

Contact: Patrice Sayre

NEW INVESTMENT ASSET ALLOCATION AND FUND MANAGER SELECTION

Action Requested: Consider recommending to the Board approval of the following:

- ♦ A diversified intermediate investment pool as an alternative to the 100% fixed income quasi endowment pool at the University of Iowa; and
- ♦ Use of State Street Index Funds as well as Vanguard Funds for diversified investment options.

Executive Summary: Regent Policy Manual §7.04C states that the Board, in consultation with the Investment Committee, shall approve investment policies, investment objectives, particular strategies, and asset allocations for institutional investment programs.

The University of Iowa requested Wilshire Consulting, the Board's investment advisor, to review the asset allocation of the quasi endowment pool and provide recommendations. Wilshire Consulting provided an extensive analysis of investment alternatives for the quasi endowment pool and recommended changes to more broadly diversify investments that include:

- ♦ The addition of new asset classes to the current 100% fixed income quasi investment pool that can be implemented substantially with low cost index fund vehicles. The new investment option would provide the capability of increased return potential with effective and enhanced management of overall risk.
- ♦ Use of low cost index fund vehicles to include State Street Global Advisors Index Funds in addition to the previously approved Vanguard Funds for implementing this new intermediate investment pool.

See the attached Program Review for Non-Endowment Portfolios for more detailed information.

Background: The University of Iowa established a fixed-income quasi endowment in February of 1998 when the Board approved a separate 100% fixed income quasi-endowment investment pool.

The pool was created to provide added flexibility for longer-duration asset investments including quasi endowments, which were longer-term in nature but had no externally-imposed restriction that the principal remain intact.

The 100% fixed-income investment pool provided the ability to reduce equity exposure to match the programmatic needs of selected funds. The benchmark for this fund has been the Barclays Aggregate Index (formerly the Lehman Aggregate.) Performance has been reported to the Board quarterly since inception.

RATIONALE FOR PROPOSED DIVERSIFIED INTERMEDIATE INVESTMENT POOL

Strategic asset allocation is the key to a successful investment program. It represents the best tool for meeting investment objectives, and provides a disciplined framework from which to diversify assets and control investment risk.

At the September 2008 meeting, the Board approved a revised and restructured investment policy which provided for the establishment of intermediate investment pools that considered time horizons and matched expected liabilities while seeking to obtain a reasonable return for a prudent level of risk.

The diversified intermediate investment option presented offers potential for incremental return while being mindful of the funds' investment horizons and objectives, having risk and return objectives reasonably suited to the purpose of the pool. The diversified intermediate investment pool provides increased return potential with a similar level of risk to the Barclay's Aggregate – the current benchmark for the externally-managed quasi endowment pool.

Wilshire Consulting projects an increase in expected return of approximately 106 basis points compared to the current 100% fixed income quasi endowment pool with only a slightly higher expected risk of 5.22% as compared to the current portfolio which is at 5.00% (Return and risk expectations are derived based on a long-term horizon, typically 10 years or more. Figures are then represented on an annual basis.)

INVESTMENT VEHICLES AND TRANSITION PLAN

Wilshire Consulting uses extensive technology as well as both qualitative and quantitative measures to identify suitable managers and funds. Wilshire evaluated index fund managers and solicited fee quotes. Based on strength of the organization, competitive fees, and ability to track closely the index, Wilshire recommends expanding the use of index funds to include State Street Global Advisors in addition to the previously approved Vanguard Funds, and continuing the use of the currently authorized fund manager, Dodge and Cox, for Core Fixed Income.

The following represents the proposed asset allocation of the intermediate diversified investment pool:

<u>Asset Class</u>	<u>Target</u>	<u>Range +/-</u>	<u>Benchmark</u>
Cash	15	3%	T-Bill (91 day)
U.S. Core Fixed Income	40%	5%	Barclays Aggregate
U.S. High Yield Fixed Income	5%	2%	Barclays US Corp HY Index
TIPS	10%	3%	Barclays US TIPS Index
U.S. Equity	10%	3%	MSCI US Broad Mkt Index
Non-U.S. Equity	10%	3%	FTSE All-World ex US Index
REITS	10%	3%	MSCI US REIT Index

IMPLEMENTATION

Wilshire will work with staff at the University of Iowa to transition assets efficiently. The transition of funds to previously approved Vanguard Funds or State Street index funds will take place over a period of several months.



