

2008

# GLOBAL PERSPECTIVES FUND

## INVESTMENT POLICY STATEMENT

MBA Student Managed Fund  
UNC's Kenan-Flagler Business School

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**I. PURPOSE**

The Global Perspectives Fund (“Fund”) at the University of North Carolina’s Kenan-Flagler Business School exists to promote the education of current and future MBA students in investment decision making. As a Student-Managed Fund, Global Perspectives supplements a Finance curriculum with co-operative, experiential learning which develops skills in security selection, portfolio and risk management, economic analysis, and investment communication. The Fund seeks to invest capital to provide practical education to students and to provide funds to maintain and improve the Investment Management curriculum.

This Investment Policy Statement (“Statement”) for the Global Perspectives Investment Fund is intended to:

- A. Outline the investment-related responsibilities of the Applied Investment Management (AIM) course participants to manage the Fund assets.
- B. Establish formal, yet flexible, investment guidelines incorporating prudent asset allocation and security selection, and realistic total return goals.
- C. Provide a framework for regular, constructive communication between course participants and other constituents.
- D. Create standards of investment performance which are historically achievable and by which the performance of the class participants will be measured, over a reasonable time period.

This Statement will be reviewed annually to ensure its contents’ relevance to current capital market conditions and the Fund’s needs. This Statement shall remain in effect until the Board approves a new or amended version of the Statement. While revisions are expected to be infrequent, changing market conditions, product developments, and increased Fund complexity will require updates. Finally, as a student managed fund, it is expected that each new class will review the Statement to ensure its suitability.

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## II. FUND OBJECTIVES AND PHILOSOPHY

The Global Perspectives Fund seeks to provide both a rich educational experience and a return that preserves the real value of the Fund's assets. In addition, distributions from the Fund will be used to support the Capital Markets Lab and the Investment Management curriculum.

### A. Education

The fund will provide a comprehensive, hands-on and unique educational opportunity for Kenan-Flagler MBA students. As part of the Applied Investment Management (AIM) class, students will actively participate in all aspects of fund management and investment analysis including asset allocation, risk measurement, investment discovery and research, and execution strategy. The student managers will make regular progress reports to the Fund's Board of Directors.

The fulfillment of this goal transcends any single class year. Preserving the Fund for the benefit of future classes is of paramount concern. As such, the fiduciary duty of student managers and analysts is not diminished by the educational nature of Fund.

### B. Funding

The Fund's distributions will be used to finance the needs of the AIM program and the Capital Markets Lab. In order to meet the long-term funding goals, the Fund should provide a sufficient, stable rate of return.

### C. Investment Objectives

The primary investment objective of the Fund is to preserve the purchasing power of the assets while providing a predictable, stable stream of earnings.

1. Long-term Objective

The Fund should generate an annual total return of inflation + 5% over multi-year time horizons. This will ensure the Fund provides a stable earnings stream to support the AIM program and the CML while preserving the real value of the Fund.

2. Short-term Objective

The Fund seeks to earn a rate of return that exceeds the return generated by the Policy Benchmark Portfolio as described in section VI B.

### D. Risk Tolerance

Given the Fund's long time horizon, the Fund can assume an above-average level of risk as defined by standard deviation of returns. Reasonable consistency in returns is desirable in order to achieve preservation of asset value and provide funding for the AIM program and the CML. Long-term stability will be provided by the strategic asset allocation guidelines and overall management structure of the Fund.

In addition, risks will be controlled through position and leverage limits and by limits on the Value at Risk defined as the possible monthly loss based on a five percent (5%) probability of loss. This Value at Risk should not exceed ten percent (10%) of the Fund's net asset value (NAV).

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**E. Constraints**1. Liquidity

Except for distribution requirements, annual liquidity needs are expected to be low. Therefore, no sizable liquid reserves are required. Liquidity could come in the form of additional contributions or the sale of marketable securities.

2. Time Horizon

The Fund has a long-term time horizon which extends well beyond normal market cycles and can be considered to be in perpetuity for the purpose of investment strategy.

3. Tax Considerations

As part of the UNC Kenan-Flagler Business School Foundation endowment, the Fund is exempt from taxes.

4. Unique Circumstances

Initially, the fund will attempt to raise capital through special donations. However, the Fund may be provided with initial seed capital directly from the general endowment. Any money contributed by the general endowment will need to be repaid as directed donations are made. These repayments may impact the liquidity of the Fund and represent an additional need above regular funding distributions.

**III. ORGANIZATIONAL STRUCTURE****A. Board of Directors**

The Board will consist of the AIM faculty advisors, the Kenan-Flagler Business School (KFBS) Investment Management concentration coordinator, a member of the KFBS Foundation Board, and between 2 and 5 professionals in Investment Management. The Board will have authority over the strategic asset allocation and the MBA management team.

