I. Course Summary:

This is a class in balanced fund management. We invest real money in domestically traded stocks and fixed income securities on behalf of a real client. The University of Washington is our client and the current market value of our fund is approximately $440,000. These monies derive from the Ivar Haglund bequest to the Business School and are entrusted to our management at the request of the School’s Dean, with the approval of the Board of Regents. Our goal is to add value to a benchmark portfolio comprised of the SP500 stock index and the Lehman Brothers Government/Credit bond index. During the spring quarter we will make decisions that significantly influence the composition of the portfolio and its returns for the following year. We will conduct investment management research and we will analyze portfolio performance. In addition, we will prepare the Fund’s annual and interim first quarter reports and present these to the Fund's Advisory Board.

II. Investment Decisions, Research, and Reporting

In managing a balanced fund there are many investment decisions that must be made. These include:

1. Strategic and tactical asset allocation: How should funds be allocated between fixed income and equity investments?

2. How should the fixed income portfolio be positioned with respect to duration and credit risk? Which specific debt instruments should be held to obtain the desired position?

3. How should the equity portfolio be positioned with respect to styles and sectors? Which specific stock investments should be made?

Each type of decision must be made with due consideration of the risk tolerance and investment objectives of the client. Moreover, prudent fund management decisions rest
on a sound foundation of careful deliberation informed by focussed research. Finally, the rationale for investment decisions and the performance of the fund should be clearly set forth and accurately reported to the client.

III. Fiduciary Responsibility, Professional Ethics, and Oversight

Members of this class will learn about the ethical standards demanded of professional managers who invest funds on behalf of clients. Members will be expected to meet these standards.

The conduct of our Fund’s business, its composition, and performance are subject to periodic review by the Fund’s Advisory Board. The members of the advisory board and their principle affiliations and titles are:

Graeme Bretall; Harris, Bretall, Sullivan, and Smith (Founding Principal)
Howard Crane; Watson Wyatt Investment Consulting (President)
S. Michael Giliberto; JP Morgan Investment Management (Managing Director)
Yash Gupta, University of Washington (Dean, School of Business Administration)
Paul Malatesta, University of Washington (Professor and Faculty Advisor to the Fund)
Michael Phillips; Frank Russell Company (Chairman and President)
Eric Schoening; Portage Bay Capital Management (Past President)
Ronald Spaulding; Safeco Asset Management (Chairman and Senior Investment Officer)
Lesa Sroufe; Wells Fargo & Company (Director of Research and Private Asset Management)

V’Ella Warren; University of Washington (Treasurer of the Board of Regents)

IV. Course Structure and Student Responsibilities

The structures of the course and student responsibilities are dictated by the job of managing a balanced fund. Students will be assigned to functional groups having responsibility for specific management or research tasks. Each student will serve as an industry-sector research analyst. In addition, all students will serve on one of four other groups having higher-level analytical or functional responsibilities.
The chart below indicates the organization of our firm.

In brief, the responsibilities breakdown as follows:

Fund Advisory Board: General oversight and advice.

President, Vice Presidents, Faculty Advisor: Coordinate and facilitate work of all groups, general management of day-to-day operations, present reports to the Advisory Board.

Fixed Income Group: conduct research related to the fixed income investments of the portfolio, submit investment recommendations for specific action.

Strategic and Tactical Asset Allocation Group: conduct research related to the Fund’s relative investment in fixed income versus equity securities, submit recommendations for specific action.

Equity Strategy and Research Group: conduct research related to the fund’s equity investment style (e.g., value vs. growth, small cap vs. large cap), themes, and sector emphases. Define sectors, assign and manage analysts. Communicate research findings.
Accounting, Compliance, and Client Reporting: record all formal actions of the Fund, monitor accounts and trades, ensure compliance with all pertinent investment policies and guidelines, prepare reports to the Advisory Board.

Sector Analysts: conduct research on potential equity investments within their assigned sectors, provide general support for and report to the Equity Research and Strategy Group, submit recommendations for specific action.

Students will be provided with several aids to assist them in performing their assigned tasks. During the first six weeks of the term experienced investment industry professionals will make presentations to the class on a series of relevant issues. Bank of America Montgomery Securities and Credit Suisse First Boston will allow us to view their password-protected research web pages, as well. In addition, I have prepared a set of required core readings and a list of recommended readings arranged by topic. (The required readings are available for purchase as a course readings packet at the Balmer Hall Copy Center.)

V. Class Meetings

There will be four types of class sessions: lectures, presentations by investment professionals, presentations by students, and working sessions. Working sessions are unstructured class time. During working sessions students will consult with each other and with me regarding their assigned research or other tasks. This unstructured time is equivalent to routine office hours for class members, permitting small group meetings within the classroom.

