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 Friday, January 11, 2008 at 8:30 a.m. in Prager, Sealy & Co., LLC Conference Room, 99 Park Avenue, Suite 1520, New York, NY.

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

MEMBERS ABSENT: Jeffrey Davis and Jeanette White.

PERSONS ALSO PARTICIPATING: Associate Vice President for Finance and University Controller Bonnie Cauthon and Jennifer Johnson, University of Vermont; LaRoy Brantley, Cambridge Associates; Elizabeth Hilpman, Barlow Partners; Jenni Lanktree, Davidson Kempner; David Wachter and Stephen Wertheimer, W Capital; JK Brown and Kevin Silva, Och Ziff Advisors; and Larry Lebowitz*, HBK Investments.

* Participating by teleconference

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

Overview of Managers Scheduled to Present

Initial comments were made on all of the University’s managers prior to the start of their presentations. A summary of those comments follow:


♦ Davidson Kempner’s performance was reported through November and was not an outlier.

♦ Och Ziff is on the watch list due to its newly attained public status. The Subcommittee expressed concerned over the additional burden placed on the firm by having a new audience, onerous reporting requirements, and the potential distraction to portfolio managers created by watching the firm’s stock price.

♦ HBK recently underwent personnel changes involving two high-ranking portfolio managers.

♦ The Subcommittee is interviewing W Capital for a potential allocation of UVM’s private equity funds. The firm operates using a different approach that may outstrip traditional returns in this asset class by accelerating its move up the J-curve, posting quicker realized gains, making faster capital calls, and creating solid vintage year diversification.
The Audit Committee will meet with the Investment Subcommittee in February to review the audit requirements for alternative investments. One important step that the Investment Subcommittee will support is to request that all marketable alternative managers engage their auditors to perform agreed upon procedures for interim valuations at the University’s fiscal year end date of June 30. Currently, the only investment manager to comply is Highline. These procedures are part of a higher level of diligence required due to the significant increase in portfolio asset allocation to these types of investments.

**Barlow Partners**

As of December 31, 2007, the Offshore Fund’s asset allocation comprised a list of fewer than 30 managers. The manager included a detailed table of historical manager returns to help illustrate the fund’s performance drivers in 2007 (page 16 of the packet). Barlow’s performance was in major part due to overall good manager selection with nine managers performing higher than 25% (three with more than 50% returns). Most of these managers are closed to new investors. However, one of the managers had a dismal year (-8.0%) . The concern Elizabeth Hilpman, Chief Investment Officer, had for this manager was the increase in managed assets that reached in excess of $12 billion.

The manager does not perceive itself as a global allocator but rather hires managers using a best fit bottom-up approach. Its arrival at a portfolio constituting more of an international profile than a domestic one occurred more through Barlow’s long-term underlying managers morphing into this style than through the manager’s seeking out and hiring new global managers. Ms. Hilpman explained how she travels annually to Asia and Europe to meet with managers; demonstrating the manager’s commitment to word of mouth searches rather than database screening searches.

The fund’s net long exposure of 65% was pointed out (on page 10 of packet) by the Subcommittee members.

Ms. Hilpman explained how all managers in the portfolio have agreed to comply with the auditors’ request for agreed upon procedures for confirming market values. Maria Colque’s name was given as a contact for fiscal year-end information.

**Davidson Kempner**

Jenni Lanktree, Product Specialist, provided a brief organizational view of Davidson Kempner. Ms. Lanktree expressed how the partnership interests are congruent with outside capital and retention is not an issue at the firm. The fund’s performance in 2007 was mostly a result of outstanding first half of the year gains.

The fund’s largest allocation is to merger arbitrage (30%), but the biggest challenges happened with leveraged buyout (LBO) deals such as Sallie Mae and Clear Channel. Since 2006, the key driver of the fund has been distressed securities; there is a correlation
between this driver and new opportunities and certain securities. The outlook for 2008 is there will be greater opportunities in private lending, LBO (retail space), and real estate.

In terms of geographic breakdown, Davidson remains invested in common law countries (i.e. Europe 30-50%, Australia) and this explains their avoidance of activity in Asian markets such as China.

The fees for new capital have increased by 50 bps to 1.5%; the University’s old capital and reinvested has been grandfathered in at the formerly charged 1% fee.

Ms. Lanktree will be in touch with Cambridge Associates with regard to the new audit disclosure requests.

**W Capital (Fund II)**

The firm’s vision is to be the leading organization in providing liquidity alternatives in direct private equity. The performance since inception of Fund I has realized returns of 114.1%. The returns are primarily driven by a certain select set of portfolio companies. The firm invests in companies, for whom the general partners can see a path to liquidity. There must be four to five “A” rated securities (i.e., “gems”) in a portfolio in order for the firm to negotiate a deal to buy it from the seller. The firm evaluates the gems with deep due diligence. The ultimate goal is not to locate a discount but rather to properly price the gems. The firm negotiated on and purchased only 8 out of 157 deals viewed. The firm has a system in place for running valuations on the portfolios. There are 2,500 companies in the system.

The firm’s plans for future growth were explained in terms of exit strategy for the companies other than the A companies. There will be a portfolio management team setup for harvesting the companies rated as “Cs.” Those with B ratings have either venture risk associated with the class or technology risk; these are challenges due to balancing time/value appropriately. Certain B companies accounted for an inordinate amount of the GPs’ time.

