it.

But, the fact that this is an asset class with typically sketchy data is only part of the issue here; the other part is simply the refusal of industry participants to even use or rely upon what data is available. We completely understand the argument that past data is not necessarily indicative of the future. However, too many private equity practitioners use that excuse to cover up for being lazy or taking short-cuts. Despite what may really be happening in the asset class, it's possible for breathtakingly inaccurate statements to be made when there is no hard data to refute them.

Rather than operating on conjecture, what we've attempted in this overview is to provide you with better information based upon an unparalleled database in the hope that reliable data allows you to perceive the market environment in a more realistic and accurate light. We also hope you find the insights and predictions we make based upon the data to be both interesting and opinionated.

So, what are some of those predictions? For starters, we do believe that markets are at some kind of turning point – not because we see a significant downturn or recession looming on the horizon, but because we believe that markets are beginning to adjust to a different reality. Up until now, global markets have been operating with the expectation that one of two realities was going to transpire: (1) growth would resume its normal course around the world or (2) the efforts to reflate the world off the back of the Great Recession would fail, leading global economies and capital markets to tank.

Over the past few years, we have been largely correct in our prediction that capital markets would surprise on the upside and, even today, we don't necessarily foresee the markets trending downward. However, we would argue there is a third potential reality worth considering – that is, markets come to the realization that a much slower global growth environment is likely to last much longer than previously anticipated. Unlike what we have experienced over the last 30 years, that environment will be characterized by lower interest rates, constant deflationary concerns and far more subdued top-line revenue growth than most want to believe. Oddly, as we outline in this overview, it will also be a better overall environment for private equity. If the markets adjust to a world of slower growth, then valuations will not run away from private equity the way they have the last few years.

Where and how should you invest specifically? Well, we can't give that away in this introduction, but we encourage you to seek out those answers by reading the rest of the book. We hope you enjoy this year's Market Overview and, as always, feel free to reach out to anyone at Hamilton Lane with questions, follow-up, disagreements and fulsome praise.

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GLOBAL ECONOMIC OUTLOOK

"Surely there comes a time when *this time it really is different?*"

Our collective lens on both the present market and the future environment may ultimately prove faulty – or at least in need of adjustment.

Whenever you hear someone make an investment prediction that begins with, "This time it's different," your best bet is probably to turn and run. At Hamilton Lane, we've been guilty of mocking fellow prognosticators for employing that expression as a means of predicting future market direction, especially over the course of the last five years. Yet, a nagging question remains: Surely there comes a time when "this time it really is different"?

Relax, we're not about to suggest that the world today is drastically different than ever before and therefore without historical comparison. If anything, we'd suggest that – based on a number of social, economic and financial factors – the world today might be shockingly similar to some prior time periods. The biggest difference is that we've recently emerged from a five-year span that, despite some similarities to prior cycles (such as the 1980s, 1990s or 2000s), was in many ways an aberration. As a result, our collective lens on both the present market and the future environment has been influenced by that experience and may, therefore, ultimately prove faulty – or at least in need of adjustment. To help us determine whether or not that's the case, we'll do a bit of time traveling throughout this overview, and consider whether the future is likely to be more reminiscent of time periods we may have forgotten.

As we've done in prior overviews, we will start by taking a look at stock market performance. Even with the recent volatility and downturn, most markets, particularly in the developed world, have done remarkably well. We've spent most of the last five years hearing predictions that the markets were headed for disaster or, at least, massive corrections. Oddly, in most markets, it simply hasn't happened. In prior cycles, the kind of market moves we have experienced over the last five-year period would surely have created a sense of euphoria. We've experienced the opposite. Consider a simple indicator such as the number of Google searches for the term "Stock Bubble"; it's hit record levels. People don't search such terms if they are feeling good. There is no euphoria. At worst, there is concern and, at best, complacency.

> "There is no euphoria. At worst, there is concern and, at best, complacency."

One factor contributing to the uneasiness is GDP growth, which has simply not been very impressive, even coming off the severe downturn of the late 2000 era. Look at the year-over-year GDP growth figures for major economies (Chart 1).

Here we take our first glimpse through the faulty lens. On an absolute level, it is concerning that growth in most economies has been more muted in the last twelve months than over the prior five years. However, even more telling is the fact that virtually all major economies are growing more slowly now than they were in the 1990s. The general understanding is that the growth seen in the '90s was "normal," and so we're right to expect faster growth than what we have seen lately. What if that is simply an incorrect assumption?

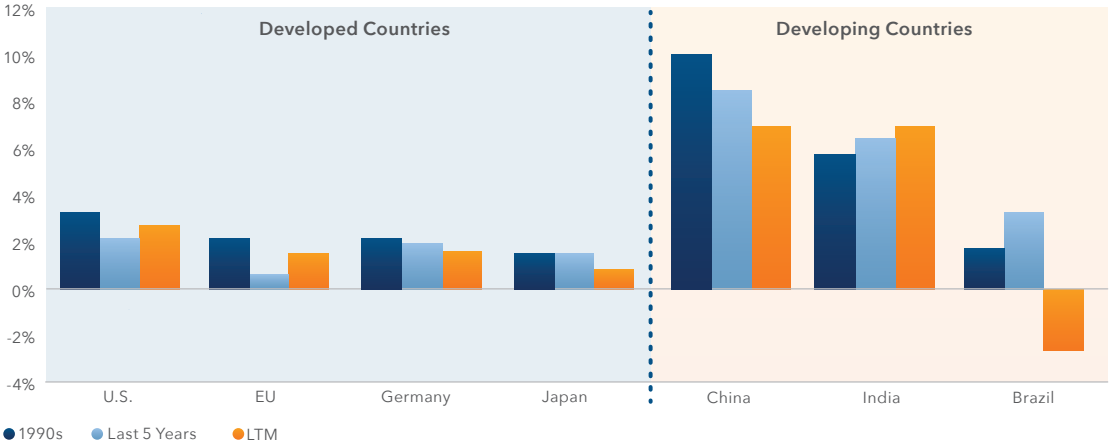
On the macroeconomic side, our thesis for this year's overview is that three factors will shape a future far more evocative of a time in our distant past; thereby proving the more recent past (1980s-2000s) to be a poor predictor of things to come. The three factors loom before us like the Fates in Greek mythology (conjuring up images of the Horsemen of the Apocalypse would have had greater dramatic effect, but unfortunately there were four of them). Lo and behold, they are:

» Debt,

» Demographics, and

» Deflation.

Chart 1: GDP Growth
Average Real GDP Growth YoY



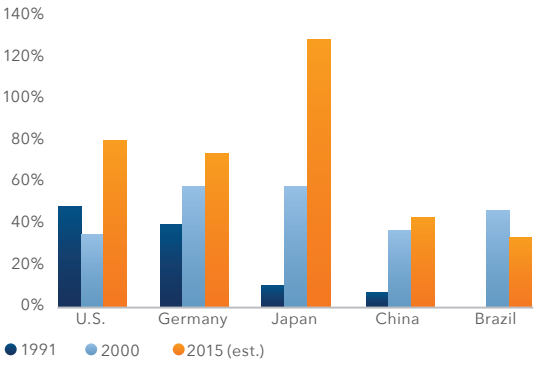
Source: World Bank, Bloomberg. LTM as of 6/30/2015. Last 5 years as of 12/31/2014 (September 2015)

DEBT

Debt, in all its forms, has been a significant factor in the economic conditions of the last 30 years. There is a famous anecdote about Bill Clinton's first term as president. His administration had come to the realization that the debt market's reaction – good or bad – to economic policy measures had a profound impact on the formulation and implementation of anything they wanted to do. One of Clinton's advisers is reputed to have said that he'd like to be reincarnated as the bond market, because then he could intimidate anyone.

Chart 2 outlines the considerable increases in the public sector debt levels of major economies over the last 25 years. These increases are both relative as a percentage and absolute as GDP figures have grown.

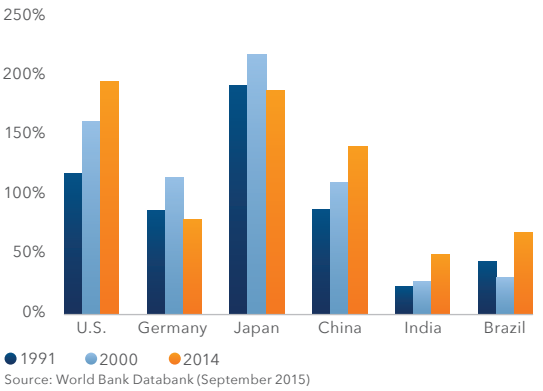
Chart 2: Public Sector Debt
As % of GDP



Source: Bloomberg (September 2015). Brazil data not available for 1990s. Germany 2015 estimate not available so 2014 value is shown.

Since 1991, private sector debt growth likewise has been strong, although the growth has not been as rapid, largely because it started from a higher base.

Chart 3: Private Sector Debt
As % of GDP



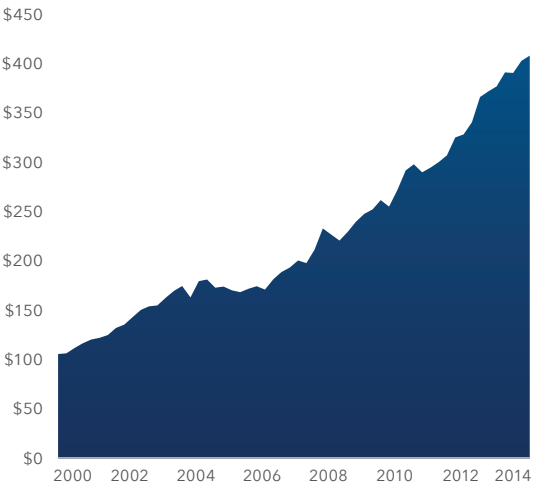
Source: World Bank Databank (September 2015)

Support for higher debt levels is not difficult to find. Monetary policy in recent history, especially dating back to the 1990s, has largely been very loose. Never has this been more evident than during the last five to seven years when virtually every central bank on earth has been focused on providing huge gushes of liquidity to keep the markets moving. Sovereign yields in recent years have been at their lowest levels in decades, and only the U.S. Fed is showing any signs that rates might be increased soon.

Private debt markets also are experiencing persistently low rates and, as a result, debt issuance has been at record levels, particularly in the high-yield market. While leveraged loan issuance in the U.S. has not reached record highs, this is likely due more so to regulators pressuring banks to reduce perceived riskier lending than to any market discipline or view that rates are too low to justify lending.

We know what the public sector has done with the borrowed money. But what about the private sector? If economic activity has been slower, where have the record levels of debt gone if not to corresponding levels of plant construction and equipment and M&A? A counter-intuitive notion is that, while public sector financials have deteriorated, the same is not true of the U.S. corporate sector. As measured by S&P 500 leverage multiples, public company leverage is below 2x. To put this in context, that figure has averaged 3.4x over the last 25 years. Even more noteworthy is the build-up of cash on those companies' balance sheets.

Chart 4: S&P 500 Cash Balances & Short-Term Investments
USD Per Share



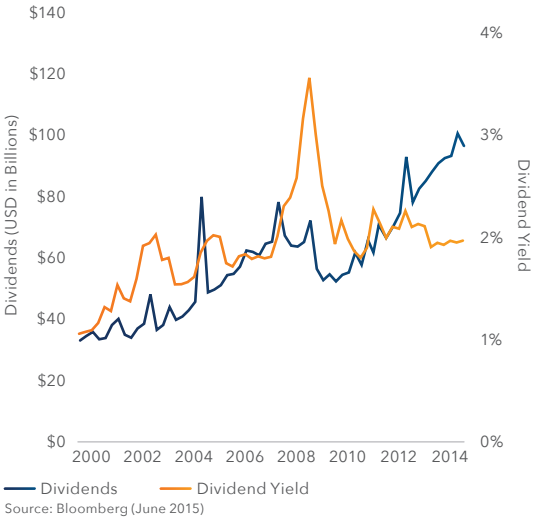
Source: Bloomberg (June 2015)

Public companies, and their private brethren, have been using the last five years to put themselves in very sound financial condition. We can debate what that means for economic growth, but it is difficult to assert anything other than the fact that those companies are as strongly positioned as they have been in recent history.

We can't help but insert here a tangential, yet important, diatribe regarding the double standard applied to private equity-owned companies.

Most S&P 500 companies have used some large amount of their borrowings to return capital to shareholders. In fact, over the last five years, they have increased cash dividends by about $50 billion.

Chart 5: S&P 500 Quarterly Dividends & Dividend Yield

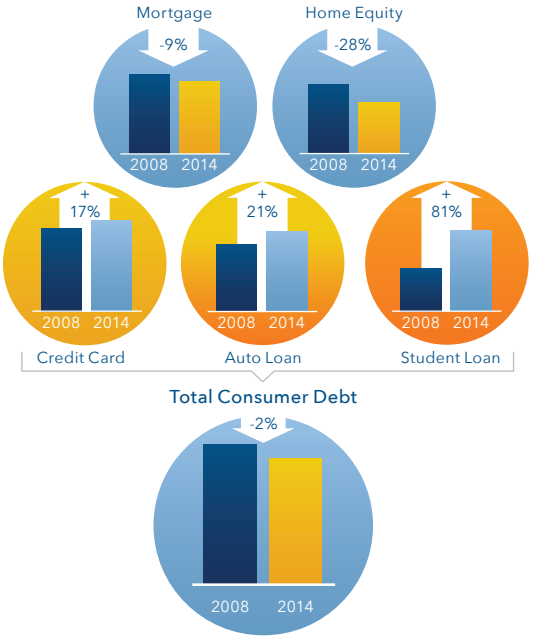


Source: Bloomberg (June 2015)

The markets applaud such use of cash. One reason that dividend yields haven't trended upward is because stock prices have appreciated so much, in some part due to the increased dividend payments. All good, right? Then, dear reader, explain to us why, when private equity companies engage in a dividend recap and *do so by the exact same practice that public companies are using to resounding applause*, the private equity industry is vilified as a scourge to the financial system? It makes no sense other than as an example of the triumph of a good sound bite over common sense.

Let's turn for a moment to what the U.S. consumer has done during this last five-year cycle. For a species renowned for its inability to turn away from a proffered loan to spend on a consumer good, the U.S. consumer has shown amazing restraint (Chart 6).

Chart 6: U.S. Consumer Debt Outstanding by Type



Source: Federal Reserve (May 2015)

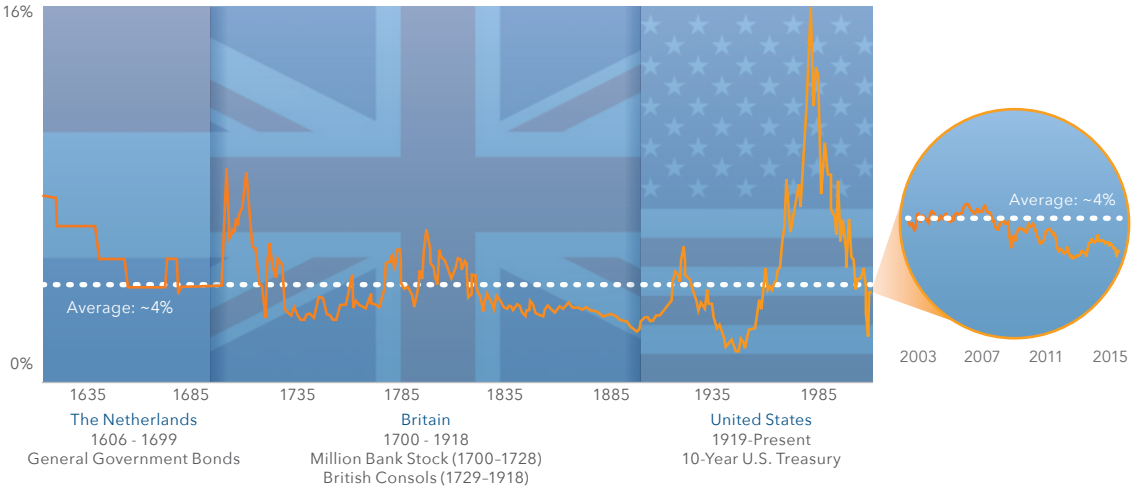
The aggregate numbers mask an important development. Student loan debt has increased significantly over this time frame, so as we think about high debt levels impacting future growth, this is certainly a level to watch. This debt is concentrated in people in a younger age bracket who will be entering peak earning (and spending) years with a debt burden that will require a meaningful share of income to unload. This can only mean some reduction in future growth prospects for the U.S. economy.

Let's turn back to the overall debt picture. Predictably, we're hearing the cries that rates can only go up – perhaps dramatically so! – and that all hell will soon break loose across the investment landscape. Alan Greenspan, former chairman of the Federal Reserve and a renowned bubble seer who accurately predicted 300 of the last two bubbles in the market, recently sounded the alarm about the bond market bubble upon us.

We won't argue that current interest rates aren't low; indeed they are. We would argue, however, that this is yet another instance of a faulty lens being used to interpret current market conditions, and that interest rates would need to rise significantly to be considered at truly "normal" historical levels.

To prove this point, let's jump into Mr. Peabody's Wayback Machine and take our first trip back in time.

Chart 7: World Interest Rates



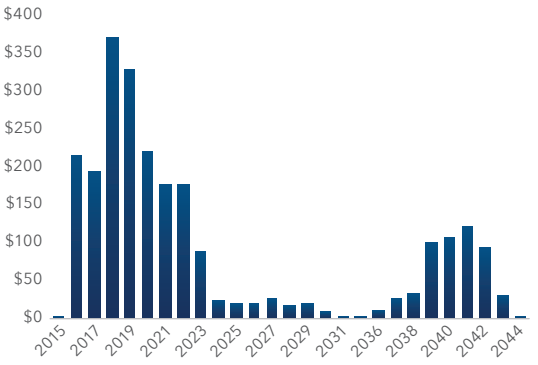
Source: Global Financial Data (April 2015)

Dating back to the early 1600s, 10-year rates have averaged 4% around the world and have frequently dipped below that level for considerable spans of time. That's more than 400 years of data supporting the argument that current interest rates are far closer to historically normal levels than those of the more recent past. While rates may increase from current levels, we think it unlikely they will rise significantly and instead believe they will surprise people with how low they remain and for how long.

For a moment, however, let's accept the consensus view, which argues that rates will inevitably go up and will do so dramatically. Why might that happen? When? The obvious cause would be some period of robust global economic growth, but does anyone actually see that on the horizon? Here we would call your attention to one particularly interesting and relevant feature of the global debt picture: its maturity profile.

Chart 8: Federal Reserve Treasury Holdings by Year of Maturity

USD in Billions



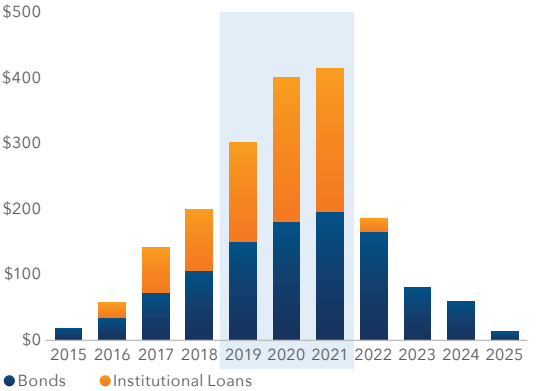
Source: FRED Database (August 2015). No holdings for maturity years 2033-2035.

John Danhakl from Leonard Green once said that he has never seen a chart of debt maturities that didn't scare him. It's true that they always look frightening given how hard it is to imagine so much debt being repaid. Globally speaking, the average maturity of government debt is four or five years. Looking at the U.S. specifically, the maturity profile is quite concentrated, both on the public and private sides (Chart 9).

The issue here is the debt being refinanced in that 2018-2019 period. There is a plausible scenario that says the easy money policies of today will be at least slightly different at that point in time, and rates will rise more rapidly than expected because of the demand for refinancing capital. Add into that equation the fear that the regulatory environment, particularly in the U.S., has decreased liquidity in the bond markets, and you have conditions that can easily create a significant updraft in interest rates. If you pressed us, we would likely pinpoint

Chart 9: U.S. Maturity Wall

USD in Billions



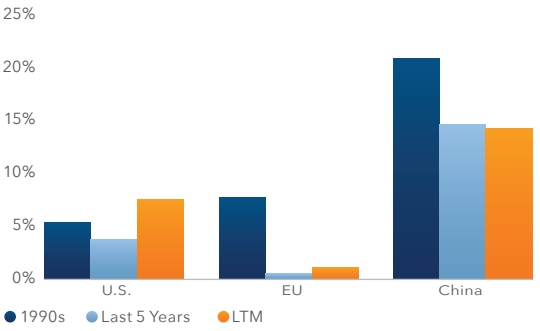
Source: Minack Advisors (March 2015)

the 2018-2019 period as the most likely time frame for the next bear market in the U.S., in some measure due to the confluence of these bond market factors.

