THE STATE UNIVERSITY OF NEW JERSEY
RUTGERS

RUTGERS POLICY

Section: 40.2.14

Section Title: Fiscal Management

Policy Name: Investment Objectives and Guidelines

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Responsible Office: Office of Administration and Finance

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Errors or changes? Contact: oevapada@oldqueens.rutgers.edu

1. **Policy Statement**
   These objectives and policies are intended to govern the overall management of the university's pooled endowment funds.

2. **Reason for Policy**
   To establish management objectives to preserve and enhance the university's endowment purchasing power while providing a relatively predictable, stable, and constant stream of earnings for current use.

3. **Who Should Read Policy**

   - Members of the university community with a need to know the university's policies on endowment investments

4. **Related Documents**
   None

5. **Contacts**
   Office of Treasury Operations
   732/445-2788

   Office of Administration and Finance
   732/932-7864

6. **The Policy**

Policy 40.2.14, INVESTMENT OBJECTIVES AND GUIDELINES

STATEMENT OF INVESTMENT OBJECTIVES AND GUIDELINES

-Approved by the Joint Committee on Investments on August 10, 2005
-Adopted by the Board of Governors on October 6, 2005 with the consent of the Board of Trustees on October 27, 2005

The following investment objectives and guidelines are intended to govern the overall management of the university's Pooled Endowment funds (the Board of Governors' Long Term Fund and the Board of Trustees' Long Term Fund, collectively "the Endowment").

A. FINANCIAL OBJECTIVES

I. The primary financial objective of the investment management of the Endowment is to preserve and, hopefully, enhance its real (inflation-adjusted) purchasing power while providing a relatively predictable, stable, and constant (in real terms) stream of earnings for current use.

B. INVESTMENT OBJECTIVES

I. The long term investment objective for the Endowment is to attain an average annual real total return[1] (net of investment management fees and disbursements to the Foundation) of at least 5%, as measured over rolling five-year periods.

2. These objectives should be achieved within acceptable risk levels, in order to avoid large short term declines in market value.

C. SPENDING POLICY

1. The university annual spending policy is to spend an amount not to exceed 4.5% of a trailing I3-quarter average of the Endowment's market values.

2. Current earned income in combination with principal (if necessary) will be used for ongoing spending requirements.

D. PORTFOLIO COMPOSITION

1. To achieve its investment objective, the Endowment's assets shall be divided into two parts: an Equity Fund and a Fixed Income Fund. The long-term commitment to these funds shall be as follows:

	Range	Long-Term Benchmark
Equity Fund	70-85%	80%
Fixed Income Fund	15-30%	20%

The division of the Endowment's assets by asset class need not necessarily be related to the division of assets by its outside investment managers. The purpose of dividing the Endowment in this manner is to ensure that the overall asset allocation between these two major asset classes remains under the regular scrutiny of the Committee and is not allowed to become the residual of separate manager decisions. Over the long run, the allocation between the two funds will be the single most important

[1] Real total return is the sum of capital appreciation (or loss) and current income (dividends and interest) adjusted for inflation as measured by the Consumer Price Index.

determinant of the Endowment's investment performance.

2. The Endowment's investments shall be diversified both by asset class (e.g., equities, bonds. other alternative asset investments) and within asset classes (e.g., within equities by economic sector, industry, quality, and size). Moreover, the Equity Fund will be placed with managers who have distinct and different investment philosophies. The purpose of diversification is to provide reasonable assurance that no single security or class of securities will have a disproportionate impact on the Endowment's aggregate results. The university will have separately managed accounts with most of its investment managers; in some cases it will use commingled vehicles or limited partnerships where access and cost dictate.

3. The purpose of the Equity Fund (including domestic stocks, foreign stocks, and other alternative assets, and fixed income reserves held by equity managers) is to provide long term appreciation of principal. It is recognized that pursuit of this objective could entail the assumption of greater market variability and risk in comparison to fixed income investments.

