

**Minutes
Investment Committee
Board of Trustees
March 10, 2009**

IN ATTENDANCE:

Investment Committee Members:	Ms. JoEtta Y. Wickliffe, Chair Mr. Stephen P. Branscum Dr. Edward Britt Brockman Mr. James F. Hardymon
Community Advisory Members:	Mr. Henry Clay Owen Mr. James W. Stuckert Mr. Billy B. Wilcoxson
Board of Trustees Members:	Ms. Mira S. Ball Mr. Everett McCorvey Mr. Erwin Roberts
Investment Staff & Consultants:	Mr. Marc A. Mathews Ms. Susan I. Krauss Ms. Donna Counts Mr. Russ Kuhns (R.V. Kuhns & Associates) Mr. Rob Palmeri (R.V. Kuhns & Associates) Ms. Becky Gratsinger (R.V. Kuhns & Associates)
Others:	Mr. Frank A. Butler Dr. Michael Karpf Ms. Barbara W. Jones Mr. Sergio Melgar

The Investment Committee meeting was called to order at 8:30 a.m. Ms. Wickliffe asked for a motion to approve the December 9, 2008 minutes. Mr. Branscum made the motion to approve the minutes, Dr. Brockman seconded the motion and all approved.

Mr. Kuhns gave an update on corporate organizational changes at RVKuhns and Associates (RVKuhns). He introduced Becky Gratsinger as the new CEO and reported an expansion of the RVKuhns Board of Directors from three people to eight people. Rob Palmeri is now a member of the Board of Directors.

Mr. Palmeri then began reviewing an asset allocation study performed by RVKuhns. Mr. Palmeri stated that it is RVKuhns' practice to review asset allocation annually to eighteen months. While they do not expect the recommended allocation to change very much from year to year, a periodic review is prudent. Ms. Gratsinger discussed the capital market assumptions, including the 10 year return and standard deviation assumptions. The result of the review was that the 2009 assumptions did not change very much, but have changed more broadly this year than recent past years. There was some increase in the volatility in hedge funds, though it is expected that they will continue to offer healthy future returns and diversify the overall portfolio. Correlations did not change dramatically, except for some negative

correlation between fixed income and real estate categories. These assumption changes were applied to the portfolios to see if the changes impacted the recommended asset allocations.

Mr. Palmeri then discussed the impact of the assumptions update on the recommended UK Endowment policy asset allocation. Mr. Palmeri referred to the efficient allocation table in the committee notebook to illustrate the effect on return and risk expectations at varying asset allocation mixes. The UK Endowment policy asset allocation is line with the efficient frontier, thus there was no compelling reason to make a change at this time. Mr. Palmeri did mention, however, that inflation may eventually be a problem in the future given the global government stimulus packages in response to the current global capital markets crisis. Consequently, the Committee many want to revisit the real return allocation at next year's asset allocation review.

Dr. Brockman asked about the recent market changes and conditions and how this was reflected in the analysis. Mr. Palmeri responded that the assumption updates did take these events into consideration, and in fact, there is a reversion to the mean element in RVKuhns' assumptions setting process. Mr. Mathews clarified that the results of the analysis support the move toward more diversification. Mr. Wilcoxson asked if the allocation analysis suggested any changes in the proposed transition. Mr. Mathews responded the analysis confirmed the allocation decision. He also stated that if members of the Committee were not comfortable with the allocation changes approved in June 2008, it should be discussed. Mr. Wickliffe then stated that the allocation recommendation seemed prudent considering the long-term investment horizon of the portfolio.

Mr. Mathews then moved on to a discussion of IC1, a proposed motion to cancel contract negotiations with two opportunistic real estate managers. In December the Committee had given approval to enter into contract negotiations with new managers of value-added and opportunistic real estate allocations. However, since December the commercial real estate market has deteriorated rapidly. Based on these conditions staff asked RVKuhns to evaluate the timing of the implementation of this investment allocation and concluded that these allocations should be delayed until market conditions improve. Mr. Mathews recommended that for now the opportunistic allocation remain with the core real estate managers and requested that the Committee authorize the University's Purchasing Division to cancel contract negotiations with two new managers for the management of the opportunistic real estate allocations. Dr. Brockman made a motion to approve IC1, Mr. Branscum seconded the motion, and all approved.

Ms. Krauss then began discussing the next item on the agenda, an update on the investment strategy implementation plan. Ms. Krauss referred to the chart in the Committee notebook that summarized the current asset allocation, the target allocation and the transition plan. Phase 1 of the transition is underway as follows:

- On December 1, 2008 State Street's Wilshire 5000 index fund (\$39 million) and Capital Guardian's EAFE fund were liquidated in order to fund Capital Guardian's new All Country World (ACW) ex-US fund Core.
- On December 15, 2008 State Street's Russell 3000 Index fund was transitioned to the Russell 1000 index fund.
- On December 15, 2008 and January 2, 2009, \$50 million of PIMCO and Reams fixed income investments were liquidated in order to fund Mondrian's new ACW ex-US Value fund, Wellington's real return fund and the initial capital call for Wrightwood Capital.
- On February 25, 2009, State Street's Wilshire 5000 index fund (\$20.0 million) and State Street's ACW ex-US Index fund (\$15.0 million) were liquidated in order to fund Gartmore's new ACW ex-US Growth fund.

