INVESTMENT SUBCOMMITTEE
BOARD OF TRUSTEES
UNIVERSITY OF VERMONT AND STATE AGRICULTURAL COLLEGE

A meeting of the Investment Subcommittee of the Board of Trustees of the University of Vermont State and Agricultural College was held on Monday, January 29, and Tuesday, January 30, 2007, at Prager, Sealy & Co., LCC Conference Room, 99 Park Avenue, Suite 1520, New York, NY.

MEMBERS PRESENT: Robert Cioffi, Chair; John Snow, Vice Chair; Ian Boyce, and Susan Hudson-Wilson

MEMBERS ABSENT: Thomas Little

PERSONS ALSO PARTICIPATING: Vice President for Finance and Administration J. Michael Gower, Associate Vice President for Finance and University Controller Bonnie Cauthon, LaRoy Brantley, Cambridge Associates, Jacob Doft, Highline Capital Management, LLC, Nancy Peretz and Bill Simmons, Ark Asset Management, Susan Carter and Kathleen Walsh, Commonfund, Bret Barakett and Donna Holmes, Tremblant Partners, L.P, and George Hambrecht and Liz Hilpman, Barlow partners, Inc..

Chair Robert Cioffi called the meeting to order at 4:16 p.m. on Monday, January 29, 2007.

Investment Principles and Strategy

Mr. Brantley provided a broad review of the capital markets for the quarter ending December 31, 2006. He highlighted the strong performance of three key asset classes – emerging markets, global ex-US equities, and REITs, which all returned close to or in excess of 10% for the quarter. (These three asset classes also had dominant calendar year performances – each up between 25% and 35%.) He noted that the UVM portfolio has direct exposure to the developed and emerging markets international equities and a limited position in REITs through Wellington (Diversified Inflation Hedges product). The technology-laden NASDAQ index also performed well. It was a year where risk was rewarded, in spite of a 2nd quarter that was “bloody.” Diversification is adding to the portfolio, but it is important to know where there are holes are.

Mr. Brantley then reviewed a chart depicting the value added by active management over different time periods. The exhibit showed that 2006 was not a great year for active management for a variety of reasons. For example, the presence of REITs in the Russell 2000 index contributed about 500 basis points (bps) for the year, because many small cap managers do not carry REITs in their portfolios. The exhibit also showed that active equity management has been able to give more of a contribution over a longer term. He then reviewed median performance of the different strategies for marketable alternative assets for December’s month and for 2006.

The Subcommittee then reviewed the investment manager allocation as of December 31, 2006. Small-cap beat large cap, and value did very well. Iridian seems to have performed better in the
last quarter after a few underperforming quarters. Ark is relatively new to the portfolio and performed significantly below its benchmark. Every investment class in the portfolio over 3 & 5 year periods has added value against the respective indices. Mr. Snow noted the need to focus on the role a chosen manager is intended to fill. Ms. Hudson-Wilson raised the question of how ETFs might fit into a portfolio for the purpose of “sector bets.” The Subcommittee proceeded with a discussion about the active vs. passive nature of ETFs and managers. That led to a discussion over the role of the Subcommittee in lieu of a “chief investment officer,” in particular about how the committee works the portfolio towards a managed program for adding value – without tactical biases. The critical role is for making asset allocation decisions. Choices of managers are important for capturing an appropriate slice of particular markets.

The portfolio outperformed the blended index benchmarks for the quarter and for the 3 & 5 year measures. For the quarter we were in the 45th percentile in the Preliminary Cambridge Associates Endowment Median universe. (Given the early time frame for the meeting, only 30 or so Cambridge clients had yet to receive their performance results.) For the fiscal year-to-date, we are 38th percentile, 41st percentile for 3-year, and 53rd percentile for the 5-year period.

The Subcommittee then reviewed the performance of particular managers. The hedge fund group is outperforming to a significant degree in relative and absolute terms. Mr. Brantley noted that fund of funds have their advantages, when it comes to diversification and access to high quality funds that are closed to new investors. The primary concern with direct investment hedge funds is manager risk; one can mitigate that exposure by hiring multiple managers – perhaps as many as sixteen managers comprise a well-diversified program. Oversight is also an issue when it comes to individual managers. This would be more of an issue if our individual managers had not performed so well, but Mr. Snow noted that the selection of these was not necessarily skill-based (and sustainable over time). We also have an access issue for many funds. He prefers a fund-of-funds to offset these risks. Cambridge largely considers hedge funds as a “skill class,” not a true asset class as with UVM’s other managers. They communicate frequently with the management team of each fund they recommend – at least quarterly (some monthly).

The Board has to have a least some first-hand knowledge to execute its responsibilities outside of consultants (Cambridge) and administration. Mr. Snow feels that we are moving to a “fund-of-funds” perspective on hedge funds over time; as there are more managers, it will be far more difficult for oversight by this committee without a CIO in place. What is the level of due diligence necessary and how can we attain it? We should be debating whether fund-of-funds manager “A” has better due diligence than manager “B” in this Subcommittee. Cambridge does provide significant research on the structures of the funds and gives us the right questions to ask.

