The Regents of the University of California

COMMITTEE ON INVESTMENTS
INVESTMENT ADVISORY GROUP
May 21, 2013

The Committee on Investments met on the above date by teleconference at the following locations: James West Alumni Center, Los Angeles campus; 1111 Franklin Street, Lobby 1, Oakland; University Center, Room 401, San Diego campus.

Members present:	Representing the Committee on Investments: Regents Kieffer, Makarechian, Mendelson, Stein, Wachter, and Zettel; Advisory members Jacob, Schultz, and Smith Representing the Investment Advisory Group: Members Martin, Rogers, Samuels, and Chief Financial Officer Taylor, Consultants Klosterman and Lehmann
In attendance:	Regent-designate Feingold, Faculty Representative Powell, Associate Secretary Shaw, General Counsel Robinson, Chief Investment Officer Berggren, and Recording Secretary McCarthy

The meeting convened at 11:05 a.m. with Committee Chair Wachter presiding.

1. **APPROVAL OF MINUTES OF PREVIOUS MEETING**

Upon motion duly made and seconded, the minutes of the meeting of February 26, 2013 were approved, Regents Kieffer, Makarechian, Mendelson, Stein, Wachter, and Zettel (6) voting "aye."[1]

2. **PUBLIC COMMENT**

There were no speakers wishing to address the Committee.

3. **TOTAL RETURN INVESTMENT POOL ASSET ALLOCATION REVIEW AND RECOMMENDATIONS**

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

The Chief Investment Officer and the Regents' General Investment Consultant recommended that the amendments to the Total Return Investment Pool Investment Policy Statement be adopted as shown in Attachment 1, with an effective date of August 1, 2013.

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

Chief Investment Officer (CIO) Berggren said this action item was a proposal to update the Total Return Investment Pool (TRIP) asset allocation policy in light of current economic and market conditions. She expressed her view that the near-term market outlook continues to be uncertain. Monetary policy has affected both equity and fixed income investments. Even though the Federal Reserve Bank reiterated its decision to continue current monetary policies, there is some concern about the potential for rising interest rates. Asset allocation is critical during this period. The market continues to be driven by rapid changes in investors' risk tolerance, responding to short-term global economic patterns.

Ms. Berggren said that since TRIP was started in 2008 its asset allocation has been structured to mitigate risk and has been heavily weighted toward bonds, with a current 65 percent allocation to bonds. However, spreads have narrowed substantially and the overall valuation of bonds has increased.

Ms. Berggren briefly described the process her office uses to arrive at a recommended asset allocation, by first developing four realistic economic scenarios and estimating the asset returns in each. Then an optimal asset mix in each scenario is developed and finally a candidate portfolio that performs best across all scenarios. That allocation is compared with the current policy to ensure that it has improved expected performance and downside protection.

Summarizing the major proposed changes to the TRIP long-term investment policy, Ms. Berggren said that the allocation to developed equity would be reduced from its current 30 percent to 22.5 percent. An emerging market equity allocation of 7.5 percent would be introduced to TRIP. Real Estate Investment Trusts (REITS) and opportunistic equity would both be increased to 20 percent; fixed income would be reduced to 20 percent. A 30 percent allocation to liquid alternatives would be added to the TRIP portfolio. Specifically, U.S. equities would remain at 15 percent; non-U.S. developed and emerging market equities would each be 7.5 percent. Opportunistic equity, global REITS, and absolute return would each be ten percent; U.S. core credit would be 7.5 percent; cross asset class would be 20 percent.

Ms. Berggren displayed a bar graph showing the changes in TRIP asset allocation over time from the portfolio's initiation in 2008. The proposed asset allocation would result in a more representative portfolio, which Ms. Berggren recommended given the asset class returns expected over the upcoming three to five years. Allowable ranges above or below the target allocation would be five percent for U.S. equity and the cross asset class, and 2.5 percent for all other asset classes. Liquidity would be a maximum of ten percent.

