Marquette Associates

Memorial Healthcare System Board Workshop

Board Workshop - Agenda

- Review historical views of risk for Operating and Pension Portfolios
- Review proposed Asset Allocation provided by Marquette
- Education for new asset classes:
  - Private Equity
  - Private Debt
  - Real Estate/Infrastructure
- Investment vehicle recommendations by portfolio
- Discuss potential changes to Governance and Investment Policy
- Investment implementation plan and next steps

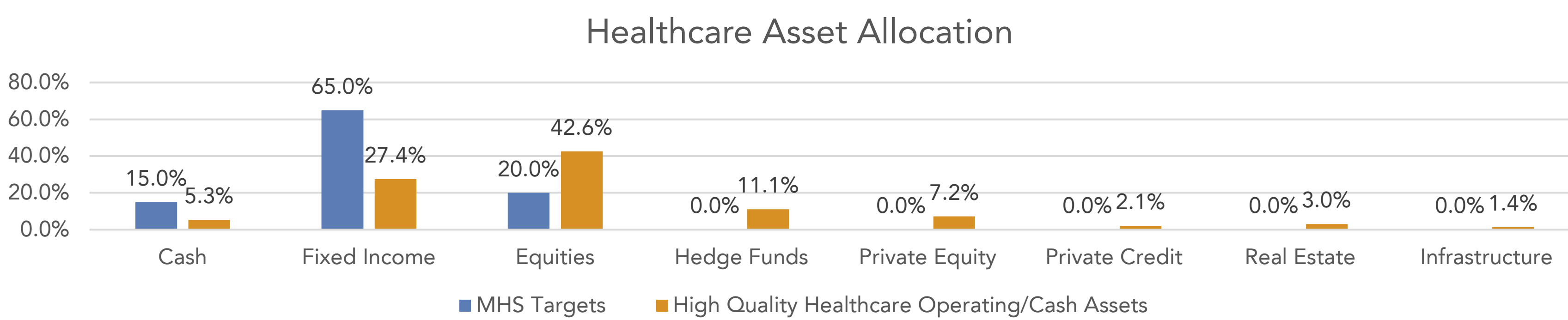
Operating Portfolio

- Review a framework to determine the optimal size of each investment portfolio. The established framework includes a target asset allocation to:
  - ✓ Liquidity: 15%
  - ✓ Principal Protection: 65%
  - ✓ Return and Growth: 20%

- The Finance Committee and the Board have discussed the need for a revised asset allocation and the need to continually reassess:
  - ✓ Sub-Asset allocation
  - ✓ Investment Strategy for each portfolio
  - ✓ Investment vehicle recommendations
  - ✓ Investment Policy Statement amendments
  - ✓ Investment managers selection
  - ✓ Implementation

MHS vs. Other Healthcare Entities

- In 2021, Goldman Sachs conducted a survey of 38 leading US-based healthcare systems which provided insights on asset allocation, expected return and risk management
- The underlying assumption for MHS's target asset allocation is to develop an allocation that preserves the hospital's access to liquidity and is in line with healthcare peers
- From a Rating Agency perspective, aggressive allocations are often viewed as a credit negative. They usually result in a credit rating downgrade only when coupled with poor operating performance or excessive leverage for the rating category



Asset Allocation by Investment Pool

- Total Portfolio's asset allocation is based on long term targets from Investment Policy Statement

Pool	Liquidity	Principal Protection	Return & Growth	Total Portfolio
$ Amount	$358.2M	$1,552.2M	$477.6M	$2,388M
Current Target Allocation	15%	65%	20%	

Asset Class				
Cash (T-bills)	100.00%	0.00%	0.00%	15.00%
Short Gov't/Credit	0.00%	15.38%	0.00%	10.00%
Intermediate Gov't/Credit	0.00%	53.85%	0.00%	35.00%
Intermediate Aggregate	0.00%	30.77%	0.00%	20.00%
Total Fixed	**100.00%**	**100.00%**	**0.00%**	**80.00%**
Global Low-Volatility	0.00%	0.00%	37.50%	7.50%
Global Defensive Equity	0.00%	0.00%	37.50%	7.50%
Global Equity	0.00%	0.00%	25.00%	5.00%
Total Equity	**0.00%**	**0.00%**	**100.00%**	**20.00%**
Total	100.00%	100.00%	100.00%	100.00%

Asset class outlook

		CHANGE	HEADWINDS		NEUTRAL	TAILWINDS	
Fixed Income	Core bonds	▲	□	□	□	■	□
	Bank loans		□	□	□	■	□
	High yield		□	□	□	■	□
	EMD		□	□	■	□	□
U.S. Equities	Large-cap		□	□	■	□	□
	Mid-cap		□	□	■	□	□
	Small-cap		□	■	□	□	□
	Value	▲	□	□	■	□	□
	Growth		□	■	□	□	□
Non-U.S. Equities	Developed large-cap		□	■	□	□	□
	Developed small-cap		□	■	□	□	□
	Emerging markets		□	□	■	□	□
Real Assets	Core real estate	▼	□	■	□	□	□
	Value-add real estate		□	□	□	■	□
	Infrastructure		□	□	□	■	□
Hedge Funds	Equity long/short		□	□	□	■	□
	Credit	▲	□	□	□	■	□
	VRP		□	□	■	□	□
Private Equity	Buyout		□	□	□	■	□
	Venture Capital		□	□	□	■	□
Private Debt	Direct lending		□	□	□	□	■
	Distressed/opportunistic		□	■	□	□	□

TAKEAWAYS

- **Fixed Income**: Higher rates have pushed the yield on the Bloomberg Aggregate higher and core bonds are providing attractive starting yield. Recession probabilities continue to tick up and core fixed income can provide protection in down markets if interest rates fall. Spread sectors remain volatile, with attractive valuations.
- **U.S.**: Risk assets remain sensitive to macro headwinds, as the Fed focuses on combatting inflation. More defensive equities and high-quality growers with stable cash flows may be poised for relative outperformance. Recent compression has led to more attractive valuation multiples across U.S. equity indices, with Value indices at historic lows. With the rising probability of recession, however, deep cyclicals may be more impacted. Earnings expectations signal the potential for the lowest earnings growth rate in two years against a backdrop of higher rates and currency movements.
- **Non-U.S.**: Recession probabilities continue to climb, especially for Europe. Developed central bank monetary policy will weigh on growth as the focus remains on inflation. The short-term outlook is negative, but valuations are very attractive, setting up for strong performance potential 3–5 years out.
- **Real Assets**: Higher interest rates, inflationary pressures, and elevated costs of capital will exert downward pressure on near-term real estate pricing. Energy transition initiatives and recent legislative measures should drive demand for infrastructure.
- **Hedge Funds**: Hedge funds should continue to help protect capital against a volatile macro backdrop. In Credit, spreads have widened to attractive levels and defaults are expected to rise, expanding the opportunity set for stressed and distressed managers.
- **Private Equity:** Profitability pressure has persisted due to continued wage increases, supply chain challenges, and the rising cost of debt. Public market volatility and valuation compression is likely to continue, which may create opportunities for those with dry powder. Continued capital in-flows into larger private market funds should remain additive to the exit environment for the small buyout, lower-middle market, and early-stage venture funds.
- **Private Debt**: Direct lending is attractive against the backdrop of increased inflation and rising rates, given a majority of loans contain floating interest rates linked to LIBOR/SOFR. Investors benefit from a strong structure and yield premium relative to traditional fixed income. Distressed and opportunistic are challenged in the current market.

For illustration only, as of September 30, 2022. These views apply to a 6- to 12-month horizon; arrows in Change column represent change in view since last quarter. This summary of individual asset class views shows relative direction and strength of conviction but is independent of portfolio construction considerations. These views should not be construed as a recommended portfolio or investment advice. Past performance does not imply future returns.

Operating Portfolio – Potential Allocations

Asset Classes	Grouping	Expected Return	Current	Portfolio A	Portfolio B	Portfolio C	Portfolio D
Int Govt/Credit	All Fixed Income	3.54%	35.0%	25.0%	25.0%	25.0%	25.0%
Short Govt/Credit	All Fixed Income	3.04%	10.0%	10.0%	10.0%	5.0%	5.0%
Int Credit	All Fixed Income	4.40%	20.0%	20.0%	20.0%	15.0%	15.0%
91 Day T-Bills	All Fixed Income	1.61%	15.0%	15.0%	15.0%	15.0%	15.0%
Global Equity	Foreign Equity	7.01%	0.0%	10.0%	0.0%	10.0%	5.0%
Global Low Volatility	Foreign Equity	6.66%	10.0%	10.0%	10.0%	10.0%	5.0%
Defensive Equity	Hedge Funds	6.20%	10.0%	10.0%	10.0%	10.0%	10.0%
Real Estate - Core	Real Assets	6.59%	0.0%	0.0%	0.0%	0.0%	5.0%
Global Infrastructure	Real Assets	6.83%	0.0%	0.0%	0.0%	0.0%	5.0%
Private Debt (Levered)	Illiquid Assets	8.58%	0.0%	0.0%	5.0%	5.0%	5.0%
Private Equity LBO	Illiquid Assets	12.09%	0.0%	0.0%	5.0%	5.0%	5.0%

Portfolio Characteristics

	Current	Portfolio A	Portfolio B	Portfolio C	Portfolio D
Avg. Annualized 10 Yr. Return	4.04%	4.51%	4.77%	5.22%	5.14%
Avg. Annualized 10 Yr. Volatility	2.13%	3.70%	2.40%	3.97%	2.93%

Implementation Timeline

- ✓ Board workshop and asset class education
- Approval of new asset allocation study
- Update Investment Policy Statement
- Review managers for new asset classes
- Fund new investments
- Continually review of managers and plan needs

* Timeline to manager selection can be achieved in 2 quarters

Private Equity Education

Private equity introduction

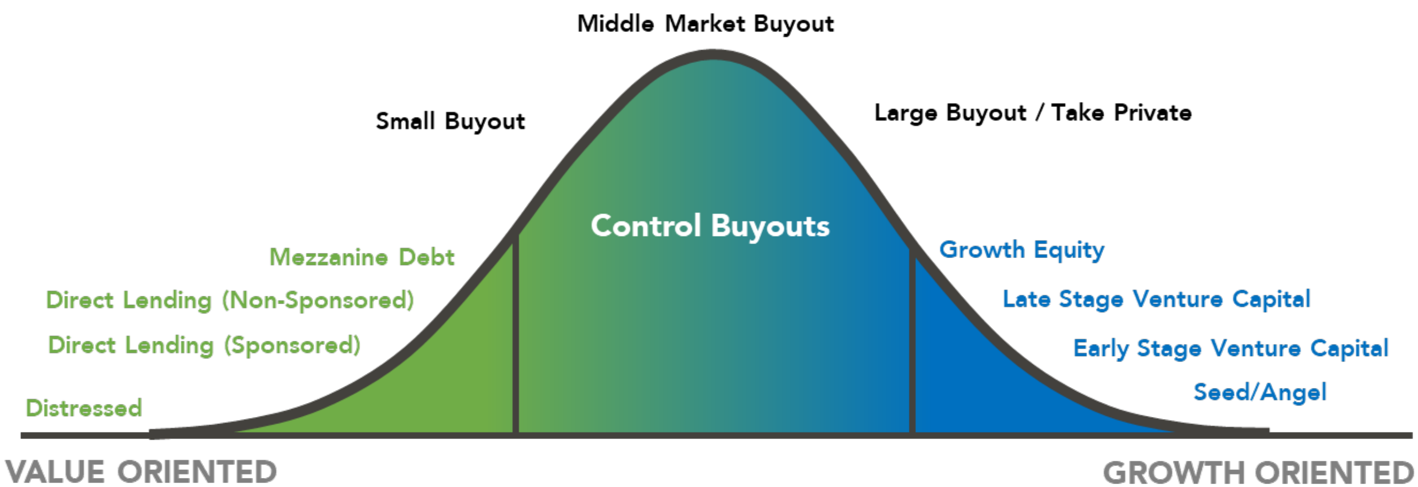
- Private equity encompasses any privately held equity investment
- The global private equity industry currently manages over $4 trillion in assets, as the industry has doubled in size over the past decade
- Strong investor demand for private equity has led to a steadily growing level of dry powder, which now exceeds $1.8 trillion
- Private equity is broken down into three main investment categories:
  - Venture Capital
  - Growth Equity
  - Buyout