Wellington’s inflation hedging product has done very well, and we have increased our position in this recently. In Fixed Income, Dwight indicated that they had problems concerning relative performance. UVM’s portfolio was underperforming other portfolios, and they were embarrassed that they had not discovered the reason for this variance until recently. Our cash was managed by an underperforming vehicle, and Dwight had been heavy in cash, and that cash was in an underperforming “sweep” account. Dwight intends to forego some of their fees to make up for the amount lost in relative performance.
We are trimming Iridian soon to move to a small cap manager ($2.5 million). Initial moves may be via ETFs or an index fund. Each has advantages and disadvantages. ETFs are good for short-term positions. The Subcommittee discussed the two options from State Street Global Markets – a Russell 2000 Index and an Interim Exposure Program. Mr. Brantley indicated that his initial concerns about the Interim Exposure Program had been satisfied. Mr. Boyce moved to take $2.5 million from Iridian and move $2.5 million to State Street Global Markets' Interim Exposure product which will invest in a Russell 2000 ETF, with an additional $2.5 million to be moved within 6 months. Ms. Hudson-Wilson seconded. The vote was 3-0 with one abstention (Mr. Snow).

After a break, the committee picked up on the summary points that Cambridge included in the discussion materials. A brief discussion ensued on the history around the University’s move out of REITs a few years ago via two manager terminations. It was concluded that it is imprudent to move completely out of an asset class as a matter of principle, and our move out of real estate is notable. That followed with a review of the asset allocations. In particular, our position in VC/PE is good, and the Subcommittee will spend time with Commonfund management on the 30th talking about their latest two products.

The Subcommittee concluded that it must review the 50 basis point Endowment fee for the capital campaign by June, 2007. This item will be placed on the agenda for the April meeting of the subcommittee.

At 7:15 p.m. the meeting was recessed. The Subcommittee reconvened at 8:45 a.m. on Tuesday, January 30, 2007. Summaries of the meetings with UVM’s individual managers follow:

**Highline Capital Management, LLC**

Jacob Doft, CEO/Portfolio Manager, Howard Singer, COO, and Kristin Meringer, Client Liaison, presented for Highline. Long/short equity firm focusing on North America companies. Looking for companies with changes (strategic, structural, and financial), and they do extensive research, particularly on complicated areas. 21 people, 15 on investment team.

The team is deeper than before, and it is Mr. Doft’s plan to develop key personnel to step in longer term. The firm registered, and they hired a COO to follow that process and had a legal background. Mr. Singer has taken on key business functions that don’t need Mr. Doft’s involvement. Mr. Doft stated that he has no goal for asset size as long as the fees can be covered well (min. $500 million). He doesn’t spend that much time marketing. Investment objective: each opportunity is assessed for risk and return, and he judges the ratio of those two (dictating position size). Focused on 12-month periods for return – mid-teens return are “normal” for the way the portfolio is constructed. The risk profile does not allow for high compounding over time. Focus on mid and large-cap companies with great stability (no lock-up). Funds of funds make up mid-teens percentage of the portfolio. Highline will remain registered – it was a positive process for them for long-term health. Registration probably will cost $100k per year – a lot more to start up.
Ark Asset Management

Nancy Peretz, Portfolio Manager, and Bill Simmons, Marketing Manager, presented for Ark. Ark is new to the portfolio (having been hired in March 2006). Focus is on individual stock selection as a large-cap manager (Russell 1000 index). The concentrated growth portfolio that UVM is in is $1.1B of the $15.4B total. Two portfolio managers and seven analysts are on the team. Adding value to the Russell 1000 index is the goal over a full market cycle. (Need to pull out tobacco and Darfur securities in an orderly fashion of 60-90 days). 2006 was a poor year – large cap growth was hard to be in, but their stock picking was poor – learned from their mistakes.

Aim to add value through stock pickers – beneficiaries of change, likely to exceed investors’ expectations. 20-35 stocks in the portfolio – start with capitalization $3B and bigger, looking for fundamental change early through basic research. Once the gap from change closes, they sell. Portfolio turnover is 100% over a twelve-to-fifteen-month period. Change includes new product cycles, managerial change, competition or industry dynamic, restructuring, and regulatory change. Who wins, and who loses in the change? These are compared to investors’ expectations and a time horizon evaluated (12-18 months). If there is a gap with what the world thinks, they buy the stock. Joel Kurth (the 2nd portfolio manager) makes the final decision, but Ms. Peretz can do so when Mr. Kurth is absent. The analysts vet ideas in a daily meeting, indicating data points around the perceived change. If there is a huge conviction level and the gap is large, the idea typically goes forward if the portfolio needs that position (relative to composition of the Russell 1000 Growth Index). There are bands in portfolio construction. The group is compensated for recommendations (buys and no-buys), within the group, and the firm’s overall profitability. They monitor both what goes in and what doesn’t go in. Compensation is weighted for a rolling, multi-year period.

Ark’s goal is to provide premium return with risk that is in line with the benchmark. It is a “best ideas” portfolio within each sector. They will not own something in Concentrated that is not in Large-Cap Growth. They are quick to sell when the thesis is not panning out. You have to treat high-expectation stocks differently from low-expectation stocks.

