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 Tuesday, July 22, 2008 at 8:30 a.m. at the offices of Cambridge Associates, 100 Summer St, Boston, MA.

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

MEMBERS ABSENT: None.

PERSONS ALSO PARTICIPATING:  Administrators: Richard Cate, Interim Vice President for Finance and Administration and Treasurer, Bonnie Cauthon, Associate Vice President for Finance and Controller
Cambridge Associates: Bets Kent, LaRoy Brantley and David DeVaughn

* Participating by teleconference

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

Approval of June 26, 2008 Meeting Minutes

A motion was made, seconded and approved to accept the minutes of the June 26, 2008 meeting.

Meeting Overview

Chair Cioffi provided a brief overview of the agenda topics emphasizing that the primary focus would be on a strategic view of asset allocation. He noted that the portfolio had withstood the current market dislocations well, similar to the resilience that it had maintained in 2002, and that the diversification work of the committee had paid off.

He asked Ms. Kent to comment on Cambridge’s (CA) view of the markets. She referred the group to the abstract of “In the Eye of the Storm” prepared in April 2008 by the Cambridge Research team. She reiterated the CA opinion in that piece that “we are entering the final leg of a secular bear market in U.S. equities that began in March 2000.” She commented that UVM had a much more diversified portfolio than a few years ago and cited the dramatic changes to the policy asset allocation targets established last year. She said that CA is still talking to clients about taking a somewhat defensive posture and trying to build an “all weather” portfolio. She said there was also an emphasis on helping clients prepare for distressed cycles where there would be a lot of opportunities. Ms. Kent concluded by stating that she was cautiously optimistic, but thought the recent UVM portfolio moves have been in the right direction for what is expected from the capital markets. Mr. Bain asked what it would take to change the current Cambridge view. Ms. Kent replied that she would be looking for
capitulation by stock buyers and, given the continuing great pressure on the financial sector, that another large blow-up could signal the bottom. Mr. Brantley commented that this was not to suggest not investing in U. S Equity and that in fact some subcategories of U.S. Equity (e.g., mega-cap and large-cap growth) were moving back to being considered fairly valued. The need to keep to the discipline of rebalancing and diversifying has gained greater significance.

**Requested Action:** Chair Cioffi asked that Cambridge redistribute the full version of “In the Eye of the Storm” to the Subcommittee in electronic format.

**Asset Allocation**

Chair Cioffi moved to the specific topic of UVM asset allocation. He began by observing that in looking at the trends over time, the dramatic changes had been a reduction in U.S Equity and Fixed Income and significant diversification. Mr. Snow added that in total the portfolio was still heavy on equity and that there had been a shift away from debt, with Mr. Brantley clarifying that the shift was from long-only debt. Ms. Hudson-Wilson noted that there were just more ways to invest in equity and added that it was important to make sure managers were in the right buckets and allocated properly. Mr. Snow asserted that there were really only three assets, equity, fixed income and real assets, along with skill; and that return could always be disaggregated into assets and skill. Mr. Brantley said that Cambridge categorized hedge funds out as a skill class (vs. an asset class) and that this was an area where you wanted to spend a lot of time on manager selection. The group reviewed Page 24 in the Discussion Materials, *Manager Role in the Long Term Portfolio*, (the check mark page). Ms. Kent raised the question of whether the Return Enhancement percentage was high enough. Chair Cioffi asked each member to comment on what they saw as issues and highlights in the portfolio. Comments were:


Mr. Snow: Do we have enough risk in portfolio? Weakest area is underexposure to Non-Marketable Alternative Assets (NMAA). Highlight is that Fixed Income has been reduced but there is still room to take down further.

Mr. Bain: Agree on long-only U.S. Equity but would not take down too much since believes it will have natural correction, thus we do not want to overshoot. There is a need to put more into Emerging Markets since internal demand in those countries will be a strong driver. We should look for ways to accelerate Private Equity investment. Fixed Income is a “time bomb,” given interest rate expectations, and unless the University needs it for cash flow he would bring it down further.

Chair Cioffi: A highlight is the significant reduction in Fixed Income. Significant increases in Emerging Markets and Real Assets were huge pluses over the past few years. The biggest disappointment is that we are exactly where we were 10 years ago on PE/VC exposure and have not been able to crack that problem. U.S. Equity is too high, especially if you consider that other managers that we have bucketed as alternatives are also invested in U.S. Equities.
The Subcommittee reviewed Discussion Materials section IIb, *Comparative Data*, which presents asset allocation data for some leading institutions and for institutions with endowments of $200 to $500 million. Mr. Snow observed that it is not that the “Leading Endowments” aren’t as exposed to long-only equities but that their primary exposure is on the private side (vs. public). He said that the question is what we need to do in order for the Endowment to meet its long term goal (over decades) and that the real question for equities is whether we want the exposure to be private or public.