This Statement will propose the Fund's structural considerations and will be considered in effect only upon Board approval. Specifically, the Board must approve (1) the strategic asset allocation, (2) position and leverage limits within the Fund, and (3) the risk management and reporting procedures.

The Board must also approve the appointments to the management team. The Board may also remove a member of the management team.

**B. Faculty Advisor**

A member of the KFBS faculty will serve as Advisor and have authority over trading and tactical allocation decisions. The Advisor must approve and execute all trades. Changes in the tactical allocation of the portfolio must also be approved by the Advisor. The Advisor has final authority and responsibility to make and execute investment decisions for the Fund during and outside of normal school sessions.

The Advisor, in his sole discretion, may reject a trade or allocation decision if the action (1) will violate the strategic allocation, position limits, or other structural limitations of the Fund, (2) will materially harm the Fund and its ability to meet its obligations and objectives, or (3) represents gross negligence or lack of due diligence on the part of the manager and analysts.

The Advisor shall timely report all trade executions to the portfolio manager, asset class manager, and the risk and compliance manager at least. The Advisor shall also report any decision rejections including reasoning to the management team and affected analyst(s). A summary of any Advisor rejections should be presented to the Board at least semi-annually.

### **C. Student Managers**

Student managers shall be selected by the Advisor and the Board of Directors and serve at the pleasure of the Board. A portfolio manager, several asset class managers, a risk manager, and a marketing manager shall constitute the management team of the Fund.

In addition to the responsibilities outlined below, the management team is endowed with the right to determine which investments are included in the portfolio and the trading strategy to best incorporate the selected investments.

#### 1. Portfolio Manager

The Portfolio Manager (PM) has oversight of the asset allocation, fund risk, trading, and adherence to position limits. The PM, along with the asset class manager(s), has responsibility to determine the trading strategy to employ for taking a position. Once determined, the strategy should be communicated to the faculty advisor for execution.

#### 2. Asset Class Managers

The various asset classes (as defined in section V) shall each have a lead manager with the responsibility for monitoring trends and news related to that asset class. The asset class managers are responsible for issuing opinions on all investments presented related to that asset class. The opinion should include whether or not to make the investment recommended by the analyst and a brief statement defending the opinion.

Certain asset classes may have several managers (e.g. domestic, foreign, and emerging equity manager). Each of these managers is considered to be part of the management team for the purposes of managing the Fund and roles and responsibilities outlined in the Statement.

#### 3. Risk and Compliance Manager

The Risk and Compliance Manager is responsible for reporting to the PM and the Advisor on the risk exposure of the Fund and ensuring compliance with the IPS regarding position limits, leverage, asset allocation and other constraints.

The Risk and Compliance Manager shall also provide a semi-annual report to the Fund's Board of Directors regarding value at risk and compliance as part of the regular reporting requirements.

#### 4. Marketing Manager

The Marketing Manager is responsible for presenting a consistent, professional image of the Fund to external parties including the Board of Directors, alumni, and students. The manager will compile the semi-annual reports from information provided by the Fund management.

The Marketing Manager is responsible for communicating the mission and objectives of the Fund to alumni, students, and prospective students in order to raise awareness of the Fund to interested parties. Such communications should be congruent with the communication standards and guidelines of UNC and Kenan-Flagler Business School. As part of these duties,

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the Marketing Manager is responsible for both the internal and external website and for hosting visitors interested in learning about the Fund and the CML.

**D. Analysts**

All class participants who are not in a managerial role shall be designated as analysts. Analysts may specialize in an asset class or industry or they may remain generalized as they choose. Analysts are responsible for generating investment ideas and carrying out research. An analyst's performance will be based on the subjective quality of their research and the objective performance of their investments against the portfolio benchmark for the appropriate asset class.

An analyst may also request that a position in the fund be sold. Reasons for a sell recommendation may include a material change in the prospects of an investment, achievement of a price or return target, or an asset allocation or other structural adjustment. In extreme events, a sell recommendation may be made outside of normal class sessions.

**E. Mid-Year Transitions**

In order to foster a broad learning experience for all members of the class, the Fund's student management team should be transitioned at the end of each academic semester. Nominations for each management position will be accepted by the faculty Advisor(s) who will make recommendations to the Board for approval. The Advisor(s) and Board may solicit the advice of the existing manager for a replacement but are not bound by any recommendation.

Each nominee who wishes to accept a nomination shall submit an application, the content of which shall be determined by the Advisor(s), by the appropriate deadline in order to be considered a candidate. Having no candidate, the Advisor may appoint an appropriate candidate. The Board and advisor(s) also have the right to retain the current manager if they feel the candidates are not qualified.

