



2011 Commonfund Global Economic and Investment Outlook

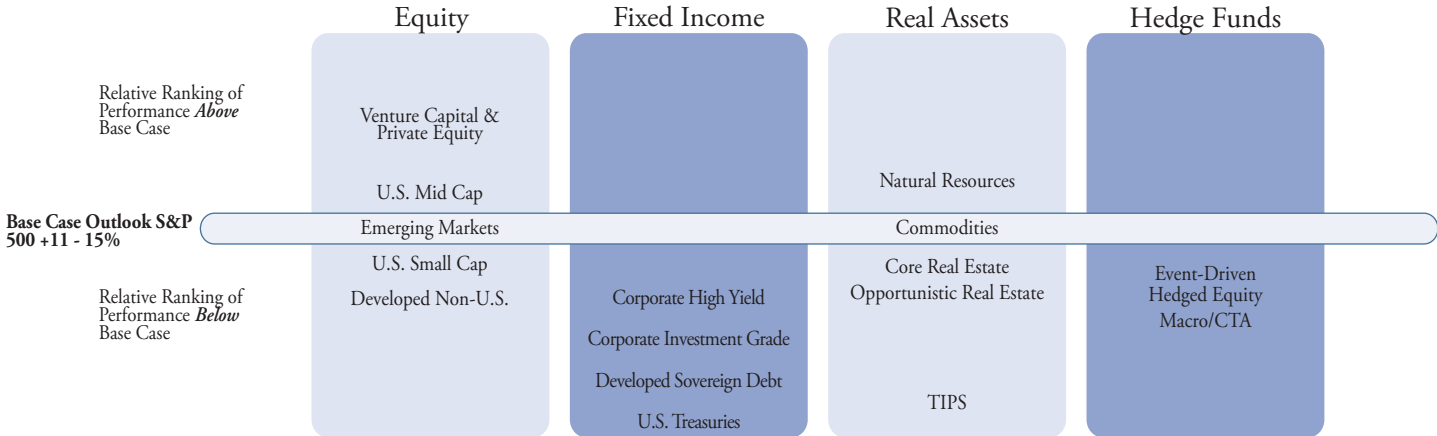
Macro Economic Environment

A year ago, consensus expectations for 2010 were for continued strength among emerging market economies, slow 1-2 percent growth in the U.S., and flat or negative GDP growth in many parts of Europe. The outlook at that time for 2011 was not much better, with most headlines trumpeting a “new normal” and continued risks of a double dip recession and fears of deflation in the U.S. The Fed’s actions of continued monetary easing underscored the central bank’s concerns about weakness in the economy, while the European Central Bank’s bailout package was little more than a stop-gap measure that did little to address the heavy debt burdens. Only emerging markets it seemed were poised for strong economic growth.

We, too, were cautious in our 2011 outlook through mid-year, forecasting improving but relatively modest global economic growth with the risk to the downside based on European sovereign debt concerns that could result in massive fiscal policy cutbacks and a series of rolling recessions across Europe. By the early fall, however, we boosted our U.S. GDP outlook for the fourth quarter of 2010 and full year 2011 as aggregate demand and industrial production continued to improve, and stated at that time that further easing and/or the extension of the Bush tax cuts could push our outlook higher. The Fed’s second round of quantitative easing (“QEII”) and a new Congress set that exact stage, and as we start the New Year we are more confident in growth in 2011 in most of the world.

- We forecast global real economic growth for 2011 to be 4.7 percent on a purchasing parity basis; with 7-8 percent growth in emerging markets; 3.7 percent growth in the U.S.; and less than 1.5 percent growth in Europe. The demand-induced strength in the emerging markets will continue to provide support to global growth as will a recovering U.S. consumer. The engine of U.S. growth will shift from a reliance on the U.S. consumer to strong performance in the industrial sector, with industrial production and capital expenditure growth above historical norms.
- On the U.S. labor front, despite the deceleration in the private sector employment growth in November and December, the majority of the labor market readings released over the last several weeks point to an improvement in employment trends. The total number of people collecting unemployment benefits has trended lower, the household labor readings have improved, and a key business survey of chief executive officers provided yet another sign that companies are getting ready to add to their payrolls and that business executives are preparing

