MINUTES
UNIVERSITY OF HOUSTON SYSTEM
BOARD OF REGENTS
ENDOWMENT MANAGEMENT COMMITTEE

Tuesday, November 15, 2011 - The members of Endowment Management Committee of the University of Houston System convened at 1:42 p.m. on Tuesday, November 15, 2011, at the Hilton University of Houston Hotel, Waldorf Astoria Ballroom E, Second Floor, Houston, Texas, with the following members participating:

ATTENDANCE –

Present	Member(s) Absent
Mica Mosbacher, Chair	Jacob M. Monty, Member
Jarvis V. Hollingsworth, Vice Chair	Jim P. Wise, Advisory Member
Nelda Luce Blair, Ex Officio	
Carroll Robertson Ray, Advisory Member	Non-Member(s) Present
	Spencer D. Armour III, Regent
	Roger F. Welder, Regent
	Welcome W. Wilson, Jr., Regent

In accordance with a notice being timely posted with the Secretary of State and there being a quorum present, the Chair of the Committee, Mica Mosbacher, called the meeting to order and asked Dr. Carlucci to report some exciting news to the board.

Dr. Carlucci noted that the NACUBO Common Fund Study of Endowments (the annual survey and report completed by the National Association of College and University Business Officers and the Common Fund) monitor university endowments. Their report for 2011showed the University of Houston had a weighted return of 20.4%, which beats the 19.8% average for all funds. Dr. Carlucci congratulated the Board and Cambridge Associates for their efforts over the past year on this accomplishment.

After this announcement, Regent Mosbacher continued with the meeting. The first item requiring committee approval was the approval of the minutes from the Endowment Management Committee meeting held on Tuesday, August 16, 2011.

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AGENDA ITEMS

Action Items

1. Approval of Minutes – Item B

   On motion of Regent Hollingsworth, seconded by Regent Blair and by a unanimous vote of

   the committee members in attendance, the following minutes from the meeting listed below were approved:

- August 16, 2011, Endowment Management Committee Meeting

Regent Mosbacher noted there were three (3) additional items on the agenda and introduced the next item to the committee.

2. <u>Introduction of New Advisory Members – University of Houston System, Item C – EM-C1</u>

   Dr. Carl Carlucci, Executive Vice Chancellor/Vice President for Administration and Finance presented this item. In accordance with Section 5.2.4 of the Board Bylaws, Dr. Carlucci stated the Endowment Management Committee, along with the unanimous approval of the Chair of the Board, Nelda Luce Blair and the Chancellor, Renu Khator, appointed two new advisory members to the Endowment Management Committee: Carroll Robertson Ray and Jim P. Wise. Both individuals were appointed to a one-year term effective September 1, 2011 through August 31, 2012 and may be reappointed each year for up to three (3) consecutive years. They may serve again after one (1) off year. Advisory members do not have voting authority. These two individuals replace the two outgoing advisory members, Michael J. Cemo and J. Christopher Jones whose terms ended August 31, 2011.

   This item was for information only and required no further committee action.

3. <u>Request for approval to liquidate the Les Dames D'Escoffier Endowment and transfer the proceeds to the University of Houston Foundation – University of Houston System, Item D – EM-D2</u>

   Regent Mosbacher stated she had discussed this item with Dr. Carlucci and requested he investigate and confirm that the terms, conditions and intent of the endowment were preserved. In accordance with UH System policy 3.F.02, Section 3.15, Mr. Eli Ciprano, Associate Vice Chancellor for University Advancement met with Mr. John Schultz, Associate Dean of the College of Hotel and Restaurant Management, who had contacted the donor regarding the criteria governing this endowment. It was reported the current value of the endowment was $147,000 and was specifically directed at funding scholarships for female students going into hotel and beverage. Dr. Carlucci stated that due to the fact that the endowment had the gender restriction, it was not appropriate to be in the state-managed endowment.

   Mr. Ciprano spoke to Terrylin Neale, Director of the UH Foundation regarding this request and Ms. Neale did agree that our intent and recommendation to transfer this from our endowment to the UH Foundation was appropriate.

   On motion of Regent Hollingsworth, seconded by Regent Blair and by a unanimous vote of the committee members in attendance, the request for approval to liquidate the Les Dames D'Escoffier Endowment and transfer the proceeds to the UH Foundation was approved.

   After committee approval of this item, Regent Mosbacher called for a motion to place this item on the Consent Docket Agenda for the November 16, 2011 Board of Regents meeting for final board approval. On motion of Regent Hollingsworth, seconded by Regent Blair and by a unanimous vote of the committee members in attendance, this item was approved and will be placed on the Consent Docket Agenda for final board approval.

