The Regents of the University of California

COMMITTEE ON INVESTMENTS
INVESTMENT ADVISORY GROUP
November 2, 2010

The Committee on Investments and the Investment Advisory Group met jointly on the above date by teleconference at the following locations: 1111 Franklin Street, Room 9204, Oakland, J.D. Morgan Center, Los Angeles Campus, and 777 California Avenue, Palo Alto.

Members present: Representing the Committee on Investments: Regents De La Peña, Kieffer, Marcus, and Wachter; Ex officio member Yudof; Advisory member Anderson; Staff Advisors Herbert and Martinez
Representing the Investment Advisory Group: Martin and Taylor, Consultants Gilman and Lehmann

In attendance: Faculty Representative Simmons, Secretary and Chief of Staff Griffiths, Associate Secretary Shaw, General Counsel Robinson, Chief Investment Officer Berggren, Executive Vice President Taylor, and Recording Secretary McCarthy

The meeting convened at 1:40 p.m. with Committee Chair Wachter presiding.

1. **PUBLIC COMMENT SESSION**

There were no speakers wishing to address the Committee.

2. **APPROVAL OF MINUTES OF PREVIOUS MEETING**

Upon motion duly made and seconded, the minutes of the meeting of September 15, 2010, were approved, Regents De La Peña, Kieffer, Marcus, Wachter, and Yudof (5) voting "aye."[1]

3. **SEPTEMBER 2010 QUARTER AND FISCAL YEAR TO DATE INVESTMENT PERFORMANCE SUMMARY – PRELIMINARY RESULTS**

[Background material was mailed to the Committee in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Chief Investment Officer Berggren presented the Preliminary Investment Performance Summary for the quarter ending September 2010 and the fiscal year to date. She noted that expectations of quantitative easing drove third quarter performance. Ms. Berggren reported that the UC Retirement Plan (UCRP) was up 9.23 percent for the quarter; the General Endowment Pool (GEP) rose 8.51 percent; the Short Term Investment Pool

[1] Roll call vote required by the Bagley-Keene Open Meeting Act [Government Code §11123(b)(1)(D)] for all meetings held by teleconference.

(STIP) rose 73 basis points. Public equity, non-U.S. equity, and emerging market sectors were very strong performers. The University sold its first separate account real estate property, a developmental apartment building in Florida, at a profit of 35 percent over two years.

Ms. Berggren reported that global equities were very strong in September, fueled by global central banks' quantitative easing programs. All stocks and risk assets performed very well during the quarter, in what Ms. Berggren characterized as a "risk asset market." The current September was the strongest in decades, completing a quarter Ms. Berggren called "spectacular" for risk assets. Equities have been outstanding performers since the market bottom 18 months prior, with particularly strong performance from non-U.S. equity and emerging markets. Equities have outperformed bonds during the period, even though bonds also performed very well.

Ms. Berggren reported that during the prior quarter the Russell 3000 Index rose 11.5 percent; the Morgan Stanley Capital International (MSCI) All Country World Ex-U.S. (Net) Index was up 16.1 percent; MSCI Emerging Markets (Net) Index rose 18 percent; Barclay's Capital Aggregate Bond Index was up 2.5 percent; and Barclay's U.S. High Yield Bond Index rose 6.7 percent. Ms. Berggren remarked that credit markets do not reflect investors' concerns at this point and credit spreads have been narrowing.

Ms. Berggren reported that all UC funds delivered very strong performance for the quarter. UCRP rose 9.23 percent, slightly below its benchmark; GEP rose 8.5 percent, in line with its benchmark; the UC Entity increased 7.25 percent, three basis points above its benchmark. Returns were tempered by an underweighting in equities going into the third quarter. The equity weighting has since been increased. Ms. Berggren noted that on the equity side, UC has a very high quality portfolio, but there has been no difference in the current market between high and low quality issues.