**F. Year-End Transitions**

During the third Mod, first year students will be introduced to the Fund through the AIM class. The new students will have the responsibility to evaluate this Statement, take over coverage of investments in the Fund, and learn the administrative procedures and tools of the Fund.

On April 1st (or the first business day following), first year students will assume managerial control of the Fund and should begin taking on the responsibilities of those roles with the incumbent second year shadowing and providing guidance.

First year students will be nominated and apply for various roles in the Fund during Mod III. The Advisor(s) and the Board will choose the new management team from among the nominations as outlined in Mid-Year Transitions above.

After the April 1st transition, 2nd year students will be responsible for assisting with an orderly transition of fund management to the 1st year students and preparing the annual report for the final board meeting. The smooth establishment of a transition from one year to the next is very important to the overall performance of the Fund.

The old managers are responsible for training the new analysts in the procedures and operational aspects of the Fund. The first objective will be to recap the proceedings of what took place during the past year and what role the holding serves in the overall portfolio. Second, the old members need to give the new members the expectations of what will happen when the new fund members

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take their place. This overview should state the reasons a certain investment was chosen or retained during the year. A template can be established to help outline key points, strategic issues to watch with each individual investment selection, and what to expect from market fluctuations. This template will centralize all information pertaining to that holding and will track weekly activity after the summer transition.

Over the summer, the first year class will continue to have responsibility for the Fund. An important aspect of training the new management is helping them establish an appropriate position for the summer months. The Fund does not have the day-to-day attention required to insure a reasonable level of safety during the summer. The ultimate safety would be to liquidate selected stock positions, in order to minimize huge fluctuations over the summer. The entire fund will not be liquidated, because such action is thought to reverse the basic educational and student-managed philosophy of the fund. The new managers will establish voting and communication procedures to ensure that the portfolio is not neglected during the break in MBA studies.

#### **IV. OPERATIONAL STRUCTURE**

The Fund maintains a unique operational structure in order to foster an open dialogue and debate about investments and market forces. While educating class members is the primary goal, the Fund represents a significant fiduciary responsibility in order to meet its other objectives and maintain its long-term viability for the benefit of future classes.

Each session of the AIM class shall be convened in part to perform the regular business of managing the Fund. Such other administrative business, not related to the Fund, as may come before the class is outside the scope of this Statement.

##### **A. Session Moderator**

The session moderator shall call the class to order and present an update of recent market events and news. This summary should incorporate a snapshot of economic reports and announcements from portfolio companies. It should also include news affecting other positions (e.g. commodity prices).

The moderator is also responsible for preparing and communicating an agenda for the class which will include updates from the management team, any investment presentations, any sell recommendations, and any other such business as may come before the class.

The session moderator shall take the minutes of the meeting and communicate them to the Advisor and the class participants by week's end for entry into the official record.

##### **B. Performance Report**

The Portfolio Manager or Risk Manager shall present an update on the Fund's positions, returns, and risk assessment at each class session. The update should include both quantitative and qualitative assessments representing the Fund management's view of the Fund and its position.

##### **C. Investment Presentation**

Any analyst or manager shall have the right to present an investment idea to the class for consideration to be included in the Fund. In consideration of each participant's fiduciary duty, investment ideas should be well researched and demonstrate an understanding of the risks and

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rewards of the investment. The presentation may also include a recommendation on the best trade strategy (option trade, pair trade, etc.).

**D. Position Closing Recommendation**

A participant may recommend that positions in one of his/her investments be closed. In these cases, the burden of research is less, though a reasoned argument should be presented.

In extreme events, a sell recommendation may be forwarded to the management team for action outside a normal class session.

**E. Previous Presentations**

Investments presented at a previous session may be considered for inclusion by the management team. Such an investment should be nominated and seconded for consideration by any two class participants, at least one of which shall be a member of the management team. Only investments presented during the current academic year can be considered in this way.

**F. Selection Procedures**

Once an investment (or divestment) has been proposed, the management team (managers and analysts) shall vote on including it in the portfolio. The Portfolio Manager is responsible for tallying votes. Votes may be cast in person or electronically within 24 hours of the initial call for a vote. In order for a vote to be binding, a quorum of 2/3 of the management team must cast a vote. In order for an investment to be made, a majority of votes cast must be in favor. Finally, all managers present during voting shall be required to cast a vote. Any abstentions will be recorded in the negative.

Furthermore, the Portfolio Manager may at his or her discretion initiate an investment buy or sell recommendation at any time and call for a vote by sending an electronic mail message to all fund managers and analysts.

In exceptional circumstances, the Portfolio Manager (PM) with the approval of the fund advisor may make buy and sell investment recommendations and decisions independently.

