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# *Financial Advisor* **RETIREMENT SYMPOSIUM**

## **When To Use Alternative Investments in A Retirement Plan**

### MODERATOR

**Michael Underhill**

Founder & CIO

*Capital Innovations, LLC*

### PANELISTS

**Mick McClendon**

Senior Regional Vice President

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**James Upham**

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*Empowered Investor, Inc.*

**Michael Weil**

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# NorthStar Income | Product Positioning

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# Risk Factors

## Consider the following risks before making an investment in NorthStar Income:

- We depend on our advisor to select our investments and conduct our operations. We pay substantial fees to our advisor that were not negotiated at arm's-length and increase investors' risk of loss.
- We have limited operating history and the prior performance of our sponsor may not predict our future results. There is no assurance that we will achieve our investment objectives.
- We have not identified some of the assets we intend to acquire with the proceeds of our offering; therefore, investors will not have the opportunity to evaluate most of our assets prior to investing.
- We intend to invest in commercial real estate loans and mezzanine loans. The collateral securing our loans may decrease in value or lose all value over time, which may lead to a loss of some or all of the principal in our investments. Mezzanine loans are typically unsecured, and this may involve a heightened level of risk.
- Our advisor and its affiliates may face conflicts of interest as a result of compensation arrangements, time constraints and competition for investments.
- We have paid distributions from sources other than our cash flow from operations, and as a result we will have less cash available for investments and your overall return may be reduced. The amount of distributions that will be paid, if any, is uncertain.
- We may change our investment policies without stockholder consent.
- No public market currently exists for our shares and we are not obligated to effectuate a liquidity event by a certain date or at all.
- We set the offering price of our shares arbitrarily. This price is unrelated to the book or net value of our assets or to our expected operating income.
- Our sponsor has agreed, under certain circumstances, to purchase our shares in order to provide additional funds for distributions to stockholders. These purchases will dilute the equity ownership of public stockholders.
- Failure to qualify as a REIT would adversely affect our operations and our ability to make distributions.
- Our intended investments in CMBS and CDOs and other structured debt securities will be subject to risks relating to the volatility in the value of our assets and underlying collateral, default on underlying income streams, fluctuations in interest rates, decreased value and liquidity of the investments and other risks associated with such securities which may be unknown and unaccounted for by issuers of the securities and by the rating agencies. These investments are only appropriate for investors who can sustain a high degree of risk.
- As with any real estate investment, there are various risks including but not limited to: unfavorable market conditions, loss of principal and limited liquidity.
- You should not assume the past performance of NorthStar Realty Finance Corp. will be indicative of future performance of NorthStar Income.
- Investors will not obtain an interest in NorthStar Realty Finance Corp. its partner or affiliates by buying shares of NorthStar Income.
- The number and type of assets we will acquire will depend upon the proceeds of this offering.

# Navigating the Low-Yield Environment

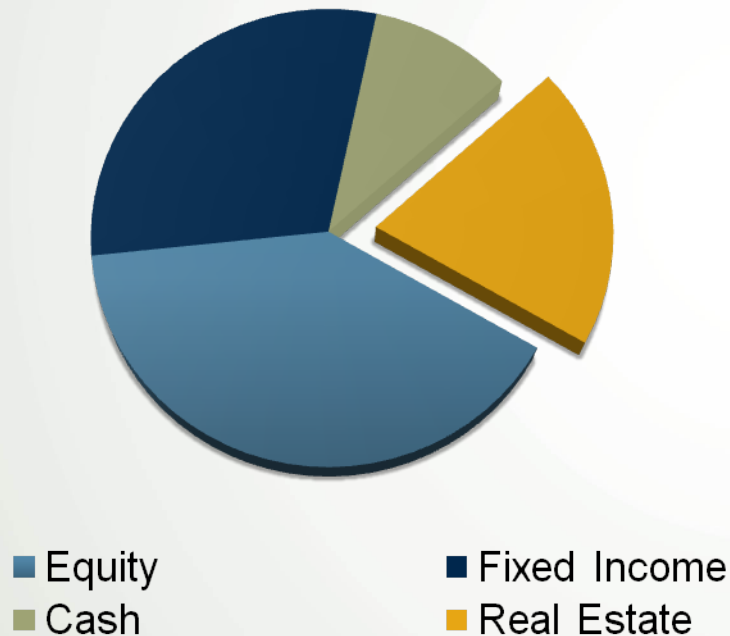
- ▶ Interest rates are hovering near historic lows
- ▶ Investors are turning to advisors for potential income solutions



# Adding Real Estate to an Investment Portfolio

- ▶ Real estate is commonly referred to as the 4<sup>th</sup> asset class

**Client Portfolio**



- ▶ You may recommend a real estate portion of the portfolio with an asset allocation similar to traditional equity & fixed income

**Real Estate Allocation**



Asset allocation must be determined based upon client objectives, suitability, existing portfolio and in accordance with firm policy pertaining to alternative investments.