Ms. Berggren reported that a review of performance over longer periods reveals that UC funds have matched their benchmarks in every period. She pointed out that this was the lowest ten-year return since the recession of 1973-74. Turning to UCRP asset class performance for the quarter, Ms. Berggren noted that U.S. equities increased 11.35 percent; non-U.S. developed equities increased 15.8 percent; emerging markets rose 19.1 percent; fixed income increased 2.8 percent; and absolute returns were up 4.65 percent. Real estate had its first positive quarter in many quarters, up 4.21 percent. Private equity was flat; Ms. Berggren noted that private equity normally lags one quarter in performance, so she anticipated excellent returns in that area in the following quarter. For the current calendar year, emerging markets, U.S. fixed income, and private equity were the best-performing assets.

Regent Kieffer asked if it would be helpful to look at returns over longer periods of time, such as 20 or 30 years. Ms. Berggren replied that she could provide returns for 20 years. Faculty Representative Anderson recalled that UC's funds were above the benchmarks for both 20 and 30-year time periods. Consultant Bruce Lehmann added that looking back over a longer time can be beneficial by adding perspective to market fluctuations.

4. **TOTAL RETURN INVESTMENT POOL (TRIP) ASSET ALLOCATION REVIEW AND RECOMMENDATIONS**

The Chief Investment Officer and the Regents' general investment consultant, Mercer Investment Consulting, Inc., recommended that the changes to the Total Return Investment Pool (TRIP) Investment Policy Statement, as shown in Attachment 1, be adopted with an effective date of January 1, 2011.

[Background material was mailed to the Committee in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Chief Investment Officer Berggren recalled that approximately one year prior the staff of the Treasurer's Office and the campuses determined that a portion of the Short Term Investment Pool (STIP) could have a longer duration and be invested with slightly higher risk. The Total Return Investment Pool (TRIP) was formed with the goals of providing higher returns and limited downside risk. While STIP's objective is yield, TRIP's objective is total return. In August 2008, $1.6 billion was moved from STIP to TRIP.

Ms. Berggren reported that TRIP's current asset allocation is 25 percent equities and 75 percent fixed income. She noted that TRIP has performed well, particularly in the negative market of 2008. Most importantly, TRIP's cumulative return has been approximately 12 percent, which Ms. Berggren characterized as quite good. Ms. Berggren recalled that simulations predicted that TRIP would have a small increase in downside potential, but a much higher upside than STIP. In actuality, TRIP has performed as expected, with the exception of the unanticipated extreme returns in September and October 2008.

Senior Managing Director Jesse Phillips reviewed the portfolio selection process for TRIP, which was the same as the process used for asset allocation for UCRP in 2009 and for GEP earlier in the current year. The first step was to develop several economic scenarios for developed economies. These scenarios were those most likely to happen, consensus-based, and not extreme, ranging from low growth with low inflation to high growth with high inflation, and including a stagflation scenario. Then, asset returns were estimated for each scenario, based on historical parallels. An optimal asset mix was developed for each scenario, having the same downside risk as the current policy. A single candidate portfolio that would perform reasonably well in all likely scenarios was then chosen. Such a portfolio would predictably have a lower upside in a very positive scenario, but would provide increased protection in a poor scenario. A proposed policy portfolio, somewhat different from the current asset allocation, was developed from the candidate portfolio.

Mr. Phillips elaborated on the process of choosing an optimized policy portfolio. The optimal four portfolios in each of the four possible scenarios were combined; the performance of this combined portfolio was examined in both up and down markets. However, this resulting portfolio contained 45 percent equities, which would have an unacceptably high risk of loss in a down market. The final proposed portfolio was similar to the current portfolio, but with a ten percent increase in equities, from 25 to 35 percent, obtained by reducing allocation to the two fixed income sectors with the lowest expected returns, while increasing equity allocation in non-U.S. developed and Real Estate Investment Trusts (REITS). He anticipated that the proposed portfolio would have improved performance, in both below-trend and above-trend markets.