There is little question that the increase in debt has contributed to overall growth. In that context, Chart 10 is sobering.

We put significant stock in using credit growth rates as a measure of broader economic growth. The reality is that the rate of growth is coming down in all major economies. To us, the combination of already high debt levels and the slowing rate of credit growth are not predictors of looming disaster, but rather are indicators of generally slower global growth rates than those to which we have become accustomed.

Chart 10: Average Credit Growth Rate YoY Change



Source: Bloomberg (September 2015).
Data for China begins in 1992. Data for EU begins in 1997.

DEMOGRAPHICS AND THE LABOR MARKET

If you read our 2014 Market Overview, you might recall us employing the expression "demographics is destiny." It's a saying we'd happily attribute to someone if not for the inconvenient fact that no one (not even Google) is really sure who first used the phrase. But we digress…. If indeed it holds true that demographics is destiny, then the destiny of the world's regions is in a fairly synchronous phase. Simply put, we are all getting older. (We know, we know. This is really earth-shattering stuff.)

Over the next few decades, each of the world's major economies is positioned to experience an increase in its median age. Some increases will be dramatic. Evidence exists that suggests an increased median age does have an impact on economic growth rates, generally slowing them down. In that regard, it is interesting to note that the U.S. and India will have relatively slower rates of aging than many other countries.

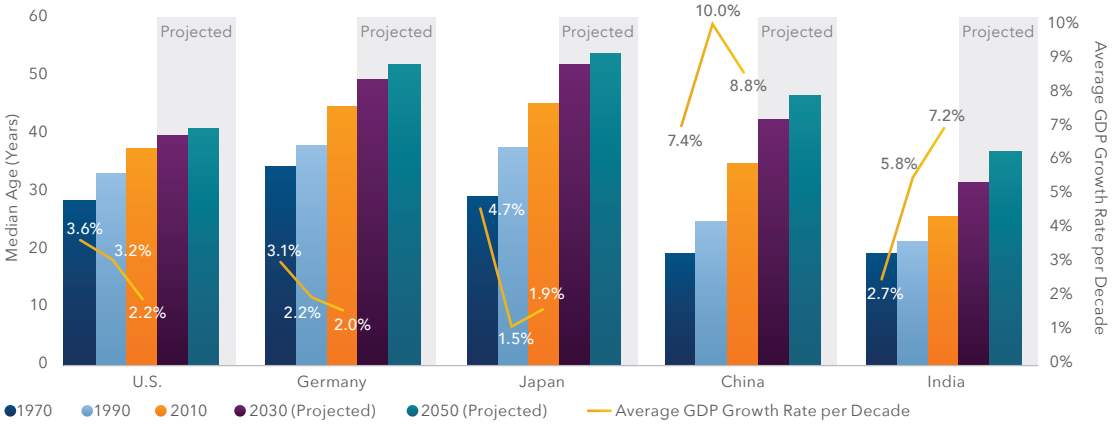
Similar to the issue of the rate of credit growth, the aging of the world's population is not the sole indicator of economic headwinds on the horizon, but it does have some very interesting ramifications:

» The proportion of older workers will increase. The U.S. has already experienced that phenomenon, with workers aged 65 and older being the only group to increase labor participation in the last 10 years.

» Unemployment rates in the developed world will remain high. Most economies have made steady progress toward reducing unemployment over the last five years. However, in the developed world, unemployment remains higher than it was in the 1990s, and we would expect this to continue to be the case.

» Wage growth will surprise on the upside, although perhaps not for a number of years. (This is where

Chart 11: Median Age and Average GDP Growth
By Country



Source: United Nations, Department of Economic and Social Affairs, World Population Prospects 2012 Revision, June 2013

If you pressed us, we would likely pinpoint the 2018-2019 period as the most likely time frame for the next bear market in the U.S.

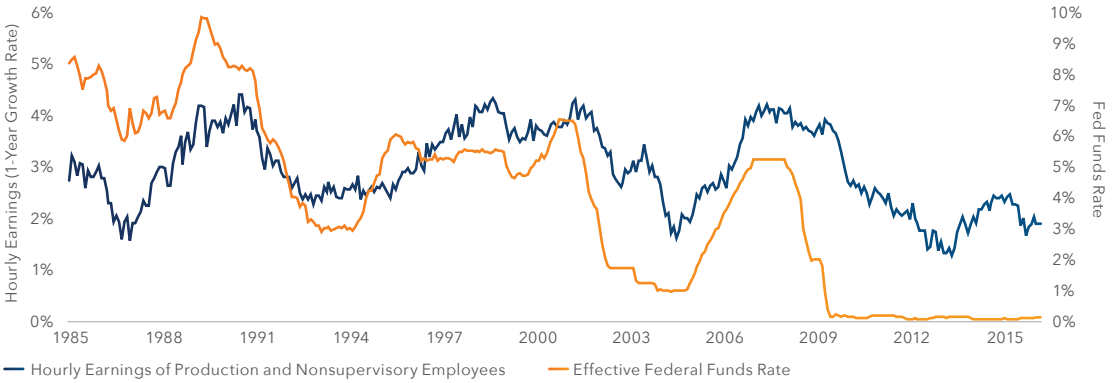
> "Simply put, we are all getting older. (We know, we know. This is really earth-shattering stuff.)"

we part with the consensus.) Wage growth around the world has been anemic at best over the last decade. Even in China, where word on the street is that wages are "exploding," the reality is that the rate of growth has decreased over the last ten years from 14% to 8%. However, if we are indeed going to see an aging population, then the labor pool, almost by definition, will shrink. That, to us, signals that wage growth will likely increase by the simple logic of supply and demand.

Let's cover the wage growth issue in one very important context today.

Countless commentators have noted that Chart 12 is the one to watch as a signal of U.S. Federal Reserve action. There exists a remarkable correlation between U.S. hourly earnings and the Federal Funds rate. It makes sense: the Fed worries about inflationary pressures and U.S. inflation has typically been a function of wage pressures. However, looking at this chart, it is hard to make a compelling case for increased U.S. rates. Until we see hourly earnings move up with any consistency, we don't foresee any U.S. rate increase being long-lived.

Chart 12: Hourly Earnings & Federal Funds Rate



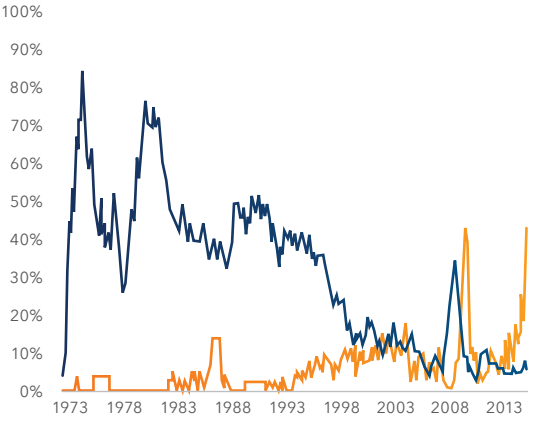
Source: St. Louis Fed Research (August 2015)

DEFLATION

You have to love Chart 13. (Well, you don't have to, but we think you should…) It tells us that we spent the pre-2007 era worrying about inflation (with good reason), and that there exist equally good reasons we ought to be spending this era worrying about deflation. Circling back to the idea that the current environment is being perceived through the wrong lens, we think the consensus is failing to appreciate the true risk of rising deflationary concerns.

Nowhere is the deflationary pressure more evident than in commodity prices. Whether we are looking at the energy complex, metals or agricultural commodities, prices in many cases are down to levels last seen in the 1990s. That is neither a bad nor a good thing (unless the strength of your business requires higher prices in any of those commodities), but a factor we all need to consider as we determine what the likely course of future growth might be. We do not believe deflationary pressures are going to abate; they will continue to impact global markets and participants' reaction to those pressures.

Chart 13: The Fall of Hyperinflation and Rise of Deflation



Source: Thomson Reuters, AMP Capital (March 2015)

ENERGY

Let's focus on one sector where deflation and the drop in commodity prices have gotten the most attention: the energy sector. Energy continues to be an incredibly hot topic and one where we spend a good deal of time, both because the 50%+ collapse in oil prices has captured headlines and because we have long said that energy, particularly in the U.S., is an integral investment area for private equity portfolios.

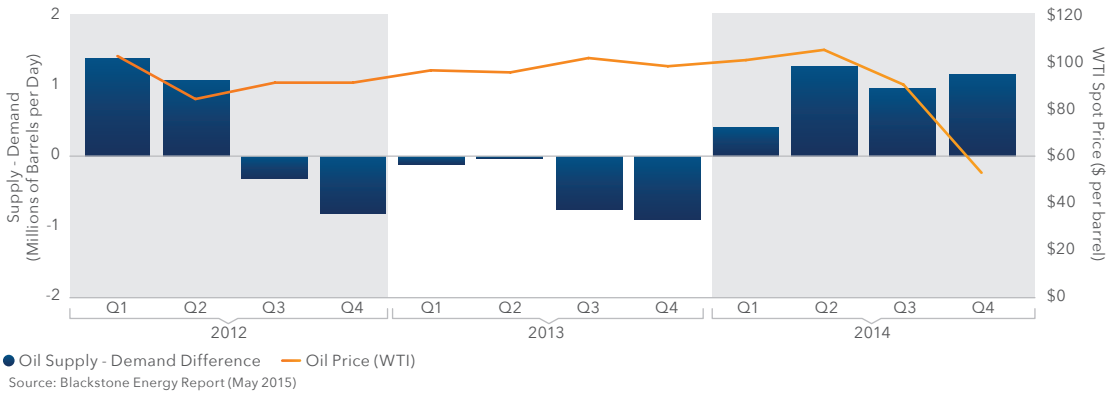
Most prior oil price declines have been the result of demand reduction, generally triggered by recessions or global downturns. This oil price decline is quite different in that it has largely been a function of surplus supply in the global oil market (Chart 14). The falling price of oil has certainly been exacerbated by factors such as the strength of the U.S. dollar, but it ultimately comes down to a fairly simple matter of lots of oil being produced throughout the world. OPEC's decision to continue production rather than cut its output to curb supply has ensured that the glut will continue until either (a) demand meets supply or (b) supply is reduced. OPEC obviously hopes that supply, mainly from the U.S. and Canada, will be reduced, because production is not profitable at lower prices.

It is our view that the market is once again using an incorrect lens to interpret the current energy situation, as well as its future outlook.

Chart 15 plainly shows that, outside of U.S. and Canadian production, very little new crude supply has entered the market since 2008. Moreover, the relatively small increases of a few nations have largely been offset by more substantial declines in others. Some figures indicate that, absent increased U.S. production over the last five years, oil would currently be in short supply and prices would indeed be in the $100 per barrel range.

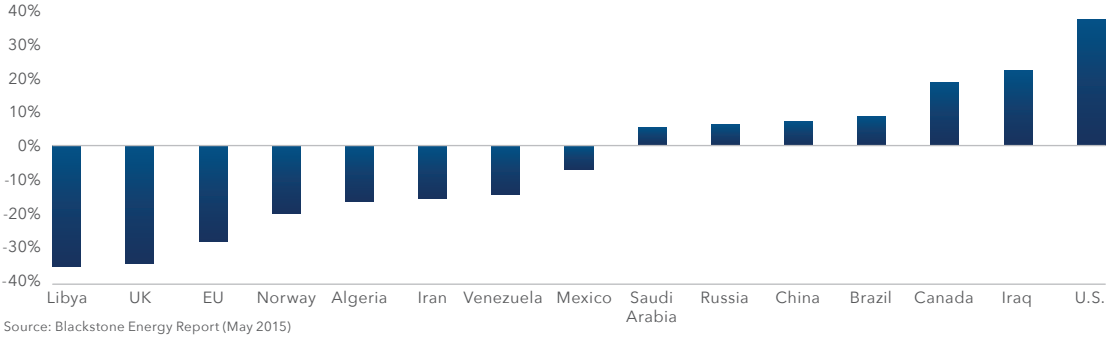
Most of the largest oil producers (Saudi Arabia, Iraq, etc.) are producing at capacity today. OPEC's determination to drive out "marginal" producers (*i.e.*, U.S. shale and Canadian oil sands) is predicated on an oil industry that has one very simple characteristic: a long investment cycle measured in multiple years needed to explore, drill and bring the oil to market. We will argue that U.S. shale, in particular, has changed the dynamics of the industry, perhaps permanently.

Chart 14: Oil Supply Surplus/Deficit vs. Oil Price



Source: Blackstone Energy Report (May 2015)

Chart 15: Change in Crude Oil Production, 2008-2014



Source: Blackstone Energy Report (May 2015)

First, look at the reported break-even prices for U.S. shale properties (Chart 16). The average U.S. oil play break-even price is below $60 per barrel. We think it unlikely that much of OPEC (and non-OPEC countries like Russia) can withstand oil remaining below $60 per barrel for any long period of time before social and economic pressures become too great. More importantly, however, is that the time frame in which U.S. shale wells can both begin producing and stop producing is narrower than the oil industry has ever seen before. In our view, what that likely means is that oil prices will react far more quickly on both the upside and downside as the new swing producer, the U.S. shale industry, comes on and offline with prices moving above and below the $40-$60 per barrel price.

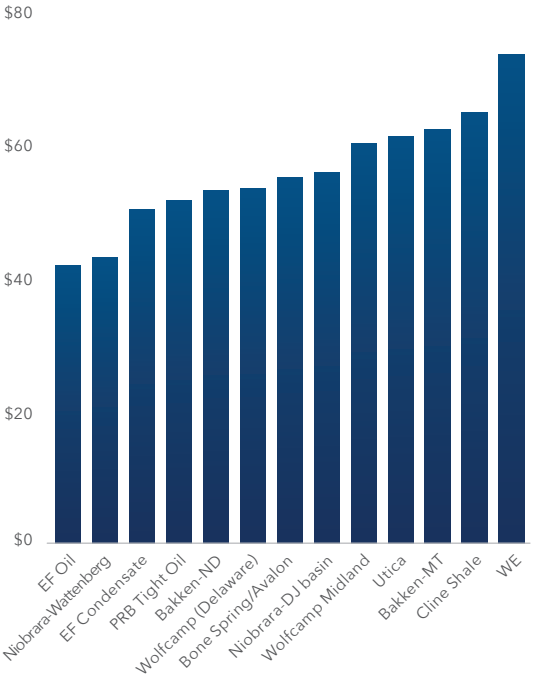
The U.S. oil industry will actually become even more competitive, and do so at lower prices, as technology continues to improve and as many of the more marginal, leveraged and inexperienced producers are driven from the market in this downturn. Our belief that oil prices will likely remain well below $100 per barrel for some period of time is another factor contributing to the generally deflationary pressure environment we foresee.

But let's move on to discuss a more existential threat to oil prices. Today, there exists a strong social and political movement to curtail the use of fossil fuels. This is manifested in moves to divest not only coal, but all fossil fuel holdings. And, while it pains us to cite a term popularized by such a sage economic publication as *Rolling Stone*, we are increasingly hearing reference to the "carbon bubble" – the idea that the value of fossil fuels on company balance sheets is inflated because global warming will prevent their eventual use. In spite of the clamoring, none of these discussions will make much of a difference to the use of fossil fuels globally; few individuals or countries will retard personal economic growth by curtailing the use of those fuels (although they will certainly urge others to do so).

The two biggest potential threats to oil prices come from (a) natural gas and (b) technological advances in battery storage. We believe both threats will develop with a speed that will surprise many investors.

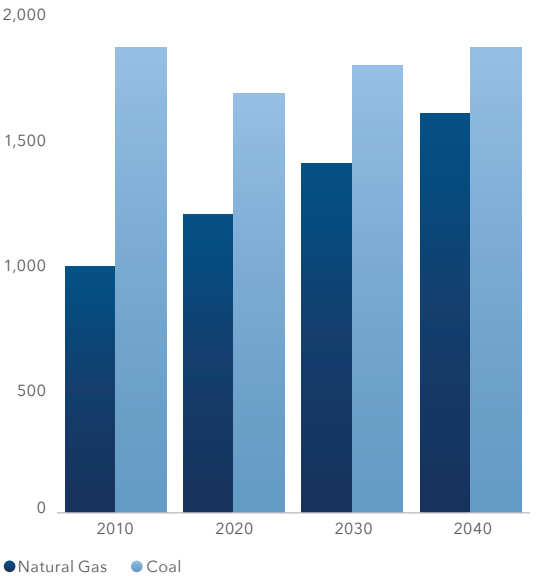
Tracking the relative increase of natural gas usage versus coal in U.S. electricity generation, Chart 17 indicates that natural gas usage will increase dramatically in the coming decades. However, we believe the increase is going to be even more significant than this chart conveys. A combination of regulation, social pressures and cost will cause natural gas to comprise a far larger share of the electricity-generating market in the U.S. than anticipated. Natural gas as a substitute for both coal AND oil will be a dominant feature playing out in the energy sector over the next decade.

Chart 16: Break-even for U.S. Shale Plays
*Cost of Production per Barrel of WTI**



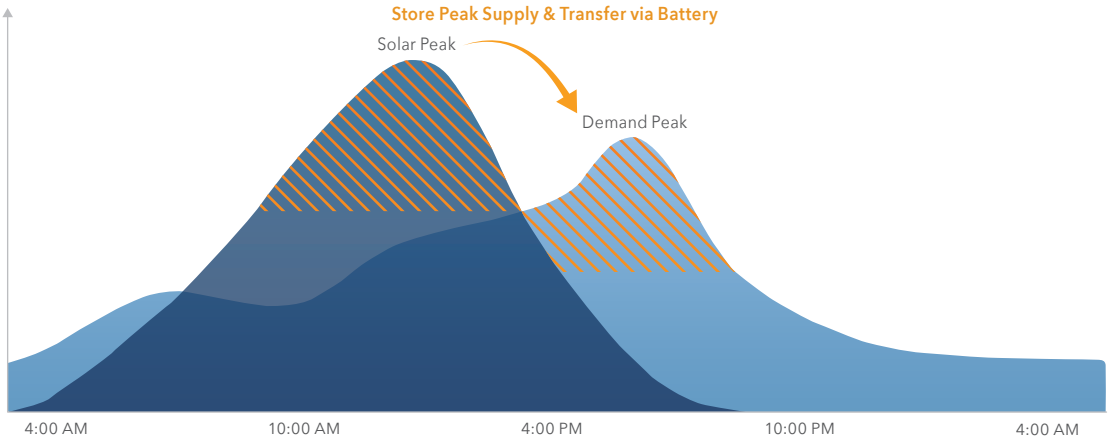
Source: Rystad Energy research and analysis.
*WTI oil price, which gives NPV of zero at 10% discount rate

Chart 17: Projected U.S. Electricity Generation: Natural Gas vs. Coal
By Billion Kilowatt-Hour



Source: International Energy Agency (May 2015)

Chart 18: Daily Solar Power Supply & Electricity Demand
By Kilowatt



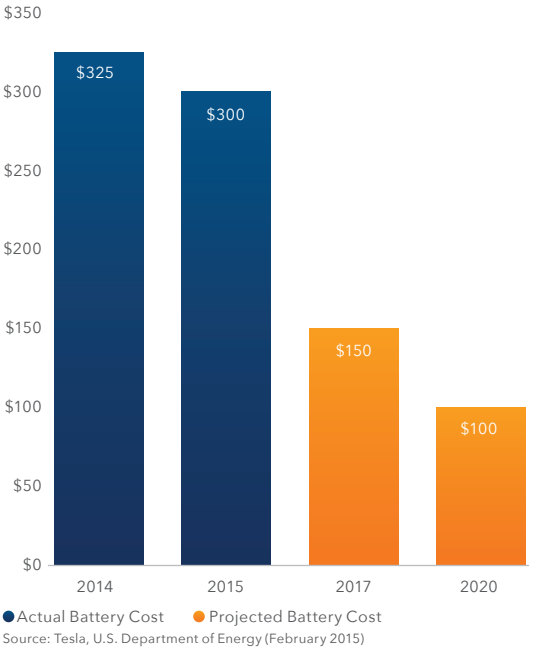
Source: Sunpower 2014 Analyst Day (November 2014)

The real game changer, however, will be in battery storage. Currently, the ability to use renewable energy sources, particularly solar, on a widespread basis, is limited by the ability to store that electricity. Chart 18 illustrates the supply/demand situation for electricity generation in the U.S.

Solar power can only supplant fossil fuels if battery storage can be provided in scale and in a cost-effective way to meet demand peaks. For those who have read about the Tesla cars being produced in the United States, you know that, for Elon Musk, the change in energy patterns is only marginally about reducing oil as a fuel for vehicles. The technology that Tesla and others are pursuing relates to the large-scale storage of electricity in batteries for commercial use – that is, for electricity generation globally. Look at the projected battery cost (Chart 19).

