Minutes
Investment Committee
Board of Trustees
December 7, 2010

IN ATTENDANCE:

Investment Committee Members:	Mr. Carol Martin Gatton, Chair Mr. William S. Farish, Jr. Dr. Joe Peek Mr. Erwin Roberts Mr. James W. Stuckert
Community Advisory Members:	Mr. Henry Clay Owen Mr. Billy B. Wilcoxson
Investment Staff & Consultants:	Ms. Angela S. Martin Ms. Susan I. Krauss Ms. Donna A. Counts Mr. Rob Palmeri (R.V. Kuhns & Associates)
Others:	Ms. Shelia Brothers Ms. Jo Hern Curris Ms. Pamela T. May Mr. Terry B. Mobley Ms. Sandy Budgie Patterson Ms. Barbara Young

The Investment Committee meeting was called to order at 10:15 a.m. Mr. Gatton asked for a motion to approve the September 14, 2010 minutes. Mr. Stuckert made the motion to approve the minutes, Mr. Roberts seconded the motion and all approved.

Mr. Gatton introduced the first item on the agenda, a review of the asset allocation and transition. Ms. Krauss updated the committee on the implementation of the asset allocation and policy changes approved at the September meeting. She summarized the fourth quarter transition activity and planned cash flows:

- In October, $22 million was added to PIMCO and Wellington's real return funds in order to increase the Real Return allocation to the new 10% target. The additions were partially funded by a $14.9 million addition to the endowment pool, with the remaining amount funded by withdrawals from Wellington's Emerging Companies strategy and the RREEF Core Real Estate strategy.
- In November, $35 million was withdrawn from PIMCO's Core-Plus Fixed Income strategy and added to PIMCO's Unconstrained Bond Fund, which is a new strategy within the Fixed Income asset class.
- In December, $102 million will be added to various alternative investment strategies by withdrawing $54 million from U.S. Equities (SSGA-$52 million; Wellington-$2 million) and $48 million from Fixed Income (Reams). The Absolute Return allocation will be increased to its new target allocation of 20%, from 10%. The University's investment with Grosvenor will increase by $74 million with the creation of the new Grosvenor See Blue Fund, which is a

separate fund-of-funds created for the University of Kentucky. This new fund will allow for more control over investment guidelines and risk parameters. Additionally, the University will add $13 million to GAM, $9 million to Berens and $4 million to PIMCO's real return strategy.

- Within the Non U.S. Equity allocation, the transition of assets from Gartmore to William Blair is currently underway and State Street Global Markets is serving as the transition manager.
- Within the Fixed Income allocation, Reams is currently implementing a new low duration strategy by transitioning $15 million out of their core-plus strategy.

Ms. Krauss reported that at the end of December, the portfolio will be within the policy target ranges for all asset classes, however the Private Equity and Real Estate asset classes will remain below target. These asset classes must be implemented over time to ensure appropriate vintage year diversification. The under target positions for Private Equity and Real Estate will be temporarily invested in U.S./Non U.S. Equities and Fixed Income, respectively. Dr. Peek asked about how the portfolio allocations were made for operating funds. Susan responded that they balance short-term liquidity needs to the long-term investment horizon. Mr. Butler added that that much of the University's operating cash and working capital is on deposit at the state. Mr. Palmeri added that safety of principal is a primary consideration for operating cash.

Mr. Gatton then introduced Mr. Rob Palmeri with R. V. Kuhns and Associates (RVK) and the next item on the agenda, the investment performance review and market update. Mr. Palmeri began by referring to the snapshot summary and the manager compliance summary in the committee notebook. He stated that there are currently no urgent manager issues that needed to be addressed. He also reported that it had been quite a good quarter for investment returns. Global equity and fixed income markets rallied as fears of a Euro-debt crisis and double dip U.S. recession eased. Over the quarter the fund had a total return of 8.4%, slightly outperforming the index by 0.2%.

Mr. Palmeri then referred to the more detailed section of the quarterly investment report. He stated that the total fund attribution report shows that for the quarter asset allocation contributed 18 basis points of the total 20 basis point performance over the benchmark target allocation index. Mr. Farish asked if an equity allocation of fifty percent domestic and fifty percent international was standard. Mr. Palmeri responded that RVK clients have been moving to a 50/50 split. He mentioned that the US now represents roughly 50% of all global markets by market capitalization. It had been higher historically. He also referred to the market performance indicators on Page 1 of the quarterly report and highlighted that the MSCI EAFE index had experienced a ten year return of 2.99% compared to the S&P index which had a loss of 0.43% over the same period. Additionally, the emerging market asset class had done even better, with this index (MSCI EM) returning 13.77% over the ten year period. International markets have added some level of diversification among overall equity.

Mr. Palmeri resumed his discussion on fund performance stating that the total portfolio had done very well and every asset class was up this quarter. The Domestic Equity Composite return for the quarter was 11.59%. Within this asset class the SSgA Russell 1000 Index fund was up 11.59% and ranked in the top 26% of fund managers while the Wellington Emerging Companies Fund returned 12.73%, also performing in the top quartile compared to other managers. The International Equity Composite returned 15.26% for the quarter, but still underperformed the index by 1.32%. Mr. Palmeri explained that international equity had big challenges over the last quarter. Capital Guardian had return of 13.65% compared to the index of 16.58% and suffered somewhat from exposure to technology and Japanese holdings. Mondrian returned 15.95%, marginally less than its index of 16.06, and had little exposure to emerging markets, which detracted from Japanese markets. Gartmore returned 18.29% for the quarter, exceeding its index of 17.09%. The Fixed Income Composite had a quarterly return of 3.44%. The Real Return Composite return for the quarter was 8.86%, again marginally less than its index of 8.94%. The Absolute Return Composite had return of 2.40%, less than its benchmark of 2.84%. Mr. Palmeri cautioned that good benchmarks for Absolute Return strategies do not exist. The index in the report is one of the more common benchmarks, and most appropriate. Further, he stated that Absolute Return strategies will not beat equity returns during in an equity bull market, but should protect the portfolio in down equity markets. Thus over the long term we would expect similar returns between absolute return and equity, but the absolute return should have better risk adjusted return. The Real Estate Composite did very well for the last quarter returning 6.11% compared to the index of 3.86%; the return was driven by capital appreciation rather than income. Mr. Palmeri concluded his remarks by referring to the scattergram on page 30 of the quarterly report which illustrates the return versus risk parameters of the portfolio. He indicated that the portfolio is moving to the upper left quadrant, which is the most desired location in order to optimize return while mitigating acceptable risk.

The next item on the agenda was a review of the Cash, Overnight and Short-Term Investment Report. Ms. Counts stated that as of September 30, 2010 the total portfolio subject to the overnight and short term investment policy was $374.2 million. Overnight investments totaled $168.8 million and short-term investments totaled $205.4 million. Ms. Counts then stated that overnight investments earned an annualized return of 0.18% compared to the 3 month T bill return of 0.11% and the Fed funds yield of 0.15% as of September 30, 2010. Short term investments include two different investment pools managed by OFM totaling $125.2 million. The University also holds $80.2 million in direct investment of federal agencies. Ms. Counts concluded her remarks.

With no further business the meeting adjourned at 11:10 a.m.

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Donna Counts
Office of the Treasurer