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# Equity and Debt Focused REITs

## CRE Debt & CRE Equity complement one another

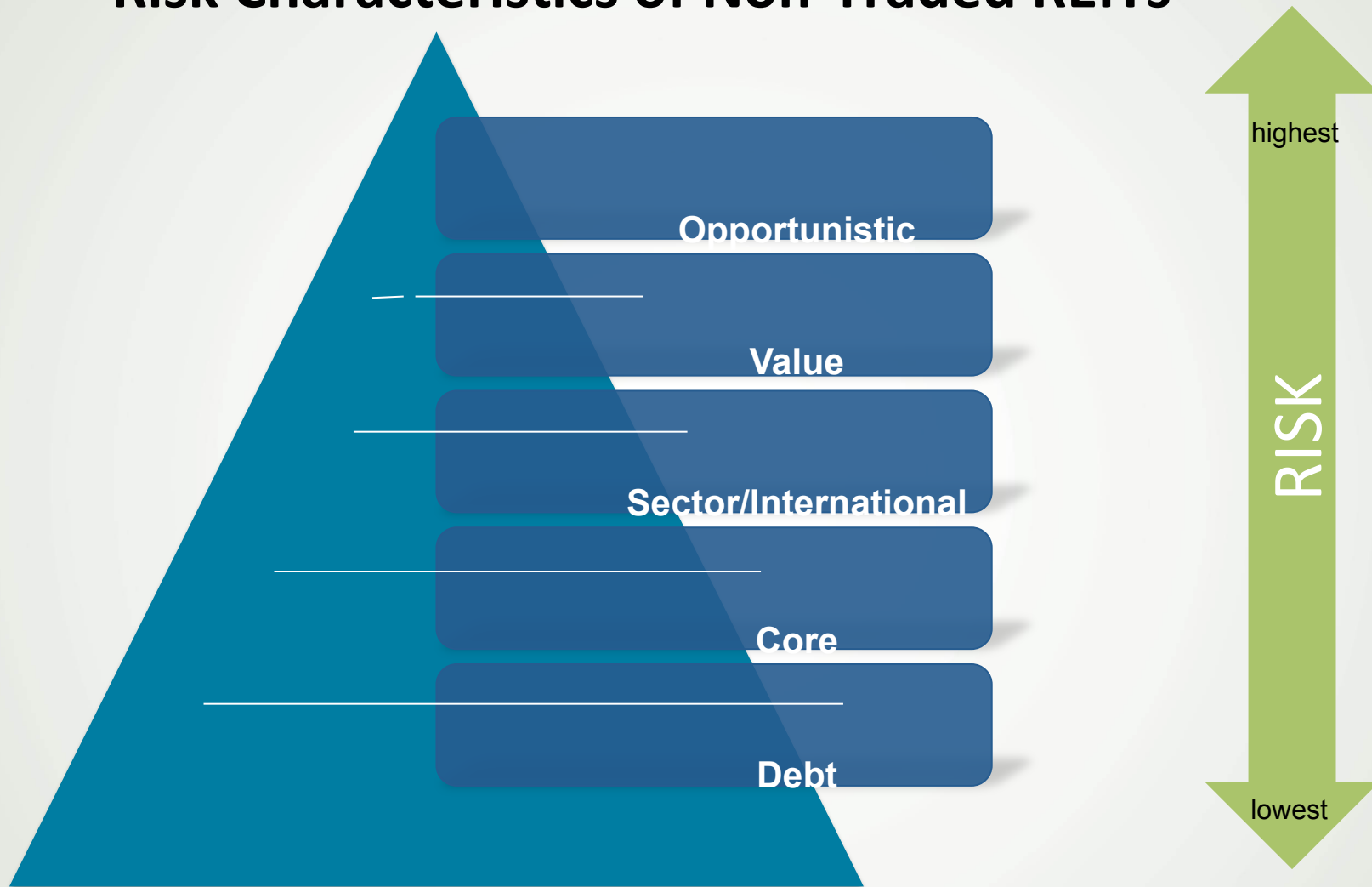
- ▶ Perform differently in various real estate pricing environments
- ▶ React differently to inflation
- ▶ Provide diversification to an investor portfolio

There is no guarantee that asset allocation will assure a profit or protect against loss in a broadly declining market.  
The statements on this slide are based on our internal professional opinion.