The drop in battery prices is expected to be significant. Once – not if – the technology develops and has widespread application, the age of fossil fuels will begin to decline. This is likely not a development in the next five years, but one that we believe will occur much faster than anticipated. Technological change is like that proverbial genie that, once let out, does not return to the bottle. When it comes to battery storage technology, the bottle is being opened slightly and this particular genie is going to come out like a lightning bolt.

Chart 19: Battery Cost: Actual and Projected
$/KwH



Source: Tesla, U.S. Department of Energy (February 2015)

"Technological change is like that proverbial genie that, once let out, does not return to the bottle."

PE and Energy

We can't leave the energy sector without a specific discussion about its role in private equity. We have contended for the last several years that PE investments in the energy industry would generate meaningful returns. Plenty of stories persist that refute this argument, and the tales of woe around Energy Futures and Sansom provide powerful examples of private equity's failure in this area.

To see whether we're really off-base here, let's go back in time once again. For this journey, let's skip the Wayback Machine and hop into the DeLorean from "Back to the Future."

As it turns out, private equity energy investments performed pretty darn well over the last several years (Chart 20). Hundreds and thousands of basis points in outperformance versus the public market indices is indicative of something more than luck. We'll pat ourselves on the back here and say this performance is proof of many of the arguments we've been making for why private equity investment in energy is a good bet:

» PE largely stayed out of the exploration and development area as prices rose. In fact, PE unloaded significant amounts of assets into that price increase.

» PE largely avoided direct commodity price plays in the energy field.

» PE took advantage of the breadth and complexity of the energy sector. With relatively few experienced players and numerous cross-currents, the rewards went to expertise and the right macro outlook.

We continue to believe that the energy sector will produce attractive returns for private equity investors, and will do so in virtually any price environment. Is this optimism simply based on a refusal to believe we were wrong to recommend energy sector exposure in all PE portfolios? No, it's actually based on some fundamental investment reasons:

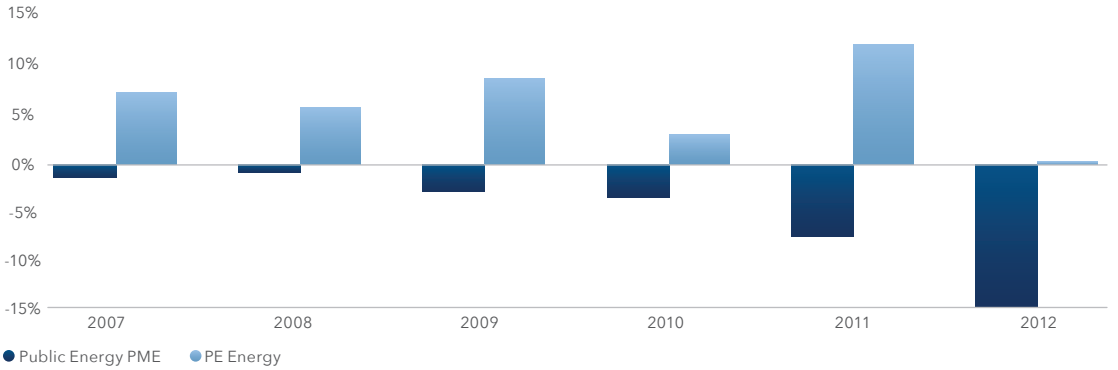
» Any time that the price of an asset, which is crucial to everyday life globally, falls more than 50%, your interest has to be piqued.

» In the current U.S. energy environment, we are likely to see a wave of bankruptcies, asset sales and debt/equity infusions that will combine to create compelling valuations of interesting assets. That's what often happens in periods marked by downturns and fear.

» Energy cycles run in multi-year periods, which are ideal time frames for making private equity buy and sell decisions.

» Whether looking at upstream, midstream or downstream investments or considering different geographic opportunities, the energy market remains quite large and covers a diverse set of assets and risk/reward structures.

Chart 20: PE Energy Returns vs. Public Markets
By Vintage Year Net IRR



Source: Hamilton Lane Fund Investment Database (August 2015). Public energy return is a PME using the MSCI ACWI Select Energy Producers IMI.

Hundreds and thousands of basis points in outperformance versus the public markets is indicative of something more than just luck.

GLOBAL OUTLOOK

Now, for the million dollar question: Where do we think the markets are headed?

Generally speaking, public markets around the globe have had a pretty good run in recent years, even with the recent downturn in most major markets (Chart 21). We suspect the fact that markets have had such strong performance over the last five years, while economic growth has been more lackluster than in periods such as the '90s, is leading many to conclude that this rise is not sustainable and we are headed for an economic downturn and bear market.

We disagree.

For the reasons already enumerated, we believe that growth globally will be much slower for much longer than the world has experienced across the past few decades. This is not necessarily a bad thing, although it does make for a very different investment playbook than was used in the 1980s, 1990s or 2000s. While capital markets are headed toward bone-rattling corrections, an extended bear market is unlikely in the near term, which we'll go out on a limb and define as the next three years. (Of course, we'll re-define that if we prove to be wrong.)

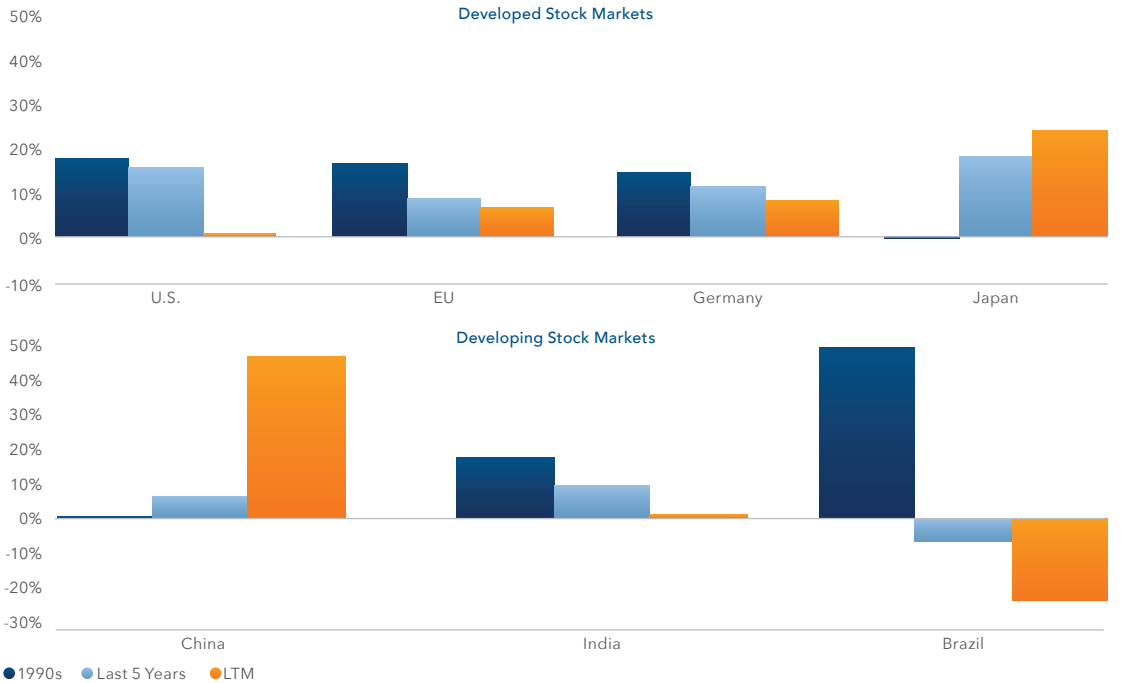
On some specific topics:

We expect the U.S. Fed will raise interest rates at least once, by one quarter point. Not because they should, but because they are leery of a prolonged zero interest rate environment and the behavioral changes it causes in investors. It will be a mistake. If the Fed attempts to raise rates much more than that one quarter point, it will have the same result as recent rate hikes by other developed economies, such as Canada, New Zealand, Denmark and Sweden; the Fed will just be forced to lower them in the future.

China's growth will continue to slow, largely due to the government's continued efforts to transform the economy from an investment-driven model to one that is more consumer-oriented. That slower growth will have real repercussions for commodity-oriented economies, such as Australia and Brazil.

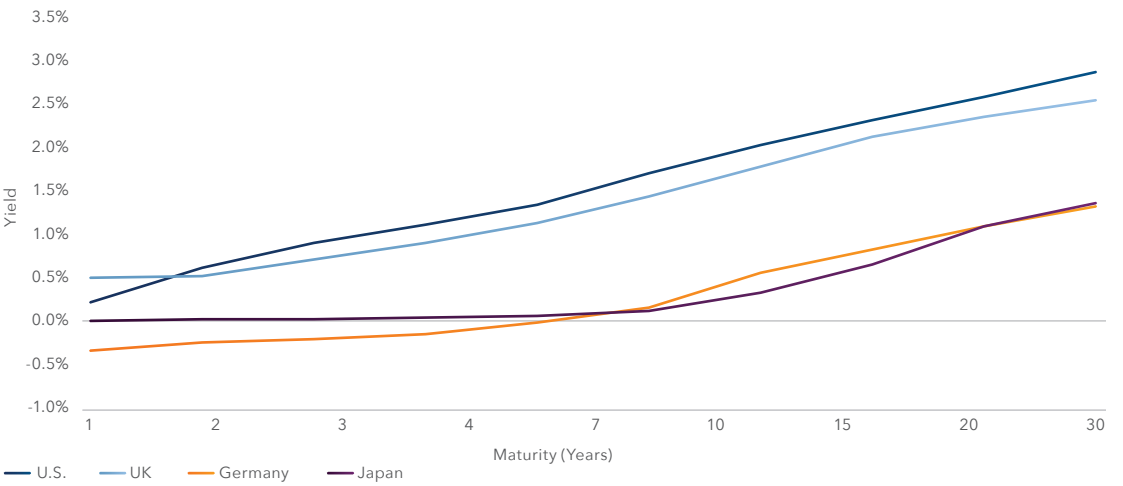
Growth in Japan and Europe will outpace the consensus, albeit not by much. This will be largely a result of depreciating currencies improving their competitive position and not of any macroeconomic improvements.

Chart 21: Annualized Rate of Return
By Country/Region



Source: Bloomberg (September 2015). India and China time series begin 12/31/1990.

Chart 22: Yield Curves
By Tenor



Source: Bloomberg (October 2015)

Why are we so confident that the prospect for recession in most economies is ZERO?

Our confidence comes in part from the yield curve chart, which we've referenced on countless occasions and which shows us a positive trend in all major economies (Chart 22). Until that inverts, we remain confident that there's no recession looming.

It's important to note that the lack of an impending recession does not mean we presume stock markets will rise forever. Our core view today is that:

» Interest rates will remain quite low.

» Deflationary pressures will be the dominant theme the world over, putting a premium on any growth that can occur in the absence of price increases.

» Commodities are largely dead money with the one possible exception of the agricultural sector, which might experience periodic spikes due to weather extremes (versus fundamental supply/demand shifts).

» Stock markets are fully valued in a low-growth world. We expect to see more volatility and flat to tepid stock market gains around the globe.

Prospects for downturn and recession in most economies?

02

THE PRIVATE EQUITY MARKET

"If Jerry McGuire were in business today, he'd be working in private equity and shouting, *Show me the money!*"

We've categorized the factors impacting private equity as positive, neutral and negative.

Moving on from our macro outlook, let's shift the focus to the private equity market. Similarly to what we've done in prior overviews, we have categorized various factors impacting the private equity landscape as positive, negative and neutral. As you might expect in an environment of low rates, high liquidity, robust valuations and solid returns, the data is mixed. We'll start by viewing the markets from the limited partner perspective.

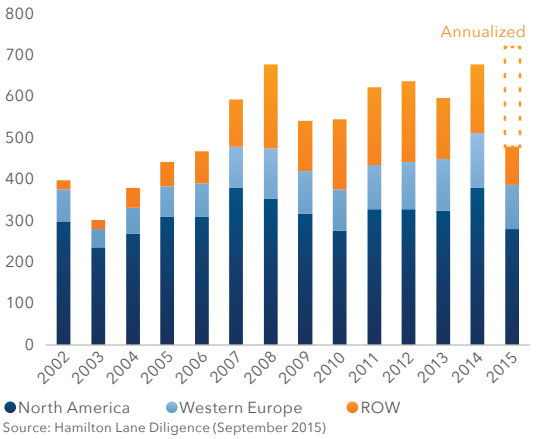
THE LIMITED PARTNER PERSPECTIVE

For limited partners, many of the indicators are positive, particularly as they relate to past and current market conditions.

PPMs Received:

Looking at the number of PPMs that Hamilton Lane receives, 2015 is on track to be another record year.

Chart 23: PPMs Received by Hamilton Lane



Source: Hamilton Lane Diligence (September 2015)

Ok, ok, quiet down out there; we can almost hear the collective cry that this is invariably a sign of a market top. In response, let us just say, "not so fast…."

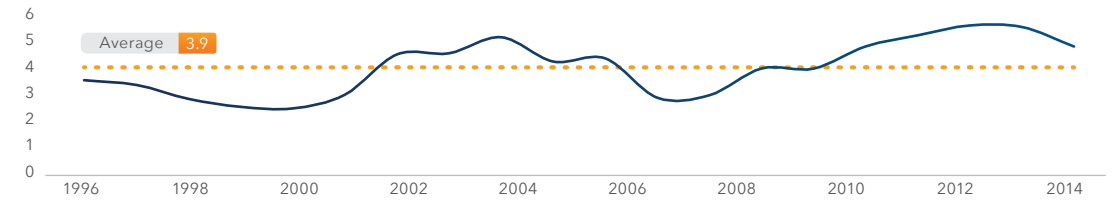
Sure, private equity may remain the most obvious industry in which asset managers earn outsized fees and mistakenly assume those fees are emblematic of their own genius and justification for new fundraising. (Well, the same could be said for hedge funds….) But, the fact that PE is so lucrative is only a partial driver of increased PPM activity.

The other drivers are indeed much more positive, reflecting the maturity of the asset class and the availability of a growing number of choices for investors. When the mutual fund industry grew from a few funds to thousands of funds, and when choices like ETFs and sector-focused funds were developed, it was almost universally viewed as positive for the industry and for investors. We feel the same way about the increased PPM level. Sure, there are terrible funds that have no business issuing a PPM, but those represent the minority. More options, particularly for smart investors, is a good thing.

Let's consider something else on this PPM issue. Our data shows a strong correlation between the last two PE market tops and the time it took a buyout shop to raise its next fund and do so with an increased fund size (Charts 24-25). It makes sense. If larger funds are getting raised faster, then it's probably an exuberant market.

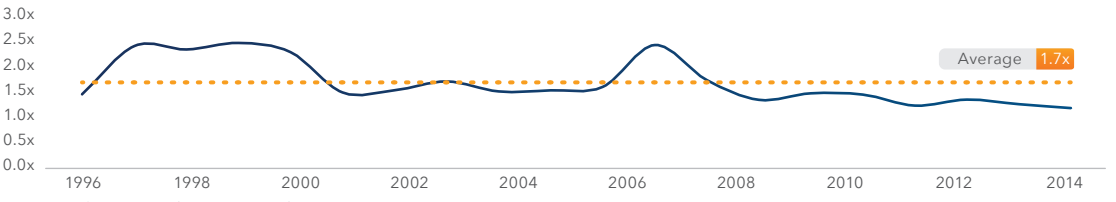
Yet, looking at Charts 24 and 25, both indicators are closer to market bottom levels than market top levels. There may be plenty of PPM activity, but, for the most part, general partners are still laboring to raise their funds and not raising much more capital in the process.

Chart 24: Buyout - Time to Next Fundraise
Median Time to Next Fund (Years)



Source: Hamilton Lane Fund Investment Database (August 2015)

Chart 25: Buyout - Fund Size Step-Up
Median Multiple of Previous Fund Size



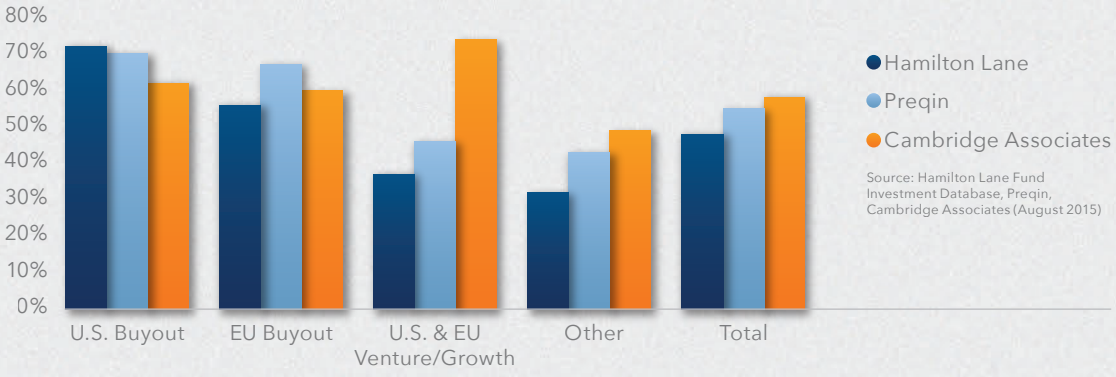
Source: Hamilton Lane Fund Investment Database (August 2015)

Hamilton Lane's Fund Data

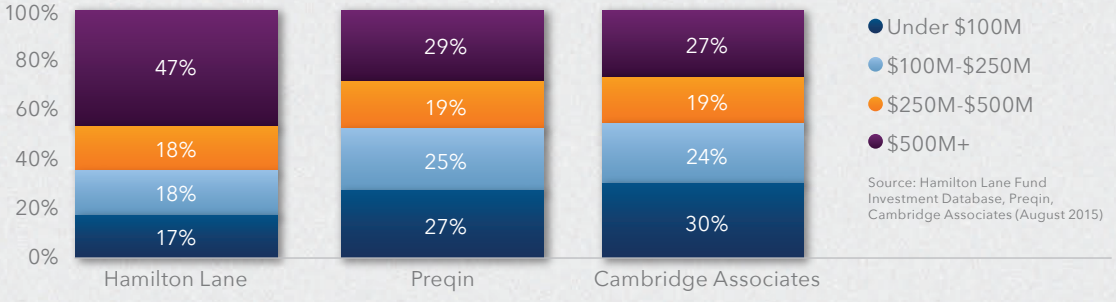
In an asset class where reliable data is scarce, the Hamilton Lane Fund Investment Database provides a unique advantage

- Daily cash flows
- Quarterly NAVs
- Represents 48% of PE capital raised
- Only 17% Hamilton Lane-backed funds

Private Equity Benchmark Coverage by Strategy
By Percentage of Capital Raised



Private Equity Benchmark Fund Size Composition
By Fund Count

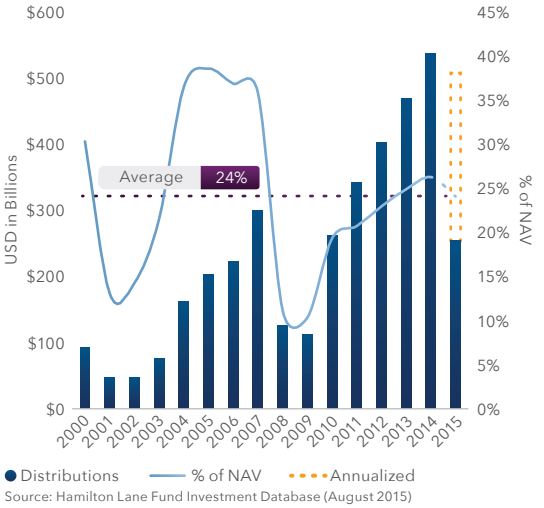


"Investors could complain that getting all this cash back isn't necessarily a good thing. *That's just rubbish.*"

Net Cash Flow:

On an absolute basis, there is no mistaking the fact that the amount of money distributed to limited partners reached record highs each of the last four years.

Chart 26: All PE Distributions



Source: Hamilton Lane Fund Investment Database (August 2015)

Based on our data, we estimate more than $500 billion of proceeds were returned to limited partners in 2014 alone. That's nearly double the previous record set in 2007 and follows what have been record high distribution years in 2011, 2012 and 2013. We imagine that if Jerry McGuire were in business today, he'd be working in PE and shouting, "Show me the money!"

While distribution pacing is trending slightly south of the historical average, it has been well above that average for the past two years and continues to be meaningful. The good news for most limited partners isn't only on the distribution side of the equation. Just take a look at the net cash flows for investors in Chart 27.