University of Iowa

Program Review for Non-Endowment Portfolios

Michael J. Dudkowski
Managing Director

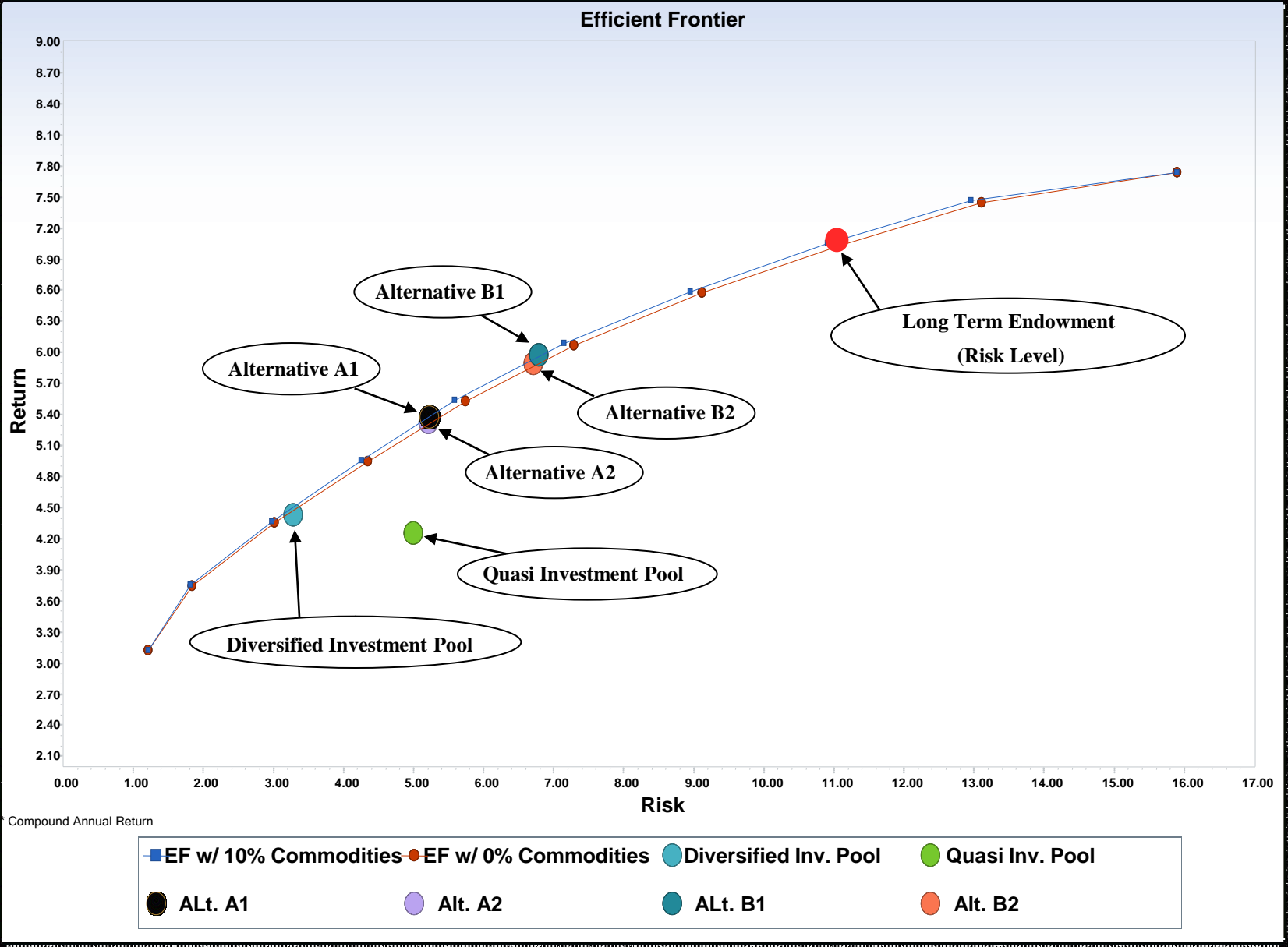
Bradley A. Baker
Associate

December 30, 2010

Quasi Investment Pool Overview

- The Quasi Investment Pool is currently allocated between two funds: Reams Core Fixed Income and Dodge & Cox Income Fund, representing 64.5% and 35.5% respectively as of December 29, 2010.
- The total market value as of December 29, 2010 was \$80.7 million.
- Wilshire's observations:
 - Portfolio balances are not completely “dedicated”
 - A significant portion of the portfolios has an intermediate investment time horizon
 - An asset mix policy taking on more risk than the diversified pool, but significantly less risk than long-term endowments, is appropriate

Efficient Frontier



Asset Mix Table

- The below table displays the current asset allocation and Return / Risk expectations for the Quasi Composite, as well as several alternatives to the current mix.