Commonfund 2011 Relative Ranking of Asset Classes & Strategies to S&P 500 Index Base Case

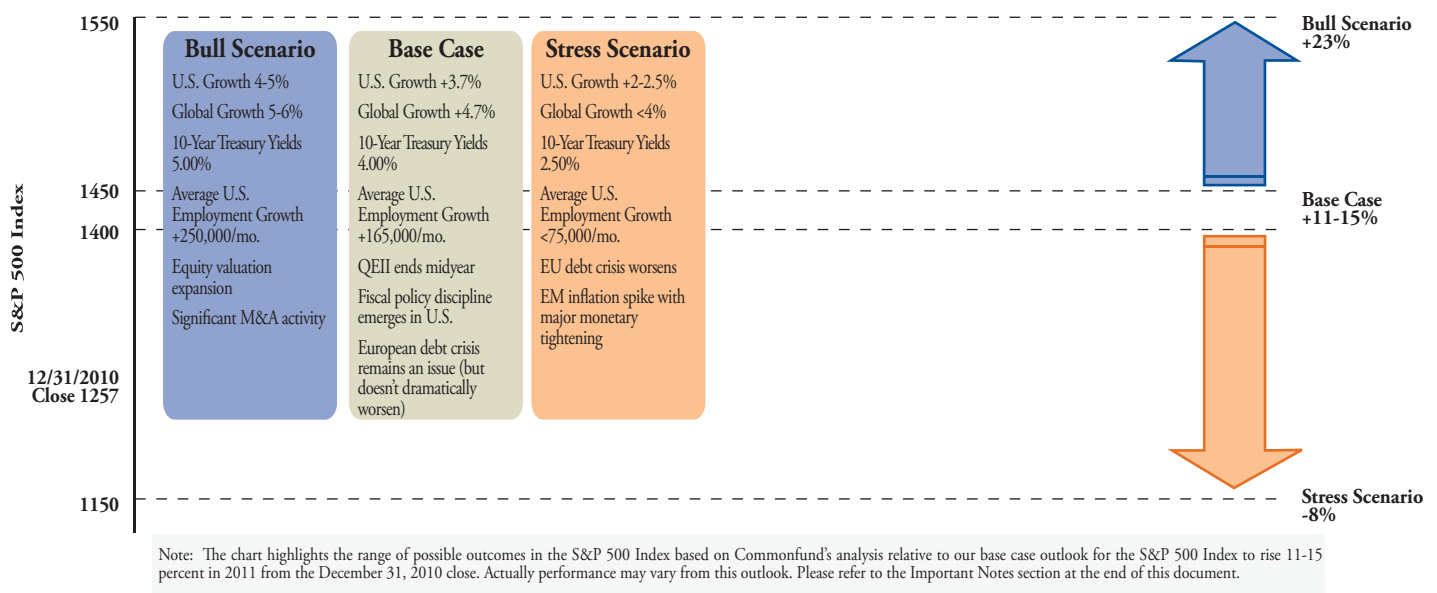


Note: This relative ranking should be viewed as a graphic depiction of Commonfund’s outlook for various asset classes and strategies relative to our base case outlook for the S&P 500 Index to return 11-15 percent in 2011; it is not intended to convey specific performance of other asset classes and strategies. Please refer to the Important Notes section at the end of this document.

their companies for a stronger domestic economy. We look for nonfarm employment to increase about 165,000 per month in 2011 (+2 million for the year). A 2.5 million gain in private payrolls should be partially offset by a 500,000 decline in government payrolls, reflecting budget-related cutbacks on the state, local, and Federal level. A somewhat stronger rise in household employment should help to reduce the civilian unemployment rate towards 8.8 percent by year end.

