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 Thursday, July 19, 2007 at 8:30 a.m., at Cambridge Associates Boston, MA.

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

MEMBERS ABSENT: Jeffrey Davis and Jeanette White.


Chair Robert Cioffi called the meeting to order at 9:00 a.m.

Overview of CA’s Research Views & Current Topics

The Managing Director of Published Research, Celia Dallas, started with an overview of Cambridge Associate’s research view and current topics from her office in Arlington, VA. The discussion on current market environment and information regarding key concerns and trends of the firm’s largest University clients was to provide a foundation to the Subcommittee’s discussion on asset allocation.

She noted that credit spreads have widened in last few months but are still very low historically. A chart was reviewed that presented emerging market and global high yield debt spreads over ten year treasuries, showing decreasing returns since 2002. She discussed what could be driving markets and presented a slide on global excess liquidity, noting that when it turns negative there usually tends to be a financial crisis. She also discussed the fragility of liquidity but commented that it can turn around quickly. The Asian Market was described as showing strong growth and profits but it would be a heroic assumption to predict its longevity. There was some discussion on Cambridge Associates Current Valuations Summary. The Current Valuations Summary shows heavy weight in Overvalued and Fairly Valued and no weight in Undervalued and Very Unvalued.

A recommendation on asset allocation in a time of global credit crisis was requested. Ms. Dallas provided the following recommendation: distressed securities, cash using treasury securities, and defensive strategy with regards to equity allocation using long/short and hedge funds. The fairly valued assets: Oil & Gas and Real Estate were singled out as the best inflation hedges over the long term.

Ms. Dallas discussed the key trends and concerns of CIO’s of large Universities. The most significant shift has been to think like a global investor. There has been a shift from the 2/3 US Equity and 1/3 Non US Equity beginning in 2004 that has resulted in 50/50 allocation. This shift is especially apparent in the shifts by hedge funds to non-US markets. Oil, gas and bonds have remained US focused. There is concern regarding overvaluation in buyouts with ample credit fueling the growth. Some institutions have sold off or dialed down commitments. There has been a lot of discussion about broad market and credit risk and how to best hedge. Some are hedging using the credit default swap market. There has also been rigorous rebalancing. The fourth trend is the need to think past
the traditional asset categories and perform a look through analysis of the portfolio to fully understand exposures and risk. Lastly, the concern described as an “arms race” is competition among peers in higher education; specifically relating to incentive compensation for 1-3 year performance.

Asset Allocation

The asset allocation discussion started with the statement that this meeting should occur annually. It was noted that if the committee did nothing else they should revisit these positions annually and articulate them to ensure that assumptions are consistent from both an asset and liability view. It was agreed upon by the Subcommittee that the asset allocation meeting was well suited to occur at Cambridge Associates in the summer. The discussion first centered on the time period for the asset ranges set and whether 1, 3, and 5 year terms versus near and long term views should be utilized. It was also noted that it was important to be clear about the process for making asset allocation decisions. There was discussion of the strategic versus tactical approach. A comment was made that the Subcommittee should be prepared to go to the Board and report that the subcommittee has met and adjusted the allocation, that the Subcommittee is aware of “x” things and that it knows about and accepts the risk. The long-term views, considered strategic, are built into the allocations and the near views may not result in allocation changes but are communicated to the full board.

There was discussion on the volatility tolerance of the endowment with regards to asset allocation because of the small impact on spending and budget decisions due to the usage of rolling 13 quarter average, low spending rate, and donor restrictions. It was noted that an ongoing challenge is to sustain the risk tolerance and maintain exposure to higher return assets. The group agreed that the portfolio had lagged through lack of exposure to emerging markets, REITs and private equity but had been strengthened by the hedge fund program and good managers like Iridian. The point was made that the portfolio should maintain a footprint in each asset class that was in the asset allocation since it is much easier to trim and ramp up vs. getting out and then trying to get back in.

Chair Cioffi used Cambridge Associate’s Alternative Allocation Target as a starting point for discussion. The following was regarded: happy to be light in bonds, okay to trim US equity because inflation hedging, private equity and other assets capture it, and an equal target rate be set for Inflation and Bonds. It was agreed upon that there is a need to research the composition of the University’s marketable alternative assets in order to know the actual % of U. S. equity exposure in the allocation.

