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

A meeting of the Investment Subcommittee (the Subcommittee) of the Board of Trustees of the University of Vermont State and Agricultural College was held on Wednesday, August 20, 2008 at 8:30 a.m. via teleconference.

MEMBERS PRESENT: Chair Robert Cioffi*, Vice Chair John Snow*, Sam Bain*, and Susan Hudson-Wilson*.

MEMBERS ABSENT: None.

PERSONS ALSO PARTICIPATING: Richard Cate, Interim Vice President for Finance and Administration and Treasurer*; Bonnie Cauthon, Associate Vice President for Finance and University Controller*; and, Elizabeth Kent*, LaRoy Brantley* and David DeVaughn*, of Cambridge Associates

* Participating by teleconference

Chair Cioffi called the meeting to order at 8:30 a.m.

Approval of July 22, 2008 Meeting Minutes

A motion was made, seconded and approved to accept the minutes of the July 22, 2008 meeting.


Chair Cioffi asked Cambridge Associates to discuss the new benchmarks introduced in the June 30 report. Mr. Brantley noted that historically the two key portfolio benchmarks used were 1) S&P 500 75%/LB Agg 25%, and 2) the Cambridge Endowment Universe Median. The new benchmarks introduced were the Broad Policy Benchmark, Custom Policy Benchmark and the Dynamic Benchmark. The new benchmarks were developed based on concerns that the existing Broad Policy Benchmark (S&P/LB) did not correspond to the current diversified portfolio.

The Broad Policy Benchmark uses an undiversified portfolio approach (comprising just the S&P 500 for equity and the Lehman Brothers Aggregate for fixed income) and thus provides a measure of the cost/benefit resulting from diversification. Consistent with portfolio target changes in 2007, the adjusted current Broad Policy Benchmark now uses a ratio of 87.5% S&P 500/12.5% LB Agg. Members asked for clarification on the Custom and Dynamic benchmarks. Mr. Brantley stated that the key difference between the two is that the Custom Benchmark comprises the policy target weights for the underlying asset classes’ benchmarks, whereas the Dynamic Benchmark is composed of the current asset classes’ benchmark weights.
In short, the former is static and the latter is dynamic. Since the Custom Benchmark reflects the target weights, it shows what the long-term strategy is capable of creating on a passive basis. The Dynamic Benchmark provides a clearer view of the impact of manager selection since it matches exactly the current index weights. A comparison of the Custom Policy and Dynamic Benchmarks illustrates the cost/benefit of tactical weightings due to not being at target (mostly attributable to difficulty of reaching target levels for private investments).

Both new hurdles provide a more internal view specific to the UVM portfolio performance, while the Cambridge Endowment Median continues to provide an externally focused peer comparison. There was some question regarding whether the names of the new benchmarks may need to be revised to more clearly describe their bases and purpose. New names proposed and adopted were Undiversified Benchmark (formerly Broad Policy), Target Benchmark (formerly Custom Policy) and Current Allocation Benchmark (formerly Dynamic Benchmark).

In reviewing the results, the portfolio had returns of 2.0% and .3%, respectively, for the quarter and fiscal year ended June 30, 2008 and -2.2% for the month of July. CYTD returns were negative, -3.5% and -5.7% at June 30 and July 31, respectively. Mr. Brantley noted that despite the difficult markets the portfolio had held up on relative terms, with diversification helping in the previous quarter and some great downside protection in July. Chair Cioffi noted that Iridian and Eaton Vance continue to be incredible performers. In looking at marketable alternatives, Mr. Brantley noted that while Tremblant had some problems, the program by and large has done what it is supposed to do in a downward moving market.

Mr. Brantley also noted that the T-bill plus benchmark is problematic in that the cash plus premium benchmark has zero volatility in down times. Vice Chair Snow said that he expected strong downside protection and did become nervous when he starts to see significant negative absolute numbers. Chair Cioffi said that he was not as concerned about the absolute return managers who as a group were slightly down in a period when the S&P was negative 11.1% but he did agree with the concern about the hedged equity group, particularly Tremblant. Vice Chair Snow said from a performance view he was concerned about Fir Tree, Tremblant and Barlow. Mr. Brantley reminded the group that Fir Tree had only been in the portfolio for one month. Despite the concerns voiced the group agreed that none of the Marketable Alternatives managers should currently be placed on the watch list.