Introduction

- Private equity encompasses any equity investment in a private business
- Private equity funds deploy capital as they acquire equity control of businesses they believe to be undervalued and where their operational and sector expertise can help to accelerate growth
- Private equity managers source investments from a larger opportunity set, over 600,000 private businesses in the U.S. employing over 20 million individuals
- The number of private equity owned businesses in the U.S. is likely to grow considerably over the next decade

Sources: Pitchbook, Worldbank.org, and U.S. Census Bureau

Private equity market segmentation

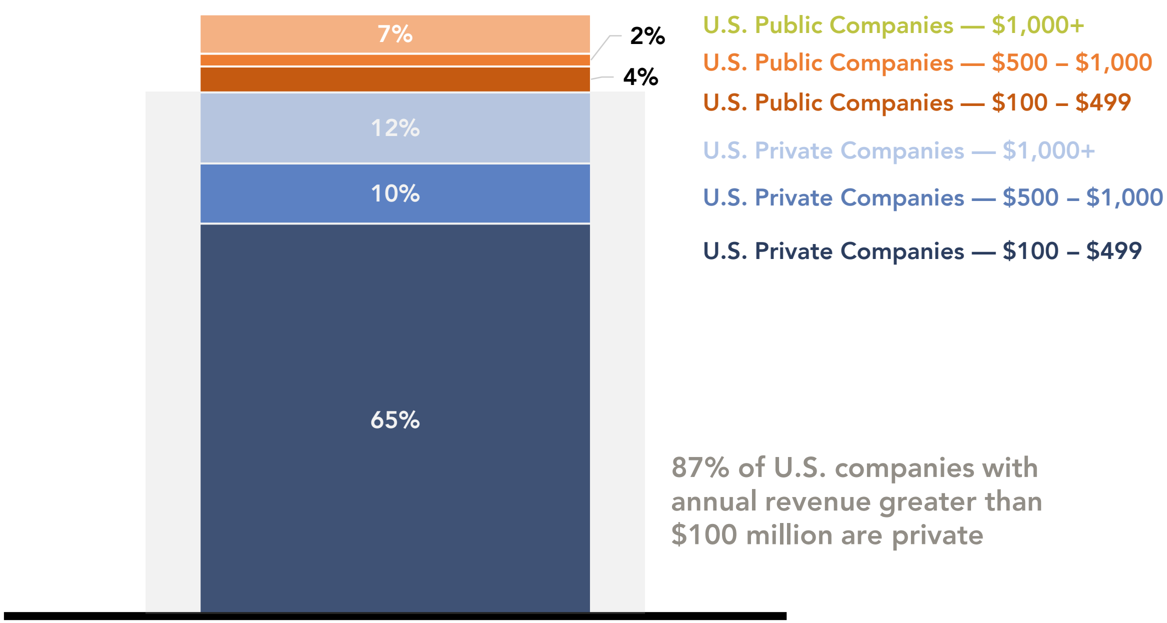


Subcategory	Expected Return	Financing	Duration of Investment	Relative Risk	Stage	Success Rate	Ownership Stake
Venture Capital	20%+	100% Equity	5 years +	High	Early	Low	Less than 50%
Growth Equity	15–20%	100% Equity	3–5 years +	Medium–High	Early Growth	Medium	Less than 50%
Buyout	13–20%	100% Equity	3–5 years +	Medium	Mature	Medium	More than 50%

Source: Marquette Associates. This table represents Marquette's best estimate of typical returns, risk, duration, and investment style of each investment category.

Expansive opportunity set for private equity managers

Private equity outperformance has the potential to persist given the opportunity set of target companies relative to the number of public companies

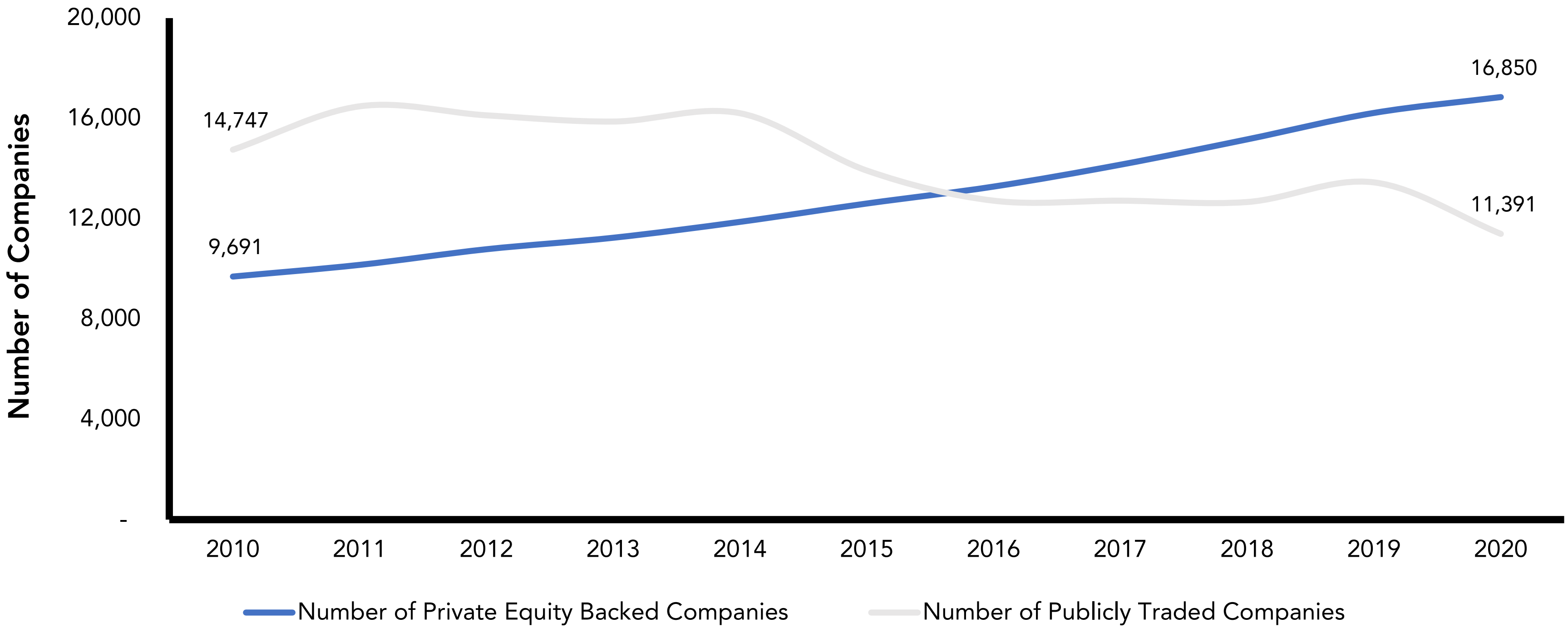


U.S. Public & Private Companies By LTM Revenue ($M)

Source: Capital IQ as of February 2021

Expanding number of private equity opportunities

The inventory gap between public and private equity owned companies continues to expand as increasing capital flows into private equity are expanding the number of investment opportunities



Sources: Pitchbook as of March 2021 and World Federation of Exchanges. Includes companies in North America, Western Europe, and Northern Europe.

Competitive advantages

Over a long time horizon, private equity has consistently delivered higher returns relative to other asset classes

Return drivers include:

↘ **Business control**	Majority ownership allows for a greater ability to affect positive operational improvements in the underlying firm by leveraging the experience, sector knowledge, and network of a private equity firm
↘ **Investment leverage**	Private equity acquisitions are typically completed with debt (40–60% of business value) which often magnifies investor returns
↘ **Alignment of interests**	General Partners are expected to commit a material amount of capital to their fund with incentive fees heavily allocated to the investment team responsible for the fund, aligning interests with their investors
↘ **Price discovery**	Deals tend to be competitive and trade infrequently requiring a great deal of due diligence pre-acquisition. Industry expertise often leads to a better understanding of the available value creation levers available to the team post-investment

Risks

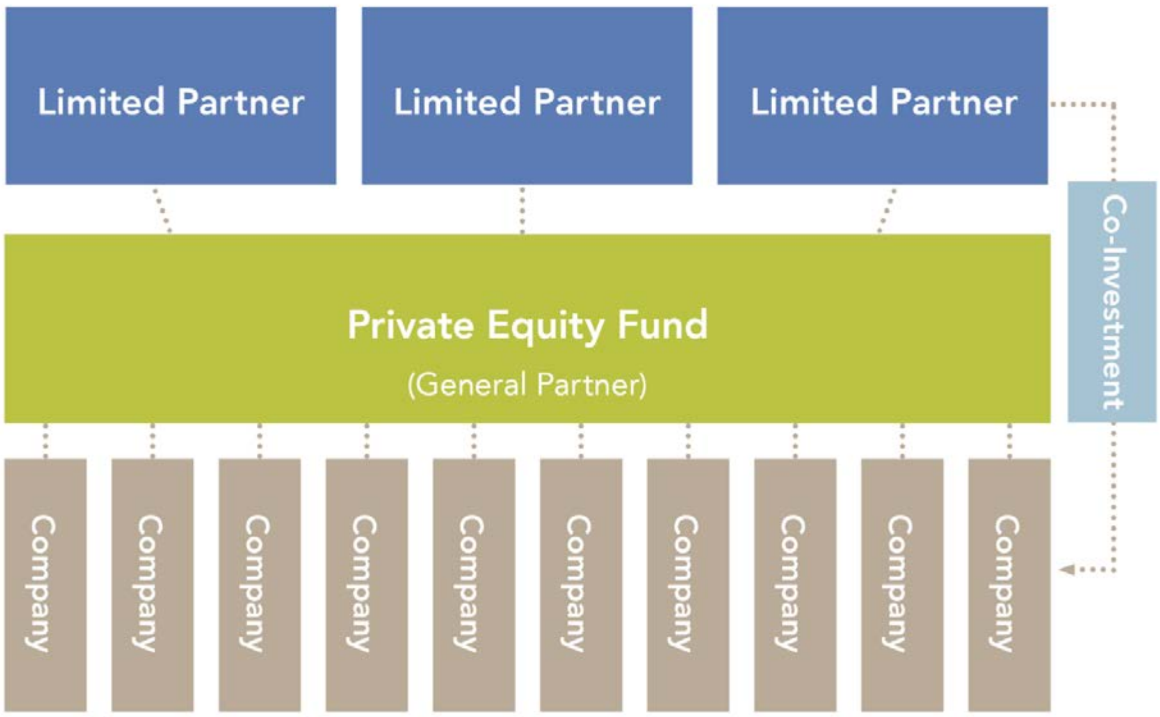
Risks for investors include:

↘ **Investment risks**	Private equity is riskier than public market investments because target firms tend to be smaller with more product and client concentration
↘ **Fund risks**	Regulatory oversight is weaker than publicly traded companies and funds tend to be highly concentrated
↘ **Illiquidity**	Private equity investments are illiquid, and after capital is committed, the investor has little to no control over the size and timing of future cash flows
↘ **High fees**	Funds tend to have high fees charged on committed capital and performance fees that require investors to split profits
↘ **Subjective performance**	Over the life of the fund, portfolio valuations are subjective because investments are not listed on public exchanges
↘ **Manager selection**	There is a large dispersion in returns between the top and bottom quartiles of funds

Private equity legal structure

Most private equity funds are organized as limited partnerships with the private equity firm acting as the general partner and the investors as the limited partners

This structure limits the liability for the investors to their fund investments



Private equity fund lifecycle

- After fundraising concludes, managers typically make 8–15 investments over a four to five-year period, followed by a five to six-year period to grow and sell each business
- Private equity funds on average have a defined life of 10 years for a direct fund and 12 years for a fund-of-funds
- Funds commonly include annual extension options of 1–3 years
- Full liquidation typically takes between 11–15 years

Fund Raising	**Investment Period**	**Harvest Period**	**Extension**
1 year	4–5 years	5–6 years	1–2 years

Private equity investments are unique

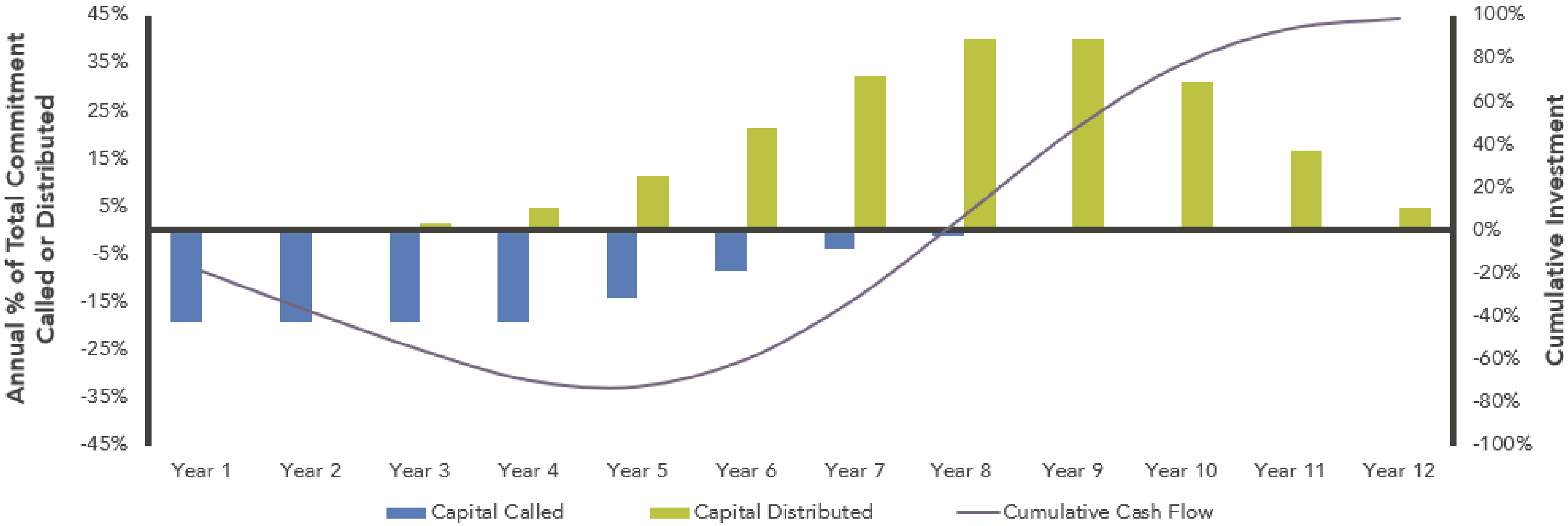
Each private equity program and investment requires monitoring as funds have unique investment term structures. The goal of a well-constructed private equity program is to have a consistent amount of capital called each year to minimize vintage year risk.

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8
Annual Fund-of-Funds								
(2-year investment period)	C	C						
Manager 1	$	$	$	$	$			
Manager 2		$	$	$	$	$		
Fund-of-Funds								
(4-year commitment period)	C	C	C	C				
Year 1 Managers Invest	$	$	$	$	$			
Year 2 Managers Invest		$	$	$	$	$		
Year 3 Managers Invest			$	$	$	$	$	
Year 4 Managers Invest				$	$	$	$	$
Secondary Fund	C							
(5-year investment period)	$	$	$	$	$			
Primary Fund	C							
(5-year investment period)	$	$	$	$	$			
Cumulative Annual Investment	$	$	$	$	$	$	$	$

LEGEND	
C	Annual Commitment by Fund
$	Annual Investment Into Companies

Investment cash flows

Committed capital called for investments and management fees



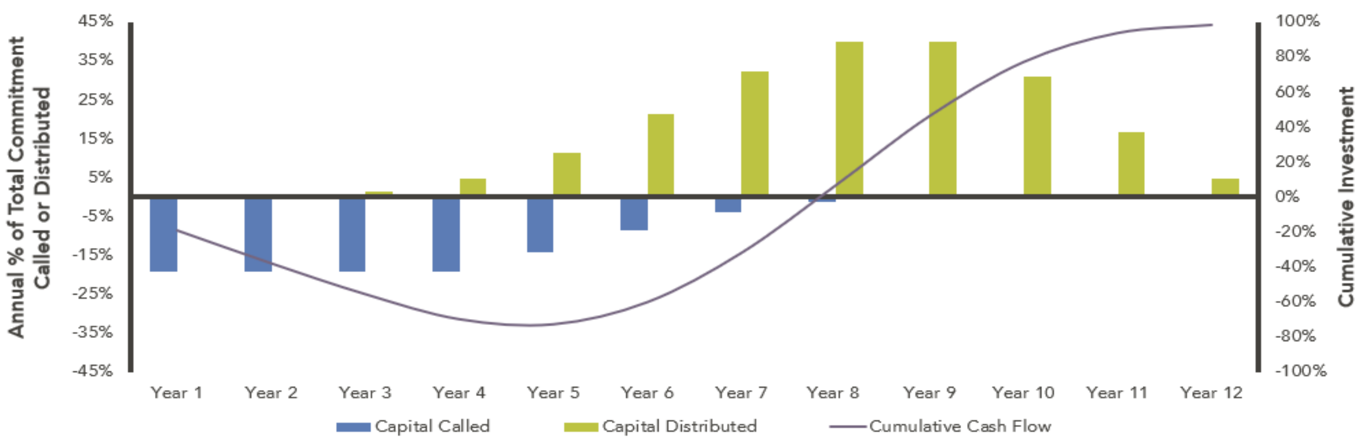
Majority of capital deployed within first 5 years

Value harvested in years 5-10+

This chart shows the amount of capital called and distributed each year on the left axis and shows the investor's total invested capital, as a percentage of committed capital, in each year on the right axis. Private equity funds typically have large capital calls in the early years of the fund's life and then make large distributions towards the end of the fund's life as portfolio companies are sold. In this example we show a fund with a 1.75x multiple, a 14% IRR, and two one-year extensions.

Investment cash flows and j-curve

- Committed capital is called from investors as investments are made and as fees are generated
- Management fees are often calculated on committed capital not invested capital
- A majority of capital is deployed during the first five years into leveraged buyouts with additional capital reserved for ongoing support of operational and growth initiatives
- Fees and slow deployment of capital often generates a negative return during the early years of a fund with higher returns in the later years as investments mature and capital is returned to investors following exits, forming a "j-curve"



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Fees

- **Management Fees** – Typically 2% of committed capital for direct funds and 0.50% – 1.00% for fund-of-funds
- **Performance Fees** – Typically 20% of profits ("carried interest") after an 8% preferred return ("hurdle rate") is achieved for investors in a direct fund and 5% of profits after an 8% hurdle rate is achieved for investors in a fund-of-funds

Industry Standard Fees

Management Fees	Typically 2% of committed capital
Performance Fees	Typically 20% of profits ("carried interest") after an 8% preferred return ("hurdle rate") is achieved for investors

Industry Standard Fund Terms

Target Fund Size	$500 Million
GP Commitment	$10 Million
Investment Period	5 Years
Term	10 Years + 2 one-year extensions
Management Fee	2%
GP Carry	20%
Preferred Return	8% hurdle rate

Historical performance

Private equity's historical outperformance of public asset classes can be attributed to four main characteristics of private equity investments:

- The significant resources, knowledge, and capital brought to a private business provides a catalyst to improve the growth and profitability
- The long-term focus and structure of private equity investment aligns the interest of management and investors and allows for more strategic deployment of capital
- Expanded flexibility in structuring deals provides excellent risk/reward characteristics
- Substantial leverage used to enhance investment returns

Performance measurement

Private equity investments are typically evaluated using three non-traditional performance measurements. Investors should consider all three metrics when evaluating both the absolute and relative investment performance.

Internal Rate of Return (IRR)

The annualized effective compounded return provided to investors in the fund calculated by determining the discount rate that sets the net present value of all cash distributions from the fund equal to the cash invested

- IRR considers the time-value of money and is useful in measuring and comparing the relative performance of different investments

Public Market Equivalent (PME)

The timing and size of cash investments into a private equity fund is matched and converted to an equal purchase of a public index in order to generate a directly comparable IRR for evaluating relative performance

- Performance metric has mathematical issues with either a strong performing private equity funds with large distributions or in a declining public market where returns are negative

Return Multiple

Total Value of Paid-In Capital (TVPI) multiple is a cash-on-cash return multiple which is unaffected by the timing of cash flows and is calculated using the total cash returned to LPs divided by the total cash called by the GP

- Private equity strategies with long time horizons tend to generate high multiples but lower IRRs

Manager access and selection is critical

The key factors to consider in manager selection include:

Investment Performance

Historical performance of previous funds is important to evaluate due to the strong persistence of returns in private equity due to the considerable skill, industry knowledge, and network that can be beneficial to a private business

Investment Team

A consistent and experienced team should be in place capable of deploying the size of the current fund. It is preferred that resources are added to the team prior to raising larger funds

Alignment of Interests

All General Partners should commit a material amount of capital to their fund with incentive fees heavily allocated to the investment team responsible for the fund. It is preferred that this capital is sourced primarily from the investment team. Additional fund terms should further support alignment, including limitations on raising future funds prior to a significant level of capital in the current fund has been deployed

Deal Flow

It is important to generate a significant and consistent level of deal flow in order to execute on attractive investments. It is preferable to have a sourcing advantage that differentiates a manager's capital and attracts proprietary deals which tend to generate better returns

Investment vehicle consideration

	Fund-of-Funds	Direct Funds
Pros	↳ Allows for proper diversification across funds, geography, strategy, and vintage year with less commitments ↳ Less administrative burden (managing fewer calls and distributions along with fewer and less frequent investment decisions) ↳ Access to restricted and often more established managers ↳ Consolidated reporting and monitoring ↳ Potential for return enhancing allocations to co-investment	↳ Construction control over customized program ↳ Less time lag from commitment to investment ↳ Lower overall fees relative to Fund-of-Funds program ↳ Build direct relationships with investment managers ↳ Improved transparency and visibility to company-level reporting
Cons	↳ More expensive overall fees relative to direct fund program ↳ Greater time lag from commitment to investment of capital ↳ Overly broad diversification can generate index-like returns ↳ Limited direct relationship with underlying investment managers ↳ Lack of transparency and visibility to company-level reporting	↳ Increased number of manager relationships and due diligence efforts ↳ Elevated manager specific risk ↳ Greater administrative burden (managing more calls and distributions along with more frequent investment decisions) ↳ Additional legal documentation and review ↳ Greater reporting and monitoring efforts ↳ Co-investment requires sourcing and underwriting expertise