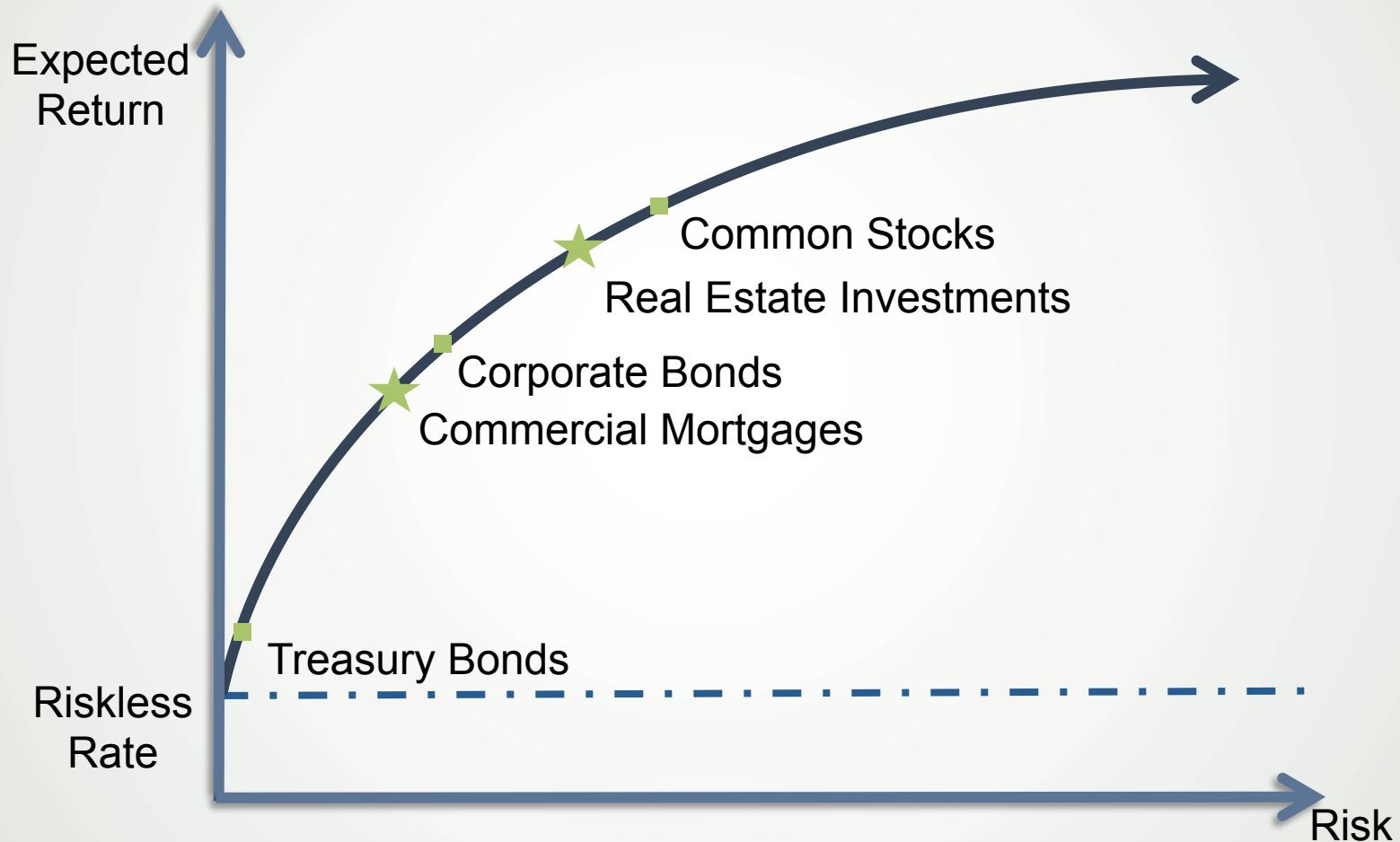
# Risk Characteristics of Non-Traded REITs



While debt investments provide greater downside protection than equity, debt investments within the capital structure also vary in degree of risk.



