

February 17, 2006

THE UNIVERSITY OF MICHIGAN
REGENTS COMMUNICATION

REQUEST FOR ACTION

Subject: Long Term Portfolio Asset Allocation

Action Requested. Widen Allowable Range to Fixed Income

Background and Summary: In 1986, the Board of Regents first approved an asset allocation policy for the endowment fund, setting a target of 70 percent equities and 30 percent fixed income. The policy emphasized higher returning equities and included a significant fixed income allocation for diversification and deflation protection.

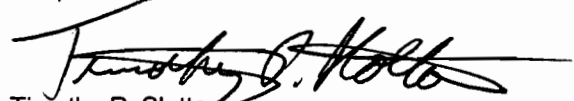
Fixed income's importance gradually diminished over time as the University diversified its equity component from consisting almost entirely of U.S. equities to including non-U.S. equities and illiquid alternative asset investments in venture capital, private equity, real estate and energy funds. In addition, the University broadened its exposure to absolute return strategies, whose objective is to produce positive returns in all markets regardless of the direction of the capital markets.

In recognition of the Long Term Portfolio's increasing level of diversification, the Board of Regents lowered the target exposure to fixed income twice, first in 1994 when it set the target exposure to 25 percent of the Long Term Portfolio and established an allowable range of 15 percent to 35 percent, and then again in 1996 to 20 percent, with no change to the allowable target range at 15 percent to 35 percent.

In 2000, the Board of Regents was presented with the first detailed Model Portfolio for the Long Term Portfolio which set model asset allocations as follows: 32 percent to U.S. equities, 16 percent to non-U.S. equities, 18 percent to fixed income, 10 percent to absolute return strategies, and 23 percent in aggregate to alternative assets (illiquid). This Model Portfolio was modified in 2004 when the model allocation to U.S. equities was lowered to 28 percent and the model allocation to absolute return was raised to 15 percent.

With a model allocation of 18 percent to fixed income, the lower end of the allowable range to fixed income of 15 percent to 35 percent has proved to be constraining in the current investment environment where fixed income is seen as a relatively unattractive asset class. We therefore recommend widening the allowable range to fixed income to 10 percent to 35 percent, which would allow for variances in the fixed income allocation relative to the model portfolio that are more consistent with that of other asset classes.

Respectfully submitted,



Timothy P. Slottow
Executive Vice President and
Chief Financial Officer

February 2006