

Contact: Patrice Sayre

FUND MANAGER ISSUES

Action Requested: Receive the report on issues affecting a Regents external fund manager and recommend that the Board transition from Goldman Sachs as manager of large cap core domestic equities to an institutional index fund managed by Vanguard.

Executive Summary: In accordance with the Board's investment policy, qualitative issues related to external investment fund managers are to be monitored by the investment advisor, Wilshire Associates, and reported to the Board.

Goldman Sachs

In March 2005, Goldman Sachs was hired to manage large cap equities. Approximately 50% of domestic equity assets are invested in the manager's Structured Large-Cap strategy. Since inception, Goldman has underperformed the S&P 500 Index benchmark. Nearing the three year anniversary of the investment mandate, it is unlikely a turnaround is imminent. The exact reasons for the troubles experienced by quantitative managers such as Goldman are not unanimously agreed upon – though many believe fallout from plummeting sub-prime mortgage-related investments contributed.

Wilshire Associates recommends termination of Goldman as manager of large cap core equities.

Following an analysis of S&P 500 index fund alternatives, Wilshire recommends moving assets currently managed by Goldman Sachs to an institutional index fund managed by Vanguard.

Goldman holds approximately \$55 million for the University of Iowa and \$30 million for Iowa State University.



TO: Board of Regents, State of Iowa
FROM: Wilshire Associates (“Wilshire”)
SUBJECT: Goldman Sachs Recommendation
DATE: January 11, 2008

Background

The purpose of this memorandum is to recommend termination of Goldman Sachs (“Goldman”) as manager of large cap core domestic equities within portfolios of University of Iowa and Iowa State University.

Goldman was hired to manage large cap equities with the first full quarter of performance beginning on March 31, 2005. Approximately 50% of domestic equity assets are invested in the manager’s Structured Large-Cap strategy. The strategy’s investment approach is quantitative in nature, utilizing six “CORE” fundamental themes as the primary investment criteria to build an actively managed portfolio.¹ The resulting portfolio is risk-controlled in nature with specific tracking error targets and with no major sector bets. Stock selection is expected to be the primary source of value added versus the S&P 500 Index.

Summary and Discussion

As of September 30, 2007, Goldman produced the following investment performance results:

	<u>QTR</u>	<u>1 Year</u>	<u>Since 3/31/05</u>
University of Iowa	-0.2%	11.6%	12.4%
Iowa State University	-0.5	10.3	11.6
S&P 500 Index	2.1	16.5	12.9

Weak stock selection in late 2006 and early 2007 was further compounded in the third quarter of 2007 as quantitative approaches such as Goldman’s struggled to keep pace with their passive benchmarks. The exact reasons for the troubles experienced by quantitative managers in this time period are not unanimously agreed upon. Many believe that fallout from plummeting sub-prime mortgage related investments held by highly leveraged hedge funds contributed to a sell-off of more liquid investments – equities. Other factors also contributed to the situation.

In recent periods, Goldman’s structured process, which it utilizes to manage equities in large-, mid, and small cap styles, produced disappointing results. Goldman continues to work to enhance their investment approach through rigorous research initiatives. They are also concurrently pursuing organizational changes with the hopes of improving investment performance. These changes include integration of the Quantitative Equity (equity) and

¹ CORE is an acronym for *computer-optimized, research-enhanced*. The investment themes within Goldman’s stock selection model include earnings quality, momentum, valuation, profitability, analyst sentiment, and management impact.

Quantitative Strategies (macro/fixed income) teams of GSAM's Quantitative Investment Strategies (QIS) Group.²

Recommendation

Wilshire recommends termination of Goldman as manager of large cap core equities. The product strategy utilized has failed to produce excess returns relative to the S&P 500 Index. Nearing the three year anniversary of the investment mandate, it is unlikely a turnaround is imminent. Further, changes within the organization as well as those associated with the investment approach are clear indicators that the process may have shortcomings such that it cannot produce similar results to those observed when Goldman was hired. It is uncertain whether the strategy in current form will be viable in future market environments.

Following an analysis of S&P 500 index fund alternatives, Wilshire recommends moving assets currently managed by Goldman Sachs to an institutional index fund managed by Vanguard. Doing so reduces the level of exposure to active management within large cap domestic equities, an area where empirical evidence demonstrates the challenges for active managers to consistently generate high levels of excess returns. Wilshire worked collaboratively with investment staff at the universities to arrive at this selection. The process considered several factors including investment vehicle and fees, tracking error, organizational quality, and other important factors. Vanguard offers an S&P 500 Index mutual fund that is competitive in all relevant aspects. If approved by the Board of Regents, Wilshire will continue to work with staff at the universities to efficiently transition assets as described herein.

² GSAM is an acronym for Goldman Sachs Asset Management.