

# UNIVERSITY OF VERMONT AND STATE AGRICULTURAL COLLEGE

## BOARD OF TRUSTEES

### STATEMENT OF INVESTMENT OBJECTIVES AND POLICIES

#### Introduction

This statement of investment objectives and policies governs the investment management of the Long Term Investment Pool, including the Endowment Fund, of The University of Vermont (the Fund). It is anticipated that this statement will be effective until modified as conditions warrant by the Budget, Finance and Investment Committee. Both the Budget, Finance and Investment Committee and investment advisors are expected to propose revisions in the guidelines at any time such guidelines would impede meeting the Fund's investment objectives.

#### A. Investment Objectives

The overall financial objective of the Fund is to provide a level of support for programs (as determined by the Fund's attached Budget Policy) consistent with the Fund's purchasing power being over time maintained or even modestly increased.

The primary objective of investment by the University is to provide a satisfactory return on investment for the support of University operations based upon the Prudent Person Principle. The specific investment objectives of the Fund are to attain an average annual real total return (net of investment management fees) of at least 5% over the long term (running five year periods). Real total return is the sum of capital appreciation (or loss) and current income (dividends and interest) adjusted for inflation by the Consumer Price Index. It is recognized that the real return objective may be difficult to attain in every five year period, but should be attainable over a series of five year periods.

See attached Consolidated Endowment Budget Policy.

#### B. Moral, Social and Ethical Considerations in Investment and Shareholder Resolutions

The University's policy of fiscal prudence shall not preclude the consideration of moral, ethical and social criteria in determining companies in which to invest.

The University will take an active role on request in pursuing shareholder resolutions through proxy resolutions and other means in order to further its goal of investing in firms that produce safe and useful products in accord with moral, ethical and social criteria.

#### C. Investment Management Structure

The Fund will be invested primarily with several investment managers. (See Exhibit I). Equity and fixed income securities will be managed separately. In the interest of diversification, the equity portion of the portfolio will be placed with managers who have different investment philosophies. The investment manager has complete discretion to manage the assets in each particular portfolio to best achieve the investment objectives and requirements, within the guidelines set forth in the policy statement.

## **D. Portfolio Composition and Asset Allocation**

1. To achieve its investment objective, the Fund shall be divided into two parts: A “Fixed Income Fund” and an “Equity Fund”. It should be noted that the division of the Fund by asset class need not necessarily be related to the division of assets to outside investment advisors. The purpose of dividing the funds in this manner is to ensure that the overall asset allocation between these two major asset classes remains under the regular scrutiny of the Budget, Finance and Investment Committee and is not allowed to become the residual of separate manager decisions. Over the long run, the allocation between the Equity and Fixed Income Funds will be the single most important determinant of the Fund’s investment performance.
2. The purpose of the Fixed Income Fund (fixed income securities and cash equivalents) is to provide a deflation hedge, to reduce the overall volatility of the Fund, and to produce current income.
3. The Fixed Income Fund should normally represent approximately 20% of total Fund assets at market value. Although the actual percentage will fluctuate with market conditions, levels in excess of 25% or below 15% will be closely monitored by the Budget, Finance and Investment Committee and additional funds will be transferred as needed to ensure that the ratio does not fall below 10% or rise above 30%.
4. The purpose of the Equity Fund is to provide a total return that will simultaneously provide for growth in principal and current income, while at the same time preserving the purchasing power of the Fund’s assets. The Equity Fund will also provide an inflation hedge. It is recognized that the Equity Fund entails the assumption of greater market variability and risk.
5. The Equity Fund should normally represent approximately 80% of total Fund assets at market value. Although the actual percentage of equities and equity reserves will fluctuate with market conditions, levels in excess of 85% or below 75% will be closely monitored by the Budget, Finance and Investment Committee and re-balancing will automatically be implemented if the ratio exceeds 90% or falls below 70%. The Budget, Finance and Investment Committee may change any of these ratios at their discretion, but it is anticipated that such changes will be infrequent.
6. Additions to principal shall be allocated by the Budget, Finance and Investment Committee. As a general rule, new cash will be used to re-balance the total fund in the direction of the 80/20 equity/fixed income ratio.
7. In July of each year, funds will be exchanged between the Equity and Fixed Income Funds to return the equity/fixed income ratio to 80/20.
8. The Fund will be diversified both by asset class (e.g., equities, fixed income securities, cash equivalents) and within asset classes (e.g., within equities by economic sector, industry, quality, and size). The purpose of diversification is to provide reasonable assurance that no single security or class of securities will have a disproportionate impact on the total fund.

