Meeting Minutes of the Investment Committee
University of Kentucky
Friday, September 10, 2021

The Investment Committee of the University of Kentucky Board of Trustees met on Friday, September 10, 2021, in the Gatton Student Center Harris Ballroom.

A. Meeting Opened

Chair of the Investment Committee, Elizabeth McCoy, called the meeting to order at 8:37 a.m. and requested a roll call.

B. Roll Call

The following members of the Investment Committee were in attendance: Elizabeth McCoy, Joe R. Bowen, Michael A. Christian and Hollie Swanson. The following Committee member was not in attendance: Carol Martin “Bill” Gatton.

The following Community Advisory members were in attendance: James F. Hardymon and Quint Tatro. The following Community Advisory member was not in attendance: William C. Britton.

The University Investment Staff was represented by Chief Investment Officer, Todd D. Shupp and Investment Officer, Nancy K. Rohde.

Cambridge Associates were represented by Eric Thornton, Drew Landry and Jasmine Richards.

C. Approval of Minutes for May 3, 2021, and June 15, 2021

Chair McCoy called for a motion to approve the minutes from the Committee meeting on May 3, 2021, and the Special Meeting on June 15, 2021. The motion was moved by Trustee Christian and seconded by Trustee Swanson. The motion passed without dissent.

D. UK Endowment Overview

Mr. Shupp outlined the agenda for the day’s meeting, then began with an overview of the UK Endowment. He started with a look at the university’s historical endowment values, flows and returns since inception in 1992, highlighting that in 2021 the Endowment crossed the $2 billion threshold and achieved the highest Fiscal Year return in its history. Next, Ms. Rohde discussed the UK Endowment breakdown of assets by type and by purpose. She next reviewed the investment objectives, stating the main objectives are to preserve the purchasing power of endowment assets and related revenue stream and to earn an average annual return, after expenses, of at least 7.5% over full-market cycles. Mr. Shupp then discussed the history of the Endowment’s target asset allocation, pointing out the lower-risk approach that was in place for much of the last 12 years. With input and support from the Investment Committee, more recent efforts have been focused on scaling up growth assets to position the Endowment to prudently take on a bit more risk.

Ms. Rohde then reviewed the university's investment philosophy. She stated that diversification is the university's best strategy for achieving long-term objectives. The focus must be on long-term results, which requires both patience and diligence. Markets are cyclical and valuation matters over the long term. Humility is important, and a blend of passive, active and less-liquid strategies is needed to reach UK's long-term goals. Mr. Shupp next addressed what the university avoids in managing the Endowment, including trying to time the market, making hasty decisions or extreme moves, being complacent and allowing past results to anchor expectations for the future. Some issues to consider with regard to the investment philosophy are that diversified portfolios underperform in certain markets, great investments often require discomfort, short-term performance dominates headlines, valuations can remain elevated for long periods and behavioral biases can challenge a long-term strategy.

Ms. Rohde next provided a review of staff activities from Fiscal Year 2021. She highlighted 170 meetings, calls, Zooms and webcasts as part of ongoing due diligence. Additionally, modeling and research were coordinated to support asset allocation changes that were approved by the Investment Committee in December 2020. The Investment Office also carried out detailed portfolio liquidity and stress testing analysis. An RFP was developed and launched for non-discretionary endowment investment consulting services. Environmental, Social and Governance (ESG) research continued alongside ongoing discussions with students. Finally, investment staff completed investment surveys from NTSE (NACUBO-TIAA Study of Endowments) and Cambridge Associates and evaluated the aggregated results for use in peer benchmarking and perspective on best practices.

Lastly, Mr. Shupp reviewed the Fiscal Year 2022 initiatives. Most significant is the onboarding of the university's new investment consultant, Cambridge Associates. Much transition work has already been completed, asset class reviews are in process, and manager reviews and training on Cambridge's online manager database will be the next areas of focus. He wrapped up the discussion with other Fiscal Year 2022 initiatives, including an update to the private capital implementation plan, continuing due diligence on ESG and ongoing discussions with students, continuing to closely monitor and manage service provider fees, and conducting ongoing capital markets research and onsite due diligence with endowment investment managers and the university's consultant.