**Requested Action:** Cambridge will send most recent Fir Tree quarterly and monthly reports to the Subcommittee.

**Emerging Markets**

Chair Cioffi asked Cambridge to introduce the discussion of prospective Emerging Markets managers. Mr. Snow disclosed a former association with State Street and recused himself from any discussion or actions regarding Rexiter.

The managers presented were Acadian, Battermarch and Grantham, Mayo. Van Otterloo (GMO), all characterized as quant managers. Mr. Brantley reported the following:
Acadian. This manager has been closed since 2004 and is selectively open within a small window of time. They are the most purely quantitative of the three and are highly recommended by the Cambridge research group (as are the other two candidates). The 24 member team is very cohesive and they have only lost one key member over their 14 years together (i.e., the Head Trader). Run by PhDs, they employ a very academic approach. The only concern expressed by Cambridge was that they closed in 2004 when they reached a target they believed they could manage well and they have grown from $7 billion in June 2004 to over $77 billion now. However, over the 14 years their returns have been both good and very consistent.

Batterymarch. This manager utilizes more fundamentals in its approach. Had a big loss in 2002 followed by great performance in 2003. The team was not comfortable with the level of volatility and have tightened this up in the portfolio, thus to do not expect as much deviation in performance going forward. Although Senior Portfolio Manager, David Lazenby has remained with the firm since 1987 and has led this product since its inception, there has been a notable amount of personnel turnover in some key positions and key-man risk has emerged as a concern. The firm is owned by Legg Mason, but it appears that LM has maintained a hands-off approach and has stabilized firm in certain areas.

Grantham, Mayo, Van Otterloo (GMO). Arjun Divecha leads this product. Founders of this firm, including (head person) Jeremy Grantham got their start at Batterymarch. Approach to investments is very similar to Batterymarch, but differs mostly in that significant portion of the performance is attributed to country selection (70%) and the remaining to stock selection (30%). While the domestic products at GMO have struggled recently, this emerging market product has been the ‘crown jewel.’ Like Acadian, this product just re-opened after being closed for over five years. Unlike the other two products, this one has both an entry and exit fee (80 basis points).

Mr. Brantley reiterated that all three are great products and come highly recommended by the Cambridge research group. He referred the Subcommittee to page 3 Emerging Markets Materials, August 4, 2008, to review the returns and then moved to page 4 which presented a correlation matrix for the managers with Rexiter, noting that there was no key difference indicating that not much diversification would be achieved. Vice Chair Snow recommended Acadian since they are strong and offer structural, if not statistical, diversification. Mr. Bain said that he was concerned about size, also leading him to favor Acadian over the larger GMO. Ms. Hudson-Wilson said that she thought GMO was interesting but agreed that it was probably not necessary to interview managers other than Acadian.

Motion: A motion was made, seconded and passed to interview Acadian and, subject to the result of the due diligence performed, to invest half of the current Emerging Markets allocation (currently about $10 million) with Acadian.

Requested Action: Cambridge to set up interview with Acadian.
Inflation Hedge – Commodities

Mr. Brantley began by reminding the group that the goal was to reduce the exposure in the Wellington DIH (now accounting for 7.5% of the Long-Term Pool portfolio) and move a corresponding amount to a commodities pure play. The prospective managers presented were Commonfund, Gresham, PIMCO, SSgA and Wellington.

Commonfund. Cambridge Research has expressed concerns about the lack of transparency divulged by Commonfund regarding its underlying managers. Ms. Hudson-Wilson recently met with CF and provided some insight into their strategy and reiterated her positive opinion of Portfolio Manager Tyler Stevens. Ms. Kent also commented on concerns regarding the short time current team has worked together in this capacity.

