MINUTES OF THE JANUARY 9, 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, January 9, 2008, at Committee Chairman David Silfen's office in New York City. Mr. Silfen was in attendance. Committee members Afsaneh Beschloss, Eli Broad, L. Hardwick Caldwell III, J. Tomlinson Hill III, Roger Sant, and Alan Spoon participated via teleconference. Staff attending the meeting were Director of Investments Amy Chen and Investment Officer Michael Giovenco. Acting Secretary Cristián Samper, Acting Under Secretary of Finance and Administration Alison McNally, Investment Analyst Warren Stock, Manager of Investment Operations Rika Feng, Treasurer Sudeep Anand, Chief Financial Officer Alice Maroni, Chief of Staff to the Board of Regents John Lapiana, General Counsel John Huerta, Assistant General Counsel Farleigh Earhart, and Controller Andy Zino participated via teleconference. Cambridge Associates Director of Research Ian Kennedy also was 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 October 23, 2007, meeting were approved.

Governance Review

Ian Kennedy, Director of Research of Cambridge Associates, discussed best practices in endowment fund governance and reviewed the current governance practices of the Investment Committee. Committee members were asked in advance to assess the Institution's investment governance through participation in a survey conducted by Cambridge. Mr. Kennedy addressed the issues referenced by the survey questions, focusing particularly on those where he and/or members of the Committee felt there was room for improvement. In general, Cambridge Associates thought the Investment Committee is well-constituted and runs in accordance with best practices. What follows summarizes recommendations for those issues needing improvement.

- In order to ensure greater continuity and accountability for investment decisions, Mr. Kennedy recommended that the Institution consider extending the tenure of Committee members (e.g., to eight to ten years, perhaps in the form of four- or five-year terms with one renewal). Term expirations could be staggered to minimize membership turnover.
- At most endowment funds, the investment committee is a stand-alone sub-committee of the board of trustees, rather than a sub-committee of the finance committee. However, this is not universal. It was recommended that the Regents consider whether there are advantages to revising the existing structure or whether it serves the Institution well.
- Expand risk reporting for the overall Endowment.

- The one area where Mr. Kennedy strongly criticized the Institution regarded the lack of sufficient investment office resources to manage a relatively complex portfolio that includes significant allocations to alternative assets like absolute return and private market investments. He noted that prior meeting minutes indicate the Committee intended to increase allocations to these asset classes, and stressed the risks of doing so without having first built out the investment office staff to the degree necessary to support such investments.

Portfolio Review

Global equity markets detracted from performance as of November 30, 2007, while the absolute return portfolio was up. The Endowment's performance did not reflect any contributions from private equity or hard assets, as reflected in the peers' performance.

Issues for Consideration

Director of Investments Amy Chen discussed the development of the portfolio and provided an estimate of the Endowment's allocation as of December 31, 2008. Notable reductions in cash (-$55 million) and U.S. Equities (-$50 million) were foreseen with the proceeds allocated largely to absolute return ($75 million), private equity ($18 million), and real assets ($14 million). Mr. Silfen suggested utilizing an allocation to non-residential Real Estate Investment Trusts, either through an index or active management, to gain real estate exposure while waiting for direct real estate asset commitments to be fulfilled. Staff was asked to consider a $10 million to $15 million allocation and come back to the Committee with a recommendation.

The next topic was to review the Committee decision at the October 23, 2007 meeting to maintain a larger-than-normal cash position, approximately 8% as of November 30, 2007, versus a target of 0%, which resulted in a favorable return as stocks fell during late-October and November 2007. The S&P 500 dropped 2.7% during the period from October 24 to December 31, 2007, while cash securities rose 0.8%, a difference of 3.5%. Committee members indicated they were in favor of keeping the current overweight cash allocation.

The Endowment's current overweight allocation to emerging markets of 6.2% vs. 5% for the policy allocation was discussed. Significant appreciation to the asset class in recent years had raised some valuation concerns. The Committee favored the continued overweight, indicating the one-to-three-year outlook for emerging markets remained strong.

Ms. Chen reviewed the decision to place a multi-strategy absolute return fund on the Committee's newly created watch list.

Audit Review

Ms. Chen discussed details of the fiscal year 2007 audit and reported that, as of this meeting, KPMG had not communicated any material weaknesses or reportable conditions related to investments. The audit of the investments portfolio was one of the focal points for KPMG last year, especially given the growing size and complexity of the Endowment. The Office of Investments subsequently improved its policies and procedures during 2007 and added a CPA to staff who oversaw the audit and operations. Another positive development this year was the addition of an Investment Specialist on KPMG's staff, who significantly enhanced the team's knowledge of investments, especially on the non-marketable side. Overall, the audit was completed successfully, though it required significant resources.

Operational Review

Ms. Chen reviewed plans for the Office of Investments and announced the Office had met all established milestones for 2007. Among the enhancements slated for 2008 are a thorough review of the Office's internal controls by an outside firm, an increase in technology infrastructure, and the hiring of two additional staff members. Ms.Chen noted that staff is experiencing some difficulty with the new bank custodian. She discussed the need to improve the accuracy and delivery of reports. Last, she discussed the hiring of a private equity consultant who will help staff with due diligence reviews of prospective managers for the non-marketable portfolio.

Executive Session

Staff was dismissed and an Executive Session was held.