Chair Cioffi noted that if you looked beyond the specific long-only U.S. Equity allocation and through to the entire UVM portfolio there was still an overexposure to U.S. Equity. Mr. Brantley also reminded the group that the Emerging Markets exposure was approximately 8½ - 9% if exposure via Templeton and American Funds was included in the calculation. Mr. Bain observed that the Leading Endowments were at 76% equity, 17% real assets and only 7% fixed income. Mr. Snow added that if we drained 12% from U.S. Equity and 6% from Fixed Income, and added 4% to VC, 7% to PE and 3% to Real Assets, we would be in line with leading institutions.

Mr. Snow initiated a discussion of risk in the portfolio. He re-asserted his belief that more risk was needed, that we do not want to find that the next 25 years repeat the previous 25 years and that there was the opportunity to take a very long term view since the Endowment distribution is not a large percentage of the University’s operating budget, unlike some institutions. He recommended the group assess whether taking on more risk was in the best interests of the Endowment, and if so whether the Subcommittee was prepared to defend that position. Ms. Hudson-Wilson presented the view that diversifying and reducing Fixed Income actually reduced risk.

When asked by Mr. Brantley how he was defining risk, Mr. Snow clarified that he was referring to risk as measured by volatility of returns only, as opposed to other types of risk such as manager risk and leverage. Mr. Snow added that, excluding manager impact, in the end over time you will get asset class returns. So taking on more risk equals more exposure to more volatile asset classes, on the theory that you will be rewarded for risk. Ms. Hudson-Wilson noted that it was important to understand where you were adding volatility. Mr. Snow agreed and suggested that if you were able to make and document the risk decision then you could codify it in order to inform the decisions of future investment committees.

**Requested Action:** Mr. Snow requested that Cambridge prepare a risk/return quadrant analysis that disaggregated the portfolio return and risk by equity and fixed income. Mr. Brantley suggested it could be shown on axes over different time periods as well.

Ms. Hudson-Wilson returned to the issue of target goals for PE/VC and asked where the percentage would be if the portfolio was fully invested for all current commitments. There are $36 million of outstanding commitments, which, if all put to work (with no off-setting distributions) would increase the NMAA percentage to 14%. Mr. Snow cited the failure to maintain an ongoing commitment to PE/VC and Chair Cioffi agreed that between 1994 and
1999 UVM basically went out of this market. Mr. Bain asked if there was a way to dial up the progress and Chair Cioffi responded that using the current fund of funds approach only added about a year of lag. He also reminded the group that vintage year exposure to PE makes a world of difference to returns.

Mr. Snow agreed that it was critical to: 1) have a program that is sustained and consistent; and 2) avoid ever sitting out three to four years again. Mr. Cioffi agreed that you can’t have holes in the program. Mr. Brantley recapped some of the options which were: 1) investment in more funds; 2) investment in more secondaries; or 3) increased bite size for commitments. Mr. Bain agreed that secondaries were interesting if you could find opportunities with open funds. Ms. Hudson-Wilson said that could result in picking up recent vintage years and questioned whether that was what you wanted to do. Chair Cioffi replied that you would if the price was right. The group agreed that we would need to stay alert about opportunities in the secondary market and continue to look at funds as they opened up.

Mr. Brantley agreed that return was the highest goal but that mitigation of risk allowed you to take fuller advantage of compounding returns. He referred the group to Page 15 of the Discussion Materials, Efficient Region Analysis, and suggested that it was a good guidance point for the asset allocation discussion. He also referred the group to Section IIC, Risk Modeling, and said that these were new models. Ms. Hudson-Wilson asked whether timing was built into the models and Ms. Kent responded that it was not. Mr. Brantley added that implementation does matter but these models do not capture that impact. Mr. Bain inquired about the take-away from the model on Page 20, Loss Expectations, and Ms. Kent replied that the overall take-away from the risk modeling charts was that at any given point during a 10-year period there are certain possibilities of real declines and that translated into “be prepared to go through some rough patches”. She emphasized the importance of education on this point and of demonstrating patience during those rough patches.