Responding to questions from Trustee Bowen and Trustee Christian regarding the cash and asset flows from the endowment pool, Mr. Shupp and Dr. Monday provided color and context to endowment values, flows and returns since inception.

E. Education Session and Asset Allocation Study

Chair McCoy introduced Eric Thornton, Drew Landry and Jasmine Richards from Cambridge Associates (Cambridge). Mr. Thornton began the Education and Asset Allocation Study with a brief overview of the two primary ways that Cambridge believes long-term results can be improved in the Portfolio: 1) adopting a higher-return asset allocation policy, and 2) improving implementation. The day's presentation was focused on the former, asset allocation policy.

Mr. Thornton set the stage by outlining Cambridge's investment philosophy. The goal is to maximize the odds of achieving primary objectives. To do so, Cambridge believes that an equity bias will enable higher long-term expected returns. However, consideration must also be given to protecting against the risk of catastrophe. Bonds typically provide protection during periods of macroeconomic contraction, while real assets can provide protection during periods of high and unexpected inflation. Finally, Cambridge believes in diversification as a core principle. Mr. Thornton next reviewed the roles of various asset classes for a portfolio, including growth (public and private equity), protection (diversifying strategies), and liquidity (real assets and fixed income).

Mr. Thornton next commented on how this philosophy can be applied to the University of Kentucky Endowment, ensuring alignment with the primary policy objectives stated in the Endowment Investment Policy and incorporating observations and conclusions from an enterprise review. He concluded that there are no material operational constraints that should limit the Endowment's ability to accept risk. He further noted his opinion that UK has the capacity to accept equity risk at least in line with peer institutions. Mr. Thornton then reviewed the recommended target asset allocation, which proposes a bit more in growth assets and a bit less in diversifying assets by moving 5% from diversifying strategies to global public equity. Also of note, the recommendation includes the elimination of the public credit target as Cambridge views this asset class on an opportunistic basis. Finally, the proposed real assets target has been reduced slightly and the expectation is that the target may be further reduced over time.

Mr. Tatro noted that valuations are high in certain equity markets and asked if Cambridge considers public equity targets in geographic terms since some regions are trading at more attractive levels. He also asked for standard deviation to be defined for the group so that expectations could be properly set in terms of volatility. Mr. Thornton replied that a drill-down into valuation differentials across global public equity markets is a worthwhile topic, and one for which future meeting time could be dedicated. In short, though, Cambridge recommends a tilt toward markets with more attractive valuations, currently emerging markets, and a tilt away from U.S. markets. Mr. Thornton next defined standard deviation but noted that this is just one tool to evaluate risk. He pointed toward expected portfolio performance in historical scenarios that may be more intuitive to understand the risk levels of the new proposed targets.

Mr. Thornton next presented a summary of a liquidity stress test on the proposed new target asset allocation that was modeled by Cambridge. Under a severely stressed scenario including an equity market decline of 30% without a quick rebound, and all unfunded commitments being called immediately, the modeling suggests a cushion equal to more than five years of spending. This should provide time for either markets to recover or other liquidity solutions to be considered. Mr. Hardymon noted that it is interesting to see what the proposed Portfolio would do in the 2008 Great Financial Crisis scenario because he recalls the Portfolio's actual drawdown in that period. Mr. Tatro asked what the max drawdown was during the COVID selloff and Mr. Shupp replied that he would follow up with that information.

Mr. Thornton then presented a risk dashboard that showed key portfolio risk metrics when looking at the UK current targets versus recommended portfolio. He also addressed intermediate-term nominal return expectations, conceding that high starting valuations suggest lower than average returns in the next decade. He stated that while "the wind may be in our face", we have levers to do better, including focusing on the assets with the most attractive valuations and selecting strong managers. Mr. Thornton concluded with a comparative asset allocation between UK and two peer universes. He noted that the recommended asset allocation moves UK's overall risk profile closer to that of similarly sized institutions. Mr. Shupp asked Mr. Thornton to comment on Cambridge's recommendation preference of private equity over private real assets. He replied that one of the primary reasons to hold real assets historically was as a partial inflation hedge. Recent dynamics in the energy landscape make it more difficult to say whether this will continue to be the case.

