Meeting Minutes of the Investment Committee
University of Kentucky
Thursday, February 17, 2022

The Investment Committee of the University of Kentucky Board of Trustees met on Thursday, February 17, 2022, in the Gatton Student Center Harris Ballroom.

A. Meeting Opened

Investment Committee Chair Elizabeth McCoy, called the meeting to order at 2:00 p.m. and requested a roll call.

B. Roll Call

The following members of the Investment Committee were in attendance: Elizabeth McCoy, E. Britt Brockman, 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: William C. Britton, James F. Hardymon and Quint Tatro.

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

Cambridge Associates was represented by Eric Thornton and Wade O'Brien.

C. Approval of Minutes for December 13, 2021

Chair McCoy called for a motion to approve the minutes from the Committee meeting on December 13, 2021. The motion was moved by Trustee Bowen and seconded by Trustee Brockman. The motion passed without dissent.

D. ICR 1 – Expansion of Mission Related Investment Program

Mr. Shupp presented a recommendation that the Investment Committee approve an expansion of mission related investment programs to an aggregated commitment level of up to $10 million. Mr. Shupp shared that the Endowment portfolio's existing mission related investment program was established in December 2013 when the Investment Committee approved a commitment of up to $5.1 million for the Student Managed Investment Funds (SMIF) Program. This commitment amount was allocated equally across two academic programs: the Undergraduate program for Finance majors and the Master of Science in Finance program.

Next, Jon Chait, instructor for the Master of Science in Finance SMIF class, provided a brief biography, as well as additional comments relating to the new SMIF course focused on responsible investing. Mr. Chait has agreed to teach the course with support from the University's Sustainability Coordinator. The course will be open to all students regardless of major who complete two prerequisite courses with a grade of B or better, one relating to Finance and one relating to Environmental Science. Trustee Swanson asked Mr. Chait if he knew what the interest level was among students for this new course. Mr. Chait replied that they feel very confident they will gain student interest, though the interest level might be light at first. Chair McCoy called for a motion to approve ICR 1. The motion was moved by Trustee Swanson and seconded by Trustee Christian. The motion passed without dissent.

E. Fixed Income Strategy Review

Mr. Thornton reviewed the fixed income strategy agenda which included the role and expectations for fixed income, UK's current fixed income portfolio, a fixed income market review and outlook, and a manager spotlight on a recent UK commitment, BioPharma Credit Investments. He reviewed UK's fixed income policy allocations, which include a 10% target to public fixed income and a 2% target to private credit.

The objectives for the public fixed income allocation are to serve as a partial hedge against deflation or a "flight to quality," provide diversification and dampen volatility, and provide a stable reserve of liquidity to meet spending needs during periods of market distress. High-quality, non-callable bonds provide the best hedge in most "risk-off" environments, and Cambridge recommends a tilt toward these assets within the public fixed income portion of the portfolio, with the target allocation sized to meet roughly two years of spending needs. Mr. Shupp cited the example of the COVID 19 outbreak, and the corresponding market drop in March 2020 for why this hedge is so important. Trustee Bowen asked if high dividend stocks and high-quality stocks could also be considered a hedge and if this entered into Cambridge's calculation. Mr. Thornton replied that while these types of stocks tend to hold up better than the rest of the equity market, they still tend to drop substantially during periods of market stress while fixed income assets tend to hold up better. He next provided details regarding the Portfolio's public fixed income allocation, which comprises three strategies: PIMCO Income, Reams Intermediate Fixed Income and Vanguard Total Bond Market Index Fund.

Next, Mr. Thornton provided a strategic overview of private credit. The objectives here are to provide a unique source of return and diversification and to generate returns that are materially higher than public fixed income and often, equity-like. This space is composed mostly of corporate debt and may also include obligations of any credit quality such as distressed debt investing. Importantly, there is limited or no immediate liquidity. The commitment goal for this allocation is $10 million per year and over a three-year cycle, the Portfolio will opportunistically commit to private credit strategies. Mr. Thornton provided an overview of a recent private credit addition to the Portfolio, BioPharma Credit Investments V. L.P. He provided remarks on the strategy's background and organization, investment strategy and portfolio construction. Trustee Bowen asked about the sourcing of these private managers, specifically if the fund managers seek out Cambridge or the other way around. Mr. Thornton replied that this varies, but for private investments, the relationships are often built through networking. In this specific case, Cambridge sought the investment manager out.