**Asset Allocation and Manager Structure**

Chair Cioffi stated that he wanted to spend the next hour on asset allocation targets and ranges. He directed the group’s attention to Page 23 of the Discussion Materials, Asset Allocation and Manager Summary Preliminary Data for June 30, 2008 and asked each Subcommittee member to begin by providing their starting recommendation for asset targets and ranges. Mr. Snow noted that to the extent it is not possible to meet the target in PE/VC that it is important to ensure the excess goes to a suitable asset class. His opinion was that the most suitable alternative was Emerging Markets. There was a discussion of U.S Equity and the impact of currency values. Mr. Bain asked if there was a different equity recommendation that Cambridge offered. Ms. Kent referred to Discussion Materials Page 26, World Equity Market Capitalization, with the Cambridge long-term recommendation of equal weightings of one-third to Europe, the Americas and and Asia. Ms. Hudson-Wilson questioned the intended time horizon for the targets and ranges and the group generally agreed three to five years was appropriate. She also expressed concern about the current ranges. She maintained that ranges should be actionable and that the current ones were not. There was a discussion that weighed the value of retaining flexibility and discretion against the need to tighten the ranges to prevent them from becoming too wide and sloppy. Ms. Kent reminded the group that careful
rebalancing to targets helped remove the “fudge factor” of the ranges. Some subcommittee members felt that the ranges were too broad and that equity in particular was too wide. Chair Cioffi agreed that he would tighten that down. Mr. Snow commented that the discussion indicated a need to better define the purpose of the ranges.

**Requested Action:** Chair Cioffi asked Mr. Snow to work with University staff to draft policy revisions that provided language defining the roles of targets and ranges, to be placed on August agenda.

There was further refining of targets and ranges to find consensus on the areas where the original recommendations had the widest variation. These were U.S. Equity with high of 25% (Mr. Bain) and low of 14% (Ms. Hudson-Wilson) and Global ex-U.S. (both Developed and Emerging Markets) with high of 28% (Ms. Hudson-Wilson) and low of 24% (Mr. Bain and Mr. Snow). All members had consistent original recommendations of bringing Fixed Income down to 10% and keeping Hedge Funds at 20%. Mr. Snow reminded members that in his view Fixed Income and Inflation Hedging should be considered as nested (i.e., if amount is given to one, it should be taken from the other).

**Motion:** Motion was made, seconded and passed to recommend to BFI for further adoption by the BOT at the September Meeting the following revisions to policy targets and ranges.

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<tr>
<th>Asset Class</th>
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<th>Current</th>
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<tr>
<td></td>
<td>Target</td>
<td>Range</td>
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<td>Developed Markets</td>
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<tr>
<td>Emerging Markets</td>
<td>11.5</td>
<td>5-20</td>
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<tr>
<td>Marketable Alternatives</td>
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</tr>
<tr>
<td>Inflation Hedging</td>
<td>15.0</td>
<td>10-25</td>
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<tr>
<td>Venture Capital/Private Equity</td>
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<td>5-20</td>
</tr>
<tr>
<td>Fixed Income</td>
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<td>5-25</td>
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<tr>
<td>Cash and Cash Equivalents</td>
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**Rebalancing**

Chair Cioffi stated that he would like to determine where rebalancing was needed prior to discussion of specific managers. He reminded the group that large-cap growth manager Ark had recently been terminated with the proceeds of approximately $25 million transitioned by SSgM into the Russell 1000 Growth ETF (Exchange Traded Fund). When a new U.S. Equity manager was selected the rebalancing could be accomplished by placing less with that manager and redeploying the excess to other asset classes. It was determined that: 1) An additional 3.5% should be allocated to Emerging Markets from U.S. Equity to bring it to 11.8% (total with look-thru), with a new manager considered for EM; 2) Marketable Alternatives did not
need any adjustment, and; 3) An additional 3.5% should be added to Inflation Hedging to bring it to 18%, with Fixed Income being reduced from 13.5% to 10%.

Manager Review – Wellington

Laura Meegan, Client Service Manager, and William Samuels, Portfolio Advisor, Wellington, met with the Subcommittee. Wellington is located in Boston, providing a good opportunity for an in person meeting, the first with this manager selected three years ago. Mr. Samuels gave a brief overview of the organization and noted that assets under management at June 30 were approximately $550 billion. Over the past three years, UVM has added about $17 million to its original commitment and currently is at about $26 million after an $8 million redemption July 1.

Mr. Samuels presented a long-term view that inflation will be with us, volatility in prices will continue and drivers will be previous loose money policy, strong demand and limited supply. He noted that while prices have gone up there has been a limited supply response. Given geopolitical and geologic factors, costs continue to go up putting upward pressure on prices. He said that Wellington tries to predict a range (vs. a specific target price) and tries to invest at the lower end of the range. He defined the bottom of the range as the marginal cost of production and the top as the point at which demand elasticity kicks in. He also noted that emerging markets have not slowed down in consumption.

