BOARD OF REGENTS
INVESTMENT COMMITTEE

September 14, 2004

Persons in attendance:

Committee members: David Neil (Chair), Mary Ellen Becker, Owen Newlin, Jenny Rokes.

Others: Robert Downer, Sue Nieland, Pam Elliott, Tom Evans, Deb Hendrickson, Joan Racki, Carolyn Farlow, Marcia Brunson, Andrea Anania, Barb Briggle, David Skorton, Doug True, Cynthia Bartels, Kevin Ward, Richard Saunders, Carol Senneff, Joan Thompson, Robert Koob, Tom Schellhardt, Gary Shontz, Luann Woodward, Ed Bittle, Mark Brubaker.

Regent Neil called the meeting to order at 1:32 p.m.

Minutes from June 15, 2004, Committee Meeting

MOTION: Regent Rokes moved to approve the minutes of the June 15, 2004, Investment Committee meeting. Regent Newlin seconded the motion. MOTION CARRIED UNANIMOUSLY.

Investment and Cash Management Report for the Quarter Ended June 30, 2004

Director Elliott reviewed information contained within the executive summary for this agenda item, as follows:

Combined Portfolios

- As of June 30, 2004, the Regent combined operating and endowment portfolios totaled $1.3 billion. The market value of the combined operating portfolios, as reported by the Regent institutions, totaled $913.1 million as of June 30, 2004, and represented a point in time during operations.

Operating Portfolios

- The internally-managed restricted operating portfolios and the two external fund managers all outperformed the Merrill Lynch 1-3 year Government/Corporate Index rate of –1.13%.

Endowment Portfolios

- Wilshire Associates, the Board's investment advisor, prepared the summary report on the endowment/quasi-endowment portfolio, which totaled $398.2 million for the quarter. The University of Iowa (excluding the quasi-endowment) and Iowa State University endowment portfolios totaled $189.8 million and $117.1 million, respectively, as of June 30, 2004. The combined investment managers' returns for the quarter were –0.02% for the University of Iowa and 0.06% for Iowa State University, while the blended asset allocation benchmark posted returns of 0.13%. The University of Iowa quasi-endowment totaled $91.3 million and returned –2.3% for the quarter ended June 30, 2004, which slightly outperformed the benchmark of –2.4%.

- The ISU 1993 Trust, which had been separately invested, was combined with the Iowa State University endowment on March 31, 2004, to reduce administrative costs. The University still maintains the Trust's separate identity within its endowment portfolio.

- Wilshire reported that, for the quarter, Vanguard's net returns equaled its benchmark, Seneca's net returns underperformed its benchmark, LSV Asset Management's net returns outperformed its benchmark, Reams' net returns underperformed its benchmark, Dodge and Cox outperformed its benchmark, as did the Grantham, Mayo Foreign Fund.

Mr. Brubaker of Wilshire Associates, the Board's investment advisor, presented a summary of the quarterly investment and cash management report. With regard to the market review, he commented on the data in the table entitled "Major Asset Class Returns" and provided a current market update through the previous day. He noted that the fixed income and equity long-term numbers were good.

Regent Newlin asked if the Regents' asset mix was the right mix. Mr. Brubaker responded that, at a high level, the 70/30 mix is appropriate for an endowment fund. The 70/30 mix ranges on the conservative side of average among the Regents' peers. Fixed income allocation is about 25 percent on average. He said the peers, on average, have a broader diversification across asset classes and a larger international equity exposure. Therefore, the Regents' equity/fixed income split is an appropriate mix based on the number of asset classes. He noted that many of the peers have diversified more into non-traditional asset classes.

Mr. Brubaker next reviewed the domestic equity markets including the returns of the various asset classes over periods of time ranging from the most recent quarter to the last 10 years.

Regent Neil asked about the returns of the various asset classes over a 20-year period. Mr. Brubaker responded that small cap stocks have outperformed large cap stocks by a slight margin in the most recent 20 years. Value to growth has been roughly equivalent.

Mr. Brubaker next reviewed fixed income data and international equity markets. During the quarter, the Federal Reserve raised its rate which resulted in bond prices being driven lower throughout the quarter. Global equity market returns were mixed as the non-U.S. market was down -0.90%.

Mr. Brubaker reviewed the total fund results for each of the portfolios. He noted that the beginning market value had changed from the last quarter due to Wells Fargo's revision of Reams' market value which it had recorded incorrectly. He stated that the University of Iowa's returns were 2.7% behind the benchmark for the three years, primarily because of Seneca's eight consecutive quarters of underperformance. Seneca has a value and large cap bias relative to the benchmark which should have helped its performance significantly.