Structure classification

Fund of Funds	Secondaries	Co-Investments	Direct
Strategy that invests in other private equity funds	Strategy that purchases private equity fund interests or portfolios of direct investments in private companies	Strategy that invests directly in private companies with the limited partner investing alongside general partner	Strategy that invests directly in private companies with the general partner investing limited partner commitments
Pros: ▪ Manager access ▪ Ease of administration ▪ Diversification	**Pros:** ▪ J-Curve mitigation ▪ Purchase at discount ▪ Shorter investment life	**Pros:** ▪ Low fees ▪ Investment control ▪ Alignment of interests	**Pros:** ▪ Single layer of fees ▪ Increased transparency ▪ Governance controls
Cons: ▪ Dual layer of fees ▪ Blind pool risk ▪ Long duration	**Cons:** ▪ Dual layer of fees ▪ Limited control	**Cons:** ▪ Concentrated risk ▪ Selection risk ▪ Increased complexity	**Cons:** ▪ Cash flow administration ▪ Blind pool risk ▪ Key person risk

Buyout

The largest portion of the PE market, buyouts focus on controlling a business through a leveraged buyout

EBITDA

Established businesses typically 10 to 35 years old

Middle Market Buyout

- Typically an established national or globally focused business with >$50M of EBITDA
- Generally institutional-owned
- Opportunities to expand geographic and product focus

Lower Middle Market Buyout

- Typically a more established nationally focused business with $10–50M of EBITDA
- Can be either founder-owned or institutional-owned
- Opportunities to professionalize management and operations

Small Buyout

- Typically a smaller, regionally focused business with <$10M of EBITDA
- Typically founder- or family-owned
- Significant opportunities for operational improvement and business growth

Time

Venture Capital

The second-largest portion of the PE market, VC focuses on investments in the form of minority equity ownership in less mature but rapidly growing businesses

Revenue

Early stage businesses from start-up to under ~10 years old

Late Stage Venture or Growth Equity

- Expansion capital provided to a company that has proven a sustainable concept by generating a significant level of revenue
- May or may not be profitable
- Capital may be considered bridge financing for a business near the point of "going public" through an IPO

Early Stage Venture

- Capital provided to set up or expand production, marketing, and/or distribution network
- Company is often generating revenues but unprofitable

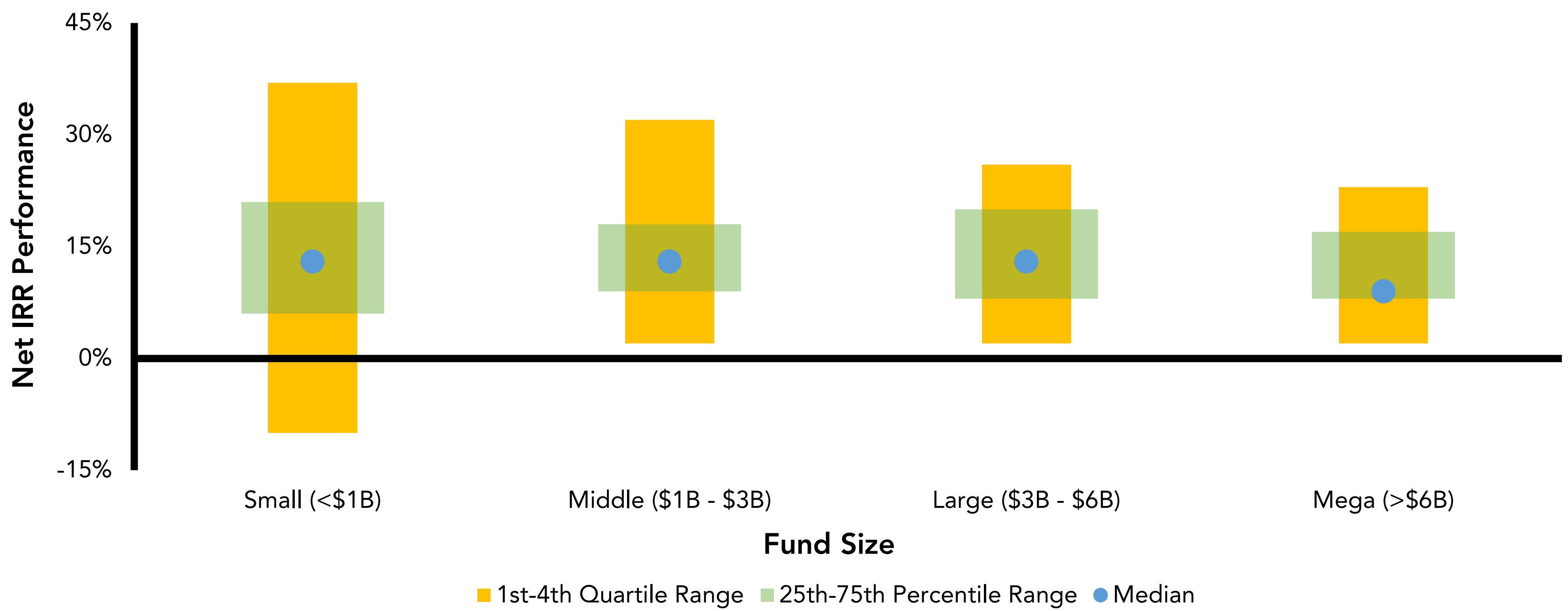
Angel or Seed

- Usually the first outside capital raised by an entrepreneur in order to launch a company, develop a concept, or build prototypes prior to entering the market
- Company is typically pre-revenue generating

Time

Small funds provide attractive risk-adjusted returns

High-quality diversification is beneficial at the lower end of the market requiring numerous fund commitments each vintage year (or the use of fund-of-funds) in order to improve the expected risk-adjusted return of a private equity program due to the significant performance dispersion



Source: Burgiss as of March 31, 2020, Pitchbook, Private iQ and Morningstar. Performance shown above reflects North American buyout funds with vintages between 2002 and 2016. Performance of funds with more recent vintages are not included as their performance is not yet meaningful. Past performance is not indicative of future results.

Benefits of fund-of-funds

Access

Investors are provided exposure to difficult-to-access funds from some of the best performing managers due to the consistent capital these managers provide and their deep relationships in the market

Portfolio Construction

Portfolios are constructed by experienced managers who actively manage and diversify exposures across investment strategies, managers, geographies, sectors, fund sizes, and vintage years

Administration

Significantly less due diligence efforts, legal fees, and administrative time required to manage a larger number of capital calls and distributions

Investment Terms

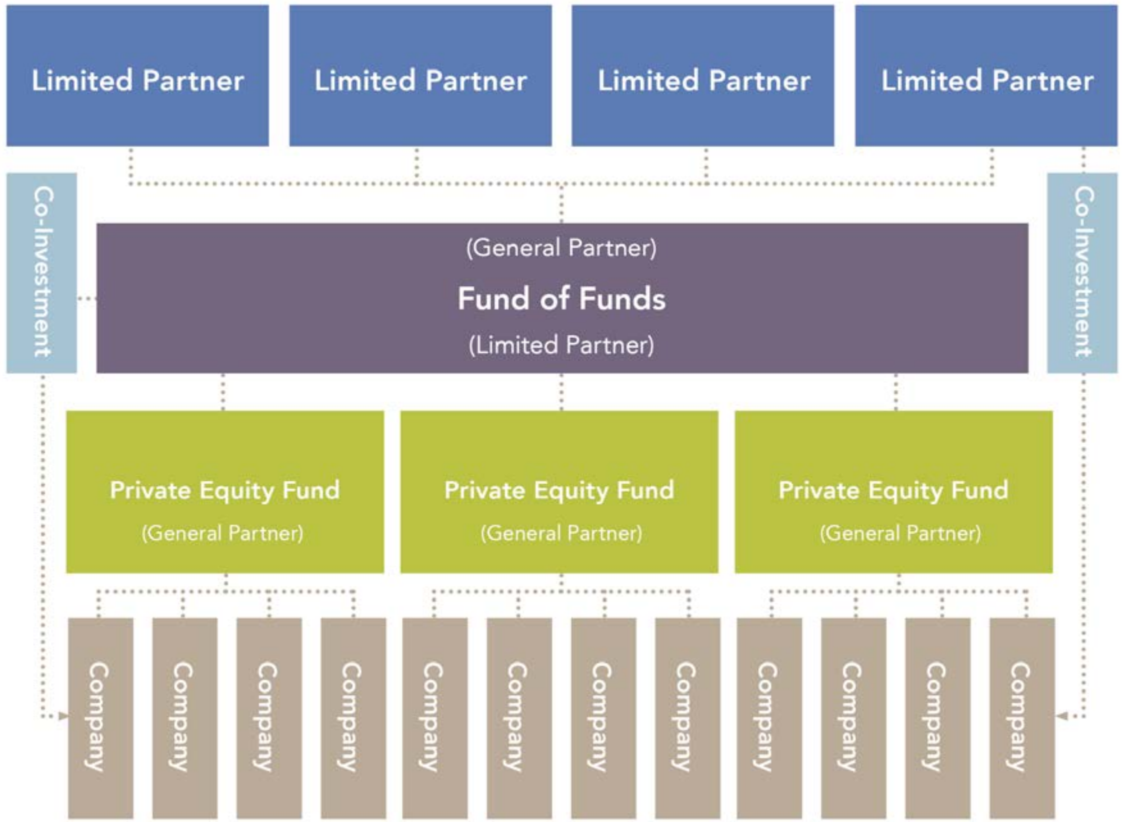
Investors benefit from the negotiating power of a larger investment into a fund which can provide beneficial fees and terms that can enhance investment returns