Mr. Phillips noted that there would be no change to TRIP’s investment guidelines, which are the same as those for UCRP and GEP. Allocation ranges would remain the same, at ten percent above or below the proposed equity and fixed income allocations. The recommended effective date would be January 1, 2011. Large-cap and small-cap U.S. equity currently in the Russell 1000 Index and the Russell 2000 Index would be combined into the single Russell 3000 Index.

In response to an inquiry from Committee Chair Wachter, Mr. Phillips clarified that this proposed asset allocation would replace the current one.

Faculty Representative Anderson asked if only accounts with longer durations would be put in TRIP or if campuses had a choice regarding how much of their asset allocation would go into TRIP. Ms. Berggren responded that the fund represents pooled assets and that a great deal of investigation of the STIP portfolio was done by the financial staff to determine how much of the then current STIP assets could withstand a little more risk. Chief Financial Officer Taylor added that the campuses were consulted regarding their needs for liquidity. He noted that excess liquidity could be invested in slightly longer-term instruments. Mr. Taylor reported that it had been suggested that campuses consider a 75/25 split between STIP and TRIP; currently the split was 82/18.

Mr. Anderson noted that some of the funds would include federal grants and contracts; for example, if the National Science Foundation were to give $500,000 at the beginning of the year to be expended over the course of the year. He cautioned that, in his example, the National Science Foundation would not be pleased if three percent of their grant were lost. Mr. Anderson asked who would be responsible should investment losses occur. Mr. Taylor responded that the campuses would be responsible for any losses.

Consultant Lehmann added that the proposed allocation represented a change from the prior tilt toward large and small cap, to a new tilt toward mid-cap equities in the Russell 3000. He noted that the increase in non-U.S. equities would be a good diversifier for the fund. He also drew attention to the reduction in fixed income risk.

Upon motion duly made and seconded, the Committee approved the recommendation of the Chief Investment Officer and the Regents’ general investment consultant and voted to present it to the Board, Regents De La Peña, Kieffer, Marcus, Wachter, and Yudof (5) voting “aye.”

5. **FIXED INCOME PROGRAM REVIEW**

[Background material was mailed to the Committee in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Senior Managing Director for Fixed Income Investments Randy Wedding reviewed the fixed income portfolio and showed a chart detailing the fixed income assets under management. He explained that fixed income assets are characterized as either core or non-core. Core assets refer to sectors in the Barclay's Aggregate; the non-core category includes Treasury Inflation Protected Securities (TIPS), high yield, and emerging market bonds. Mr. Wedding noted that the current total under management in the fixed income portfolio was over $25 billion, including almost $20 billion in core assets and almost $6 billion in non-core assets. The Short Term Investment Pool (STIP) and the savings fund are managed to maximize income return, while the other portfolios focus on total return. Core assets are subdivided into three categories: "governments" including Treasuries, agencies, and government-sponsored enterprises (GSEs); "collateralized" including residential mortgage-backed securities, commercial mortgage-backed securities, and asset-backed securities; and "credit" consisting of both corporate and sovereign debt.

In response to an inquiry from Investment Advisory Group Member Martin, Mr. Wedding said that sovereign debt included non-U.S. sovereign debt. Mr. Wedding cited the example of an emerging market country's dollar issuance that would be included in the Barclay's Aggregate and thus be a core portfolio position. In response to a further question from Mr. Martin, Mr. Wedding said the portfolio contained no non-U.S. dollar-denominated exposure.

Mr. Wedding reported the asset allocation in the core portion of the portfolio. As a result of extraordinarily low government rates, the portfolio is underweight in the government sector and correspondingly overweight in the collateral and credit sectors. He noted that, even after two years of a recovery rally in risky assets, investment-grade credit returned 4.65 percent in the third quarter.

Regent Marcus asked what the average duration was for the collateral and credit portions of the portfolio. Mr. Wedding responded that the durations were very close to benchmark levels, with collateral at approximately two-years duration, and credit at four-and-a-half to five years. In response to a question from Committee Chair Wachter, Mr. Wedding noted that the portfolio contained floating rate as well as fixed rate securities, with the floating rate mostly in STIP. These are typically short-term, asset-backed floaters, London Interbank Offered Rate (LIBOR) plus 15-20 basis points, Triple-A rated.

