

Minutes of the Meeting of the Investment Committee  
University of Kentucky  
Thursday, June 21, 2018

The Investment Committee met on Thursday, June 21, 2018, in the Lewis Honors College Meeting Room.

A. Meeting Opened

Mark P. Bryant, Chair of the Investment Committee, called the meeting to order at 2:02 p.m. and requested a roll call.

B. Roll Call

The following members of the Investment Committee answered the call of the roll: Mark P. Bryant, Claude A. Berry, III, James H. Booth, Michael A. Christian, Elizabeth McCoy, Robert D. Vance, and Barbara S. Young. Carol Martin "Bill" Gatton was not in attendance.

The following Community Advisory Members answered the call of the roll: William E. Seale, and Myra L. Tobin, by phone. William C. Britton was not in attendance.

Kristina Goins announced that a quorum was present.

The University Investment Staff was represented by Susan I. Krauss, Treasurer, and Todd D. Shupp, Chief Investment Officer.

Fund Evaluation Group (FEG) was represented by Nolan M. Bean, Michael J. Aluise, and Christian S. Busken.

C. Approval of Minutes for April 30, 2018

Chair Bryant called for a motion to approve the minutes from the Committee meeting on April 30, 2018. The motion was moved by Trustee Christian, seconded by Trustee Vance, and approved by all.

D. Real Assets Strategy Review

Mr. Nolan Bean, FEG, introduced Christian Busken, FEG's Director of Real Assets. Mr. Busken began his discussion by defining real assets as the tangible assets comprised of the basic inputs in the economy. These assets are made up of three major categories, real estate, natural resources, and infrastructure. Real estate includes commercial property, land, and residential property. Natural resources encompass four broad categories: energy, agriculture, timber, and metals and mining. Infrastructure is made up of bridges, toll roads, pipelines, and power generation. Given that inflation is a primary component of the portfolio's return objective, allocating capital to inflation-sensitive securities is prudent. The primary goals of real assets are inflation protection and total return. Mr. Busken continued by stating "Though we haven't seen

inflation in a while, that doesn't mean we never will. Real assets have been under pressure over the last three years with oil prices in 2015, and real estate prices more recently. Although real assets have faced headwinds more recently, over the long term, they have produced attractive risk-adjusted returns. Another item of consideration is unexpected inflation, a period in which real assets tend to perform well.”

Mr. Bean then shifted the discussion to UK's current implementation of the real asset portfolio. He began by reviewing a pie chart showing UK Target Allocations. “The portfolio will allocate across real asset strategies via both public and private investments, and the relative allocations can be adjusted based on valuations. Within public real asset strategies, the portfolio has cost-effective market exposure, comprised of 40% passive Real Estate Investment Trusts (REITs) and Treasury Inflation-Protected Securities (TIPs), 30% invested in an Master Limited Partnership (MLP) strategy, and 30% invested in Pacific Investment Management Company, LLC (PIMCO) Inflation Response Multi-Asset Fund (IRMAF). Private real asset strategies include allocations to niche managers, often in the early stage of their life cycle, with high-conviction portfolios invested in less efficient markets. Commitments will be made to the most compelling investment areas first, mindful of aggregate portfolio risk. Modeling suggests \$40 million in commitments is needed each year to reach and maintain the private real assets target allocation.”

Mr. Busken then highlighted a case study of one of our existing real assets managers, Rivercrest Capital. Royalty interests represent ownership in shares of oil and gas minerals existing on, or produced from a property. Some compelling attributes of royalty interests include the fact that they are at the top of the capital structure, avoid operating expenses and risk, and have equity-like upside with compelling current income. He next reviewed the attractive firm-level attributes of Rivercrest. The fund is led by Bob Ravnaas and, from 1998-2016, the strategy generated strong performance. Mr. Busken stated the current portfolio yield is 19%, and Dr. Seale asked whether the yield was for UK's investment or for the Rivercrest fund. Mr. Bean replied that this was the yield on invested capital. Mr. Busken stated “With low inflation and a high-performing equity market, the past few years have been challenging for real assets. Many real assets are currently attractively priced, specifically within the energy space. The UK real asset portfolio is well diversified in real estate and positioned for strong performance. In summary, the focus looking forward is private strategies with attractive return potential.” Chair Bryant asked a question regarding the valuation of real estate within UK's portfolio. Mr. Bean replied, “The underlying managers have independent auditors to determine fair value.”

#### E. Investment Staff Report

Mr. Shupp presented the Investment Staff Report, beginning with an overview of the Endowment asset allocation as of April 30, 2018, stating that the portfolio remains within the policy ranges and well diversified across asset classes. He then reviewed asset flows for the period between April 1 and April 30, noting there were very few changes to the asset allocation since the prior Investment Committee meeting. He highlighted a minor rebalancing in which \$10.5 million was reallocated from a Global Tactical Asset Allocation (GTAA) manager to funds within the hedged equity portfolio. He added that amidst market volatility, good opportunities exist for active managers. Mr. Shupp then noted that the portfolio's passive exposure has been increased, with recent investments in multiple funds managed by the Vanguard Group. Some of this exposure is

