

INVESTMENT POLICY FOR ENDOWMENT FUND

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140.011 INVESTMENT POLICY FOR ENDOWMENT FUND

A. INTRODUCTION

The University's Endowment Fund includes all gifts, bequests and other funds directed to be used to support a University program in perpetuity. Some donors require such a commitment as a condition of their gift. (These donations are referred to as "true endowments.") Also, funds may be assigned to function as endowments by the Board of Curators or by University administration. (These funds are referred to as "quasi endowments.") Examples of activities supported by true and quasi endowments include:

- chairs, professorships, and lectureships
- scholarships
- research support
- unrestricted use

This Investment Policy is established to provide direction for the investment and management of the endowment assets.

B. RESPONSIBILITIES AND AUTHORITIES

The Board of Curators of the University of Missouri bears the ultimate responsibility for the management and oversight of endowment assets. The Board has delegated implementation of the Board's policies to the President of the University. The University officials with operating and supervisory responsibilities are the Vice President for Finance and Administration and the Treasurer.

C. OBJECTIVES

The primary objective of the management of the endowment assets is to ensure that the endowment fund supports continually the purposes established by the Board in conformance with donor stipulations. It is the objective of the University to achieve investment results over time that will i) support the purposes for which the endowment was established and ii) maintain the purchasing power of the endowment. In pursuing these objectives, compliance will be maintained with the fiduciary duties applicable to investments set forth in Section 105.688 of the Revised Statutes of Missouri, as the same may be amended from time to time.

D. DEVELOPMENT OF INVESTMENT PHILOSOPHY AND STRATEGY

1. Spending Limits

The University Endowment Fund must be managed to provide ongoing support of endowed programs for perpetuity. The investment implication: a prudent approach to spending and reinvestment, using a spending formula, is necessary to provide protection against inflation over time. The spending formula to be used distributes annually 5% of a trailing 12-quarter average of the endowment's total market value, with the understanding that this spending rate over the long-term will not exceed total real return (return net of inflation) from investments.

To achieve some uniformity in amounts to spend from one year to the next, the actual amount available to spend in any given year will not exceed 106% of the prior year's expenditure, or be less than 96% of the prior year's expenditure.

2. Asset Mix

Simulations were done using various inflation scenarios and asset mixes, resulting in a broad spectrum of investment risk and return. The implication: the probability of meeting long-term real return targets is higher through a diversified portfolio with heavier equity exposure; increased real spending from the endowment is more likely with a heavier equity emphasis; and, over time, there is a slightly higher probability of shortfall from real return targets with a heavier equity exposure. The simulations show the importance of maintaining a long-term orientation to investment of the assets.

It is concluded that the University should have a substantial commitment to equities. Investment sectors include (but are not limited to) U.S. domestic stocks, foreign stocks, real estate, and private equities. The role of fixed income investments is to provide cash flow and diversify exposure. The role of hedge funds is to provide a positive real return over the return on U.S. Treasuries.

E. INVESTMENT SECTORS

1. Asset sectors were analyzed with regard to long-term expected rates of return, volatility and correlations among asset sectors. As a result, approved investment sectors include:

- a. U.S. equity
- b. International equity
- c. Emerging markets equity
- d. Alternative investments
- e. Real estate
- f. Global fixed income

2. Each sector's assets will be invested by professional managers. Sector strategies and managers will be structured to enhance the probability of meeting the fund's objectives.
3. Diversification will be maintained both between and within sectors.
4. The attached individual sector guidelines (and, within the sector guidelines, individual manager guidelines) are incorporated as part of this Statement of Investment Policy (See Attachments A, B, C, D, E, and F).

F. TARGET ASSET MIX

1. On the basis of a long-term orientation, the asset mix is as follows:

Sectors	Target Asset Mix	Allowable Range
U.S. equity	42.5%	37.5-47.5%
International equity	20%	15-25%
Emerging markets equity	5%	0-10%
Alternative investments	5%	0-10%
Real estate	5%	0-10%
Global fixed income	22.5%	17.5-27.5%

2. Short-term changes in market behavior may result in variations from the target within the allowable range. The portfolio will be monitored on an ongoing basis. Rebalancing will take place at least annually, and more often if necessary to maintain allocations within the allowable range.

G. FIXED INCOME POOL

In addition to the University's main endowment fund, there is a fixed income fund, called the Fixed Income Pool, which, due to donor restrictions, can only be invested in fixed income securities. The spending policy of the pool is to distribute all income earned.