Mr. Wedding indicated that a new passive allocation to the aggregate index had been created to serve as a buffer while monies are moved during asset allocation rebalancing, to insulate the active portfolios from those cash flows. Mr. Wedding noted that a similar allocation had been used on the public equity side for some time.

Mr. Wedding discussed yields of the various sectors since 2008. The government sector nominal yield was currently just above one percent, which Mr. Wedding characterized as unattractive. Real yields in this sector were negative out to 2018. The mortgage-backed and credit sector yields are also unattractive, but are better than yields in government securities.

Regarding strategy in the government sector, Mr. Wedding advised that the portfolio had a slightly shorter duration than the benchmark, since real yields are negative out to 2018 maturities. Given the large amount of monetary stimulus in the system, expectations for future inflation are quite elevated. The government sector has contained the government version of a spread product in GSE and Resolution Funding Corporation (REFCORP) debt. Very short-term TIPS have also been used strategically as substitutes for nominal Treasuries.

Turning to strategy in the credit sector, Mr. Wedding observed that, despite a few abrupt interruptions, the market had favored risky assets. He noted that spread product and credit do very well in such a market. Mr. Wedding expressed the opinion that the probability of a double dip recession had been reduced. The mid-term national election of this date and the anticipated monetary stimulus by the Federal Reserve Board lend support to risky assets. Currently, the credit portfolio had a slightly higher beta than the benchmark. The portfolio was index-weight in the financial sector; spreads were quite attractive, but were balanced by regulatory uncertainty. Ms. Berggren noted that the credit portion of the portfolio was reviewed in great detail by the staff. Mr. Wedding commented that his staff used a unique, exhaustive process to evaluate each credit; this process has been successful.

Mr. Martin asked about the prospect of a continuing weakening of the U.S. dollar. Mr. Wedding replied that there were various possible scenarios. In a “flight to quality” scenario, the dollar would rally, spreads would widen on risky assets, the stock market would go down, and Treasuries would sell off as well. On the other hand, in a scenario favoring risk assets, a weakening dollar could indicate that risky assets would do well. He believed that the Federal Reserve Board’s quantitative easing would weaken the dollar.

Committee Chair Wachter asked if currency risks could be taken within the emerging market category of the portfolio. Mr. Wedding replied that all assets were dollar-denominated and there was no currency risk. Foreign sovereign debt was dollar-denominated as well. Mr. Wedding noted that the portfolio had contained an allocation to non-dollar government bonds, but that allocation had been eliminated. Mr. Phillips commented that the non-dollar government bonds performed well during the market downturn, but the yield going forward was unattractive, given the additional currency risk. In response to a question from Committee Chair Wachter, Mr. Phillips responded that the guidelines permitted buying foreign currency government bonds.

Mr. Martin commented that the Treasurer’s Office had created a currency investment exposure program. He asked if the currency risk that might normally be found in an international bond portfolio had been moved over to the new program. He asked what the current global currency strategies were. Ms. Berggren replied that her office had decided to have an active currency program under two managers. She noted that her office was not trying to mesh the portfolio with the currency program.

Mr. Wedding noted the extraordinary current period in the collateralized sector. The Federal Reserve Board has completed purchase of $1.25 trillion of newly issued residential mortgage-backed securities, pushing rates to multi-decade lows. Current rates for a 30-year fixed-rate conforming mortgage were under four percent. Because of continuing uncertainty in the mortgage market, UC was keeping its risk low in this area. UC still held legacy, non-agency securitizations, but these holdings had shrunk by almost 50 percent due to sales and principal repayment, a trend that Mr. Wedding expected would continue.