# Balancing Risk and Return

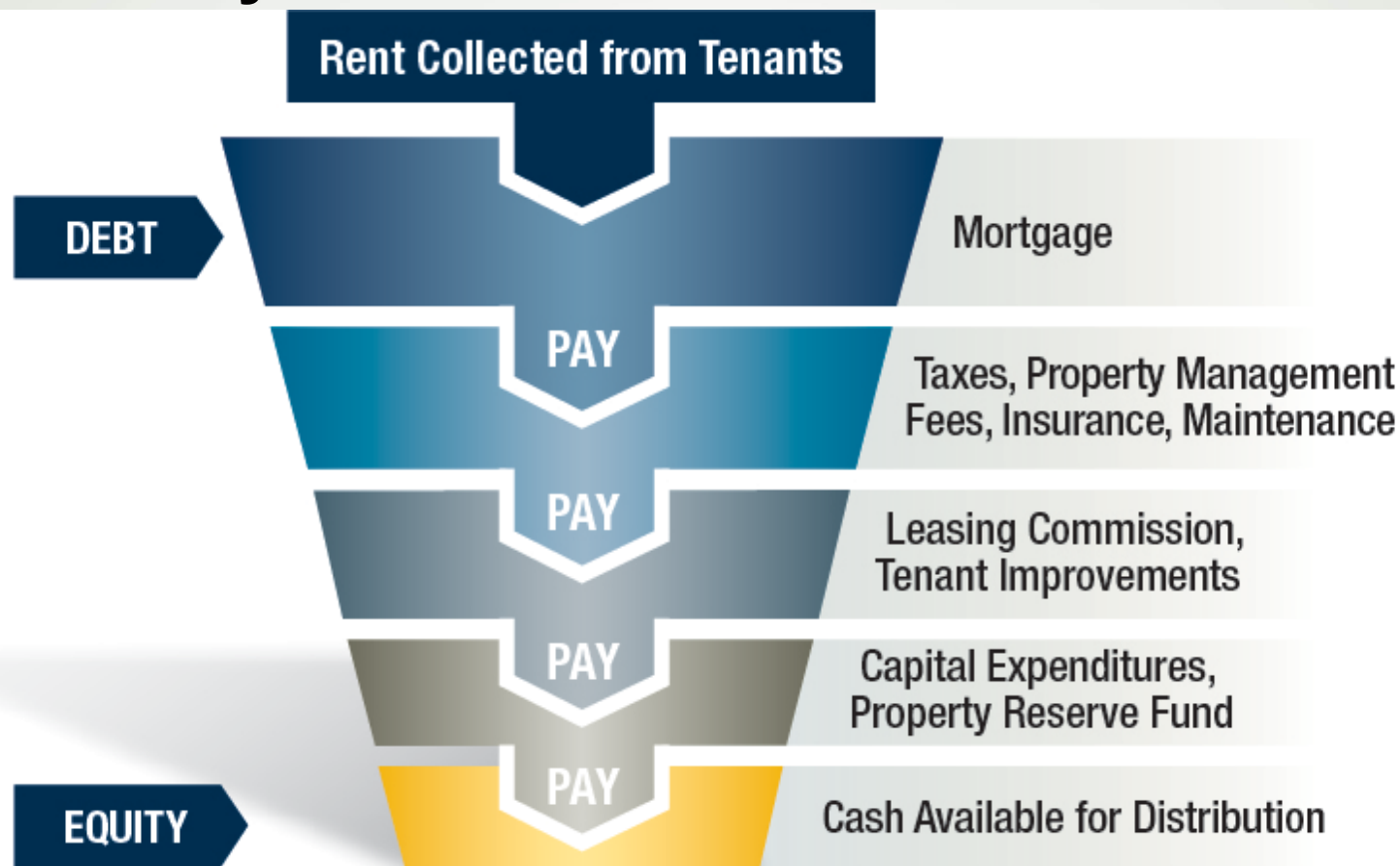


Source: Brueggeman, William B., and Jeffrey D. Fisher. *Real Estate Finance and Investments*. Boston: McGraw-Hill Irwin, 2008.



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# Priority of Income – Investor Cash Flow