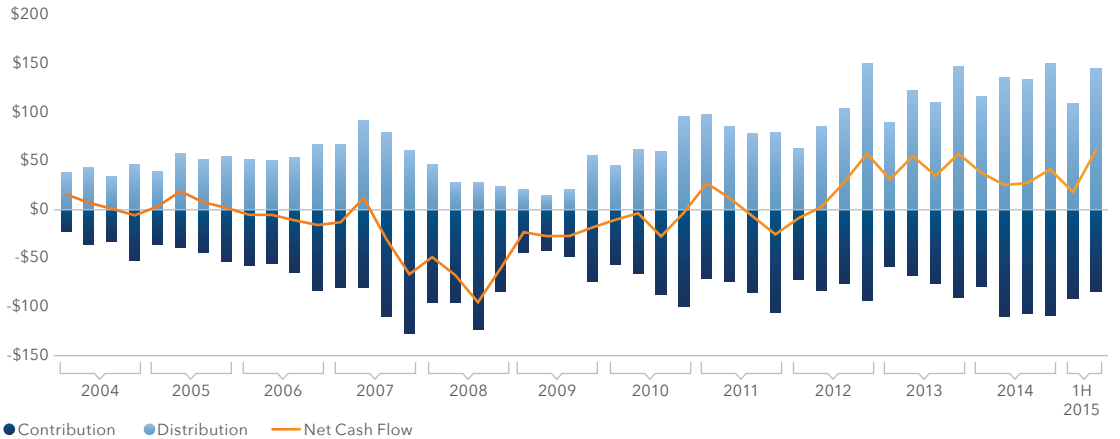
For most mature portfolios, private equity is a self-funding asset class and has been a net contributor to liquidity for the last four years. We understand that investors tend to focus on the negative. They could complain that getting all this cash back isn't necessarily a good thing given that it raises reinvestment risk in a frothier environment and presents various other maladies that only cash returned in torrents can bring.

That's just rubbish.

The vast majority of private equity investors need and want cash back – they want it to pay benefits and bills; they want it to reinvest in better, or more defined, or more random sets of managers; they want it to prove that this asset class does indeed run full cycle and return money as promised. Record distributions should be considered a uniformly positive occurrence.

What remains interesting to us is the source of those distributions. Almost 10% of money returned to investors in 2014 actually came from pre-2004 funds. That's rather reassuring to know that even many of the geriatric partnerships have plenty of performance left in them. As you might expect, the majority of distributions came from 2006-2008 funds. The financial crisis certainly delayed those distributions, but it didn't obliterate them as it did in some other asset classes. The geographical mix of the cash streams did shift a bit, with the U.S. coming down slightly from prior years and EU buyout increasing proportionally.

Chart 27: All PE Quarterly Contributions & Distributions
USD in Billions



Source: Hamilton Lane Fund Investment Database (August 2015). Excludes real estate, secondary and funds-of-funds strategies.

Returns (over a 10-year period):

Looking at Chart 28, one could make the argument that LPs should be 100% invested in private equity. (No, of course we don't really advocate that investment allocation. Investors should probably keep, say, 5% or so in cash or short-term bonds in case of emergencies.) The reality remains that private equity has proven itself a strong-performing asset class over a tumultuous 10-year period that witnessed both dramatic declines and rallies. For a truly balanced assessment of PE returns, however, we do have to discuss the one "BUT" in this analysis.

Chart 28: 10-Year Asset Class Risk Adjusted Performance as of 3/31/2015

Asset Class	Annualized Total Return	Annualized Volatility	Sharpe Ratio
Private Equity	12.6%	15.3%	0.61
Domestic Equities	8.4%	16.8%	0.31
International Equities	5.0%	19.9%	0.09
Emerging Market Equities	8.5%	24.6%	0.21
High Grade Bonds	6.7%	6.4%	0.53
High Yield Bonds	7.7%	12.4%	0.36
Hedge Funds	5.3%	7.7%	0.26
REITs	9.5%	25.8%	0.25
Commodities	-3.6%	20.5%	< 0

Indices used: Hamilton Lane All Private Equity with volatility de-smoothed; Russell 3000 Index; MSCI World ex US Index; MSCI Emerging Markets Index; Barclays Aggregate Bond Index; Credit Suisse High Yield Index; HFRI Composite Index; FTSE/NAREIT Equity REIT Index; Dow Jones-UBS Commodities Index. Geometric mean returns in USD (August 2015)

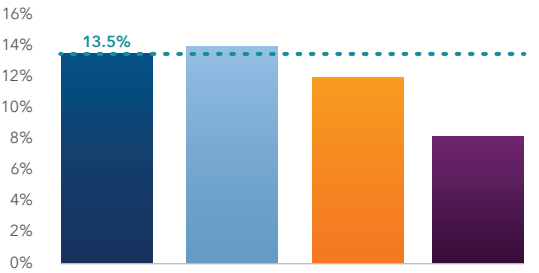
Returns (across 1-, 3-, and 5-year periods):

The 10-year numbers, as discussed, are impressive. However, shorter time horizons don't look nearly as strong (Chart 29). The one-, three- and five-year private equity returns fall short of at least one of the most common public market benchmarks over comparable periods. "Off with its head!" goes the PE haters' battle cry. Why invest in an asset class that can't even beat the public markets?

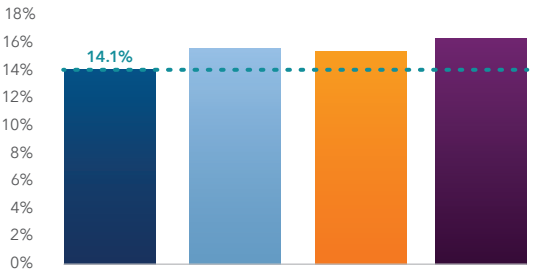
Good question. If that were always the case, even we would be hard pressed to argue you should. If you know (or believe) that the public indices are going to rise double digits each year, then don't go into private equity. That's an incredibly challenging bet to make, however. Had you wagered that over a 10-year time frame, you would have lost yourself a cool 400-600 basis points in annualized return. Even over shorter time periods, there are a number of public market benchmarks that private equity outperformed handily.

Chart 29: Local Currency Time-Weighted Returns

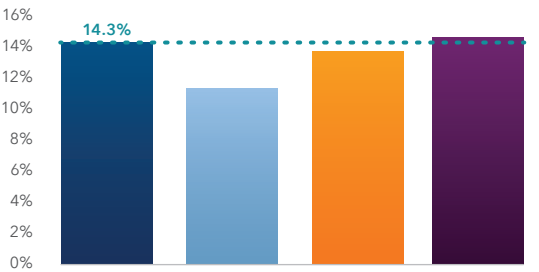
1-Year TWR



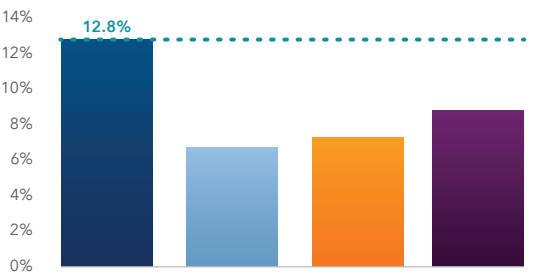
3-Year TWR



5-Year TWR



10-Year TWR



All PE MSCI World S&P 500 Russell 2000

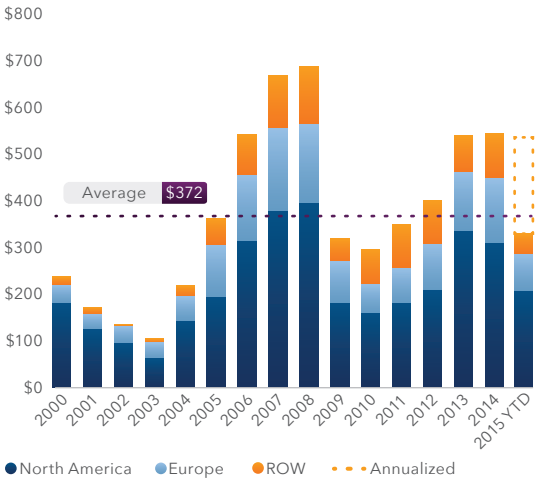
Source: Hamilton Lane Fund Investment Database; MSCI World Net TR Index; S&P 500 Net TR Index; Russell 2000 Net TR Index (August 2015). Returns through 3/31/15.

"Off with its head! goes the PE haters' battle cry."

Global Private Equity Fundraising:

Typically one of the better indicators for future returns, fundraising remains in neutral territory, much as it has for the last few years.

Chart 30: Global Private Equity Fundraising
USD in Billions



Source: Preqin (August 2015). Fundraising data includes real estate, secondary funds and funds-of-funds.

While 2015 fundraising figures might even see a decline from 2014 levels, the reduction won't be to any meaningful degree and certainly not enough to shift this indicator into positive territory. While the 2015 number will once again be north of longer-term average fundraising levels, we rank it neutral largely because for the third straight year it is not going up. If we were in an irrational market, we would expect to see a steep upward slope reminiscent of the 2004-2008 time frame. What's particularly interesting is that private equity fundraising remains flat at the same time as the industry is seeing new entrants and investors increasing their allocations to the asset class.

Which leads us to our next topic….

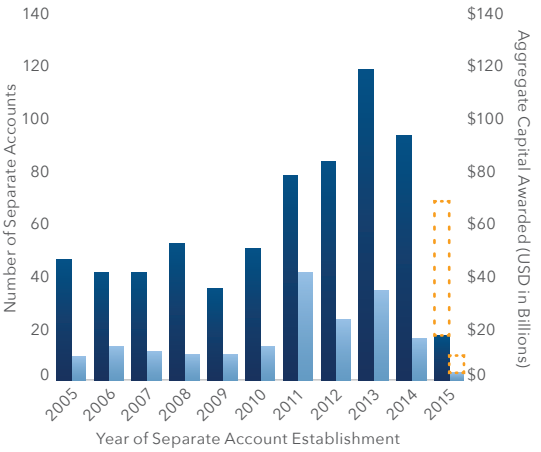
Shadow Fundraising:

We've covered this issue over the past few years. Simply put, the amount of capital being deployed in separate account and co-investment structures is large, increasing and virtually impossible to capture accurately.

Co-investment. One of the reasons we believe industry fundraising figures are flat is that they are not capturing the meaningful amount of capital being deployed in co-investment transactions. When limited partner A commits $100 million to general partner B and then adds another $25 million in co-investment capital for two or three specific deals, the $100 million is the only amount captured in the statistics. Our data indicates that almost $400 billion in co-investment capital has been deployed since 2007. At about $50 billion annually, this number actually strikes us as conservative and, given current fundraising volumes, we think co-investment adds an additional 10% to the totals.

Separate Accounts. Here we're faced with another area that's difficult to quantify. Preqin's estimate of an average of $30 billion annually in separate account capital being raised from 2011 through 2014 is most likely lower than actual numbers (Chart 31). Moreover, the decline shown in 2015 is deceptive; that is, some of these separate accounts are almost perpetual in nature and, therefore, recycling capital year after year. If this capital were allocated to traditional partnership structures, it would be counted as a new and separate commitment upon each renewal. As with co-investment capital, this is money that ought to be captured in the fundraising statistics somehow. If it were, fundraising would point to a far more bearish future private equity environment considering the amount of money continuing to flow into the asset class.

Chart 31: Separate Accounts Awarded



Source: Preqin (June 2015)

THE GENERAL PARTNER PERSPECTIVE

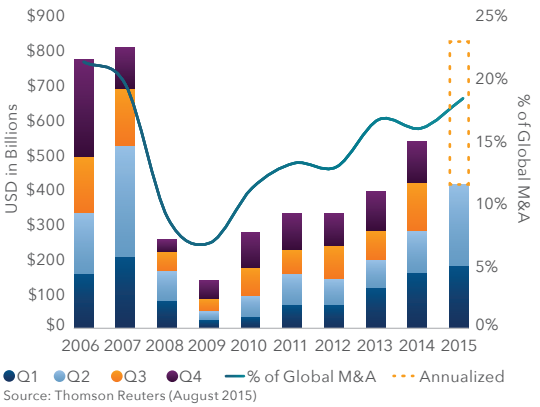
Let's turn now to the PE factors most impacting the general partners. Much of the company level data included in this section is derived from the Hamilton Lane Fund Investment Database. As we've shown, we believe our data is industry-leading in terms of its depth and scope. With that said, it's worth noting that our data – compared to the S&P LCD statistics, for instance – tends to skew more heavily toward the middle-market, resulting in slightly lower leverage multiples and purchase prices. The trends we discuss are relevant whatever the data source, but if you've been seeing higher figures being floated around, this is most likely the explanation.

Similar to the LP indicators, the data around the general partner's perspective is quite mixed. We'll start with the negative factors to get those out of the way.

Deal Volume:

In an environment of low interest rates and freely-flowing capital, it would make sense to expect robust deal volume. It's true that deal volume is up, but last year was nowhere near prior peak levels. For limited partners, that's a positive as it indicates discipline and restraint being exercised by the general partner community. (You might want to laminate that sentence given how infrequently "general partner" and "discipline" appear in the same sentence.) Actually, the same could have been said of general partners in 2012 and 2013; yet, in hindsight, GPs probably should have done every deal that walked in the door during that time period. If they had, they'd be exiting them profitably today at higher prices on a multiple expansion basis alone.

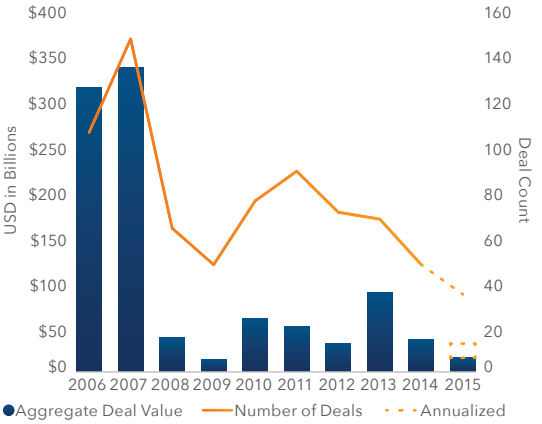
Chart 32: Global Private Equity Deal Volume



Source: Thomson Reuters (August 2015)

One reason deal volume remains somewhat temperate is the absence of public-to-private acquisitions occurring in private equity portfolios. Take a look at the decline in this number, particularly from the 2007 peak.

Chart 33: Number and Aggregate Value of Public-to-Private Acquisitions



Source: Preqin (September 2015)

Public-to-private deals are occurring only opportunistically today, representing merely 11% of aggregate value in 1H 2015. Compare this to 2007 when they represented 4% of buyout deals by count, but a whopping 49% of aggregate value, and that's a significant decrease from peak levels.

Bear with us as we don our Pollyanna hat for a minute to assess Chart 33. While it certainly tells us these types of deals have declined, we also glean two other important points:

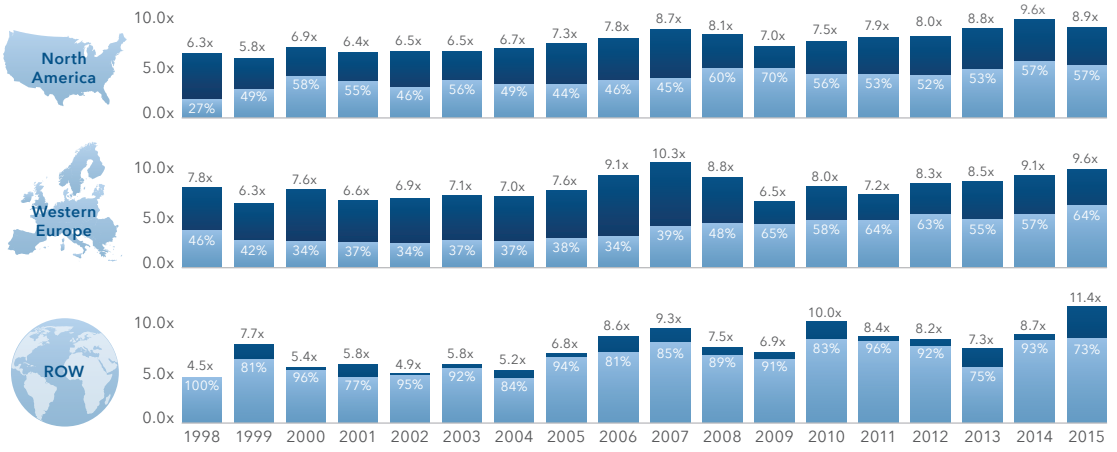
1. General partners are not overpaying to take companies private as they did in 2007, and
2. Private equity can still thrive in the absence of public-to-private deal flow.

If you had asked whether that could be the case in 2008, you would have been met with a resounding "Heck, no!"

Setting aside the implications of reduced public-to-private deal flow, the primary reason this type of deal volume remains low can probably be attributed to the single most negative indicator in today's private equity universe: purchase prices.

"You might want to laminate that given how infrequently 'general partner' and 'discipline' appear in the same sentence."

Chart 34: Purchase Prices
EV/EBITDA and % Equity, Median by Deal Year



Source: Hamilton Lane Fund Investment Database (August 2015). EBITDA positive companies.

Purchase Prices:

Everything is just too damn expensive, isn't it? If you take 2007 as the standard for what can be considered too expensive, then you are either uncomfortably close to that level or exceeding it, depending upon your geography. (On a multiples basis, we'd also note that our data, skewed as mentioned earlier to smaller deals, are a turn and one half lower than that of the S&P.) In fairness, the U.S. has been operating at that level for the last three years and has survived unscathed, but are we unwittingly playing a game of Russian roulette, waiting around for the lone bullet in the chamber to shoot our PE programs?

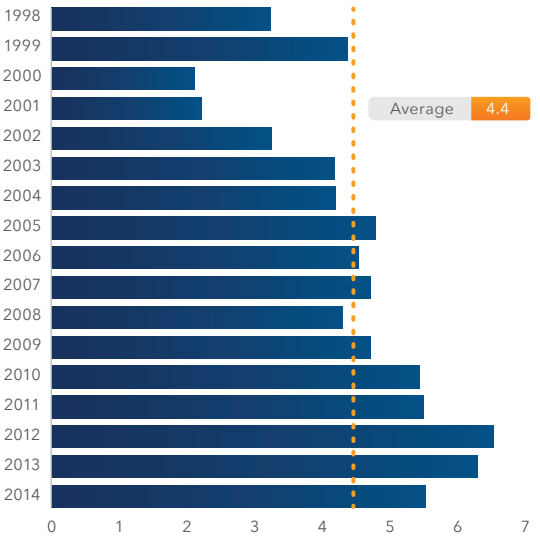
We'll offer some reasons later on why steep purchase prices might not be as bad as they seem, but the purists reading this will object to what they believe are pathetic rationalizations we make to keep investing. They will argue that high prices are not relative, and we are at dangerously high levels that have indicated lousy returns in the past.

Holding Periods:

It is surprising that in an environment of massive distributions, we would find holding periods or the age of general partners' portfolios to be an issue. And yet we do and they are.

Irrespective of the pace of capital being returned, the sheer volume of deals in general partner inventory has led to a steady increase in the median holding period for portfolio companies (Chart 35). Holding periods have been at record levels for more than six years. We've heard folks argue that this is actually all good because the values must be increasing at astonishing IRRs.

Chart 35: Median Holding Period
By Year of Exit

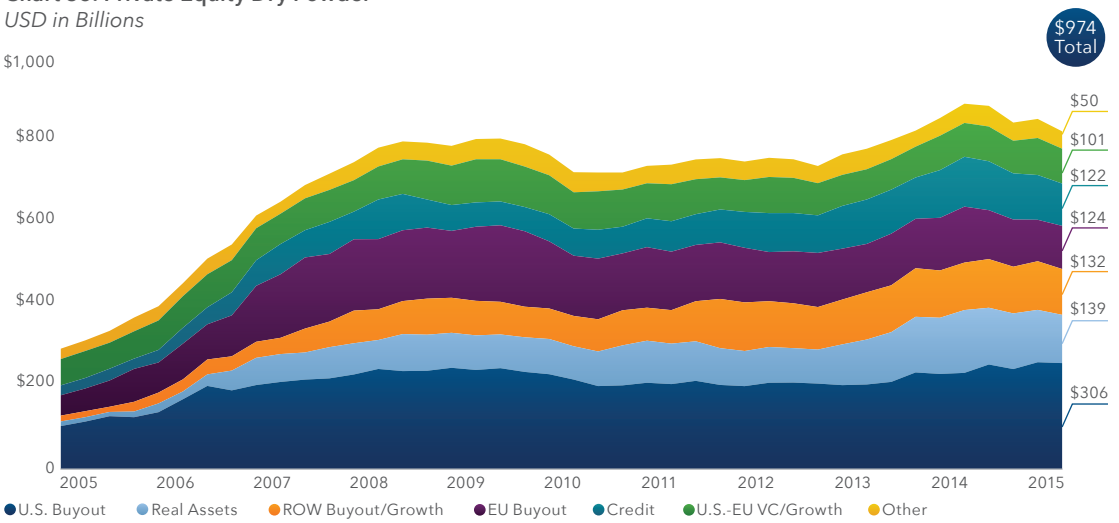


Source: Hamilton Lane Fund Investment Database (August 2015)

Unfortunately, that's simply not the case.

