Minutes
Investment Committee
Educational Session
Board of Trustees
May 12, 2008

IN ATTENDANCE:

Investment Committee Members:	Mr. Billy B. Wilcoxson, Chair Mr. Stephen P. Branscum Mr. James F. Hardymon Ms. Myra Leigh Tobin Ms. JoEtta Y. Wickliffe
Board of Trustees Members:	Ms. Mira S. Ball
Investment Staff & Consultants:	Mr. Marc A. Mathews Ms. Susan I. Krauss Mr. Russ Kuhns (R.V. Kuhns & Associates) Mr. Rob Palmeri (R.V. Kuhns & Associates) Mr. Bruno Grimaldi (R.V. Kuhns & Associates) Mr. Mike Paolucci (R.V. Kuhns & Associates)
Others:	Mr. Frank A. Butler Mr. Barbara W. Jones Mr. Henry Clay Owen

The educational session was called to order at 9:05 a.m.

Mr. Mathews discussed the draft Endowment Investment Policy noting that the significant change to the policy is the asset allocation, which is based on the asset allocation study performed by R.V. Kuhns & Associates ("RVK"). The asset allocation changes are being proposed with the goal of increasing endowment returns and reducing the volatility of returns. RVK will present the asset allocation study to the Committee and explain how the addition of new asset classes can accomplish this goal. Mr. Wilcoxson stated that establishing the asset allocation is the most important decision the Committee will make. Mr. Mathews and Mr. Palmeri discussed the other changes to the investment policy, which are minor in nature and are being proposed for organization and clarification purposes. There was some discussion by the Committee about whether the manager structure section should be included in the policy or in the appendix to the policy. It was decided to leave the manager structure section in the policy since the full Board is not required to approve the policy and staff can update this section as managers are added or terminated by the Investment Committee.

Mr. Wilcoxson commented on the March flash report that had been distributed in April and requested that RVK and staff work to condense the report to a one-page summary if possible.

Mr. Kuhns presented the asset allocation study that was conducted by RVK and staff. The study is based on expected returns, standard deviations and correlations of the various asset classes, which are based on historical data modified for future expectations. The asset allocation model uses this information to build "optimal" or "efficient" portfolios that produce either a specific rate of return with the lowest level of risk or the highest rate of return with a specific level of risk. Mr. Kuhns explained the different scenarios or "efficient frontiers" presented in the study, which included UK's current asset classes; UK's current asset classes plus real return; UK's current asset classes plus absolute return; UK's current asset classes plus value added and opportunistic real estate; and UK's current asset classes plus all three new asset classes. With each scenario, the addition of the new asset class increased the expected return and/or decreased the expected risk or standard deviation, as compared to UK's current target allocation

Mr. Kuhns discussed the proposed asset allocation, which includes real return, absolute return and value added and opportunistic real estate, comparing it to the current target allocation as follows:

Asset Class	Current Target Allocation	Proposed Allocation
Broad U.S. Equity	49%	26%
Broad International Equity	16	20
U.S. Core Fixed Income	22	18
Real Estate – Core	8	4
Private Equity	5	7
Real Return		7
Absolute Return		10
Real Estate –Value Added		4
Real Estate – Opportunistic		4
Total	100%	100%
Expected Annual Return	7.70%	8.07%
Expected Risk (Std. Deviation)	11.86%	10.20%

Mr. Kuhns explained that by adding the three new asset classes, UK's expected return is 37 basis points higher and the expected risk is 166 basis points lower.

Ms. Krauss presented a summary which compared the proposed allocation to the average allocation of the University's nineteen benchmarks and also to the allocations recommended by other consulting firms during the consultant search. The proposed allocation of 36% to alternative investments is reasonable when compared to UK's benchmarks, which have an average allocation of 36% to alternatives (based on the 2007 NACUBO Endowment Study), and also to the proposed allocations recommended by other consulting firms. Ennis Knupp and Hammond Associates proposed allocations to alternative investments of 20% and 50%, respectively.