## **E. Guidelines for the Fixed Income Fund**

1. The objective of the Fixed Income Fund is to outperform the Lehman Brothers Aggregate Bond Index (net of fees) as well as the Cambridge Associates bond manager median. (See Section J - Definitions) Performance will be monitored on a regular basis and evaluated over a running three- to five-year period.
2. Money market instruments as well as fixed income securities may be used in the Fixed Income Fund, but equities and convertible bonds are excluded. The fixed income fund manager(s) may employ either a passive, index-driven, or so-called active management techniques that exercise interest rate

anticipation and intersectoral arbitrage. For the active style of investment, changes in average duration should usually be moderate and incremental. Since the fund is designed as a deflation hedge, an average (See Section J - Definitions) duration within one year of the Lehman Aggregate Index should be maintained.

3. With the exception of US Treasury, agency and agency mortgage issues, no more than 5% of the portfolio may be invested in the obligations of any one issuer.
4. The weighted average portfolio quality must be rated at least A1 by Moody's and/or A+ by Standard & Poor's. Individual investments must be rated at least BBB/B at the time of purchase. No more than 20% of the Account's assets may be rated below Baa/BBB- at time of purchase. Issues downgraded below B/B- must be disposed of in a prudent manner with a target disposition within ninety days after the date of the downgrade. In the case of split-rated issues, the lower of the two ratings will prevail. If an issue is not rated by either Moody's or Standard & Poor's, the rating of another Nationally Recognized Statistical Rating Organization (NRSRO) may be used. These NRSROs include Fitch and IBCA.
5. The aggregate notional value of derivative instruments such as options, futures, index- based securities (swaps), or derivative mortgage backed securities may be used up to a limit of 25% of the manager's portfolio. No derivative transaction will constitute more than 5% of the portfolio's assets. Credit counterparties will have at least a "AA" rating. Derivatives transactions may be entered into for hedging purposes, return enhancement, or as a substitute for a specific instrument, but not for speculative purposes or as a means to circumvent other stated objectives and policies. Under no circumstances should the use of derivatives lengthen the duration of the portfolio beyond 150% of the duration of the Lehman Brother's Aggregate Index.

#### **F. Guidelines for the Equity Fund**

1. The objective for the Equity Fund is to outperform the S&P 500 stock index (net of fees) as well as the Cambridge Associates' equity manager median (See Section J - Definitions).
2. The Equity Fund will be broadly diversified according to economic sector, industry, number of holdings and other investment characteristics. However, it is recognized that in order to achieve its investment objective, the Equity Fund must be actively managed and therefore cannot be fully diversified.
3. Decisions as to individual security selection, security size and quality, number of industries and holdings, current income levels, turnover and the other tools employed by active managers are left to broad manager discretion, subject to the usual standards of fiduciary prudence. Index options, individual security options, and currency futures utilized by the equity managers may only be used to reduce total portfolio risk or to efficiently manage market exposure. The notional value of any derivative securities in the manager's portfolio may not, in aggregate, exceed 25% of the value of the portfolio's assets. No single derivative transaction will constitute more than 5% of the portfolio's assets. Credit counterparties will have at least a "AA" rating. Derivative securities may not be used to increase market exposure beyond 200% of the underlying equity capital or to decrease it below 0%. The portfolio may not be leveraged or net short. This paragraph does not apply to mutual fund investments which follow their own investment guidelines detailed in the prospectus.
4. Unless otherwise instructed, an equity manager may at his/her discretion hold investment reserves of either cash or bonds, but with the understanding that performance will be measured against stock indexes as described in the paragraph above.
5. For purposes of this Statement, a diversified investment manager is one who generally holds securities in more than 40 companies, while a non-diversified investment manager is one who generally holds securities in fewer than 40 companies. A diversified investment manager may not purchase a security if

at the time of purchase the security accounts for more than 5% of the manager's entire portfolio. This restriction shall not apply to non-diversified investment managers, since the restriction may unnecessarily impair their performance.

6. If the University invests in mutual funds, the fund manager shall adhere to the guidelines contained in its prospectus or other written presentation to the Budget, Finance and Investment Committee or its consultants.
7. All investment managers are expected to maintain the risk controls described in their presentations to the Budget, Finance and Investment Committee or its consultants.