Instead, what is happening is that longer holds are going to drag down IRRs. That is an unhappy result for any investor, general partner and limited partner alike. Also worth considering is the median age of NAV held by limited partners. Whereas it stood at 3.8 years in 2008, it currently stands at 5.8 years; the longer-term average is 4.7 years. Again, the growing median age of NAV offers another indicator of longer duration in investor portfolios and raises the likely prospect of reduced IRRs to come.

Chart 36: Private Equity Dry Powder
USD in Billions



Source: Hamilton Lane Fund Investment Database (August 2015). Real assets includes infrastructure and natural resources. Excludes real estate, secondary and funds-of-funds strategies. Sum of strategy dry powder may not equal total dry powder due to rounding.

Capital Overhang:

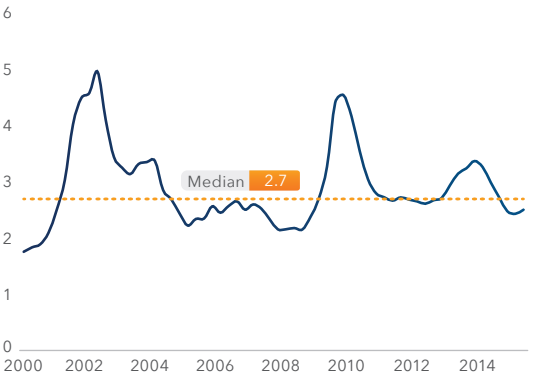
At Hamilton Lane, we have remained relatively sanguine when it comes to the capital overhang debate, particularly when it first presented itself as an issue in 2008.

Looking at the figures today, it's clear the capital overhang from 2008 never went away as private equity expanded further into credit, real assets and emerging markets (Chart 36). Yet, it recently has come down across all segments of alternatives. This isn't necessarily surprising given that fundraising has flattened and deal volume has increased. Nor is it surprising given the fact that neither co-investment capital nor most separate accounts are captured in the capital overhang figures.

Chart 37 has a very interesting data point. You might expect that periods with high capital overhang to be those that signal a peak in the private equity market. It's what we all believe, right? "Hey, there's too much capital out there and that can only lead to lower returns."

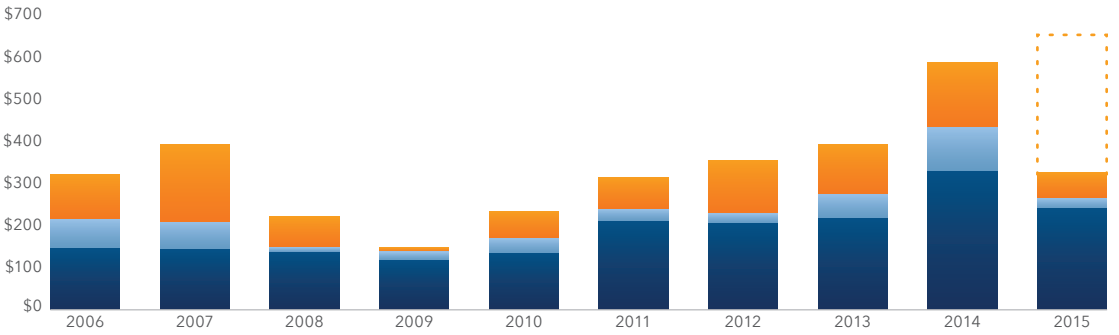
The truth is, we need to look at capital overhang in the context of deal flow. Chart 37 plots the ratio of capital overhang over new deal flow. We see spikes when deal flow decreases, such as in 2009-2010. Those spikes were short lived, and were great times to be investors because they represented market bottoms. Today's capital overhang doesn't look concerning because deal flow is keeping up and the ratio is about average. Admittedly, the same was true in 2007, which leads us to believe that capital overhang levels are not a reliable predictor of market tops.

Chart 37: Time to Deploy Capital Overhang
Years at LTM Pace



Source: Hamilton Lane Fund Investment Database (August 2015)

Chart 38: Private Equity Exits
USD in Billions



Source: Pitchbook (August 2015)

Exits:

It is not at all surprising that the general partner exit experience mirrors the limited partner distribution experience. As Chart 38 shows, exit activity has been massive.

Exits have occurred in all shapes and sizes, whether by acquisitions or IPOs. An increase in corporate M&A in particular provided significant exit opportunities for private equity in 2014. In short, the general partner community has taken advantage of strong markets and cheap financing to sell in every manner possible.

Financing Ratios and Multiples:

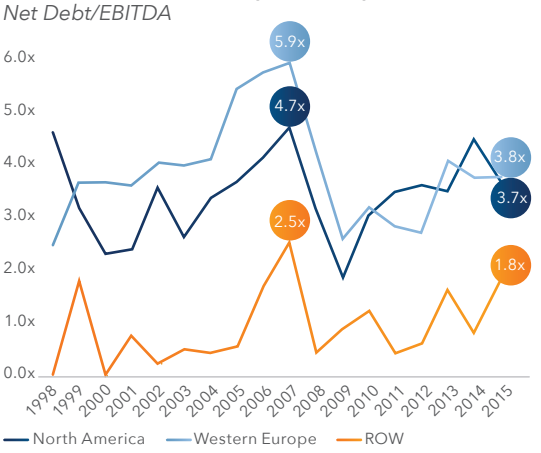
Let's close the discussion on general partner indicators with one of the most positive features of the current market: financing statistics.

Against a backdrop of low interest rates, high valuations and plentiful capital, it would be intuitive to expect leverage ratios to be at record levels; but the truth is, they aren't. In fact, leverage ratios remain well below those seen in prior peaks (Chart 39). (Hmm, maybe it was too soon to laminate our previous "general partner discipline" comment after all….) Undoubtedly, more moderate ratios can be at least partly attributed to regulatory pressure on banks to curb risky lending in the form of highly leveraged financing packages. Regardless of the reasons driving lower leverage ratios, the fact is that the transactions today are much safer than they were ten years ago.

Coverage ratios are also a positive signal.

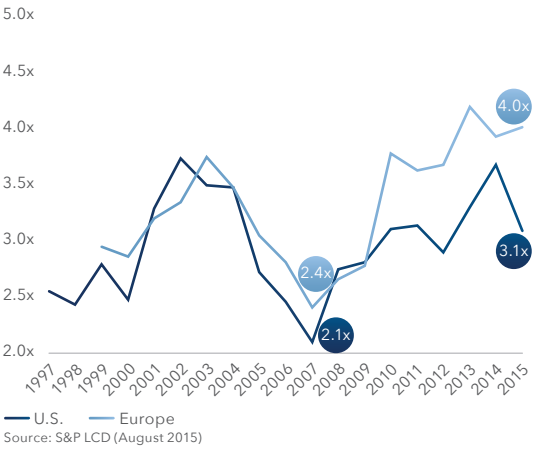
Given the low interest rate environment, which has allowed companies to service debt at historically reasonable levels, U.S. coverage ratios are in the mid-range of either market peaks or troughs. That is an exceptionally bullish sign in this market environment. An outlier can be found in European coverage ratios, which have trended to the highest level on record.

Chart 39: Leverage Multiples at Acquisition
Net Debt/EBITDA



Source: Hamilton Lane Fund Investment Database (August 2015).
EBITDA positive companies.

Chart 40: Coverage Ratios at Acquisition



Source: S&P LCD (August 2015)

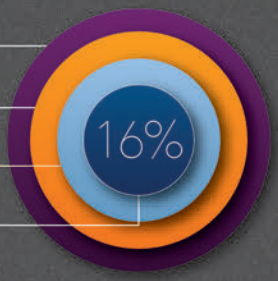
The general partner community has taken advantage of strong markets and cheap financing to sell in every possible manner.

Hamilton Lane Builds Portfolios Designed to Outperform

Concentrated

Over the last 18 months, Hamilton Lane received 1,137 PPMs, yet we invested in only 16% of those funds

1,137 PPMs Received
729 Meetings
182 Site Visits
185 Investments



* As of August 31, 2015

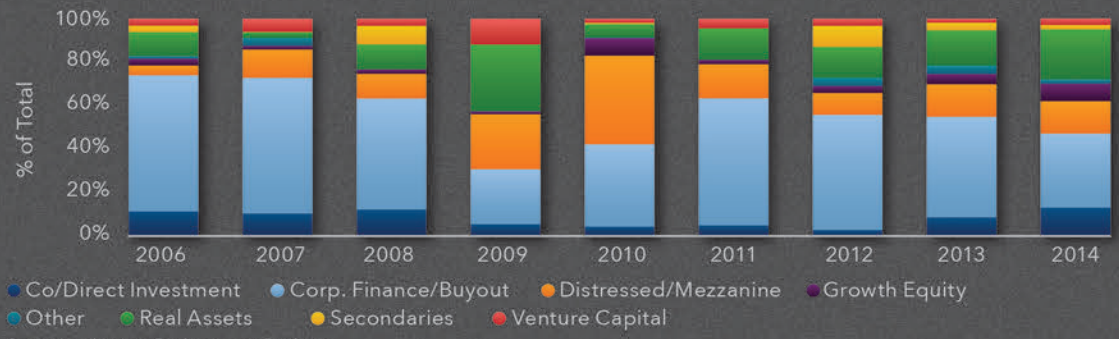
Consistent Deployment

Annual Commitments to Primary Funds[1]

[1] The 2011 to 2014 annual commitment amounts include all primary commitments for which Hamilton Lane retains a level of discretion for the investment decisions and Advisory client commitments to Hamilton Lane broadly recommended funds.
All amounts exclude commitments made by Hamilton Lane's secondary and co-investment commingled funds.

Tactical Allocations

Hamilton Lane Discretionary Commitments by Vintage Year/Strategy, % of Total



Source: Hamilton Lane Fund Investment Database

Diversified

Investments Across Multiple Sectors

Energy SMID Healthcare Debt

03

WHAT'S NEXT– AND WHERE TO INVEST?

Let's kick off the conversation about where we are in the private equity market cycle and where we should invest by asking our general partners.

GP DASHBOARD: WHAT DO OUR GENERAL PARTNERS THINK?

Last year, we introduced the GP Dashboard, and we're pleased to present it again this year. We polled 84 of the most well-known, top-performing and smartest general partners from around the world to answer questions about the markets in general and their portfolios in particular. We will be publishing the complete results separately, but have included many of the responses here, as they are relevant to our broader discussion of where the market is headed.

One of the more interesting shifts from the 2014 responses is what CEOs of underlying companies are expressing as their biggest worry. Last year, more than half were worried most about competition, whereas, this year, more than half are primarily worried about growth. This strikes us as a telling shift and one that is consistent with our view that growth potential represents the greatest challenge facing economies globally and private equity specifically.

How do GPs view the current investment environment? An impressive 76% responded that they are underwriting their deals to the same standards as last year, with only 2% responding that their underwriting is a lot lower. We find that encouraging and take it as a reflection of GP wariness about current valuation levels. Surprisingly, the number of anticipated exits over the next year remains the same and at very high levels, with more than 60% responding that they are pursuing an exit of anywhere from 10-30% of their portfolio over the next 12 months. Given the enormous number of exits to date, we expected that to be a little lower, but suppose it supports our earlier commentary that portfolios are still teeming with companies that need to be sold.

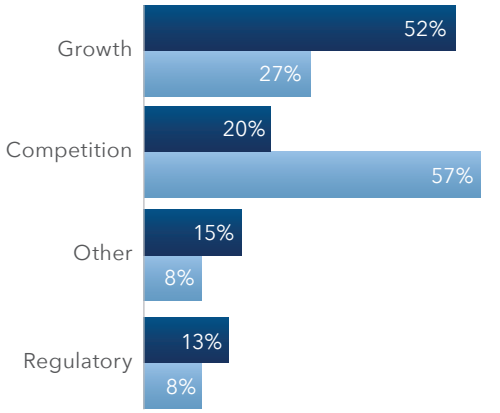
Take a look at what GPs are most worried about and what they're anticipating from PE returns in the current market environment. It's fascinating that geopolitical concerns are the single biggest issue facing GPs and troubling that this is the one exogenous factor that no investor can really plan for, let alone control. It's challenging to fashion an investment strategy around Armageddon.

Interestingly, GPs are slightly more optimistic about returns in this vintage year than they were last year. This change shouldn't be overstated, though, since fully 55% foresee this year's returns being no better than average. However, given the meaningful reduction in the number that see this as a below average year, we would rate GP sentiment as neutral to slightly optimistic regarding vintage year 2015/2016 returns.

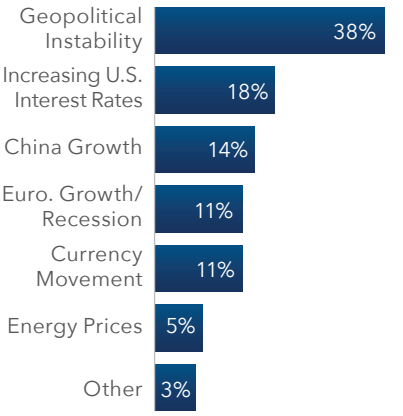
We intend to make the GP Dashboard an annual feature of our overview. Over time, the aggregate responses will allow us to develop a sense of whether this group of GPs is a good, bad or indifferent leading indicator of market movements.

Chart 41: GP Dashboard

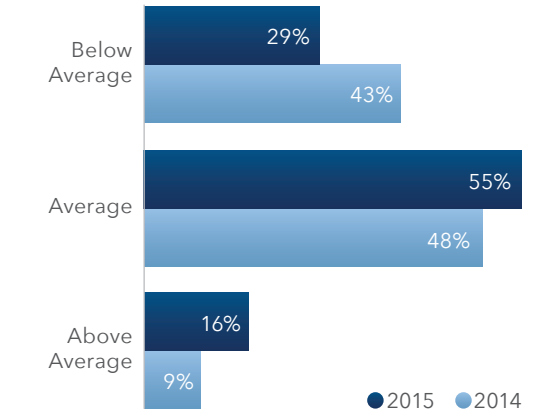
What are the biggest worries heard from CEOs?



What is the biggest risk/concern for the world macro economy in 2015/2016?



PE returns for the following vintage years will be:



PE DATA: WHERE DO INDICATORS TELL US WE ARE?

In case you don't know this about us, we're proud data junkies here at Hamilton Lane. We love burrowing through our enormous private equity database, which encompasses not only accurate but also real-time information, to identify historical patterns and find clues to future behavior.

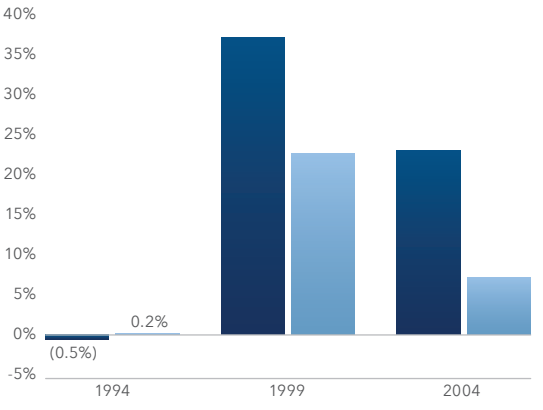
PE in a rising rate environment

One of the elephants in the room is the notion that investment returns in general, and for private equity in particular, are decimated by higher interest rates. Everyone expects the Fed will raise rates at some point, so it stands to reason that PE returns will suffer when that happens.

Fortunately, we have the data (which is so much better than anecdotal evidence, don't you think?) to look at what has happened historically to private equity returns following a Fed rate hike in order to determine if that line of thinking is correct. We'll use a different time machine for this trip. How about the one the boys in the "Big Bang Theory" borrowed from H.G. Wells?

Traveling back through our database, we find four prior instances when the Fed began raising rates. We looked at what happened to private equity returns one year after the first rate hike in the years 1988, 1994, 1999 and 2004. (We left out 1988 in Chart 42 since there weren't enough funds to make the numbers meaningful.)

Chart 42: U.S. Buyout Returns 1Y Following First Rate Hike
Annual Time-Weighted Return

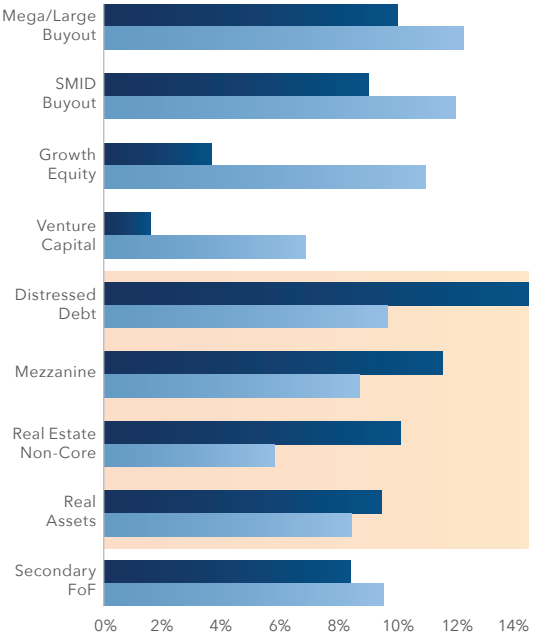


Source: Hamilton Lane Fund Investment Database (June 2015)

In 1994, U.S. Buyouts performed roughly the same as the public markets, although neither did very well. However, in 1999 and 2004, the evidence is clear that the right place to be was in private equity. Given that fact, history would suggest that investors should be leaning into PE when the Fed starts raising rates.

OK, you say; that's interesting, but in which sectors should I be focused on making new commitments when the Fed raises rates? Well, we can look to the Hamilton Lane Fund Investment Database once again to get some indications on that front.

Chart 43: U.S. Private Equity During Rate Hikes
Median Net IRR, Vintages 1984-2010



Source: Hamilton Lane Fund Investment Database (June 2015).
Funds actively investing includes all funds investing at least 30% of committed capital during the first year of rate hike period.

If we're being honest, the data surprised us. It turns out that investors should be leaning into credit strategies during rate hikes, while growth strategies are the most negatively impacted when rates increase (Chart 43). Is this because we experienced market downturns following rate hikes? Perhaps. Or, perhaps it's because, with rates rising, it follows that returns on interest rate-dependent strategies also rise. We'd be remiss if we didn't note that all alternatives have proven to perform well in a rising rate environment; we simply focused here on the ones that seemed to benefit the most.

Are we looking at PE data through the right lens?

Hopefully by now we've driven home one of our themes in this overview – that is, if we have the wrong or incomplete perspective, we run the risk of drawing incorrect conclusions. Consider that notion as it relates to the current private equity market, where the absolute data suggests that PE is expensive and the market is frothy.

Now, let's consider an alternative reality, perhaps this time joining Alice as she steps through the looking glass. From the other side of the mirror, our perception of the world might just be altered enough to allow us to draw strikingly different conclusions about today's market environment. If we adjusted our thinking to consider private equity as an asset class that exists within a much larger financial ecosystem, what might the PE data look like when adjusted for what has happened in the broader capital markets?

As you can readily see from Chart 44, it's difficult to compare time frames because the macroeconomic conditions were so different in each. Nevertheless, it's a fair exercise to ask what the private equity indicators would look like today if they were adjusted for the peaks reached by the public markets.

Do you recall our prior discussion in which we categorized valuations as a negative market indicator? Over the last four years, private equity multiples have increased 14% from 7.8x to 8.9x (Chart 45). During that same period, public multiples have increased 34%! Even if private equity simply kept pace with the public increase, its multiples would reach 10.5x, a full turn and one half higher than where they sit today.

So, based on this, here's our prediction: *we will not reach a private equity market top until valuation multiples move at least another full turn upward in this cycle.*

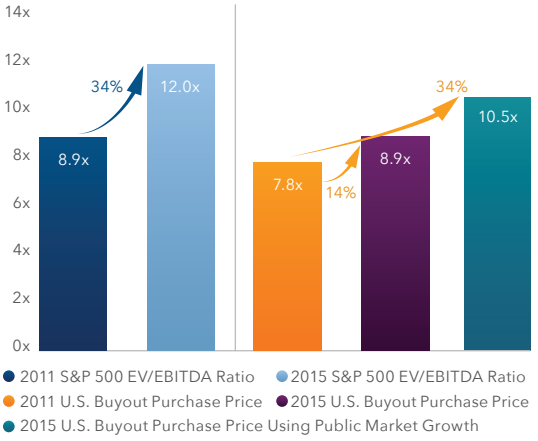
How about we take another look at capital overhang and adjust that metric as well? Especially compared to prior periods, the capital overhang seems like a staggeringly large number. Yet, when we adjust that number relative to the increase in size of the entire equity universe, we come out fairly close to average levels (Chart 46). We would argue that this adjusted perspective is actually the proper one. Private equity operates within the broader equity world and, as that world grows or shrinks, so too should private equity. It would make sense to consider most of these indicators – whether fundraising totals or PPMs issued, for example – in this adjusted context that takes into account the broader arena in which private equity transacts.

