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STATE OF VERMONT
OFFICE OF THE STATE TREASURER

TO: Jeb Spaulding, Secretary of Administration, and the
Higher Education Subcommittee of the Prekindergarten-16 Council

FROM: Elizabeth Pearce, State Treasurer

RE: Annual Report on the Higher Education Endowment Trust Fund

DATE: September 1, 2011

I am pleased to present the Secretary of Administration and the Higher Education Subcommittee (Subcommittee) of the Prekindergarten-16 Council with the State Treasurer's twelfth annual report on the Higher Education Endowment Trust Fund (Fund).

The General Assembly established the Fund in the Office of the State Treasurer in 1999 to provide non-loan financial aid to Vermont students attending the University of Vermont (UVM), the Vermont State Colleges, and other Vermont post-secondary institutions (16 V.S.A. § 2885).

Performance Summary

During Fiscal Year 2011, the Fund's dollar weighted investment return was 10.79% gross of fees. This return compares to the Barclays Aggregate Bond Index return of 3.9% and to the S&P 500 Stock Index return of 30.73% for the same period, and is less than the Fund's target allocation index rate (that is, the rate of return that would have been realized if 30% of the Fund was invested in the S&P 500 Index, and 70% in the Barclays Aggregate) of 11.68%. In general the Fund underperformed its Index due to a more conservative stance in the fixed-income space as well as due to equity market volatility in late 2010. This conservative position is consistent with the objective of providing a high likelihood of annual distributions from the Fund. It should also be noted that the Fund has outperformed since its inception in 2000, returning 8.11% on an annualized basis against 6.18% for its benchmark. The Fund has also outperformed its benchmark over the past three, five, seven and ten fiscal year periods. A detailed discussion of the Fund's performance is included in this report.

5% Distribution from Fiscal Year 2011

The statute provides that in August of each fiscal year, the State Treasurer is to withdraw 5% of up to a 12-quarter moving average of the Fund's assets and divide the amount equally among UVM, the Vermont State Colleges, and the Vermont Student Assistance Corporation (VSAC). The amount appropriated, however, cannot exceed an amount that would bring the Fund balance

below total contributions to principal. Total principal contributions through June 30, 2011 have been \$17,500,823.36.

The 5% distribution available this year is \$912,044.36 in total or \$304,014.79 each for UVM, the Vermont State Colleges, and VSAC. This amount represents a 2.52% increase over the distribution made following Fiscal Year 2010 of \$296,529.83 for each institution. **Appendix A** to this report includes quarterly market values and distributions for Fiscal Year 2011, and **Chart #1** shows principal contributions to date.

2% Distribution from Fiscal Year 2010

16 V.S.A. § 2885 further provides that during the first quarter of each fiscal year, the Secretary and the Subcommittee may authorize the State Treasurer to make an additional amount equal to up to 2% of the Fund’s average assets available to UVM and the Vermont State Colleges for the purpose of creating or increasing a permanent endowment fund. Similar to the 5% distribution, the amount appropriated cannot exceed an amount that would bring the Fund balance below total contributions to principal. Further, each institution is required to match the appropriation by raising private donations of at least twice the appropriated amount, to certify to the Commissioner of Finance and Management (Commissioner) that it received private donations in the requisite amount, and that the funds will be used to create or increase a permanent endowment at the respective institution.

At its meeting last year, then-Secretary Neale Lunderville and the Subcommittee authorized this 2% appropriation in the amount of \$355,835.80, or \$177,917.90 each for distribution to UVM and the Vermont State Colleges, dependent upon a finding by the Commissioner that the terms of this appropriation were met. Each of these institutions is in the process of establishing the required certification. Due to the Fund’s positive return in Fiscal Year 2011, the Fund will be able to make the full distribution amount.

