Minutes
Investment Committee
Board of Trustees
March 9, 2010

IN ATTENDANCE:

Investment Committee Members:	Dr. Edward Britt Brockman, Chair Mr. Carol Martin Gatton Mr. Erwin Roberts Mr. James W. Stuckert
Community Advisory Members:	Mr. Henry Clay Owen
Board of Trustees Members:	Ms. Mira S. Ball Mr. Stephen P. Branscum Ms. Ann Brand Haney Ms. Jo Hern Curris Ms. Sandy Bugie Patterson Ms. Robynn M. Pease
Investment Staff & Consultants:	Ms. Angela S. Martin Ms. Susan I. Krauss Ms. Donna A. Counts Mr. Rob Palmeri (R.V. Kuhns & Associates)
Others:	Dr. Lee T. Todd, Jr. Mr. Frank A. Butler Ms. Barbara W. Jones Mr. D. Michael Richey Mr. Sergio L. Melgar Ms. Ronda S. Beck

The Investment Committee meeting was called to order at 10:05 a.m. Dr. Brockman asked for a motion to approve the December 1, 2009 minutes. Mr. Roberts made the motion to approve the minutes, Mr. Stuckert seconded the motion and all approved.

Dr. Brockman introduced the first item on the agenda, a review of the NACUBO-Commonfund study of investments. Ms. Krauss reported that this was the first year that NACUBO had partnered with Commonfund to produce the study. In prior years each organization had produced an independent study. In this year's joint study there were 842 institutions that participated in the survey. The study was just released in February; however, the data covers endowments as of June 30, 2009. Institution specific asset allocation data is not available this year for confidentiality purposes. However, Ms. Krauss stated that she will request that NACUBO-Commonfund do a specific benchmarking analysis for UK, comparing UK endowment performance and asset allocation to that of the top twenty public research institutions. The benchmarking analysis will be forwarded to the Committee upon receipt from NACUBO-Commonfund.

Ms. Krauss then reviewed the 2009 NACUBO-Commonfund Study of Endowments Average Investment Pool Rates of Return summary in the committee notebooks. The equal weighted average return for all endowments was a decrease of 18.7%. Ms. Krauss pointed out that in the past larger returns were experienced by institutions with larger endowments due to higher allocations to alternative investments. However, this year the smallest institutions had the best performance due to lower allocations to alternatives, which performed worse than traditional investment during the year ended June 30, 2009. Endowment funds greater than $1 billion decreased by 20.5% on average, while endowment funds less than $25 million had an average loss of only 16.8%. However, over the 3- , 5- and 10-year periods, endowments greater than $1 billion had higher returns due to the strong performance of alternatives over the longer-term periods.

Ms. Krauss then reviewed the asset allocations reported in the NACUBO-Commonfund study. Institutions with endowment funds of $25 million or less had 27% of assets in fixed income, compared to only 10% for institutions having endowments greater than $1 billion and 21% for the equal -weighted average. Alternative strategies accounted for only 13% of assets for the less than $25 million endowments, but accounted for 61% for the endowments greater than $1 billion and 25% for the equal-weighted average. She pointed out an error in the dollar-weighted average row and said a corrected table would be forwarded to all committee members, along with the benchmarking analysis. Ms. Krauss then referred to tables summarizing net returns and asset allocations for the top decile and top quartile performers, information not previously reported in the NACUBO study. The top decile performers realized an average loss of 8.1% compared to an average loss of 18.7% for all institutions responding to the survey. The top decile institutions had a total of 29% allocated to fixed income compared to 13% for all institutions reporting, illustrating the positive performance for this asset class for 2009.

Dr. Brockman then introduced the next agenda item, the review of asset allocation and status of the transition plan. Ms. Krauss referred to the transition summary in the committee notebooks. She stated that Phase 1 of the transition was completed over a three month period beginning in December 2008 and involved implementation of new U.S. and non-U.S strategies, and also Wellington's real return strategy. Phase 2, which involves implementing the absolute return strategies and PIMCO's real return strategy over four quarters, is in process and will be completed with the final quarterly installment this month. She noted that she would also be doing a full rebalancing this month so there will be several manager additions and withdrawals taking place in March. Ms. Krauss reported that the final phase, Phase 3, includes fully transitioning to the private equity and real estate allocations. This phase is ongoing and will take approximately four to six years.

Dr. Brockman then introduced the next item on the agenda, the performance review and market update by RVK. Mr. Palmeri began by referring to the first page of the quarterly report, which was an update on the RVK long-term management transition plan. The founder, Mr. Russ Kuhns is retiring on June 30th and Becky Gratsinger has been appointed as the Chief Executive Officer. RVK will purchase 100% of Mr. Kuhns' shares to allow RVK to remain 100% employee owned and independent, with the ownership distributed among 18 partners. Ms. Gratsinger visited with the Investment Committee in the past and will be attending the special meeting next month. Mr. Palmeri stated he would be unable to attend the special meeting due to a commitment made prior to the scheduling of the special meeting.

Mr. Palmeri then began his review of the capital markets. He stated although equity markets had moved up sharply since March, 2009 had been a challenging year for the economy. There was some rebound in the US dollar, but unemployment had increased from 7.6% in January to 10% in December. While the US economy has seen some recovery, it has been a jobless recovery. So far there appears to be minimal evidence of inflation, but the consensus is that inflation will be a factor in the future; however, there is no consensus when that will happen, the magnitude of an increase, or how long it will last.

