MINUTES OF THE NOVEMBER 23, 2009, INTERIM INVESTMENT COMMITTEE MEETING

The Investment Committee ("the Committee"), a committee of the Smithsonian Board of Regents, conducted a telephonic meeting on Monday, November 23, 2009, at 2:30 p.m. Participating were Committee Chair David Silfen and Committee members Afsaneh Beschloss, Eli Broad, and Roger Sant. Staff in attendance included Chief of Staff to the Secretary Patricia Bartlett, Chief Investment Officer Amy Chen, Investment Analyst Ryan Dotson, Manager of Investment Operations Rika Feng, Investment Officer Michael Giovenco, Chief of Staff to the Regents John K. Lapiana, General Counsel Judith Leonard, and Investment Officer Chris Weldon.

Call to Order

Committee Chair David Silfen called the meeting to order.

Long-Term Asset Allocation

The purpose of the interim meeting was to discuss the revision of the long-term asset allocation targets in light of market dislocations in 2009 and the current market environment.

The first item discussed was establishing a timeframe for the new policy portfolio. Traditionally the long-term policy portfolio has been a broad statement of the Investment Committee's long-term views over a market cycle (five to seven years). In the current dynamic environment there is a movement towards more frequent reviews. While the Endowment's Investment Guidelines do not include a specific timeframe for the policy portfolio's review, it was agreed that the long-term asset allocation should be targeted for a three to five year timeframe, subject to annual reviews.

A discussion ensued regarding the nomenclature of the asset classes in the current policy targets. Specifically, the asset class "absolute return" encompasses a group of investment strategies that provide portfolio diversification and lower correlation to public markets. Absolute return managers are currently classified by the following strategies: long/short equity, credit distressed, and multi-strategy. It was suggested that a more appropriate categorization would be "hedge funds" instead of "absolute return."

The Committee then reviewed proposed changes to the Endowment's target asset allocations and ranges. The proposed changes follow.

Asset Class	Proposed Policy Target	Ranges
Global Developed Equity	25%	15–55%
Emerging Markets Equity	10%	3–20%
Absolute Return	35%	15–45%
Private Equity and Venture Capital	10%	5–20%
Real Assets	10%	0–15%
Fixed Income/Cash	10%	4–25%
Intermediate Government/Bank Loans	10%	4–15%
Cash	0%	0–10%
Total Endowment	**100%**	

The consensus was that the target weights were reasonable but that the ranges should be tighter around the targets. Committee Chair David Silfen and Chief Investment Officer Amy Chen were tasked with revising the ranges. Staff was tasked with circulating a final proposal with the changes discussed along with a ballot for approval by the Investment Committee.

The Committee also reviewed the proposed implementation plan and supported the use of indexes or exchange-traded funds (ETFs) as a means of acquiring exposure in the portfolio until a manager is selected or as an investment when a suitable manager is unavailable or the ETF is more appropriate.

The meeting was adjourned at 3:00 p.m.

ADDENDUM

Ms. Chen subsequently spoke with each Investment Committee member regarding refinements to the proposed policy target and ranges. Suggested revisions to the Smithsonian Institution's Investment Guidelines and its Long-Term Asset Allocation Policy were then distributed to Committee members. By mail ballots recorded on December 11, 2009, the Committee unanimously approved the adoption of the revised Investment Guidelines and Long-Term Asset Allocation Policy.

The Smithsonian Institution's Long-Term Asset Allocation Policy and Investment Guidelines follow.

Guide to revisions: deletions are indicated by ~~[red] strikethrough~~ and new text is *[red] underlined and italicized*.

Smithsonian Institution
Investment Guidelines

As amended by the Board of Regents' Investment Committee on ~~4/15/08~~ *12/11/09.*

The Smithsonian Institution's objectives for its Endowment are:

- To provide a stable, growing stream of payouts for current expenditures and to protect the purchasing power of the Endowment (net of new gifts and transfers) against inflation.

- To earn a long-term real return (net of management fees) of at least 5.5% while minimizing risk.

- To have long-term investment performance in the top quartile of comparable institutional portfolios.

The current payout policy is to pay (over the long term) 5.0% of the average market value per share over the prior five years. Current expenses are somewhat less than 0.5% of the market value. Hence, the Endowment must earn a long-term real return of 5.5% to maintain its purchasing power.

