

MINUTES OF THE FINANCE COMMITTEE
BOARD OF DIRECTORS
UNIVERSITY OF LOUISVILLE FOUNDATION, INC.

The Finance Committee of the University of Louisville Foundation, Inc. met on Tuesday, June 10, 2003 at 12 Noon in the Alumni Board Room of the University Club with members present and absent as follows:

Present: Mr. Burt Deutsch, Chairman
 Mr. H. Scott Davis
 Mr. Robert W. Rounsavall, III
 Mr. William Wilcox

Absent: Mr. Nathaniel E. Green

Other Directors

Present: Mr. Malcolm Chancey
 Ms. Sandra Metts Snowden

From the
University:

Dr. James R. Ramsey, President
Dr. Shirley Willihnganz, Acting Provost
Mr. Larry Owsley, Vice President for Finance & Administration
Mr. Joe Beyel, Vice President for Development & Alumni
Mr. Mike Curtin, Director, Office of Planning & Budget
Ms. Susan Ingram, Assistant Director, Office of Planning & Budget
Mrs. Susan Magness, ULF
Mr. Joe Gahlinger, Special Assistant to the VP for Finance & Admin.
Mrs. Kathleen Smith, Assistant Secretary
Mrs. Debbie Dougherty, Board Liaison

Foundation

Legal Counsel: Ms. Leslie Vidra, Stites & Harbison

Others

Present: Mr. Kent Meyers, Cambridge Associates
 Mr. John Tyler, Cambridge Associates

I. Convene Meeting

Having determined a quorum present, Chair Deutsch called the meeting to order at 12:15 p.m.

Minutes for March 11, 2003

Mr. Deutsch recommended the inclusion of the word "Committee" in the first line of the minutes. Mr. Rounsavall made a motion, which Mr. Wilcox seconded, to approve the minutes of March 11, 2003 as amended. The motion passed unanimously.

II. Information Items:

Interim Financial Statements

Vice President Owsley reviewed the financial statements as of March 31, 2003 (copy attached). There were no questions.

Cambridge Associates Discussion

Messrs. Meyers and Tyler distributed updated market value and asset allocation analyses through March 31, 2003 (copy attached)

Mr. Tyler recommended no rebalancing at this time. Mr. Meyers acknowledged two investment areas that have performed well: energy and distressed securities; and he expressed concerns about Commonfund's bond fund performance. He recommended the Committee interview fixed income money managers at the next meeting. Chair Deutsch requested inviting Commonfund's managers and managers from an additional 2-3 companies to the next meeting, referencing the Committee's past practice to interview managers prior to considering replacement.

III. Action Item: Approval of Operating Budget for 2003-04

Chair Deutsch informed the Committee of his meeting with Mr. Curtin and Ms. Ingram, and suggested legal counsel review the narrative statements guiding the Operating Budget before it goes to the Board of Directors for approval. Mr. Curtin walked through highlights of the 2003-04 Operating Budget. Mr. Curtin commended Ms. Ingram and staff in the Office of Planning & Budget for their excellent work in compiling this budget. He acknowledged Vice President Owsley and the Controller's office staff who have done an exceptional job during this busy time. Mr. Curtin noted the budget is unusually tight for FY 2003-04. Low interest rates continue to impact earnings available from short-term investments. Budgeted revenues were down again this year and had an adverse effect on the institution's fiscal flexibility. As a result, some important initiatives, funded in previous Foundation budgets, will go unfunded during the upcoming fiscal year. Facing this difficult budget, the President made tough but prudent budget decisions and provided support for strategically important programs that are critical to the University and the *Challenge for Excellence*. Mr. Curtin reported the Foundation will provide approximately \$33 million in operating funds for UofL programs during FY 2003-04. This represents a 6% reduction in support from fiscal year 2002-03. In response to Mr. Chancey's inquiry why the 2002-03 budget was so much larger than the 2003-04, Mr. Curtin stated one reason was the return of the significant annuity purchased for President Shumaker. Chair Deutsch reminded the Committee the specific items listed behind the budget detail represent the recommendations made by various operating units; in approving the budget, the Committee endorses those recommendations. Mr. Davis made a motion, which Mr. Wilcox seconded, to approve the

President's recommendation that the Board of Directors approve the proposed operating budget for the fiscal year 2003-2004 for the University of Louisville Foundation, Inc. as specified in the attached budget document and supporting schedules; and

That the President be authorized to make adjustments for discretionary programmatic expenditures from budgeted reserves up to the balance available in the reserve. All such adjustments shall be reported to the Board quarterly.

The motion passed unanimously.