Chart 44: Market Indicators

	2Q 1990	4Q 2000	3Q 2007	Current
Federal Funds Rate	8.5%	6.2%	5.0%	0.1%
10-Year Treasury Yield	8.3%	6.0%	4.7%	2.1%
Inflation	4.8%	3.4%	2.4%	0.5%
GDP Growth YoY	2.5%	2.9%	2.3%	2.7%
Yield Curve	Flat	Inverted	Flat	Steep
Length of Bull Market	8 years	10 years	6 years	6 years
"Hot" Deal Type	Junk Bonds/ PIK Notes	Tech/ Telecom	Public to Private	None

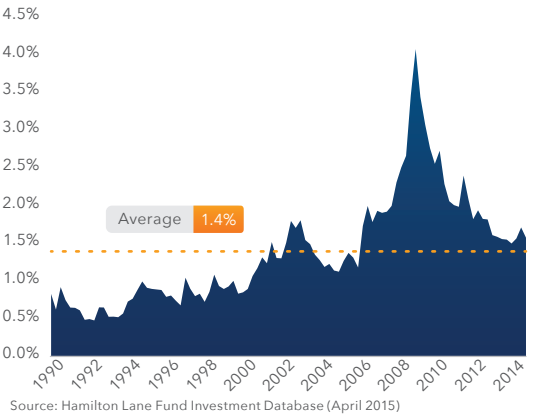
Source: Hamilton Lane, Bloomberg (September 2015)

Chart 45: Public vs. Private Valuation Growth
2011 Through 2Q 2015



Source: Hamilton Lane Fund Investment Database, Bloomberg (September 2015)

Chart 46: U.S. Buyout Capital Overhang % of S&P 500 Market Cap

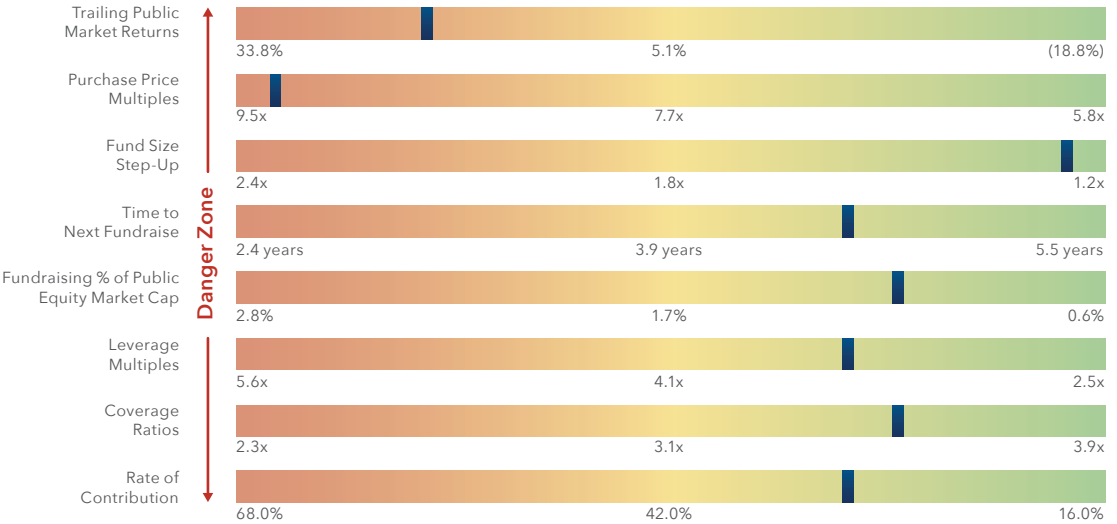


Source: Hamilton Lane Fund Investment Database (April 2015)

Hamilton Lane Sentiment Index

We have employed some version of a sentiment index for years. As in the past, the indicators remain decidedly mixed. One's view on where we are in the market cycle will depend on which indicators are weighted most heavily. The purchase price multiple is the most negative in an historical context, while many of the indicators that could be said to measure fear and greed (e.g., rate of contribution, time to fundraise) simply don't indicate that the market has wandered into that dreaded greed territory.

Chart 47: Hamilton Lane Sentiment Index

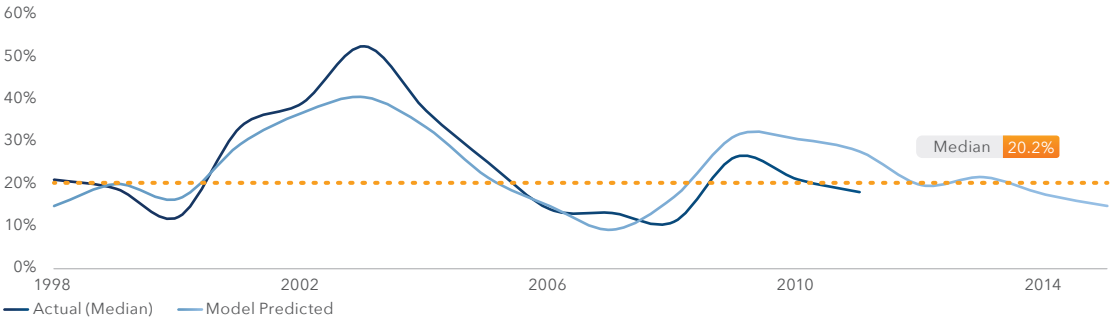


Source: Hamilton Lane Fund Investment Database, Bloomberg, S&P (September 2015)

The HL Predictive Indicator

Next let's look at an analysis by the HL Predictive Indicator, which is compiled using our database on *individual* company data, not at the fund level. We use various indicators, including correlation of deal returns to purchase price multiples, debt multiples, coverage ratios and trailing public market returns to predict gross returns for individual deals done in the current market. So, what is the model telling us today?

Chart 48: Deal Vintage Year IRR vs. Predictive Model
Provides Indication of Current Cycle's Returns Relative to Average Buyout Deal Returns



Source: Hamilton Lane Fund Investment Database (September 2015)

Well, that's a bummer. Our own model is not only showing that there hasn't been much improvement from last year's levels, but also is projecting that the current cycle's returns will be below average. In short, the HL Predictive Indicator is flashing caution in an environment of high public market and private equity valuations. We have come to respect this model, and it is largely why we have been investing far more selectively today than we would in an environment of lower valuations.

WHERE TO INVEST: FUND STRATEGIES

And now we come to the section of this overview where we present to our faithful readers what, to us, has become blindingly obvious.

But why, you ask, would we do that other than to fill space? Mainly because, in private equity, the blindingly obvious is too often ignored in favor of the anecdotal evidence, or the specific deal example, or occasionally even the pursuit of what's "fun to do" rather than what's right to do.

For those familiar with our prior overviews, you'll recognize Chart 49. The big takeaway here is that certain parts of the asset class perform better than others every year. Pretty darn obvious, right? Yet, it never ceases to amaze us how often we still hear claims that active portfolio management doesn't work in private equity. It absolutely does; the trouble is that no one wants to take the risk of doing it wrong. (That last statement is true with the one notable exception of large buyout, where it seems the vast majority of investors believe returns can't be good and so opt instead to invest in other areas. Yet, if you follow the returns of the pale blue boxes, chances are they performed better than any portfolio created by investors that was completely devoid of large buyout exposure.)

At Hamilton Lane, our view is that we are paid to make active portfolio management decisions. So should you be.

Chart 49: Pooled Returns by Vintage Year

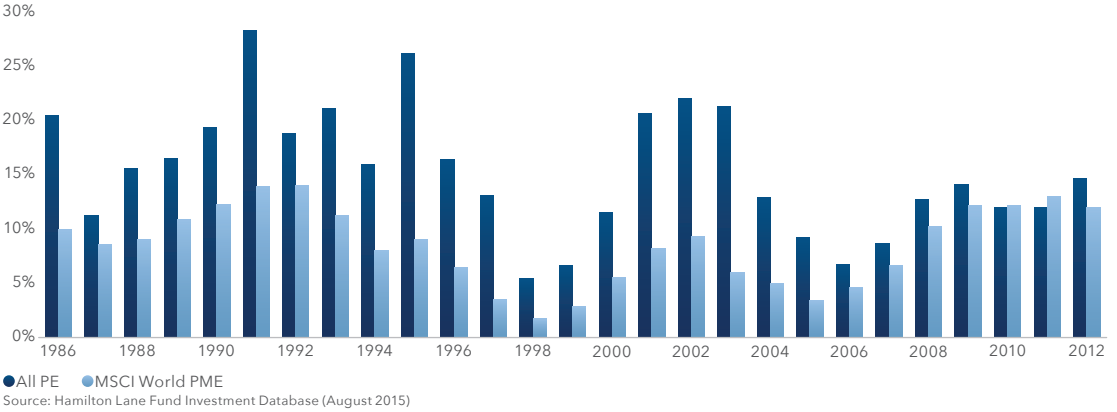
2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
22.2%	35.9%	32.8%	22.5%	20.5%	21.3%	10.6%	18.2%	26.3%	24.4%	28.3%	37.7%	26.6%
19.6%	26.3%	20.6%	18.0%	16.0%	17.7%	8.6%	17.1%	20.7%	20.3%	25.8%	32.7%	25.3%
19.4%	22.3%	19.6%	16.2%	11.3%	11.8%	8.2%	15.5%	16.1%	18.7%	25.8%	19.3%	18.9%
13.5%	21.6%	12.4%	12.6%	11.0%	9.6%	8.1%	12.9%	15.1%	15.7%	23.7%	18.4%	18.2%
13.3%	21.4%	3.4%	4.9%	10.3%	8.8%	7.8%	11.1%	15.0%	13.8%	21.0%	16.0%	17.2%
11.2%	19.3%	-2.8%		9.3%	7.9%	6.9%	10.6%	12.2%	12.9%	13.7%	14.2%	17.2%
9.9%	8.9%			7.6%	7.6%	5.5%	10.4%	11.8%	12.0%	13.6%	11.2%	16.4%
9.8%	4.9%			1.1%	6.8%	4.5%	10.3%	10.3%	10.9%	11.1%	10.4%	13.5%
2.6%	-0.5%				6.5%	4.4%	9.8%	10.0%	10.2%	10.8%	10.3%	11.3%
1.1%					5.5%	2.8%	6.8%	8.5%	-11.1%	10.2%	7.1%	10.3%
-2.5%					-2.1%	1.4%	6.5%	8.0%		7.0%	6.1%	8.3%
						1.2%	4.7%	6.0%		6.5%	1.5%	7.7%
							4.1%	4.6%				5.3%
							1.3%					-1.0%

U.S. SMID, U.S. Large/Mega, EU Buyout, Growth Equity, Seed/Early VC, Multi-Stage VC, Infrastructure, Natural Resources, ROW, Distressed Debt, Mezzanine, Late Stage VC, EU Buyout, Real Estate, Secondary FoF

Source: Hamilton Lane Fund Investment Database (August 2015)

"In private equity, the blindingly obvious is too often ignored in favor of anecdotal evidence."

Chart 50: Private Equity Net IRR vs. PME
By Vintage Year



Source: Hamilton Lane Fund Investment Database (August 2015)

The punchline of Chart 50 makes for yet another obvious statement: private equity outperforms the public markets virtually every year. Dating back to 1986, PE is 24 for 26; that's 92% of the time. Moreover, we predict that, soon, 2010 and 2011 vintages will outperform the public markets as well, and that number will increase to 100%. Even without any additional information, if you were told there was an asset class that outperformed the public markets more than 92% of the time, would you spend so much time agonizing over whether or not you should be in it?

Let's turn our attention to a chart that certainly drives fund selection (Chart 51).

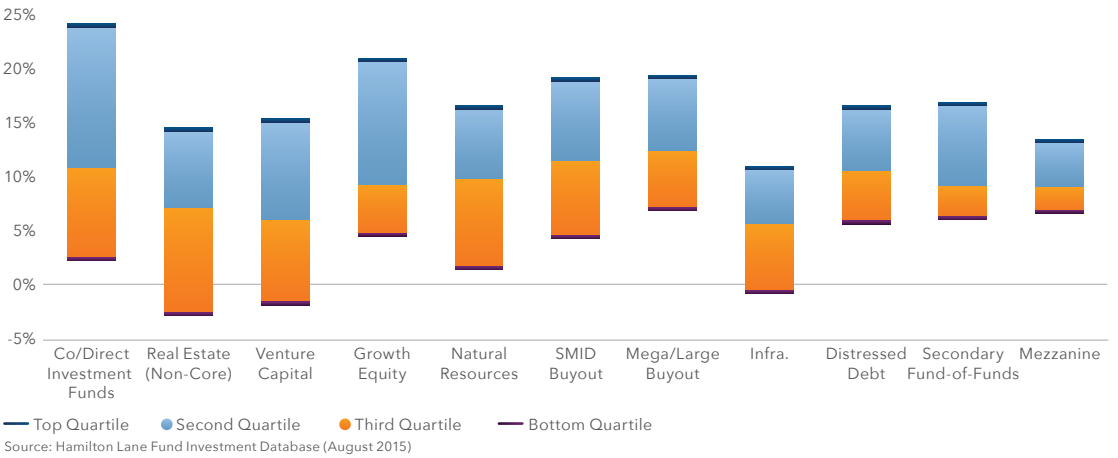
By now, most of us are well aware that alternatives exhibit the highest dispersion of returns of any asset class, but it is interesting to peel back the layers and examine the dispersion among various PE strategies.

There are some things in Chart 51 that might not be so obvious. It certainly makes you wonder why there's such fascination with infrastructure….

We view this chart as important mainly because it forces us to consider risk, an oft-forgotten word in private equity investing.

Just take a look at co-investments. We have been actively co-investing for a long time, largely because co-investments generate the highest potential returns, and we think we do them pretty well. With that said, as the chart plainly shows, they also have the highest risk profile of any PE strategy as measured by the wide dispersion of returns. We worry quite a bit that the current rush by limited partners into co-investing – when they may or may not have the resources, expertise and discipline to do it well – is missing that risk consideration completely.

Chart 51: Spread of Returns by Strategy
Vintages 1979-2010, Ordered by Top to Bottom Quartile Spread



Source: Hamilton Lane Fund Investment Database (August 2015)

WHERE TO INVEST: SECTOR STRATEGIES

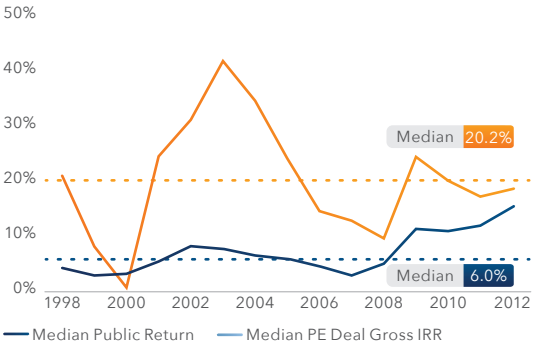
For some time now, we've been discussing the growing ability of investors to tailor-build private equity portfolios. The explosion of strategies, and separate accounts, and investing styles makes this customization possible. The jury is still out on whether this will be a good thing. In our view, the luxury of choice in an illiquid asset class will likely morph into an abundance of poor investment selections for many investors. The proliferation of choice in this asset class, however, is yet another genie that is never going back into the bottle and, simply will mean that some investors will outperform because they are better at choosing.

With such increased selection, sector- and company-level decision making becomes even more important. The Hamilton Lane Fund Investment Database gives us unparalleled information and insights into company-level performance. This year, we are sharing some of that data analysis for the first time and introducing what we've dubbed the Periodic Table of Gross Portfolio Company Performance (Chart 52).

As the volume of sector-focused funds and co-investment programs expands, investors need to consider these numbers. What sector will be favored? What areas should be de-emphasized? As Chart 52 shows, you didn't want to be in information technology from 1999-2001 or telecom in 2000, 2001 or 2007. What is particularly fascinating about this table is how rarely money is lost in any industry by private equity investors. That insight leads us to what we believe to be the most stunning chart in this entire book.

Chart 53: Gross PE Deal Performance vs. Public Markets

By Deal Year



Source: Hamilton Lane Fund Investment Database (August 2015).
Public return uses MSCI World TR Index and assumes single purchase and exit event.

Chart 53 gives us both the sound and the fury around private equity. (We're being rather liberal with our literary reference; while in Macbeth, the sound and the fury signified nothing, we're suggesting it means quite the opposite here. Forgive us, Shakespeare.) The sound: this asset class is extraordinary. *Over an almost 20-year period, private equity has outperformed the public markets by an average of 1,400 basis points across multiple market cycles.* This is just extraordinary performance and should put an end to the arguments advanced by any cynics or academics who contend that general partners are merely lucky, or just use leverage to boost returns, or don't add value, or whatever other nonsense comes to mind.

Chart 52: Periodic Table of Gross Portfolio Company Performance

1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
93.8%	33.0%	21.5%	60.3%	69.2%	108.9%	59.2%	80.0%	28.5%	30.4%	26.9%	46.0%	27.0%	63.7%	43.7%
29.8%	22.0%	16.7%	36.6%	41.1%	106.0%	54.1%	36.1%	28.2%	20.0%	16.4%	42.0%	25.4%	23.9%	39.9%
28.9%	12.7%	15.2%	32.8%	32.6%	61.5%	40.0%	32.4%	21.2%	17.1%	15.5%	32.7%	23.1%	23.0%	28.9%
21.0%	11.2%	10.9%	29.4%	31.6%	47.7%	36.4%	31.5%	20.8%	9.2%	14.5%	27.0%	22.3%	18.0%	21.6%
12.0%	10.7%	10.2%	28.2%	26.0%	36.7%	30.1%	28.2%	18.1%	7.6%	10.7%	23.2%	21.1%	18.0%	18.8%
10.1%	3.5%	7.6%	24.6%	22.2%	22.7%	23.0%	25.5%	14.3%	6.5%	7.0%	22.4%	20.2%	17.0%	18.2%
	0.0%	0.1%	20.2%	21.8%	19.7%	19.1%	24.5%	12.1%	5.0%	5.8%	13.5%	18.9%	13.0%	14.8%
		-19.9%	-8.5%	20.9%	12.8%	16.5%	17.4%	12.0%	4.0%	3.1%	-4.3%	15.5%	2.6%	0.1%
			-10.6%			11.9%	15.8%	10.0%	-19.0%	-12.2%		15.3%		

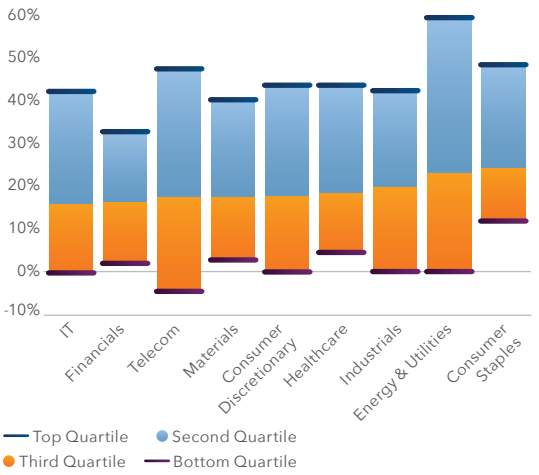
Consumer Discretionary IT Industrials Healthcare Telcom Financials Energy & Utilities Materials Consumer Staples

Source: Hamilton Lane Fund Investment Database (August 2015)

Now, the fury: the drag from the fees and costs of private equity reduce the net returns substantially. It's almost unbelievable that an asset class, whose gross returns so far outpace those of which other asset classes can only dream, would simultaneously present such a heavy cost load. In this reality, private equity is reduced to defending its net return and will continue to do so until the cost structure shifts. Perhaps this is why so many investors are currently flocking to co-investments. Either way, there is no doubt that the huge friction cost associated with private equity has encrusted this asset class like barnacles and has repeatedly called into question its validity in one's portfolio.

Let's look more closely at particular company performance.