Discussing implementation of the proposed asset allocation, Ms. Berggren said the new long-term policy targets would be effective August 1, 2013. Current policy weights would remain as the basis for the total fund performance benchmark in the interim. The CIO would move the portfolio to the long-term target allocations as market conditions warrant and as investment opportunities become available, with current policy weights gradually converging on the long-term targets. As usual, the Regents' investment consultant would approve any benchmark changes before new investments are made.

Committee Chair Wachter asked Ms. Berggren to explain the purpose of TRIP, the rationale behind the proposed asset allocation, and the most significant recommended changes. Ms. Berggren said that TRIP contains operating capital of the University, money that was originally in the Short Term Investment Pool (STIP). TRIP has a longer time horizon than STIP and a higher expected return. Her office recommended these changes to the asset allocation to seek a better return than STIP and because the more highly diversified allocation would provide lower risk than the current allocation. The most significant recommendation is to reduce the portfolio's fixed income allocation from 65 percent into a more diversified portfolio. Her office recommended this change at the current time because bonds were not as attractively priced as some of the other asset classes. Committee Chair Wachter said that the 65 percent fixed income allocation would be reduced to 20 percent, which he characterized as a major change. Ms. Berggren said that this portion of the portfolio would be moved to emerging market equities, REITS, opportunistic equity, and liquid alternatives. Committee Chair Wachter asked Ms. Berggren to explain the liquid alternatives, since they would comprise 30 percent of the TRIP portfolio. Ms. Berggren responded that liquid alternatives include hedge funds and cross asset allocation. In response to a further question from Committee Chair Wachter, she explained that the cross asset class is invested with strategic managers who use a global macro strategy to provide her office with an assessment of investments across all asset classes and an ability to invest in attractive satellite asset classes.

Investment Advisory Group Member Martin said it would be appropriate to move away from bonds at the current time, since bond prices were at a 100-year high and yields are extremely low. Investment Advisory Group consultant Lehmann said it has become increasingly obvious that a large portion of the funds in the STIP were actually long-term funds. He said it is appropriate to have a longer term strategy for TRIP, and it is a good time to re-examine the investment policy since short-term investment strategies are earning record lows. Chief Financial Officer Taylor added that members of his staff joined the CIO, Senior Managing Director Jesse Phillips, and others from the Office of the CIO on visits to individual campuses to explain this change, for which the campuses' financial staffs expressed support.

Investment Advisory Group Member Samuels asked how moving from bonds into alternative investments would lower the risk of the portfolio. Ms. Berggren said that any time the portfolio is diversified by adding more assets, the risk of the portfolio is reduced by definition, because the portfolio would not be dependent upon one asset class. She acknowledged that the weighted average risk would not be much lower, but it would be lower. The current 65 percent allocation to fixed income would cause the TRIP portfolio to be heavily dependent upon the performance of that asset class. Mr. Phillips added that risk refers not only to volatility; it also involves valuations. Buying an expensive asset carries more risk than buying a low-priced asset. Currently, the relative value between equity and fixed income is high. Committee Chair Wachter acknowledged that Mr. Samuel's question was well-founded, but said that management of a large portfolio must include consideration of the risk of making low returns for a period of time. A more highly diversified portfolio would include more different kinds of risk, but the volatility and valuation risk would be spread out over more varied assets. Mr. Samuels said that returns on various asset classes were highly correlated during the 2008 financial crisis; Ms. Berggren agreed. Mr. Samuels commented that the current economic situation is somewhat artificial in that interest rates have been so low; that situation would change. Committee Chair Wachter agreed, and said that there could be concern about having 65 percent of the TRIP portfolio in bonds that were not short-term at the present time, since these bonds have a large interest rate and inflation risk. Ms. Berggren said that there would be a decline in valuation of bonds as interest rates rise.

Regent Makarechian asked which asset class would be the source of funds for those asset classes to which allocations would be increased. Ms. Berggren said that such decisions were made based on valuations of the assets at any point in time. Her office examines the valuations of asset classes weekly to determine which assets it views as overvalued or undervalued. Changes in holdings toward the target allocations are made based on this evaluation.

