

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

The members of the University of Louisville Foundation Finance Committee met on Tuesday, March 11, 2003, at 11:30 a.m. in the Alumni Board Room, University Club, with members present and absent as follows:

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

From the University: Dr. Shirley Willihnganz, Acting Provost
Mr. Larry Owsley, Vice President for Finance & Administration
Mr. Joe Beyel, Vice President for Development & Alumni
Mrs. Susan Magness, ULF
Mr. Joe Gahlinger, Special Assistant to the VP for Finance & Administration
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

I. Convene Meeting

Having determined a quorum present, Chairman Deutsch called the meeting to order at 11:30 a.m.

- Minutes for December 3, 2002

Mr. Davis made a motion, which Mr. Wilcox seconded, to approve the minutes of December 3, 2002. The motion passed.

II. Information Items:

Vice President Owsley reviewed the Interim Financial Statements. There were no questions.

III. Information Item: Investment Performance Summary

- Cambridge Associates Discussion

Mr. Meyers distributed updated market value and asset allocation analysis through February 28, 2003 (copy attached), and provided the following highlights:

- The fourth quarter featured what we might call a "hope rally", as investors added to equities following the steep drop in September and early October. The action was interestingly focused on the stocks that had been down the most, including beaten up technology stocks with little prospect for improvement in their business. These companies, which may not survive, had substantial short interest. The sharp rally caused a lot of hedge funds to cover short positions to contain losses, adding further fuel to the rally. Consequently, even though fundamentals continued to deteriorate, the buying of many of these single digit stocks triggered a powerful rally that then spread somewhat to the broader market. The rally faded in December, and markets continued to languish into 2003, with losses spread broadly across all markets.
- The effects of these market events played through in the managers employed by the University of Louisville Foundation. In general the managers did not hold the low quality tech stocks that experienced the biggest rally, so they largely underperformed the market during the fourth quarter and then experienced losses in line with the market through the first two months of 2003.
- After meeting with Hilliard Lyons and NAM and speaking with ICM, it became clear that ULF's portfolio is currently biased to economic recovery. NAM, which positioned for the recovery early last year and suffered accordingly, has not changed its outlook and maintains a recovery bias in its portfolio. Hilliard also has a number of positions that should do well in a recovery, with substantial overweights in consumer and financial stocks. ICM has made a substantial bet on some smaller cap technology companies trading at or below cash on the balance sheet, as well as significant bets in consumer and industrial stocks, all of which are dependent on a recovery. Those positions, coupled with a substantial diminution in liquidity in small cap stocks, cost them dearly in 2002 and continue to hurt in 2003. The firm has high conviction that these stories will play out positively this year and likens events to late 1998 and early 1999 when they also were too early. Earnest has done a superb job navigating through this environment, but is also down with the market so far in 2003. Weatherbie got off to a good start last year, but is likewise down with the market in 2003.
- On the international front, Silchester continues to consistently add value relative to the benchmark and other managers, although they characteristically lagged the narrow rally in the fourth quarter. They are interestingly now market weight in Japan, after having been substantially underweight through their entire history. Boston Company's performance is about in line with the index so far, but emerging markets have substantially outperformed developed markets in the U.S. and abroad, so losses have been minimal.
- Wellington experienced a very strong quarter due to the run-up in energy prices, while EII has continued to underperform both the REIT index and other managers. The relatively high current yield on REITs has provided some cushion to the returns in this market, and it has played its role in the overall portfolio, but we are concerned about the

continued relative underperformance of EII. We will be meeting with them within the next month to make an assessment of the prospects for the manager.

- Distressed securities continue to be an attractive area for investment as supply still far outstrips capital devoted to the area. Spreads have generally narrowed since the end of the third quarter, which has improved the mark to market returns of managers such as Varde. The firm has performed extremely well relative to other distressed securities managers over the past few years and is off to a solid start in 2003.
- The narrowing of corporate bond spreads also worked to the advantage of the Commonfund Multi-Strategy Bond Fund, as it has outperformed the Lehman Aggregate index by 1.8% and the High Quality Bond Fund by 1.0% since the end of the third quarter.
- In total, the recovery bias in the portfolio and the lack of a substantial allocation to hedge funds (which has provided downside protection to many other endowments) have hurt performance relative to other endowments over the past year. With 123 endowments reporting, ULF ranked in the 43rd percentile for the quarter, the 91st percentile fiscal YTD and the 70th percentile for the calendar year. Rankings over three and five-year periods and since inception (1989) continue to be very strong at 14, 4 and 7 respectively.