Chart 54: Gross Performance Quartiles by Sector
Sorted by Median Return

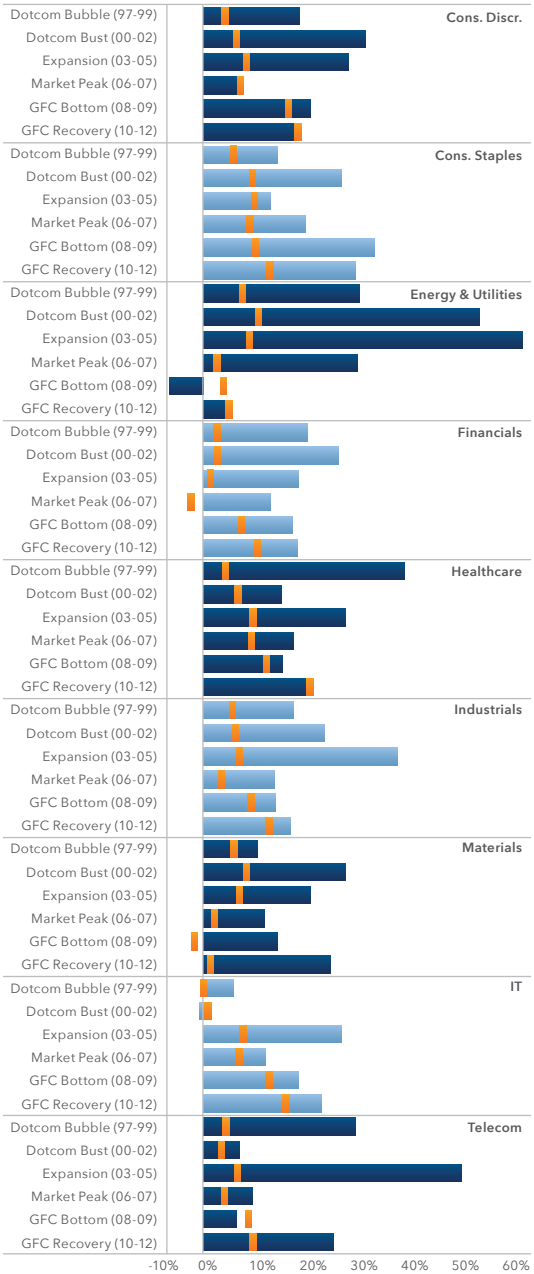


Source: Hamilton Lane Fund Investment Database (August 2015)

Chart 54 clearly highlights why PE's historical focus on consumer goods, healthcare and industrials is justified; the risk/return profile of each is the better among the choices. Drilling down into more specific detail offers a wonderful chart (Chart 55). Amazing, isn't it? Using gross numbers, we see the consistent pattern of PE outperformance across market cycles, time periods and sectors. In fact, some sectors, such as industrials, energy & utilities and financials, outperform the public indices by consistently wide margins.

We sometimes hear the refrain from limited partners that private equity firms should mirror the indices in order to improve performance – especially if that performance is being measured against a public equity benchmark. We'd counter that argument by saying that sector selection is one of the primary reasons PE outperforms the public markets. Compared to the S&P 500 index, private equity has generally been far more exposed to industrials and the consumer sector and, conversely, less exposed to financials. This has helped in any benchmark comparison. Limited partners, particularly those looking to build co-investment programs, ought to pay far more attention to sector risk and return metrics if they hope to come out as winners.

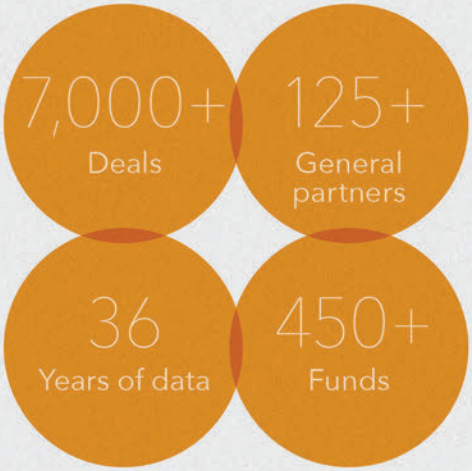
Chart 55: Gross Portfolio Company Performance vs. Sector Indices
By Sector and Deal Era, Gross IRR vs. MSCI Sector TR Index



Source: Hamilton Lane Fund Investment Database (August 2015).
MSCI Sector TR Index replaced by MSCI World TR Index where unavailable.

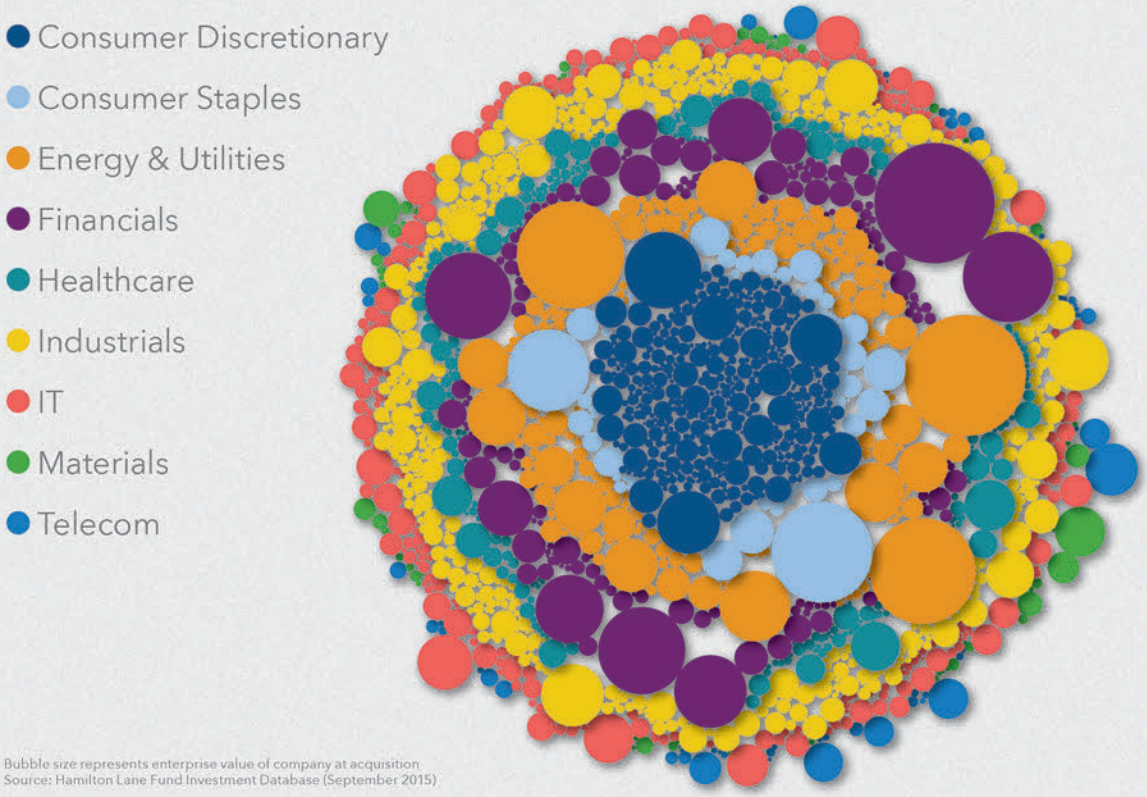
Hamilton Lane's Company-Level Data

In an asset class where reliable data is scarce, Hamilton Lane's proprietary database provides a unique advantage



- Performance & valuations
- Pricing & leverage
- Detailed financials
- Sector & geography

Portfolio Company Data Sample Set by Sector



Bubble size represents enterprise value of company at acquisition
Source: Hamilton Lane Fund Investment Database (September 2015)

HOW TO INVEST: PORTFOLIO CONSTRUCTION

So far in this overview, we've attempted to determine where we are in the market cycle, and we took a closer look at fund and sector data. Next, let's get to the heart of what drives private equity outperformance: portfolio construction.

Part 1: Artificial Construction

Working in private equity, you develop a thick skin. It's probably a good thing too, given that we're sometimes asked: what the heck do we need Hamilton Lane for? What can you or any other manager do for me that I can't do for myself? In fact, what do we need anyone for?

Ok, these are all fair questions. While we would be sad for you to get rid of us, let's walk through a few scenarios to get a sense of just what it is you'd be in for were you to go it alone and implement strategies that either mimic private equity performance or pursue black box portfolio construction approaches that don't need human intervention.

Just Lever the Stuff

Since private equity is nothing but levered public equity (what, you didn't know that?), we'll first just invest in a leveraged S&P ETF as a way of mimicking PE returns (Chart 56).

How did that work out? Not very well, we're sorry to report. That strategy experienced more than 300 basis points annual underperformance, along with more than three times the volatility. The levered ETF failed to even beat the S&P, mainly due to too much downside being captured. This exercise suggests that attempts to mimic PE by simply leveraging public markets carry additional risk and fail over the long term.

But don't give up so easily. Not before we introduce you to the Bot Army.

Algorithm Bots

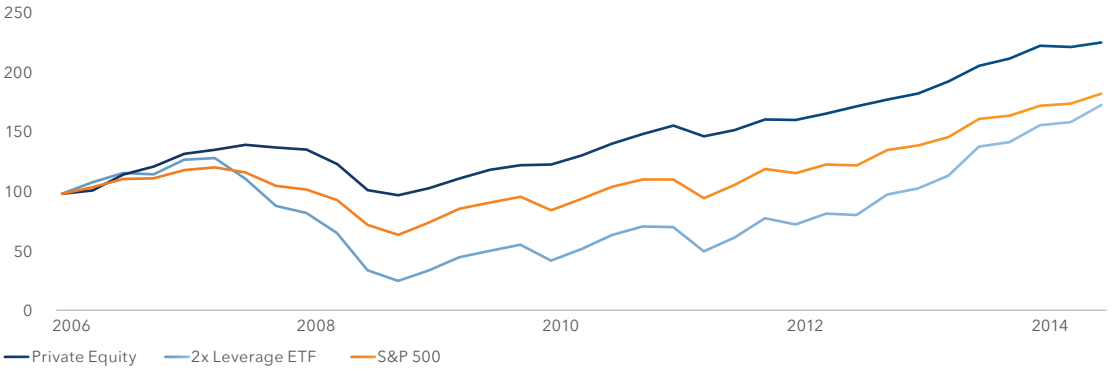
Using various criteria, we ran a number of simulations investing $100 million annually from 2000 to 2014 in which each "investor bot" selected all funds that meet its particular criteria. We also included Hamilton Lane in the analysis, using our actual investments for that period (please refer to the 500 pages of performance disclosures included at the end of this overview).

Chart 57: Fund Selection Algorithms

"Investor"	Selection Criteria
Optimized	Fund is 1 to 3 times the size of previous fund, starts investing 3 to 5 years after the previous fund, and previous fund is top or second quartile
Bottom Avoider	Previous fund is not in the bottom quartile
Performance Chaser	Previous fund is in the top quartile
Emerging Managers	First or second time funds
Market	All funds available
Hamilton Lane	Funds in discretionary portfolios

Don't cheat here. Which "investor" do you think won? Who had the best performance? You might have picked Hamilton Lane on the theory that only a fool would present performance figures in which they didn't come out on top. Alas, we didn't win; but we did come in second, managing to outperform each of the strategies that we typically see investors trying to put into practice.

Chart 56: Private Equity vs. Leveraged Equity Growth
Base 100



Source: Hamilton Lane Fund Investment Database, Bloomberg (July 2015). 2x Leverage ETF = ProShares Ultra S&P 500.

Emerging manager junkies, relax. We realize no amount of hard data will dispel the myth that investing in first-time funds is the way to build performance.

The results are pretty interesting, aren't they? It turns out that only two of the bots outperform the market to any meaningful degree and one, the emerging manager bot, not only underperforms the most, but does so with the highest risk (Chart 58-59). (Emerging manager junkies, relax. We realize no amount of hard data will dispel the myth that investing in first-time funds is the way to build outperformance.) What struck us as particularly interesting is that portfolios constructed around one core rule – bottom avoiding or performance chasing – actually led to some impressive results.

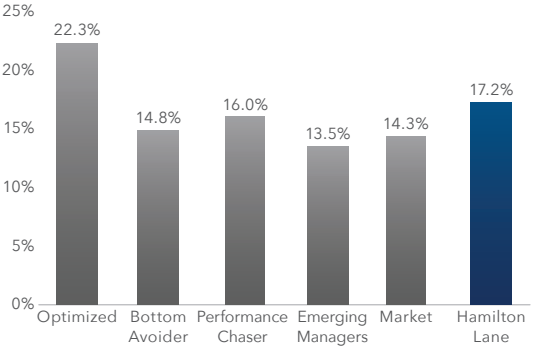
So, why was it that the Optimized Bot (we'll call it "Optimo" here) was able to outperform every other strategy?

Optimo had the advantage of its creator form-fitting the simulation around the data. (That is always the danger of simulations.) More importantly, Optimo lives in a perfect world that allows it to move into funds without having to consider capacity constraints and without concern that a GP might deny Optimo entry into Fund IV after Optimo rejected Fund III. So, why did we include Optimo? Because Optimo can help us pinpoint what it is we should be doing differently or better. We use Optimo to help us move our performance numbers closer to Optimo. So should you.

Part 2: The Real World

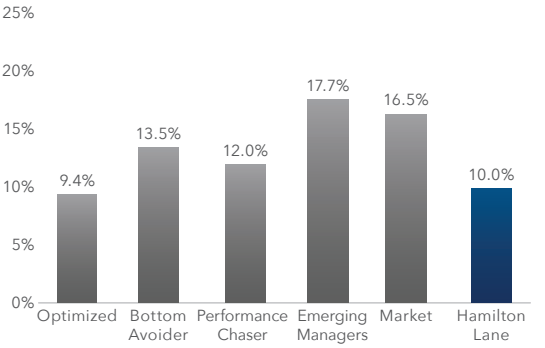
Let's move on to constructing private equity portfolios in as close to an ideal way as possible in the current market environment. We will once again borrow from different strategies that characterize various market participants (Chart 60).

Chart 58: Portfolio IRRs
Investing $100M/Year Since Vintage Year 2000



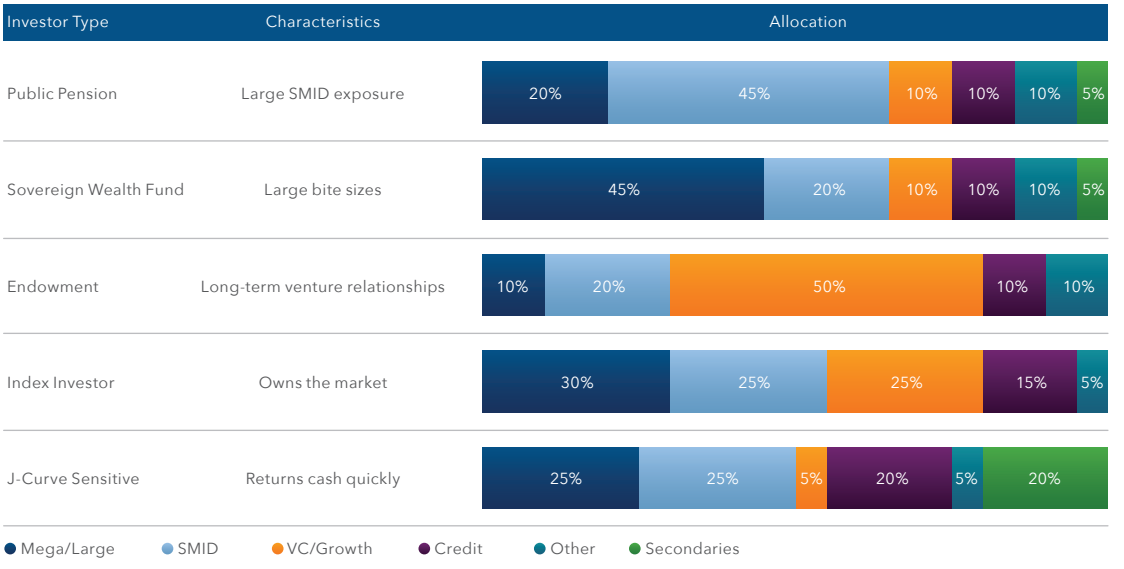
Source: Hamilton Lane Fund Investment Database (August 2015)

Chart 59: Loss Ratios
Vintage Years 2000 - 2011



Source: Hamilton Lane Fund Investment Database (August 2015)

Chart 60: Example Investor Profiles



We ran a Monte Carlo simulation, annually selecting 10 funds (we'll explain why 10 funds a little later) that were evenly invested across three years. What was the performance?

Chart 61: Return Summary at Year 10

Investor	IRR	TVPI
J-Curve Sensitive	12.8%	1.55x
Sovereign Wealth Fund	13.2%	1.59x
Public Pension	12.5%	1.58x
Index Investor	12.5%	1.57x
Endowment	11.0%	1.53x

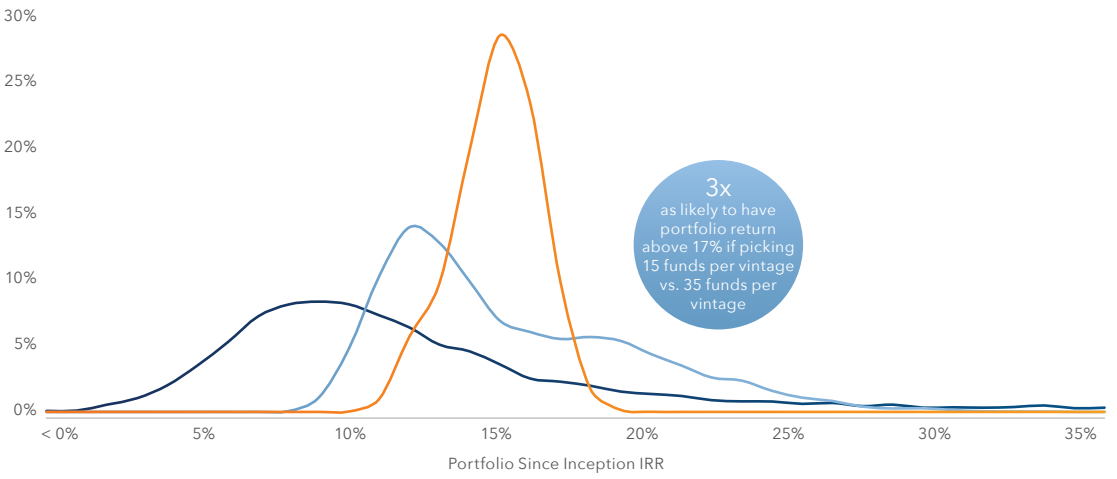
Interestingly, the 10-year period results are fairly tightly clustered with the exception of the endowment model, which includes a larger weighting to venture capital and its relatively poor performance over the last 15 years. We produced other data that demonstrates that the dispersion of returns is also wider for the lower-returning portfolios. That suggests investors are often taking greater risk and not being compensated for it. What is striking, however, is the large difference in returns over the first three years; the portfolios that are more heavily weighted to J-curve mitigating strategies and larger buyout tend to generate much stronger early performance.

You've heard us beat this drum before, but we will beat it again. Investors often inform us that they are not sensitive to the J-curve and are in private equity for the long-term returns. *The vast majority of them are either kidding themselves or lying.* Building portfolios for both shorter-term and longer-term performance is crucial.

Next let's tackle the question of how many funds should be selected annually. Using a Monte Carlo simulation once again, we varied the number of funds selected per year and used a random fund selection for vintages from 1995 to 2013. So, what's the magic number?

As Chart 62 demonstrates, you are three times as likely to generate portfolio returns greater than 17% by selecting 15 funds per vintage compared to picking 35 funds per vintage. We have long espoused the view that the portfolio that invests in 10-15 names annually is best positioned to outperform.

Chart 62: Distribution of Returns
Percent of Trials by Number of Funds Picked Per Year



Source: Hamilton Lane Fund Investment Database (July 2015)

"Investors often inform us that they are not sensitive to the J-curve. *The vast majority are either kidding themselves or lying.*"

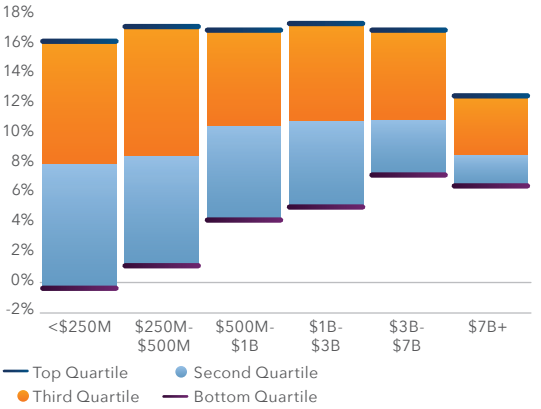
HOW TO INVEST TODAY

Now that we've honed our most promising selections around sectors, styles, quartiles and numbers, there are some other variables we need to address to build an outperforming portfolio.

Fund Size

Ah yes, the age old question of large versus small. The debate around fund size is yet another area of private equity lore where anecdote reigns supreme. It seems the majority argues the virtue of smaller funds. But what does the data suggest?