Achievement of these objectives requires complementary actions by the ~~Smithsonian~~ Investment Committee and the investment managers selected by the Committee.

The ~~Smithsonian~~ Investment Committee is responsible for determining the long-term asset allocation for the Endowment. Currently, the ~~"normal"~~ policy asset allocation for the Endowment and allowable ranges for deviation from this target are:

Asset Class	**Long-Term Asset Allocation %**	**Allowable Ranges**
Global Developed Equity	~~40%~~ *25%*	~~25-55%~~ *15–35%*
~~U.S. Equity~~	~~20%~~	
~~Global ex U.S Equity~~	~~20%~~	
Emerging Markets Equity	~~5%~~ *10%*	~~3-15%~~ *5–15%*
~~Absolute Return~~ *Hedge Funds*	~~25%~~ *35%*	~~15-40%~~ *25–45%*
Private Equity	10%	~~5-20%~~ *5–15%*
Real Assets	10%	0–15%
U.S. Fixed Income*/Cash*	10%	~~5-20%~~ *5–15%*
~~Cash~~	~~0%~~	~~0-10%~~
Total Endowment	100%	

While the Institution is building up its investments in alternative asset classes, the overall asset allocation will deviate considerably from this policy allocation. Given the difficulty and time required to build a high quality investment program in venture capital and private equity, investment in this asset class is likely to remain below the policy allocation for a considerable period of time.

The asset allocation of the portfolio will be rebalanced in three ways:

- Additions to and withdrawals from the Endowment during the year can be used to move the asset allocation of the portfolio closer to the policy allocation.

- The Endowment's actual allocations will be evaluated and monitored during the year to ensure allowable ranges are not violated within the constraints mentioned below.

- At any point the portfolio may be rebalanced, within the specific ranges as set in the policy portfolio, towards or away from the policy portfolio to take advantage of opportunistic events.

Investments in alternative asset classes are generally illiquid and difficult to change. The rebalancing will be done within these constraints.

The current policy allocation is expected to result in a long-term <u>real</u> return of at least 5.5%. The ~~Smithsonian~~ Investment Committee will select investment managers to implement this policy and monitor their performance. The Office of Investments will propose investment managers, monitor their performance and assure that the <u>composite</u> portfolio is consistent with this policy.

Investment managers will be provided guidelines ~~which~~ *<u>that</u>* are consistent with the overall guidelines for the Endowment. In cases where the Endowment invests in a comingled (or mutual) fund, it will have to accept the manager's guidelines. In such cases, the Office of Investments will review these guidelines prior to investment to ensure that they are acceptable. These guidelines define the universe in which managers are expected to operate and benchmarks for performance measurement. Over the long term, each manager is expected to add value relative to its benchmark after fees. Over shorter periods, it is acceptable for managers to have investment performance that may vary significantly from their benchmarks.

The following guidelines should be observed in implementing strategies to achieve the investment objectives:

1. It is expected that there will be modest annual additions to the Endowment. In addition, the Smithsonian will establish approximate liquidity needs for each fiscal year taking into account the Endowment's constraints with regard to the alternative

investments and the need to make monthly payouts. The withdrawal plan will be fine tuned during the year.

2. Investment managers will be selected from time to time to manage designated portions of the Endowment. Allocations will be determined with the Endowment's long-term objectives in mind.

3. Types of investments utilized by the investment managers may include common and preferred stocks, private placements, derivatives, bonds, convertible issues, and cash or high-grade short-term securities for investment reserves. No restriction is placed on the size of the organization for investment.

4. Investment managers are not required to receive prior approval before making purchases and sales.

5. The investment managers will maintain close communications with the ~~Smithsonian's~~ Office of Investments. The Investment Office is to be kept advised of any personnel changes among principal officers or policy makers of the investment manager's organization, and of any major changes in investment policies or emphasis upon types of securities held in "model" accounts. Information on these matters will be relayed by the Office of Investments to members of the ~~Smithsonian~~ Investment Committee.

6. Policies, procedures, and performance of the investment managers will be reviewed periodically by the ~~Smithsonian~~ Investment Committee.