MINUTES OF THE APRIL 15, 2008, SMITHSONIAN INVESTMENT COMMITTEE MEETING

The Smithsonian Investment Committee ("the Committee"), a subcommittee of the Finance and Investment Committee of the Smithsonian Board of Regents, met at 3:00 p.m. on Tuesday, April 15, 2008, at Committee Chair David Silfen's office in New York City. Mr. Silfen and Committee member J. Tomlinson Hill III were in attendance. Committee members Afsaneh Beschloss, Eli Broad, L. Hardwick Caldwell III, Roger W. Sant, and Alan G. Spoon participated via teleconference. Staff attending the meeting were Secretary-Designate G. Wayne Clough and Chief Investment Officer Amy Chen. Acting Secretary Cristián Samper, Acting Under Secretary for Finance and Administration Alison McNally, Investment Officer Michael Giovenco, Investment Analyst Warren Stock, Manager of Investment Operations Rika Feng, Treasurer Sudeep Anand, Chief Financial Officer Alice Maroni, Chief of Staff to the Regents John K. Lapiana, General Counsel John E. Huerta, and Assistant General Counsel Farleigh Earhart participated via teleconference. Rich McMullen and Leslie Kiefer of Cambridge Associates' Arlington, Virginia, office were also in attendance.

Call to Order

David Silfen called the meeting to order.

Approval of Minutes

After consideration and upon motion duly made, seconded, and unanimously approved, the minutes of the January 9, 2008, meeting were approved.

Portfolio Review

Rich McMullen and Leslie Kiefer of Cambridge Associates (CA) reviewed the Endowment's recent performance and activity during 2007. Capital markets underwent a dramatic change as the year progressed, which was reflected in the emergence of the sub-prime credit crisis and resulting flight to quality on the part of investors. In this difficult environment, the Endowment returns were strong in both absolute and relative terms.

Compared to nonprofit institutions in general, the Endowment also performed well for the year. Over the one-year period ending December 31, 2008, the Endowment ranked in the 34th percentile of this more focused peer group.

The Endowment's trailing three- and five-year returns also compared favorably to the policy portfolio benchmark, with excess returns of 80 and 50 basis points, respectively. Results were even stronger compared to the simple blend of U.S. stocks and bonds. Peer group standings were not as strong over trailing three- and five-year periods. Within the CA custom peer group, the Endowment's returns fell below median and ranked at the 76th and 71st percentiles, respectively. However, it is important to note that the Endowment's investment portfolio prior to 2005 was undiversified relative to peer institutions.

Asset Allocation

The Endowment's 12/31/07 asset allocation differed from long-term policy targets due to the time needed to build private equity and real asset programs. The high cash position was the result of a tactical decision taken in the fourth quarter of 2007. The decisions taken regarding asset allocation and manager selection resulted in $22.5 million in value added for the Endowment. Overall, Cambridge felt the lineup of managers was strong.

Risk Management

An overview of "best practices" in governance oversight was given to the Committee in early 2008, and several key questions were posed to zero in on whether the Endowment has been compensated for the risks it has taken. These questions largely focused on quantitative measures of risk and definitions of success. Cambridge Associates' analysis came to the following conclusions:

- An historical analysis of the Endowment's returns versus its policy portfolio benchmark showed that the Institution had been compensated for the investment risks associated with managing the Endowment.
- The expected risk profile of the current policy is similar to that of peer institutions and superior to an undiversified portfolio.
- The Endowment did not take significant risks relative to the benchmarks over the three-, five-, and 10-year time horizons.
- The joint probability of the Endowment experiencing a decline in real value *during* the 10-year period (45%) and *not recovering* during the next five and 25 years is 40% and 21%, respectively.
- While the probability of facing a meaningful reduction in real spending (10%) in any given year is quite small, ~2%, the probabilities of such a reduction approach 20% in the three-year period. The probabilities of not recovering after a decline of 10% on a real spending basis can be quite high even over periods as long as 10 years.

To facilitate a discussion, the presentation included a "Risk Management Checklist" with some qualitative factors the Institution may consider using in real time. Staff was asked to consider which measures would be most appropriate to incorporate into future risk monitoring and to develop a risk presentation for the Board of Regents.

Portfolio Implementation

Ms. Chen reviewed the proposed implementation plan, which included consideration of the placeholder in cash, revising the policy ranges for absolute return, and implementing liquid assets within the real assets allocation.

Dr. Samper asked how consistently the Institution's investment policy was implemented relative to its mission. He indicated that several advisory board members and staff had inquired about the Endowment's investments relative to environmental impact or degradation of cultural artifacts. The Committee suggested developing a general policy statement regarding investment activities.

Audit Review

The Office of Investments received no deficiencies from KPMG during the recent audit, and Ms. Chen indicated the office hoped to utilize KPMG's investment specialist again during 2008. Due to KPMG's request, staff has escalated the need to identify a solution for the Institution's private equity administration and monitoring. Two options are being evaluated: (1) acquire Private I combined with additional subscription services and staff resources or (2) expand the current consultant relationship to include monitoring and administration.

Operational Review

It was reported that staff had been working with the Institution's Chief Technology Officer to improve systems and automate processes. PerTrac, which offers a database system integrated within Outlook and is the Institution's provider of analytical software, was identified as a key building block and the best solution on the market. Acquisition and implementation will begin over the next year.

Executive Session

Staff was dismissed and an Executive Session was held.