FUNCTION: Oregon State Board of Higher Education  
ACTIVITY: Pooled Endowment Fund Investment  

POLICY: An asset allocation policy shall be adopted and appropriate guidelines shall be defined for the Oregon University System Pooled Endowment Fund.

I. INTRODUCTION

This statement governs the investment of the Pooled Endowment Funds (the “Fund”) of the Oregon State Board of Higher Education (the “Board”).

This statement is set forth in order that the Board, the Office of the State Treasurer (OST), the Oregon Investment Council (OIC), and others entitled to such information may be made aware of the policy of the Fund with regard to the investment of its assets. This statement of investment policy is set forth to:

1. Establish a clear understanding by the OIC, the Board, and OST staff, of the investment goals and objectives of the portfolio.
2. Establish a basis for evaluation of the investment managers.
3. Establish guidance and limitations on investment of the funds.

It is intended that these objectives be sufficiently specific to be meaningful but flexible enough to be practical. It is expected that the policy and objectives will be amended from time to time to reflect the changing needs of the endowment; however, all modifications will be in writing and approved by the OIC.

II. OREGON UNIVERSITY SYSTEM POOLED ENDOWMENT FUND

The Fund is a permanent fund and is expected to operate in perpetuity, so these funds will be invested long-term. It is important to follow coordinated policies regarding spending and investments to protect the principal of the Fund and produce a reasonable total return.

III. RESPONSIBILITY OF THE BOARD

The role of the Board is to recommend to the OIC broad investment goals, including spending rate information and to provide input into the asset allocation process.

IV. RESPONSIBILITY OF OIC AND OST

The OIC will have the responsibility and authority to establish the asset allocation of the Fund, and approve the retention and termination of all investment managers. OST staff and the OIC’s consultant will recommend to the OIC a specific asset mix reflecting judgments as to the investment environment as well as the specific needs of the Fund. Other duties
assigned to OST staff include:

- Recommending professional investment managers.
- Negotiating and/or monitoring Fund investment expenses.
- Monitoring investment managers, on an ongoing basis.
- Assuring proper custody of the investments.
- Reporting to the Board, on a quarterly basis, the Fund’s investment results, its composition and other information the Board may request.

V. SPENDING POLICY

The amount of endowment return available for spending (distribution) is based on a percentage of the average unit market value of the 20 quarters preceding the current fiscal year. The distribution per unit (under Exhibit A) is determined by the Board. The distribution amount per unit is multiplied by the current number of units and any additional units added during the current year as new endowment money comes into the Fund. This shall be exclusive of investment management fees.

VI. INVESTMENT POLICY GUIDELINES

A. Asset Allocation

The most important component of an investment strategy, toward achieving its purpose, is the allocation among the various classes of securities available to the Fund. The OIC will establish the target asset allocation for the investments that will mostly likely achieve the investment goals of the Fund, taking into consideration the appropriate level of portfolio risk.

The risk/return profile shall be maintained by establishing a long-term “target” strategic asset allocation that is set forth in Schedule I of this policy.

B. Investment Time Horizon

In making investment strategy decisions for the Fund, the focus shall be on a long-term investment time horizon that encompasses a complete business cycle (usually three to five years). Interim evaluation will be required if a significant change in fees, manager personnel, strategy or manager ownership occurs.

While the quantitative assessment of managerial competence will be measured over a complete market cycle, OST staff and the OIC’s consultant may make period qualitative assessments as well. Specific qualitative factors which will be considered by OST staff and the consultant may include any fundamental changes in the manager’s investment philosophy, any changes in the manager’s organizational structure, financial condition and personnel, and any change, relative to their peers, in the manager’s fee structure.
VII. PRUDENCE AND ETHICAL STANDARDS

A. Prudence

The standard of prudence applicable to the Fund is defined in ORS 293.726: “The investment funds shall be invested and the investments managed as a prudent investor would do, under the circumstances then prevailing and in light of the purposes, terms, distribution requirements and laws governing each investment fund.”

B. Ethics and Conflicts of Interest

Consistent with all the activities of the OST and the OIC, the ethical standards established in OIC policy and in Oregon Law (ORS 244), shall apply to the management of the Fund.

VIII. INVESTMENT OBJECTIVES

The investment objective of the Fund is to seek consistency of investment return with emphasis on capital appreciation over long periods of time, since the Fund will operate in perpetuity. In keeping with the performance goals included in the Policy, achievement of this objective shall be done in a manner that provides investment returns that, over a long-term planning horizon, will meet the spending rate established by the Board and maintains the purchasing power of the principal.