After payments of \$912,044.36 and \$355,835.80, the Fund balance at the end of Fiscal Year 2011 totals \$18,471,131.54. An accounting of the Fund balances is provided below:

Ending balance FY 2010	\$19,080,449.90
Contributions received FY 2011*	<u>0.00</u>
Opening balance FY 2011	\$19,080,449.90
5% Distributions: University of Vermont	(296,529.83)
Vermont State Colleges	(296,529.83)
Vermont Student Assistance Corp.	(296,529.83)
2% Distributions: University of Vermont	(174,535.22)
Vermont State Colleges	(174,535.22)
Income earned FY 2011	1,222,955.10
Appreciation (Depreciation) FY 2011	749,735.12

Fees and Other Charges FY 2011	(75,468.49)
Balance June 30, 2011	\$19,739,011.70
5% of 12-Quarter Moving Average as of June 30, 2011	(912,044.36)
Distributions: University of Vermont	(304,014.79)
Vermont State Colleges	(304,014.79)
Vermont Student Assistance Corp.	(304,014.79)
2% Income Available for Endowments from FY 2010	(355,835.80)
Balance after distributions	\$18,471,131.54
Total contributions as of June 30, 2011	\$17,500,823.36
2% Income Available for Endowments from FY 2011 (requires institutional match in FY 2012)	\$364,817.75

*Does not include \$11,030,026.35 of receipts that the State collected during FY 2011 that were added to the Fund in FY 2012.

2% Distribution for Fiscal Year 2011

All principal contributions to the Fund through June 30, 2011 total \$17,500,823.36, which also represents the minimum balance that must be maintained in the Fund. The 2% distribution proposed for this year of \$364,817.75 would leave a balance of \$18,471,131.54 excluding contributions to be received, the 5% distribution following FY 2011, and any gains from investment activity in FY 2011. If the Secretary and the Subcommittee authorize this distribution, each institution's share will be \$182,408.87 with a required match to be raised by each entity in FY 2011 of \$364,817.75. The attached **Chart #2** provides a graphical depiction of authorized distributions, including this 2% distribution subject to the Secretary's and the Subcommittee's approval.

Fund Balances

Appendix B to this report shows the total return of the entire Trust Investment Account, of which the Higher Education Endowment Trust Fund, with a balance of \$19.7 million (prior to cash distributions to be made in FY 2011) comprises approximately 31%. The Tobacco Trust Fund comprises 39% of the account, or \$24.9 million, and the remaining 30% is made up of, in decreasing size, a State Employee's retirement benefit trust fund totaling \$9.4 million, the ANR Stewardship Fund at \$4.4 million, the Waterfowl Stamp Fund at \$2.2 million, the Fish and Wildlife Trust Fund at \$1.5 million, two Veterans' Home trusts totaling \$1.1 million, and eight small trusts totaling just over \$550,000. **Chart #3** displays the relative share of the Higher Education Endowment Trust Fund compared to the entire Trust Investment Account.

Chart #4 presents the Fund's balances, inclusive of distributions, for fiscal years 2000 through 2011. The balance increased significantly in FY 2007 due to Estate Tax receipts of

\$5,223,449.94, and a \$600,000 contribution from the State's unclaimed property fund as a result of legislation proposed by the Treasurer in FY 2006. Assets decreased modestly in FY 2008 and FY 2009 due to low investment returns and minimal fund contributions. Finally, the fund balances in both FY 2010 and FY 2011 benefited from a continued equity market rebound from the 2008 financial crisis, as well as from an Estate Tax contribution during FY 2010.

Asset Allocation, Investment Managers and Performance

The Trust Investment Account's target asset allocation is 70% fixed income securities and 30% equities. As of June 30, 2011, the Account's actual allocation comprised 68.8% fixed income securities and 31.2% equities, versus 73.2% fixed income securities and 26.8% equities, respectively, on June 30, 2010. To minimize transaction costs, the Account is rebalanced annually in October, and other contributions and withdrawals from the various funds are used to "fine tune" the asset allocation during the year.