Students will present the results of their research to the class as a whole. Each such presentation will be focussed on key investment management decisions that we confront. Written memoranda will accompany presentations. These memos, suitably edited, will be incorporated in reports to our Advisory Board. In general, the presentations will contain an evaluation of alternatives and recommendations for specific action. The class will consider the recommendations and decide the course of action.
The table below outlines the schedule of class meetings:

<table>
<thead>
<tr>
<th>Day</th>
<th>Date</th>
<th>Speaker</th>
<th>Topic</th>
<th>Firm</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mon</td>
<td>4/01/02</td>
<td>Paul Malatesta</td>
<td>Introduction</td>
<td>UW</td>
</tr>
<tr>
<td>Wed</td>
<td>4/03/02</td>
<td>Douglas Breckel</td>
<td>Meet our client, UW CEF</td>
<td>UW</td>
</tr>
<tr>
<td>Mon</td>
<td>4/08/02</td>
<td>Paul Malatesta</td>
<td>Fiduciary duties</td>
<td>UW</td>
</tr>
<tr>
<td>Wed</td>
<td>4/10/02</td>
<td>Paul Malatesta</td>
<td>Asset Allocation</td>
<td>UW</td>
</tr>
<tr>
<td>Mon</td>
<td>4/15/02</td>
<td>Howard Crane</td>
<td>Role of Investment Consultants</td>
<td>Watson Wyatt</td>
</tr>
<tr>
<td>Wed</td>
<td>4/17/02</td>
<td>Paul Malatesta</td>
<td>Framework for Equity Analysis</td>
<td>UW</td>
</tr>
<tr>
<td>Mon</td>
<td>4/22/02</td>
<td>Lesa Sroufe</td>
<td>Investment Research &amp; Analysis</td>
<td>Wells Fargo</td>
</tr>
<tr>
<td>Wed</td>
<td>4/24/02</td>
<td>Working Session</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mon</td>
<td>4/29/02</td>
<td>Wally Niemasik</td>
<td>Equity Management</td>
<td>Snyder Capital</td>
</tr>
<tr>
<td>Wed</td>
<td>5/01/02</td>
<td>Paul Malatesta</td>
<td>Framework for Fixed Income Analysis</td>
<td>UW</td>
</tr>
<tr>
<td>Mon</td>
<td>5/06/02</td>
<td>Mary Pugh</td>
<td>Fixed Income Management</td>
<td>Pugh Capital</td>
</tr>
<tr>
<td>Wed</td>
<td>5/08/02</td>
<td>Paul Kaplan</td>
<td>Fixed Income Management</td>
<td>Wellington Management</td>
</tr>
<tr>
<td>Mon</td>
<td>5/13/02</td>
<td>Working Session</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wed</td>
<td>5/15/02</td>
<td>Students</td>
<td>Asset Allocation Group</td>
<td></td>
</tr>
<tr>
<td>Mon</td>
<td>5/20/02</td>
<td>Students</td>
<td>Equity Strategy Group</td>
<td></td>
</tr>
<tr>
<td>Wed</td>
<td>5/22/02</td>
<td>Students</td>
<td>Sector analyst reports</td>
<td></td>
</tr>
<tr>
<td>Mon</td>
<td>5/27/02</td>
<td>Working Session</td>
<td>HOLIDAY</td>
<td></td>
</tr>
<tr>
<td>Wed</td>
<td>5/29/02</td>
<td>Students</td>
<td>Sector analyst reports</td>
<td></td>
</tr>
<tr>
<td>Mon</td>
<td>6/03/02</td>
<td>Working session</td>
<td>Fixed Income Group</td>
<td></td>
</tr>
<tr>
<td>Wed</td>
<td>6/05/02</td>
<td>Students</td>
<td>Preparation for Board meeting</td>
<td></td>
</tr>
<tr>
<td>Fri</td>
<td>6/07/00</td>
<td></td>
<td>BOARD MEETING 3:00 PM</td>
<td></td>
</tr>
</tbody>
</table>
VI. Investment Decisions and Trading

Class members may make motions to trade during class sessions. Motions that are properly seconded and that receive a majority of affirmative votes will be implemented, unless I deem the trade to be imprudent. It is highly unlikely that I will deem a popular trade motion to be imprudent if:

1. it is supported by a written memorandum articulating the rationale for the trade,
2. the Accounting, Compliance, and Client Reporting Group states that the trade is permissible under governing investment guidelines and policies, and
3. the Fund President and Vice Presidents support the motion.

Once a trade is agreed upon, I will direct our broker to execute it. I am the only one having direct trading authority over the Fund’s account(s).