**G. Trade Execution**

Once an investment is approved by the management team, the Portfolio Manager and Risk Manager shall consider how best to formulate a trade based on the investment. In many cases this may be a simple long or short position. However, more complex strategies are also possible. The managers may also consult other managers or the Advisor(s) for advice.

The trade strategy must be communicated to the Advisor for execution and to the class for their educational benefit with a discussion of the risks, rewards, and rationale for the strategy. The strategy will be entered into the record along with the minutes of the session where the investment was considered.

**H. Majority and Minority Reports**

Majority opinions shall be communicated in written form to the session moderator within 24 hours by one of the managers who find with the majority. Such a report should outline the reasons for the vote.

Minority opinions and reports are encouraged in order to further vigorous debate and present other viewpoints that enhance the educational experience. Written minority reports may be communicated to the session moderator for inclusion in the minutes within 24 hours.

**I. Carryover Positions**

When a new class year begins, it is expected that the Fund will be invested in various assets initiated by the previous class. These carryover positions may remain in the Fund.

When a class is preparing to break for the summer, short positions and special situation investments should be closed. In addition, derivative contracts with expiration dates prior to September 30<sup>th</sup> should be closed as well to avoid any possible physical delivery obligations. If an intern is employed by the Fund for the summer, then these restrictions will be relaxed.

**J. Distribution Policy**

The Fund shall distribute assets based on three considerations (1) the needs of the CML and IM program, (2) a distribution timeframe, and (3) the payout rate of UNC Management Co. First and foremost, the Fund shall not be required to make distributions unless a beneficial expenditure in support of the funding objectives is identified beforehand. Distributions shall not be on a more than quarterly basis. Finally, the distribution rate of the Fund shall not be greater than the UNC Management Co. rate but may be less than that rate.

**K. External Audits**

Audits will be conducted by an external auditor on a semi-annual basis. The auditor will generate a report of risk and compliance that will include an analysis of current holdings and trading activity. Items to be presented include, but are not limited to, (1) report of performance including benchmark comparisons, (2) asset allocation analysis, (3) report on risk measures such as exposure and value at risk, and (4) compliance with position limits. The auditor may also report on qualitative aspects such as control and monitoring procedures for the fund.

The auditor may receive assistance from the Risk Manager, Portfolio Manager, and Advisor in generating the audit report.

**V. PORTFOLIO COMPOSITION**

The Global Perspectives Fund will provide a comprehensive, hands-on, and unique investment education for Kenan-Flagler students. The Fund is intended to achieve an inflation-adjusted return of 5% with minimum risk that will provide support for the Capital Markets Lab and the IM curriculum at Kenan-Flagler.

These objectives will be achieved through an asset allocation strategy consistent with the tenets of Modern Portfolio Theory. The Fund will have a global multi-strategy investment profile with the ability to invest in all major liquid asset classes.

In this Statement, gross exposure is defined as the sum of the absolute notional values of all positions except cash and money markets. Net exposure is the notional value of all long positions minus the absolute notional value of all short positions excluding cash and money markets. In determining portfolio composition, dollar delta exposure is used to estimate the sensitivity of a position to a change in the value of an asset and is of particular importance when considering combined positions.

**A. Asset Allocation**

The Strategic Target Allocation and Tactical Ranges are provided below. The Tactical Ranges provide flexibility for shifts in the actual asset allocation to take advantage of market conditions. The

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actual asset allocation may temporarily fall outside of these guidelines with approval from 2/3 of the Board that the allocation is appropriate under the circumstances.

The broad asset classes below are further defined in APPENDIX A.

<b>Asset Class</b>	<b>Target<sup>1</sup></b>	<b>Allowed Range<sup>1</sup></b>
<b>Global Equities</b>	<b>55%</b>	<b>25%-70%</b>
Domestic	20%	10%-40%
Non-US Developed	25%	10%-40%
Emerging	10%	0%-20%
<b>Fixed Income &amp; Cash</b>	<b>25%</b>	<b>5%-70%</b>
Domestic	15%	5%-60%
International	10%	0%-30%
<b>Real Assets</b>	<b>10%</b>	<b>0%-25%</b>
<b>Special Situations</b>	<b>10%</b>	<b>0%-50%</b>

<sup>1</sup> Net exposures as a percent of total NAV

## B. Asset Class Strategy

Decisions regarding allocations among Asset Classes, or the addition of new Asset Classes, will be made when such actions are expected to produce incremental return, reduce risk, or both. The investment characteristics of an Asset Class including expected return, risk, correlation, and its overall role in the portfolio will be analyzed when making such decisions. It is expected that extreme individual positions will be avoided to prevent the possibility of a significant reduction in value due to adverse market conditions.

