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, January 27, 2009 at Cambridge Associates, 100 Summer Street, Boston, MA.

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

MEMBERS ABSENT: None

PERSONS ALSO PARTICIPATING: Interim Vice President for Finance and Administration and Interim Treasurer Richard Cate, and Bets Kent, LaRoy Brantley and David DeVaughn of Cambridge Associates.

Chair Robert Cioffi called the meeting to order at 8:40 a.m.

New Business

To begin the meeting, Richard Cate was asked to give an update on the marketable investments in the Short-Term Pool (operating funds) that the University has remaining with Commonfund. The University has been in the process of transitioning away from Commonfund since October 2008. Currently there is:

- $27 mm in the Short Term Fund
- $9 mm in the Intermediate Bond fund
- $22 in the Absolute Return fund

Mr. Cate has been notified that Commonfund is going to shut down the Absolute Return fund altogether, but has not been given the details of that process nor the timing.

Mr. Cate informed the ISC that the University now has a short-term account with TD Banknorth:

- 1.4% interest rate
- $128 mm currently in this account, but it will fluctuate

The ensuing discussion focused on the different layers to the operating pool – the current needs layer, an intermediate layer, and a “deep” core. The big question is the relative size of each layer and how each one should be invested. For example, some would say that the deep core should be invested in the Long-Term Pool. An outcome of the review was that Mr. Cate and the ISC will revisit the structure of the operating pool.

Additionally, there was some discussion of underwater endowments and how they can be treated, and the new UPMIFA legislation. This will be reviewed at the February ISC conference call. In the meantime, Mr. Cate crafted some wording that the ISC approved as a letter to be sent to the legislature:

> Whereas, as a non-profit education corporation subject to the laws of the State of Vermont, the University of Vermont is subject to Uniform Management of Institutional
Funds Act (UMIFA) and some elements of this act are, after over 35 years, somewhat dated; and

Whereas, in July 2006, the National Conference of Commissioners on Uniform State Laws (NCCUSL) approved and recommended for adoption by all states the Uniform Prudent Management of Institutional Funds Act (UPMIFA), which is an update of UMIFA; and

Whereas, UPMIFA further protects donor intent regarding distributions from endowments and provides clarity about how endowments are to be managed in times when their market values decline below the value of the gifts when they were originally made; and

Now Therefore be it Resolved, that the Investment Subcommittee of the Board of Trustees of the University of Vermont, recommends that the State of Vermont respond to the recommendation of the NCCUSL and adopt UPMIFA during the 2009 legislative session.

Market Overview

Cambridge gave a quick review of current market environment, reviewing charts on what has been happening over the past few months. This was to set the context for what types of valuations we currently see and what opportunities and risks there are for 2009.

Manager Presentations

Eaton Vance (Susan M. Brengle and Nancy Tooke)

Susan M. Brengle (client service, a UVM alum) and Nancy Tooke (portfolio manager) gave an update on the Eaton Vance Small Cap Core fund (in which the LT Pool invested in mid-August 2007) and the current market environment. Ms. Tooke saw the fall of Lehman Brothers in September 2008 as a “watershed” event that influenced the entire fourth quarter crisis and market environment. She did a significant amount of restructuring of the portfolio during that quarter. She is excited by the fact that some of the companies she had had to “kiss goodbye” when they grew out of the small cap space over the past few years have now returned to her. Highlights of the commentary follow:

- Eaton Vance had $125 billion assets under management at 12/31/08. The figure was $22 billion higher three months earlier
- Small cap stocks are inherently illiquid; there was a very negative impact last quarter from hedge fund selling
- From 9/30 – 11/20 small caps (Russell 2000 index) returned -43%; Eaton Vance also returned -43%
- From 11/20 – 12/30 the Russell 2000 was +30%, Eaton Vance gained 20%
- Once they realized we would have a deeper than normal recession, the analysts went back and scrubbed all earnings estimates
- She repositioned the portfolio through Q4 to make sure it consisted of companies that could get through ’09 in good shape
- A “slow and sloppy” 2010 is expected
They only own two banks right now—but did add three P&C insurance companies, that are gaining market share from AIG
As for technology companies, their companies have cash, no debt, and can take market share
Energy—they like domestic Exploration & Production companies; oil/gas prices will rebound
There is a glimmer of some M&A activity
Turnover is normally 50-70% per year but it went way up in Q4 '08 and was 50% Q4 alone
The research analysts are like kids in a candy store, given current valuations

Iridian (Harold Levy, David Cohen, Meg Guzewicz, Alice Hicks)

Harold Levy, David Cohen (both are portfolio managers), Meg Guzewicz (client service, and UVM alum), and Alice Hicks (client service) gave an update on Iridian’s Mid-Cap strategy (in which the University has been invested since 5/31/94). In essentially a “good cop, bad cop” scenario, Mr. Cohen and Mr. Levy played off each other: Mr. Cohen sees the next two years as being very difficult, that the full extent of earnings and job losses will take a while to uncover and is confused by analysts who think otherwise. He believes that corporate managements are still far too optimistic. Mr. Levy also predicts a difficult next couple of years, but is more excited by the opportunities out there and believes that more of the bad news is already priced into stocks. Highlights of their commentary follow:

- Bank of Ireland (which owns the firm) is struggling and going through a recapitalization plan. This should be sorted out in the first quarter 2009. Iridian is a very tiny piece of B of I’s business, but may be sold. Iridian may try to repurchase its business from B of I, but has not yet been able to get the attention of the bank’s senior management on this issue.
- Mr. Cohen—his view is that the current market turbulence is part of what will be a long, deep negative cycle.
- The fact that there was a housing bubble and that we were in a highly leveraged economy—these things were highly visible. What was not as transparent was the extent of issues in the financial sector.
- The current fiscal stimulus—a very minor palliative
- Issue—highly dependent on foreign economies to purchase our securities. Traditional purchasers—Chinese, Middle East—have a need to worry about their own economies and keep some funds at home
- Auto industry—is used to selling 17 mm cars/year; now it’s 10 mm, may settle out at 12 mm
- In general, corporate managements are too optimistic (still)
- Japan—at least it’s self-financing; the US is not, so in some ways we are in worse shape
- Mr. Cohen believes that we do not need to worry about inflation for years.
- Mr. Levy—says that we do not know where companies are, given that they had to very quickly adjust for the slow environment—we are in the teeth of it right now
- If Iridian is sure that the companies are going to be there (debt situation is fine, for example), they are OK owning them; examples are Precision Castparts, General Dynamics
- Another example -- Devon Energy—the stock is pricing in oil at just $10 / barrel
Asset Allocation Discussion

The Asset allocation discussion began with a question as to whether the ISC is looking at the portfolio in the right way. The ISC decided in the summer of 2008 that, in addition to analyzing the portfolio by asset class, it would also look at it in terms of the investment managers’ classification. During the summer, the Subcommittee decided on three categories: Return Enhancement, Volatility Reduction and Inflation Protection. There is now some question as to whether “return enhancement” was the right phrasing choice. Key issues are:

- What is the total return objective?
- Are we aiming for a portfolio that earns at least 5% real over long period of time, so it can cover the spending rate? (This is what is included in the Investment Policy Statement.)

The Subcommittee then reviewed all the manager summaries provided in the materials. Two in particular were of note:

- Tremblant—not happy with performance, will revisit at the end of year, can’t get out until early 2010
- Barlow—disappointed that did not preserve capital in 2008 as would have hoped/expected. Discussed merits of direct vs. Fund of Fund strategies; can’t exit Barlow until end of 2009

The ISC followed the manager review with reworking the Long-Term Policy Targets for the portfolio. Each ISC member suggested new targets and ultimately the column marked “New Targets” was agreed upon:

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<tr>
<th></th>
<th>Current Targets (%)</th>
<th>New Targets (%)</th>
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<tbody>
<tr>
<td>US Equity</td>
<td>22</td>
<td>25</td>
</tr>
<tr>
<td>Non-US Developed Mks</td>
<td>11.5</td>
<td>12</td>
</tr>
<tr>
<td>Non-US Emerging Mks</td>
<td>11.5</td>
<td>10</td>
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<tr>
<td><strong>Total Non-US</strong></td>
<td><strong>23</strong></td>
<td><strong>22</strong></td>
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<tr>
<td>Marketable Alternatives</td>
<td>20</td>
<td>17.5</td>
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<tr>
<td>Private Equity /Venture Cap</td>
<td>10</td>
<td>10</td>
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<tr>
<td>Real Assets</td>
<td>15</td>
<td>12.5</td>
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<tr>
<td>Fixed Income</td>
<td>10</td>
<td>10</td>
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<tr>
<td>Cash &amp; Cash Equivalents</td>
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The Subcommittee then discussed an issue regarding non-marketable alternatives—if the portfolio does not get any distributions, this allocation could grow faster than expected; given that Net Asset Value plus unfunded commitments are already near target.

There was general agreement that the ISC wants to stay positioned in equities and other market-based strategies so that a market rebound will be very beneficial. That being said, there was some interest in tracking / unearthing what superior hedge funds are out there that are now taking new money. This part of the conversation wrapped up with one view that as money is freed up from the bond portfolio, it could be invested one-half in US equities and one-half in emerging markets. Specific rebalancing decisions will be made at the upcoming conference calls, as some
of the previously planned fundings (Acadian emerging markets, Gresham commodities) take place.

**Action Items**

- Focus on the Vanguard TIPs fund which was incepted 7/11/08
  - Cambridge will review how portfolio is constructed
    - Is it completely passive?
    - Are they doing corporates? (These are allowed by fund prospectus)

- The Subcommittee agreed that there are significant concerns with Wellington DIH after receiving an update that the asset allocation (overlay) portfolio manager will be moving to Hawaii and will run the fund from there. **The ISC decided to exit the fund at the next exit date (end of February for March 1 exit).**
  - This will involve restructuring the Real Assets part of the portfolio; however, the ISC is well along that path already due to the addition of Vanguard TIPs and approval of Gresham (commodities).
  - As part of the restructuring project, Cambridge Associates will analyze the energy exposure in the overall portfolio (going beyond the real assets segment).

- Cash—the ISC wants to keep six months of liquidity so that it is readily available; given the 5% spending draw, in a normal world this would be replenishing 2.5% per 6 months. Richard did note that their cash needs are seasonal. He will draw up a policy about this.

- The new asset allocation targets established in the meeting will take effect 1/31/09 for purposes of performance reporting.

- Cambridge Associates will arrange for a representative of Commonfund Capital to talk to the ISC in February to review the existing non-marketable investments.

- Contact the investment managers to give them the ISC members' email addresses and ask them to send quarterly performance commentary to each person.

**Adjournment**

There being no further business, the meeting was adjourned at 3:17 p.m.

Respectfully submitted,

Robert Cioffi, Chair