VII. Examinations and Grading

This is not a traditional college class. There will be no conventional written examinations. Your grade in the class will depend on the quality of your research and other contributions to our collective fund management effort. In assigning grades, I will consider written memoranda that you submit, presentations that you make, management tasks that you perform, your collegiality, and anything else I can think of that affects how well our work is done.

Ultimately, our Advisory Board, our client, and a future generation of students will undertake the assessment of our work as a group. If we do our work well, our Fund’s performance likely will be good. Our Board will commend us and our client will be pleased. And next year, Spring 2003, the Fund’s annual report, containing all of our names, will boast of our accomplishments. In any case, the report will contain our names.
VIII. Recommended Reading

These readings are organized into topical groups. Some of the articles are sufficiently important that everyone in the class should read them. Others, however, will be much more useful to some students than to others. I do not expect any student to read everything on this list. This is largely a matter of common sense. The readings on fixed income are, obviously, more relevant to a member of the Fixed Income Group than to a member of the Asset Allocation Group. I expect students to concentrate on materials that support their particular fund management research and functional specialties. I also expect every student to read beyond the list. Do not let my recommendations for core readings in any area prevent you from looking for additional resources. I will be disappointed if I do not receive advice from each of you regarding useful additions to the current list of recommended readings.

There is a packet of required readings, but no textbook, per se, for the class. However, you may wish to purchase the book by Maginn and Tuttle in addition the readings packet. This book, though a decade old, is not out of date. I believe it provides a very useful survey of investment management topics and is worth your money. You should be able to order it through PBD Books at their web site:


(Maginn and Tuttle)

Product Number: 909003

In addition to the specific readings listed below, I commend to you in general the Journal of Portfolio Management, and the Financial Analysts Journal.

Abbreviations:


A. Overview of portfolio management, responsibilities of managers

M&T chp 1 The Portfolio Management Process and Its Dynamics (Maginn & Tuttle);
R&B chp 26 Professional Asset Management, appendix B Code of Ethics and Standards of Professional Conduct;
E&G chp 26 Portfolio Management Revisited;
S chp 20 Fiduciary Duties and Responsibilities;
Standards of Practice Handbook, 8th ed., AIMR, 1999;

B. Know your client

M&T chp 3 Individual Investors (Kaiser), chp 4 Determination of Portfolio Policies: Institutional Investors (Ambachtscheer, Maginn, Vawter);
R&B chp 2 The Asset Allocation Decision;
S chp 5 Investment Policy.

C. Market Conditions and Expected Returns

M&T chp 5 Capital Market Expectations: The Macro Factors (Diermeier), chp 6 Individual Asset Expectations (Gray);
R&B chp 18 Stock Market Analysis, chp 19 Industry Analysis;
D. Asset Allocation

**M&T** chp 7 Asset Allocation (Sharpe);


**S** chp 25 Contemporary Issues in Portfolio Management, 552-556;


E. Fixed Income

**M&T** chp 8 Portfolio Construction: Fixed Income (H. Giford Fong);

**R&B** chp 15 Bond Fundamentals, chp 16 The Analysis and Valuation of Bonds, chp 17 Bond Portfolio Management Strategies;

**E&G** chp 20 Interest Rate Theory and the Pricing of Bonds, chp 21 The Management of Bond Portfolios;

**S** chp 16 Revision of the Fixed Income Portfolio;


F. Equity

**M&T** chp 9 Equity Portfolio Management (Condon);
**R&B** chp 18 Stock Market Analysis, chp 19 Industry Analysis, chp 20 Company
Analysis and Stock Selection, chp 22 Equity Portfolio Management Strategies;
**S** chp 11 Security Screening, chp 15 Revision of the Equity Portfolio;
Bernstein, Style Investing, Wiley, 1995;
Christopherson, J. and C. Williams, “Equity Style: What It Is and Why It Matters,” in
The Handbook of Equity Style Management, 2nd ed, Fabozzi Associates, 1997;
Damodaran A., Damodaran on Valuation: Security Analysis for Investment and
Corporate Finance, Wiley, 1994, chp 3 Estimation of Discount Rates, chp 4 Estimation of
Cash Flows, chp 5 Estimation of Growth Rates, chp 6 Dividend-Discount Models, chp 7
Free-Cash-Flow-to-Equity Discount Models, chp 8 Valuing a Firm – The Free-Cash-
Flow-to-Firm Approach, chp 10 Price/Earnings Ratios, chp 11 Price/Book Value Ratios,
chp 12 Price/Sales Ratios, chp 17 Overview and Conclusion;
Equity Markets and Valuation Methods, ICFA, 1988
6 Analyzing the Firm’s Operations;