The Account achieved modest positive returns in both FY 2008 and FY 2009, during some of the worst financial market conditions since the 1930s, and achieved sufficient returns to fully fund distributions in both FY 2010 and FY 2011. Given that the asset allocation has enabled the Fund to perform in both exceptionally adverse and very positive markets, the Treasurer's Office believes the current asset allocation has been appropriate. In particular, the Treasurer's Office is mindful of the need to balance the equity and fixed-income exposures in light of the expectation for annual distributions from the Fund.

The Account return underperformed its benchmark in FY 2011, due in part to conservative fixed income managers lagging their benchmark during the year. The lag was due primarily to riskier fixed income securities (e.g., CMBS instruments) outperforming Treasuries and a somewhat shorter duration in the portfolio versus the benchmark. Equity performance during the fiscal year was impacted primarily by underperformance during the fourth calendar quarter of 2010.

The Account has four investment managers, three of whom are Vermont-based and have managed Account assets for at least ten years: two equity managers, Prentiss Smith & Co. of Brattleboro, and Hanson & Doremus of Burlington, and fixed income manager Sentinel Asset Management (a National Life company), of Montpelier. Each of these managers has outperformed their benchmark in seven of the past eleven fiscal years.

The fourth manager, Minnesota-based fixed income manager RBC Global Asset Management (formerly Access Capital), manages a fund that invests in debt securities that support affordable housing, job creation and community development for low- and moderate-income individuals and communities in Vermont. RBC underperformed in FY 2008, outperformed in FY 2009, and lagged the benchmark in both FY 2010 and FY 2011 but in those years has posted higher returns than Sentinel. As such, this investment is meeting its goals of capital preservation and investment return, along with providing benefits to Vermonters.

In conclusion, the Treasurer's Office believes that the Fund's asset allocation is appropriate to its goals of asset growth, capital preservation and supporting distributions, and that the investment managers have performed in a manner consistent with these goals. However, since future distributions depend upon Fund performance, and because interest rates are near fifty-year lows

(limiting the upside to owning fixed-income investments), the Treasurer's office is considering changes to the asset allocation as well as asset classes going forward.

Please feel free to contact me if you have any questions or concerns regarding this report.

cc: James Reardon, Commissioner of Finance & Management
Donna Russo-Savage, Legislative Council

**APPENDIX A
HIGHER EDUCATION ENDOWMENT TRUST FUND - DISTRIBUTIONS
For Period Ending June 30, 2011**

<u>Quarter-End Balances</u>	<u>September 30</u>	<u>December 31</u>	<u>March 31</u>	<u>June 30</u>
Fiscal Year 2009	\$16,966,384.87	\$16,320,715.01	\$16,315,441.73	\$17,050,798.96
Fiscal Year 2010	\$18,084,136.99	\$18,649,777.82	\$19,114,425.82	\$19,080,449.90
Fiscal Year 2011	\$19,046,186.38	\$19,080,907.03	\$19,442,411.23	\$19,739,011.70

Twelve Quarter Average **\$18,240,887.29**

5% Distribution FY2011 **\$912,044.36**

VSAC	\$304,014.79
UVM	\$304,014.79
Vermont State Colleges	\$304,014.79

2% FY2011 (Projected) **\$355,835.80**

UVM	\$177,917.90
Vermont State Colleges	\$177,917.90

2% FY2011 (Actual) **\$355,835.80**

UVM	\$177,917.90
Vermont State Colleges	\$177,917.90

Balance after Distributions **\$18,471,131.54**

2% FY2012 (Projected) **\$364,817.75**

UVM	\$182,408.87
Vermont State Colleges	\$182,408.87

Total Contributions

2001	\$6,000,000.00
2002	\$1,000,000.00
2003	\$635,881.49
2004	\$0.00
2005	\$0.00
2006	\$2,363,355.61
2007	\$5,823,449.94
2008	\$57,208.65
2009	\$0.00
2010	\$1,620,927.67
2011*	\$0.00

Total: **\$17,500,823.36**

*Excludes \$11,030,026.15 of receipts that the State collected in FY 2011 that were added to the fund in FY 2012

