MINUTES OF THE UNIVERITY OF LOUISVILLE
FOUNDATION FINANCE COMMITTEE MEETING

SEPTEMBER 16, 2003

The Finance Committee of the University of Louisville Foundation, Inc. met on Tuesday, September 16, 2003 at 11:30 a.m. 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. Nathaniel E. Green
	Mr. Robert W. Rounsavall, III
	Mr. William Wilcox
Other Directors Present:	Mr. Malcolm Chancey
From the University:	Dr. James R. Ramsey, President
	Mr. Joe Beyel, Vice President for External Affairs
	Mr. Mike Curtin, Vice President for Finance
	Mr. Larry Owsley, Vice President for Business Administration
	Mr. Dave Barker, Director, Audit Services
	Ms. Susan Ingram, Assistant Director, VPFA Office
	Ms. Cheri Jones, Associate Director, Audit Services
	Mrs. Susan Magness, ULF
	Mr. Joe Gahlinger, Special Assistant to the VP for Business Admin.
	Mrs. Kathleen Smith, Assistant Secretary
	Mrs. Debbie Dougherty, Board Liaison
Foundation Legal Counsel:	Ms. Leslie Vidra, Stites & Harbison
	Mr. Kennedy Helm, Stites & Harbison
Others Present:	Mr. Kent Meyers, Cambridge Associates
	Mr. John Tyler, Cambridge Associates

I. Convene Meeting

<u>Minutes of June 10, 2003</u>

Mr. Davis made a motion, which Mr. Wilcox seconded, to approve the minutes of June 10, 2003 as amended. The motion passed unanimously.

II. Report of the President

Outstanding Financial Issues

At the June Committee meeting, President Ramsey agreed to review and recommend a repayment schedule for the Foundation's loan for Cardinal Park. President Ramsey will work with Vice Presidents Jurich and Curtin to develop a proposal for repayment which is fair and responsive to the needs of the Foundation and Athletic Association. President Ramsey asked Vice President Curtin to summarize the repayment discussion thus far. Mr. Curtin reported the Athletic Association made a recent payment of $500,000 out of 2002-03 funds. He also noted that only $6.9 million remains outstanding. The Athletic Association expects to pay a minimum of $500,000 annually, until it is financially feasible to accelerate repayment.

III. Information Items:

Investment Performance Summary

Vice President Owsley presented the investment performance summary as of June 30, 2003. There were no questions concerning the report.

Cambridge Associates Discussion

Mr. Tyler reviewed information contained in Cambridge's September 10 Investment Review (attached). He noted the Foundation's diversified portfolio, as well as limited economic recovery, continues to be positive in the current market environment. Mr. Meyers recommended the Committee consider rebalancing its funds. In response to Mr. Chancey's inquiry about ULF's juxtaposition to other university foundations, Mr. Meyers noted the ULF is at the low end of the distribution, mainly because the ULF's portfolio is positioned for growth economy. Mr. Meyers discussed EII's recent performance, noting there were some positive signs but the Foundation's current investments through Metlife are subcontracts through EII. Metlife changed advisors for its mutual funds, and Mr. Meyers noted an improvement in current results. In response to Mr. Chancey's inquiry, Mr. Meyers was uncertain whether the dividends were included in the yield. Mr. Chancey indicated this may be a good item to follow. In regard to Mr. Davis' inquiry about Cambridge's database of fund managers, Mr. Meyers stated their database includes historical data on approximately 5000-6000 managers.

IV. Executive Session - Directors Only

Minerva Ventures Report

Vice President Owsley reviewed his notes from several meetings with Leslie Vidra and Jim Siffert (of Stites & Harbison) held since December 2002. To date, Minerva has drawn down $650,000, but the review concluded that the $3 Million fund makes it difficult for Minerva to achieve its business objectives. The managers do have experience in venture capital, but they work as volunteers, which is not sufficient to sustain progress of the entity. Mr. Chancey observed Dr. Shumaker's idea was visionary and appropriate, but the problems seem to stem from the staffing. He recommended assigning someone on the staff with expertise to monitor the use of these funds. Mr. Helm inquired regarding the financial obligations to continue with the funding. President Ramsey responded that he recently met with George Fischer whereby Minerva acknowledged some confusion occurred approximately one year ago. At that meeting, Mr. Fischer expressed his full support if the Foundation wished to start over. President Ramsey acknowledged Mr. Fischer's commitment to the university and noted Mr. Owsley's discussion about possible alternatives. Messrs. Chancey and Deutsch acknowledged that starting anew should be seriously considered as an option.

