

**Minutes
Investment Committee
June 10, 2013**

IN ATTENDANCE:

Investment Committee Members:	Carol Martin Gatton, Chair William C. Britton Mark P. Bryant William S. Farish, Jr. James W. Stuckert
Community Advisory Members:	James F. Hardymon Billy B. Wilcoxson
Investment Staff & Consultants:	Eric N. Monday Angela S. Martin Susan I. Krauss Donna A. Counts Ronald L. Klotter (R.V. Kuhns & Associates) Rob Palmeri (R.V. Kuhns & Associates) – Via Telephone

Mr. Gatton called the meeting to order at 5:00 p.m. and asked for a motion to approve the minutes from the meeting for May 13, 2013. Mr. Britton made the motion to approve, Mr. Stuckert seconded and all approved.

Mr. Gatton introduced Ms. Krauss to review the first agenda item, IC 1, a recommendation for approval of a revised Endowment Investment Policy. Ms. Krauss said the revised policy included a revised asset allocation that was discussed in detail at the May meeting. The changes would reduce long-only Equities and Fixed Income to 24% and 10%, respectively, and increase Alternatives to 66%. The changes within Alternatives involve establishing two new allocations, Long-Biased Long/Short Equity at 14% and Global Tactical Asset Allocation at 8%, reducing Absolute Return to 10%, increasing Private Equity to 12%, and increasing Real Estate to 12%. The objective of the allocation changes is to produce an average annual nominal return of 7.5% and a real return of 4.5%, the amount necessary to support spending, inflation and allow the endowment to grow. The summary of the revised manager structure and new strategy definitions related to the asset allocation changes were added in appendices 2 and 3, respectively. Finally, new language was added to the spending policy section to allow the Vice President for Financial Operations and Treasurer to approve exceptions to the policy of suspending spending distributions on certain quasi and term endowments underwater by more than 20%.

Ms. Krauss reported that a formal review was conducted of endowments underwater between 10% and 20% in accordance with the spending policy approved by the Committee in December 2012. Staff met with every dean or department head to review the endowments and the UPMIFA spending guidelines. She said the meetings went well and resulted in reductions to budgeted spending distributions. Mr. Britton asked about the underwater endowment funds and Ms. Krauss referred him to the summary of endowments as of March 31, 2013 behind tab six of the committee notebooks. As of March 31, 2013 there were 479 funds underwater compared to 637 in December 2012 and there were only 99 funds underwater greater than 10% at March 31st, so things are improving. Mr. Gatton asked about the total market value of all endowments and Ms. Krauss referred to another report behind tab six, Total Endowment and External Trusts, March 31, 2013 and 2012. She reported that the total value, net of liabilities, including the externally managed trusts, was \$1,007.7 million as of March 31, 2013. The net

value without the externally managed trusts was \$970.5 million at March 31st. Mr. Stuckert then asked about the delay in spending on new endowments and Ms. Krauss confirmed that was also added to the policy last December and would be effective July 1, 2014.

Ms. Krauss then discussed the manager structure changes in more detail. She said the US Equity allocation was decreasing from 20% to 12%, with the majority of that indexed to the Russell 1000 index. Enhanced passive strategies, such as the PIMCO Stocks Plus strategy or the Northern Trust Quality Dividend Focus strategy, are being considered but will be limited to 6% of the total. For Non-US Equity the allocation is decreasing from 20% to 12% and active strategies offered by Mondrian and William Blair related to emerging markets and small caps are being considered. Within Fixed Income, the Reams Low Duration strategy will be eliminated and the Reams Core-Plus strategy will be reduced to allow for implementation of a new Unconstrained strategy to allow them flexibility to manage duration more effectively. In response to a question on the timing of the transition, Ms. Krauss responded that it is anticipated that the liquid strategies could be implemented by January 1st and the illiquid strategies of private equity and real estate will take longer. Ms. Krauss then continued by saying that the new Long-Biased Long/Short Equity allocation of 14% would be implemented using some combination of existing managers, and that the actual allocation percentages would vary depending on risk/return metrics. For Private Equity, options being considered include giving additional funds to Neuberger Berman or issuing an RFP to hire a second separate account manager. Under Global Tactical Asset Allocation, the current PIMCO Real Return allocation will be reclassified to GTAA and an RFP will be issued to hire a second manager. The Absolute Return allocation will be reduced from 20% to 10% and Grosvenor will be the sole manager. Wellington will be the lead manager for the Diversified Inflation Strategies allocation and an RFP will be issued for a new manager for a closed-end, illiquid strategy. The Real Estate allocation will increase from 8% to 12% and a RFP will be issued to hire one or more managers. She reported that she expects to bring finalist recommendations to the September meeting for Real Estate and GTAA. Mr. Stuckert made a motion to approve the revised endowment investment policy, Mr. Britton seconded and all approved.