APPENDIX B
TRUST INVESTMENT ACCOUNT - TOTAL RETURN ANALYSIS¹
 Period Ending June 30, 2011

<u>MANAGER</u>	Fiscal Year <u>2002</u>	Calendar Year <u>2002</u>	Fiscal Year <u>2003</u>	Calendar Year <u>2003</u>	Fiscal Year <u>2004</u>	Calendar Year <u>2004</u>	Fiscal Year <u>2005</u>	Calendar Year <u>2005</u>	Fiscal Year <u>2006</u>	Calendar Year <u>2006</u>
DOMESTIC EQUITY										
Hanson & Doremus Investment Management	-7.78%	-18.01%	-1.89%	42.55%	29.10%	15.92%	22.25%	19.18%	21.10%	20.28%
Prentiss Smith & Co.	3.60%	-7.35%	7.70%	18.17%	11.47%	13.25%	11.00%	10.68%	15.77%	16.61%
S&P 500	-17.99%	-22.11%	0.25%	28.69%	19.14%	10.90%	6.32%	4.91%	8.63%	15.80%
DOMESTIC FIXED INCOME										
Sentinel Asset Management, Inc.	9.41%	9.48%	8.92%	5.43%	3.48%	5.56%	7.42%	3.07%	0.26%	5.31%
RBC Global Asset Management (Access Capital) ²										
Barclays (formerly Lehman) Aggregate	8.63%	10.25%	10.40%	4.10%	0.32%	4.34%	6.80%	2.43%	-0.81%	4.33%
TOTAL FUND DOLLAR WEIGHTED RETURN										
	7.94%	5.15%	8.59%	11.24%	7.59%	8.14%	10.17%	6.64%	5.86%	9.48%
Total Fund Target	3.94%	3.29%	9.23%	9.94%	4.96%	6.23%	6.76%	3.27%	2.19%	7.96%
TOTAL FUND MARKET VALUE (\$ million)										
	\$33.3	\$34.9	\$37.3	\$38.8	\$39.3	\$41.1	\$43.5	\$48.6	\$49.7	\$52.8

<u>MANAGER</u>	Fiscal Year <u>2007</u>	Calendar Year <u>2007</u>	Fiscal Year <u>2008</u>	Calendar Year <u>2008</u>	Fiscal Year <u>2009</u>	Calendar Year <u>2009</u>	Fiscal Year <u>2010</u>	Calendar Year <u>2010</u>	Fiscal Year <u>2011</u>	
DOMESTIC EQUITY										
Hanson & Doremus Investment Management	29.13%	14.32%	-14.64%	-38.44%	-28.04%	22.93%	10.42%	18.90%	32.15%	
Prentiss Smith & Co.	20.09%	10.85%	-4.96%	-23.98%	-9.34%	35.30%	12.30%	11.04%	26.57%	
S&P 500	20.60%	5.50%	-13.13%	-37.00%	-26.21%	26.42%	14.43%	15.16%	30.73%	
DOMESTIC FIXED INCOME										
Sentinel Asset Management, Inc.	6.12%	7.61%	9.10%	7.81%	8.77%	5.03%	7.95%	6.67%	3.27%	
RBC Global Asset Management (Access Capital) ²										
Barclays (formerly Lehman) Aggregate	6.12%	6.96%	7.12%	5.24%	6.06%	5.94%	9.49%	6.54%	3.90%	
TOTAL FUND DOLLAR WEIGHTED RETURN										
	12.02%	9.47%	3.10%	-3.62%	2.40%	13.06%	9.93%	9.76%	10.79%	
Total Fund Target	10.62%	6.80%	1.14%	-6.59%	-1.19%	13.18%	12.06%	9.88%	11.68%	
TOTAL FUND MARKET VALUE (\$ million)										
	\$55.5	\$58.8	\$59.3	\$55.7	\$59.2	\$66.1	\$60.6	\$61.2	\$64.0	