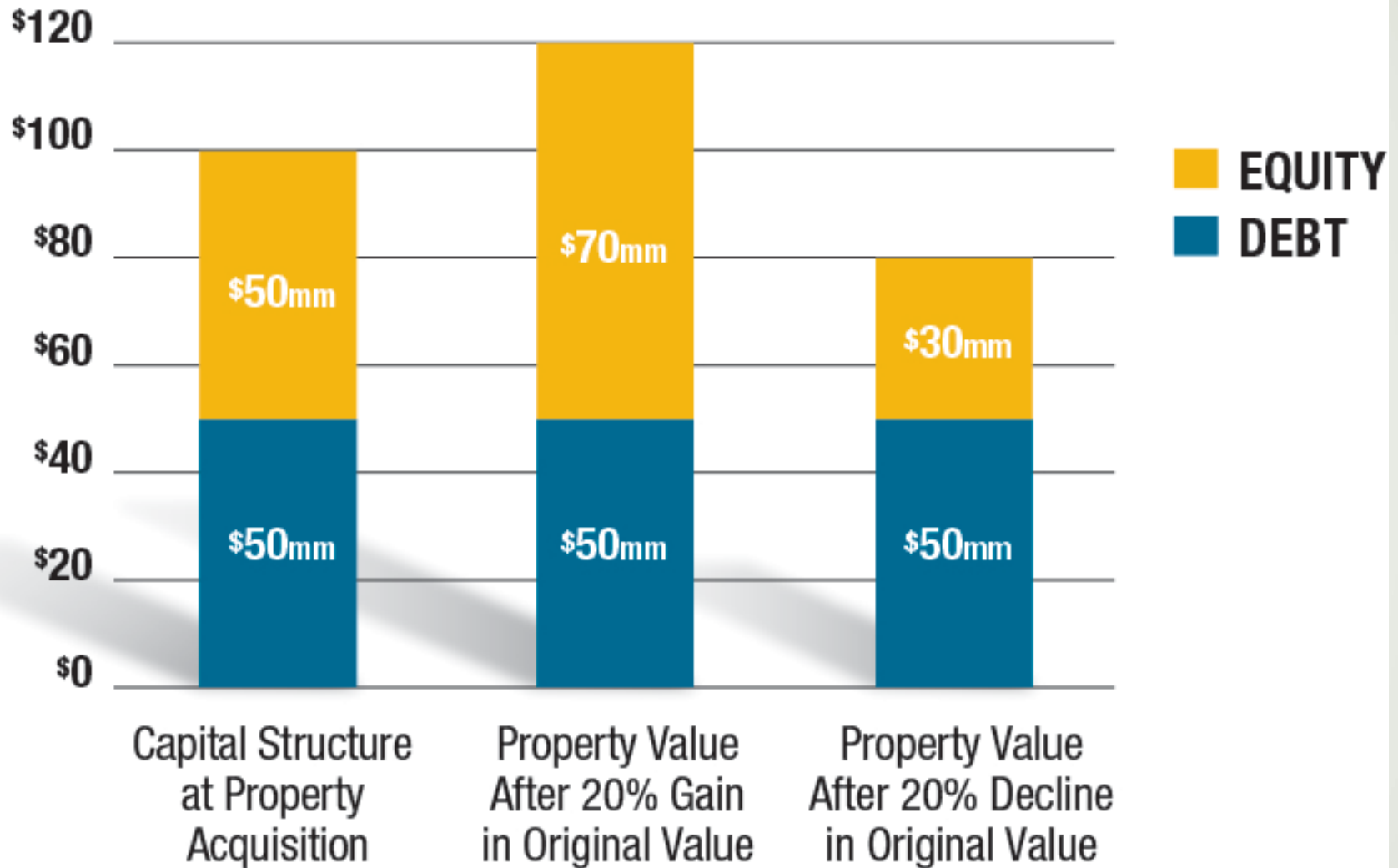


This illustration is hypothetical in nature and is provided for informational purposes only. While debt investments provide greater downside protection than equity, debt investments within the capital structure also vary in degree of risk. The amount of distributions that will be paid, if any, is uncertain. All distributions paid in excess of our cash flows from operations have been paid using offering proceeds, including the purchase of additional shares by our sponsor. For the year ended December 31, 2012, we declared distributions of \$27.9 million compared to cash flow from operations of \$13.2 million. The remaining \$14.7 million, or 53%, was paid using proceeds from our offering. Distributions have also exceeded our net income of \$15.3 million for the same period. Fees that we pay our advisor reduce the amount we can invest in income producing assets and your overall return may be reduced.



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# Shelter Against Declines in Property Values



This illustration is hypothetical in nature and is provided for informational purposes only. While debt investments provide greater downside protection than equity, debt investments within the capital structure also vary in degree of risk.



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# Product Cycle



**List**

Management team  
with experience  
of listing a company  
on a national exchange

**Sell**

Transparent,  
active debt market

**Mature**

Natural,  
contractual finality

You should not assume that the past performance of NorthStar Realty Finance Corp. (NYSE: NRF) will be indicative of the future performance of NorthStar Income. We cannot assure you that a liquidity event will be completed within five to eight years or at all.



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# Introduction to Alternative Investments