Mr. Meyers suggested the Finance Committee meet with EII money managers. In response to Mr. Davis' inquiry regarding other foundations and their use of cross base aggregate, Mr. Meyers responded that it was a pretty common practice.

Mr. Meyers distributed a Preliminary Net Investment Returns by Manager and Investment Strategy Information Sheet as of February 28, 2003 (copy attached). In answer to Mr. Davis' question to compare Chrysalis against its benchmark managers, Mr. Meyers assessed that it is too soon to provide a meaningful comparison, noting the need to have 3-4 years of comparable data.

- Asset Allocation Discussion

Mr. Gahlinger distributed asset allocation information. Mr. Meyers reported the portfolio is close to target, but under in equities and alternatives and over in the marketable portion of the portfolio. Mr. Meyers suggested increasing the allocation to the Varde Fund. Mr. Meyers noted the current Varde Fund allocation totals 3.4% of the portfolio and recommended adding \$5 million to that area of investments. In response to Mr. Wilcox's inquiry about the duration of the investments, Mr. Meyers stated they were approximately equivalent. Mr. Davis made a motion, which Mr. Wilcox seconded, to approve the

Withdrawing of \$5 million from the Commonfund Multi Strategy Bond Fund and re-allocating it to the Varde Fund LP.

The motion passed unanimously.

IV. Information Item: Reconciliation of Gifts Variance

Vice President Owsley referred to the December 2002 minutes concerning Vice President Beyel's inquiry about a variance in the gift total included in the Combined Statement of Activities and the Development and Alumni report. Mr. Owsley said the difference of \$10,168,000 results from 1) \$8,009,000 in gifts to the Athletic Association; 2) conditional pledges totaling \$1,780,000; 3) \$812,000 to record an increase in liability for future annuitant payments; and 4) the remaining \$1,191,000 as the difference between cash and accrual reporting. Mr. Owsley stated the amounts listed in the ULF statements were accurate, and Vice President Beyel's report is also accurate but served different purposes.

V. Other Business

Vice President Owsley discussed an issue related to an amendment from the Commonfund and asked Ms. Vidra to comment. Ms. Vidra reported the receipt of amendments to the two limited partnership agreements through the Commonfund. The amendments appeared to reduce the required investment and fees. She noted that the amendments added a confidentiality disclosure agreement, which gives the general partner the absolute right to withhold information that normally is shared. She expressed concern that nondisclosure could keep the Foundation from having adequate background information to make financial investment decisions. She noted that before sending it to Vice President Owsley for signature, she wanted the Finance Committee to be aware of the amendment. Mr. Meyers said that one of the premier venture capital firms has indicated it will have a confidentiality requirement with all partnership agreements. Ms. Vidra remarked this amendment was broad and vague but contained notice provision for open records purposes. Chairman Deutsch expressed his understanding of the need for the amendment and his willingness for the Foundation to agree to it. Ms. Vidra was directed to contact Commonfund legal counsel to obtain written assurances that financial information needed for audit purposes will continue to be distributed to the limited partner/investors.

VI. Presentation of Money Managers

The Finance Committee heard presentations from Chrysalis and Commonfund.

VII. Review and Discussion of Money Manager Presentations

The Committee discussed the money manager presentations. The consensus was that the Foundation's direct allocation to venture capital was sufficient at present and should neither be increased nor decreased until after the completed evaluation period for Chrysalis and Minerva Ventures, which was originally determined to be 3-5 years.

VIII. Adjournment

There being no further business to discuss, the meeting adjourned at 2:30 p.m.

BOARD ACTION:

Passed X
Did not pass
Other

Asst. Secretary *Katalin M. Smith*