Gresham. This is the only one of the five prospective managers where commodities are the manager’s only line of business. Gresham’s investment practice has over thirty years of experience, a cohesive team and a time-tested and proven process. Of the candidates, this is the most active manager of commodities. Tactical and strategic weighting of the underlying commodities’ sectors show the team is not a collection of index huggers.

Pacific Investment Management Company (PIMCO). This is a passively managed commodities product started in 2003. Returns have been strong and manager uses a different approach to collateral management via TIPS (versus short duration fixed income product). Uses the Dow Jones AIG as its benchmark.

State Street. This is another passively managed Dow Jones AIG product. Had issues with collateral management fund (Limited Duration) that took 40% in August 2008 hit but has switched to higher quality, more liquid fixed income vehicle and has been doing well since the change.

Wellington. This is one of the stand-alone sleeves of the Diversified Inflation Hedge (DIH), a product that UVM is already in. The Subcommittee considered this an opportunity to increase its commodity exposure while leaving all of its public real assets capital with Wellington.

Chair Cioffi polled the group and after a brief discussion it was agreed that interviews would be conducted with Gresham and PIMCO. Mr. Bain asked about the amount of the mandate and Chair Cioffi confirmed that it would be $10 million (roughly half of what Wellington currently invests.

Requested Action: Cambridge to set up interviews with Gresham and PIMCO.

Alternative Investments Valuation – Risk Assessment for Audit

Mr. Cate updated the group on the work that is being done regarding valuation of marketable alternatives for the audit of the financial statements at June 30, 2008. He reported that he and Ms. Cauthon contacted the CFOs of each of the hedge funds following a meeting with KPMG, which was attended by Vice Chair Snow. As a result we have been able to get commitments
from several of the managers to provide either a list of holdings or an agreed-upon-procedures report. The managers who have not agreed to provide either one are HBK, Davidson Kempner and Barlow Partners. Vice Chair Snow also commented that it is a process of building up bricks of evidence and that in the case of Barlow, the fund of funds manager, this will be necessary since we cannot expect to get a list of holdings or an AUP report from them. He recommended that we clarify with the auditors their position regarding fund of funds valuations. Mr. Cate said that he would meet with KPMG, continue to work with managers to obtain adequate evidence to support the financial statements, and will report back to the Subcommittee.

Cash Policy

Mr. Cate referred the Subcommittee to the proposed revision of the Cash Policy which has been updated to reflect the current investment program for the operating funds, referred to as the Limited Term Asset Pool. He noted that there had been some discussion about the program at the May BFI meeting but that much of the concern had been regarding the FY 2008 budget that had been established with expectations beyond the Treasury Bill return that he believes is appropriate for budgeting returns on this pool. Aside from the budget issue, he requested feedback from the Subcommittee members regarding the investment parameters established by the proposed policy. There was some discussion and the Subcommittee requested background on the current program. Given the limited time and need to discuss further, Chair Cioffi asked that the discussion be moved to the September 24 agenda. Mr. Bain asked how other institutions managed their operating funds and Ms. Kent responded that many institutions took an approach similar to UVM.

Other Business

Chair Cioffi asked for discussion on draft resolutions as follows:

Reserved Rights of the BOT
Asset Allocation Policy (targets established at July 22 meeting)
Spending Rate for FY 2010
Administrative Fee

Vice Chair Snow noted that he participated in the working group that thoroughly reviewed the Administrative Fee last year and that he believed the recommendations of that group were still valid this year but that a thorough review should be done every few years.

Motion: A motion was passed to recommend to the BFI acceptance of the Reserved Rights of the BOT, Asset Allocation Policy, Spending Rate for FY 2010, and Administrative Fee resolutions.

The Subcommittee discussed future meeting schedules and agreed to meet next on September 24 and to schedule subsequent meetings for Fiscal Year 2009 on the third Wednesday of each month, from 8:30 – 10:00 a.m.
Adjournment

There being no further business, the meeting was adjourned at 10:30 a.m.

Respectfully submitted,

Robert Cioffi, Chair