#### **G. Individual Managers' Objectives and Policies**

1. The manager structure includes portfolio managers for marketable securities with historically successful yet quite different investment strategies. The varying styles and strategies reduce the risk implicit in having one manager, or more than one manager all with the same approach.
2. In late 1997, the committee adopted a core/satellite manager structure, with a passive position in the S&P 500 index fund comprising the core, and concentrated active managers making up the satellite managers. This allocation will be reviewed at the first meeting of the new fiscal year and adjusted as deemed appropriate. New funds to the endowment will be distributed to the managers in amounts proportionate to the allocations in Exhibit I, consistent with Section D 6, unless otherwise determined by the Trustee Budget, Finance and Investment Committee.
3. The individual managers will be expected to generate returns (net of trading costs) that match or surpass the appropriate index and manager medians that the Budget, Finance and Investment Committee finds most appropriate to the investment style of that particular manager.

#### **H. Guidelines for Transactions**

1. As a general guideline that should apply to all assets managed, transactions should be entered into on the basis of best execution, which is interpreted normally to mean best realized price. Notwithstanding the above, commissions may be designated for payment of services rendered to the University in connection with investment management.

#### **I. Monitoring of Objectives and Results**

1. All objectives and policies are in effect until modified by the Budget, Finance and Investment Committee, who will review these at least annually for their continued appropriateness.
2. If at any time a manager believes that any policy guidelines inhibit his/her investment performance, it is his/her responsibility to clearly communicate this view to the Budget, Finance and Investment Committee.
3. The Fund portfolios will be monitored on a continual basis for consistency in investment philosophy, return relative to objectives, and investment risk as measured by asset concentrations, exposure to extreme economic conditions, and market volatility. Portfolios will be reviewed by the Budget, Finance and Investment Committee on a quarterly basis, but results will be evaluated over running three- to five-year periods. However, the Budget, Finance and Investment Committee will regularly review the managers in order to confirm that the factors underlying the performance expectations remain in place.
4. Each investment manager will report the following information quarterly: total return net of all commissions and fees, additions and withdrawals from the account, current holdings at cost and market

value, and purchases and sales for the quarter. Regular communication concerning investment strategy and outlook is expected. Additionally, managers are required to inform the Budget, Finance and Investment Committee of any change in firm ownership, organizational structure, professional personnel, account structure (e.g., number, asset size and account minimum) or fundamental investment philosophy.

## **J. Definitions**

The Cambridge Associates' manager medians represent the mid-point return of a universe of managers involved in a given strategy. Average refers to a weighted average based on current market values.

*Adopted by the Board of Trustees, August 13, 2000*

*Section E (#2 ) adopted by the Board of Trustees, May 22, 2004*

*Section E (#3,4) adopted by the Board of Trustees, September 11, 2004*

*Section F (#5) adopted by Investment Committee, March 13, 2006*

*Section F (#5, 6, 7) adopted by the Board of Trustees, May 20, 2006*

*Revised by the Board of Trustees, November 11, 2006*

## **EXHIBIT 1**

### **UNIVERSITY OF VERMONT**

### **ASSET ALLOCATION STRATEGY**

| Asset Class                      | Current Target (%) | Revised Target (%) | Current Range (%) |
|----------------------------------|--------------------|--------------------|-------------------|
| U.S. Equity                      | 22.0               | 25.0               | 15-30             |
| Global ex U.S. Equity            | 23.0               | 22.0               | 15-45             |
| Developed Markets                | 11.5               | 12.0               | 10-25             |
| Emerging Markets                 | 11.5               | 10.0               | 5-20              |
| Marketable Alternatives          | 20.0               | 17.5               | 15-25             |
| Real Assets (Inflation Hedging)  | 15.0               | 12.5               | 10-25             |
| Private Equity / Venture Capital | 10.0               | 10.0               | 5-20              |
| Fixed Income                     | 10.0               | 10.0               | 5-25              |
| Cash & Cash Equivalents          | 0                  | 3.0                | 0-5               |

*Adopted by the Board of Trustees - August 13, 2000*

*Exhibit 1 Approved as revised by the Board of Trustees: May 21, 2004*

*Exhibit 1 Approved as revised by the Board of Trustees: February 11, 2005*

*Exhibit 1 Approved as revised by the Board of Trustees: February 9, 2006*

*Exhibit 1 Approved as revised by the Board of Trustees: September 6, 2007*

*Exhibit 1 Approved as revised by the Board of Trustees: September 5, 2008*

*Exhibit I Targets revised by Investment Subcommittee: January 27, 2009*