Asset Class	Diversified Investment Pool ¹	Current Quasi Composite	Alternative A ¹ Alternative A ²		Alternative B ¹ Alternative B ²		Long Term Endowment (Risk Level)
Cash	40.0	0.0	10.0	15.0	0.0	0.0	0.0
U.S. Core Fixed Income	30.0	100.0	40.0	40.0	35.0	45.0	15.0
U.S. High Yield Fixed Income	5.0	0.0	5.0	5.0	5.0	5.0	5.0
TIPS	10.0	0.0	10.0	10.0	10.0	10.0	0.0
Total Cash and U.S. Fixed Income	85.0	100.0	65.0	70.0	50.0	60.0	20.0
U.S. Equity	8.0	0.0	10.0	10.0	15.0	15.0	30.0
Non-U.S. Equity	2.0	0.0	10.0	10.0	15.0	15.0	30.0
REITS	5.0	0.0	7.5	10.0	10.0	10.0	10.0
Commodities	0.0	0.0	7.5	0.0	10.0	0.0	10.0
Total Equity and Other	15.0	0.0	35.0	30.0	50.0	40.0	80.0
Total Portfolio	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Expected Return (%)	4.43	4.25	5.37	5.31	5.97	5.89	7.00
Expected Risk (%)	3.28	5.00	5.24	5.22	6.80	6.72	11.00
Return / Risk (%)	1.35	0.85	1.03	1.02	0.88	0.88	0.64

¹Constraints: High Yield (5% Max.) / TIPS (10% Max.) / REITS (10% Max.) / Commodities (10% Max.)

²Constraints: High Yield (5% Max.) / TIPS (10% Max.) / REITS (10% Max.)

Implementation Scenarios: Portfolio A1

- The below table displays possible implementation scenarios based upon the desired asset allocation mix of Portfolio A1

Asset Class	Fund Name	Active / Passive	Target (\$mm)	Target (%)	Policy +/- (%)	Management Fee / Expense (bps)
Cash	SSgA Liquid Reserves Fund	Active	\$8,065	10.0	3.0	12.0
U.S. Core Fixed Income	TBD	Active	\$32,260	40.0	5.0	TBD
U.S. High Yield Fixed Income	SSgA U.S. High Yield Bond Index	Passive	\$4,033	5.0	2.0	25.0
TIPS	SSgA U.S. TIPS Index	Passive	\$8,065	10.0	3.0	6.0
Total Cash and U.S. Fixed Income			\$52,423	65.0	5.0	
U.S. Equity	SSgA U.S. Total Market Index	Passive	\$8,065	10.0	3.0	8.0
Non-U.S. Equity	SSgA MSCI ACWI ex-U.S. Index	Passive	\$8,065	10.0	3.0	15.0
REITS	SSgA U.S. REIT Index	Passive	\$6,049	7.5	2.5	15.0
Commodities	TBD	Active / Passive	\$6,049	7.5	2.5	TBD
Total Equity and Other			\$28,228	35.0	5.0	
Total Portfolio			\$80,650	100.0		

Implementation Scenarios: Portfolio A2

- The below table displays possible implementation scenarios based upon the desired asset allocation mix of Portfolio A2

Asset Class	Fund Name	Active / Passive	Target (\$mm)	Target (%)	Policy +/- (%)	Management Fee / Expense (bps)
Cash	SSgA Liquid Reserves Fund	Active	\$12,098	15.0	3.0	12.0
U.S. Core Fixed Income	TBD	Active	\$32,260	40.0	5.0	TBD
U.S. High Yield Fixed Income	SSgA U.S. High Yield Bond Index	Passive	\$4,033	5.0	2.0	25.0
TIPS	SSgA U.S. TIPS Index	Passive	\$8,065	10.0	3.0	6.0
Total Cash and U.S. Fixed Income			\$56,455	70.0	5.0	
U.S. Equity	SSgA U.S. Total Market Index	Passive	\$8,065	10.0	3.0	8.0
Non-U.S. Equity	SSgA MSCI ACWI ex-U.S. Index	Passive	\$8,065	10.0	3.0	15.0
REITS	SSgA U.S. REIT Index	Passive	\$8,065	10.0	3.0	15.0
Commodities	TBD	Active / Passive	\$0	0.0	0.0	TBD
Total Equity and Other			\$24,195	30.0	5.0	
Total Portfolio			\$80,650	100.0		

Overall Comments

- Alternative mix analysis shows the Diversified Investment Pool continues to be an appropriate asset mix and additional improvement is very much “at the margin”.
- Quasi Investment Pool analysis identifies modestly more aggressive risk profiles that may be better suited for the portfolio’s intended purpose and objectives.
- Several index alternatives exist and could be used in expanding the Quasi’s asset class exposures.