<u>MANAGER</u>	Quarter Ended <u>9/30/2010</u>	Quarter Ended <u>12/31/2010</u>	Calendar Year <u>2010</u>	Quarter Ended <u>3/31/2011</u>	Quarter Ended <u>6/30/2011</u>	Fiscal Year <u>2011</u>	Portfolio Value <u>6/30/2011</u>	Portfolio Percent <u>6/30/2011</u>
DOMESTIC EQUITY								
Hanson & Doremus Investment Management	14.27%	13.17%	18.90%	4.06%	-1.80%	32.15%	\$9,668,127	15.1%
Prentiss Smith & Co.	12.00%	6.72%	11.04%	4.84%	1.00%	26.57%	\$10,287,966	16.1%
S&P 500	11.30%	10.80%	15.16%	5.90%	0.10%	30.73%		31.2%
DOMESTIC FIXED INCOME								
Sentinel Asset Management, Inc.	1.43%	-1.06%	6.67%	0.63%	2.26%	3.27%	\$40,935,394	64.0%
RBC Global Asset Management (Access Capital) ²	0.65%	0.22%	5.40%	0.44%	2.45%	3.80%	\$3,092,805	4.8%
Barclays (formerly Lehman) Aggregate	2.48%	-1.30%	6.54%	0.42%	2.29%	3.90%		68.8%
TOTAL FUND DOLLAR WEIGHTED RETURN								
	4.74%	2.40%	9.76%	1.84%	1.44%	10.79%		
Total Fund Target	5.02%	2.46%	9.88%	2.16%	1.60%	11.68%		
TOTAL FUND MARKET VALUE (\$ million)								
	\$59.5	\$61.2	\$61.2	\$62.4	\$64.0	\$64.0	\$63,984,291	100.0%

Notes:

1. Includes cash balances of: Hanson - \$398,023, Prentiss - \$460,133, Sentinel - \$699,458 as of June 30, 2011.
2. Access Capital added to Trust Investment Account on October 12, 2007.

**APPENDIX C
TRUST INVESTMENT ACCOUNT PERFORMANCE¹**

<u>MANAGER</u>	<u>Fiscal Year 2011</u>	<u>Calendar Year 2010</u>	<u>Last 3 Fiscal Years</u>	<u>Last 5 Fiscal Years</u>	<u>Last 7 Fiscal Years</u>	<u>Last 10 Fiscal Years</u>	<u>Since Inception in FY2000</u>
DOMESTIC EQUITY							
Hanson & Doremus Investment Management	32.15%	18.90%	1.64%	2.97%	8.00%	7.18%	9.04%
Prentiss Smith & Co.	26.57%	11.04%	8.82%	8.02%	9.52%	8.92%	8.80%
<i>S&P 500</i>	30.73%	15.16%	3.35%	2.95%	4.22%	2.72%	1.12%
DOMESTIC FIXED INCOME							
Sentinel Asset Management, Inc.	3.27%	6.67%	6.64%	7.02%	6.08%	6.43%	6.78%
RBC Global Asset Management ²	3.80%	5.40%	7.04%	N/A	N/A	N/A	N/A
<i>Barclays (formerly Lehman) Aggregate</i>	3.90%	6.54%	6.46%	6.52%	5.48%	5.74%	6.14%
TOTAL FUND DOLLAR WEIGHTED RETURN							
<i>Total Fund Target</i>	11.68%	9.88%	7.34%	6.71%	6.06%	6.05%	6.18%
TOTAL FUND MARKET VALUE (\$ millions)	\$64.0	\$61.2					

Notes:

1. Returns for periods longer than one year are annualized.

2. Formerly Access Capital Management, inception date of September 17, 2007.

Chart #1
Higher Education Endowment Trust Fund
Fund Contributions (Fiscal Years)