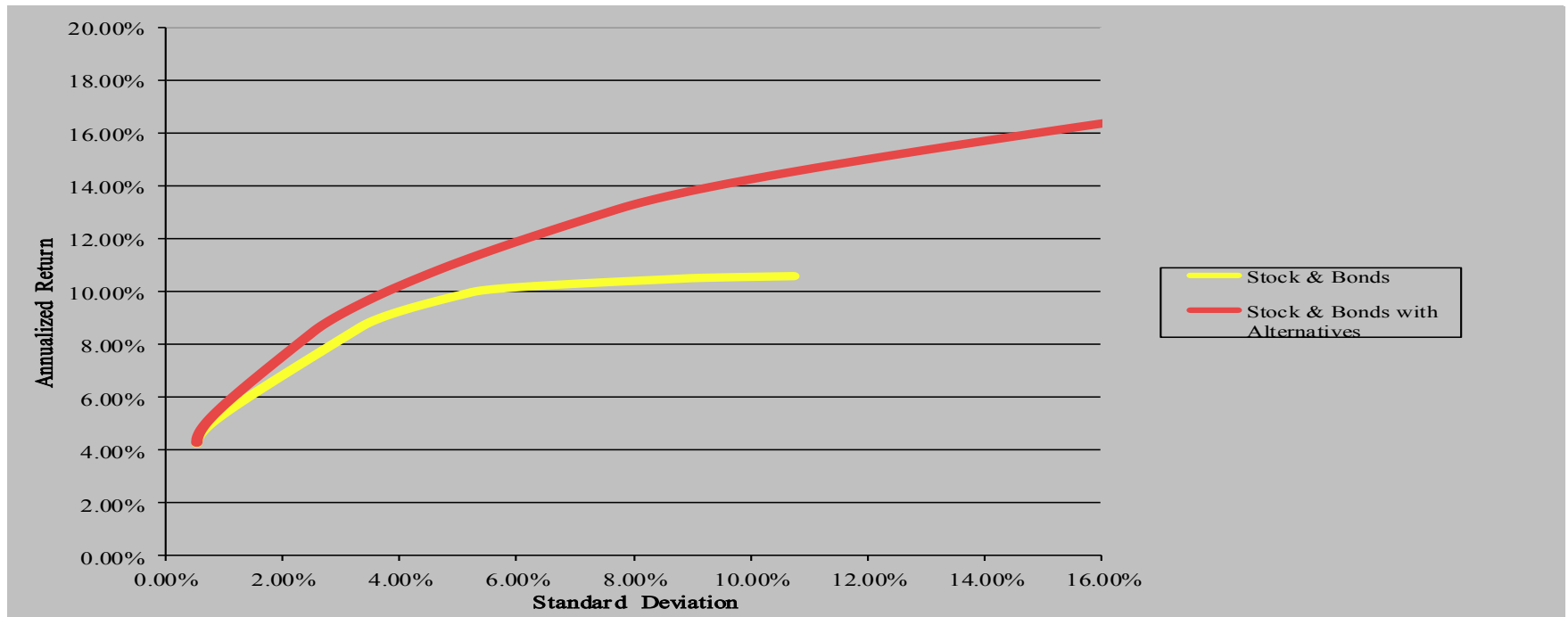
## Major Alternative Asset Classes

<b>Private Equity</b>	Negotiated private investments in (most often) non-public companies at different stages of maturity with the objective of reselling at a higher price in the future
<b>Hedge Funds</b>	Private investment funds investing primarily in the global equity and fixed income markets and typically employing sophisticated trading strategies, using leverage and derivative instruments
<b>Real Estate</b>	Negotiated private investments in real estate assets with the objective of generating current income and/or reselling at a higher value in the future
<b>Structured Products</b>	Pools of fixed income securities purchased with equity from investors and leveraged with the objective to generate spread income for investors. Opinion on if these are truly 'alternatives' varies
<b>Managed Futures</b>	Investments in global markets including futures, options and forwards on traditional commodities, financial instruments and currencies

# Modern Portfolio Theory – Adding Alternative Investments Improves Portfolio Performance

Historically, Adding Alternative Investments To Traditional Portfolios May Have Resulted In Enhanced Risk Adjusted Returns

## Comparative Return Profile (*July 1994-June 2012*) *For Illustrative Purposes Only*



Source: Equity: S&P 500 Index. Bonds: Lehman Aggregate Bond Index. Private Equity: Venture Economics Private Equity Universe. Hedge Funds: HFRI Fund of Funds Index. Real Estate: NCREIF National Property Index. Managed Futures: CISDM Index Note: All performance data based on historical returns from July 1994 through June 2012. This is the most recent data available for all asset classes collectively. **Past performance does not guarantee future results..**

# **Commercial Real Estate Can Play An Important Role In an Investment Portfolio**

## **➤ Portfolio diversification**

- Historically, low correlation with other asset classes

## **➤ Low volatility**

- Historically, has provided steady returns over the long-term

## **➤ Attractive overall returns**

- Historically, has performed well vs. other investments

## **➤ Commercial real estate differs from single family homes**

- Different drivers, different market conditions

## **➤ Choices of investments**

- Risk/return trade-off in various real estate investments

# Risk Considerations

**An investment in Real Estate can involve a degree of risk. These risks may include:**

<b>Real Estate Ownership:</b>	Real estate historically has experienced significant fluctuations and cycles in value and local market conditions may result in reductions in the value and the income associated with real property interests, including possible loss of principal investment
<b>Leverage:</b>	Most real estate investments employ leverage. Leverage has the effect of magnifying both gains and losses, including potential loss of principal
<b>Interest Rate Risk:</b>	Real estate investments may or may not include the use of floating rate leverage. Floating rate leverage increases the volatility of real estate returns, including increasing the potential loss of principal. Other risks related to interest rates include the risk associated with refinancing properties
<b>Illiquid Investments:</b>	Many non- public REIT real estate investments are illiquid, and are not listed on any exchange. Investments should generally be regarded as fixed and long term. Generally, there are no liquidity provisions and no mechanisms in place for sale of partial interests in non-realized real estate funds. There are often significant restrictions on transfer
<b>Competition for Investments:</b>	Results depend on the availability of real estate investments and a manager's ability to identify and consummate such transactions.

*Note: This is a partial list of risks for illustrative purposes.*



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# Real Assets in a Defined Contribution Plan

Maintaining the purchasing power of participant assets



*Real Assets can provide unique attributes that contribute to an investment portfolio's overall diversification and income needs while providing for a much needed inflation hedge.*