<u>Information/Approval Items</u>

4. <u>Report and Recommendations from Cambridge Associates Regarding Endowed and Non-Endowed Assets – University of Houston System, Item E – EM-E3</u>

Regent Mosbacher asked Hamilton Lee, from Cambridge Associates, to brief the committee on the performance of the endowed and non-endowed assets since the Endowment Management Committee's last meeting held on August 16, 2011.

Below is an executive summary of Mr. Lee's remarks:

Mr. Lee's discussion points highlighted the third quarter 2011 performance of the Endowment and included a market commentary. Global equity markets plunged 16.6% in the third quarter as the S&P 500 declined 14%. Large-to mega-cap stocks outperformed small-caps by over 700 basis points as investors sought safety in higher quality investments. International equities ended the quarter down 19% due, in part, to the renewed fears of European defaults (more specifically, Greece) and potential contagion risks to the global financial system. After sustaining a rapid correction in early August on the heels of sovereign debt and economic concerns, global equity markets, and higher beta assets in particular, have remained extremely volatile. While continued volatility and uncertainty will likely persist, Cambridge believes equity valuations are quite reasonable, suggesting favorable intermediate-to long-term portfolio return prospects.

The University of Houston's Endowment returned -9.0% in the third quarter, outperforming both the Implementation and Dynamic Benchmarks by 100 bps. While shorter term performance has been disappointing in absolute terms, the portfolio has pulled ahead of both benchmarks over the trailing 3-years, gaining 2.5% versus 1.8% and 1.9% for the Implementation and Dynamic benchmarks, respectively.

In 2009, the Endowment Management Committee approved the creation of a dedicated non-marketable alternatives ("private investments") program with a long-term target allocation of 10%. In recognition of the fact that building such a program takes time, an interim target asset allocation was created and approved in order to reflect the temporary underweight to private investments and corresponding over-weights to other asset classes. Since that time, the University's private investment program has grown to represent over 4% of total Endowment assets.

Due to the advances made in the University's direct private investments program, Cambridge recommended adjusting the interim asset allocation targets to reflect a larger allocation to private investments from 2.0% to 5.0%, sourced from a reduction in the University's target interim investments to U.S. equity, inflation hedging, fixed income, and cash accordingly. This adjustment would allow for more accurate benchmarking of the total portfolio.

On motion of Regent Hollingsworth, seconded by Regent Blair and by a unanimous vote of the committee members in attendance, the recommendation to increase the interim private investments allocation from 2.0% to 5.0% was approved. This action, approved by the committee, requires no further board action.

For the benefit of the new committee members, Chair Mosbacher requested Mr. Lee brief the committee on the Watch List criteria objectives and performance-related issues. Mr. Lee stated the purpose of the Watch list was to highlight managers whose ability to generate long-term excess return was in question because of demonstrated performance deficiencies or changes that may jeopardize the manager's ability to outperform the market. Placing these managers on the Watch List facilitates closer monitoring and allows the committee to address on a regular basis whether they should remain in the portfolio. The Watch List lists the manager(s), the reason they were placed on the list, benchmark, a comment/update section, recommended action, portfolio inception, and the date they were placed on the list.

Mr. Lee addressed the current Watch List and made note that the only action item on the Watch List was Silchester International Value. One of the criteria for manager inclusion was that any short-term underperformance by a manager by more than 350 basis points be added to the list. Silchester International Value did underperform one quarter but in the long run they have generated a multiple return of the index because of their ability to reserve capital. Cambridge recommended they be removed from the Watch List.

Mr. Jeff Blazek, from Cambridge Associates, presented the committee an overview of the current market. Below is a brief summary of his remarks:

- Market Returns - very difficult quarter for stocks; bonds are now only asset class in black for year;
- Stocks/credit were very weak, while flight to quality drove down Treasury yields;
- Equities by County and U.S. Sector were addressed with defensive countries and sectors significantly outperformed year-to-date;
- Lower quality lagged in third quarter; smaller, lower ROE, and lower dividend stocks underperformed;
- Economic headwinds: ECRI index hints at recession risks; Fed expected to stand pat for a long while;
- Economic concerns overseas: indicators tied to emerging and "growth" economies are also showing weakness;
- Dire situation in Greece; market already appears to price in default; Greek economy remained troubled;
- Sovereign risk hitting European banks; European banks have sold off significantly, and CDS has spiked;
- More than half of S&P now out-yields Treasuries; Europe even more divergent;
- Equity risk premium - relative earnings yield of U.S. stocks now higher than level in 2008-2009.

Mr. Blazek also addressed the liquid assets portfolio recommendation proposed by Cambridge. The University's current investment policy guidelines dictate that the University's investment in a given financial product may not exceed 10% of that product's total assets. Cambridge believes this represents best practice for any portfolio.