G. Execution and Trading

**M&T** chp 12 Implementation of Portfolio Building: Execution (Treynor and Wagner);

H. Performance Assessment and Presentation

**M&T** chp 14 Evaluating Portfolio Performance (Dietz and Kirschman);
**R&B** chp 27 Evaluation of Portfolio Performance;
**E&G** chp 24 Evaluation of Portfolio Performance;

I. Financial Statement Analysis

Program Description

University of Washington MBA Student Investment Fund

I – Description
The University of Washington MBA Student Investment Fund is a collaborative effort of MBA students, Business School faculty and staff, and investment professionals. Students function as managers of an actual portfolio structured as a balanced fund, under the supervision of a faculty advisor and Fund Advisory Board. Participating students also enroll in the course “Practical Investment Management,” offered by faculty of the Department of Finance and Business Economics. Monies invested by the Fund are derived from charitable contributions to the University of Washington Business School.

II – Objectives of the Fund
There are two primary objectives of the Fund. The first is to provide an integrative learning experience for graduate business students in the University of Washington MBA program. Students will be engaged in the full range of activities required to support a balanced investment fund. These activities include research, reporting, asset allocation, and security selection. The other primary objective of the Fund is to provide financial support for the Business School. It is intended that the principal of the Fund grow over time, and that increases in the value of the portfolio from interest, dividends, and capital gains be available to maintain and enhance the educational programs of the Business School.

III – Investment Philosophy
The Fund shall be managed in a disciplined and prudent fashion consistent with current standards of care and expertise applicable to financial fiduciaries. The investment portfolio shall be diversified both as to fixed income and equity holdings so as to reduce risk yet provide reasonable prospects for growth of principal.

IV – Management and Operations
The MBA Student Investment Fund Advisory Board shall be composed of the Treasurer of the Board of Regents of the University, the Dean of the Business School, a Faculty Advisor designated by the Dean, such additional Business School faculty members as are deemed necessary by the Dean, and four to six experienced investment professionals from outside the University. Each spring the Board will solicit applications from students completing the first year of the MBA program and select from among the applicants a Fund President and one or more Vice Presidents to serve one-year terms commencing the second Monday of the following June. The Fund President, Vice President(s), and Faculty Advisor shall constitute the Investment Management Committee of the Fund. The Investment Management Committee shall be responsible for the daily operations of the Fund. The Treasurer of the Board of Regents shall designate a custodian bank to hold Fund assets, however, and only the Faculty Advisor will have authority to initiate trades. The Committee shall report quarterly to the Advisory Board, which shall provide general oversight and guidance of the Fund.

The Investment Management Committee will invite qualified students completing the first year of the MBA program to participate in Fund management beginning in the fall of their second year. The Committee will form a number of working subcommittees of these students, depending on the extent of student interest, to assist in Fund operations. Participating students will enroll in the “Practical Portfolio Management” class during the spring quarter of their second year. Students in this class, under the supervision of the Faculty Advisor, will conduct a complete review of the portfolio, undertake related investment research projects, and prepare the Annual Report of the Fund for presentation to the Advisory Board. It is anticipated that compelling analysis presented by students during the spring quarter class will prompt most of the trades undertaken by the Fund.
The Investment Fund is composed of endowment and other contributions. It is intended that the principal of the fund grow over time, and that increases in the value of the portfolio from interest, dividends and capital gains be available to support Business School/MBA investment related initiatives and programs. This spending policy is subject to limitations on expenditure rates that apply to University of Washington endowments.

I. GOALS AND OBJECTIVES

A. The primary objective of this investment fund is to serve as a hands on integrative learning experience for graduate business students in the University of Washington MBA program.

B. The secondary objective is to provide financial support for courses, programs, and scholarships within the School of Business.

II. INVESTMENT PHILOSOPHY

A. The investment portfolio shall be managed in a disciplined and prudent fashion consistent with current standards of care and expertise applicable to financial fiduciaries. Our primary investment philosophy is to seek growth and preservation of capital through a balanced approach emphasizing both equity and fixed income securities with strong fundamentals. Investment decisions will be made utilizing a combination of technical, quantitative, and fundamental analysis techniques.

B. The investment portfolio shall be diversified both as to fixed income and equity holdings to provide risk reduction, capital preservation, a dependable source of income, and growth of principal.

III. INVESTMENT MANAGEMENT

A. The Investment Fund Advisory Board of Directors, through its Investment Management Committee, shall be responsible for overseeing the management of the Investment Fund.

B. All of the goals, objectives and guidelines herein shall be monitored by the Investment Management Committee and reviewed quarterly by the Investment Fund Advisory Board of Directors.

C. The Investment Management Committee requires quarterly statements detailing portfolio transactions from the brokerage firm and custodian
bank.