The pool shall have a medium term investment outlook in order to dampen the effect of changes in short-term rates. Investment sectors include (but are not limited to) fixed income securities issued by the United States government and its agencies, corporate fixed income, commercial paper, and repurchase agreements.

The assets of the Pool will be invested by professional managers within the University of Missouri's Treasurer's Office. The investment results will be measured on a quarterly basis and analyzed upon the completion of a full market cycle. Investment results will be compared against the Lehman Brothers Government/Credit Bond Index.

The investment objectives of the Pool are to provide a 2.75% premium over the rate of inflation over a full economic/market cycle and to counteract the effect of interest rate shifts on endowment distributions. On an annualized fee-adjusted basis the Pool is expected to deliver an excess of 0.50% over the risk benchmark return. The risk benchmark will be the Lehman Brothers Government/Credit Bond Index, which approximates the characteristics of the U.S. fixed income market. Fixed income securities must have a quality rating of "A" or better as determined by Standard and Poor's Rating Service.

H. SEPARATELY INVESTED ACCOUNTS

In addition to the University's main endowment fund, there are separately invested accounts for individual endowment funds which, due to donor restrictions, cannot be commingled for investment purposes.

I. MASTER CUSTODIAN

A master custodian shall be retained by the Fund to provide a variety of services, including, but not limited to: safekeeping of securities, collection of income and other inflows, disbursement for investment management fees, and a monthly accounting of all transactions.

J. SECURITIES LENDING

The Treasurer is authorized to implement a securities lending program. Securities participating in the program shall be fully collateralized and marked to the market daily.

K. PROXY VOTING

Proxy voting power is an asset of the Fund and is subject to the same management as all other Fund assets. Accordingly, the investment manager has the responsibility and liability for voting proxies appurtenant to the Fund-owned securities under its management. The voting of proxies must be done in a prudent manner and solely in the interest of the Fund.

L. CASH FLOWS

The Treasurer is responsible for identifying the sources and destinations of all cash flows consistent with this investment policy, including gifts, distributions and transfers.

M. BENCHMARKS

1. Market Cycles

The investment program is constructed to deliver a 4.69% premium above inflation over market cycles for all sectors. A market cycle is defined to include both a period of declining prices and a period of rising prices. Generally, a full cycle will include a "bear" leg of at least two calendar quarters. The duration of a complete cycle would be a minimum of 3 to 5 years, and possibly longer.

2. Active/Passive Management

a. Expecting that active management (security selection) will add value in excess of passive implementation (investment in a market index), all sector investments will be actively managed by professionals specialized in that sector. The results of their decisions will be measured on a quarterly basis and analyzed upon the completion of a full market cycle.

Investment results will be compared against a hybrid market index constructed as follows:

Sectors	
Russell 3000 equity index	45%
EAFE index	20%
IFC Investable Composite Index	5%
T-bills plus 5%	2.5%
Russell-NCREIF real estate index	5%
Salomon World Government bond index (50% hedged/50% unhedged)	22.5%

b. The Treasurer will monitor and report on a regular basis on the overall structure and results of the investment program and recommend changes as required to meet the established objectives.

INVESTMENT POLICY AS SET FORTH IN THIS STATEMENT WILL BE REVIEWED ANNUALLY AND POLICY AMENDMENTS WILL BE SUBMITTED TO THE BOARD OF CURATORS AS NECESSARY.

**SECTOR GUIDELINES - U.S. EQUITY
(Attachment A)**

A. INVESTMENT OBJECTIVE: to provide a **5.0% premium** over the inflation rate. The composite U.S. equity sector will be structured to give full exposure to the U.S. equity market, as measured by the Russell 3000 equity index.

B. IMPLEMENTATION:

Assets will be actively managed by professionals with proven track records.

C. DIVERSIFICATION BY STYLE:

To ensure diversification by style, a minimum of four separate managers will be employed, filling different and complementary strategies of equity investing. The composite U.S. equity portfolio will be compared to the market exposure of the Russell 3000 index, to ensure the absence of either under or over-exposure to particular style approaches.

D. FOREIGN ASSETS:

ADR's (dollar-denominated foreign securities) may be held in the portfolio, in those instances in which country allocation judgment has been demonstrated, and if expressly authorized in individual portfolio guidelines.

E. EXPOSURE TO THE EQUITY MARKET:

Unless specifically otherwise authorized in the individual manager guidelines, all portfolios are expected to remain fully invested, with average cash levels below 10%.

F. RISK BENCHMARK:

The Russell 3000 index has been selected as a proxy for the readily investable universe of U.S. domestic stock issues. The composite of all equity portfolios will be measured on a regular basis to keep characteristics in the composite in line with those of the Russell 3000 index.