### 1. Equities

Equities are included to provide long term capital appreciation and to protect the portfolio from the effects of inflation. A mix of domestic and international equities is included to enhance return and provide diversification.

### 2. Fixed Income

Fixed income investments preserve principal during periods of deflation, provide current income, and reduce overall Fund volatility. These investments provide diversification benefits not available in any other asset class.

### 3. Real Assets

Investments in real assets are principally intended to hedge against inflation and provide significant real returns during periods of rising inflation. Real assets historically have shown little correlation to equity or fixed income assets and provide a diversifying benefit to the portfolio.

### 4. Special Situations

These strategies are intended to provide a way for the portfolio to hedge against certain risks such as interest rate risk or currency exposure. In addition, these strategies have historically

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provided consistent, stable returns with reduced volatility. These strategies provide further diversification benefits due to a low correlation with equities and real assets.

The Advisor will make the final determination as to the appropriate asset class for an investment based on securities involved, risk sources, and strategy intent.

### **C. Position Limits**

In order to manage risk, limits on the exposure of the Fund and on the size of any position are established. These limits will ensure that implicit leverage (through derivative contracts) is controlled and that the Fund's assets will be sufficiently diversified.

#### 1. Overall Fund Limits

The Fund is not allowed to borrow, but may employ leverage through the use of derivative contracts. The Fund may not exceed a gross exposure of 200% of net asset value (NAV).

#### 2. Single Investment Limits

##### a. Equities

Individual equity investments shall have a net exposure of no more than 4% of NAV and a gross exposure of no more than 6% of NAV. Investments in equity index tracking securities (such as ETFs) must conform to limits for the asset class and cannot exceed a gross exposure of 150% of the asset class range.

##### b. Fixed Income

Net exposure to an individual credit risk cannot exceed 5% of NAV even if hedged with other securities. US Treasury securities are exempted from this limitation. Investments that track a fixed income index must conform to limits for the asset class and cannot exceed a gross exposure of 150% of the asset class range.

##### c. Derivatives

The Fund may only invest in standardized derivatives contracts that are traded on an exchange.

The notional principal of derivatives such as futures and options may not exceed 200% of the related asset class investment. This limit applies to the aggregate of all derivative contracts within an asset class. See APPENDIX C for information about notional values of derivatives contracts.

### **D. Prohibited Investments**

The following investments represent an extraordinary risk of loss or a poor educational opportunity and are not appropriate for the Fund.

#### 1. Assets Not Listed on an Exchange

Any asset not listed for trading on an exchange is not appropriate for the Fund. Certain private equity or venture capital investments may be exempted from this restriction upon approval from the Board. Assets in the Fund subsequently removed from the exchange must be reviewed by the Advisor and Portfolio Manager.

#### 2. Market Cap and Share Price Restrictions

Stocks with a market cap under \$100 million and bond issues with a total principal value of less than \$100 million are not appropriate for the Fund. In addition, the Fund is prohibited from investing in stocks trading under \$2.00 per share. Previous investments that no longer meet these criteria are subject to review by the Advisor and Portfolio Manager.

3. *Investment Company Funds*

Investments in actively managed funds are prohibited unless a suitable alternative is not available. This prohibition is intended to maintain the educational value of the Fund.

**E. Rebalancing Policy**

Deviations in actual asset weights from the stated targets are expected and can result from (1) overall market movements, (2) cash flows, and (3) performance variations of Fund investments. Substantial deviations may adversely affect the risk and return characteristics of the Fund.

The Portfolio Manager and Risk Manager are authorized to recommend a rebalancing when they believe it necessary. A rebalancing proposal should include a list of trades and a strategy rationale that considers the costs of rebalancing along with the benefits. The proposal should only include changes to investments already in the Fund and shall not take new positions but may eliminate some positions. In order to rebalance the portfolio, a majority vote of the management team must approve the rebalancing plan.

An approved rebalancing plan should be submitted for execution to the Advisor. The Advisor will generate an execution report for the Portfolio Manager and Risk Manager.

**VI. PERFORMANCE MEASUREMENT**

**A. Benchmarks**

Suitable benchmarks should be used for each asset class to measure the performance of the Fund's investments against similar assets. Criteria for suitable benchmark index include the ability to measure its return, a stable, well-defined constituency, and sufficient historical information. In addition, the various benchmarks should hold mutually exclusive assets.