D. A formal account review process will be conducted every year whereby the Investment Management Committee and Fund’s Advisory Board will evaluate the investment policy and make any necessary changes. The Investment Management Committee will also be responsible for completing the Investment Fund Annual Report.

E. The University of Washington will designate a custodian bank. A brokerage firm will be selected by the Investment Management Committee and approved by the Investment Fund Advisory Board.

IV. PORTFOLIO COMPOSITION AND RISK

A. The allocation of assets between fixed income securities and equities shall be based primarily on relative attractiveness and the investment/economic outlook over a one- to three-year period.

B. The equities portion of the fund shall range between 30% and 80% of the total fund. The fixed income portion shall range between 20% and 70% of the total fund.

C. The Fund shall not invest in derivative securities except where they offer the most economic means of improving the risk/reward profile of the portfolio. Derivative securities shall not be used in any way that results in outright exposure to changes in the value of assets or indices that by themselves would not be purchased for the portfolio. The Fund shall not make use of margin nor engage in short selling.

D. The Fund shall not invest in real estate or other illiquid assets.

E. **Fixed Income Securities:**

1. The fixed income portfolio duration shall not exceed 150% of the duration of the Lehman Brothers Government/Credit Bond Index.

2. Bond investments (one year or longer) shall be limited to U.S. government and agency issues, mortgage instruments, and quality investment grade corporate bonds. Corporate issues must be in the top quality ratings of Moody’s, Standard & Poor’s or other recognized credit services (BBB, Baa) or higher with good marketability.

3. No single corporate holding in any one corporate issue may exceed 10% of the total fixed income portfolio.

F. **Equities:**
1. The equities portfolio shall consist of investments in high quality companies whose securities have good marketability. These companies typically will have strong management, exhibit leadership within their industries, and emphasize earnings growth, profitability, and shareholder value.

2. The following rules apply to equity investments including convertible securities:
   
a. The equity securities of any single company shall not exceed 10% (at cost) or 20% (of market) of the equity portfolio.

b. Companies from which equity securities are purchased should be at least $250 million in market capitalization.

c. Equities must be listed on the New York Stock Exchange, American Stock Exchange or NASDAQ. The Fund may not invest in private placements.

d. American Depository Receipts of foreign companies meeting the above requirements may be purchased.

V. PERFORMANCE STANDARDS

The performance of the Investment Manager(s) and the Total Fund shall be reviewed annually against the following standards:

A. The equities portfolio will be measured against the S&P 500 and against a diversified universe of professionally-managed equity funds.

B. The fixed income portion of the portfolio will be measured against the Lehman Brothers Government/Credit Bond Index and against a diversified universe of professionally-managed fixed income funds.

C. The total portfolio will be measured against a balanced policy portfolio of 60% S&P 500, 40% Lehman Brothers Government/Credit Bond Index.

D. The total portfolio return is expected to perform in the top half of a universe of public balanced mutual funds over five years.
INVESTMENT FUND PROCEDURES

INVESTMENT FUND

Spending Policy

The Investment Management Committee and Fund’s Advisory Board shall review and recommend once annually, the amount, nature, and timing of (if any) distribution from the fund.

Distributions shall be annual.

The amount to be distributed in a fiscal year is subject to the authorization of the Dean of the Business School and other spending limits. Any distributions will also be reviewed by the University of Washington Treasurer’s office.
Investment Guidelines

University of Washington MBA Student Investment Fund
Domestic Balanced Fund Account

Accepted ....

I – Policies and Communication
The Portfolio will be managed in accordance with the “Statement of Investment Objectives and Policies for the Consolidated Endowment Fund” of the University of Washington (the “University”). All communications shall be directed to the Treasurer of the Board of Regents of the University. This includes portfolio performance reports, changes in management structure or personnel, any shifts in investment philosophy, and questions or concerns on the part of the MBA Student Investment Fund President, Vice President(s), Faculty Advisor, and Advisory Board.

II – Performance
The Portfolio objective is to outperform, net of commissions, the benchmark portfolio and to outperform the median public balanced mutual fund. The benchmark portfolio will be comprised of 60% Standard & Poor’s 500 Stock Index and 40% Lehman Brothers Government/Credit Bond Index. Performance will be measured by total annual return and will be calculated over one, three, and five-year periods and over complete market cycles for comparison to the benchmark portfolio and to the universe of public balanced mutual funds.

III – Portfolio Structure and Strategy
The investment strategy is to seek growth and preservation of capital through a balanced approach emphasizing both equity and fixed income securities with strong fundamentals. Investment decisions will be made utilizing a combination of technical, quantitative, and fundamental analysis techniques. The allocation of assets between fixed income and equity securities, and the sector, capitalization, and style emphases of the fund shall be based primarily on relative attractiveness and the investment and economic outlook over a one to three-year period. The Fund shall not make use of leverage nor engage in short sales.