Next, Ms. Jasmine Richards provided a brief update on Cambridge's diversity research initiative. She presented an overview of the research team's organization and structure and how diversity and ESG manager research is fully integrated into the global research process across asset classes. She briefly discussed her role at Cambridge and why her position was created. Ms. Richards concluded with statements about Cambridge's' twenty-year history of commitment to diverse managers. The organization currently tracks over 590 minority- and women-owned investment managers, and 1,700 minority- and women-owned investment funds. In Cambridge client portfolios, they are proud that there are 240 minority- and women-owned investment managers and 5% of assets on which they advise or manage for clients are invested with minority- and women-owned investment managers.

F. Proposed Changes to Endowment Investment Policy

Next, Mr. Shupp reviewed the proposed changes to the Endowment Investment Policy. As previously outlined by Cambridge, the policy reflects the proposed asset allocation changes including an increase in the global equity allocation, a small reduction in fixed income, a slight decrease in real assets, and finally, a decrease in diversifying strategies. Additionally, a broader range is being proposed for global equity, as well as real assets and diversifying strategies. Expanded language is being added for each of the asset classes within the Portfolio. Mr. Shupp also noted a change in policy benchmarks associated with each of the asset classes. This included a change to Cambridge Associates benchmarks for a few of the asset classes and Mr. Thornton provided brief comments regarding the rationale for this shift. Lastly, Mr. Shupp noted that the Appendix memo will be updated by the UK Legal Team to remove references to UK's prior consultant.

G. Endowment Manager Presentation: Lime Rock Management

Mr. Mark McCall from Lime Rock Management provided an introduction and brief update on his firm as well as an overview of the Lime Rock New Energy Fund in which UK is invested.

H. Investment Staff Report

Mr. Shupp presented the Investment Staff Report beginning with an overview of the Endowment asset allocation as of July 31, 2021. He stated that the Portfolio remains well-diversified and within the established asset allocation targets. While there were no massive changes since the last meeting, the most significant change was the increase in the global equity portfolio. Private equity was the primary driver as first-quarter values came in and lifted that portion of the Portfolio. Public equities also increased given an uplift in the markets. He noted that both fixed income and real assets remained relatively flat. The decrease over the period came from diversifying strategies, driven by an ongoing reduction in the less liquid portions of the Portfolio. Lastly, Mr. Shupp noted the inclusion of both the June 30, 2021, and July 31, 2021 asset allocation files.

Next, Ms. Rohde discussed recent manager appointments, terminations and due diligence for the period. She reported that there were no new manager appointments since the last meeting. On the terminations side, UK redeemed in full from Fir Tree Capital Opportunity Fund, as well as from two international equity strategies tied to UK's previous consulting firm. These funds were moved temporarily to passive Vanguard vehicles. In addition to ongoing and regular meetings with managers over the past few months, many conversations took place with Cambridge and other service providers as the consultant transition took place.

I. Performance Review and Market Update

Mr. Thornton conducted a Fiscal Year 2021 performance review of the UK Portfolio. The portfolio generated a strong return that is likely to be revised upward as private allocation marks continue to be updated. In the FY21 period, all major asset classes delivered gains, led by public and private equity. Overweights to small-cap and emerging markets were additive, and strong relative results from non-US equity managers and public fixed income managers helped relative results. Relative detractors in the Portfolio included private equity, diversifying strategies, private credit and natural resources which trailed their respective industry benchmarks.

Next, Mr. Landry briefly discussed the performance and asset allocation snapshot for the Portfolio as of July 31, 2021. On the performance side, he stated most asset classes were additive with the exception of diversifying strategies which was down very slightly. Addressing asset allocation, asset classes were largely in line with current policy targets, with a slight overweight to global equity and slight underweight to diversifying strategies. Lastly, he reported that Cambridge is in the final stages of creating the first quarterly performance report as of June 30, 2021.

J. Other Business

Mr. Shupp reviewed the 2021 Investment Committee Meetings and tentative agenda items, noting only December's meeting remains on the schedule for this year. This meeting's agenda includes the Endowment Investment Policy approval as well as an education session on private equity. One-on-one meetings will be scheduled with each Committee member to discuss the policy updates and to answer any questions.

K. Meeting Adjourned

Hearing no further business, the meeting was adjourned at 11:15 a.m.

Respectfully submitted,

Kristina W. Goins
University Financial Services