IX. MANAGER(S) RESPONSIBILITIES

A. Legal Compliance - The investment manager(s) is responsible for compliance with the provisions of their investment management agreement.

B. Authority of Investment Manager(s) in the Managed Accounts - Subject to the terms and conditions of this policy and the investment management agreement, manager(s) shall have full discretionary authority to direct investments of assets in the managed accounts. Investment manager(s) will recommend changes to this Policy when the manager(s) views any part of this Policy to be inconsistent with overall market or economic conditions, or investment policies.

The OIC directs all managers to vote proxies and to vote them in the best economic interest of the Fund. The managers will report to the OST staff, as to how proxies were voted, when requested.

Meetings between Fund managers and OST staff will occur consistent with the policies established for the OIC’s other managers, to discuss such things as: the manager’s performance, outlook, and investment decision process.
X. REPORTING REQUIREMENTS

Investment results will be regularly monitored by OST staff and an independent consultant under contract by the OIC, as well as by OUS staff.

A representative of OST shall meet with the Board, at least annually, to review, for each manager: (i) past performance; (ii) compliance with the Investment Policy, Guidelines and Objectives of the Fund, including but not limited to asset allocation, actual return, and comparative return in relation to applicable index (indices) and to a universe of comparable funds; (iii) risk profile; (iv) ability of manager to fulfill the stated objectives of the funds; and, (v) any other material matter.

A representative of the OST, or the consultant, shall report investment results, or other information, to the Board annually. Any material non-compliance with the Investment Policy, Guidelines and Objectives of the Fund or with the investment management agreement, discovered by OST staff or the consultant, will be reported to the Board immediately.

XI. INVESTMENT GUIDELINES

A. CASH: The Fund shall maintain minimal cash, consistent with short-term requirements. Short term cash will be invested in the Office of the State Treasurer Short Term Fund.

B. FIXED INCOME: Fixed-income securities, for purposes of these guidelines, shall mean mortgage-backed securities, U.S. government securities, investment-grade corporate bonds, and other fixed income securities, such as certificates of deposit and commercial paper. The objective of this component of the Fund is to preserve capital in keeping with prudent levels of risk, through a combination of income and capital appreciation. Realization of income will be subordinate to safety, liquidity, and marketability (securities should be readily marketable). This component of the fund shall adhere to the following categories:

1. Average credit quality shall be A or better.

2. With the exception of US Government and Agency issues, no more than 10% of the bond portfolio, at market value, will be invested in the securities of a single issuer or 5% of the individual issue.

3. There shall be a maximum limitation on below investment grade bonds of 15% of the bond portfolio.

4. There shall be a maximum limitation on non-US bonds of 20% of the bond portfolio.

Fixed-income managers have full discretion over the allocation between long-term, intermediate, and cash equivalent investments.
C. EQUITIES

1. **Objective:** The objective of the equity portfolio is to enhance total return by investing in a broadly diversified portfolio of domestic and international stocks. The OIC and the Board are mindful of the volatility of the equity markets and choose to dampen this volatility through diversification.

2. **Strategy:** Hold a fully invested, diversified portfolio of global equity securities, approximately weighted 50 percent domestic equity and 50 percent international equity, including emerging markets.

3. **Permitted Holdings:** Publicly traded domestic and international common stock, and other financial instruments consistent with the guidelines of the investment management agreements.

4. **Diversification:** The OIC recognizes the need for diversification to minimize the risk of significant losses to the Fund. Diversification by capitalization, style, and sector distribution shall be obtained through the selection of complementary investment managers. Not more than five percent of the market value of any investment fund will be invested in any single issuer or security, unless part of an index fund.

5. **Portfolio Restrictions:** There will be no engagement in short sales, purchases on margin, or investments in options, futures, or private placements unless consistent with the underlying investment management agreements.

D. PERFORMANCE

Performance expectations for each of the asset classes are described in Exhibit A.

XII. OTHER INVESTMENTS

Recognizing that the addition of other investment classes may reduce total fund volatility while enhancing returns, the OIC has targeted 15 percent of aggregate Fund assets in Inflation Hedging Assets consisting of real estate, Treasury-Inflation Protected Securities (TIPS), and other hard assets. This allocation is to provide for return enhancement and portfolio diversification. In addition, 10 percent of aggregate Fund assets have been targeted for traditional private equity, to provide diversification and potential return enhancement to the Fund's growth asset category.