Turning to strategy in the emerging market sector, Mr. Wedding reiterated that the U.S. economy is slow compared to emerging market economies, particularly those driven by commodity prices. This situation, accentuated by dwindling issuance, had resulted in an increase in prices, a decrease in yields, and a narrowing of spreads. Mr. Wedding pointed out that the main risk in this sector was the elevated level of prices (low spreads). For example, spreads in some sovereign bonds had become comparable to those of Single-A rated U.S. corporate bonds, leading his office to question their value.

Consultant Lehmann asked about credit risks for sovereign bonds (i.e., government issues) going forward. Mr. Wedding responded that, in general, sovereigns have performed well and that their fundamentals, such as monetary policy, fiscal policy, and trade deficits, have improved, which has been reflected in the ratings upgrades they have been receiving. Thus, much of emerging markets was currently investment grade and in the Lehman Aggregate. Mr. Wedding expressed the opinion that risks for these countries were currently idiosyncratic, rather than systemic. In response to a question from Mr. Lehmann, Mr. Wedding responded that UC's position in the sector was well-diversified.

Mr. Wedding stated that the high-yield sector had also seen a tremendous rally, with returns over the past two years approaching returns normally seen in equities. Mr. Wedding noted that, during this period, some of the worst-rated issues had fared best, because investors were reaching for yield. While UC's current overweight in B and Triple-C rated bonds would indicate higher risk, Mr. Wedding pointed out the importance of choice of issues within these categories. He reported that the high-yield sector had tracked the index well over the prior few months and the beta returns had been excellent.

Mr. Wedding reported on STIP and the savings funds, which are managed for current income. STIP had done extremely well, with a current average income return of 240 basis points. Stakeholders had been pleased with these returns, resulting in an influx of funds into this portfolio. He cautioned that his office must be prepared to react quickly when interest rates begin to rise, which would depend on the policy of the Federal Reserve Board.

In summary, Mr. Wedding pointed out that performance of the stock market was not necessarily linked to that of the U.S. economy. Over half of the companies in the Standard and Poor's 500 derive over half of their revenue from offshore sources. Mr. Wedding noted that UC would attempt to position the credit portfolio to take advantage of the relative strength of emerging market economies and non-U.S. developed economies.

6. **ABSOLUTE RETURN STRATEGIES PROGRAM REVIEW**

[Background material was mailed to the Committee in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Managing Director of Absolute Return (AR) Lynda Choi reported that some growth and stability had begun to return to the hedge fund industry following the turmoil of the prior two years. Much of the growth came from performance, which was strong in 2009, and asset flows had turned positive in the current year. Much of this new capital had been invested with managers of large funds with assets over $5 billion, which Ms. Choi believed would create some areas of opportunity. New industry regulation would require managers with assets over $100 million to register with the Securities and Exchange Commission (SEC) by June 2011. Because of the Volcker Rule, some banks had already started to decrease their proprietary trading, which Ms. Choi believed would lead to new hedge fund launches. As a result of lessons learned from the 2008 crisis, some positive structural changes had taken place. For example, many fund managers had changed their liquidity terms to better reflect their assets and liabilities, had diversified their investor base, and had been much more willing to comply with investors' need for transparency.

Ms. Choi reported that the UC Absolute Return portfolio currently had 39 managers and assets of $3.6 billion, representing 23.5 percent of the GEP and 5.7 percent of the UCRP. The portfolio returned 9.1 percent for the fiscal year ending June 30, 2010, 350 basis points over its benchmark. On a trailing three-year basis, the portfolio returned 30 basis points, while the Standard and Poor's 500 returned a negative 7.2 percent. On a trailing five-year basis, the Absolute Return portfolio had out-performed the equity indices, with less than half the volatility.

Ms. Choi reported that, during the past fiscal year, UC's AR group had focused on allocating capital to strategies that could benefit the overall portfolio, regardless of market direction. Some of those strategies included global macro funds, convertible arbitrage, and relative value credit. Ms. Choi expressed the opinion that these strategies should improve the fund's diversification and therefore the portfolio's upside/downside skew. Equity beta exposure remained low, with a 0.3 long-term average.