Committee Chair Wachter said that his biggest concern had been the proposed allocation to the cross asset class. He said that the CIO and her team feel strongly that the cross asset class is a way to get the best ideas from managers and to compete more effectively. Mr. Lehmann asked whether it was appropriate to view the cross asset class as a macro hedge fund. Ms. Berggren answered in the negative. She said that cross asset class managers give her office their perspective on all the asset classes. Each cross asset class manager would overweight or underweight various asset classes compared with TRIP's asset allocation. The cross asset class managers would also have access to very attractive satellite investments that they are exploring. The composition of the cross asset class managers in TRIP would be similar to the managers already employed in the UC Retirement Plan and the General Endowment Pool.

Investment Advisory Group consultant Klosterman said that the cross asset class managers would not coordinate their tactics with one another, and could have differing opinions and tactics. Ms. Berggren said her office has performed a great deal of due diligence on the cross asset class managers, and that the managers chosen have very different styles. She said her office has a monthly call with each manager. Ms. Berggren stated that other institutions are showing interest in this strategy, which UC was one of the first to employ.

Upon motion duly made and seconded, the Committee approved the Chief Investment Officer and the Regents' General Investment Consultant's recommendation, and voted to present it to the Board, Regents Kieffer, Makarechian, Mendelson, Stein, Wachter, and Zettel (6) voting "aye."

4. **ADOPTION OF EXPENDITURE RATE FOR TOTAL RETURN INVESTMENT POOL**

The Chief Investment Officer recommended and the Regents' General Investment Consultant concurred that the expenditure rate (payout rate) for the Total Return Investment Pool (TRIP) for the fiscal year 2013-14 be 4.75 percent times the average of the month-end TRIP Net Asset Value, calculated over the 60 months ending June 2013, to be implemented in stages, in a manner to be determined by Office of the Chief Financial Officer in consultation with the campuses.

[Background material was provided 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 Jesse Phillips said that the Regents approve the Total Return Investment Pool (TRIP) expenditure rate annually. The payout rate historically has been similar to the expected return and is currently six percent. The Chief Investment Officer (CIO) recommended that the payout rate be changed to 4.75 percent, which is coincidentally the same as that of the General Endowment Pool (GEP). More importantly, this rate is the expected rate of return of the new TRIP asset allocation over the four possible varying economic scenarios developed by the Office of the CIO to arrive at its recommended asset allocation. The CIO also recommended moving to a payout that, like that of the GEP, would be based on a 60-month moving average of the month-end net asset values, rather than the current net asset value. This basis of calculation would be consistent with the longer term nature of the TRIP liabilities. Mr. Phillips displayed a graph showing the expected returns and downside risk of the TRIP in the four varying economic scenarios.

Committee Chair Wachter asked whether the payout rate was related to the expected return rate. Mr. Phillips answered in the affirmative, adding that the original guidelines of TRIP specify that the CIO recommend a payout rate no greater than the expected rate of return. CIO Berggren said that the expected rate of return for the GEP and the UC Retirement Plan (UCRP) is roughly five percent; the expected rate of return for TRIP is about 4.7 percent based on a three-year time horizon. In response to a question from Committee Chair Wachter, Chief Financial Officer (CFO) Taylor said that the UCRP's assumed long-term rate of return for actuarial purposes is 7.5 percent. Committee Chair Wachter said that TRIP holdings did not include any private equity; Ms. Berggren explained that her office wanted to have only liquid assets in TRIP.

