

THE UNIVERSITY OF MICHIGAN
REGENTS COMMUNICATION

REQUEST FOR ACTION

Subject: Long Term Portfolio Asset Allocation

Action Requested: Adjustment to the Model Portfolio and Allowable Ranges

Background and Summary: The Board last year adopted a practice to annually (1) review in public session the investment results and summary composition of the investment portfolio and (2) establish and discuss investment allocation ranges for each individual asset class in the Model Portfolio as the guidelines for the investment of the portfolio for the ensuing fiscal year. Board oversight of a large long-term portfolio by the establishment of allowable investment allocation ranges for each individual asset class is a common practice at other institutions that manage investment portfolios of similar sizes and investment goals where items that are determined to be of strategic importance typically are presented to the governing body for approval on an annual basis. Strategic items typically include the overall investment policy, asset allocation policy, performance benchmarks, and review of investment performance.

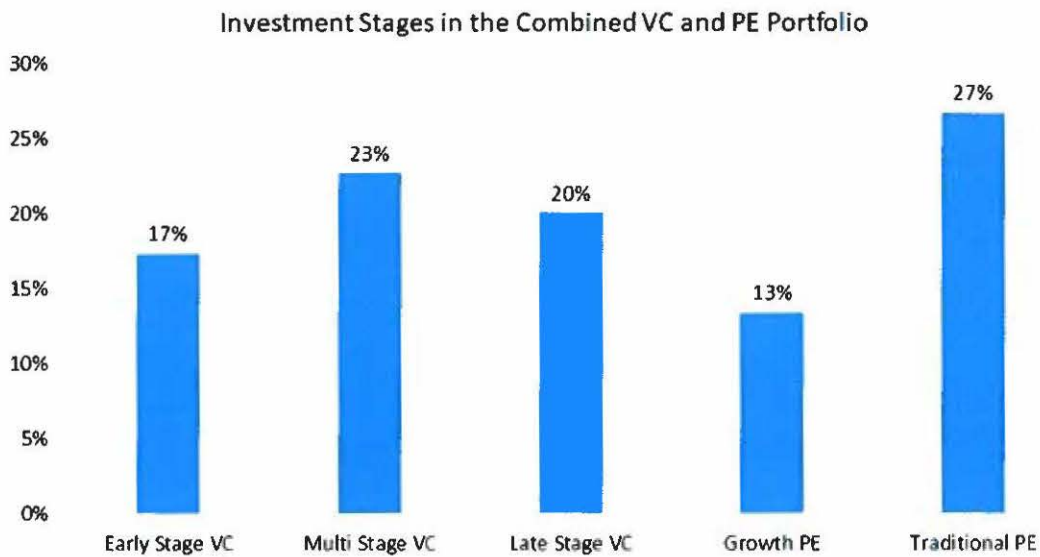
The table below describes the Model Portfolio with allowable ranges for each asset class that the Board approved last year.

LTP – Current Model Portfolio with Allowable Ranges

MARKETABLE SECURITIES	Model Portfolio	Maximum Allocation	Minimum Allocation	Allowable Range
Equities	28.0%	40.0%	20.0%	+12%/-8%
Fixed Income	12.0	20.0	4.0	+8/-8
Cash	2.0	10.0	0.0	+8/-2
Absolute Return	18.0	26.0	10.0	+8/-8
TOTAL MARKETABLE SECURITIES	60.0%	80.0%	50.0%	+20/-10%
ALTERNATIVE ASSETS (ILLIQUID)	Model Portfolio	Maximum Allocation	Minimum Allocation	Allowable Range
Venture Capital	10.0%	15.0%	5.0%	+5%/-5%
Private Equity	12.0	17.0	7.0	+5/-5
Real Estate	10.0	15.0	5.0	+5/-5
Natural Resources	8.0	12.0	4.0	+4/-4
TOTAL ALTERNATIVE ASSETS (ILLIQ.)	40.0%	50.0%	20.0%	+10/-20%

These allowable allocation ranges were thought to be sufficiently wide to delegate to staff flexibility to manage allocations between the various asset classes, yet sufficiently narrow to ensure maintenance of desired levels of diversification and adherence to a specific risk-return profile for the Long Term Portfolio (LTP). However, rapid appreciation in the Venture Capital portfolio combined with a tendency of venture-backed companies to stay private longer has resulted in a current actual allocation of 18 percent, which is greater than the Model Portfolio weight of 10 percent and outside of the 15 percent current allowable range.

Further, the previously distinct difference between Venture Capital and Private Equity has blurred in recent years. Venture-backed companies now stay private longer and often grow into profitable companies before being exited, and venture capital and private equity firms are raising funds that bridge the gap between the two asset classes. Today, the university's VC and PE investments can broadly be characterized along a continuum of investment categories as described in the chart below.



We therefore recommend combining Venture Capital and Private Equity into one allocation in the Model Portfolio with a combined weight of 25 percent and benchmark the combined allocation to a reference portfolio of 50 percent Venture Capital and 50 percent Private Equity with an offsetting reduction in the allocation to Equities.

Market Traded Equities (Equities), Private Equity and Venture Capital fill the functional role of return enhancers in the overall LTP. They are expected to be among the highest performing asset classes over time as they have in the past. These asset classes represents ownership of companies in public and private formats where performance is closely linked to economic growth. While the basic drivers of performance are largely similar among the three asset classes, VC and PE offer more opportunities to add value and generate returns in excess of Market Traded Equities. The trade-off is less liquidity in these two asset classes compared to Equities due to the structure of the investment vehicles and the nature of the underlying investments.

The recommended changes are described in the table on the following page.

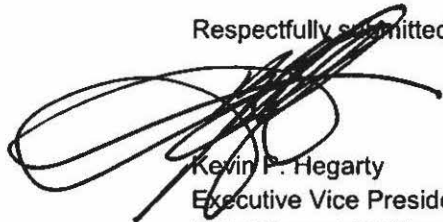
LTP - Recommended 2020 Model Portfolio with Allowable Ranges

MARKETABLE SECURITIES	Model Portfolio	Maximum Allocation	Minimum Allocation	Allowable Range
Equities	25.0%	40.0%	15.0%	+15%/-10%
Fixed Income	12.0	20.0	4.0	+8/-8
Cash	2.0	10.0	0.0	+8/-2
Absolute Return	18.0	26.0	10.0	+8/-8
TOTAL MARKETABLE SECURITIES	57.0%	80.0%	45.0%	+23/-12%

ALTERNATIVE ASSETS (ILLIQUID)	Model Portfolio	Maximum Allocation	Minimum Allocation	Allowable Range
Private Equity and Venture Capital	25.0%	35.0%	15.0%	+10%/-10%
Real Estate	10.0	15.0	5.0	+5/-5
Natural Resources	8.0	12.0	4.0	+4/-4
TOTAL ALTERNATIVE ASSETS (ILLIQ.)	43.0%	55.0%	20.0%	+12/-23%

We request that the Board of Regents adopt the 2020 Model Portfolio with the recommended allowable ranges as outlined above and review them on an annual basis.

Respectfully submitted,



Kevin P. Hegarty
Executive Vice President and
Chief Financial Officer

October 2019