IV. Other Business

Minerva Ventures

Chairman Deutsch remarked that the Minerva Ventures investment needs further review and stated that Vice President Owsley would follow up. He said that investigation by legal counsel would be part of the review. Ms. Vidra clarified that legal counsel was available to consult on broad best practices issues; however, it was her understanding that Vice President Owsley would carry out the specific review on behalf of the UofL Research Foundation.

Cardinal Park

Chairman Deutsch reminded the Committee that in 1999 the Foundation loaned \$8.5 million to the UofL Athletic Association. This loan was in addition to the funds authorized for the Bass Tennis Center. In response to Mr. Chancey's inquiry, Vice President Owsley provided a repayment loan history as of May 31, 2003 (copy attached). Mr. Chancey reiterated the Foundation's agreement that the \$8.5 million loan would be paid back to the Foundation. Vice President Owsley's summary indicates that pledges totaled \$9 million, the original loan totaled \$8.5 million, which leaves \$500,000 for stadium expenses. Out of the \$9 million pledged, the Foundation has received \$3.6 million. Vice President Owsley mentioned one complicating factor in the ULAA's repayment of the loan was the rebalancing of the ULAA operating budget. Deferral of the \$1.6 million payment balanced their budget. Chairman Deutsch remarked the timing was now appropriate to look into the spirit of the original agreement. President Ramsey concurred it was a good time to work with Athletics on the budget and to move forward in constructing a specific repayment schedule. He offered to work with Athletics to develop the schedule for presentation at the next Board meeting. President Ramsey recognized the efforts of Mr. Curtin and the Athletics staff to build a five-year budget for Athletics. He further recognized the 2002-03 budget included several one-time payments such as fees for hosting the Conference USA tournament. The inclusion of one-time fees makes for some difficulty in building an ongoing budget. Football ticket sales far exceeded budgeted sales. In the 2003-04 season, there are no high-profile home games. Dr. Ramsey noted that, in light of the budget cuts on campus, ULAA has cut nearly \$1 million in expenses. One major revenue item was the Nelligan Sports revenue. President Ramsey expressed optimism about the budgetary progress made.

Amelia Place

Mr. Chancey reported that he and President Ramsey met with Don Allen's (the owner of the carriage house) power of attorney. The Foundation has indicated an interest in purchasing the carriage house and explained the University's procedures regarding appraisers. The Foundation obtained appraisals indicating the property value at \$420,000 to \$480,000. Mr. Chancey, Dr. Ramsey, and Don Allen's representatives will meet to discuss the appraisals. Mr. Chancey will keep the Foundation board apprised of any developments

V. Information Update

UMIFA – (Uniform Management of Institutional Funds Act) issues

Ms. Vidra reported the Uniform Management of Institutional Funds Act (UMIFA) provides specific distribution rules for charitable and educational societies to replace traditional trust law definitions of principal and income, permitting the distribution of appreciation as income. The UMIFA permits an institution to base its spending policy on a fund's appreciation, but also sets a floor, the historic dollar value, on the institution's ability to use appreciation to support its spending. Ms. Vidra distributed a handout detailing the UMIFA, its issuance, history, and recommendation concerning the Act (copy attached). Ms. Vidra requested the Finance Committee provide some guidance. In response to Chairman Deutsch's inquiry, Ms. Vidra said it affected the restricted endowment funds only. Mr. Tyler offered to provide the directors with research material. Mr. Chancey inquired whether the UMIFA applied to any 501(C) (3) entity. Ms. Vidra replied that 48 out of 50 states passed it and it applied to donor restrictions only. Vice President Owsley distributed a summary of analysis identifying each program whose market value at December 31, 2002 had fallen below "historic dollar value" (copy attached). Ms. Vidra remarked that past practice has been to use December 31st as the date for determination. If the Board's practice is a different date, it would need to use that new date consistently. In response to Mr. Curtin's inquiry if unspent accumulated fund balances could be used over time, Ms. Vidra said that money not spent is not part of the market value. Chairman Deutsch acknowledged that a lot of detailed explorations need to be made in the next several days. He further acknowledged that the Foundation has historically taken the most conservative view of restricted funds. Mr. Deutsch noted that the legally restricted endowment funds were smaller in amount than those funds categorized as "restricted" in the Foundation's financial records. Ms. Vidra recommended the current budget be approved so programs can move forward since this is a spending restriction rather than a budget restriction. After staff has time to analyze each account, then that part of the budget should return to the directors for approval.

VI. Presentation of Money Managers

The Finance Committee heard presentations from EARNEST Partners, EII, and ICM Asset Management.

VII. Review and Discussion of Money Manager Presentations

VIII. Adjournment

The meeting adjourned at 3:30 p.m.