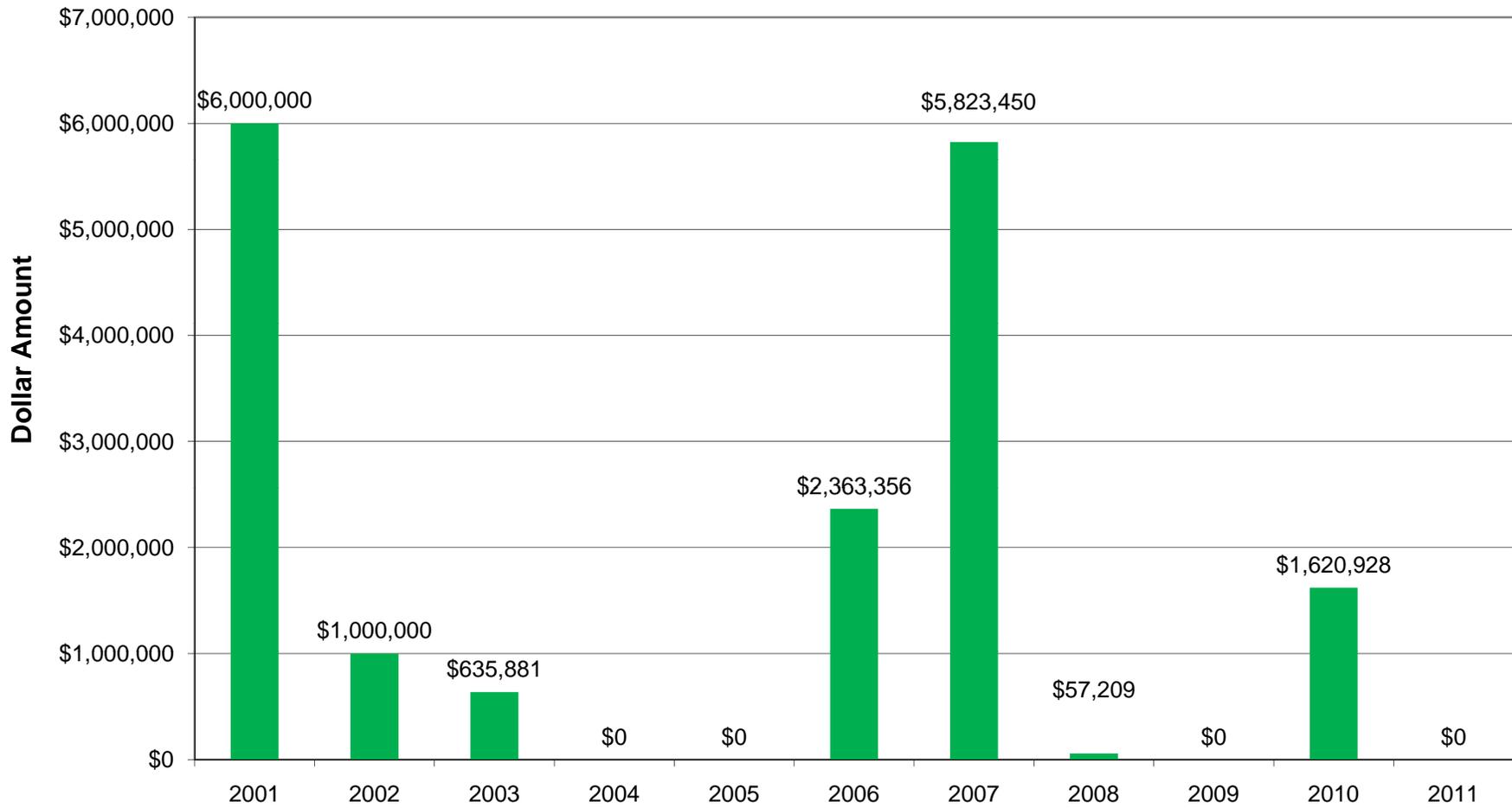
