

**Minutes  
Investment Committee  
Board of Trustees  
March 28, 2011**

IN ATTENDANCE:

Investment Committee Members:	Mr. Erwin Roberts, Acting Chair Mr. William S. Farish, Jr. Dr. Joe Peek Mr. James W. Stuckert
Community Advisory Members:	Mr. Henry Clay Owen
Investment Staff & Consultants:	Ms. Angela S. Martin Ms. Susan I. Krauss Ms. Kimberly C. Lush Mr. Rob Palmeri (R.V. Kuhns & Associates) Mr. Steve Hahn (R.V. Kuhns & Associates)
Others:	Ms. Pamela T. May

The Investment Committee meeting was called to order at 3:40 p.m. Mr. Roberts, Acting Chair in the absence of Mr. Gatton, asked for a motion to approve the December 7, 2010 minutes. Mr. Stuckert made the motion to approve the minutes, Mr. Farish seconded the motion and all approved.

Mr. Roberts introduced the first item on the agenda, an update of the Endowment Advisory Group. Ms. Martin updated the committee on the Endowment Advisory Group as follows:

- The Endowment Advisory Group (EAG) was approved by the Board of Trustees Investment Committee in September 2010, established by the President in November 2010, and held two meetings in January 2011. The group developed recommendations to reduce spending distributions on certain underwater endowments and to establish new minimum endowment levels. These recommendations were presented to the Deans in February 2011.
- Effective for FY 2011–12, spending distributions will be reduced by 25% for endowments that are underwater by more than 10% as of December 31, 2010 (also, the management fee for these endowments will be suspended).
- As of December 31, 2010, the University had 1,971 endowments, 704 of which were underwater - 298 of those were underwater by more than 10%. The FY 2011-12 impact of the reduced spending distributions for the 298 endowments is a reduction of \$1.1 million. The 298 endowments had accumulated fund balances at 12/31/10 of \$6.9 million.

Ms. Martin reported that the EAG also endorsed a proposal for new minimum endowment levels. Mr. Michael Richey, Vice President for Development, discussed the proposed minimum endowment levels anticipated to become effective July 1, 2011. The proposed levels are based on benchmarking of the University's Top 20 benchmark institutions and SEC institutions. He noted that the current levels have been in place since 1968. Scholarship and Fellowship Levels are proposed to increase from \$10,000 to \$25,000, \$100,000, \$250,000 or \$350,000, depending on type. Faculty Support Levels are proposed to

increase as well. Professorships could increase from \$100,000 to \$250,000, \$300,000 or \$500,000, depending on type. Chairs could increase from \$1 million to \$2 million or \$4 million, depending on type.

Next on the agenda was a discussion by Ms. Krauss of the 2010 NACUBO – Commonfund Study of Endowments. The University of Kentucky was ranked 84th in size out of 865 participating institutions, with a reported market value of \$779 million as of June 30, 2010. UK returned 13.1% for the year versus the average survey return of 11.9% due to a higher allocation to equities. UK returned 2.3% for the ten years ended June 30<sup>th</sup> compared to the average return of 3.4%, also due to a higher allocation to equities. Ms. Krauss pointed out that larger institutions performed better than smaller institutions over each time period reported (1, 3, 5, and 10 years) due to higher allocations to alternative investments. Ms. Krauss reviewed the asset allocations reported in the survey, noting that the overall average allocation to alternative investments was 26%. Smaller institutions, or those with endowments less than \$25 million, had an allocation of 12% to alternatives while larger institutions, or those with endowments greater than \$1 billion, had an allocation of 60% to alternatives at June 30, 2010. UK's allocation to alternatives at June 30, 2010 was 28%, including the real return investments reported as "Other" in the survey. UK is in the process of implementing a new asset allocation approved by Investment Committee in September 2010 that includes a 45% allocation to alternative strategies. Ms. Krauss also reviewed returns and asset allocations of the top-quartile and top-decile performers, asset class returns for fiscal year 2010 and a summary of the survey results for the top-20 benchmark institutions.

Mr. Roberts then introduced the next item on the agenda, which was a review of the asset allocation. Ms. Krauss reported that the implementation of the new asset allocation approved by the Committee last September was completed in the fourth quarter of 2010, with exception of the private equity and real estate asset allocations which will be fully implemented over the next several years. Ms. Krauss reported that the implementation included the following:

- Withdrawals from various equity and fixed income investments and additions to absolute and real return in order to rebalance the portfolio to the newly established targets;
- Transition of assets from Gartmore to William Blair;
- Conversion of PIMCO's real return investment from the All Asset Fund to the All Asset All Authority Fund;
- Implementation of the newly established Grosvenor See Blue Fund;
- Implementation of a new allocation to PIMCO's Unconstrained Bond Fund; and
- Implementation of a new allocation to Ream's Low Duration Strategy.