Mr. Paolucci made an educational presentation on real estate, describing the various investment considerations of core, value added and opportunistic strategies. Core real estate, which is what the University's currently invests in, consists of a fully diversified portfolio of income producing (substantially leased) properties. A modest amount of leverage is utilized in core real estate funds. The majority of the return (>75%) from core real estate investments comes from the rental income, with the remaining return from appreciation. Value added real estate involves redevelopment, releasing and repositioning of existing properties and utilizes a greater amount of leverage. The return from value added real estate contains both income and appreciation. Opportunistic real estate involves development of properties and/or extensive redevelopment of existing properties and utilizes a significant amount of leverage. Since opportunistic is speculative in nature, the return comes mainly from appreciation of the properties. Mr. Paolucci indicated that his real estate team meets regularly with real estate managers and is very familiar with the different firms and strategies and will work with UK to select managers for the proposed 4% value added and 4% opportunistic allocations. Mr. Paolucci commented that it would take three to five years to implement the proposed allocations.

Mr. Palmeri made an educational presentation on real return, which is defined as a strategy that targets a return exceeding inflation by a defined premium, such as the consumer price index plus 5%. Real return investments are used in a portfolio to provide protection during inflationary environments since traditional stock and bond investments struggle when inflation rises. Real return assets typically include Treasury Inflation Protection Securities (TIPS), commodities, currency, REITS, timber products, infrastructure and global natural resources. Mr. Palmeri discussed various implementation issues of this asset class and noted that RVK recommends a fund-of-funds approach which would involve selecting managers that invest in a diversified mix of the various types of real return assets. Mr. Palmeri indicated that two of the leading real return managers are PIMCO and Wellington and that the University should consider these firms due to their existing relationship with the University.

Mr. Grimaldi made an educational presentation on absolute return, which seeks to provide consistent positive returns, with relatively low correlation to other asset classes. RVK defines absolute return investing as a fund-of-funds strategy using a diversified range of underlying hedge funds. RVK expects the absolute return asset class to produce an average annual net return of 8.0%, with a standard deviation of 6.5%. Mr. Grimaldi discussed hedge funds, describing them as private, unregulated investment partnerships that invest in a broad range of strategies and securities. Hedge funds utilize leverage, short-selling and derivatives and the fees are very high. Mr. Grimaldi presented a return analysis of hedge funds since 1990, as compared to the S&P 500 and the Lehman Brothers Aggregate, demonstrating that hedge funds participate in up markets and provide protection in down markets. RVK recommends a fund-of-funds approach in this asset class, despite the additional layer of fees, as the fund-of-funds approach provides diversification and risk reduction, as well as access to the top hedge fund managers. Additionally, the fund-of-funds structure is optimal for institutional investors with limited staffing since this asset class requires a significant amount of due diligence and oversight. Mr. Kuhns stated that if the Committee approves the proposed allocation of 10% to absolute return, he recommends that staff perform on-site visits with the fund-of-funds managers before they are hired in order to obtain a better understanding of how the firms select hedge funds investments and manage risk.

After some discussion by the Committee on the proposed asset allocation, Mr. Wilcoxson inquired about the implementation timeline and whether certain changes could be made immediately, such as shifting part of the U.S. equity allocation to non-U.S. equity. Ms. Krauss responded that staff and RVK will proceed with developing an implementation plan for the proposed asset allocation and present it to the Committee in June. The purpose of today's meeting was to obtain feedback and general buy-in from the Committee on the proposed asset allocation and to provide education on the new asset classes being proposed.

Mr. Wilcoxson discussed the proposed change to the University's governing regulations that will allow the appointment of up to three advisory members to the Investment Committee and emphasized the importance of finding advisory members that are knowledgeable on investment matters.

Ms. Krauss distributed a revised RVK work plan detailing the agenda items to be discussed at the upcoming Investment Committee meetings. In addition to the regular quarterly sessions scheduled for June, September and December, the Investment Committee will have special sessions on October 13, 2008 and December 8, 2008 to conduct manager interviews. Ms. Krauss also distributed the March 2008 Total Endowment and External Trust report, noting this report will be distributed to the Committee on a quarterly basis in the future. The report will be prepared monthly to facilitate responding to inquiries about the value of the University's endowment.

With no further business, the meeting adjourned at 2:00 p.m.

Susan I. Krauss
Office of the Treasurer