G. RATE OF RETURN BENCHMARKS:

1. Over a full economic/market cycle, the U.S. equity sector is expected to deliver both a 5.0% premium over the inflation rate and, on an annualized and fee-adjusted basis, a 0.75% excess over the return of the Russell 3000 index.
2. Over shorter measurement periods, the U.S. equity sector is expected to deliver a fee-adjusted return equal to or better than the index return.

SECTOR GUIDELINES WILL BE REVIEWED AND REVISED AS NECESSARY IN CONJUNCTION WITH ANNUAL REVIEW OF INVESTMENT POLICY.

**SECTOR GUIDELINES - INTERNATIONAL EQUITY
(Attachment B)**

A. INVESTMENT OBJECTIVE: to provide a **5.8% premium** over the rate of inflation, and to provide diversification with U.S. equity investments to further enhance long-term real growth.

B. IMPLEMENTATION:

Assets will be actively managed by professionals with proven track records.

C. DIVERSIFICATION BY STYLE:

Managers of different and complementary styles shall be used to provide diversification.

D. U.S. ASSETS:

U.S. assets and ADR's (dollar-denominated foreign securities) may be held in the portfolio, in those instances in which country allocation judgment has been demonstrated, and if expressly authorized in individual portfolio guidelines. Unless specifically otherwise authorized in the individual manager guidelines, all portfolios are expected to remain fully invested, with average cash levels below 10%. Where cash is held pending investment, it may be held in foreign currency.

E. EXPOSURE TO CURRENCY EFFECT:

Each manager may hedge their currency exposures back to the U.S. dollar based on the manager's outlook and strategy at the time of the hedge. However, unless otherwise agreed to, the manager will be compared against an unhedged benchmark.

F. RISK BENCHMARK:

The MSCI EAFE (Europe, Australia and the Far East) equity index will be used as a proxy for the readily investable universe of foreign stock issues. The composite of all international equity portfolios will be measured on a regular basis to ensure that exposure characteristics in the composite are in line with those of the index.

G. RATE OF RETURN BENCHMARKS:

1. Measured over a long time period, such as five years or a full U.S. domestic economic/market cycle, the international equity sector is expected to deliver a 5.8% premium over inflation and, on an annualized fee-adjusted basis, a 1% excess over the return of the EAFE equity index.

2. Over shorter measurement periods, the international equity sector is expected to deliver a return equal to or better than the index return.

SECTOR GUIDELINES WILL BE REVIEWED AND REVISED AS NECESSARY IN CONJUNCTION WITH ANNUAL REVIEW OF INVESTMENT POLICY.

**SECTOR GUIDELINES - EMERGING MARKETS EQUITY
(Attachment C)**

A. INVESTMENT OBJECTIVE: To provide a **6.8% premium** over the rate of inflation, and to provide additional diversification with U.S. equity investment to further enhance long-term real growth.

B. IMPLEMENTATION:

Assets will be actively managed by professionals with proven track records.

C. DIVERSIFICATION BY STYLE:

Managers of different and complementary styles shall be used to provide diversification.

D. U.S. ASSETS:

U.S. assets and ADR's (dollar-denominated foreign securities) may be held in the portfolio, in those instances in which country allocation judgment has been demonstrated, and if expressly authorized in individual portfolio guidelines. Unless specifically otherwise authorized in the individual manager guidelines, all portfolios are expected to remain fully invested with average cash levels below 10%. Where cash is held pending investment, it may be held in foreign currency.

E. EXPOSURE TO CURRENCY EFFECT:

Each manager may hedge their currency exposures back to the U.S. dollar based on the manager's outlook and strategy at the time of the hedge. However, unless otherwise agreed to, the manager will be compared against an unhedged benchmark.

F. RISK BENCHMARK:

A standard IFCI Composite emerging markets equity index will be used as a proxy for the readily investable universe of emerging markets stock issues. The composite of all emerging markets equity portfolios will be measured on a regular basis to ensure that exposure characteristics in the composite are in line with those of the index.

G. RATE OF RETURN BENCHMARKS:

1. Measured over a longer time period such as five years or a full U.S. domestic economic/market cycle, the emerging markets equity sector is expected to deliver a 6.8% premium over inflation and, on an annualized fee-adjusted basis, 2%-4% excess over the return of a standard IFCI Composite equity index.
2. Over shorter measurement periods, the emerging markets equity sector is expected to deliver a return equal to or better than the index return.

SECTOR GUIDELINES WILL BE REVIEWED AND REVISED AS NECESSARY IN CONJUNCTION WITH ANNUAL REVIEW OF INVESTMENT POLICY.