The non-endowed portfolio investment in Invesco's STIC Prime Portfolio exceeds this 10% threshold. As such, Cambridge recommended transferring 25% of the current cash allocation held in the Non-Endowed Portfolio's STIC Prime Portfolio (current 10.2% of Invesco's STIC Prime Portfolio holdings) to Invesco's Liquid Assets Portfolio. These two funds have similar objectives, liquidity, and expected return, but are managed separately.

On motion of Regent Hollingsworth, seconded by Regent Blair and by a unanimous vote of the committee members in attendance, the recommendation to transfer 25% of the current cash allocation held in Invesco's STIC Prime Portfolio to its Liquid Assets Portfolio was approved. This action, approved by the committee, requires no further board action.

Mr. Lee reviewed the implementation schedule with the committee and discussed Cambridge Associates' recommendation for raising cash for the Endowment's annual payout to the universities, totaling $16.5 million. Mr. Lee stated this is a beneficial way to rebalance the portfolio, and Cambridge Associates recommended that the funds be raised from a reduction in the Laddered Treasuries and Cash allocations. Below is the breakdown of the recommended transaction:

- $10 million from Laddered Treasuries and
- $6.5 million from cash.

On motion of Regent Hollingsworth, seconded by Regent Blair and by a unanimous vote of the committee members in attendance, the recommendation to withdraw $16.5 million for use in endowment payout to the universities was approved. This action, approved by the committee, requires no further board action.

Gene Lohmeyer, from Cambridge Associated, updated the committee on the Hedge Fund Program. Below is a brief summary of Mr. Lohmeyer's remarks.

- As of September 30, 2011, the University of Houston's Hedge Fund Program was valued at $121.4 million or 25.1% of the portfolio;
- The program is currently comprised of seventeen (17) hedge funds, including eight (8) hedged equity and nine (9) absolute managers;
- Among the University's hedged equity managers, returns ranged from 2.2% to -18.9% during the third quarter;
  - Exposure to economically sensitive industry sectors was the predominant factor driving absolute and relative returns, as the S&P 500 sub-sectors for financials, industrials, energy, and materials each declined more than 20% for the quarter.
  - In addition to industry sector and overall net exposure positioning, geography and market capitalization had a major impact on manager level results during third quarter.
  - Top performers were Coatue (2.2%) and PFM (-0.8%) which benefited from a combination of tactical defensive positioning, strong stock selection, and exposure to the information technology sector, which suffered approximately half of the losses of broad equity markets during the quarter.
  - Maverick (-18.9%) was a negative outlier during third quarter, as the fund suffered the second worst quarterly loss in its history.
- Among the University's absolute return managers, returns ranged from 0.7% to -11.2% during the third quarter;

- Top performing absolute return manager, Mason, benefited from short exposure to European sovereign credit and financial sector holdings while suffering modest losses on the long side of their portfolio.
- HBK (-0.6%) and Och Ziff (-3.5%) provided strong relative returns, largely due to their use of multiple layers of hedges and long volatility trades. Davidson Kempner (-3.7%) also protected capital reasonably well, thanks in part to a tactical shift away from financial sector holdings and a larger than normal cash position.
- Those managers with long-biased event-driven equity and distressed credit exposure were the worst performers on the absolute return side of the hedge fund portfolio during the third quarter. Specific examples include York (-11.2%), Taconic (-7.5%) and Whippoorwill (-7.2%).

Listed below were the Hedge Fund Program objectives addressed by Mr. Lohmeyer:

- Return of T Bills +4% over the course of a full market cycle.
- Beta less than 0.4 vs. broad equity markets throughout a full market cycle.
- Volatility (as measure by standard deviation) less than ½ of that of broad equity markets.

While these are long-term (3 to 5 year) goals, short-term results may vary substantially from long-term expectations. Over shorter time periods, the Hedge Fund Research Inc. (HFRI) Funds-of-Funds Index may be utilized as a comparative performance measure.

There being no further business to come before the Committee, the meeting adjourned at 3:29 p.m.

All documentation submitted to the Committee in support of the foregoing action items, including but not limited to "Passed" agenda items and supporting documentation presented to the Committee, is incorporated herein and made a part of these minutes for all purposes; however, this does not constitute a waiver of any privileges contained herein.

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Others Present:

Renu Khator	Hamilton Lee	Gene Lohmeyer
Carl Carlucci	Jeff Blazek	Tom Ehardt
Dona Cornell	Raymond Bartlett	Eli Ciprano
Rathindra Bose	Barbara Stanley	Pam Muscarello
Ed Jones	Jon Aldrich	Marquette Hobbs
Gerry Mathisen		