Audit Report of Executive Expenses

Mr. Barker presented the Audit Services Report of Executive Expenses. He noted this audit was a planned activity, and part of his audit schedule for the FY 04. Subsequent to Dr. Shumaker's problems with the University of Tennessee, the President asked that the scope of the audit include all of Dr. Shumaker's credit card transactions and reimbursements through 2002. Audit Services reviewed every credit card transaction and reimbursement, and noted the sources of funds were split as follows: 53% from UofL Foundation, 45% from UofL Research Foundation, and 2% from general funds. Mr. Barker and his staff reviewed the documents and receipts to determine if the expenses complied with policy. Mr. Barker acknowledged the office files detailing the trips helped to validate the business purpose.

Mr. Barker stated transactions were appropriate and reasonably documented. Chairman Deutsch stated that as someone who had much experience with receiving audits, this was a good report. Compliance was documentation and the underlying transactions were considered appropriate. Mr. Deutsch further stated that only two transactions within the report could be perceived as beyond the norm, but with further explanation he thought they were appropriate. Mr. Helm noted the majority of transactions were documented and all were in compliance. Mr. Barker estimated approximately 50% of the airfare expense was initially coach, and Dr. Shumaker utilized his frequent flyer miles for most upgrades.

Mr. Barker acknowledged the quarterly reports that informed Trustees Executive Committee, Chair of the Foundation, Treasurer of the Foundation, and Chair of the Foundation Finance Committee demonstrated an excellent measure of institutional control. The Audit team compared quarterly reports with each transaction and noted 97% of all transactions were reported in the quarterly reports. Mr. Deutsch observed no problems with the quarterly reporting practice and requested its continuation. With these reports, he believed trustees and Foundation directors can determine the relative importance of expenses. Mr. Chancey asked staff to review Amelia Place expenses, both construction and operation. Mr. Chancey observed that the appropriateness of an expense is a judgment call he expects the President to make. Mr. Green made a motion, which Mr. Davis seconded, to approve the

Finance Committee's acceptance of the Audit Services Report to the University of Louisville Foundation, Inc. regarding Executive Expenses and recommendation to the University of Louisville Foundation Board of Directors that it approve the audit at its September 18 meeting.

The motion passed unanimously.

V. Open Meeting Reconvenes with Presentation of Money Managers

Members of the Finance Committee heard presentations from The Vanguard Group, BlackRock, Inc., Deutsche Asset Management, and Wells Capital Management.

VI. Review and Discussion of Money Manager Presentations

The Committee discussed the money manager presentations.

VII. Adjournment

The meeting adjourned at 4:10 p.m.

BOARD ACTION:

Passed_______X__________
Did not pass_____________
Other___________________

Asst. Secretary Kathleen M. Smith _____________________

TO: Joe Gahlinger
University of Louisville Foundation ("ULF")

FROM: Kent Meyers
John Tyler
Jennifer Dilts

DATE: September 10, 2003

RE: Investment Review

Capital Markets: For the second quarter of 2003, U.S. equity indices posted double-digit returns, despite the lack of solid evidence of an immediate economic recovery or growing corporate profits (data since then have been confirming the beginnings of an economic recovery and substantially improved corporate profits). The Dow Jones Industrial Average returned 13.1%, with the S&P 500 returning 15.4% and the NASDAQ returning 21.0%. The overall figures, however, mask the tremendous volatility that characterized the quarter: speculation is still rife in the market, and traders have returned to their old high-beta favorites in force. Non-U.S. equities enjoyed one of their strongest quarters in 30 years, posting a return of 19.3%. Europe ex U.K. equities were the quarter's best performers, returning 24.5%, as corporate balance sheets appear to be improving, and exports receive a substantial boost from gathering momentum in the U.S. economy. In the U.S. fixed income market, low policy interest rates have triggered high demand for fixed-income sectors offering enhanced yields. For the quarter, the Lehman Brothers Aggregate Bond Index returned 2.5%.

With 125 endowments reporting, ULF rose to the 19th percentile for the quarter, with total assets returning 13.1% compared to the Cambridge Associates total endowment median of 11.3%. While ULF remains at the 99th percentile for the fiscal year, 6/30/02 through 6/30/03, percentile rankings over three and five-year periods, and since inception, continue to be top quartile at 25, 4, and 8, respectively.

With investors having moved from the gloom mentality of the first quarter to a much more optimistic stance, the marginal evidence of global economic strengthening led to further equity advances for a fourth consecutive month in July. We have our concerns about the sustainability of the rally without significant economic improvement or top-line revenue growth, but the market appears to believe that these are forthcoming and small signs of increases in business investment are being read as confirmation that the rally has further to go. The speculative and liquidity-driven nature of the initial rally is particularly worrisome if fundamentals do not continue to improve dramatically. High levels of unemployment, production overcapacity, and low capital spending remain the biggest threats to equity markets, while rising bond yields may also have a dampening effect on equity prices, absent significant economic improvement. Markets are, first and foremost, discounting mechanisms and this market is certainly discounting significant improvement in the bottom line. Year-to-date through July 31, the S&P 500 Index has returned 13.7%, the NASDAQ 29.9%, and non-U.S. equities have returned 12.14%.