Chart 63: Quartiles by Fund Size
Spread of Net IRRs, Vintages 1979-2010



Source: Hamilton Lane Fund Investment Database (August 2015).
Excludes real estate, secondaries and funds-of-funds.

Based on Chart 63, it's pretty obvious there is little return justification for favoring one segment over another. (The data for the $7B+ funds represents one era only; we will need to see how the current crop of similarly-sized funds performs before drawing too many conclusions.) What differs from segment to segment is the risk profile as expressed in dispersion of return. We'll say it again: generating the highest return in private equity requires a balanced blend of large and small funds.

Only Top Quartile

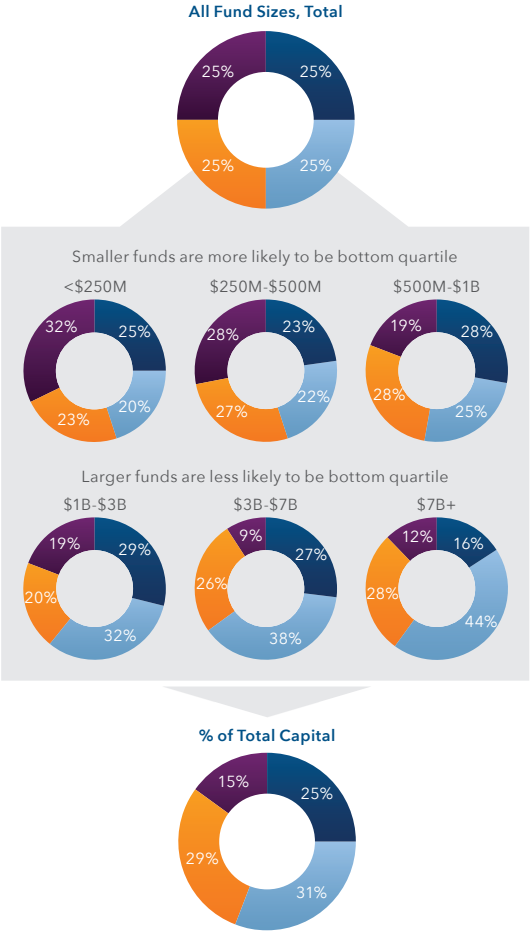
This asset class is obsessed with top quartile, and the obsession leads to a multitude of misstatements:

» every GP claims to be top quartile (they're not);

» investors only outperform public markets if they invest in top quartile (not true);

» picking top quartile funds is the sole key to outperformance (hmm, let's look at this last one).

Chart 64: % of Fund Count, Total and Breakout by Fund Size

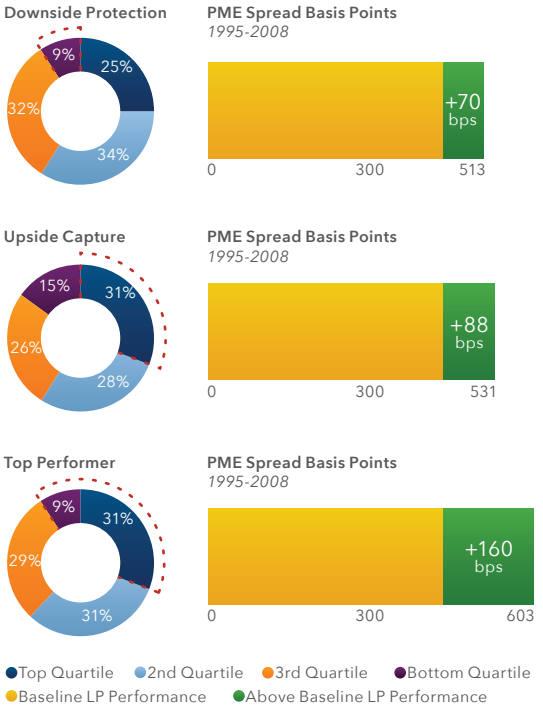


Source: Hamilton Lane Fund Investment Database (August 2015).
Vintages 1979-2010.

We know that 25% of all funds are bottom quartile. That's a pretty obvious statement since 25% of funds are every other quartile as well – it's the definition, after all. Yet, the statement becomes less obvious as it relates to different fund sizes. As Chart 64 shows, smaller funds are more likely to be in the bottom quartile than larger funds. The converse is not necessarily true. There is not much difference between the percentage of top-quartile funds grouped by fund size except for the 2007-era mega funds. So, by capital weighting, you are likely to have a portfolio that is more heavily oriented to the second and third quartiles, *and that may be just fine!*

Let's next take a look at a really busy chart, which builds upon a theme we presented last year that the real risk in private equity is not protecting on the downside, but rather failing to capture the upside.

Chart 65: Private Equity Outperformance by Selection Skill



Source: Hamilton Lane Fund Investment Database (July 2015).
PME uses MSCI World Net Total Return Index.

Spend some time with this data. It's important, and it tells us a couple things of note:

» Investors spend a great deal of time worrying about and trying to protect against the downside in private equity. In challenging vintages, however, returns actually tend to cluster more so than in other periods. In other words, fund selection simply doesn't matter as much in poor vintages.

» Equally important, top performers can have relatively equal weighting across first, second and third quartiles. It is avoiding the bottom quartile, which they have accomplished through smart selection, which has contributed to their success.

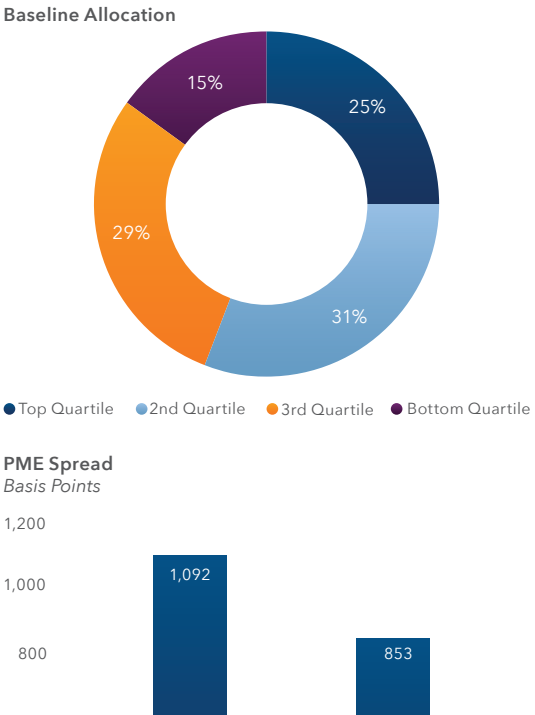
If we believe what the data is telling us, then we should probably stop asking LPs such a singularly focused question as how many top-quartile funds do they have in their portfolio. Instead, we should be asking what proportion of their fund selections is bottom quartile. The data serves as proof that the lower that number, the better-performing the portfolio.

How Much Outperformance?

Taking the baseline allocation discussed in Chart 64, we ran private equity's outperformance by pooled vintage year groups (Chart 66).

The findings confirm that portfolios should be aiming for at least 300 basis points outperformance in this asset class. However, the results also suggest that investors ought to be focused on achieving even greater levels of outperformance during the "good times" in private equity. This last point further underscores the notion that the real risk in private equity lies in failing to capture the upside. Almost by its very nature as a long-term asset class, private equity excels at achieving that goal.

Chart 66: Private Equity Outperformance



Source: Hamilton Lane Fund Investment Database (July 2015).
PME uses MSCI World Net Total Return Index.

Sector Outlooks

Market Sentiment at a Glance

	Accessibility	Supply/ Demand Balance	Near-Term Outlook	Long-Term Outlook	Trending
U.S. Buyout					
Large	🟢	🟡	🟡	🟢	🟡
SMID	🟡🔴	🟡	🟡	🟢	🟡
Europe Buyout					
Large	🟢	🔴	🟡	🟢	🟢
SMID	🔴	🟡	🟢	🟢	🟢
Distressed Debt					
U.S.	🟢	🔴	🔴	🟡	🔴
Europe	🟡	🟡	🟢	🟢	🟢🟡
Mezzanine/Loans					
U.S.	🟢	🔴	🔴	🟡	🟡
Europe	🟢	🟡	🟡	🟢	🟡
Emerging Markets	🟡	🟢	🟡	🟢	🟢
Venture					
	🔴	🟡	🟡	🟡	🟡
ROW					
	🟡	🟡	🔴	🟡	🟡
Infrastructure					
	🟢	🔴	🔴	🟡	🟡
Real Estate					
	🟢	🟢🟡	🟢🟡	🟡	🟡

Source: Hamilton Lane.

The real risk in private equity lies in failing to capture the upside.

04

CONCLUSION

For the last few years, we have maintained that a robust public equity environment presented a real risk to private equity. We believe we have been proven correct in that assessment. This is not to say that we think the upward trajectory the public markets have been enjoying is without end. We would expect more volatility with a continued upside bias, but nowhere near the almost double-digit gains we have seen over the last five years.

Let us be clear that we are not turning bearish on private equity. In fact, if anything, we are almost more bullish.

We believe private equity performs best in environments of greater volatility combined with more subdued public stock appreciation, and this is exactly the scenario we think is most likely to occur. Our enthusiasm is tempered only by our macro outlook that global economies will continue to struggle with low growth and deflationary pressures. That doesn't make for an ideal investment backdrop for any asset class. So, what are our best ideas:

» Basic buyouts remain attractive. While we have formerly been extremely biased toward U.S. buyout, we'd subdue that bias somewhat and look more favorably upon European buyout. The prices are certainly concerning, but the combination of depreciating currencies and continued ECB support make for a more positive overall European picture.

» ROW continues to be both more interesting and more challenging. Valuations are coming down significantly; they should be, however, since growth prospects are trending downward as well. In a world of slower growth, depreciating currencies and social risk, we remain unconvinced that a widespread strategy of minority investments in companies will be successful.

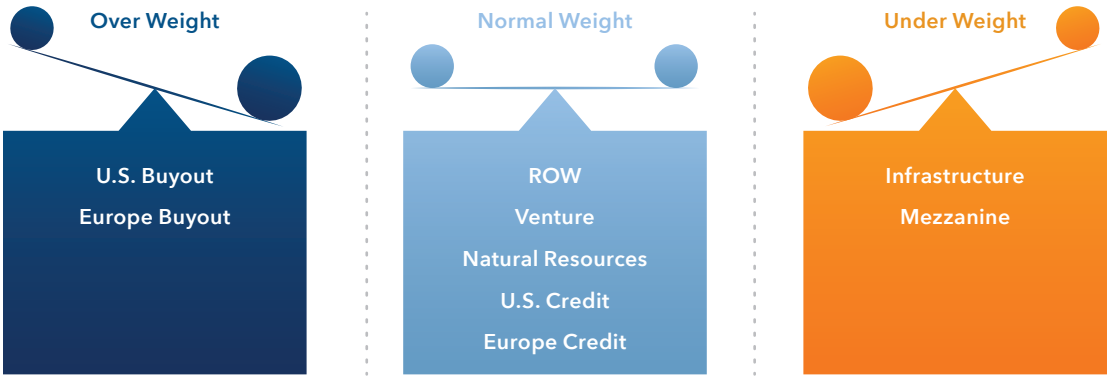
» Debt strategies continue to be interesting. With interest rates at chronically low levels, the higher returns from illiquid credit strategies are quite attractive.

» We remain supporters of the energy sector, particularly in the United States. This isn't because we believe oil is returning to $100 per barrel. Rather, we believe, over the next year in particular, that many distressed assets will become available and, while some should remain distressed, many will provide interesting and promising opportunities.

» Venture and growth will stay mixed. Any growth will command a premium in a low-growth world. Globally speaking, however, the public markets will not be as accommodating and that will present exit challenges in the future. Even so, the pace of change in various sectors, particularly biotech and social media, will not stop and will undoubtedly produce some incredible returns for venture investors.

Last year, we wrapped up our Market Overview with a note of caution about attempting to time the private equity market. We said you'd fail then, and we would say the same thing now. This year, we offer an additional perspective around the way we all view the market and the impact that has on private equity investing. By now, PE investors have become well accustomed to market cycles and investment trends, but it is our view that we are likely being short-sighted when considering the time frame with which we are making comparisons and creating expectations. Given the very real implications this has for private equity investing, it may be time to reshape the lens through which we are viewing the future.

In a world of slower growth, lower rates and more pressure on pricing power, what do you need to do to succeed? What should you do differently? We hope we have begun to show how factoring in today's market realities might affect your portfolios. One thing of which we are certain is that the importance of, access to and analysis of accurate data only increases in this type of environment. Don't make investment decisions based on anecdotal evidence alone. In this environment, we advocate a more active investment management discipline that involves making clear portfolio construction choices in order to generate performance in your private equity portfolio. This is not a novel investment strategy; it is actually how most asset classes are run. However, it's a strategy that the larger private equity universe has been slow to adopt historically. We recommend reconsidering that stance in favor of adopting a more active investment strategy now.



ABOUT HAMILTON LANE

Hamilton Lane is an independent alternative investment management firm providing innovative private markets solutions to sophisticated investors around the world. The firm has been dedicated to private markets investing for more than two decades and currently has more than 235 employees operating in offices throughout the U.S., London, Hong Kong, Rio de Janeiro, Tel Aviv and Tokyo.

With over $233 billion in total assets under management and supervision[1], Hamilton Lane offers a full range of investment products and services that enable clients to participate in the private markets asset class on a global and customized basis. The firm has been named an Inc. 5000 Fastest-Growing Company and a "Best Place to Work in Money Management" by Pensions & Investments for three consecutive years.

www.hamiltonlane.com

1 As of June 30, 2015

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Indices Used

S&P 500: The S&P 500, or the Standard & Poor's 500, is an American stock market index based on the market capitalizations of 500 large companies having common stock listed on the NYSE or NASDAQ. The S&P 500 index components and their weightings are determined by S&P Dow Jones Indices.

Shanghai Composite: The SSE Composite Index is a stock market index of all stocks (A shares and B shares) that are traded at the Shanghai Stock Exchange.

Euro Stoxx 50: The Euro Stoxx 50 is a market capitalization-weighted stock index of 50 large, blue-chip European companies operating within Eurozone nations.

NSE CNX NIFTY: The NSE CNX NIFTY is a stock index endorsed by Standard & Poor's and composed of 50 of the largest and most liquid stocks found on the National Stock Exchange (NSE) of India.

Ibovespa: The Bovespa Index is an index of about 50 stocks that are traded on the São Paulo Stock, Mercantile & Futures Exchange

NIKKEI 225: The Nikkei 225 is a price-weighted index comprised of Japan's top 225 blue-chip companies on the Tokyo Stock Exchange.

Markit CDX North America High Yield Index: Markit's North American High Yield CDX Index, or the CDX.NA.HY Index (the "HY Index"), is composed of one hundred (100) liquid North American entities with high yield credit ratings that trade in the CDS market.

Markit CDX North America Investment Grade Index: Markit's North American Investment Grade CDX Index, or the CDX.NA.IG Index (the "IG Index"), is composed of one hundred twenty five (125) of the most liquid North American entities with investment grade credit ratings that trade in the CDS market.

Markit iTraxx Europe Index: The European Markit iTraxx indices trade 3, 5, 7 and 10-year maturities, and a new series is determined on the basis of liquidity every six months. The benchmark Markit iTraxx Europe index comprises 125 equally-weighted European names.

MSCI World Net Total Return Index: The MSCI World Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity performance of developed markets with net dividends reinvested.

S&P 500 Net Total Return Index: The S&P 500 Total Return Index is a capitalization-weighted index of 500 U.S. large cap stocks that assumes all dividends and distributions are reinvested.

Russell 2000 Net Total Return Index: The Russell 2000 Net Total Return Index is an index measuring the performance approximately 2,000 small-cap companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks with net dividends reinvested.

MSCI World Index: The MSCI World Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity performance of developed markets.

Russell 3000 Index: The Russell 3000 index tracks the equity performance of the 3,000 largest U.S. companies.

ProShares Ultra S&P 500: ProShares Ultra S&P 500 seeks daily investment results, before fees and expenses, that correspond to two times (2x) the daily performance of the S&P 500®.

WTI Crude: WTI Crude is light, sweet crude oil commonly referred to as "oil" in the Western world. WTI is the underlying commodity of the New York Merchantile Exchange's oil futures contracts.

MSCI ACWI Select Energy Producers IMI: The MSCI ACWI Select Energy Producers Investable Market Index (IMI) aims to focus on companies in the energy industries that are highly sensitive to underlying prices of energy commodities. The index includes companies at or near the initial phase of energy production that are primarily engaged in the exploration and production of oil and gas or in the production and mining of coal and other consumable fuels related to the generation of energy--as classified by the Global Industry Classification Standard GICS®. The index excludes companies that derive a majority of their revenues from the marketing, storage and/or transportation of oil and gas and companies involved primarily in alternative fuels.

MSCI World ex US Index: The MSCI World ex. U.S. Index tracks large and mid-cap equity performance in developed market countries, excluding the U.S.

MSCI Emerging Markets Index: The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets.

Barclays Aggregate Bond Index: The Barclay Aggregate Bond Index tracks the performance of U.S. investment grade bonds.

Credit Suisse High Yield Index: The Credit Suisse High Yield index tracks the performance of U.S. sub-investment grade bonds.

HFRI Composite Index: The HFRI Composite Index reflects hedge fund industry performance.

FTSE/NAREIT Equity REIT Index: The FTSE/NAREIT All Equity REIT Index tracks the performance of U.S. equity REITs.

Dow Jones-UBS Commodities Index: The Dow Jones-UBS Commodity Index tracks the performance of exchange traded futures on physical commodities, and currently represents 20 commodities.

PE Definitions

Public Market Equivalent: Calculated by taking the fund cash flows and investing them in a relevant index. The fund cash flows are pooled such that capital calls are simulated as index share purchases and distributions as index share sales. Contributions are scaled by a factor such that the ending portfolio balance is equal to the private equity net asset value (equal ending exposures for both portfolios). This seeks to prevent shorting of the public market equivalent portfolio. Distributions are not scaled by this factor. The IRR is calculated based off of these adjusted cash flows.

All PE: All Private Equity (All PE) includes all funds classified as buyout, growth equity, venture capital, distressed debt, mezzanine, and real assets in addition to other miscellaneous strategies. The sample excludes real estate, secondary, and fund-of-fund strategies.

PE Energy: Private Equity Energy includes any All PE funds with a strategy focus on the production, processing, or distribution of energy.

North America: North America includes all funds with a geographic focus on the United States and Canada

Western Europe: Western Europe includes all funds with a geographic focus on Western Europe

ROW: Rest of World (ROW) includes all funds whose principal focus is not North America or Western Europe, including regions such as Eastern Europe, Latin America, Africa, Asia, Australia, and other emerging markets.

Buyout: Buyout includes any All PE funds whose principal strategy is corporate finance and leveraged buyout.

Venture Capital: Venture Capital includes any All PE funds focused on any stages of Venture Capital investing, including Seed, Early-Stage, Mid-Stage, and Late-Stage investments.

U.S. Buyout: U.S. Buyout includes any All PE funds with a geographic focus of North America and a strategy focus of Buyout.

EU Buyout: EU Buyout includes any All PE funds with a geographic focus of Western Europe and a strategy focus of Buyout.

U.S.-EU VC/Growth: U.S.-EU VC/Growth includes any All PE funds with a geographic focus of either North America or Western Europe and a strategy focus of either Venture Capital or Growth Equity.

Credit: Credit includes any All PE funds with a strategy focus of either Distressed Debt or Mezzanine Debt.

ROW Buyout/Growth: ROW Buyout/Growth includes any All PE funds with a geographic focus of Rest of World and a strategy focus of Buyout or Growth Equity.

Real Assets: Real Assets includes any All PE funds with a strategy of either Infrastructure or Natural Resources. Real Estate is not included.

Other: Other includes any All PE funds not included in U.S. Buyout, EU Buyout, U.S>-EU VC/Growth, Credit, ROW Buyout/Growth, and real assets.

Mega/Large Buyout: Mega/Large Buyout includes any All PE funds with a strategy of Buyout and a sub-strategy of Mega or Large.

SMID Buyout: SMID Buyout includes any All PE funds with a strategy of Buyout and a sub-strategy of Small or Mid.

Growth Equity: Growth Equity includes any All PE funds with a strategy focusing on providing growth capital as an equity investment.

Distressed Debt: Distressed Debt includes any All PE funds with a strategy that invests in the debt of distressed companies.

Mezzanine: Mezzanine includes any All PE funds with a strategy to invest in the mezzanine debt of private companies.

Real Estate Non-Core: Real Estate Non-Core includes all real estate funds with a focus on non-core real estate. This excludes funds that are separate accounts or joint ventures.

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