Co-Investments / Secondary Investments

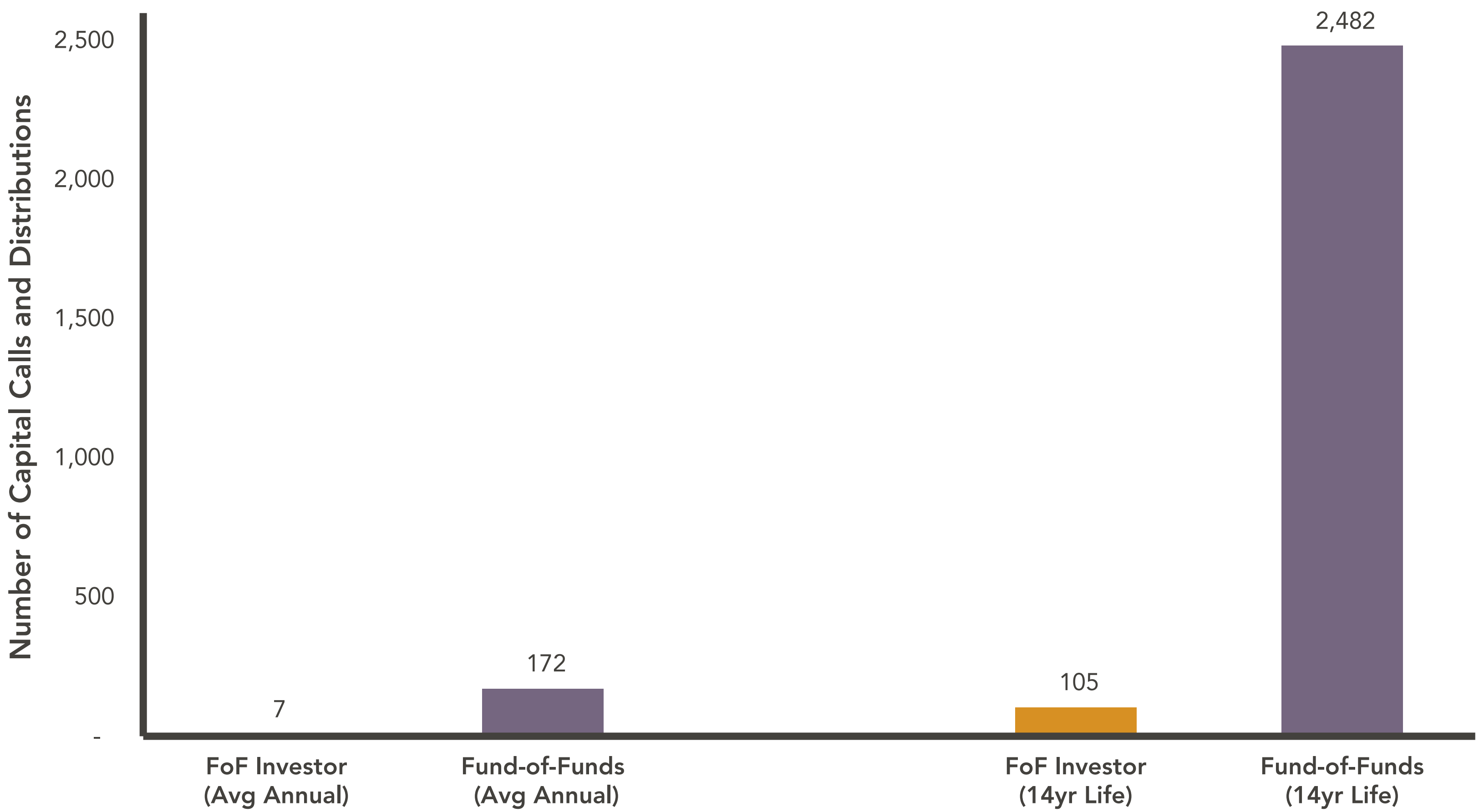
Investors benefit from the manager's underwriting experience and ongoing monitoring of opportunities in the market to purchase attractive assets that help to mitigate the j-curve and can enhance investment returns

Private equity fund-of-funds legal structure

With private equity fund-of-funds, the investors are still the limited partners but the fund-of-funds is both the general partner and the limited partner



Administrative Requirement: Calls & Distributions



This chart shows the number of capital calls and distributions on an annual basis for both a FoF investor and FoF with a 14 year average life. In this graph, we show 7 and 172 as the average annual calls/distributions for a FoF investor and manager of a Fund-of-Funds, respectively. The number of calls and distributions over a 14 year average fund life is 105 and 2,482 for a FoF investor and manager of a Fund-of-Funds, respectively. This analysis was derived by looking at the average from 8 top-tier managers of a Fund-of-Funds.

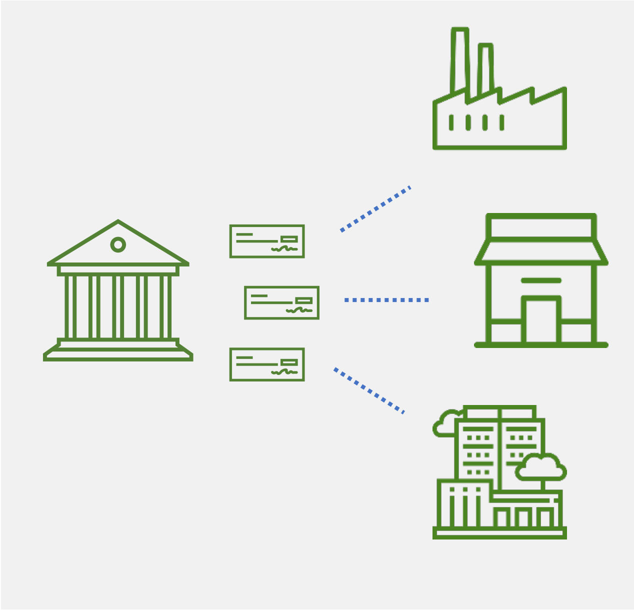
Private Debt Education

What is private debt?

- Private debt has existed for decades — often provided by national and regional banks — as financing to support private businesses as well as private equity leveraged buyouts
- Private debt is simply loans to private companies that can exist across the debt capital structure, from senior secured loans to mezzanine debt
- Over the past decade private debt has yielded more than 8%, higher than high yield bonds and syndicated loans
- Most private debt features a floating rate yield and a 5–6 year duration

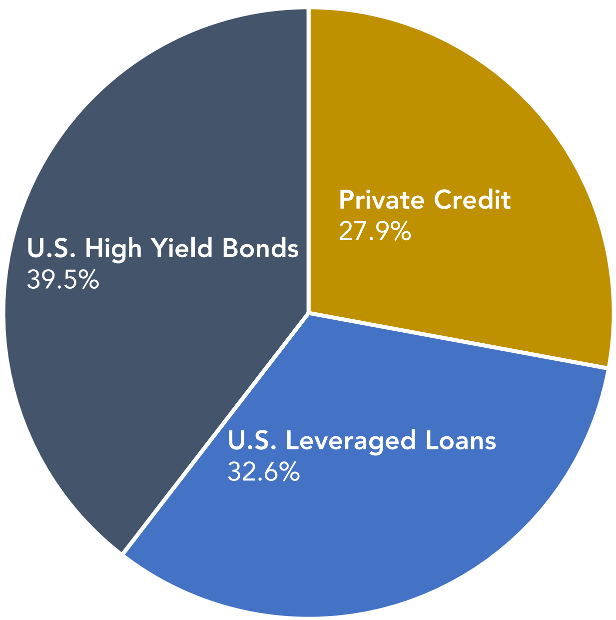
Introduction

- Private credit is loans to private companies across the debt capital structure
- Private credit has existed for decades, often provided by national and regional banks, as financing to support private businesses
- Over the past decade, private credit has yielded more than public credit (high yield bonds and leveraged loans)
- Most private credit features a floating rate yield and an intermediate duration

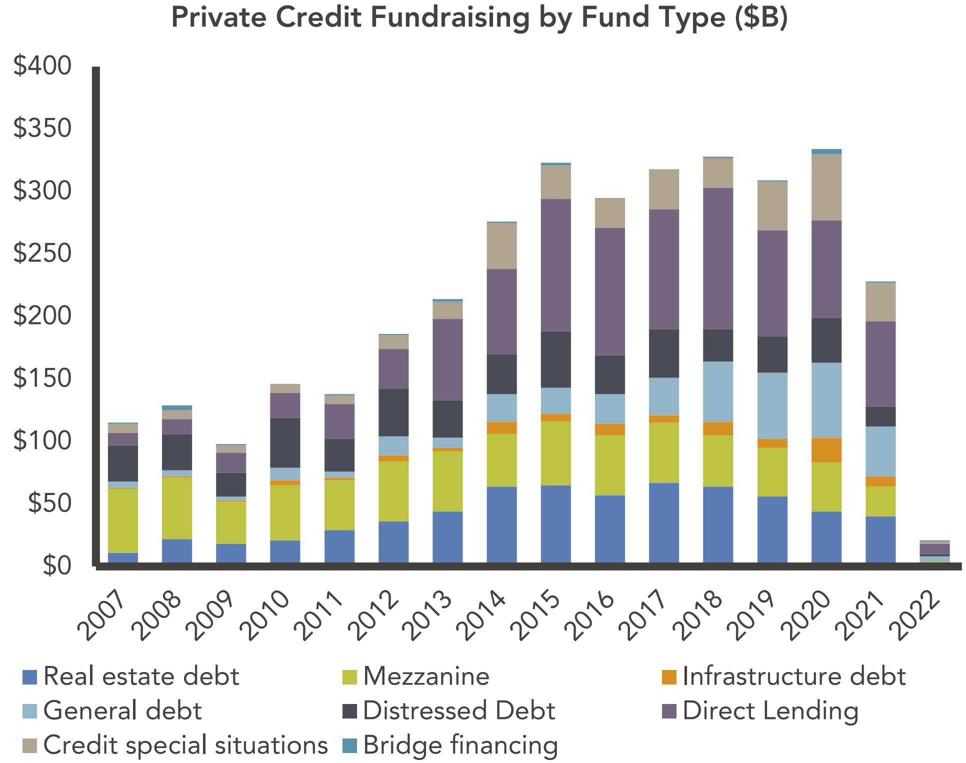


The private debt market

U.S. non-investment grade credit market is ~$4.3 trillion



Direct Lending continues to be the strategy of choice for LPs



Source: Pitchbook

Private debt characteristics

	High Yield Bonds	Private Debt **Direct Lending, Mezzanine, Distressed, Special Situations, Venture Debt**	Leveraged Loans
Maturity	7–10+ Years	3–5 Years	3–6 Years
Seniority	Subordinate	Senior & Subordinate	Senior
Securitization	Unsecured	Secured & Unsecured	Secured
Rate Structure	Fixed Rate	Floating Rate	Floating Rate
Target Company Size	\$300M–\$2B EBITDA[1]	\$5M–\$100M EBITDA[1]	\$300M–\$2B EBITDA[1]
Average Deal Size	~\$500M	~\$5M–100M	~\$400M
Origination	Bank Origination	Non-Bank / Asset Mgr Origination	Bank Origination

Sources: Preqin; [1] The Annual Manual; U.S. Leveraged Finance Primer

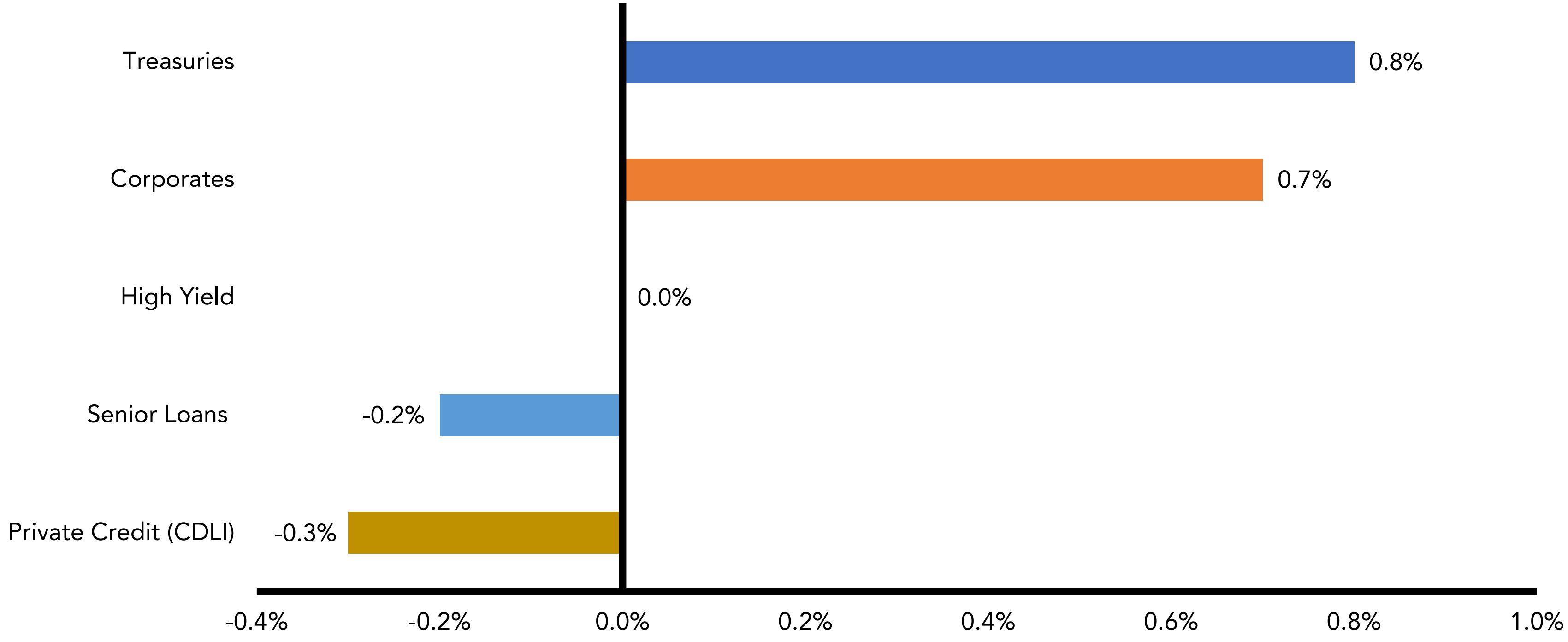
Why investors should consider private debt

