**REVIEW OF DIVERSIFIED INVESTMENT POOLS**

**Recommended Action:** Receive this report and an oral report by Regent University Treasury staff.

**Executive Summary:** In accordance with Board of Regents policies, investment performance is presented quarterly by Wilshire Consulting, the investment advisor to the Board of Regents. This report highlights the continuous due diligence by the three Regent Universities and Wilshire in evaluating, testing, and validating the potential return and risk of the Diversified Operating Pool since its inception in 2009.

The Universities will present a three year assessment of the Diversified Operating Pool which was initiated at the University of Iowa in late February, 2009, and was subsequently utilized by Iowa State University and the University of Northern Iowa. Likewise, a review and assessment will be presented on the Diversified Intermediate Pool used at the University of Iowa.

**Background:**
In September of 2008, the Board approved a diversified operating funds investment option and the use of Vanguard Index Funds. A breakout of the component investments is depicted below. This alternative provided increased return potential with a similar level of risk to the Merrill Lynch 1-3 Year Government/Corporate Index – the benchmark for the externally managed operating funds.

**Diversified Operating Pool**

The diversified pool option also provided increased return potential for intermediate pool investments, with a similar level of risk as compared to the Lehman Aggregate (now Barclay’s Aggregate) - the benchmark for the externally managed quasi-endowment which has a longer time horizon than for operating funds. A breakout of the component investments is depicted below.
In February 2009, the University of Iowa began funding the diversified strategy, and in 2010 both Iowa State University and the University of Northern Iowa invested operating funds in the Diversified Operating Pool multi-asset investment strategy. All three universities have now utilized the Diversified Operating Pool for several years. Details of the development of the investment option, the extensive analyses by Wilshire Consulting, and the on-going due diligence by the institutions will be presented to the Board.

Since 1996, the Regent Universities invested operating funds to some degree with external fund managers. These funds were actively managed and each institution maintained a separately managed account but the accounts were aggregated for calculating lower manager fees. These accounts were short bond funds and were benchmarked to the Merrill Lynch 1-3 Year Government/Corporate Index.

The investigation of an alternative investment option for operating funds began as early as 2006, and in 2007 Wilshire presented a preliminary recommendation of a diversified portfolio that provided the potential of increased returns with similar level of risk to short bond funds.

In early 2008, the University of Iowa worked closely with Wilshire and consulted with its campus Investment Advisory Committee that includes faculty from the Tippie College of Business and the College of Law. Stress testing of annual, quarterly, and monthly returns was extended as far back as 1926, and also focused on the turbulent market period from 1973-1982. The University of Iowa also consulted with current and past business partners to independently evaluate the risk and return projections. Thereafter, an inter-institutional effort was launched to further review details of the Diversified Operating Pool proposal, consider investment policy implications, and to plan for the implementation of the investment strategy.

The Board of Regents approved the Diversified Operating Investment Option in 2008, but the University of Iowa waited until late February, 2009 to begin funding the strategy. Annualized returns for the current 3 plus years are presented here with comparative benchmark results for the same period through FY 2012. The current 3 year annualized return of 7.1% exceeds the return of the short bond benchmark by over 3%, and was comparable to the longer, core bond benchmark performance of 6.9% for the same 3 year period.
Annualized Return for Fiscal Year 2010-2012

7.1%  Diversified Operating Pool

Benchmarks:
3.7%  Short Bond – Merrill Lynch 1-3 YR Government/Corporate Index
6.9%  Core Bond – Barclay’s Aggregate (formerly Lehman Aggregate) Index

In 2010 Iowa State University created and began funding its Diversified Operating Pool. That year the University of Northern Iowa began participating in the University of Iowa’s Diversified Operating Pool. In 2010 a broader application of the Diversified Pool approach was evaluated, and in 2011 the Board of Regents approved a recommendation by Wilshire and the University of Iowa to establish an Intermediate Diversified Pool. The University of Iowa initially funded the Intermediate Diversified Pool in June 2011. Validation of the risk and return projections is on-going, and both diversified pools were stress tested again in 2012 for inflation considerations, but no asset allocation modifications were made as a result of these analytics.

Current risk/return analysis provided by Wilshire is abstracted in the table below.

The diversified pools have been highly successful thus far. However, the Universities intend to work together and with Wilshire using over 3 years of experience with this investment model to reassess it fully and to bring to the Board’s Audit/Compliance and Investment Committee any recommended changes.