<b>Asset Class</b>	<b>Benchmark</b>
<b>Global Equities</b>	
Domestic	DJ Wilshire 5000
Non-US Developed	MSCI EAFE Index
Emerging	MSCI Emerging Markets Index
<b>Fixed Income &amp; Cash</b>	
Domestic	Lehman Brothers US Aggregate Bond Index
International	Lehman Brothers EUR/APAC Aggregate Bond Index

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**Real Assets**

DJ-AIG Commodity Index

**Special Situations**

US PCE Deflator + 5%

**B. Policy Benchmark Portfolio**

In order to measure the performance of the Fund in aggregate against its benchmark, a weighted average of the benchmarks' performance will be calculated. The Policy Benchmark shall be

- 20% x DJ Wilshire 5000 return +
- 25% x MSCI EAFE return +
- 10% x MSCI Emerging Markets return +
- 15% x Lehman US Aggregate Bond return +
- 5% x Lehman EUR Aggregate Bond return +
- 5% x Lehman APAC Aggregate Bond return +
- 10% x DJ-AIG Commodity return +
- 10% x (US core PCE deflator + 5%)

**C. Overall Return Objectives**

The Fund will seek to exceed the return of the Policy Benchmark on an annual basis. In addition, the Fund seeks to earn an annual return that places it in the top quintile (20%) of student managed funds at US universities to the extent that a meaningful data sample can be obtained.

In the long-term, the fund seeks to provide real returns for the benefit of the Capital Markets Lab and the Investment Management curriculum. Therefore, the fund seeks to return 5% above the rate of inflation as measured by the US Personal Consumption Expenditure (PCE) Deflator over rolling five and ten year periods.

**D. Asset Class Returns**

Each asset class seeks an investment return, net of fees, greater than that of its benchmark as identified above. Where an Asset Class has multiple segments (e.g. Equities), each segment's performance should be measured against the defined benchmark for that segment.

**E. Performance Monitoring**

The following performance measurements should be maintained for the Fund

- Portfolio return as measured by change in NAV for all relevant time periods including, but not limited to, daily, weekly, monthly, and fiscal year to date.
- Returns for all positions on a daily, weekly, monthly, and since inception basis.
- Returns on all asset classes for the last month, last quarter, year to date, one, three, five, and ten year periods as applicable.
- Returns for all benchmarks for the last quarter, year to date, one, three, five, and ten year periods as applicable.

Dividend and coupon payments should be credited to the total return of the position generating the income. Income should be further consolidated into the asset class return as well.

**VII. PORTFOLIO MONITORING**

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The efficient use of risk yields superior investment returns over the long term. Several risk measures will be put into place so that the management team and the Advisor can effectively monitor risk and adjust the Fund's portfolio to respond to market movements.

**A. Methodology**

Closing prices should be used to calculate position values. For currencies and other derivatives traded continuously or nearly continuously, the standard end of day price should be used. This methodology ensures consistency of valuation and calculation of other metrics such as exposure and position weightings.

**B. Position Monitoring**

The following statistics related to positions must be tracked on a regular basis

- List of all positions in the Fund including cash and unsettled trades
- Acquisition date, price paid, transaction costs, and benchmark price at acquisition
- Daily closing price and position value
- Notional value for a derivative contract (see APPENDIX C for details on notional value)

Statistics on the fixed income portfolio should include

- Duration and convexity of the portfolio
- Breakdown by credit rating as a percentage of total fixed income portfolio

In addition to monitoring metrics, the Portfolio Manager and Risk Manager should be cognizant of the special situation positions used to hedge portfolio risk or capitalize on an arbitrage opportunity. These positions should be monitored to ensure that they are still relevant and sufficient to meet the needs of the portfolio.

**C. Risk Monitoring**

Risk measurement statistics shall be maintained on a regular basis including

- Calculation of the monthly expected return and standard deviation of returns shall be performed every month and after a trade execution
- Calculation of the 30-day VaR with 95% confidence based on the latest calculated standard deviation and correlation shall be performed every month and after every trade execution
- Calculation of the dollar delta exposure of the portfolio
- Direct currency risk exposure

The 30-day value at risk should not be greater than ten percent (10%) of net asset value (NAV). In order to avoid forced selling, violations of this rule can be corrected over a reasonable period of time. Times of extreme market stress are likely to raise volatility and thus increase the VaR temporarily. During such events, the Portfolio Manager and Risk Manager will consult with the Advisor to determine an appropriate response.

**D. Portfolio Monitoring**

Portfolio statistics should be monitored to ensure conformance to the constraints outlined in the Policy Statement. In addition, cost and execution metrics will provide insight into how efficiently the portfolio is being managed.

- Asset Allocation
  - Position weightings
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- Transaction costs
  - Turnover rate

Statistics related to the aggregate value of positions should be monitored to ensure compliance with the Statement. These metrics should be calculated daily.