Capital markets did extremely well for the quarter ended December 31, 2009. Emerging markets were up 8.6% and Commodities were up 9.0%. The UK endowment portfolio was beginning to see the benefits of diversification. There was significant improvement in the fiscal year-to-date returns, increasing 16.1%.

The asset allocation continues to be overweight in domestic and international equities which actually benefited performance for this period. The overweight to equities was a conscious decision the Committee made when it agreed to dollar cost average out of equities and into alternatives as a part of a long term asset allocation transition plan. However, Mr. Palmeri reminded the Committee that the overweight to equities will detract from relative (vs the index) performance if and when equities are down for a period. Thus far, the transition Plan and overweight to equities has helped the Endowment recoup a significant amount of losses from the market meltdown of 2008. For the quarter ending December 31, 2009 the total value added, or out-performance of the policy benchmark, was 1.08%. Of this .54% was due to the asset allocation and .53% was due to manager performance. However, for the six months ending December 31, 2009 the total value added was 3.62%, of which 3.04% was due to asset allocation. Again, this illustrates that the phased-in transition to the new asset allocation had paid off during this period.

Mr. Palmeri then referred to the risk-return scattergram on page 31 of the report. He pointed out that the investment objective is to maximize returns and minimize standard deviation. A higher return and lower risk portfolio should provide greater long term results due to compounding. The current allocation is in the upper right quadrant and signifies greater risk. However, the target allocation index is very close to the median return and standard deviation, which is consistent with the objective.

Next Mr. Palmeri reviewed the returns and the asset class performance. Total return for the quarter, net of fees, was 3.49%, compared to 2.96% for the active allocation benchmark and 2.42% for the target allocation benchmark, or policy benchmark. The performance gross of fees was 3.58% for the quarter. Fiscal year-to-date the gross return was 16.29%, compared to the active allocation benchmark of 15.51% and 12.48% for the target allocation benchmark. The UK endowment ranked in the top third of performers for the last six months. The domestic equity composite had a gross return of 22.89% for the fiscal year-to-date compared to its index of 23.08%. In this asset class the Wellington Emerging Companies Fund did extremely well, with a gross return of 47.02% over the calendar year and a percentile rank of 13. Within the Global Equity asset class Wellington Global Research had a gross return of 40.72% for the calendar year, but a loss of 4.76% over a three year period. This manager will be phased out as part of the asset allocation transition. The International Equity Composite had a gross return of 4.97% for the quarter and ranked in the 19th percentile. This was led by Gartmore International Equity with a quarter-to-date return of 6.99% and a rank in the 4th percentile. Conversely, Mondrian had gross returns of only 29.16% over the calendar year compared to the index of 44.29%. Mondrian's investment style is to buy high quality dividend producing stocks and many companies had to cut dividends last year which in part explains the poor performance. RVK understands this issue and its relative impact on performance, but will monitor this manager to see if the performance rebounds during a more rational market environment. The Fixed Income Composite showed equity like returns in 2009, with gross returns for 23.26% in calendar year 2009. Reams' performance in this category was especially noteworthy. They had a gross calendar year return of 29.73% and ranked in the 8th percentile. Reams had heavy exposure to CMBS and high yield holdings, as compared to the Barclays Aggregate Bond Index. In 2008 Reams was one of the worst performing managers, but they bounced back significantly over the past twelve months, bringing their longer term performance numbers ahead of the index. REAMS is a good example of a manager sticking to discipline so that when the market favors its style, they should do very well which is exactly what happened.

Mr. Stuckert asked Mr. Palmeri about the effect of inflation on the fixed income investments. Mr. Palmeri responded that as inflation increases, the values of fixed income investments will more than likely decrease creating a headwind for fixed income managers moving forward especially if the Fed increases interest rates. He noted that the fixed income managers, PIMCO and Reams, are planning for this possibility.

Mr. Palmeri then reported that the real return composite gross return was 4.65% for the quarter and 16.16% fiscal year-to-date. Within this category Wellington WTC-CIF did well with a gross return of 8.40% for the quarter and 21.72% for the fiscal year-to-date. The Absolute Return Composite had a gross return of 1.81% for the quarter, compared to the benchmark of 1.07%. He stated that the Real Estate sector continues to have problems. The Real Estate Composite had a gross loss of -3.24% for the quarter and -25.06% for the calendar year. This compares to an index loss of -2.11% for the quarter and a loss of -16.86% for the calendar year. There are currently multiple real estate managers in the portfolio, covering core and value added. He stated that the target allocation for real estate will be revisited as part of the upcoming asset allocation study. This concluded Mr. Palmeri's comments.

The next item on the agenda was a review of the Cash, Overnight and Short-Term Investment Report. Mr. Butler began by stating that the Office of Financial Management had established a separate short term fund for state universities. Ms. Counts then reported that as of December 31, 2009 the total portfolio subject to the overnight and short term investment policy was $441.1 million. Total cash and investments, including funds invested by the state, was $797.1 million. Overnight investments totaled $220.8 million, and had a rate of return of 0.06%. Ms. Counts reported that overnight investment returns were less than the market performance indices of the three month T-bill rate of 0.09%, the Fed Funds yield of 0.12%, and the Libor 3 month rate of .25%. Short term investments totaled $220.3 million. The total short term average weighted return was 2.18%, as compared to the 2 Year Treasury Note yield of 0.87%.

With no further business the meeting adjourned at 10:50 a.m.

Donna Counts
Office of the Treasurer