- We expect U.S. interest rates will rise throughout 2011 with the 10-year U.S. Treasury yield testing the 4.0 percent area during the year. On the monetary policy front, we look for the completion of QEII to mark the end of the Fed’s easing process and by calendar year-end the monetary policy discussion will likely be centered on how to remove the excess liquidity in 2012.
- The U.S. trade-weight dollar index (DXY) will likely rise with improving domestic economic growth and higher market interest rates; and we expect the DXY dollar index to appreciate about 3 to 5 percent in 2011, reflecting improvement against the Euro, Sterling, and the Yen. However, we look for the dollar to weaken against the strong emerging market currencies in Southeast Asia and Latin America as well as many of the global resource-oriented currencies. China and India may also be willing to accept a stronger upward adjustment in the value of renminbi and rupee, respectively, to help to offset the impact of higher inflation pressures, especially imported food costs.
- U.S. consumer inflation will rise slightly to 2.0 - 2.5 percent during 2011 (1.7 percent for core CPI). A similar inflation rate in Europe may challenge the ECB’s ability to meet the divergent needs of the countries in Europe, where the southern “club Med” plus Ireland countries need extremely accommodative policies, while Germany could benefit from some monetary policy restraint. Inflation risks from higher foods prices in China will persist, but we expect the Bank of China to take action to hold inflation there to 5-6 percent. India will face added challenges associated with wage pressures, but in both countries headline inflation should decelerate in the second half of the year.
- Budget deficits and debt-to-GDP levels in developed economies, with the notable exception of Canada, are approaching dangerous levels. Failure to address deficits through a combination of spending cutbacks and selected revenue increases to rein in the debt poses a significant challenge and risk that needs to be addressed in the upcoming years.
- The sovereign debt crisis in southern Europe represents the largest point of uncertainty and risk to global economic activity. Heavy debt burdens in Greece, Ireland, Portugal, Belgium, and Spain should continue to test the finances of several European countries, as well as the structure of the European Union, European economic activity, European banks that own the sovereign debt and the Euro itself.

Upside/Downside to Commonfund 2011 Outlook Base Case S&P 500 Index



Our Asset Allocation Perspective

In light of our macro outlook we offer the following asset allocation guidance for investors within the context and bands of their policy portfolios. Within each of these four broad asset allocation categories of equities, fixed income, real assets and hedge fund strategies, we further recommend investors consider specific strategies based on our assessment of valuations, market fundamentals and risk.

Equities

We suggest investors consider an overweight to equities to the upper bands within their asset allocations. Our outlook is for the S&P 500 to rise to 1400-1450 in 2011, an appreciation of 11-15 percent over the December 31, 2010 close. Within the U.S. public equity market, we view large and mid-caps as a more compelling risk-adjusted opportunity than small caps where valuations are stretched. Overall we see little in terms of valuation expansion across U.S. equities; rather performance is likely to be driven by accelerating growth in the U.S. and sustained growth in emerging markets. A stronger environment for M&A activity should accrue to the benefit of mid cap stocks.

We favor U.S. equities over EAFE based on a recovering U.S. economy; and a strengthening U.S. dollar is also likely to moderate returns for non U.S. markets. Nonetheless we see strength among European exporters and potential near term improvement in Japan as that market reflects an improved U.S. outlook. Accordingly, we favor active managers with the skill to differentiate winners even in challenged regions. We expect that the MSCI Emerging Markets Index will roughly match that of the S&P 500 index. Adding to emerging markets performance will be strong earnings growth and some currency benefit; however some of these benefits we expect will be offset by increasing inflation pressures and monetary policy tightening in the region. Equity valuations in emerging markets are far less compelling now than before the dramatic run up of recent years and as such we believe that actively managed portfolios, particularly those that look for opportunities across the full range of countries and sectors will outperform.

In private capital, we expect strong market returns for the coming year with outperformance over public indices. (Important note: annual returns for private capital investments can be highly variable based on changing investment and exit markets as well as vintage year; as such we caution investors not to be overly sensitive to annual returns, but rather to long term performance over the life of the partnerships.)