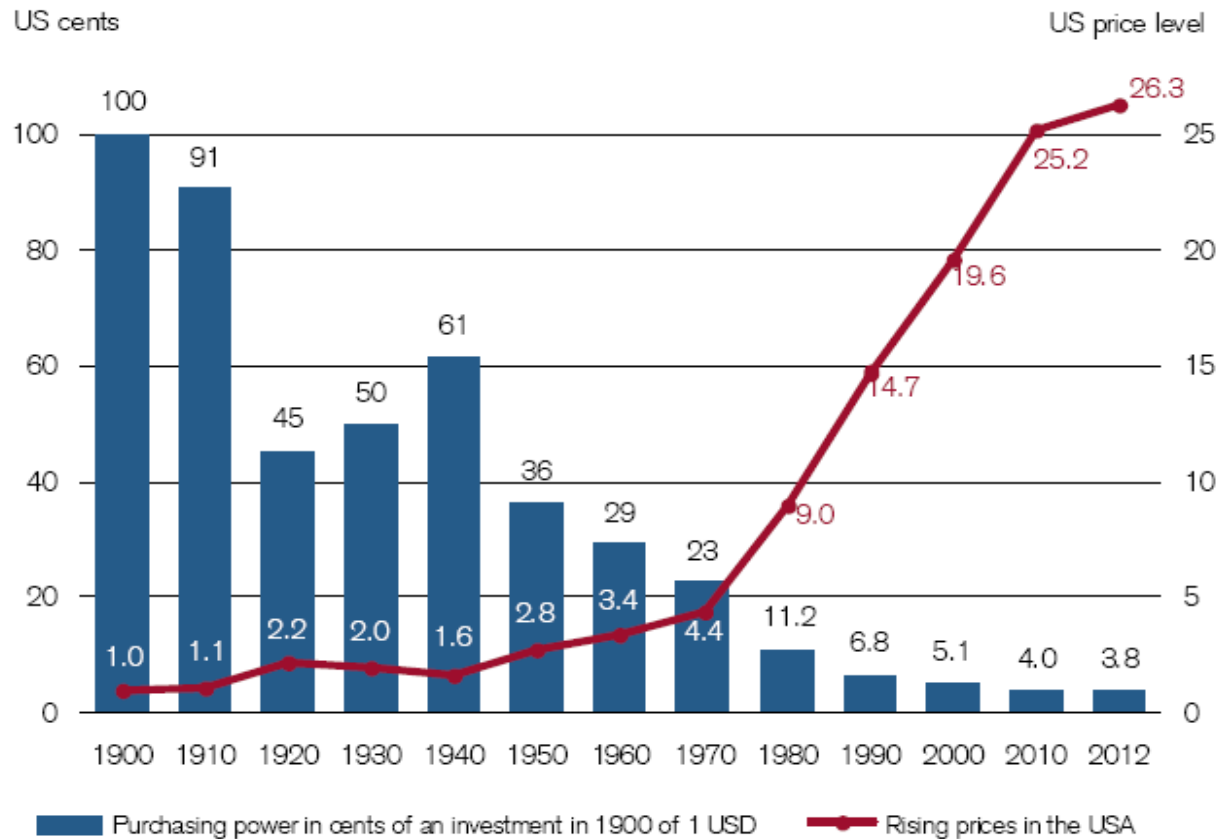
# Disclosure

The information herein reflects prevailing market conditions and our judgments as of the date of this document, which are subject to change. In preparing this document, we have relied upon and assumed, without independent verification, the accuracy and completeness of all information available from public sources. Opinions and estimates may be changed without notice and involve a number of assumptions which may not prove valid. There is no guarantee that any forecasts or opinions in this material will be realized. Information should not be construed as investment advice.

# Consumer price inflation in the United States, 1900-2012

## Consumer price inflation in the United States, 1900-2012

Source: Elroy Dimson, Paul Marsh, and Mike Staunton, *Triumph of the Optimists*; authors' updates



# Why add a diversified Real Asset option to your DC plan?

- Even low to moderate inflation can dramatically impact participants' purchasing power over time.
- For example, a 2% annual inflation means that a dollar today will only have the purchasing power of 55 cents 30 years from now.
- Defined contribution plan investor must manage to a real liability—his or her own expenses in retirement. The objective of a defined contribution plan is to generate cash flow in retirement.
- If the inflation adjusted value of a plan participant's savings falls significantly, they have to make some hard choices around how to reduce their levels of spending.
- In order to protect retirees from significant erosion in purchasing power, it is useful to include investments that mitigate the impact of inflation.



# Why add a diversified Real Asset option to your DC plan?

- Unexpected inflation is a change in prices that differs from the consensus view of what inflation is expected to be.
- When we talk about inflation risk, we are commonly talking about unexpected inflation.
- While expected inflation must be planned for in retirement budgeting, unexpected inflation causes uncertainty in prices because it represents a surprise to the market.
- Since it cannot be predicted, managing the risk of unexpected inflation is critical.
- A real assets strategy should comprise tangible real asset classes, whose values are driven by barriers to supply and rising replacement costs.
- Inflation-linked assets like Agribusiness, Timber and Infrastructure produce a higher return when inflation rises and help provide unique attributes that contribute to an investment portfolios overall diversification and income needs while providing for a much needed inflation hedge.