Ms. Krauss then discussed timing of the transition and rebalancing adjustments needed to implement the revised policy. Phase I of the transition will involve rebalancing of the liquid strategies and Phase II will involve implementation of the illiquid strategies over several years. She said she expects to implement Phase I by January 1st, and will need to issue the RFP's previously discussed and negotiate contract amendments with existing managers Northern Trust, Wellington, Reams, Berens, Prisma and Grosvenor. She said that the funds targeted for the private equity and real estate allocations will be invested in passive US and non-US equity investments with Northern Trust until those funds can be fully invested. Ms. Krauss indicated that a transition manager would be used during the Phase I implementation to maintain market exposure and minimize transaction costs.

Mr. Gatton then moved onto the next agenda item, the Performance Review and Market Update. Mr. Klotter began discussing the monthly update as of April 30th and said that overall market performance as measured by the S&P 500 and EAFE was up double digits calendar year-to-date with very strong returns in the equity markets. However, emerging markets have lagged quite a bit. Bonds yields have been flat. For the UK Portfolio, calendar year-to-date the portfolio is up 5.72% and fiscal year-to-date is up 13.37%, which exceeded the actual allocation index by 1.23% indicating good manager selection for this period. Equity performance followed the market, which is as you would expect since equities are largely indexed. However, Wellington continues to lag. On the international side, UK performance has been good, up 8.3% calendar year-to-date for all managers. The developed markets have done well while the emerging markets have underperformed. Mr. Klotter felt this was in part due to an increase in demand for high quality, high dividend stocks due to the 1% and 2% yields on bonds. He said fixed income performance has been good with overall bond returns exceeding the benchmark by 40 basis points calendar year-to-date. Real return has been down slightly, but he noted that the purpose of that asset allocation is to serve as a hedge against inflation and RVK was satisfied with this performance. He said one of the most

meaningful pieces of good news is the absolute return composite. He noted that hedge funds in general have had a good year and UK's hedge funds have had a really good year, up 5.5% for calendar year-to-date and that performance was spread pretty evenly across managers.

Mr. Gatton moved to the next agenda item and Ms. Counts summarized the Operating Fund Cash and Investment Report as of April 30, 2013. She said the total funds subject to the investment policy were \$355.1 million. Of this \$252.9 million was invested overnight, with daily liquidity, and a fiscal year-to-date return of 0.16%. She noted that while this was low, it compared favorably to the current fed funds yield of 0.14%. There was \$60.0 million invested in the state intermediate pool and \$42.3 million in direct investments, for an average return of 0.92% fiscal year-to-date. She indicated that the most recent operating investment activity involved buying federal agency step-ups, which have rates that increase over time to provide interest rate protection over the long-term. Funds on deposit at the state were \$270.2 million, with total operating cash and investments of \$625.3 million at April 30th.

Mr. Gatton next asked Mr. Rickey about fund raising and Mr. Richey responded that donors and gifts and pledges are up and so far total \$116 million to fiscal year-to-date compared to \$105 last year. Additionally they have processed in excess of 103,000 gifts. Mr. Richey credited the success of the fundraising programs to maturation of the UK development program, better relations, expansion of giving options, improved donor relations and excellent staffing.

Mr. Gatton asked if there were any further items for discussion. Being none, the meeting adjourned at 5:45 p.m.

Donna Counts
Office of the Treasurer