The equities portion of the Portfolio shall be between 30% and 80% of the total. Equities must be listed on the New York Stock Exchange, American Stock Exchange, or NASDAQ. The equity securities of any single company shall not exceed 10% at cost, or 20% at market, of the Portfolio. The Fund will not purchase the equity securities of companies having market capitalization less than $250 million. ADRs of foreign companies meeting the above requirements may be purchased.

The fixed income portion of the Portfolio shall be between 20% and 70% of the total. The duration of the fixed income portion shall not exceed 150% of the duration of the Lehman Brothers Government/Credit Bond Index. Bond investments (one year or longer until maturity) shall be limited to U.S. Government and Agency issues, mortgage instruments, and investment grade corporate bonds. Corporate issues must be in the top quality ratings (BBB, Baa, or higher) of Moody’s, Standard & Poor’s, or other recognized credit services, with good marketability. No single corporate holding in any one corporate issuer may exceed 10% of the fixed income portion of the portfolio and the fixed income portfolio overall must maintain a credit rating of A or better on a market-weighted basis.

IV – Portfolio Contact
The University of Washington MBA Student Investment Fund employs a team approach to investment management. The Investment Management Committee is comprised of two or more second-year MBA students (the Fund President and Vice President(s)) and a Faculty Advisor appointed by the Dean of the Business School. The primary portfolio contact will be Paul H. Malatesta, the Faculty Advisor to the Fund.

Accepted By:

V'Ella Warren                             Paul H. Malatesta
Treasurer, Board of Regents              Faculty Advisor
INTRODUCTION

The Board of Regents of the University of Washington is vested by statute with responsibility for the management of the properties of the University, including its Consolidated Endowment Fund and other University Funds. This statement of investment objectives and policies governs the investment management of the Consolidated Endowment Fund (CEF). It is anticipated that this statement will be effective until modified as conditions warrant by the Board. Both the Board and investment managers are expected to propose revisions in the guidelines at any time these guidelines may impede meeting the CEF’s investment objectives.

The Board has delegated to its Finance and Audit Committee the responsibility for overseeing its investment program within the general principles enumerated herein.

A. INVESTMENT OBJECTIVES

1. The overall financial objective of the CEF is to provide a level of support for programs (as determined by the CEF’s spending policy summarized below) consistent with the CEF’s purchasing power being maintained over time.

2. The primary investment objective of the CEF is to provide a maximum level of return consistent with prudent risk levels. The specific investment objective of the CEF is to attain an average annual real total return (net of investment 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 during every five-year period, but should be attainable over a series of five-year periods.

3. The CEF’s investment policies should be based on the assumption that annual spending over the long term will be 5% of the average market value of the CEF for the previous three years. In this way, the CEF’s distributed income is expected to keep up with inflation and its capital value will be preserved over time.
4. Over the long term (rolling five year periods), the CEF is expected to achieve returns which are at least comparable to the median return of representative college and university endowments as published by the National Association of College and University Business Officers (NACUBO).

5. The investment performance of the CEF will also be evaluated, on a risk-adjusted basis, against a policy benchmark that is weighted 60 percent in the S&P 500 index and 40 percent in the Lehman Government bond index. Other blended market indices reflecting the strategic asset allocation of the fund will be utilized as appropriate. Over the long term (rolling five-year periods), the CEF’s diversification is expected to generate risk-adjusted returns that meet or exceed those of blended market indices.

B. ETHICAL CONSIDERATIONS

1. While fiscal goals are of central importance, due consideration shall be given to the degree of corporate responsibility exercised by the companies in which investments are made.

C. INVESTMENT MANAGEMENT STRUCTURE

1. The CEF will be invested primarily by external investment managers. External investment management firms will be selected on the basis of factors including, but not limited to, the following: the experience of key personnel; investment philosophy; assets under management; organizational structure; performance record; investment management fees; and the firm’s ethical and financial viability.

2. Equity and bond securities will be managed separately. In the interest of diversification, the equity portion of the portfolio will be placed with managers who have distinct and different investment philosophies. The investment managers have the discretion to manage the assets in their individual portfolios to best achieve the investment objectives and requirements set forth in this policy statement and in their individual investment guidelines.

