



NEPC, LLC

To: NEPC Clients

From: NEPC Research

Date: January 26, 2017

Subject: EnTrustPermal Due Diligence Status Change: *Upgrade from HOLD to WATCH*

Product Rating: EnTrustPermal Fixed Income Holdings N.V. ("EPFIH") and EnTrustPermal Fixed Income Holdings (ERISA) Ltd. ("EPFIHE"): *Maintain Current Rating (Neutral) and Current Due Diligence Status: HOLD*

Roughly one year since the announcement that EnTrust and Permal would merge and form a combined entity (EnTrustPermal) and subsidiary of Legg Mason, we are comfortable that the integration process is proceeding in line with expectations. At the firm level, there has been some reduction in overall assets under management but within expectations given a significant corporate event. We expect further integration efforts to occur over time to continue to gain efficiencies in the investment process and make efforts to extract additional fee savings from underlying managers. We will continue to monitor the ongoing integration but at this time we believe it is appropriate to upgrade the firm Due Diligence rating of EnTrustPermal from HOLD to WATCH. This means that we have gained comfort with how they have addressed a significant event (merger of two firms) but believe continued monitoring is appropriate.

We are maintaining the current Due Diligence Status of HOLD on the legacy Permal Fixed Income Holdings strategies (EPFIH and EPFIHE) as we feel a higher level of monitoring and awareness is appropriate given relatively large redemptions in these strategies over the last year. Increasing investor outflows from the legacy Permal flagship fund (EPFIH), driven largely by non-NEPC investors (primarily Private Clients and Family Offices), have led to a drop in AUM of approximately 40% since the beginning of 2016. This asset decline could potentially present some liquidity concerns for NEPC investors in the Fund should more investors redeem. The ERISA Fund (EPFIHE) experienced a smaller asset drop in 2016 (~20%) but we are aware of anticipated additional redemptions of more than 30% in that fund. EnTrustPermal has indicated they there are prepared to manage those redemptions effectively.

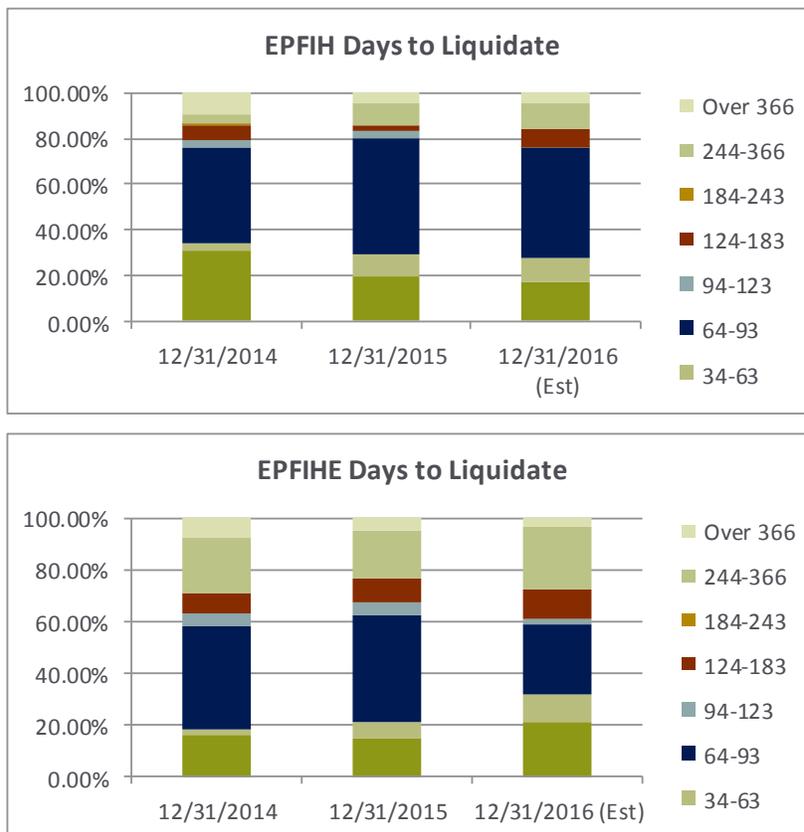
Historically, EnTrustPermal has managed portfolio liquidity of these funds effectively, including during this recent period of redemptions. The portfolio management team has prudently balanced portfolio flows and underlying manager redemptions while utilizing lines of credit to help mitigate the portfolio impact. Additionally, the team and processes remain the same.