SECTOR GUIDELINES - ALTERNATIVE INVESTMENTS
SUB-CLASS: HEDGE FUNDS
(Attachment D)

A. INVESTMENT OBJECTIVE: To provide a **5.0% premium** over the 3-month T-bill rate.

B. IMPLEMENTATION:

Assets will be actively managed by professionals with proven track records.

C. DIVERSIFICATION BY SUB-CLASS:

To ensure diversification within the alternative investments sector, sub-classes will be employed. 2.5% of the endowment fund portfolio will be allocated to hedge funds. Within the hedge funds sub-class a minimum of two separate managers will be employed filling different and complementary strategies of investing.

D. RISK BENCHMARK:

The U.S. Treasury Bill has been selected as a proxy for the readily investable universe of hedge funds. The composite of all hedge fund portfolios will be measured on a regular basis.

E. RATE OF RETURN BENCHMARKS:

Over a full economic/market cycle and on an annualized and fee adjusted basis, the hedge funds sub-class is expected to deliver a 5% premium over the 3-month T-bill rate.

SECTOR GUIDELINES WILL BE REVIEWED AND REVISED AS NECESSARY IN CONJUNCTION WITH ANNUAL REVIEW OF INVESTMENT POLICY.

**SECTOR GUIDELINES - REAL ESTATE
(Attachment E)**

A. INVESTMENT OBJECTIVE: To provide a **4.0% premium** over the rate of inflation.

B. IMPLEMENTATION:

Assets will be actively managed by professionals with proven track records.

C. RISK BENCHMARK:

The Russell-NCREIF real estate index, which approximates the characteristics of the real estate sector, has been selected as a proxy for the investable universe of real estate.

D. RATE OF RETURN BENCHMARKS:

Over a full economic/market cycle and on an annualized and fee adjusted basis, real estate investments are expected to deliver a 4.0% premium over the rate of inflation.

SECTOR GUIDELINES WILL BE REVIEWED AND REVISED AS NECESSARY IN CONJUNCTION WITH ANNUAL REVIEW OF INVESTMENT POLICY.

**SECTOR GUIDELINES - GLOBAL FIXED INCOME
(Attachment F)**

A. INVESTMENT OBJECTIVE: To provide a **3.25% premium** over the rate of inflation, to counteract the effect of interest rate shifts on endowment distributions and to provide additional diversification of total fund assets.

B. IMPLEMENTATION:

Assets will be actively managed by professionals with proven track records. U.S. fixed income securities must have a quality rating of "A" or better as determined by Standard and Poor's rating service.

C. RISK BENCHMARK:

The Salomon World Government Bond index, 50% hedged/50% unhedged, which approximates the characteristics of the global fixed income market, has been selected as a proxy for the readily investable universe of global fixed income securities.

D. RATE OF RETURN BENCHMARKS:

Over a full economic/market cycle, the global fixed income sector is expected to deliver on an annualized fee-adjusted basis, a 3.25% premium over the rate of inflation.

E. EXPOSURE TO CURRENCY EFFECT:

Each manager may hedge their currency exposures back to the U.S. dollar based on the manager's outlook and strategy at the time of the hedge. However, unless otherwise agreed to, the manager will be compared against an unhedged benchmark

F. ALLOCATIONS TO U.S./NON-U.S. BONDS:

Each manager has the ability to shift between U.S. and non-U.S. bonds. This will result in wide variations over time in the percentages held in U.S. versus non-U.S. bonds. It is expected that the allocation to U.S. bonds will vary between a low of 15% and a maximum of 60%. The allocation to non-U.S. bonds can be expected to fall between a band of 40% to 85%.

SECTOR GUIDELINES WILL BE REVIEWED AND REVISED AS NECESSARY IN CONJUNCTION WITH ANNUAL REVIEW OF INVESTMENT POLICY.

RESPONSIBILITIES

The Board of Curators delegates to the President of the University the following responsibilities:

1. Recommend to the Board policies to meet investment objectives for the Endowment Fund.
2. Implement and monitor investment policies.
3. Recommend custodians, investment managers, and consultants as needed for the management of the funds and report actions to the Board.
4. Evaluate and monitor custodians, investment managers, and consultants and report to the Board.
5. Report periodically to the Board on the status of the funds relative to the satisfaction of the investment objectives.
6. Monitor the effects of the spending policy and recommend modifications as appropriate.
7. Maintain accurate records for the Fund.

<http://www.umsystem.edu/uminfo/rules/financial/140011.htm>