D. PORTFOLIO COMPOSITION AND ASSET ALLOCATION

1. To achieve its investment objective, the CEF shall be divided into two parts: an “Equity Fund” and a “Fixed Income Fund.” 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 Finance and Audit Committee. Over the long run, the allocation between the Equity and Fixed Income Funds may be the single most important determinant of the CEF’s investment performance.
### Manager Allocation

<table>
<thead>
<tr>
<th>III.</th>
<th>Domestic Equity</th>
<th>Long-term Target</th>
<th>Policy Range</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>International Equity</td>
<td>15%</td>
<td>10-20%</td>
</tr>
<tr>
<td></td>
<td>Absolute Return</td>
<td>10%</td>
<td>5-15%</td>
</tr>
<tr>
<td></td>
<td>Performance Enhancement</td>
<td>15%</td>
<td>10-20%</td>
</tr>
<tr>
<td>TOTAL EQUITY FUND</td>
<td>80%</td>
<td>65-85%</td>
<td></td>
</tr>
<tr>
<td>Domestic Bonds</td>
<td>15%</td>
<td>10-25%</td>
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</tr>
<tr>
<td>Global Bonds</td>
<td>5%</td>
<td>0-10%</td>
<td></td>
</tr>
<tr>
<td>TOTAL FIXED-INCOME</td>
<td>20%</td>
<td>15-35%</td>
<td></td>
</tr>
</tbody>
</table>

1. Rebalancing will be automatically implemented if the Equity Fund ratio exceeds 85% or falls below 65%. The Finance and Audit Committee may change any of these ratios at its discretion, but it is anticipated that such changes will be infrequent.

2. The purpose of the Equity Fund is to provide a total return that will simultaneously provide for growth in principal and current income (along with that from the Fixed Income Fund) sufficient to support spending requirements, while at the same time preserving the purchasing power of the CEF’s assets. It is recognized that the Equity Fund entails the assumption of greater market variability and risk.

3. The purpose of the Fixed Income Fund (bonds and cash equivalents) is to provide a deflation hedge, to reduce the overall volatility of the CEF, and to produce current income (to be added to dividend income from the Equity Fund), in support of spending needs.

4. Annually, the Finance and Audit Committee will formally review the portfolio structure. As deemed appropriate, funds will be exchanged between the Equity and Fixed Income Funds to return the equity/fixed income ratio to 80/20.

5. The CEF will be diversified both by asset class (e.g., equities, bonds, cash equivalents, non-U.S. securities, performance enhancement funds, absolute return funds) and within asset classes (e.g., within equities by country, 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 EQUITY FUND**

1. The objective for the Equity Fund is to outperform, net of commissions and fees, the S&P 500 stock index on a risk-adjusted basis. In addition, performance will be monitored against the average return of a representative universe of active equity managers. Performance will be monitored on a regular basis and evaluated over running three- to five-year periods.

2. The Equity Fund will be broadly diversified by country, economic sector, industry, number of holdings and other investment characteristics. To achieve its investment objective, the Equity Fund may contain a mix of actively and passively managed strategies. Index funds and/or quasi-index fund strategies will provide the passive core within the Equity Fund. With the exception of passive strategies, assets under management by individual active equity managers – including quasi-index managers - will not exceed 20% of the CEF. A manager with an allocation close to 20% will be characterized by a diversified, highly liquid portfolio; a stable management team; a varied client base; and significant assets under management.

3. Decisions as to individual country and 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. The usual standards of fiduciary prudence set forth in this policy statement and in individual investment management agreements and guidelines apply.

4. Direct investments in tobacco companies are prohibited.

5. If allowed under their individual investment guidelines, equity managers may at their discretion hold investment reserves of either cash equivalents or bonds, but with the understanding that performance will nonetheless be measured against a representative stock index. Derivatives (currency forwards and options, futures, etc.) may be used to manage certain exposures (such as currency or market risk) if so specified under individual investment manager guidelines.

6. The objective of the Performance Enhancement strategy is to exceed the long-term return on domestic equities by 5%.

7. The objective of the Absolute Return strategy is to provide consistently positive real returns and a measure of portfolio protection in down markets.

**F. GUIDELINES FOR THE FIXED INCOME FUND**

1. The objective of the Fixed Income Fund is to outperform, net of commissions and fees, the Lehman Brothers Government Bond Index on a risk-adjusted basis. In addition, performance will be monitored against the average return of a representative universe of active fixed income managers. Performance will be monitored on a regular basis and evaluated over running three- to five-year periods.
2. Money market instruments as well as bonds may be used in the Fixed Income Fund, but equities and convertibles (if the latter are bought at prices above their investment value) are excluded. Derivatives (currency forwards and options, futures, swaps and mortgage-related structured notes) may be used to manage certain exposures (such as currency or prepayment risk) if so specified under individual investment manager guidelines.

Fixed Income Fund managers are expected to employ active management techniques, but changes in average maturity should be moderate and incremental. Managers should maintain a minimum average maturity consistent with the Fixed Income Fund’s deflation hedge objective. The minimum average maturity, or some equivalent measure, should be communicated to the Finance and Audit Committee.