Ms. Choi advised that her group planned to continue to add more managers and strategies to help capture the market's upsides, while preserving capital on the downside. Particularly, the group would focus on increasing regional, strategic, and fund size diversification.

Consultant Lehmann asked if Ms. Choi found that strategies of various managers were currently more highly correlated. Ms. Choi responded that managers who survived the 2008 market downturn tended to manage larger funds. These same managers had been the beneficiaries of much of the returning capital. UC AR would try to find managers of smaller funds to benefit from possible diversification of strategy.

Investment Advisory Group Member Martin asked Ms. Choi to expand on plans to diversify further into emerging markets. Ms. Choi responded that the portfolio's current seven percent emerging market exposure was underweight. In addition to capitalizing on growth opportunities in emerging markets, further investment there would increase diversification in the portfolio. She expressed the opinion that many excellent opportunities existed in emerging markets. Improvements in legal and regulatory frameworks such as property rights protection also made emerging market investment attractive. Specifically, Ms. Choi noted opportunities in Latin America and Indonesia.

Ms. Choi explained the UC AR portfolio construction process, which combined quantitative and qualitative analytics. Quantitative analysis included attribution, upside/downside skew, beta exposures, and liquidity. The group attempted to maximize liquidity without sacrificing long-term returns. Qualitatively, UC AR examined firms' management and organization. Core fund managers in whom staff had higher conviction and whose funds had slightly less volatility were more heavily weighted. For instance, a manager of an emerging market fund with inherently higher volatility would have less weighting than a domestic, large-cap fund manager.

Ms. Choi reported on current strategy allocation as of September 30, 2010. She pointed out that equity hedge (i.e., Long/Short equity funds) had become a smaller portion of the portfolio, with those funds being re-directed into global macro and convertible arbitrage. Sector exposures within the equity portion of the AR portfolio were well-diversified across all sectors. Ms. Choi noted that UC AR was not expected to outperform a bull market, but was expected to outperform a downturn in equity markets. UC AR had outperformed down markets by an average of 3.7 percent over the past five years. On a rolling 12-month basis, during the past three years, UC AR captured 52 percent of the upside of positive markets and only 35.6 percent of the downside of negative markets. Since UC AR's 2003 inception, Ms. Choi reported that the trend in its upside capture had been steadily improving.

Regarding emerging markets, Mr. Lehmann asked if strategies regarding Latin American countries correlated with those for Asian countries. Ms. Choi said that she could provide him with that information. She added that these areas were considered separately for their investment potential.

7. **INVESTMENT CONSULTANT REVIEW OF UNIVERSITY OF CALIFORNIA CAMPUS FOUNDATIONS JUNE 2010 QUARTER PERFORMANCE REPORTS**

[Background material was mailed to the Committee in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Mr. Terry Dennison of Mercer Investment Consulting noted that his report covered the quarter ending June 30, 2010 and represented data collated from ten campus foundations. He reported that the vast majority of the foundations provided positive returns relative to their benchmarks, which for the second quarter meant that they lost less money than their benchmarks.

Mr. Dennison presented a graph showing Portfolio Return and Risk for Three Years Ending June 2010 and explained that the UC Santa Barbara Foundation was an outlier on the graph because of a decision made by the campus to transition away from pure General Endowment Pool (GEP) in 2007. At that time, UCSB adopted a benchmark with a 42 percent allocation to alternative investments, which reflected its long-term intention. Since it took time to implement an alternative portfolio, the benchmark was not comparable; UCSB was exploring the possibility of using an interim benchmark.

Mr. Dennison reported that all campuses were within policy compliance; UCSB was again an outlier because of the time necessary to implement the alternative portfolio. He noted that the GEP change of its Hedge Fund benchmark from T-bills plus 4.5 percent to the market-based HFRX led to the appearance of underperformance in the GEP.

The meeting adjourned at 2:40 p.m.