a strategic allocation, while a portion of this capital will likely be moved into smart beta strategies. Mr. Shupp then presented a report on manager appointments, terminations, and due diligence for May 1 through June 21, 2018. He noted that for May, the sole new addition was a \$15 million commitment to Scout Energy Partners IV, LP within the private real assets portfolio. This investment is intended to continue diversification within the private real asset portfolio and assist with reaching our allocation target. Lastly, Mr. Shupp summarized due diligence completed by investment staff during the period. This included several meetings with FEG on enhanced cash strategies within the operating pool, as well as discussions concerning private real assets with FEG, as well as Northwood Investors. He also noted a meeting with Wellington Management Company to discuss asset allocation and industry trends in Endowment and Foundation portfolio management. Regarding the portfolio asset allocation table, Dr. Seale asked whether return and expense ratio information could be provided in addition to manager allocations. Mr. Shupp replied that more detail can be provided and noted that performance and fee details are included in FEG's quarterly performance reports. Trustee Young asked whether we have a threshold and methodology to determine whether action needs to be taken for managers that underperform. Mr. Shupp replied that performance benchmarks exist for all managers and asset classes and emphasized that it is important to evaluate managers over a longer-term time period. A key focus is gaining an understanding of a fund's strategy prior to investing, so it can be determined whether subsequent performance is in line with the manager's stated investment style. Ms. Tobin asked why there was a need for 40 managers in the portfolio. Mr. Shupp replied that the reason for this was diversification purposes, and Ms. Krauss added that the number of managers has expanded as we have expanded direct alternative investments and reduced funds of funds. Chair Bryant asked whether it costs twice as much to have 40 managers versus 20. Mr. Shupp replied that this was not necessarily the case, as the cost depends on the types of strategies being considered. Dr. Seale asked a question regarding the beta of the U.S. equity portfolio versus the S&P 500 Index, and the non-U.S. equity portfolio versus the MSCI All Country World Index. Mr. Shupp and Mr. Bean stated that they would follow up with this information, but indicated these figures were likely very close to 1.0. Dr. Seale then inquired about the spliced blend benchmarks utilized on certain Vanguard funds. Mr. Bean replied that this reflects a fund that changed its benchmark at some point, and the previous and current benchmark returns are linked.

#### F. Performance Review & Market Update

Mr. Bean began with reviewing the manager memo for Scout Energy Partners. This investment will be held within the private natural resources portion of the real assets portfolio. Mr. Bean then shifted the discussion to performance as of April 30, 2018. The total portfolio generated an estimated return of 0.2% for the month, and the portfolio's market value was at \$1.46 billion. He then reviewed returns for each of the asset classes within the portfolio. Mr. Bean stated that in public equity markets, we have expanded exposure to passive and quasi-passive strategies. Returns for domestic and international equity were 0.3% and 0.1%, respectively. Regarding fixed income, the April return was -0.4%, reflective of the rising interest rate environment. He finished by drawing attention to real assets, which showed a return of 1.5% for the period. Mr. Bean noted that this performance was driven primarily by Harvest, whose return was 7.8%. Mr. Bean concluded his discussion with a review of the Endowment's private, illiquid investments. The Internal Rate of Return (IRR) net of fees for private equity since the beginning of the Endowment was 11.3%. He added that there were double digit returns in the categories of private credit and

private real estate, as well. Chair Bryant asked a question regarding how much would be invested in Scout. Mr. Bean answered that \$15 million has been committed, and that \$6 million of this would be called within the next week and a half. Mr. Aluise then followed up on Ms. Tobin's earlier question, stating that several of the alternatives managers had multiple UK investments, so there are fewer managers than the number of line items suggests.

#### G. Operating Fund Cash & Investments

Ms. Krauss provided a report on the University's operating fund cash and investments as of April 30, 2018. She called attention to total funds available for operations, which were \$1.38 billion. Included in that amount are Tier IV assets, which are the operating funds invested in the Endowment, totaling \$382 million. As a reminder, Tiers I through III are the liquid investments, invested in strategies to help satisfy our near-term obligations. She noted that we remain well within our established targets for days cash on hand. Within Tier I, commercial paper holdings totaled approximately \$85 million, of the total \$288 million for the period. Ms. Krauss noted that since April 30<sup>th</sup>, prime funds were once again being utilized and the commercial paper program will be phased out. She then gave a brief history of the SEC reform regarding prime funds. Ms. Krauss continued by stating that UK is also conducting a review of various enhanced cash strategies, partnering with FEG. This would include possible changes to the Tier III line-up. These assets totaling \$146 million are managed by staff and include CDs, municipals, and agencies and instrumentalities. This portion of the portfolio will eventually be phased out in favor of a shift to an external manager. Also in this category is an investment in a Reams low duration strategy, totaling \$93 million. Ms. Krauss concluded her comments by stating that assets are performing as expected.

#### H. Other

Ms. Krauss reviewed items contained in the Other section, beginning with the 2018 meeting schedule and tentative agenda items, stating that no changes occurred since the last meeting. She noted September's meeting will be an Annual Retreat most likely held in the Student Center. An overview of the Endowment will be presented, as well as an in-depth review of asset allocation. Also in September, the annual review of the Investment Policy will be conducted and staff will present proposed changes to the policy. December's meeting will include formal approval of the endowment investment policy as well as a Student Managed Investment Fund (SMIF) class student presentation. Ms. Krauss concluded by noting the supplemental reports provided as of March 31, 2018. Trustee Young asked a question regarding principal additions from philanthropic endeavors on the summary of historical asset values, flows, and returns as of March 31, 2018. Ms. Krauss replied that additional detail could be provided on this summary or a separate summary could be provided to show the impact of philanthropy.

Mr. Bryant then introduced FEG's biennial survey to the Investment Committee and it was distributed by Mr. Bean and Mr. Aluise.

#### I. Meeting Adjourned

Hearing no further business, the meeting was adjourned at 3:06 p.m.

Respectfully submitted,

A handwritten signature in blue ink that reads "Kristina W. Goins". The signature is written in a cursive style with a large initial 'K'.

Kristina W. Goins  
University Financial Services