**Discussion of W Capital (and Hedge Fund Program)**

A motion was made, seconded and passed to allocate investments of $10 million to the W Capital Partners Fund II, L.P. and $5 million to the Harbourvest Dover Street VII Fund.

There was also discussion on the overall purpose of hedge funds within the portfolio, which hinged on whether the role is specifically volatility reduction or return generation. For example, Davidson Kempner is seeking to remove incremental risk in a volatile market. Over time, the University’s hedge fund program has become much more diversified with regard to strategies and managers as a whole. This development poses the question whether there’s still a need for an absolute return manager within the portfolio. The debate then arrived at whether the hedge fund program’s individual
managers should be aiming for higher returns or mitigating risk. It was agreed that Davidson Kempner is a role player (within the firm’s mission) as an absolute return manager. The firm’s fit in the University’s portfolio mission and asset allocation came under question.

The discussion broadened to risk budgeting and where exactly to spend that risk in the portfolio. In terms of overall management of the portfolio, the goal of the hedge fund program is defined as volatility reduction. The “go-forward” asset classes of the portfolio were identified as private equity and venture capital, areas where large excess returns are expected in upmarkets. The broad difference in hedge fund strategies was discussed (in terms of expectations) and the overall commonality was determined to be legal and fee structures. The Subcommittee also looked at the return correlations for the hedge fund managers between each other and within the aggregate program (to get a feel for strategies as a whole). The correlation ratio over 6 ¼ years for marketable alternatives vs. S&P 500 was high at 0.84x (due primarily to the up markets over the last five years).

**Och Ziff Advisors**

The Subcommittee expressed serious concern over the firm’s recent transition from a privately held company to a publicly traded entity (November 2007). The manager provided two reasons for this decision: the means for retention of current talent through an equitable share of company profits; and the ability to attract senior talent through public stock options (versus straight cash compensation). In response to the first reason stated, it was noted that Och Ziff has a 97% retention record. The firm was seeking broader ownership than the prior full equity ownership of the 18 partners. The manager also explained the firm’s interest in raising capital for use in a private fund vehicle, which had been inaccessible to employees due to offshore capital limitations. All of the proceeds from the IPO went to fund this product. The initial public offering was sold at $32/share and is currently trading at $24/share.

The manager projected growth in private equity and the following sectors: credit, financials, media telecomm, industrials, retail, energy, and healthcare. The manager has personnel in Europe, Asia (e.g., Tokyo, Hong Kong, Bangladesh, Beijing). The manager further emphasized that the ability to compensate with its new public status will provide incentives for a greater team-driven approach within the firm.

The firm’s assets are allocated as follows: 50% US and 50% ex U.S. (with 23% in China). There are six to eight investments to realize through selling or offering to public. The manager explained how the energy sector is expensive, they have moved out of certain alternatives (e.g., ethanol and wind), but that they are looking globally to Brazil and Mexico. They are also the largest holder of carbon credits (sold from Swiss Bank).

The firm will be offering a mid-year audit in order to address auditors’ need for a set of agreed upon procedures for evaluating assets.
HBK Investments

The firm was very candid about its dismal performance in 2007, which was the worst set of results in its 16-year history. Several of the manager’s strategies accounted for the lackluster annual performance: structured credit (i.e. subprime), U.S. event driven, relative value, and quantitative.

The team identified a number of opportunity sets for 2008. The firm is heavily invested in emerging markets credit lending and structured credit (multi-year opportunities). The credit sector will focus on credit scarcity (i.e., provide financing at attractive rates compared to banks), prime mortgages and auto loans. The following allocations were cited: 31% corporate credit, 11% non-corporate credit, 6% event driven, 22% equity relative value, 25% quantitative, and 5% fixed income.

The firm explained changes made to its management structure. The firm will be more specialized going forward. There are now two partners delegated to firm management and two other partners in charge of portfolio management. They explained how this will improve efficiency in execution within the organization.

The manager provided an analysis of the poor performance in 2007. There was a forced liquidation following the subprime mortgage crisis and certain paper was forced out of the hands of holders to be sold in public market. HBK purchased these liabilities for its unleveraged rate of return and ability to evaluate them. In response to a question posed by the Subcommittee, the biggest worry in the next year for HBK is massive redemptions by investment clients rather than putting their capital to work. The manager explained the rate of redemptions at year end was 10% (vs. a 4-5% typical rate).

HBK has been actively conversing with its auditor, PriceWaterhouseCooper, and other auditors on the broad acknowledgment and adoption of agreed upon procedures. They will send a summary of evaluation procedures to Cambridge Associates. Jennifer Strickland was identified as an HBK contact on this specific issue.

Hedge Fund Program

The Subcommittee would like to add to the hedge fund program to the February Investment Subcommittee meeting agenda with the two following items: 1) the structural proposals for the underlying hedge fund managers (as originally created for the November 2007 meeting), and 2) a definition of a hedge fund strategies for Subcommittee members.

Adjournment

There being no further business, the meeting was adjourned at 3:30 p.m.

Respectfully submitted,
Robert Cioffi, Chair