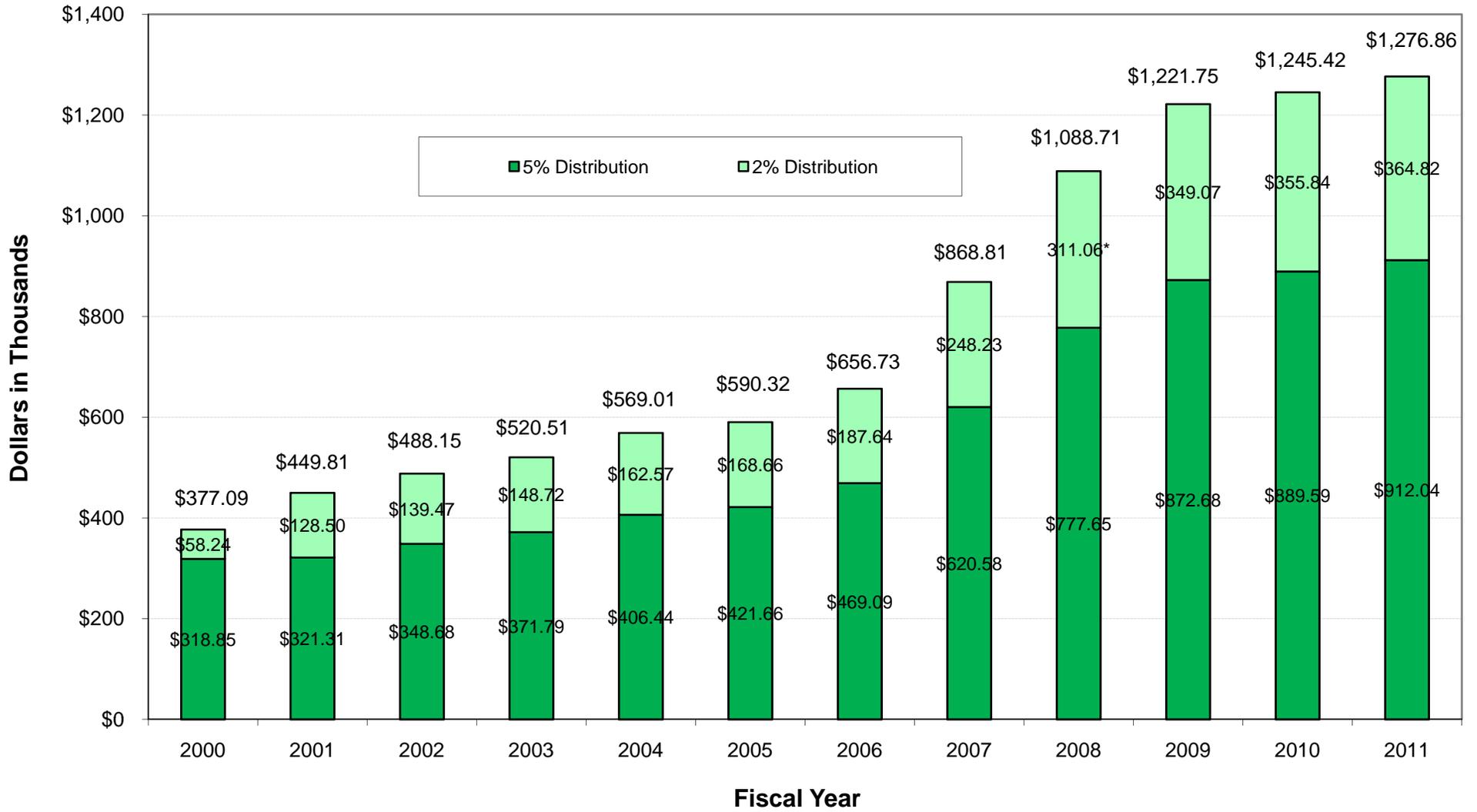