4. The Equity Fund should normally represent approximately 80% of total Endowment assets at market value. Although the actual percentage of equities will vary with market conditions, levels in excess of 85% or below 70% will be closely monitored by the Committee and the staff. Should the allocations move outside these ranges, additional funds will be transferred as needed (the amount and timing to be determined by members of the Committee) to bring the overall asset mix back within the desired range.

5. The purpose of the Fixed Income Fund is to provide a hedge against deflation, to increase current returns relative to an all-equity fund, and to reduce the overall volatility of the Endowment.

6. The percentage of total assets allocated to the Fixed Income Fund at any time should be sufficient to ensure that neither the current income nor the capital value of the total Endowment declines by an intolerable amount during a period of extended deflation. The Fixed Income Fund should normally represent approximately 20% of the total Endowment assets at market value. Although the actual percentage will fluctuate with market conditions, levels less than 15% or in excess of 30% shall be closely monitored by the Committee and the staff. Additional funds will be transferred as needed when the ratios fall outside this range. The Committee may change any of these ratios or the ratios in paragraph 4 above; however, it is anticipated that these changes will be infrequent.

7. The current target and ranges for the combined portfolio are illustrated in **Appendix A**. They may be revised periodically.

8. New cash flow shall be allocated to investment managers by the Committee with assistance from staff. As a general rule, new cash will be used to rebalance the total Endowment in the direction of the equity/fixed income ratio most recently ratified by the Committee. It is anticipated that shifting assets among managers will occur infrequently.

9. The investment managers, subject to the guidelines set forth in this policy statement, shall have complete discretion to manage the assets in each portfolio to best achieve the investment objectives.

E. GUIDELINES FOR EQUITY MANAGERS

1. The investment objective for the total Equity Fund is to outperform by 1% per annum (net of fees) the S&P 500 stock index. To ensure that this objective is met, the performance of each equity manager will be measured against an appropriate equity index and against an appropriate manager peer group, (e.g., Cambridge Associates' U.S. Equity ex Small-Cap Manager Median) and evaluated over rolling one, three and five-year periods.

2. The Equity Fund may include investments in institutional mutual funds. When such investments are made, the guidelines for a respective mutual fund will take precedent over the University's stated guidelines. However, no investment will be made in any mutual fund which allows significantly different investment practices than those permitted under the Endowment's investment guidelines without approval of the Committee.

3. Decisions as to individual security selection, security size and quality, number of industries or holdings, current income levels, and turnover are left to broad manager discretion, subject to the usual standards of fiduciary prudence. However, in no case (excepting mutual fund shares) shall a single security exceed 10% of the market value of the equity fund at purchase. Additionally, no single industry shall represent more than 25% of the market value of the Equity Fund. It is understood that, in order to achieve its investment objectives, the Equity Fund must be actively managed and therefore will not be as diversified as an indexed approach to equity management.

4. Equity managers may at their discretion hold investment reserves of either cash equivalents or bonds (including convertible issues) without limitation in terms of asset size or period of time, but with the understanding that their performance will be measured against stock indices as described in paragraph 1 above. To the extent that cash equivalents are used, their quality shall be governed by the guidelines set forth in **Appendix B**.

5. Managers may buy and sell individual security options against long positions held in the portfolio. Stock index futures and options may be used to decrease the overall market risk in the portfolio provided such investments do not increase market exposure beyond 100% of the underlying equity capital or decrease it below 0% (i.e., the portfolio may not be leveraged or net short). The combined value of individual security options and stock index futures and options may not exceed 25% of the portfolio and no single transaction may exceed 5% of the portfolio. Currency futures may be used to hedge against the currency risk of non-U.S. dollar investments held in the portfolio. The value of a given currency hedge must fall between 0% and 100% of the long position associated with that hedge. Credit counter-parties will have at least a "AA" rating.