# Why add a diversified Real Asset option to your DC plan?

- Recent market turbulence has many participants worried about their retirement savings .
- Sponsors want to help, but don't want to overwhelm participants with too many choices
- They also want to help participants effectively diversify to...
  - manage for inflation
  - weather volatile stock and bond markets
  - ultimately achieve the lives they want in retirement
- Non-traditional asset classes may help sponsors and participants achieve some or all of these goals

# DB Pensions already know these asset classes can help

- DC plans are typically less diversified than DB plans
- DB has historically outperformed DC
- Potential benefits of particular alternative asset classes:
  - Increased portfolio diversification
  - Access to new sources of potential return
  - Protection against potential inflation

# Potential challenges of alternative asset classes

- Participants perceptions about risk/complexity
- Sponsor perceptions about:
  - Cost
  - Volatility
  - Participant education challenges
  - Crowded investment menus

# Potential to offer multiple benefits and less risk

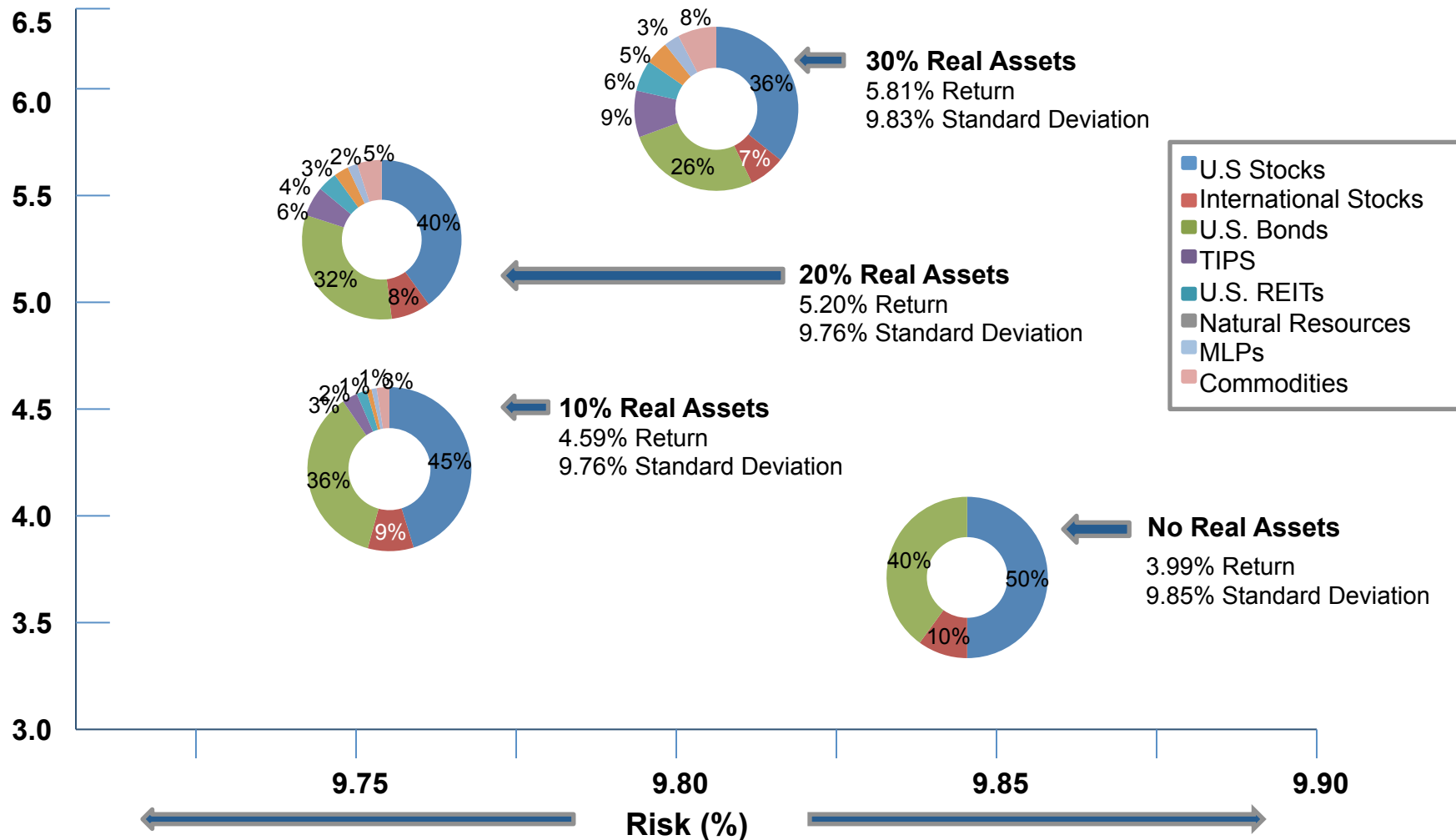
- Lower combined volatility
- Low correlation to traditional menu options
- Potentially attractive risk-adjusted performance
- Protection against potential inflation
- Broad diversification
- Daily liquidity
- One new menu option vs. many



# Improved Risk Return Profile with Real Assets

## Historical Effect of Allocating to Real Assets (January 2001- December 2011)

A diversified allocation to real assets within a portfolio has historically offered lower risk and potential for enhanced returns



2% annual inflation  
means that a dollar  
today will only have  
the purchasing  
power of 55 cents  
30 years from now