Given the decline in assets and trend of outflows, we think it is appropriate to maintain our HOLD recommendation as we continue to monitor and evaluate the portfolio and overall asset flows. While the significant outflows are a concern, this is somewhat offset by the following factors:

- The portfolio management team has historically shown an ability to manage through periods of outflows and adjust positions to meet monthly redemptions.
- The funds performed well on a relative basis in 2016 despite the outflows.
- Effective liquidity management is evidenced by the fact that the liquidity profile of the Fund's underlying holdings has remained relatively similar to previous years. While the majority of assets are still in vehicles that require more than 30 days to liquidate, the overall profile remains consistent.

255 State Street | Boston, MA 02109 | TEL: 617.374.1300 | www.nepc.com

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Source: NEPC, EnTrustPermal (12/20/2016). 12/31/2016 liquidity is estimated. The charts shown above are based on "a most restrictive liquidity review" by EnTrustPermal which for year end 2016 is estimated as of December 20, 2016. The "days to liquidate", has been defined by EnTrustPermal as the number of days until the next effective available redemption date of the underlying investments in EPFIH and EPFIHE

- While the use of credit lines increased meaningfully for the EPFIH during this period, EnTrustPermal has indicated that the funds' borrowing needs have dropped as outflows have slowed and they have continued to manage portfolio cash flows. In addition, they noted that they have additional borrowing capacity. This capacity should allow them to continue to manage the portfolio consistent with past practice.
- EnTrustPermal noted that they are considering merging the EPFIH and EPFIHE funds in order to improve the overall flexibility across all of the funds. We are supportive of this concept because of the potential additional benefits to clients and will keep you informed if this moves forward.
- If redemptions increase to the point that it could negatively impact remaining investors, it is possible that EnTrustPermal could impose a gate. As indicated by EnTrustPermal, the purpose of the gate would be to manage liquidity of the funds in the best interests of its continuing investors. This provides another potential layer of protection for remaining clients, but, if triggered, could lead to a slower repayment



of redemption proceeds than what the Fund's stated terms offer for those clients redeeming.

- EnTrustPermal provided information about "advisor concentration". NEPC clients now represent the largest group under one advisor with approximately 35% and 45% of total assets in EPFIH and EPFIHE, respectively. No other advisor represents more than 10% of client assets in the EPFIH fund and there are three advisors that each represents 10-20% of the EPFIHE fund. We recognize that a change in our recommendation to Client Review or Terminate could potentially trigger a gate at the Fund level and we would therefore work to understand and communicate the implications if our assessment of the situation warrants a potential downgrade.

We recommend clients continue to assess EPFIH and EPFIHE and the role that each plays in the strategic asset allocation of your portfolio(s). At this point, we are comfortable with NEPC clients maintaining their exposure to the EPFIH and EPFIHE funds, subject to the specific circumstances of your particular investment program.

We will continue to monitor asset flows, portfolio construction and performance. If the situation changes, we will keep you informed. While we are not recommending any action at this point, we do want to remind you of the current notice periods which are outlined below.

Vehicle	Redemption Terms	Notice By	Redemption Date
EPFIH N.V.	Monthly 20 days notice	February 10, 2017	February 28, 2017
EPFIH Institutional (feeder)	Monthly 25 days notice	February 3, 2017	February 28, 2017
EPFIHE	Monthly 61 days Notice	January 27, 2017	March 31, 2017