Attest:

Secretary and Chief of Staff

Effective Date: January 1, 2011~~April 1, 2010~~
Replaces Version: April 1, 2010~~May 7, 2008~~

TOTAL RETURN INVESTMENT POOL (TRIP) INVESTMENT GUIDELINES

The purpose for these performance objectives ("Objectives") and management guidelines (Guidelines") is to clearly state the investment approach, define performance objectives and to control risk in the management of the University's Total Return Investment Pool, or TRIP ("Program"). These Objectives and Guidelines shall be subject to ongoing review by the Committee on Investments. Capital market conditions, changes in the investment industry, new financial instruments, or a change in the Committee on Investments' risk tolerance, are among factors to be considered in determining whether the Guidelines shall be revised.

1. Investment Policy

a. Background:
The TRIP is an investment pool established by The Regents and is available to UC Campuses and the UC Office of the President. The TRIP allows Campuses to maximize return on their long-term working capital, subject to an acceptable level of risk, by taking advantage of the economies of scale of investing in a larger pool and investing across a broad range of asset classes.

b. Incorporation of Regents Investment Policies
1. Investment governance, philosophy, policies and oversight procedures for this Program will be similar to those for the University of California Retirement Plan (UCRP) and General Endowment Pool (GEP), as specified in the Investment Policies for the UCRP.
2. Relevant policies from Sections 1-3 of the UCRP Investment Policy Statement are incorporated by reference into this Policy.

c. Investment Objective
The Objective of the Program is to generate a rate of return, after all costs and fees, in excess of the policy benchmark, and consistent with liquidity, cash flow requirements, and risk budget. See Section 2 for asset allocation and benchmark. As its name implies, TRIP is managed according to a total return objective, and will be subject to interest rate risk, credit risk, and equity risk. It is appropriate for longer-term investors who can accept this volatility in exchange for higher expected return.

d. Investment Strategy
The Program shall be implemented by the Treasurer's Office, using a combination of internal and external management ("Managers"), employing actively managed strategies where appropriate. Active strategies will include both sector allocation and security selection. The Treasurer will monitor the Program's adherence to these Guidelines.

e. Risk Objective

The Program shall be managed so that its annualized tracking error budget shall be 300 basis points. This budget is consistent with the ±10% ranges around the combined asset classes (see 2a below), and incorporates both sector allocation and security selection differences from the aggregate benchmark.

Each Manager or asset class segment will have a unique active risk budget, relative to its asset class benchmark, which is appropriate to its individual strategy, and specified in its guidelines, and which will reflect the risk-return profile of its specific investment objectives.

f. Other Constraints and Considerations

- Managers shall comply with applicable State and Federal laws and regulations
- Managers shall at all times act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims
- Managers shall act solely in the interest of the Program's owners.

2. Investment Guidelines

The portfolio will be invested primarily in marketable, publicly traded equity and fixed income securities denominated in (or hedged back to) U.S. dollars.

a. Strategic Asset Allocation and Allowable Ranges

	Target Allocation
US Fixed Income – Government	~~10~~5%
US Fixed Income – Credit	45%
US Fixed Income – Securitized	~~10~~5%
High Yield Debt	10%
US Equity - All Cap	15%
~~US Equity - Large Cap~~	~~10%~~
~~US Equity - Small Cap~~	~~5%~~
REITS	5%
Non US Equity (hedged)	~~10~~15%
Liquidity	0%

Combined Asset Classes	Target Allocation	Minimum	Maximum
Public Equity	35~~25~~%	25~~15~~%	45~~35~~%
US Fixed Income	65~~75~~%	55~~65~~%	75~~85~~%
Liquidity	0%	0%	10%
Total	100%		

b. Total TRIP Performance Benchmark

This is the composition of the total TRIP performance benchmark:

Percentage	Benchmark
~~10~~5%	× ~~Lehman~~ Barclays Capital US Aggregate Government Index
45%	× Barclays Capital~~Lehman~~ US Aggregate Credit Index
~~10~~5%	× Barclays Capital~~Lehman~~ US Aggregate Securitized Index
10%	× BofA / Merrill Lynch HY Cash Pay BB/B rated Index
15%	× Russell 3000 Index (Tobacco Free)
~~10%~~	~~× Russell 1000 Index (Tobacco Free)~~
~~5%~~	~~× Russell 2000 Index (Tobacco Free)~~
5%	× FTSE / NAREIT US REIT Index
~~10~~15%	× MSCI World ex US Net Index (hedged) (Tobacco Free)

Notes on Total Program benchmark:

1. The calculation of the Total Program benchmark will assume a monthly rebalancing methodology.
2. In the event of a significant change in asset allocation, The Regents' generalist consultant may specify an alternative weighting scheme to be used during a transition period.

c. Rebalancing Policy

There will be periodic deviations in actual asset weights from the policy asset weights specified above. Causes for periodic deviations are market movements, cash flows, and varying portfolio performance. Significant movements from the asset class policy weights will alter the intended expected return and risk of the Fund. Accordingly, the Investment Committee authorizes the Treasurer to rebalance the Fund when necessary to ensure adherence to the Investment Policy.

The Treasurer will monitor the actual asset allocation at least monthly. The Committee directs the Treasurer to take all actions necessary, within the requirement to act prudently, to rebalance assets to within the policy ranges in a timely and cost effective manner when actual weights are outside the prescribed ranges. The Treasurer may utilize derivative contracts (in accordance with the Derivatives Policy found in Appendix 4 of the UCRP Policy Statement) to rebalance the portfolio.

The Treasurer shall assess and manage the trade-off between the cost of rebalancing and the active risk associated with the deviation from policy asset weights. With approval from the Chair of the Committee, the Treasurer may delay a rebalancing program when the Treasurer believes the delay is in the best interest of the Plan. Results of rebalancing will be reported to the Committee at quarterly meetings.

d. Asset Class Guidelines

The Program will be invested in a diversified portfolio of equity and fixed income securities.

Each Segment of the Program, as defined above, will be subject to the Regents Asset Class guidelines that is appropriate and in effect for that Segment. These Guidelines are found in the Appendices to the UC Retirement Plan Investment Policies, and are hereby incorporated by reference.

e. Restrictions

The Managers may **not:**

- Purchase securities of tobacco related companies, as per the UCRP Investment Policy, section 5b.
- Invest in mutual funds or group trusts unless specifically allowed in its guidelines
- Buy party-in-interest securities
- Buy securities restricted as to sale or transfer, except for 144A securities, which are permitted
- Buy or write structured ("levered") notes
- Employ economic leverage in the portfolio through borrowing or derivatives, or engage in derivative strategies that conflict with the Derivatives Policy

Subject to the limitations above, the Managers have complete discretion with regard to choosing sector weights, issuers, and maturities.

3. Evaluation and Review

a. Policy and Guideline Review

The Treasurer's Office shall review the Objectives and Guidelines at least annually, and report to the Committee on Investments on the impact of the Guidelines on the Program's performance.

b. Program performance and risk exposures shall be evaluated at multiple levels in accordance with the Objectives of the Program and individual Managers.

4. Reporting

On a quarterly basis, the Treasurer's Office shall provide the following reports to the Committee on Investments:

a. A summary of Program investments and risks.
b. A summary of Program performance, on an absolute and benchmark relative basis.

Each Manager will be required to provide the Treasurer monthly and quarterly reports, including but not limited to:

a. Monthly accounting statements showing portfolio income, holdings and transactions
b. Quarterly review of portfolio and strategy performance including a market outlook
c. Annual statement of compliance with investment guidelines

5. Investment Operations and Restrictions

a. University Financial Management may establish limitations on Campus investments to maintain sufficient short term liquidity for University cash needs, and restrictions on withdrawals as is appropriate for the investment of longer-term assets.

b. Annual distributions of income and capital gains will be made to participating Campuses, according to a spending rate will be reviewed and approved annually by the Committee on Investments.

6. Definitions: See Appendix 8 of the UCRP Policy Statement