XIII. ASSET CUSTODY AND SECURITIES LENDING

Custodial responsibility and the selection of a securities lending agent, for all securities, is to be determined by OST.

XIV. CONCLUSION

Implementation of this Policy, including investment manager selection, shall be the responsibility of OST Staff subject to the necessary approvals of the OIC. This Policy shall be reviewed by the OIC and OST at least every two years.
SCHEDULE I

ALLOCATION OF ASSETS

The following represents target allocations and the ranges by asset category:

<table>
<thead>
<tr>
<th>Class</th>
<th>Target Allocation</th>
<th>Ranges</th>
<th>Policy Benchmark</th>
</tr>
</thead>
<tbody>
<tr>
<td>Growth Assets</td>
<td>60%</td>
<td>50%-75%</td>
<td></td>
</tr>
<tr>
<td>US Equity</td>
<td>25%</td>
<td>20%-30%</td>
<td>Russell 3000</td>
</tr>
<tr>
<td>International Equity</td>
<td>25%</td>
<td>20%-30%</td>
<td>MSCI ACWI ex US</td>
</tr>
<tr>
<td>Private Equity</td>
<td>10%</td>
<td>0%-15%</td>
<td>Russell 3000+300 bps</td>
</tr>
<tr>
<td>Inflation Hedging</td>
<td>15%</td>
<td>7%-20%</td>
<td></td>
</tr>
<tr>
<td>Real Estate</td>
<td>7.5%</td>
<td>0%-10%</td>
<td>NCREIF Index</td>
</tr>
<tr>
<td>TIPS</td>
<td>7.5%</td>
<td>0%-10%</td>
<td>BC Inflation Note Index</td>
</tr>
<tr>
<td>Diversifying Assets</td>
<td>25%</td>
<td>20%-30%</td>
<td></td>
</tr>
<tr>
<td>Fixed Income</td>
<td>25%</td>
<td>20%-30%</td>
<td>Barclays Capital Aggregate</td>
</tr>
<tr>
<td>Cash</td>
<td>0%</td>
<td>0%-3%</td>
<td>90 Day T-Bill</td>
</tr>
</tbody>
</table>

Note: The current Target Allocation Policy benchmark is 27.5% Russell 3000 Index, 27.5% MSCI ACWI ex US Index, 25% Barclays Capital Aggregate Index and 10% Russell 3000+300 bps, 7.0% BC Treasury Inflation Protection Index, 3.0% NCREIF Index.

As the fund is invested in the OIC adopted asset allocation, noted above, the Target Allocation Policy benchmark will be adjusted accordingly.
EXHIBIT A

Performance Monitoring Return Expectations

Spending Policy
The distribution rate for the Fund is 4.0 percent of the five-year moving average unit market value.

Total Fund
The total fund will be evaluated quarterly. Specific performance objectives include, but may not be limited to, the following:

1. Exceed the return of the Policy benchmark (Schedule 1) by 0.50 percent (after fees) over a market cycle.
2. Exceed the level of inflation by 5.0 percent or more as measured by the Consumer Price Index (CPI) over a market cycle.
3. Exceed the median fund in a universe of other endowments over a market cycle. A market cycle is defined as an investment period lasting three to five years.

U.S. Equities - Large Capitalization
Equity accounts will be evaluated quarterly. This allocation will be invested passively and is expected to match the return to the S&P 500.

U.S. Equities – Small/Mid Capitalization
Small/Mid capitalization accounts will be evaluated quarterly. Specific performance objectives are to exceed the return of the Russell 2500 (after fees) by 1.0 percent over a market cycle.

International Equities
International developed and international emerging markets equity accounts will be evaluated quarterly. Developed market account objectives are to exceed the return of the MSCI World ex US IMI Index by 1.0 percent (after fees) over a market cycle. Emerging market account objectives are to exceed the return of the MSCI Emerging Markets IMI Index by 1.5 percent (after fees) over a market cycle.

Fixed Income
Fixed Income accounts will be evaluated quarterly. Specific performance objectives are to exceed the return of the Barclays Capital Aggregate Bond Index by 0.5 percent (after fees) over a market cycle for core bond investments. Treasury Inflation Protected Securities (TIPS) are expected to meet the return of the BC Treasury Inflation Protection Index.

Alternative Investments
The performance objective of the private equity component of the Alternative Investments portfolio is to exceed the Russell 3000 Index plus 300 basis points (lagged one quarter). The performance objective of the real estate component is to exceed the NCREIF Property Index (lagged one quarter). Both are expected to be achieved over a market cycle.