Regent Makarechian asked who receives payouts from TRIP and to what extent. Mr. Phillips said the campuses are the participants in TRIP. Regent Makarechian asked whether every campus participates in TRIP. Ms. Berggren said that the campuses choose the extent of their investment in TRIP. Mr. Taylor added that his office talks with each campus annually to determine its preferred balance between the Short Term Investment Pool (STIP) and TRIP; campuses want to have enough money in STIP to pay their bills and put their longer term funds in TRIP to gain its higher return. Decisions regarding this allocation are made jointly by the campuses and the Office of the CFO. Mr. Taylor explained that the Regents determine the TRIP payout rate; the campuses determine how they will use the funds. Committee Chair Wachter clarified that the payout rate was being decreased because the expected rate of return was lower. Mr. Phillips explained that the payout rate was based on the expected rate of return from the asset allocation the Committee was asked to approve in the prior item. Once the payout rate has been approved by the Regents, it is the responsibility of the CFO to administer.

Investment Advisory Group consultant Lehmann said that some funds that were actually longer term had been kept in STIP when they could have earned a higher return in TRIP. Ms. Berggren recalled that when TRIP was started, a great deal of work was done cooperatively among the campuses, the Office of the CFO, and the Office of the CIO to understand the campuses' objectives and to familiarize the campuses with the advantages of TRIP for longer term funds. Ms. Berggren said that TRIP assets need to be more liquid than those in the GEP. Committee Chair Wachter asked what the expected rate of return had been based on TRIP's existing asset allocation. Ms. Berggren said the expected rate of return based on current market conditions was 2.4 percent.

Regent Makarechian asked Mr. Taylor what funds were available for campuses that have exhausted their short-term funds. Mr. Taylor said the University holds back about $4 billion in very short-term cash investments as additional reserves in case of an unexpected emergency, such as an earthquake, which would require a large amount of cash immediately. In addition, the University could access $600 million in lines of credit with major banks around the country within 24 hours.

Investment Advisory Group Member Samuels commented that the campuses might be concerned with the reduced payout rate occurring at the same time they had to increase their contributions to UCRP. Mr. Taylor stated that the campuses would gain stability, which would increase their ability to plan. Mr. Lehmann added that TRIP could have a higher return with its changed asset allocation. Mr. Taylor said that TRIP's returns have been excellent for the past few years; Ms. Berggren commented that TRIP's good returns were based largely on bonds' performance during that time, particularly compared with STIP returns during the current period of very low interest rates. Mr. Taylor said that the campuses are being encouraged to put some of these steady earnings into UCRP in order to save money in the long term.

In response to a question from Investment Advisory Group consultant Klosterman, Mr. Phillips said that the Office of the CIO uses a two percent core inflation rate. He reminded the Committee that this was a short-term scenario, forecasting for a three-year period, after which he expected that rate to increase.

Upon motion duly made and seconded, the Committee approved the Chief Investment Officer's recommendation, and voted to present it to the Board, Regents Kieffer, Makarechian, Mendelson, Stein, Wachter, and Zettel (6) voting "aye."

5. **FIRST QUARTER 2013 AND FISCAL YEAR TO DATE INVESTMENT PERFORMANCE SUMMARY**

[Background material was provided 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 said that the global equity markets had excellent gains in the first quarter of 2013, masking disparate performance in some risky asset classes. The Russell 3000 Index rose 11 percent for the quarter, reflecting very good fourth-quarter earnings, improved business conditions, a U.S. economy that was better than the non-U.S. economy, and continued good monetary policy. The MSCI World ex-U.S. Index rose 4.7 percent in the quarter, reflecting muted gains for European securities, and concerns about the Italian elections and the Cypriot banking crisis. The MSCI Emerging Market Index fell 1.6 percent for the quarter on concern about a slowdown in China.

Turning to returns in fixed income, Ms. Berggren said there was flat performance in bonds for the quarter, reflecting concern that the Federal Reserve Bank would stop its current monetary policy sooner than had been expected. High-yield bonds rose 2.9 percent, with investors seeking higher returns and showing concern about the volatility in the equity market. Emerging market debt fell 2.3 percent for the quarter, over concern about slowdowns in some emerging market economies.