With stable capital markets, venture backed IPO volume in 2011 should be strong and could even exceed the 2010 levels. Typically there is a healthy mark-up for companies that go public, resulting in the 2011 forecast for good valuation increases in mature venture portfolios. A wave of increased merger and acquisition activity could drive 2011 returns as well. Our base case outlook for U.S. private equity is for a 400 basis point outperformance compared to that of the S&P 500 Index. Continued strengthening in M&A and/or IPO activity, stronger public stock market performance, as well as improved EBITDA and debt paydown at the company level we expect will lead to continued strengthening of private equity performance. More clarity on present domestic regulatory uncertainty across a number of industries could aid investments in healthcare, post-secondary education and financial services.

As in the United States, strong global stock markets, M&A and IPO activity will assist global private equity in outperforming public markets in 2011. In general, for our base case we expect a similar 400 basis point outperformance of global private equity compared to local public market indices. Europe, our largest focus area, has seen a bifurcation with the Northern countries (Germany, Sweden etc.) performing well from a macro and public market perspective. Conversely, Southern Europe (Spain, Portugal etc.) has struggled on both fronts.

Fixed Income

We expect fixed income strategies to face a challenging environment in 2011 driven by our overall economic outlook, and as such suggest that investors consider an allocation to the lower ends of their fixed income policies. Treasuries and TIPS will be hard pressed to provide strong positive returns as we expect yields, nominal and real, to rise throughout the year based on a stronger economy and expectations of eventual removal of liquidity by the Fed. Our outlook is for the 10-year Treasury note to move toward 4 percent during the year, which would result in negative annual return expectations of approximately 2 percent. Our base case for the Barclays Aggregate Bond Index is for a modest positive return to 2 percent, based on spread tightening to historical levels offsetting some of the impact of rising interest rates.

Real Assets

For 2011 we counsel investors to consider adding to inflation hedging strategies over the year. However, we do not view TIPS today as a compelling value currently and advise a “go slow” approach in the timing of real estate investments. Conversely, in terms of commodities and natural resources, we recommend investors maintain or build allocations to the upper range of policy allocations where possible.

While we believe there will be opportunities in core real estate markets going forward, particularly relative to traditional fixed income, these opportunities should be pursued in a measured way. We also believe there will be select opportunities in discrete markets experiencing distress. Historically high return targets for opportunistic investing of over 20 percent are unlikely to be achieved due to less available leverage for assets with significant development or leasing risk. However, this may present a compelling opportunity for skilled managers who may be able to achieve compelling returns with lower levels of debt financing. But we believe the real estate recovery

We believe that corporate and high yield issues provide value to actively managed fixed income portfolios. While the debt overhang exists and default rates are likely to increase in 2012 and beyond, we expect high yield performance to be in the 7-8 percent range based on spreads tightening from current levels and defaults increasing but remaining at manageable levels. However, due in part to aggressive buying of high yield by mutual funds, this sector has increased risk to investor flows.

Global bonds are unlikely to offer an attractive alternative as we expect the major international fixed income markets to back up similarly to U.S. Treasuries. Natural resource-oriented countries and local emerging market debt we expect will provide an attractive segment within global bonds as emerging market currencies appreciate versus the dollar.

will take time and is still in its nascent stage. Core strategies should continue to offer competitive income returns of 6-7 percent along with the potential for further long-term appreciation in property pricing. By virtue of steeper price declines and discounts to replacement cost, opportunistic strategies should offer more total return upside than core but with greater volatility.

We expect that commodities should again this year provide strong investment performance with returns matching those of the S&P 500 index. Supply shocks (often weather driven) and demographic trends in emerging markets could further push commodity returns higher. Within natural resources, our base case forecasts a 200 basis point outperformance compared to the S&P 500 index. Higher capacity utilization within the services, manufacturing, mining and infrastructure sectors should lead to stronger company performance, while weak natural gas prices and lackluster demand should lead to flat company performance in that important sector.