6. Rutgers' Marketable Alternative Assets Program overall design and resultant manager selection are based upon the core objectives of generating equity-like returns over the long run, while maintaining a defensive posture during periods when equity markets perform poorly. Accordingly, the Program is expected to exhibit lower volatility than that of the S&P 500, and moderate correlation with the balance of Rutgers' endowment portfolio. In order to avoid manager concentration risk, the Program consists of a diversified portfolio of hedge funds that in aggregate should not be highly correlated with one another. Please see **Appendix C** for the Marketable Alternative Program's Investment Objectives, Benchmarks and Strategy.

F. GUIDELINES FOR CORE FIXED INCOME MANAGERS

1. The investment objective for the Core Fixed Income Fund is to perform in line with the Lehman Brothers Aggregate Bond Index. To ensure that this objective is met, the performance of each fixed income manager will be measured against this benchmark and against an appropriate bond manager universe (e.g., Cambridge Associates' Fixed Income Manager Median) and evaluated over rolling one, three and five year periods.

2. Money market instruments as well as bonds may be used in the Core Fixed Income Fund, but equities and convertible bonds are excluded. Core Fixed Income Fund managers may employ so-called active management techniques such as interest rate anticipation and inter-sectoral arbitrage, but changes in average duration should be moderate and incremental. Since the fund is designed as a deflation hedge, a minimum average[2] duration of approximately four years should be maintained. The maximum duration of the fixed income portfolio cannot be greater than 33% above the duration of the Lehman Brothers Aggregate Bond Index. In addition, current coupons and call protection should be emphasized to assure a high and stable level of income.

3. Individual bonds shall be rated investment grade by at least two of the three rating agencies (Moody's, Fitch, and Standard & Poor's). The average credit quality of the Core Fixed Income Fund shall be maintained at "AA" (by S&P or equivalent rating by Moody's or Fitch) or higher. The prospect of credit risk or risk of permanent loss shall be avoided in the Core Fixed Income Fund. Issues of state or municipal agencies shall not be purchased except in unusual circumstances. A fixed income manager

[2] A weighted average based on current market values.

may invest in foreign securities up to a limit of 20% of the portfolio. The investment manager must make a report to the Committee if he is not in conformance with the guidelines.

4. In general, the Core Fixed Income Fund shall be well diversified with respect to type, industry, and issuer in order to minimize risk exposure. However, obligations issued or guaranteed by the U.S. Government may be held without limitation. To the extent that cash equivalents are used, their quality shall be governed by the guidelines set forth in **Appendix B**.

5. Derivative instruments such as options, futures, index-based securities (swaps), may be used up to a limit of 25% of the manager's portfolio. No derivative transaction will constitute more than 5% of the portfolio's assets. Derivative transactions may be entered into for hedging, return enhancement, or as a substitute for a specific instrument, but not for speculative purposes.

G. GUIDELINES FOR TRANSACTIONS

1. Under normal circumstances, all transactions should be entered into on the basis of best execution, which means best-realized net price. Notwithstanding the above, commissions may be designated for payment of services rendered to the Endowment in connection with its management.

H. MONITORING OF OBJECTIVES AND RESULTS

1. All objectives and policies are in effect until modified by the Committee, which will review these at least annually for their continued appropriateness. It is anticipated that the Committee and the staff will propose revisions in these guidelines at any time that they could potentially impede the university from meeting its objectives.

2. If, at any time, an investment manager believes that any policy guideline inhibits investment performance, it is the manager's responsibility to communicate clearly this view to the Committee.

3. The individually managed portfolios and the total Endowment assets will be monitored for consistency of investment philosophy, return relative to objectives, and investment risk as measured by asset concentration, exposure to extreme economic conditions, and market volatility. Individually managed portfolios will be monitored by the Committee and the staff on an ongoing basis, but results will be evaluated on a rolling three- to five-year basis. However, the Committee will regularly review the managers in order to confirm that the factors underlying the performance expectations remain in place. Total Endowment results will be evaluated on a rolling five-year basis.