Ms. Berggren said that all UC portfolios had very strong absolute and relative performance, outperforming their benchmarks for the quarter and the fiscal year to date, driven by active portfolio management. The UC Retirement Plan (UCRP) gained 4.6 percent for the quarter and 12.4 percent for the year to date, benefiting from both asset allocation and manager selection. The General Endowment Pool (GEP) had similar earnings, attributable mainly to gains in its hedge fund portfolio. The Total Return Investment Pool (TRIP) had good returns for the fiscal year to date because bonds had performed to expectations, and the U.S. equity, non-U.S. developed equity, and Real Estate Investment Trusts (REITS) asset classes had outstanding returns.

All UCRP asset classes had positive performance for the fiscal year to date; however emerging market debt and emerging market equity performed poorly in the first quarter of 2013. The best-performing asset class for the first quarter was U.S. equity, up 11 percent, followed by modest gains in non-U.S. developed equity, fixed income, private equity, absolute return, cross asset allocation, private real estate, and public real estate. For the fiscal year to date, performance in U.S. equity, non-U.S. developed equity, emerging market equity, and REITS was outstanding.

Committee Chair Wachter asked why returns in the cross asset class underperformed the benchmark in both the first quarter and the year to date. Ms. Berggren said that the cross asset class has a large allocation to a manager who is more heavily hedged, which helped the portfolio's performance in other periods, but hurt performance in the current period. She said the cross asset class had performed well from its initiation to date. In response to a question from Committee Chair Wachter, Ms. Berggren said the benchmark for the cross-asset class is the UC Entity portfolio benchmark. She explained that the particular manager had a difficult period because he manages his portfolio to perform well over the long term in every type of market and his portfolio has been overweight in fixed income, which had performed less well than equities. Ms. Berggren said her office would like to hire a few additional managers in the cross asset class.

Discussing asset allocation, Ms. Berggren said the portfolios were overweight in asset classes that had performed well. Decisions to underweight Treasury Inflation-Protected Securities (TIPS) and core fixed income helped overall performance, since those asset classes performed relatively poorly.

Almost all asset classes in the UCRP added to the 85 basis points (bps) of excess return generated by the Office of the CIO. Asset allocation in U.S. equity, core fixed income, and TIPS contributed to performance. Ms. Berggren said the hedge fund portfolio was largely responsible for the GEP's 165 bps of excess return.

Investment Advisory Group Member Samuels asked why the UCRP portfolio had not doubled since 2003 if its ten-year average return is about 7.5 percent. Ms. Berggren said that funds are paid out of the UCRP. Mr. Samuels also asked whether moving into alternative investments in TRIP would increase the volatility of its returns. Ms. Berggren said that would depend on the alternative asset class. She cited the example of private equity, which has had periods of peak returns without significant negative downturns. She explained that, while hedge funds were considered an asset class, the class is actually a combination of different types of assets. Committee Chair Wachter said that a 7.5 percent average return is a straightforward mathematical computation. He said the riskiness of various asset classes changes in different circumstances and not all alternative investments are more risky than traditional asset classes. Some alternative investments such as private equity add to the portfolio's illiquidity, which was a large problem for some institutions during the 2008 financial crisis. Investment Advisory Group consultant Lehmann added that the 7.5 percent was the average compounded rate of return. Mr. Samuels commented that the average rate of return has been an important topic for unions. Ms. Berggren said she would provide Mr. Samuels with the amounts of payouts from the UCRP.

6. INVESTMENT CONSULTANT REVIEW OF UNIVERSITY OF CALIFORNIA CAMPUS FOUNDATIONS FOURTH QUARTER 2012 PERFORMANCE REPORT

[Background material was provided 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 (Mercer) stated that his office provides the Committee quarterly reports evaluating the performance and asset allocations of the ten campus foundations. He displayed a graph showing that the returns of the ten campus foundations were tightly packed around the median. All funds had positive returns in one-, three-, and five-year periods and their returns were similar.

Although each campus foundation pursues its own investment strategy, they all have produced positive returns in a fairly narrow range. Mr. Dennison said there was nothing of note he wished to raise with the Committee.