Ms. Krauss then moved to the next item on the agenda, which was an update regarding private equity. This asset class was established in 2005 when the University hired Commonfund. In 2007, Pantheon was hired as the second manager for private equity, with Siguler Guff and Drum Capital both hired in 2008. The University's current allocation to private equity is approximately 4% with the target allocation being 7%. It was emphasized that without new commitments, the University's private equity would top out at approximately 4.5% in 2013 and the allocation would then decline due to distributions. Mr. Steve Hahn from R. V. Kuhns and Associates (RVK) presented a private equity pacing analysis and stated that a commitment of \$172 million over the next several years (through 2018) would allow the University to reach its target allocation of 7% in 2015 and maintain an allocation of 7 – 8% for several years thereafter. Mr. Hahn then provided a quick highlight of the University's current private equity commitments and discussed the time weighted returns presented for the first time in the December 31, 2010 quarterly performance report. Since inception, the private equity investments have lost 4.0%; however, Mr. Hahn commented this is not surprising as the private equity program is still fairly new. We should expect to see the returns increase in the future as underlying portfolio companies are sold and the fund managers begin to return capital to investors. Ms. Krauss reported that the University will issue a request for proposals for a new private equity separate account manager that will enable us to have more control over the

investment guidelines as compared to a traditional fund-of-funds manager. Additionally, with a \$100 million separate account, we should be able to achieve an annual fee savings of 15 to 25 basis points. The RFP will be issued soon and a finalist recommendation is expected to be made at the September Investment Committee meeting.

Mr. Roberts then introduced Mr. Rob Palmeri with 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. In particular, he noted the portfolio had a value of \$868.7 million at the beginning of the quarter and a value of \$915.4 million at December 31, 2010. Next, Mr. Palmeri presented a summary of their due diligence review. He noted that one manager, GAM, had been experiencing a significant amount of personnel turnover and had been put on watch. RVK would continue to monitor the firm closely. Further, he stated there were no other current manager compliance issues. Also, he informed the committee that Ms. Krauss and RVK would soon be making an on-site due diligence trip to visit PIMCO, Capital Guardian and Pantheon.

Mr. Palmeri then presented the detailed Investment Performance Analysis. While reviewing asset allocation versus target allocation difference, Mr. Palmeri noted that the policy benchmark would be updated to reflect the new asset allocation effective January 1, 2011. Relating to fund performance, the pool had a total value added of -0.11% for the quarter ended December 31, 2010, as the Fund underperformed the policy benchmark by 11 basis points. The International Equity Composite return for the quarter was 6.49% and 8.47% for the year. Within the asset class, Capital Guardian and Mondrian underperformed their respective benchmarks for both periods. Mr. Palmeri mentioned there were some concerns about Capital Guardian's performance that would be addressed during the upcoming on-site visit. The Fixed Income Composite return for the quarter was -1.12% and 8.67% for the year. The percentage yield for the Real Return Composite was 4.94% for the quarter and 14.82% for the preceding year. The Absolute Return Composite for the quarter was 2.84% and 4.42% for one year. Mr. Palmeri commented that GAM was underperforming mainly due to significant losses incurred on two underlying fund investments, but reminded the Committee that RVK had placed the manager on watch due to personnel turnover not the short term underperformance. The Private Equity Composite for the quarter returned 0.3 %, compared to 4.45% for one year. Mr. Palmeri concluded by presenting a scattergram of the University's total pool, an illustration of the return versus risk parameters.

The next item on the agenda was a review of the Cash, Overnight and Short-Term Investment Report by Ms. Martin. As of February 28, 2011, the total portfolio subject to the overnight and short term investment policy was \$364.5 million. Overnight investments totaled \$120.3 million and short-term investments totaled \$244.2 million. Short term investments include two different investment pools managed by OFM totaling \$150.1 million. The University also holds \$94.1 million in direct investment of federal agencies. Ms. Martin stated that the University's balances are down in total by approximately \$100 million since last year due to the construction of the Chandler Hospital's Patient Tower.

The final item on the agenda was the schedule of 2011 Investment Committee Meetings and Tentative Agenda Items presented by Ms. Krauss. She noted that representatives from PIMCO and Grosvenor would be attending the June 13, 2011 meeting to present their outlook and strategy update. With no further business, the meeting adjourned at 5:20 p.m.

---

Kimberly C. Lush  
Office of the Treasurer