Commonfund Capital

Susan Carter, President, and Mark Fitzgerald, Associate Director, presented for Commonfund Capital (CF). Most of our VC/PE positions are with Commonfund; we are also looking at Commonfund’s two new PE products. CF has more than $8B committed for over 500 investors. PC is up to 1/3 of CF’s total assets. Principles: Invest in a diversified approach and not trying to time-the-market for these assets (getting vintage year diversification). Private capital can enhance the endowment’s rate of return – 400-600 bps over the S&P in general. CF’s returns have exceeded that historically. The markets are becoming more efficient, and there is more money in the market (private equity and large buy-outs), so returns may start to trend downward. The organization is stable, and that stability contributes to the companies’ advisory committees. They look at the team and its maturity, at the strategy, how it fits into the portfolio, how the organization and compensation of the company are set.
They also do reference checking on GPs and key management, off of the reference list. There is a team of five rotating analysts. They spend time with the managers on strategy and culture, along with a standard analysis for each one, each time they re-up with a manager. They also focus on alignment of interest in fees, personal commitments, focus, and quality. Most of the team members have done direct investing before, and there is very little turnover with the senior team. They are opening a London office this summer to have a closer connection to Europe managers. There is a dedicated accounting team + CF’s legal and compliance group can be tapped.

The team meets every Monday to go over work, analyses, and recommendations. There are at least four people on every due diligence effort. Their pace of investment is now around 2 years vs. their preferred 2-1/2 years.

The Subcommittee then reviewed each fund that UVM is in, followed by a review of the new funds available. There is a heavier weighting to growth and middle market. The weighting is multi-manager and multi-style in constructing the portfolio. CF thinks a 10-20% allocation to private capital makes sense (20% is high). International PE is getting close to US (40:60 split). Global venture has the highest risks and the highest potential returns. It’s all about access, but don’t fill the bucket with lesser quality. CF recommends distribution between the sectors to achieve the desired returns over time. Cambridge recommends a lower target for “younger” portfolios, but 5% is something of a minimum. The fees for the new funds will be an average 0.53%/year + a 2.5% share of the profit share for the carry. The first close will be February 9, and the second will be March 30. There is unlikely to be a capacity issue by the March date.

At 12:40 p.m. the meeting recessed. The Subcommittee reconvened at 1:05 p.m.

**Tremblant Partners, L.P.**

Brett Barakett, Portfolio Manager, and Donna Holmes, Consultant Relations, presented for Tremblant. They are looking for the ways to double money over 3 years – best long and short ideas. They look at analyses of the business model (qualitative) and analyses of the financial model (quantitative – cash flows, return on capital – EVA, proprietary ROI-IC, free cash flows, and allocation of free cash flows). Core longs will be 2-4%, core shorts will be 1-2%, balance will be 1.1 – 1.9. There was a lot of volatility in 2006 as well as bad picks/performance, for which Mr. Barakett gave examples. They perform iterative research on ideas.

If something unfortunate were to happen to Mr. Barakett, the fund would immediately unwind. Most employees have money in the fund. All investment decisions come through Mr. Barakett who is the sole equity owner of the firm. Tremblant registered when first required by the SEC, but they withdrew when the requirement was removed. They

**Barlow Partners, Inc.**

George Hambrecht, President and Portfolio Manager, and Liz Hilpman, CIO and Portfolio Manager, presented for Barlow. UVM is up 8.56% through December. Barlow invests only in long/short equity hedge funds and hire stock pickers only. They are expecting equity-like returns over a market cycle. These funds have small positive absolute returns in a falling market, and they track 67% of the S&P in a rising market.
Mr. Hambrecht and Ms. Hilpman are the sole owners of the firm; they have long hedge fund experience prior to Barlow. The two do all of the interviews and selections and do their own analysis. They like managers who are capacity constrained and they attempt to keep sector presence at or below the S&P 500. They try to avoid overlap for managers’ positions (e.g. avoid Apple in multiple funds). References for managers are extremely important. To get into the portfolio today, the manager has to be doing something better than one already there, completely different, or filling a hole in the portfolio. Risk management has to do with the thinking beyond managing the portfolio (e.g., philosophy around long/short). The net exposure is around 60%, on the high side (sweet spot is 40%). They never want to have greater than 10% of a fund’s investments, but currently account for 40% of a relatively small emerging fund.

Wrap Up and Discussion

The Subcommittee debriefed about the manager meetings and perceptions about the various management perspectives. The group reviewed the value of fund-of-funds vs. individual hedge fund managers from the perspective of Subcommittee decision-making capacity; they will continue the discussion. The Subcommittee plans to discuss the Commonfund offerings in private capital at its February meeting in order to have the opportunity, if desired, to enter these funds. Two questions: how much, and the spread across each fund? The Subcommittee found this meeting very useful, and the goal is to meet each manager once-per-year for at least an hour.

Adjournment

There being no further business, the meeting was adjourned at 4:00 p.m.

Respectfully submitted,

Robert Cioffi, Chair