- Private debt is on pace to the be the third-largest alternative market behind private equity & hedge funds
- A supply void has been created by the departure of traditional banks from the lending market
- The private debt market is less efficient and growing
- Cash yields remain higher than public debt & real estate
- Lower overall fees and higher risk-adjusted returns compared to other illiquid investments
- Shorter illiquid duration
- Enhanced J-Curve mitigation
- Added diversification benefit due to lower correlations

Private debt historical yield & correlations

Middle market loans have offered high yields and exhibited limited correlation relative to other fixed income and public market asset classes

Correlation to Investment Grade Bonds (15-Years, Annualized)

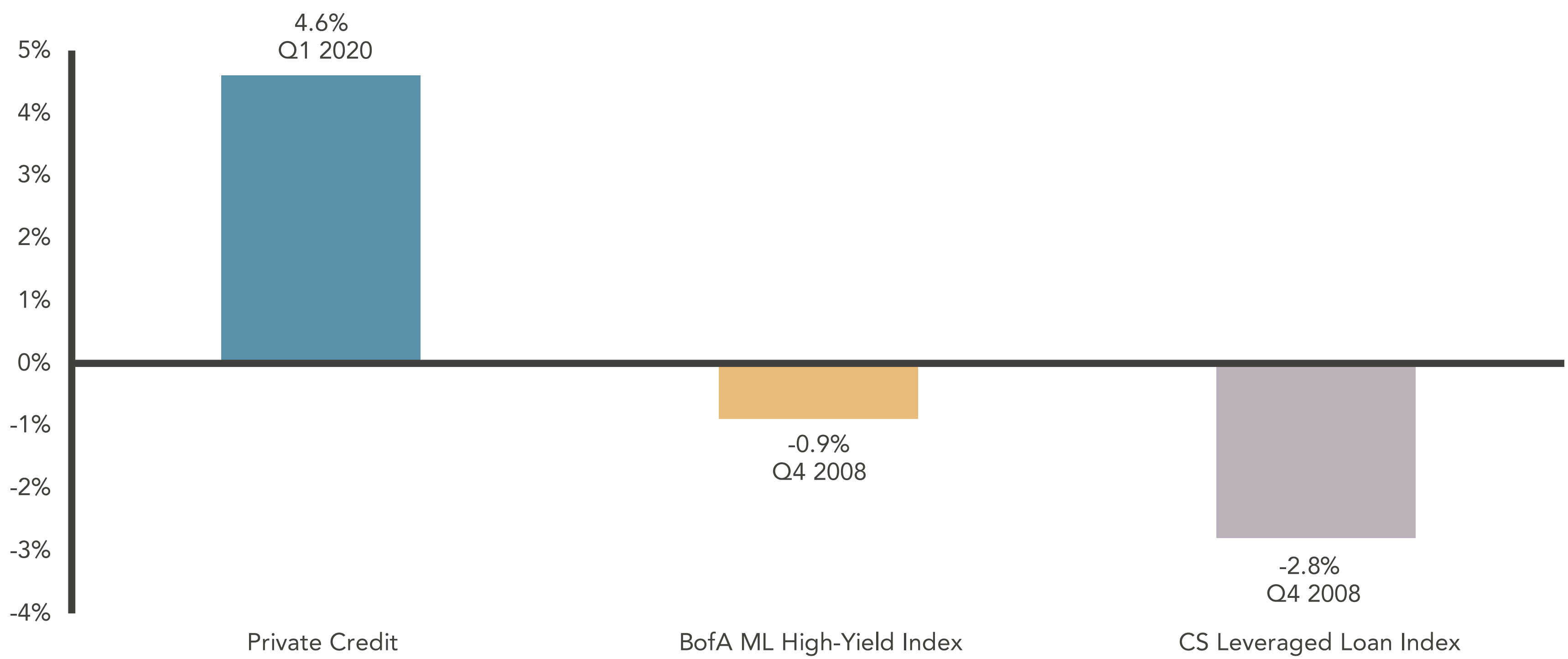


Sources: Blackstone, Morningstar, Cliffwater Direct Lending Index as of March 31, 2022

Downside performance is compelling

Private credit allocations provide investors a defensive allocation shift within many portfolios as the asset class has demonstrated strong downside performance and diversification benefits against other private and public asset classes

Lowest 5-Year Annualized Performance

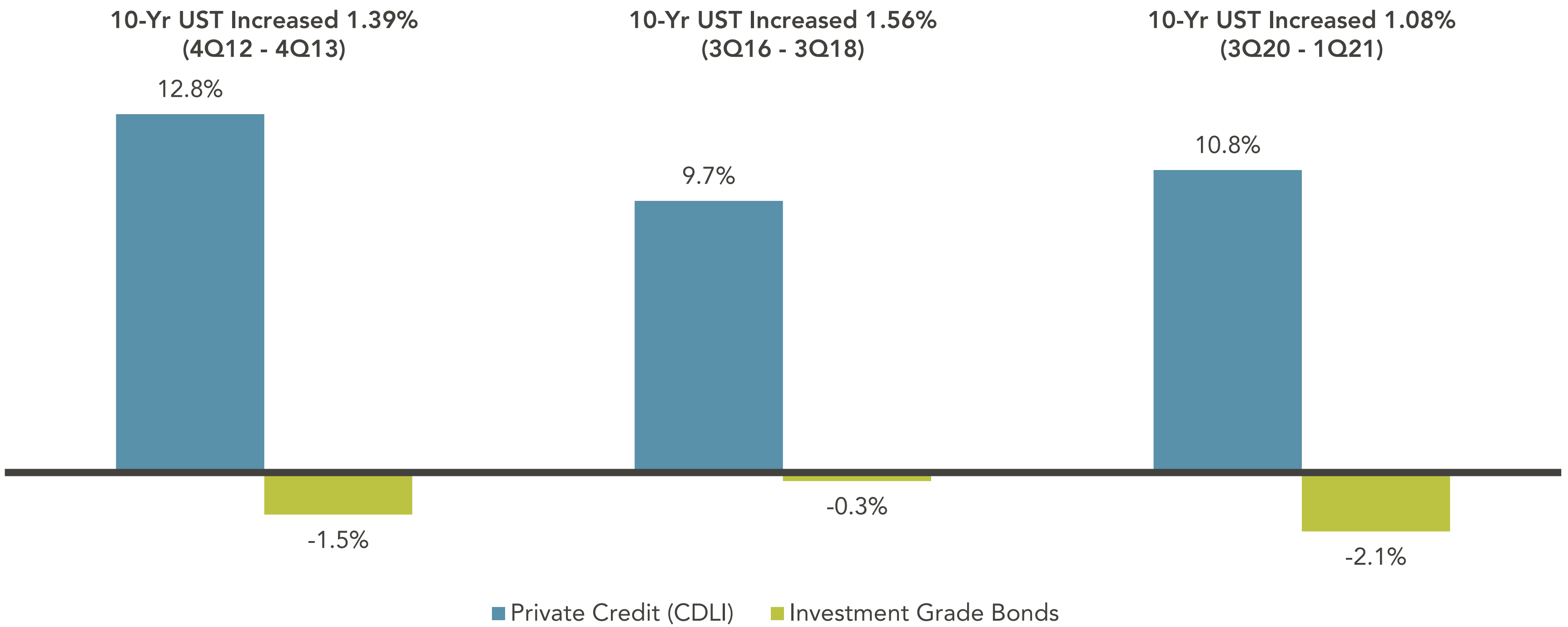


Sources: Hamilton Lane Data via Cobalt, Bloomberg (January 2022)

Historical private debt performance

- Private Credit as an asset class his historically performed well relative to Investment Grade Fixed Income during periods of monetary tightening
- Average outperformance of ~1,240bps relative when rates increased by at least 75bps over the past decade

Historical returns when rates increased by 75bps+ in past 10 years

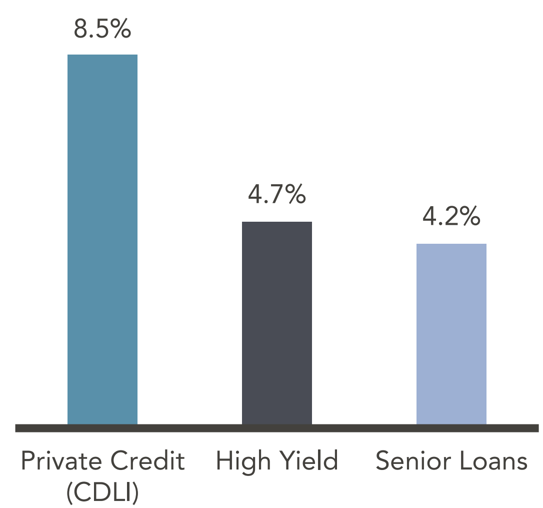


Sources: Blackstone, Morningstar, Cliffwater Direct Lending Index

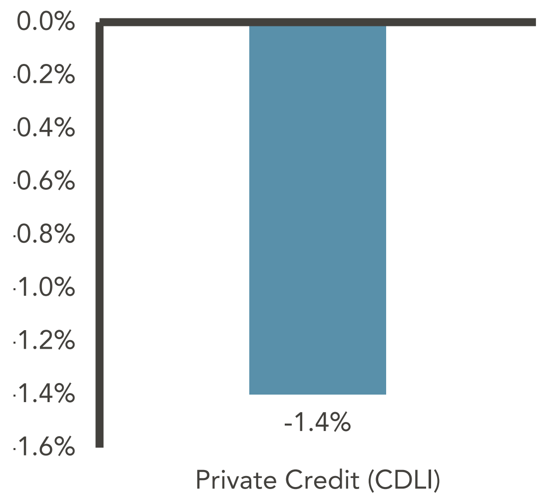
Compelling downside protection

- Middle Market Private Credit has historically offered an attractive yield premium relative to loss rates of traditional fixed income instruments
- Private Credit continues to offer diversification benefits and yield enhancement when added to an existing portfolio of traditional fixed income or alternatives

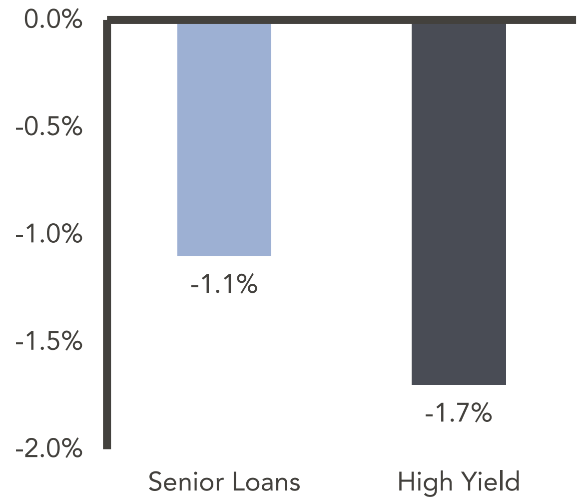
↘ Annualized 12-Month Yield



↘ Average Loss Rates



↘ Average Realized Loss (2006 – 2021)

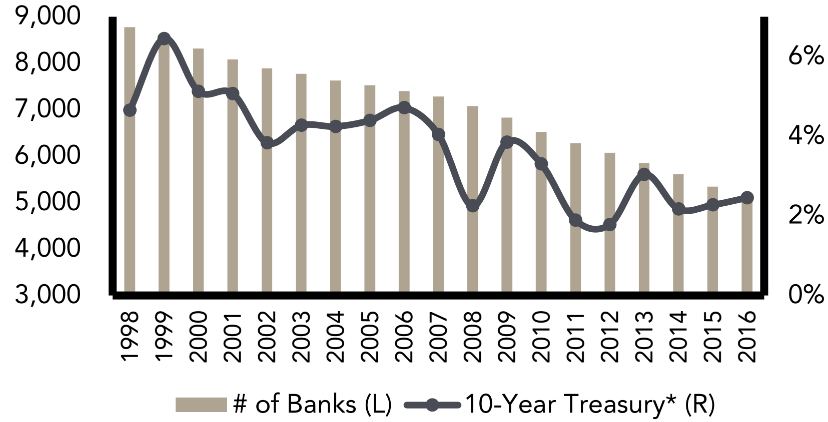


Sources: Blackstone, Morningstar, Cliffwater Direct Lending Index, JPM Default Monitor, S&P/LSTA Leveraged Loan Index as of December 31, 2021.
Note: "Senior Loans" is represented by the S&P/LSTA Leveraged Loan Index. "High Yield" is represented by the Bloomberg Barclay's High Yield Index.

