PiperJaffray.

Private Capital

Alternative Investment Strategies

Private Equity Partners | market update

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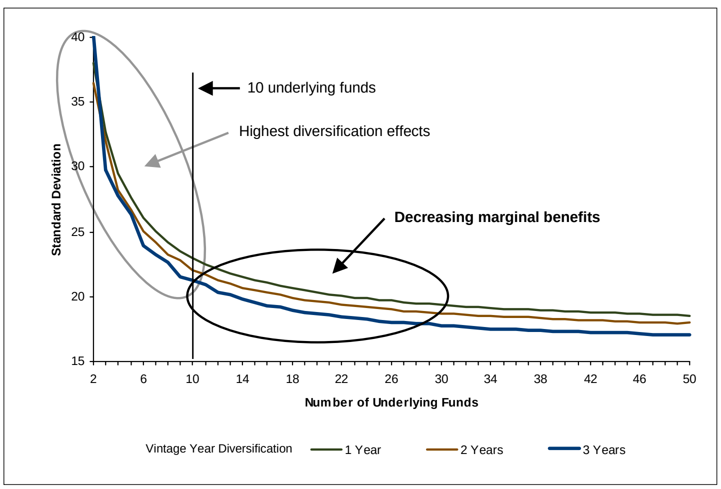
Quantifiable Benefits of a Fund of Funds (follow-up report)

In January, we presented a fund of funds study that used Monte Carlo simulations to test various diversification scenarios. The analysis was done separately for venture capital and buyout funds but the results were similar. The data empirically demonstrated the diversification benefits of a fund of funds by showing that randomly generated funds of funds had almost a 2x median return and a dramatically lower standard deviation versus randomly selected individual funds. While the results supported what we have intuitively known to be true, hard data in this area had previously been scarce so the study was an important step in the right direction. Yet we wanted more. We wondered if we could determine an optimal level of fund and vintage year diversification that would maximize returns and minimize expected volatility (standard deviation). We engaged Bjoern Born, one of the study's authors, to extend the study using 2-50 funds and 1-5 vintage years of diversification.

Optimal Diversification – Venture Fund of Funds



The old and new studies show that volatility (standard deviation) decreases as the number of funds and the vintage year diversification are both increased. But the new study clearly shows that the incremental benefits of diversification diminish with each addition such that the primary diversification benefits are achieved with roughly the first 6-10 funds and only a few years of vintage year diversification. For example, a portfolio of three underlying funds spread across three vintage years (i.e., one fund in each year) has a standard deviation of 30%, while a 10-fund portfolio and a 20-fund portfolio spread across three vintage years has a standard deviation of 21% and 19%, respectively. So there is substantial benefit in going from a 3-fund portfolio to a 10-fund portfolio but there is only a modest incremental benefit in going from a 10-fund portfolio to a 20-fund portfolio.

The new data indicates that vintage year diversification, while certainly important, has a smaller impact on volatility than diversification across a number of underlying funds. For example, moving from one year to three years of vintage diversification only reduces volatility by 1.8% for a 10-fund portfolio. In fact, the largest such decrease achieved by changing the vintage year diversification is only 2.9% across the entire data set.

Conclusion

Due to limitations in the data set, we cannot pinpoint the optimal diversification levels, but Mr. Born's analysis strongly supports our diversification strategy whereby we use a highly selective process to construct a portfolio with 10-15 of the highest quality underlying funds and 2-3 vintage years of diversification. We believe diversification beyond these levels would (1) add little marginal benefit in terms of reducing volatility, (2) create unnecessary cost (i.e., more funds require more oversight resulting in higher expense ratios due to increased accounting, travel, reporting and other administrative costs) and (3) result in lower expected returns by drawing the fund closer to being an index fund, resulting in only median returns rather than the top quartile returns we are targeting.

Piper Jaffray Companies Announces Sale of Private Client Services

Piper Jaffray recently announced a definitive agreement to sell its Private Client Services branch network to UBS AG. The transaction is expected to result in after-tax cash proceeds of approximately $510 million and is expected to close early in Q3 2006. This sale will not affect your investment in the Private Equity Partners series of funds, which will remain at Piper Jaffray within our Private Capital division.

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The sale will be the culmination of a thoughtful and comprehensive process, and the transaction will create the best overall result for our private clients, employees and shareholders. Piper Jaffray will continue to operate its Capital Markets and Private Capital businesses. We will redeploy capital from the transaction to pay down debt, repurchase common stock, expand into new businesses and enhance existing businesses (including Private Capital).

While this is ultimately a very positive development for our firm and our group, we are sad to see the many exceptional colleagues we have in Private Client Services move to another firm. We wish them well and hope to continue working with them in the future.

We are excited about our future and are better positioned than ever to service your private equity needs. If you have any questions, please contact us. To access the full press release relating to this announcement, please visit our website at www.pjc.com.

Fundraising Update

We recently began marketing **Private Equity Partners III** ("PEP III"), our third diversified fund of funds. PEP III will be similar to PEP II, with commitments to 10-15 venture capital funds and 10 buyout funds. We have begun to warehouse commitments to oversubscribed funds, including Madison Dearborn V, Alta Partners VIII and (on May 19) Oak XII. Several others are pending, particularly VC funds that are in high demand.

In addition, we are midway through raising and investing a "cleantech" fund of funds for certain of our family office and foundation clients. **Piper Jaffray CleanTech Ventures** will invest in solar, wind, biomass, fuel cell, advanced materials and water companies. We are the only U.S. fund of funds dedicating resources to this increasingly important sector, which accounted for 10% of all VC investments in Q4 of 2005. This fund will close to new investors in 60 days.

If you would like additional information on either of these funds, please contact Gretchen Postula.

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*Piper Jaffray was established in 1895 and has grown to become a nationally and internationally recognized firm serving growth companies and growth company investors. We have a significant commitment to alternative assets through our series of fund of funds, **Private Equity Partners.***