Ms. Krauss reported that phase 2 of the transition will involve the funding of the new absolute return investments and PIMCO's real return investments mainly with funds currently invested in US and global equity investments, which have experienced significant declines in the last year. The new absolute return strategies and PIMCO's real return strategy have not experienced losses to the extent that the US and global equities have experienced losses. Ms. Krauss reported the transition to these assets will be delayed to allow the equity markets time to rebound. Transitioning to these assets is planned to begin on June 30, 2009 in quarterly installments in order to "dollar cost average" the implementation.

Ms. Krauss also highlighted the addition of information on liquid versus illiquid investments on the transition plan schedule per a request from Mr. Stuckert at the last meeting. As of January 31, 2009, \$537.8 million, 85% of the portfolio, was invested in investments that are publically traded (liquid investments) and \$94.9 million, 15% of the portfolio, is invested in privately traded securities (illiquid investments). Ms. Krauss indicated that she did expect some write-downs of the private equity investments in the first quarter and this should be reflected in the March 31, 2009 statements. Mr. Palmeri stated that this would be an issue for all endowments.

The next item on the agenda was the performance review and market update by RVKuhns. Mr. Palmeri highlighted the performance of the overall markets. In December, the Fed further cut the federal funds rate to a range of 0.00% - 0.25%, marking the tenth time it had cut rates in the last 15 months. This represents the lowest target the Fed has ever set for its overnight lending rate. Mr. Palmeri noted that most market segments ended the year with massive losses due to the problems in the credit markets. For the quarter hedge funds were down 10%, but still much less than the decline in equities of 22% and commodities, with 30% declines.

Mr. Palmeri referred the committee to page 14 in the performance report which highlighted the UK asset allocation compared to all other endowments as of December 31, 2008. The composite chart illustrates UK's relatively high allocation in equities and low allocation in alternative investments compared to other funds. Mr. Palmeri then referred to page 15 of the report and reviewed the endowment performance against benchmark and peer data for the period ending December 31, 2008. For the quarter, the fund declined by 16.88% compared to the policy benchmark decline of 15.57%. For the year ended December 31, 2008, the total fund decreased 30.47%, compared to the UK policy benchmark of decrease of 28.14%. He stated the driver for this negative performance compared to the benchmarks is the high exposure to equities. Mr. Palmeri then went on to address specific manager performance and noted no issues of concern.

Mr. Owen commented that the UK performance numbers were reported net of fees, but that the peer performance numbers were gross (fees not excluded) and asked if there was a way to impact the estimate of fees on the benchmark performance. Mr. Palmeri indicated they would research that issue.

Ms. Krauss then reported on the 2008 NACUBO Endowment study results. The NACUBO study is an annual study that measures market values, investment performance and asset allocation for college and universities. For the one year period ending June 30, 2008 the median rates of return were -3.3% compared to the UK rates of -8.2%. Over a ten year period, the median rate of return was 6.3%, compared to UK's rate of return of 5.7%. A review of rates of return over the one year period by asset class indicated that the categories of alternative asset classes performed best with returns for private equity of 8.6%, for venture capital of 10.5% and for natural resources of 23.9%. UK had minimal holdings of these asset classes during this period. Alternatively, the largest declines were for US Equity (-10.2%) and Real Estate (-10.1%). The study also showed that investment portfolios of other Universities were more diversified than UK.

Ms. Krauss stated that due to the changes in the markets in the fall, NACUBO conducted a follow-up survey in December to gauge performance from July 1, 2008 through November 30, 2008. The results showed that for the 435 institutions that responded to the survey, investment returns had declined by 22.5%. This compared to a decline for the University of Kentucky of -25.8%. The follow-up survey also asked about planned changes in spending as a result of the market changes. No changes were indicated by 44.8% of the respondents, 3.7% indicated they would increase spending, 17.0% indicated they planned to decrease spending and 34.5% did not respond or did not know. Ms. Krauss indicated that the Investment Committee would need to discuss UK's spending rate in the future.

The next item on the agenda was a review of the Cash, Overnight and Short-Term Investment Report. Ms. Counts reported that as of January 31, 2009 the total portfolio subject to the short term investment policy was \$402.5 million. Overnight investments totaled \$1.3 million. Short term investments totaled \$401.3 million, of which \$65.2 million was invested in the OFM short term investment pool with an annualized monthly return of 0.72%, \$60.0 million was invested in the OFM intermediate pool with an annualized monthly return of 2.03%. \$121.7 million was invested in the Fidelity Government Fund, with an annual return of 0.84%, \$60.1 million was invested in the Dreyfus Governmental Fund with an annual return of 0.72% and another \$90.3 million was invested directly in federal agencies and instrumentalities having yields ranging from 2.76% to 3.5%. Ms. Counts reported that investment returns compared favorably to the market performance indices of the three month T-bill rate of 0.23%, the fed funds yield of 0.23% and the 2 year Treasury note rate of 0.95% as of January 31, 2009

Ms. Krauss then reviewed next agenda item, the Summary of Endowment Pool Activity. This schedule summarized the inflows and outflows of the endowment pool from July 1, 2008 to Jan 31, 2009. This report had been requested by Mr. Stuckert and will be provided for future meetings.

With no further business the meeting adjourned at 10:00 a.m.

Donna Counts
Office of the Treasurer