BOARD ACTION:

Passed X
Did not pass
Other

Asst. Secretary Katalin M. Smith

TO: Joe Gahlinger
University of Louisville Foundation (“ULF”)

FROM: Kent Meyers
John Tyler

DATE: June 5, 2003

RE: Investment Review

Capital Markets: For the quarter ending 3/31/03, U.S. equities posted mixed results, with the S&P 500 returning -3.2% and the NASDAQ returning 0.4%. These final figures conceal enormous volatility, as war concerns dominated headlines and economic worries unnerved capital markets. International equities declined 8.2% as rising global economic and geopolitical risk aversion exacted a heavy toll. The U.S. fixed income market was also quite volatile, though yields on most Treasuries ended the quarter nearly identical to the level where they began. For the quarter, the Lehman Brothers Aggregate Bond Index returned 1.4%.

With 142 endowments reporting, ULF slipped to the 94th percentile for the quarter and the 99th percentile for the period 6/30/02 through 3/31/03. Still, percentile rankings over three and five-year periods, and since inception, continue to be top quartile at 24, 8, and 8, respectively.

The good news is that the market rally through June has made the first quarter report less relevant, and should enhance shorter-term results. U.S. and international equity markets experienced a sharp rebound as investor concerns about Iraq (at least in the short-term) evaporated, earnings across multiple industrial sectors strengthened, and the markets interpreted Fed comments on deflation as an unambiguous signal that interest rates will remain low for the time being, if not cut further. Through May 31, the S&P 500 Index has returned 10.38%, the NASDAQ 19.5%, and non-U.S. equities have returned 8.16% bringing year-to-date performance back into positive territory. While it may be too early to declare that the bear market is “history”, there is greater breadth to the market, the correction in equity valuations is well along its course, and if recent gains hold, ULF may have positive (if modest) returns for the year ending 6/30/03.

Performance: For the quarter, the ULF portfolio returned -2.7% (gross), compared to a -1.79% return for the Cambridge Associates College and University median (41 schools reporting). For the fiscal year to date (6/30/02 through 3/31/03), the Foundation returned -10.7% compared to the College and University median return of -6.8%. Based on changes in market values through May 31, the recent equity rally has resulted in positive absolute returns through May across all asset categories and managers. Year to date through May 31, Total Foundation Assets have returned approximately 8.0%. Relative returns were reasonably good, though more managers than not lagged their indexes as much of the initial rally was in the most beaten-down names. Fiscal year to date through May 31, Total Foundation Assets were down 0.9%.

Manager Review: **Weatherbie** experienced the largest shortfall (510 bps) to its index through May. Stock selection issues and over weights to consumer products (fared poorly) and under weights to financials stock (fared well) drove underperformance. **ICM** is down 3.7% to its benchmark, but it staged a nice recovery in May with a 480 basis point positive variance as their positions in technology and health care gained traction. ICM will take large positions in

which they have conviction, and this can work to the advantage of investors willing to rebalance regularly. **Hilliard Lyons** lagged the index slightly through May, but over the longer term (3 & 5 years), they have consistently added value through bottom up, valuation sensitive stock selection. **Earnest** continues to perform well. Note that though all the U.S. managers run relatively concentrated portfolios, which could result in higher volatility, strong stock selection and attentive risk controls have preserved ULF capital reasonably well.

Silchester and **The Boston Company** continue to perform well, reflecting bottom up stock selection skills. We note that Silchester has added several new analysts to support Messrs. Cowan and Butt. The Boston Company grew assets materially in the last few years, from \$285 million at 6/30/00 to \$2.8 billion at 3/31/03. The product is on the verge of closing which is to investors' advantage.

Concluding Thoughts: Despite renewed investor optimism in recent months, we remain skeptical of claims that a new bull market has begun.

- Any substantial snap-back in depressed earnings seems already discounted by rising valuations (former poster children of the Internet boom are back to sky high P/E ratios: Yahoo! at 103, eBay at 94, Cisco at 34, and Intel at 41). While valuations have improved substantially since a year ago, the S&P 500's P/E ratio (at April 30) was 24.2x, or about one standard deviation above its 17.1x historical average.
- It would be unprecedented for the leading sector from the preceding bull market to lead the charge again in the next bull phase. The market is still responding eagerly and emotionally to any hint of good news—and secular bear markets don't typically end until good news is dismissed and ignored by investors burned by dead-end rallies.
- There are multiple forces at work whose impact on capital markets remains unclear: likely depressed employment levels (the jobless recovery), government stimulus in the form of increased spending and monetary policy, a \$350 billion tax cut, and pressure on the U.S. dollar.

In summary, while acknowledging that the current rally may continue, we are inclined to view higher prices more as a chance to rebalance than the heralding of a new bull market. The economic recovery bias of the Foundation has helped in the last few months, and we believe the well-diversified portfolio allocation continues to be appropriate in the current market environment.