Hedge Funds

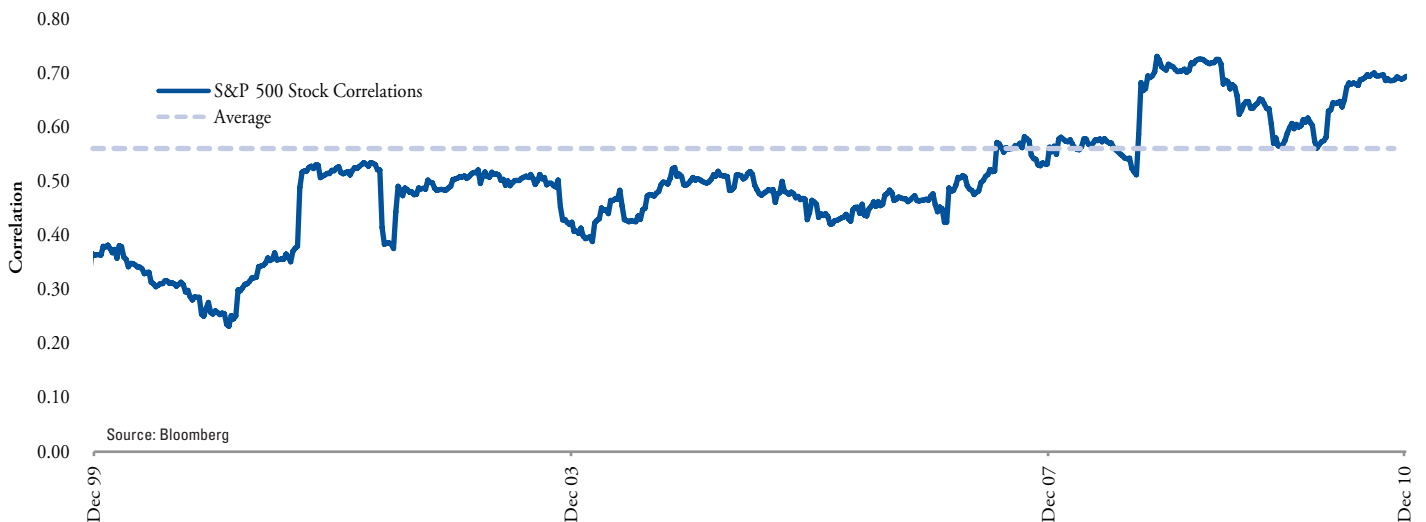
Our view for investors is to consider maintaining allocations to marketable alternative strategies near the mid-point of policy portfolio ranges for the coming year, but to add to positions in 12-18 months as equity valuations become more fully priced. However, we would suggest that these allocations be closely monitored. There are a number of factors which could increase the performance of hedge fund strategies in an equity friendly environment should correlations fall and long term buyers emerge. While we would not recommend specific weights for specific strategies (that is a decision which should be made objectively by each investor, depending on your portfolio), we would slightly favor hedged equity and event-driven managers over macro/CTA managers in 2011.

While returns of hedged equity strategies can lag those of long-only strategies in a beta dominated “risk-on” environment, we nonetheless believe that investors should look to maintain neutral allocations to hedged equity in the next year, as a number of “qualitative” factors could favorably impact returns. In addition, these strategies have historically provided valuable downside protection should the markets falter. Forecasting hedge fund returns is a balance of art and science, requiring qualitative judgment to complement quantitative projections based on historical regression analysis. In this context, our base case forecast is for returns of hedged equity and event-driven strategies to range from 10- 12 percent with returns of macro/CTA strategies ranging from 9-11 percent.

We believe these return projections could be revised to the upside in our 11-15 percent S&P 500 index base case if the following events were to occur:

- Stock correlations decrease from their current highs to more “normal” levels (good for hedged equity stock pickers)
- M&A and restructuring activity increases, caused in part by a sustained environment of lower or at least more “normal” levels of volatility (good for event-driven and hedged equity managers)
- Private equity activity increases (as with M&A, another long-term buyer in the market looking for fundamental value would also be good for event-driven managers and fundamental stock pickers)
- QEII continues, as projected, for the next six months. Divergent rate policies between the developed and developing world have caused upward trends in hard assets and downward trends in debased currencies, a target rich environment for macro/CTA strategies. However, returns from long term trend followers could be challenged - temporarily - should QEII be withdrawn in the second half of the year and these trends reverse.