Investment Advisory Group Member Rogers expressed his concern about the overall performance of the General Endowment Pool (GEP), saying that it is the worst- or near-worst-performing large endowment fund in the nation for three-, five-, and ten-year periods. Mr. Rogers said that these returns, rather than quarterly returns, should be the Committee's focus. He said that the quarterly reports to the Committee from the Office of the CIO do not address the fact that the performance of the GEP relative to its peer group of 18 university endowments with assets over $5 billion has not improved for years.

Investment Advisory Group consultant Lehmann expressed his view that the GEP was in fact a superbly performing endowment. He said that, while the GEP may have lower returns than some other endowments over certain periods of time, the investment management in the asset classes in which the GEP is invested following investment guidelines established by the Regents is excellent. Performance may vary by quarter, but on balance, over time and particularly in the past six or seven years, when the investment strategy has been modernized, the GEP has performed fairly well. Mr. Lehmann said that the variation in performance among large university endowments is not because of the performance of their investment managers, but rather because the endowments have different asset allocations. For instance, the other two large public university endowments, the University of Texas and the University of Michigan, have much larger allocations to alternative investments than UC's GEP does. Mr. Lehmann said that any questions about the performance of the GEP should be directed to the Regents since they determine the asset allocation. He said the Regents would decide whether they want to follow the same type of risk-return structure that is followed at Harvard and Yale involving larger allocations to private equity and real estate. Mr. Lehmann said it is perfectly reasonable to question the chosen asset allocation, but not to question the performance of the Office of the CIO in managing the investments within the asset classes.

Committee Chair Wachter said that over the years he has been involved with the Committee, the portfolio's asset allocation has moved to include more alternative investments. Private equity and real assets such as real estate and timber are a larger part of the endowments of Yale, Stanford, and Harvard than of the GEP. He said he has continually supported increased allocations to real assets and real estate, although perhaps not to the extent of the private endowments'. Committee Chair Wachter said that Mr. Rogers' point was well-taken, although he cautioned that the portfolio's performance would appear different for varying time periods.

Regent Kieffer asked whether the asset allocation of the GEP is changing fast enough and whether there could be a danger in its changing too rapidly. He noted that Committee Chair Wachter has advocated moving the asset allocation in the same direction that Mr. Rogers advocates. He asked what an appropriate period of time would be to arrive at an allocation with which the Committee is most comfortable, if the Committee is not comfortable with the current allocation.

Mr. Rogers said that five CIOs of large university endowments with returns that compare well to the group of 18 large endowments use an allocation similar to the Swensen model, the investment management and asset allocation model developed by Mr. David Swensen in managing Yale's endowment, with a few minor modifications. He said that the bonuses of these five CIOs are based on their endowments' returns compared with the returns of the other large university endowments, which is different from the way bonuses are determined at the UC Office of the CIO. Mr. Rogers expressed his view that the GEP could have comparable returns with the endowments of other large public universities such as the University of Michigan.

Mr. Lehmann said that the GEP has less than ten percent private equity, while Yale's endowment has 35 percent private equity. He said the Regents have not been comfortable with increasing allocation to alternative investments. Increased allocations to private equity, absolute return, and real estate would also mean increased illiquidity and downside risk.

Regent Kieffer asked about the effect of the requirement to publicly disclose certain investment information from alternative managers, particularly in venture capital. Mr. Lehmann said that lawsuits have resulted in UC's having to forego certain investment opportunities. Regent Kieffer said it is important for the public to understand the effects of requirements for transparency on returns. Committee Chair Wachter agreed, particularly in the venture capital area. Regent Kieffer asked whether the Committee thinks the GEP's asset allocation should be more aggressive than it has been, and, if so, to what extent.

Mr. Lehmann said the Committee reviews asset allocation annually. He expressed his view that the GEP private equity portfolio should be increased, but the allocation to hedge funds should not be increased. He said that perhaps the allocation to real estate should be increased, although he cautioned that real estate is a difficult asset class to manage.

