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 and State Agricultural College was held on Wednesday, March 17, 2010, at 8:30 a.m. in the President’s Conference Room, 351 Waterman Building, Burlington, VT.

MEMBERS PRESENT: Chair Samuel Bain*, Vice Chair Susan Hudson-Wilson*, Ian Boyce* and David Daigle*

PERSONS ALSO PARTICIPATING: Vice President for Finance and Administration and Treasurer, Richard Cate; Controller, Claire Burlingham; Assistant Controller for Tax and Treasury Services, Kathy Snell; Bets Kent*, LaRoy Brantley* and David DeVaughn* of Cambridge Associates; and Trustee Robert Cioffi.*

*By means of conference telephone.

Chair Samuel Bain called the meeting to order at 8:35 a.m.

Approval of Minutes

A motion was made, seconded and voted to approve the minutes of the February 23, 2010 meeting.

Update on Portfolio Rebalancing

Mr. Bain opened the meeting and provided an update to the Subcommittee on the portfolio rebalancing. He noted that the redemption request of $1.8 million from David Kempner should be received by the end of March and the funds will be invested with Fir Tree. He also noted that the tail-end of the full redemption previously received from Barlow is due to settle at the end of this month. Mr. Bain stated he would like to develop a pie-chart illustrating current investment allocations, and another one illustrating the targeted allocations; he will want the help of ISC members.

Flash Report

Mr. Brantley led the review and discussion of the Flash Report for the month ending February 28, 2010. As a follow-up to Mr. Bain’s comments on asset allocation, he explained that in the asset allocation section of the performance reports provided by Cambridge, the Manager Allocation column reflects what the University has invested directly with the managers in those particular asset classes. He also added that managers, particularly long-only managers, will hold discretionary cash at various times based on conditions in the market. This cash number is not a part of the Cash and Equivalents line item in the performance reports. The ability to hold discretionary cash during difficult economic times can benefit active managers over index funds, which are fully invested in the market at all times.
Mr. Brantley noted that the externally managed investments’ performance for the month of February was +1.2%. He explained that 150 basis point (bps) underperformance of the Undiversified Benchmark for the month was due largely to the fact that only three equity-based managers in the portfolio were able to keep up with the S&P 500’s strong results – the index was up over 3% for the period. At the request of Mr. Bain, he reviewed for new members of the Subcommittee the rationale of how the Subcommittee made recent manager changes in the emerging markets program. He explained that over time the two long-tenured developed markets managers had carried emerging market exposure in their respective portfolios that usually totaled 2% of the portfolio. With this in mind, members of the Subcommittee would try to keep the amount allocated to dedicated emerging markets managers 2% under the policy target, when rebalancing the portfolio. The Subcommittee subsequently decided to establish more control over the emerging markets exposure by terminating one of the developed markets managers that had carried a relatively high exposure to the asset class and to hire Mondrian Investment Group, a manager that invests more largely in the EAFE-based countries.

**Performance Attribution**

Relative Performance through January 31st: Mr. Brantley then reviewed the Flash Investment Returns by Composite and the Performance Attribution report as of January 31, 2010. He noted that the Current Allocation Benchmark result reported in the January Flash Report should have been 25.6% for the trailing year (instead of 30.2%) and negative 2.4% (instead of positive 2.1%) for the month. The errors in stating the benchmark performances resulted from the need by the performance reporting team to use proxies for the CPI-U component in order to have the performance results ready in time for the Subcommittee monthly calls. These substitute numbers ended up being overstated a number of times due to the actual deflation that occurred in the market in 2009. The University’s actual cumulative annual performance of 23.3% lagged by only 230 bps in relation to the benchmark, instead of by the previously reported 690 bps.

Mr. Brantley directed the Subcommittee to the “Attribution by Asset Class” portion of the report and explained the components used for calculating relative performance versus the Target Benchmark. The first component is Asset Allocation, which essentially determines a positive contributing asset class to be one where there portfolio has an overweight to an outperformer or an underweight to an underperformer. Conversely, performance detractors are overweights to underperformers and under-weights to outperformers. The second component is the Manager Structure, where a difference (plus or minus) emerges from one/some of the individual managers having separate benchmarks than the composite level benchmarks (e.g., U.S. and Global ex U.S. equities). The third component of the report entails the Active Management, which directly compares how the managers in an asset class performed against the benchmark. Active management was the key driver for overall portfolio underperformance, with real assets (particularly the private real estate managers) and the private equity/venture capital managers accounting for over 500 bps of negative effect. Both asset classes failed to keep up with their premium based benchmarks over this time (CPI-U +5% and S&P 500 + 5%, respectively) and thus displayed a wide lag in performance. Mr. Brantley cautioned that this type of analysis is more meaningful when the performance is evaluated over a longer term than one year.
Follow up from January 13th Meeting