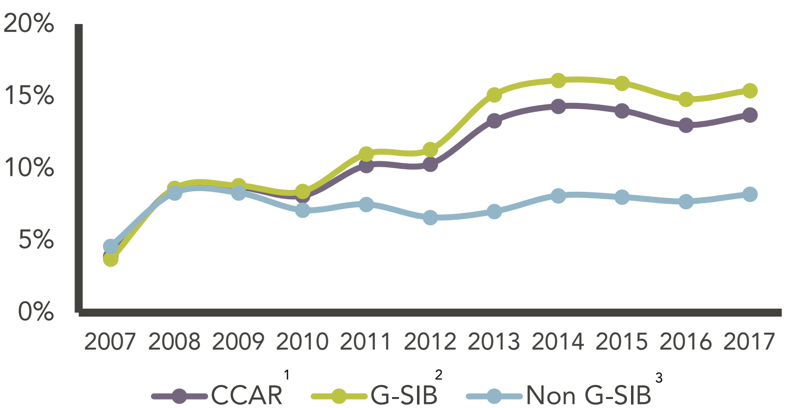
Market shift creating opportunity

- The U.S. market has experienced a ~40% decrease in the total number of banks since 1998
- Following the Global Financial Crisis, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act; banks now face higher regulatory capital requirements & decreased capacity to lend
- Today, there are more than 200 private debt managers managing ~$760B versus 31 managers managing ~$330B in 2010

↘ Decreasing # of Banks & Declining Interest Rates



↘ Increasing Bank Capital Requirements



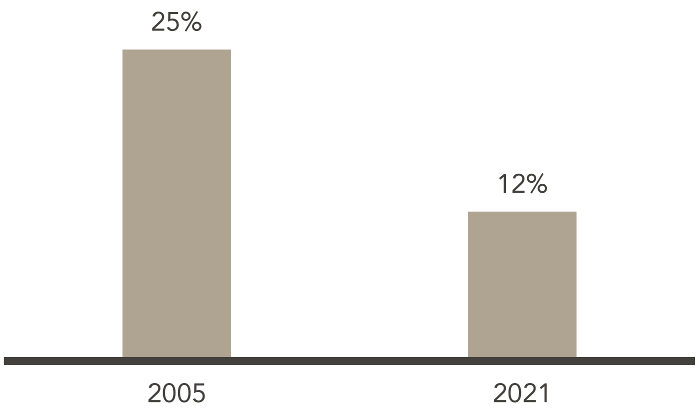
*End of year, constant maturity; Source: Federal Reserve Economic Data and Fortress
[1] CCAR : Comprehensive Capital Analysis and Review is a stress-test regime for large U.S. banks. It aims to establish whether lenders have enough capital to cope with a severe economic shock, and assesses their risk modelling practices;
[2] G-SIB: Financial Stability Board's (FSB) labeled global systemically important banks;
[3] Non G-Sib: non global systemically important banks

Bank participation in credit markets

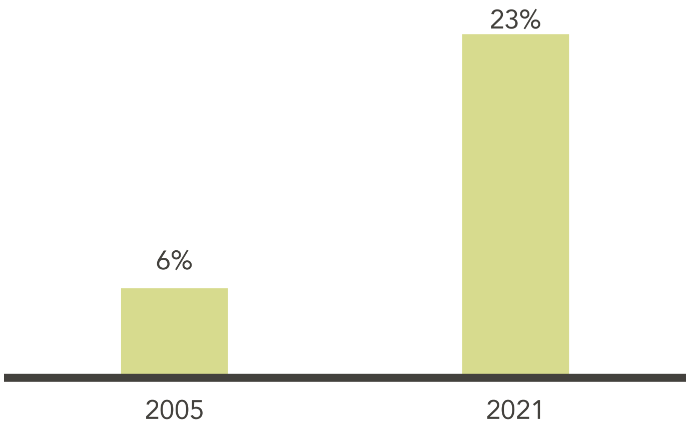
Demand for direct lending has increased as U.S. banks have withdrawn from the market

- As a result of the shifting market, today banks only participate in 8% of the leveraged loan market as compared to 73% in 1995
- Institutional investors, mainly through private debt funds, have become the most important source of capital for the U.S. levered loan market

Bank Participation in U.S. Loans as of December 31, 2021



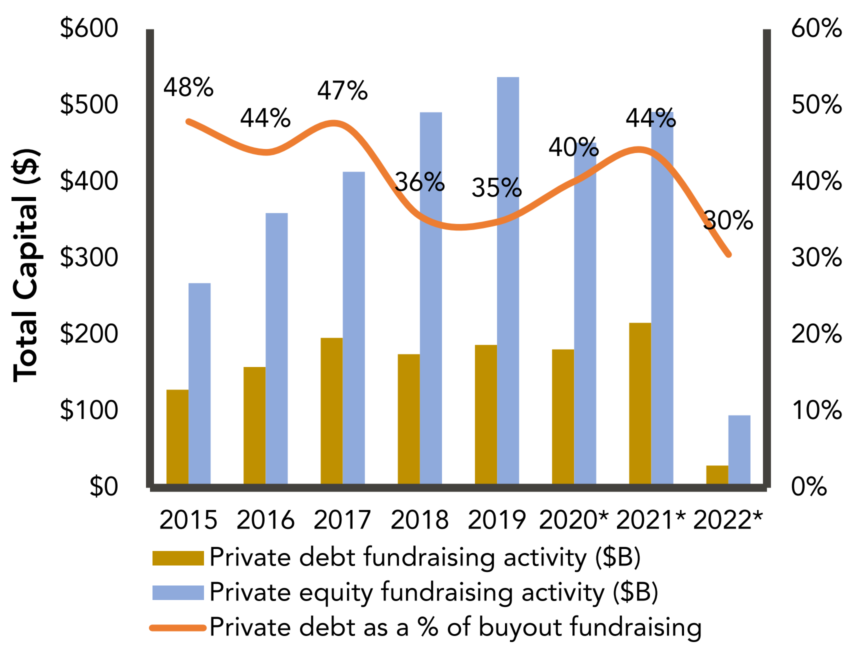
Private Credit as a Percentage of the Credit Markets as of September 30, 2021