Committee Chair Wachter expressed his view that the GEP portfolio is underweight in private equity, but that liquidity requirements must be considered. He would also support increased use of co-investment in private equity deals, which can be illiquid, but very profitable. He noted that the current allocation to real estate was still 2.5 percent below the policy allocation. He said that liquidity must be considered, and such changes might be more appropriate for the GEP than for the UC Retirement Plan (UCRP). He emphasized that the allocations have been moving in that direction. In comparison, five or six years ago, the Committee discussed whether the portfolio should contain any private equity, hedge funds, or real estate investments. The allocations have gradually changed, and currently the GEP portfolio is roughly ten percent private equity, five percent real estate, and 25 percent hedge funds. Committee Chair Wachter said that, while he has advocated for moving the portfolio in this direction, he respects the

Committee's careful and cautious approach. He noted that the Committee and the Office of the CIO have looked at other endowment and pension funds' returns and attempted to determine the differences in strategies. He added that returns could vary significantly depending on which time period is included.

Mr. Lehmann said the Committee should examine policy asset allocations. For instance, he suggested comparing Yale and UC's allocations to private equity, given the average return on the private equity asset class. The big difference is not the performance of the Office of the CIO; rather, the determining factor is asset allocation.

Mr. Rogers expressed his view that performance should be judged relative to the portfolios of peer institutions. Mr. Lehmann reiterated that an examination of the reasons underlying the performance would indicate that the asset allocation is the determining factor.

Regent Kieffer said that the kinds of changes that Mr. Rogers has called for have been underway and that the Regents have long held a conservative investment philosophy of protecting the assets of the University at a time when State funds were more available. He said it is currently a different era and the Regents' investment philosophy has become relatively more aggressive, but he and the Board are still very concerned with protecting the assets of the University and having pension funds available to pay obligations. The Committee has sought better returns and has gradually changed the investment policy over time. He acknowledged that Mr. Rogers had raised a good point, but cautioned that a longer perspective may be necessary.

Committee Chair Wachter noted that UCRP had always paid out pensions, but had no income for twenty years. The GEP also has no new incoming donations, only outgoing payments, unlike Harvard, Stanford, and Yale's endowments. He said it is easier for the private endowments to have more risky asset allocations when they have large sums coming into their portfolios. However, he agreed with Mr. Rogers' point that the GEP returns should be competitive with its peers' returns and expressed his view that UC should strive to earn returns in the top one-third of that group.

The meeting adjourned at 12:15 p.m.

Attest:

Secretary and Chief of Staff

Additions shown by underscoring; deletions shown by strikethrough

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~~ certain other related entities. The TRIP allows ~~Campuses~~ UC organizations 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, foreign exchange risk, commodity risk, and investment manager (implementation) risk. It is appropriate for longer-term investors who can accept this volatility in exchange for higher expected return. While the program will generally invest in liquid, marketable securities, there will at times be a trade-off of illiquidity for higher expected return.

d. Investment Strategy

The Program shall be implemented by the Chief Investment Officer, 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 Chief Investment Officer 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 asset / 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~~	~~5%~~
~~US Fixed Income – Credit~~	~~45%~~
~~US Fixed Income – Securitized~~	~~5%~~
~~High Yield Debt~~	~~10%~~
~~US Equity - All Cap –~~	~~15%~~
~~REITS~~	~~5%~~
~~Non US Equity (hedged)~~	~~15%~~
~~Liquidity~~	~~0%~~