In looking at the Diversified Inflation Hedges (DIH) fund Ms. Hudson-Wilson inquired about why the portfolio included RE equities. Mr. Brantley concurred that it was questionable and asked also how a true inflation hedging portfolio could have 55% allocated to equities. Ms. Hudson-Wilson asked Mr. Samuels to talk about how Wellington approached commodities as a direct connector into inflation hedging. He replied that they were active managers in the commodities space and thought they could add significant value there. He cited sector selection, commodity selection within sector and contract selection. He noted that contract selection had added value attribution of 40%. Mr. Samuels also discussed a problematic LIBOR Plus collateral account that had been “de-risked”.

Ms. Kent asked about the decision process and who played “devil’s advocate” for Sr. VP and Portfolio Coordinator Scott Elliott, who has final say on asset allocation decisions. Mr. Samuels replied that they did have an asset allocation strategy group and there was input from a diverse group of analysts but at the end of the day Mr. Elliott took responsibility for decisions made in the DIH portfolio.

Requested Action: Ms. Hudson-Wilson asked Wellington to provide a report of correlation to inflation for each of the underlying independent portfolios and Chair Cioffi requested a listing of which of the individual funds were open. The Subcommittee also asked to see Wellington’s presentation on its stand-alone Commodities product (Cambridge will obtain and distribute this).
Manager Structure Implementation – Specific Decisions

Chair Cioffi reviewed what the Subcommittee needed to accomplish in the afternoon: 1) EM; 2) Real Assets/Commodities; 3) VC/PE and Distressed including Siguler Guff; and, 4) U.S. Equity and style mix, including DSM.

Ms. Hudson-Wilson reported on her commodities research, as presented in a memorandum to the Subcommittee. She reported a very favorable impression of Commonfund’s senior team in this area; that there are limited places to play in commodities and futures; and that private real estate is positively correlated with inflation but public real estate does not hedge inflation since it tends to get sucked down with the equity market, of which it is a small part. She expressed a concern that the portfolio was overexposed to Wellington and Chair Cioffi concurred. He suggested that the Subcommittee might need to deploy $24 million, $12 million from Fixed Income and $12 million from a Wellington rebalancing. Mr. Snow expressed concern about the amount of hedging vs. returns. Mr. Bain noted that Real Estate might provide both a hedge and returns. Mr. Brantley also noted that there should be an in-depth consideration of Fixed Income and whether as currently structured it is a true deflation hedge.

Requested Actions: Chair Cioffi asked Cambridge for the August meeting to bring information on 3-4 recommended managers for Commodities. He also requested that the Subcommittee review the Fixed Income portfolio at a subsequent meeting with focus on whether it should be changed in order to make it a true deflation hedge.

Chair Cioffi reminded the Subcommittee that based on the rebalancing targets, an additional $10.8 million would be added to EM. There was consensus that this should be accomplished by adding a new manager to complement incumbent manager Rexiter. Cambridge provided information in the Discussion Materials on Aberdeen, Batterymarch and City of London. Mr. Snow suggested that a mix of two managers with different styles was needed and that adding a manager with a quant (quantitative) approach would provide diversity.

Requested Action: Chair Cioffi asked Cambridge to provide summary information on additional quant managers and to include Batterymarch on the list.

Chair Cioffi and Ms. Hudson-Wilson reported on their call with Siguler Guff on June 30. Ms. Kent clarified that SG had already called 20% of Fund III so there would have a retroactive cap call.

Motion: Motion was made, seconded and passed to commit $7.5 million to Siguler Guff Distressed Opportunities Fund III for the July 31, 2008 closing.

The Subcommittee would like Cambridge to keep it informed of other interesting managers in the distressed investing Fund of Funds space.
Chair Cioffi and Ms. Hudson-Wilson reported on their call with DSM on June 30. Both recommended adding DSM to U.S. Equity. It was recommended this be done via reallocation of funds among U.S. Equity managers, with exception of Iridian. Mr. Snow noted that DSM held Schlumberger and reminded the Subcommittee of the Tobacco and Sudan free mandates adopted by the Board of Trustees. Ms. Kent agreed to discuss this issue with DSM to ensure they could manage this screen.

**Motion:** A motion was made, seconded and passed to invest $15 million with DSM in a separate account, subject to their ability to screen for Tobacco and Sudan.

**Requested Action:** Chair Cioffi requested a tickler be put into place to ensure the Subcommittee re-visits U.S. Equity in 6 months.

**Follow–up Assignments**

Chair Cioffi made the following Subcommittee assignments for work to be targeted for completion prior to the August 20 meeting:

- Conference call with Real Asset/Commodities managers (Cambridge to provide) – Mr. Bain and Ms. Hudson-Wilson
- Conference call with Emerging Markets managers (Cambridge to provide) – Chair Cioffi, Mr. Snow.

**Adjournment**

There being no further business, the meeting was adjourned at 3:45 p.m.

Respectfully submitted,

Robert Cioffi, Chair