3. Direct investments in tobacco companies are prohibited.

G. GUIDELINES FOR TRANSACTIONS

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. Commissions may be designated for payment of services rendered to the University in connection with investment management.

H. MONITORING OF OBJECTIVES AND RESULTS

1. All objectives and policies are in effect until modified by the Finance and Audit Committee, which will review these periodically for their continued appropriateness.

2. At any time, if managers believe that any policy guideline inhibits their investment performance, it is their responsibility to clearly communicate this view to the Treasurer of the Board of Regents.

3. The CEF 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. Performance will be reviewed by the Finance and Audit Committee on a quarterly basis, but results will be evaluated over longer time frames including the inception period, running three- to five-year periods, and complete market cycles.

4. The Finance and Audit Committee will review individual managers as needed in order to confirm that performance expectations remain in place. In addition, portfolio activity initiated under the Chair of the Finance & Audit Committee and the Treasurer’s delegated authorities will be reviewed on a quarterly basis.
5. 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 under the terms of the University’s Investment Management Agreement to inform the Treasurer of the Board of Regents of any change in firm ownership, organizational structure, professional personnel, account structure (e.g., number, asset size and account minimum) or fundamental investment philosophy.

6. A statement of investment objectives and guidelines will be maintained for each investment manager.

I. DELEGATIONS

Delegations related to the management of the University’s investment portfolios are as follows:

1. Board of Regents:

   a. Approve investment policies, which establish broad guidelines for the management of the University’s investment portfolios based upon the recommendation of the Finance and Audit Committee and the administration.

   b. Liquidate quasi-endowments. These funds represent assets donated to the University which have been accepted by the Board of Regents or its administrative designee as “quasi-endowments.” The decision to place the assets in a quasi-endowment is based on administrative recommendation and can therefore be reversed. Full or partial liquidation of quasi-endowments valued at $1 million or higher requires action by the full Board of Regents. Full or partial liquidation of quasi-endowments valued at less than $1 million is delegated to the Finance and Audit Committee of the Board of Regents.

2. Finance and Audit Committee:

   a. Approve the dollar value of assets assigned to new managers.

   b. Appoint investment management firms, investment-consulting firms, and investment custodian based upon the recommendation of the Chair of the Finance and Audit Committee of the Board of Regents and the Treasurer.

   c. Approve follow-on limited partnership investments within the Performance Enhancement Fund.

   d. Approve the overall asset allocation of the Consolidated Endowment Fund within the long-term ranges established under this policy.

   e. Oversee the University’s investment programs within the broad guidelines established by the investment policies.
To include the following:
?? Asset allocation strategies.
?? Performance enhancement strategies.
?? Absolute return strategies.
?? Global and International strategies.
?? Derivative usage.
?? Manager terminations.

3. Chair of the Finance and Audit Committee:

   a. Recommend appointment of investment management firms and/or approve limited partnership investments to the Finance and Audit Committee of the Board of Regents. Recommendations will be developed in conjunction with the Vice Chair and/or the Treasurer. The Vice Chair may substitute for the Chair when the Chair is unavailable.

   b. Appoint investment management firms and/or approve limited partnership investments when timely approval cannot otherwise be accommodated within the regular meeting schedule set by the Finance and Audit Committee. Approvals will be developed in conjunction with the Vice Chair and/or the Treasurer. The Vice Chair may substitute for the Chair when the Chair is unavailable. To the extent possible, both the Chair and the Vice Chair will be involved. This authority is limited to allocations / commitments up to $25 million in any one manager / partnership.

4. Executive Vice President:

   a. Sign investment management agreements, investment limited partnership agreements, custody agreements and other investment related documents upon satisfactory completion of reviews as appropriate by the State Attorney General, outside legal counsel and the University’s investment consultant. Signing authority is delegated to the Treasurer of the Board of Regents when the Executive Vice President is otherwise unavailable.

   b. Administer internal fees for management and administrative activities related to the endowment.

5. Treasurer of the Board of Regents:

   a. Approve the dollar value of assets assigned to current investment managers and reallocate assets among managers in accordance with long-term strategic targets. This authority is extended only with current managers previously appointed by the Board of Regents or its Finance and Audit Committee.

   b. Approve individual investment manager guidelines.

   c. Monitor all individual investment managers on a regular basis in order to confirm that the performance expectations remain in place.
d. Move assets from a particular investment management firm in the event of the
departure of the key portfolio manager or other extraordinary circumstances. The
Chair and/or Vice Chair of the Finance and Audit Committee will be notified
immediately. The assets may be moved into the portfolio(s) of one of the
University’s other investment managers or held in cash by the University.

e. Take action as appropriate in support of shareholder resolutions related to human
rights violations in Burma. This delegation will remain in effect until November