Correlations Tend to Revert to the Mean - Fundamental security selection will return
S&P 500 Rolling 36-week stock correlations



Risks to our Forecast

The biggest risks to our base case forecast are two-fold: (1) the sovereign debt crisis reaches a breaking point and (2) emerging market economies institute more aggressive monetary tightening to stave off inflationary pressures. In addition, a significant concern we have in the current market environment is that of investor consensus. In other words, is everyone too bullish and thus more susceptible to bad news (and an overreaction) if it were to materialize? Certainly market environments such as we face today run this risk and history shows there is more of a risk that returns fail to reach our forecast 11-15 percent return on the S&P 500 index than there is opportunity to exceed 15 percent.

Overall, we believe that the downside risk based on a series of adverse events in a stress case scenario is for a fall in the S&P 500 index in the range of 5-10 percent – certainly weak performance, but not draconian.

For this to happen, the following would likely have to occur: (1) QEII fails to provide liquidity and stimulus; (2) employment trends weaken and unemployment goes higher; (3) consumer confidence drops; (4) corporations continue to hold cash and do not make strategic acquisitions; (5) a worsening European debt crisis leads to debt defaults and/or restructurings; and (6) inflationary pressures in emerging markets increase dramatically. These events would likely push 10-year Treasury yields back down toward 2.5 percent, again making Treasury returns attractive.

As we discussed earlier, the sovereign debt crisis in southern Europe, still represents the largest point of uncertainty and risk to global economic activity. Greece, Ireland, Portugal, and Belgium are all likely to face financing difficulties during the year, which, in turn, could test the structure of the European Union, European banks that own the sovereign debt, and the Euro itself. EU authorities are well aware that the current policy of addressing the debt problem only after it becomes unsustainable, along with an occasional ECB intervention, is not a long term solution. Transforming the European Financial Stability Facility (EFSF) into a real issuance entity that could exchange a portion of a challenged entities debt for a version of Eurobonds is a potential solution. This could come in the form of a “Brady bond” like restructuring that would be guaranteed by the EFSF and secured by a long-dated zero or low interest rate bond. Such action should incorporate a haircut to current bond holders in this debt exchange as well as the implementation of stringent fiscal policy restraint for the country that receives financing help.

Domestically, the fiscal challenges in Europe have helped to provide a reality check to many people and entities in the U.S. that our nation needs to do significantly greater work to get our fiscal house in order. The Federal budget issues have become a focus of attention among Washington officials; however, we are becoming increasingly more concerned about the state and local budget issues that are fueling unrest in the municipal bond markets. Last year 47 states were challenged with deficits. Although GDP growth is improving it could take another 6 to 12 months before many states begin to see the benefit of better economic activity on their revenues. Near term the most pressing states such as Illinois and California will need to take action to both raise taxes and cut expenditures. On the state level, we believe that defaults will be avoided, but we are becoming increasingly concerned that other municipalities, on either the city or county level, may not be as fortunate.

While higher gasoline prices could temper consumer discretionary spending in 2011, we do not see this as a significant risk unless gasoline prices rise to \$4.00 per gallon and stay at that level for an extended period.

Closing Observations

The outlook that we have put forth in this document clearly reflects an optimistic market view for the coming year. We are confident in this view and believe that market conditions will result in strong equity growth in particular over the next 12 months. Yet beyond 2011, we expect that headwinds from structural economic challenges and the end of global monetary stimulus will create a more difficult investment environment. Such an environment will favor investors who are agile, and who have access to resources and investment acumen capable of finding and taking advantage of rapidly changing market opportunities and risks.

Indeed, the next five years are likely to be challenging for the long-term institutional investor. Investors will face significant difficulties in achieving real returns at least equal to their liability streams – whether endowment spending, foundation payouts or pension distributions. This will demand diligence by investment leadership and governing boards of all organizations to continue to adapt and manage investment policies consistent with the needs and missions of their institutions.

We are grateful to the more than 1500 institutions that have entrusted Commonfund in the last year in the management of their investment portfolios, and we look forward to working with you in the years ahead.

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