- Fund net asset value (NAV)
- Fund total net exposure
- Fund total gross exposure
- Total (gross) notional value of all derivative positions

## **VIII. REPORTING**

The management team shall make semi-annual reports on Fund performance, risk, and compliance to the Board. Initial reports shall be made within 15 days after the end of the first half (September 30) and the fiscal year end (March 31). Final reports are to be completed by November 15 for the first half and April 30<sup>th</sup> for the fiscal year. One page (front and back) portfolio summaries are to be updated monthly with data current as of the last business day of the previous month (for the months ending September to March) by the 5 business day of each month. It is the responsibility of the Portfolio Manager and Risk Manager to provide the updated information for these reports and the responsibility of the Marketing Manager to generate the report.

### **A. Report Summary**

The report should summarize the investment strategy of the Fund including tactical allocation during the period. Summary performance statistics should be presented as well.

### **B. Performance Report**

The performance report should detail the performance of the Fund over the last 30 days, year-to-date, and for the one, three, and five year, and since inception periods. The effects of fees and commissions should also be noted in the report.

The report must include the alpha generated by the Fund, defined as risk-adjusted returns generated above the Policy Benchmark, for the appropriate time periods. In addition, the returns relative to benchmark should be broken out for each asset class over the appropriate time periods.

Risk measurements such as standard deviation, beta relative to benchmark, Sharpe and Treynor ratios, and VaR should be reported. In addition, relevant portfolio statistics for each asset class should also be reported. Examples of these include credit quality and maturity of the fixed income portfolio, currency exposure, sector exposure, and geographical exposures.

### **C. Compliance Report**

A compliance report highlighting the Fund's positions versus position and leverage limits shall be presented as part of the semi-annual report. Compliance with structural constraints of the Statement, including asset allocation, will be included in the report.

### **D. Portfolio Holdings**

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The portfolio's holdings should be detailed in the report. The position report should include opening date, cost basis, market value, and exposure values. Aggregate position performance against the relevant benchmark should also be included.

**E. Financial Position**

A statement of the Fund's financial position including cash flows and investment gains and losses (realized and unrealized) will be included in the annual report. The statement should include a breakdown of costs, distributions, and sources of funds.

**F. Market and Economic Forecast**

The management team should present their outlook for the global economy and the various local economies. Relevant macroeconomic drivers expected to impact asset prices should be considered and discussed in developing a forecast.

The management team's outlook for the markets in which the Fund participates should also be included in the forecast.

**G. Forward Looking Strategy**

Using their forecast for economic movements, the management team should develop and report on their investment strategy for the upcoming period. Decisions such as amount of market exposure, tactical asset allocation, and sector weightings will be part of the strategy.

**IX. OTHER CONSIDERATIONS**

**A. Fiscal Year**

The Fund's fiscal year shall run from April 1 – March 31. This will allow for student management to report on the Fund's year-end and first half performance in April and November respectively which will correspond well with the academic year.

**B. Service Providers**

The Board will periodically review the performance and suitability of various service providers such as custody, brokerage, and auditing. The Board may seek counsel from the student management team and Advisor during such reviews. In addition, reviews may be prompted by recommendations from the Advisor or Fund management.

**C. Proxy Votes**

The Marketing Manager and Fund Advisor shall vote all proxies. In general, proxies should be voted per company management's recommendations. Votes on mergers, divestitures, acquisitions, and other reorganizations must be presented to the Fund management team for their consideration and vote. A majority of all managers voting shall be sufficient to make a determination on such matters. In the event that the management team is unavailable to vote, the Advisor shall vote in the best interest of the Fund.

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**APPENDIX A Asset Class Definitions and Examples****Geographies**

Domestic investments are defined as:

- Debt or equity investments in companies based in or substantially operated within the United States.
- Investments in debt instruments issued by the US Government or a sponsored entity (e.g. FNMA) or any government of a municipality within the US.
- Derivative contracts based on domestic debt or equity instruments.

Foreign investments are investment in any equity, debt, or related derivative issued by an entity based outside the United States. Foreign investments are divided between developed and emerging markets based on the respective IMF definitions.

**Equities**

- *Definition:*  
An equity investment is any investment where the primary risk to principal is derived from exposure to the equity price risk of a company or group of companies (e.g. an index).
- *Examples:*
  - Long or short position in an individual stock.
  - Long or short position in an equity index exchange traded fund (ETF).
  - Long or short position in an equity or equity index option.
  - Long or short position in an equity or equity index future or futures option.
  - Long position in a stock combined with a long (protective) position in a put option or a short (covered) position in a call option.
  - Structured fixed income security with principal contingent on the value of an equity security or index.

**Fixed Income**

- *Definition:*  
A fixed income investment is any investment where the primary risk is derived from exposure to a debt security or interest rate.
- *Examples:*
  - Long or short position in an individual bond.
  - Long or short position in a bond index exchange traded fund (ETF).
  - Long or short position in a bond or interest rates future or futures option.