Performance: For the quarter, the ULF portfolio returned 13.1% (net), compared to a 11.4% return for the Cambridge Associates College and University median (35 schools reporting). For the fiscal year (6/30/02 through 6/30/03), the Foundation returned 0.5% (net) compared to the College and University median return of 3.8%. Based on changes in market values through July 31, the equity rally has continued to result in positive absolute returns through July for all equity managers. Fixed income market values have fallen slightly as July's Treasury sell-off signaled a rise in long-term interest rates. Year to date through July 31, Total Foundation Assets have returned approximately 11.0% (representing change in value; not manager-reported returns). Relative returns were reasonably good, though more managers than not lagged their indexes as much of the rally continues to be in the most beaten-down and smaller/mid cap names.

Manager Review: For the second quarter, the portfolio's equity managers posted mixed results on a relative basis, with all but one manager underperforming its benchmark. Nevertheless, absolute returns were strong with all equity managers reporting double-digit returns and taking advantage of the equity rally. All returns are net of manager fees.

For the quarter, **Weatherbie** lagged the Russell 2500 Index by 140 basis points which represents somewhat of an improvement over its calendar year to date variance of –380 basis points. Poor stock selection relative to the index, as well as a slight technology underweight hurt the portfolio. However, given Weatherbie's valuation focus, we would expect them to underperform in the kind of liquidity-driven rally we had in the second quarter. **ICM** again had an exceptionally strong quarter, returning 29.7% and beating its benchmark by 680 basis points. The portfolio benefited from a renewed interest in smaller cap stocks and its sector positioning; industrials and technology sectors – both of which ICM is overweight – rallied strongly in the second quarter. In particular ICM had taken early positions in a number of beaten-down companies where their research indicated the companies would not only survive, but would have significant leverage to a recovery. These positions hurt the portfolio in the first quarter, as ICM was too early on the call, but drove returns in the second quarter **NAM** continues to underperform its index, down 660 basis points year to date which could reflect its more top-down approach to investing that may have missed the bottom-up nature of the rally in low quality names. We would have expected their bet on economic recovery, however, to have played out more as the quarter advanced. We will continue to watch them closely. Despite its slight underperformance for the quarter (lagging the Russell 2000 Value by 180 bps), **Earnest** continues to do extremely well for the fiscal year (6/30/02-6/30/03), ranking in the fourth quartile of CA Small Cap Value Managers and beating its benchmark by 1290 basis points. Note that although 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** posted absolute returns of 17.6% and 22.6% respectively, although each underperformed their respective indices. Emerging markets equities had an exceptionally good quarter, courtesy of abundant global liquidity, as well as strengthening domestic demand and rising export growth among emerging economies.

Both **Wellington- Energ**y (up 1360 basis points to its index fiscal year to date) and **E.I.I**. posted attractive returns, especially E.I.I, which for the quarter posted above median returns, perhaps indicating that some of the reforms under new director of research Jim Kammert may be bearing fruit.

Concluding Thoughts: Despite the persistence of the equity rally, multiple structural economic concerns continue to plague the economy: high debt levels, production overcapacity, fiscal stimulus that may drive inflation, lack of capital spending, and continued jobless rates. By the same token, there are some encouraging signs that the economic skid may be finding some sort of bottom, which is a prerequisite for recovery. In any event, the recent positive returns are welcome.

- We continue to believe U.S. equities are overvalued given the economy seems poised for a slow recovery and valuations are extremely high. The S&P 500's trailing P/E currently exceeds that of March 2000 during the height of the Internet bubble. Due to the unpredictable and volatile nature of bear market rallies, investors must pay close attention to policy allocations and remain vigilant about rebalancing.

- Although S&P reported profits have so far exceeded expectations by 6.2% - compared to historical outperformance of only 2.7% - share price performance was relatively subdued, as the quality of profit growth has once again been called into question. Companies continue to lack pricing power, leaving many with no option but to aggressively cut costs in an attempt to meet earnings expectations and remain competitive.

- The recent rally in equities has contributed to bonds being underweight at about 17% to their 20% target. We will bring to the September 16th meeting an asset allocation analysis updated through August 31, and may propose rebalancing steps to bring allocations in line with their policy targets.

In summary, the U.S. equity rally ran on in July despite little evidence the economy is truly on the mend, and managed to withstand strong headwinds from high valuations and sharply rising interest rates. While some might call this resilience, we believe the market continues to exhibit classic symptoms of a bear market rally. The well-diversified portfolio allocation of the Foundation, as well as its economic recovery bias, continues to be appropriate in the current market environment.