When discussing targets, the efficient region analysis graph was relied upon as a gauge of the bare minimum performance of specific targets on meeting the endowment’s spending rule. The implied real compound return using asset class assumptions reveals that Emerging Markets, Venture Capital, Private Equity and Oil & Gas will meet the spending policy for the University.

There was concern over 28% asset composition in Inflation Hedging and Bonds being too high; due to its tradeoff of light returns and little growth for heavy hedging. It was remarked that the biggest worry of a University is Inflation versus Deflation. Vice Chair Snow expressed his view on bonds as less a hedge against deflation than equity. He recommended a 15% allocation to inflation hedging and 10% allocation to Bonds showing the bias to inflation.

The discussion next turned to Equity. Mr. Brantley cautioned the Subcommittee from going to 0 to 10% allocation to emerging markets in a relatively short time. However, it was expressed how there is value added by allocating to the volatility of emerging markets due to high returns. There was
reference to the table Comparative Asset Allocation of CA Colleges and Universities of Similar Size to point out that only 1 institution had over 10% allocation to Emerging Markets.

The Subcommittee discussed how the new investments in Private Real Estate funds: ING Clarion Lion Fund and Morgan Stanley Prime Fund could be classified under US Equity versus Private Equity.

After a great deal of discussion by the entire committee and Cambridge, the Subcommittee settled on the following asset allocation ranges and targets:

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Allowable Range</th>
<th>Target Allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Equity</td>
<td>15-40</td>
<td>20.0</td>
</tr>
<tr>
<td>Global ex U.S. Equity</td>
<td>15-40</td>
<td>24.0</td>
</tr>
<tr>
<td>Developed Markets</td>
<td>5-25</td>
<td>14.0</td>
</tr>
<tr>
<td>Emerging Markets</td>
<td>5-15</td>
<td>10.0</td>
</tr>
<tr>
<td>Marketable Alternatives</td>
<td>15-25</td>
<td>20.0</td>
</tr>
<tr>
<td>Inflation Hedging</td>
<td>10-25</td>
<td>12.5</td>
</tr>
<tr>
<td>Venture Capital/Private Equity</td>
<td>5-15</td>
<td>10.0</td>
</tr>
<tr>
<td>Bonds</td>
<td>10-25</td>
<td>12.5</td>
</tr>
<tr>
<td>Cash and Equivalents</td>
<td>0-5</td>
<td>1.0</td>
</tr>
</tbody>
</table>

These targets and ranges will be recommended to BFI at the September meeting.

**Lunch & Discussion**

Sandy Urie, CEO and President of Cambridge Associates, spoke to the Subcommittee during lunch. She discussed the mission, history, focus and resources of the firm.

**Manager Overview**

Longwood’s past performance has been plagued by stock picking issues. The firm’s most recent quarter performance was reviewed, showing a turnaround; performing 200 bps above the Russsell 2000 Growth Index. The subcommittee discussed whether to exit Longwood and implement a different approach to small cap equity or to exit Longwood based on their past performance and hire a new manager.

A motion was made, seconded and passed to exit Longwood, fully redeem State Street ETF, and to hire Eaton Vance with an investment of $10 million using either a separate account or commingled fund.

The Subcommittee moved into talks about Private Real Estate and the argument for allocation to Private Equity versus Inflation Hedging.

A motion was made, seconded and passed to allocate an initial investment of $5 million to the private real estate funds of funds, Metropolitan.

The Subcommittee will determine the appropriate classification of this investment, since it could be considered to be either private equity or inflation hedging.
Wrap-Up Discussion & Next Steps

The Subcommittee will discuss the types of vehicles available for investing in Oil & Gas. Cambridge was asked to provide white paper on oil and gas investments.

Once the new managers have been added to the mix, the Subcommittee will determine the rebalancing needed to meet the new targets. In addition, the Subcommittee requested that Cambridge provide a look through analysis to determine true exposures, particularly for US equity.

There will be further discussion of the role of Bonds in the next meeting in preparation for the meeting with Dwight Investment Manager.

Cambridge was asked to provide secondary PE managers currently or expected to be in market.

The Subcommittee will review the Investment Policy with plan to change investment objective to 6% real return.

The Subcommittee will look at the audit issues surrounding evaluations of Non-marketable Assets and their implications; this is a discussion item for October.

Adjournment

There being no further business, the meeting was adjourned at 2:11 p.m.

Respectfully submitted,

Robert Cioffi, Chair