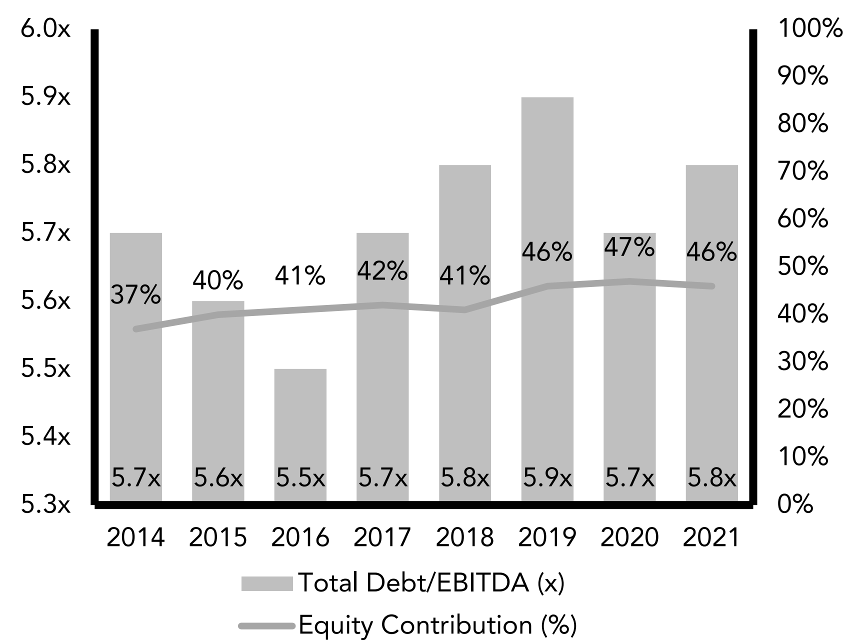


Sources: Blackstone, S&P Global Market Intelligence, Preqin, Credit Suisse

Private equity demand driving private debt

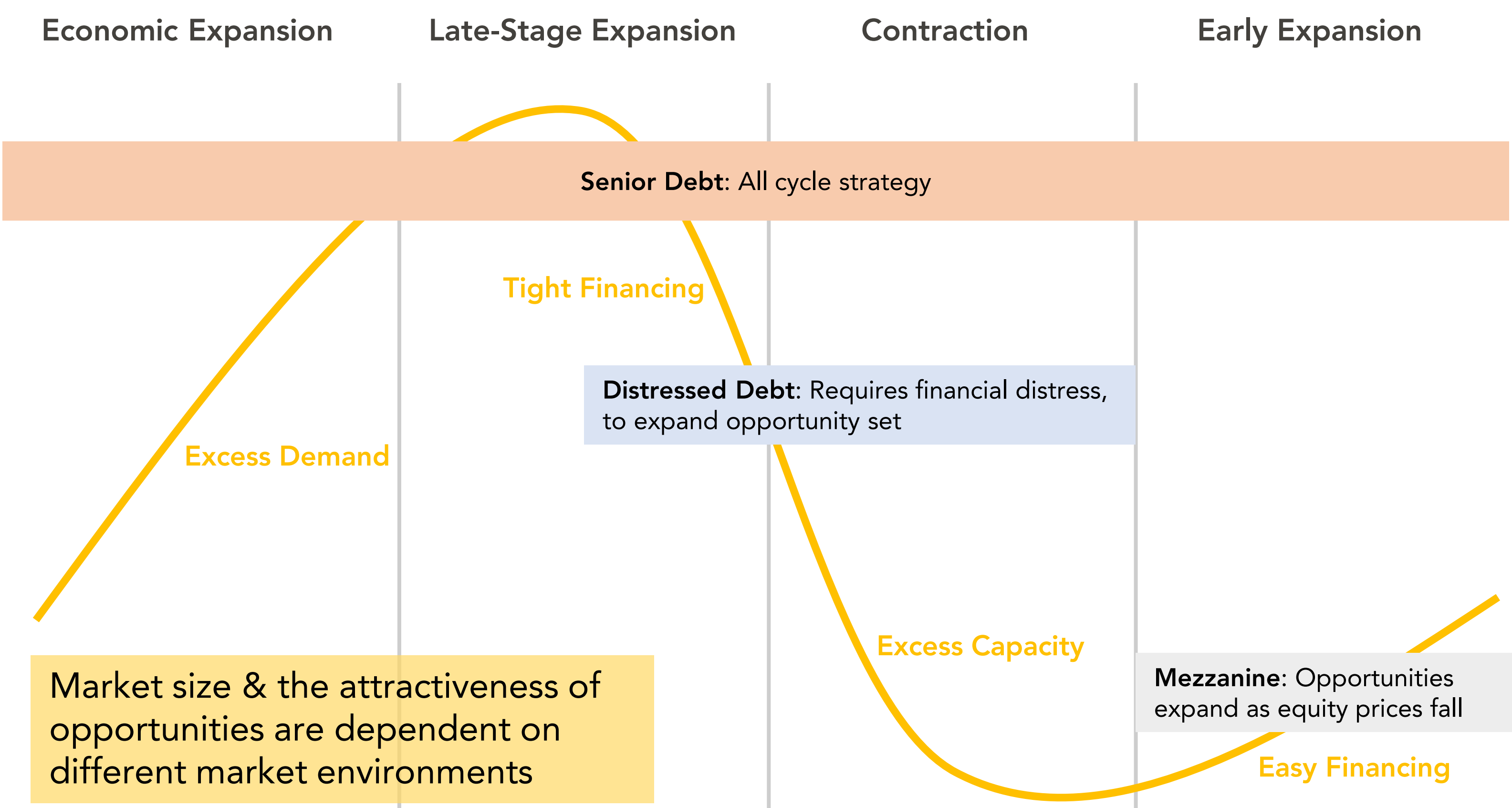
- While the private debt asset class has grown extensively, \private debt has only raised $1 for every $3 raised by private equity since the GFC
- Since the average buyout is financed with approximately 40% debt and 60% equity, this figure is below the financing needs of private equity sponsors
- This debt shortfall allows private debt managers the opportunity to invest alongside private equity sponsors





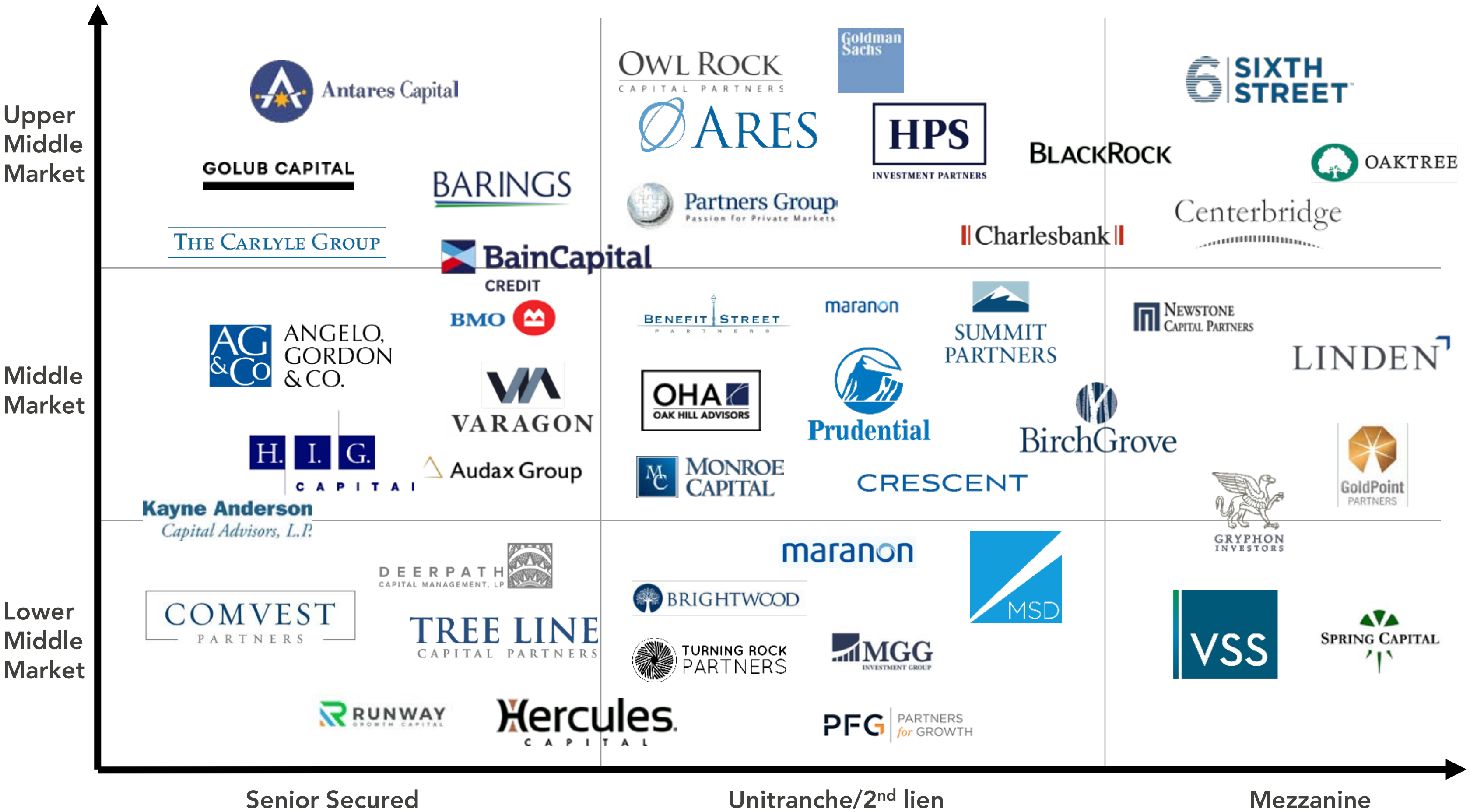
Sources: Neuberger Berman, Pitchbook

Private debt strategies across economic cycle



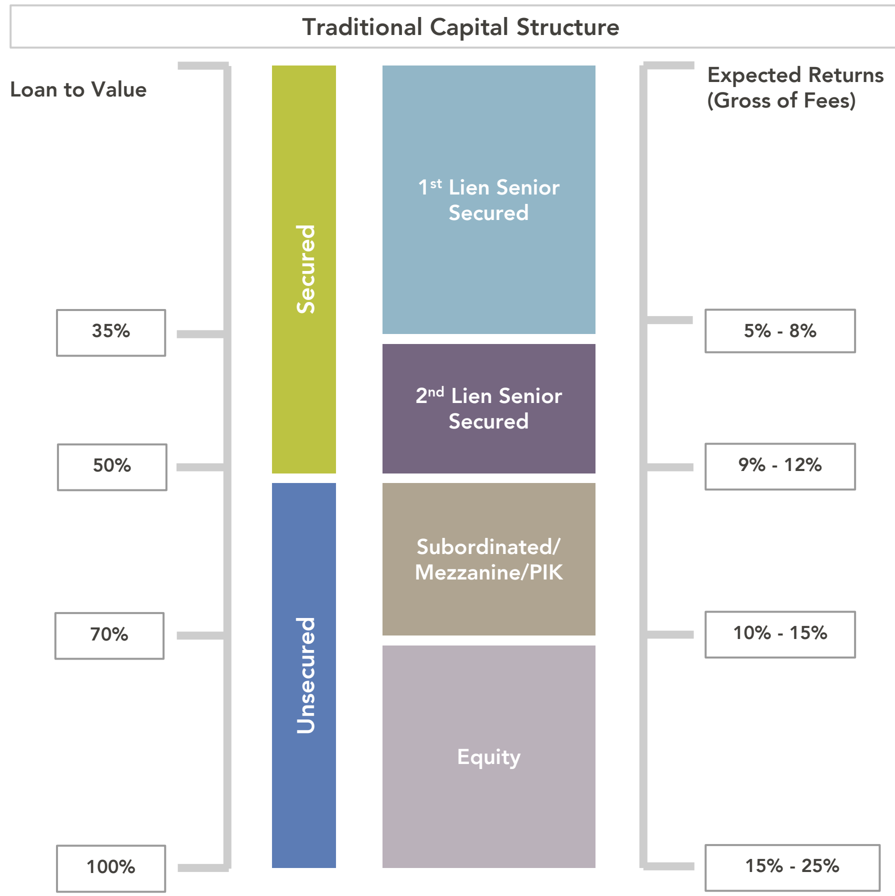
Source: Blackrock

Private debt market segmentation



Traditional private business capital structure

Many investors have chosen to take advantage of both the security within 1st lien senior loans and attractive yields, while adding fund leverage, to generate a double-digit net returns as opposed to taking on more business risk investing lower down the debt capital structure



Credit terms & covenants

Key Covenants to Watch for				
Protective Covenants	Debt Incurrence	Asset Liens	Acquisitions	Change of Jurisdiction
	Dividends/ Restricted Payments	Asset Sales	Change of Control	Definition of EBITDA

Source: Crescent

Risks

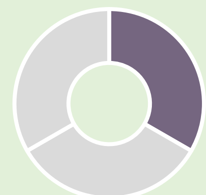
Private credit has unique risks when compared to traditional public credit markets

↘ **Maturity**	Less mature asset class as compared to public credit markets as well as other alternative markets.
↘ **Competitiveness**	Investor demand is increasing manager competitiveness. More managers and newer managers without workout experience across market cycles could lead to diminished returns.
↘ **Illiquidity**	Private credit investments are illiquid. After capital is committed, the investor has little to no control over the size and timing of future cash flows.
↘ **Default**	Non-investment grade credit with subordination risk. Slowing economic market environment may increase risk of defaults.

Positioning private debt in a portfolio

Middle market private credit can play a variety of roles in a portfolio

Risk-Mitigating

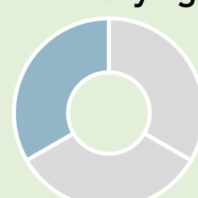


Middle Market Lending:
Asset yields:
+ 7% to 10% (Senior)
+ 11% to 13% (Junior)

Return-Seeking

Middle Market Lending:
+ Low correlation
+ Low volatility
+ Hedge to raising rates

Diversifying



Middle Market Lending:
+ Current income
+ Low loss rate

Conclusion

- Private debt is an attractive asset class for the following reasons:
  - Significant yield premiums
  - Downside protection
  - Diversification benefit with limited correlation relative to other fixed income and public market asset classes
- The private debt market has experienced a secular shift as many banks have exited the cash flow-based lending and the number of residual banks have declined
- As a result of the growth in global buyout dry powder and the declining participation in the loan market by traditional banks, demand for private debt remains strong with clear visibility towards continued growth
- The rising the demand coupled with the benefits of the asset class, investors have been adding a separate allocation for private debt within investment portfolios
- Suitable private debt benchmarks include the Credit Suisse Leveraged Loan Index[1] (CSLLI) and the ICE BofAML U.S. High Yield Master II Index[2] (HUCO)

[1]Credit Suisse Leveraged Loan Index: Tracks the investable market of the U.S. dollar denominated leveraged loan market. It consists of issues rated "5B" or lower, meaning that the highest rated issues included in this index are Moody's/S&P ratings of Baa1/BB+ or Ba1/BBB+
[2] ICE BofAML U.S. High Yield Master II: Tracks the performance of U.S. Dollar-denominated below investment- grade corporate debt publicly issued in the U.S. domestic market