Public Real Asset Managers: The members reviewed the meeting materials on both passively and actively invested managers provided by Cambridge Associates and discussion ensued surrounding the correlation matrix and the performance analysis. The members were reminded that the goal of investing in this market category is to provide inflation hedging. It was noted that the investment in commodities has been effective at inflation hedging and is performing well. Discussion then ensued about gaining more exposure to the energy sector specifically in the real assets program to further diversify the inflation hedging assets and whether to choose a passive manager versus an active manager. After much discussion, the members agreed that an active manager would be the better choice, especially given the current economic environment. One member commented that an active manager should be able to respond to the relative attractiveness of the energy sources more readily than a passive manager, and would be in a better position to hedge inflation. The Subcommittee continued the discussion by reviewing the various managers listed in the report and shared comments on BlackRock’s All Cap versus Small Cap attributes. Cambridge Associates offered the comments on the strengths and weaknesses of the various managers listed in the report. Following the discussion and comments, the Subcommittee unanimously agreed to invest with BlackRock Global All Cap Energy. Mr. Bain noted that the target is to add 2% to the Real Assets allocation which amounts to $7 million. Ms. Kent pointed out that bonds are overweight. The Subcommittee inquired about the cash availability to initiate the investment subscription. Ms. Snell noted that a redemption request of the 8% available liquidity (approximately $2 million) was placed with State Street Passive Bond fund, to settle on March 22nd. Mr. Brantley inquired about the $9.6 million position in cash on the Cambridge performance report. Mr. Cate confirmed that there was available cash but that the amount was closer to the $6 million level. The Subcommittee requested that $5 million be invested with BlackRock All Cap, using the pending State Street Passive Bond Fund redemption, and some of the available cash.

Distressed Credits: Ms. Kent directed the Subcommittee to the 4th quarter 2009 report from Varde and provided a brief review on the Varde funds. She noted that the performance in 2009 was poor due to the mark down of the private holdings. Ms. Kent also commented that Cambridge Associates has been having ongoing discussions with Varde to get a better understanding of the performance drivers. Ms. Kent further commented that the University’s current portfolio exposure of 9.2% (via hedge funds and private equity) in distressed credit is within an acceptable range. The Subcommittee decided to postpone the discussion on further investment in distressed credits until the May or June meeting.

Hedge Funds: Mr. DeVaughn provided a brief overview of the various information that Cambridge Associates receives on a quarterly basis for due diligence performed on hedge funds. He specifically noted the analysis received by Cambridge’s due diligence team from Measurisk, a company that they deem reliable.

The Subcommittee then entered into a discussion surrounding a recent message received from PGGM, a Netherlands Company, who is making an offer to purchase the University’s position in Morgan Stanley Prime Property, at a 9% discount. The University placed a redemption request in December 2008 with Morgan Stanley Prime Property, which the manager has not fulfilled due to
the lack of liquidity. The offer from PGGM consists of a 9% discount on the net asset value of the asset holdings as of March 31, 2010. Cambridge Associates reminded the Subcommittee that they do not become involved in secondary market transactions. Following some discussion about the secondary market and possible negotiations, the members unanimously agreed to have Mr. Bain and Ms. Hudson-Wilson arrange for a conference call to discuss a negotiation with PGGM and report back to the Subcommittee.

Other Business

RFP for Investment Advisor Services: Mr. Cate requested that members submit any comments regarding the RFP document by the end of the day on Friday, March 19th.

Socially Responsible Investing Work Group: The next meeting will be scheduled in early April. Mr. Cate noted that a decision was made to elect a leader for the work group, who is not a Trustee. He added that a call for nominations would go out to the Work Group shortly. Board Chair Robert Cioffi will join the April meeting to facilitate this process. The Subcommittee was reminded about the annual Reaffirmation of the Divestment Resolutions at the May Board meeting.

April 21st Agenda Items: Ms. Kent reminded the Subcommittee that their contract includes attendance at 9 out of 12 meetings per year. The members agreed that Cambridge Associates would not participate in the April 21st meeting. Mr. Bain noted the items to discuss at the April meeting will include:

- Benchmark questions on Real Assets
- Select Hedge Fund manager(s) to invite to the NYC meeting in July
- Report from Ms. Hudson-Wilson and Mr. Bain on conference call with PGGM
- Discuss the RFP for Investment Advisory Services
- Operating Fund
- Divestment Reaffirmation (SRIWG)
- Investment Transparency (SRIWG)
- Continued discussion on Distressed Credit will be deferred to May/June

Adjournment

There being no further business, the meeting was adjourned at 10:20 a.m.

Respectfully submitted,

Samuel Bain, Chair