Mr. Brubaker presented Wilshire Associates' recommendation to select an alternative fund manager for Seneca. Reasons for doing so include the fact that Seneca has not recovered while it has been maintained "on watch". It would also be desirable to change to a more pure small- to mid-cap growth manager and one that would plot on the style map more closely with the Russell 2500 growth index. Mr. Brubaker stated that doing so would provide more opportunity to add value.

Regent Neil recommended that a couple of firms be interviewed and that staff determine the timeframe in which to do so. Regent Newlin suggested that three firms be interviewed.

Mr. Brubaker reviewed the returns for the other asset class categories. He stated that both Dodge and Cox Income Fund and Reams Asset Management are ahead of the index from inception to date. He also reviewed the data on international equity returns.

Mr. Brubaker referred to discussion at last summer's Investment Committee meeting during which the Committee members questioned how Wilshire's performance should be evaluated. He stated there are three major activities of Wilshire that drive the portfolios' performance. First, Wilshire assists in the selection of the optimal asset mix. Second, Wilshire assists in the development of the investment structure. Third, there should be clearly-stated goals for each asset class. He suggested that the Committee review Wilshire's performance annually.

Regent Neil responded that the Committee's work plan included an annual performance review of the investment advisor in December.

Mr. Brubaker continued with the report on total fund results by reporting on the University of Iowa's quasi-endowment. The data was presented both as gross and net of fees. He noted that there should have been a "N/A" for gross of fees in the report on Dodge and Cox. Regent Neil suggested that such a footnote be included in the next report. He asked that similar footnotes be included on the fund results pages for the University of Iowa and Iowa State University endowments.

Regent Neil asked that the Committee act on Mr. Brubaker's recommendation to replace Seneca, stating that he would entertain a motion to look at three "winning" firms.

MOTION: Regent Becker moved to adopt Wilshire Associates' recommendation to seek an alternative for Seneca by interviewing three "winning" firms. Regent Newlin seconded the motion. MOTION CARRIED UNANIMOUSLY.

Proposed Changes for Domestic Equity Fund Managers and Manager Allocations

Mr. Brubaker reviewed the activities that had culminated in the interview of four firms for consideration as large capitalization fund managers. The unanimous recommendation was to select two active large capitalization domestic equity fund managers with differing investment philosophies: Goldman Sachs Asset Management and Lotsoff Capital Management. Each manager would be allocated an equal share of the large capitalization component of the endowment portfolios to optimize returns and limit risk. To implement this recommendation, the relationship with Vanguard, an index fund manager with a passive investment philosophy, would need to be terminated. The Board's policy on manager allocations would need to be modified. The transition of funds to the new managers would take place as soon as practical after Board approval.

An issue left open after the interview was Goldman Sachs' fees. The firm had offered a 10% discount which brings its fees into the area of high 30 basis points. Lotsoff's fee, as originally proposed, was 35 basis points. Mr. Brubaker stated that both of those fees are on the very low side for an account of the Regents' size.

Regent Neil stated that a selection committee composed of members of the Investment Committee and representatives of the institutions had interviewed the four managers and recommended the hiring of these two managers to handle approximately $140 million which would be split 50/50.

Director Elliott stated the recommendation included terminating the relationship with Vanguard and necessitated a change in Board policy, all of which were included in the recommended action.

MOTION: Regent Newlin moved to recommend the Board approve, for the institutional endowment portfolios: (1) Selection of Goldman Sachs Asset Management as the new large capitalization domestic equity fund manager with an enhanced index philosophy. (2) Selection of Lotsoff Capital Management as the large capitalization domestic equity fund manager with an active, fundamental, bottom-up philosophy. (3) Termination of Vanguard, the Board's current large capitalization index fund manager. (4) Immediate modification to the manager allocation section of the Board's investment policy. (5) Continue with Seneca until a new manager is selected. Regent Becker seconded the motion. MOTION CARRIED UNANIMOUSLY.

Modifications in Banking and Broker Relationships

Director Elliott explained the proposed recommended action.

MOTION: Regent Rokes moved to recommend the Board approve (1) An increase in the maximum deposit for Iowa State University at Bankers Trust – Des Moines from $75 million to $100 million. (2) The list of financial institutions, subject to the limitations specified as to purpose and maximum amount. (3) The list of brokers, as presented. Regent Becker seconded the motion. MOTION CARRIED UNANIMOUSLY.

Meeting adjourned at 2:13 p.m.

Pamela Elliott, Director of Business & Finance

Gregory S. Nichols, Executive Director

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