Chart #2
Higher Education Endowment Trust Fund
Authorized Distributions by Year and Type



* Actual 2% distribution for 2008 was \$298,227.18.

Chart #3

Trust Investment Account Fund Composition as of June 30, 2011

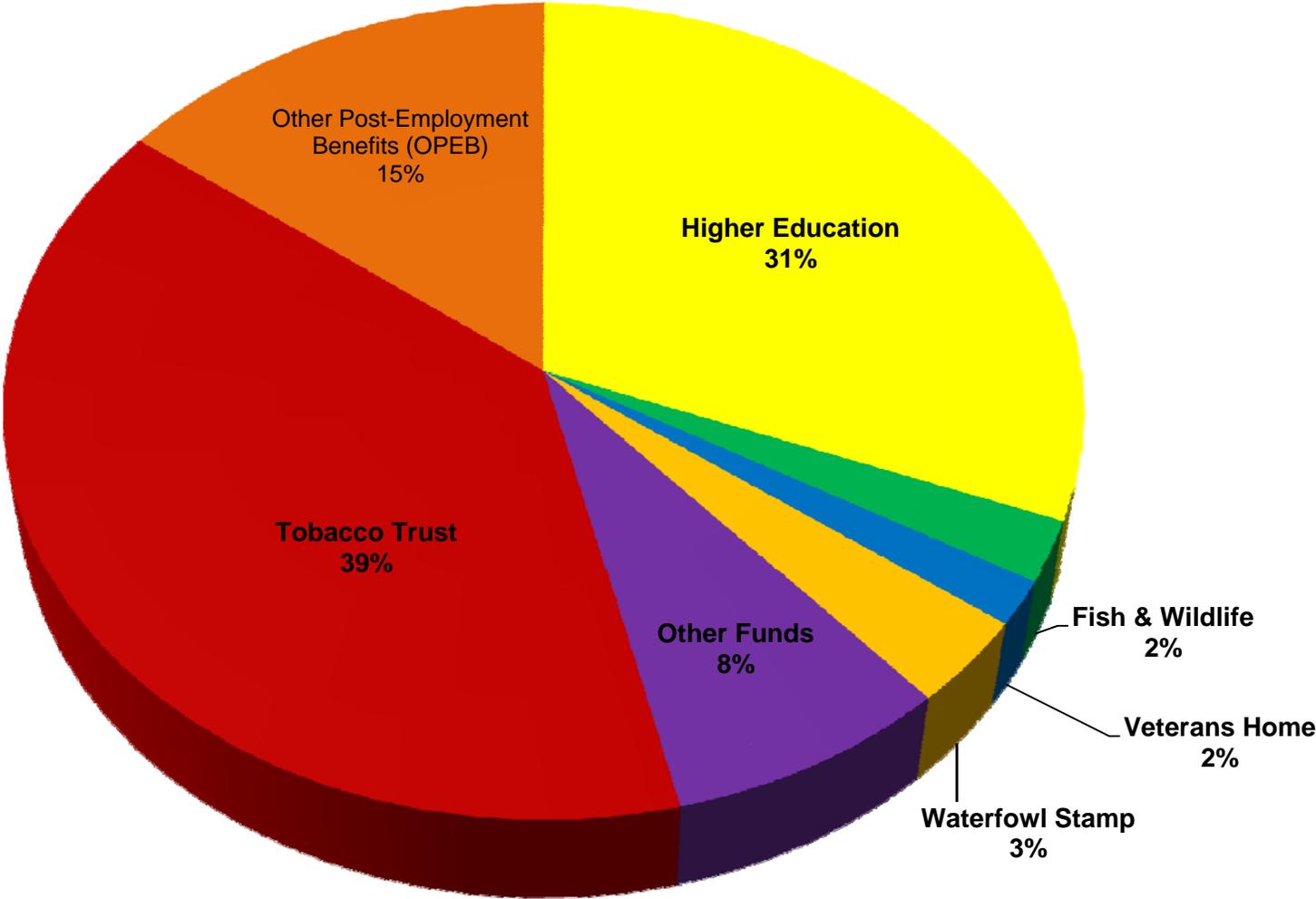


Chart #4
Higher Education Endowment Trust Fund
Asset Growth, 6/30/2000 to 6/30/2011
(Includes Distributions)