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

Asset Category	Target Allocation	Lower Bound	Upper Bound
U.S. Equity	15.0%	10.0%	20.0%
Non-U.S. Devel. Equity	7.5	5.0	10.0
Emerging Market Equity	7.5	5.0	10.0
Opportunistic Equity	10.0	7.5	12.5
Global REITS	10.0	7.5	12.5
U.S. Core Gov't.	2.5	0	5.0
U.S. Core Credit	7.5	5.0	10.0
High Yield Debt	5.0	2.5	7.5
Emerging Market Debt	5.0	2.5	7.5
Absolute Return	10.0	7.5	12.5
Cross Asset Class	20.0	15.0	25.0
Liquidity	-	0	10.0
TOTAL	100.0		
Public Equity	50.0	35.0	65.0
Fixed Income	20.0	10.0	30.0
Alternatives	30.0	22.5	37.5
TOTAL	100.0		

b. Total TRIP Performance Benchmark

This is the composition of the total TRIP performance benchmark, which reflects the weights in the "Target Allocation" above:

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

Percentage	Performance Benchmark
15.0%	× Russell 3000 Index (Tobacco Free)
7.5%	× MSCI World ex U.S. Index (Net) (unhedged) (Tobacco Free)
7.5%	× MSCI Emerging Market Index (Net)
10.0%	× MSCI All Country World Index (Net)
10.0%	× FTSE / EPRA / NAREIT Global REIT Index
2.5%	× Barclays U.S. Aggregate Government Index
7.5%	× Barclays U.S. Aggregate Credit Index
5.0%	× BofA / Merrill Lynch HY Cash Pay BB/B rated Index
5.0%	× JP Morgan Emerging Markets Bond Index Global Diversified
10.0%	× HFRX Absolute Return Index (50%) + HFRX Market Directional Index (50%)
20.0%	× Aggregate TRIP Policy Benchmark

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 Chief Investment Officer to rebalance the Fund when necessary to ensure adherence to the Investment Policy.

The Chief Investment Officer will monitor the actual asset allocation at least monthly. The Committee directs the Chief Investment Officer 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 Chief Investment Officer may utilize derivative contracts (in accordance with the Derivatives Policy found in Appendix 4 of the UCRP Investment Policy Statement) to rebalance the portfolio.

The Chief Investment Officer 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 Chief Investment Officer may delay a rebalancing program when the Chief Investment Officer 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, and other 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~~RP Investment ~~Policies~~Policy Statement, and are hereby incorporated by reference.

Managers may utilize derivative contracts and strategies in accordance with the Derivatives Policy found in Appendix 4 of the UCRP Investment Policy Statement, and may employ leverage as circumscribed in the relevant asset class guidelines.

e. Diversification and Concentration

The Program's investments will be appropriately diversified to control overall risk and will exhibit portfolio risk characteristics similar to those of the Benchmark. The Chief Investment Officer is responsible for managing aggregate risk exposures.

It is expected that each Manager's portfolio will be appropriately diversified, within limits established in its guidelines and relative to its performance objectives, to control risk, but without unduly restricting a Manager's ability to out-perform its benchmark. That is, an individual

Manager’s portfolio may be more concentrated than is appropriate for the Program’s aggregate investments.

f~~e~~. Restrictions

The Managers may **not:**

- Purchase securities of tobacco related companies, as per the UCRP Investment Policy Statement, section 5b.
- Invest in mutual funds or group trusts unless specifically allowed in ~~its~~ their 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 Chief Investment Officer 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 Chief Investment Officer 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.

~~b.~~c. A performance attribution explaining differences in sector weights and returns, between the aggregate Program investments and the Benchmark, and an explanation of any material differences

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

~~a. Monthly accounting statements showing portfolio income, holdings and transactions~~

a. A monthly performance statement for the portfolio (gross and net) and the benchmark, and provide the gross performance for the product Composite at least quarterly.

b. If available, a monthly or quarterly forecast risk report, using the Manager's risk system, showing the total, systematic ("common factor"), and non-systematic ("residual") risk of the portfolio relative to the benchmark.
c. A monthly or quarterly variance analysis, indicating sources of performance variances (difference between portfolio and benchmark return), and an explanation of any material differences.
~~b.~~d. Quarterly review of portfolio and strategy performance including a market outlook
~~c.~~e. 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 UC entities~~Campuses~~, according to a spending rate which will be reviewed and approved annually by the Committee on Investments.

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