Mr. Britton asked if an expected return of 1.5 - 2% for global fixed income assets over the next five to ten years is a reasonable expectation and, if so, if the Portfolio is potentially overly hedged given a combined allocation of 30% to fixed income, cash and diversifying strategies. Mr. Shupp responded that a reasonable estimate of future return for high quality fixed income is the yield, which stands at 2.1% for the UK public fixed income portfolio. He acknowledged that this figure is low but pointed out that a market selloff can provide higher-returning opportunities within the asset class and shared the example of a high yield credit investment in the spring of 2020 that delivered a return of over 19%. He also stated that private credit return expectations are higher than those for public fixed income, so overall fixed income returns should be more interesting than 2%. Mr. Shupp said that the question of whether UK is overly diversified has been discussed extensively with the Committee since he joined UK seven years ago, and the allocation targets have since been adjusted to ensure the Portfolio is not overly hedged. Mr. Thornton added that his team concluded in their initial portfolio review in June 2021 that UK had the ability to take more equity risk in the portfolio and are in the process of doing so. He stated that the question of how much risk to take is the ultimate policy question, and this is something to review at least annually as a Committee. Mr. Britton raised the concern that the allocations to fixed income and diversifying strategies could result in the total Portfolio missing its performance objective of 7.5% given his expectation that those asset classes are geared to return 3% or less over the next 10 years. Mr. Thornton responded by stating that while fixed income held up within expectations in 2020, the market rebound came so quickly that this allocation may have seemed unnecessary. But he warned that the speed of the COVID-induced market decline and recovery was abnormal, and it is not appropriate to assume that the next recession will be so short-lived. The fixed income allocation is in place to protect against more sinister and prolonged stock market selloffs. Mr. Shupp concluded his comments by acknowledging that the Portfolio became overdiversified following the Great Financial Crisis of 2008, but we have not been complacent. He added that several steps have been taken to adjust the risk positioning within our asset allocation policy to ensure that there are enough growth assets in the Portfolio.

Mr. Wade O'Brien, Managing Director of Capital Markets Research at Cambridge, conducted a fixed income market review. He stated that heading into 2022, investors faced a difficult climate for liquid fixed income given narrow spreads and low yields. He reviewed fixed income performance from 2021, highlighting that long duration, lower yielding fixed income suffered while niche floating-rate, lower quality debt such as CLOs did pretty well. Looking more recently, spreads have generally risen over the past six weeks amid the sell-off, which improves the opportunity set for liquid fixed income. Mr. O'Brien added that credit fundamentals staged a dramatic recovery after COVID-related deterioration, which is encouraging. Turning to areas of interest in private credit, opportunities in distressed debt investing remain very limited and lending terms and standards are deteriorating in direct lending given the influx of money to the space. For these reasons, manager selection remains as important as ever.

F. Investment Staff Report

Mr. Shupp presented the Investment Staff Report beginning with an overview of the Endowment asset allocation as of December 31, 2021. He noted this allocation includes the new policy targets approved in December and that there was very little change in allocation since the previous meeting. He stated that the Portfolio remains well-diversified and within the established asset allocation targets. Regarding recent rebalancing activity, a new emerging markets value strategy was added to the international equity portfolio. This was done to improve the balance between growth and value strategies and was funded from a passive Exchange Traded Fund (ETF). Secondly, the fixed income portfolio was restructured with an intention of improving the credit quality of the Portfolio and raising duration slightly to counterbalance the recent increased target to equities. He concluded his comments by noting that manager concentration improved since the last meeting as Grosvenor rolled off the concentration list.

Next, Ms. Rohde discussed recent manager appointments, terminations and due diligence for the period. On the appointments side, UK made new investments in or commitments to the following funds: Vanguard Total Bond Market Index Fund, BioPharma Credit Investments V, ARGA Emerging Markets Equity, Sino Vision Great China MN Fund and Kline Hill Partners Solutions Fund I. On the terminations side, UK redeemed in from Vanguard Short Term Treasury Index Fund and the Artisan High Income Fund. These funds were reinvested in the previously mentioned Vanguard Total Bond Market Index Fund. A full redemption was also made from Parallax Offshore Investments Fund. Lastly, Ms. Rohde discussed manager due diligence and research during the period which included regular monthly updates with Cambridge, as well as meetings with their private team.

G. Performance Review and Market Update

Mr. Thornton began with a snapshot of the 2021 market performance, stating it was a fantastic year in absolute terms. This was largely due to very robust equity markets. Overall, while stocks and real assets soared, fixed income suffered as central banks sounded more hawkish. Mr. Thornton highlighted the themes for the year which included continued economic recovery, earnings having a banner year, continued support from fiscal and monetary authorities, volatility surrounding market regulations in China, energy price surges and inflation. Mr. Thornton illustrated how each theme was reflected in the Portfolio’s annual return numbers overall and for each asset class.

Turning to UK-specific performance information, he stated that UK’s return for the calendar year will almost certainly be revised upward as private investment returns continue to come in. All major asset classes delivered gains in the calendar year 2021, with U.S. equity and private equity being the best performers. The highest absolute gain was delivered by Master Limited Partnerships (MLPs). Lower duration in public fixed income and an overweight to small cap in non-U.S. equities were also additive. Holding back returns was relative underperformance from U.S. equity and non-U.S. equity managers versus benchmarks, and alternative strategies lagging their respective benchmarks.

H. Other Business

Mr. Shupp reviewed the schedule of 2022 Investment Committee meetings and tentative agenda items. He highlighted that April's meeting agenda includes an update on the Master of Finance (MSF) SMIF portfolio and student presentation, as well as the annual portfolio risk review.

I. Meeting Adjourned

Hearing no further business, the meeting was adjourned at 3:31 p.m.

Respectfully submitted,

Kristina W. Goins
University Financial Services