**Real Assets**

- *Definition:*  
A real asset investment is any investment where the primary risk is derived from exposure to a commodity or tangible asset. Real assets also include investments in real estate.
- *Examples:*
  - Long or short position in a commodity fund.
  - Long or short position in a commodity future or futures option.
  - Long or short position in a registered real estate investment trust (REIT) or REIT index.
  - Structured fixed income security with principal contingent on the value of a commodity or commodity index (e.g., gold-linked note).

**Special Situations**

- *Definition:*  
A special situation investment is any allowed investment that is not classified as an equity, fixed income, or real asset investment. Various arbitrage and pair trade strategies are also considered special situations.
  
- *Examples:*
  - Long position in a bond combined with a position in a stock (or stock option) of the issuing company designed to hedge credit exposure (e.g. convertible arbitrage).
  - Currency hedge with currency futures or futures options.
  - Option combinations (e.g., spreads, straddles, etc.)
  - Assorted arbitrage strategies (merger arbitrage, pair trading)
  - Long or short positions in volatility and related indexes
  - Carry trades
  - Macro and factor hedging strategies (e.g., portfolio immunization or insurance)

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**APPENDIX B    Glossary of Terms**

**Alpha** – a measure of excess return over the return predicted by market movements. The Fund defines alpha as the difference between realized return and the beta adjusted market return where beta is the coefficient on the excess market return estimated by the CAPM.

**Beta** – a measure of the correlation of an asset's return to the market return defined as the covariance of an asset with the market divided by the variance of the market.

**Delta Exposure** – estimated percentage change in value of a position given a 1% change in the value of the underlying asset times the net exposure to that asset. This measure is of particular importance when considering the effects of combined positions such as covered options or convertible arbitrage trades.

**Derivative** – any investment, such as an option or futures contract, that derives its value from the price of an underlying asset.

**Duration** – the weighted average of the times to each cash flow from a fixed income instrument where the weights are the present value of the payment divided by the price of the investment.

**Excess Return** – the portion of an asset or portfolio's return that exceeds the risk-free rate.

**Gross Exposure** – the principal or notional dollar value of all long positions in the Fund (or asset class) plus the absolute principal or notional dollar value of all short positions in the Fund (or asset class).

**Net Asset Value** – the total dollar value of the Fund's investments and cash position based on market price of the investments times the number held by the fund. abbr. NAV.

**Net Exposure** – the principal or notional dollar value of all long positions in the Fund (or an asset class) minus the absolute principal or notional dollar value of all short positions in the Fund (or asset class).

**Sharpe Ratio** – a measure of risk-adjusted returns defined as the asset's excess return divided by the standard deviation of returns.

**Treynor Ratio** – a risk-adjusted return measure calculated by dividing the portfolio's excess return by its beta.

**Turnover** – a measure of how frequently a fund's assets are bought and sold calculated by taking either the notional dollar value of purchases or sales, whichever is less, over a given period and dividing by the total net asset value of the fund at the end of the period.

**Value at Risk** – the dollar value of a theoretical loss based on a certain probability of incurring that loss. Typically this is defined over a 30 day period as the expected loss of value with a 5% chance of incurring that loss with any greater loss having a lower probability (the 30 day VaR at 95% confidence). abbr. VaR.

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**APPENDIX C      Examples of Notional Value****Long Option Position**

The notional value of an option position can be found by multiplying the contract size by the strike price then by the number of contracts held.

- A position in 5 options to buy 100 IBM at \$110 has a notional value of \$55,000.
- A position in 10 options to sell 100 CSCO at \$20 has a notional value of \$20,000.

**Short Call Option Position**

The notional value of a short position in call options is dependent upon the current price of the underlying asset. The value is calculated by multiplying the number of contracts times the contract size times the price of the underlying.

- A short position on 5 options to buy 100 AAPL when AAPL is trading at \$160 has a notional value of \$80,000 regardless of the strike price.
- In the above example, if the price of AAPL rises to \$200, the notional value is \$100,000.

**Short Put Option Position**

The notional value of a short position in put options is calculated the same way as for a long option position.

- A short position on 5 options to sell 100 INTC at \$20 has a notional value of \$10,000.

**Futures Position**

In order to determine the notional value of a futures contract, you must know the specification. The notional value of one contract is simply the specification times the spot price of the underlying asset.

- A standard S&P 500 futures contract has a specification of \$250 x index value. If the index is 1,350, then the notional value is \$337,500.
- A standard NYMEX crude oil future has a specification of 1,000 barrels. At \$100 per barrel, the notional value is \$100,000.
- A standard Japanese Yen contract has a contract size of ¥12,500,000. At 100 yen per dollar, the notional value in USD is \$125,000.