4. Each investment manager will report to the Committee the following information quarterly: total return (on a time-weighted basis) net of all commissions and fees, additions and withdrawals from the account, current holdings at cost and market value, and purchases and sales for the quarter. Regular communication concerning investment strategy and outlook is expected. Additionally, managers are required to inform the Committee of any change in firm ownership, organizational structure, professional personnel, account structure (e.g., number, asset size, account minimum), or fundamental investment philosophy.

5. The Committee will meet with its investment managers on an “as needed” basis. The Committee will rely on staff and Cambridge Associates to monitor and evaluate the investment managers on an ongoing basis. Generally, meetings with investment managers will occur when there is a concern with a manager's performance.

6. The Committee will evaluate itself on an ongoing basis concerning its decision-making process.

Appendix A

Revised and Approved May 11, 2005

Current Target and Ranges for Combined Portfolio

ASSET CLASS	TARGET (%)	RANGE (%)
U.S. Equity	25.0%	15 - 35
Global ex U.S. Equity	20.0%	10 - 30
Marketable Alternative Assets	17.0%	10 - 25
Venture Capital & Private Equity	10.0%	0 - 15
Inflation Hedging	10.0%	0 - 15
TOTAL EQUITY	82.0%	70 - 85
TOTAL FIXED INCOME/U.S. Bonds	18.0%	15 - 30

Appendix B

Appropriate Cash Equivalent Investments

1. "Cash equivalent investments" are defined as U.S. dollar-denominated fixed income instruments with maturities of one year or less.

2. Permissible cash equivalent instruments are:

   a. Direct obligations of the United States.

   b. Obligations unconditionally guaranteed (principal and interest) by the United States government.

   c. Obligations of any agency or instrumentality of the United States including:

      i. Federal Home Loan Bank
      ii. Federal National Mortgage Association
      iii. Government National Mortgage Association
      iv. Federal Farm Credit Banks

   d. Negotiable certificates of deposit, bankers' acceptances and floating rate notes issued by, or time deposits placed with, banks meeting the following criteria:

      i. U.S. chartered banks must have debt ratings of ***"A"*** or higher, ready access to world capital markets, a demonstrated record of capital profitability, and a sizeable ongoing C.D. issuance or deposit collection program.

      ii. Foreign chartered banks must be domiciled in nations with strong economies, established capital markets, and central banks capable of controlling effectively domestic monetary movements. Instruments must be recognized as direct obligations of such banks, not as obligations of their subsidiaries.

   e. ***"Al-Pl"*** Commercial Paper issued by large companies domiciled in the U.S. or abroad. Instruments issued by state-owned companies must be guaranteed by the government owner.

   f. Repurchase Agreements secured by U.S. government and Federal Agency obligations, such obligations to be priced at least 102% of market value.

   g. Money Market Funds of commercial banks and other major investment advisors.

Appendix C

Marketable Alternatives Program

Investment Objectives, Benchmarks and Strategy

I. OBJECTIVES AND BENCHMARKS

A. The primary objectives of the Marketable Alternatives Program are to earn roughly the long-term annualized net return of traditional equities (S&P 500) over rolling five- to ten-year periods, and to exhibit a lower volatility, as measured by standard deviation, than the traditional equities.

B. The Marketable Alternatives program benchmark will be the 90-day Treasury Bill + 5%. The benchmark will be calculated over rolling three-year periods and will be compared against the program's average annual total return (net of fees).

C. The Program's performance will also be evaluated against the Cambridge Associates Hedge Fund manager median and/or other similar funds of funds' manager medians.

II. PORTFOLIO IMPLEMENTATION STRATEGY

A. Identify superior managers with long-term records.

B. Identify start-up managers with background and experience that typically yield superior long-term records.

C. Reduce Program risk by adding strategies with low correlation to the U.S. stock market.

D. Rebalance between managers to increase exposure to undervalued strategies and decrease exposure to overvalued strategies.