Meeting Minutes of the Investment Committee
University of Kentucky
Thursday, April 28, 2022

The Investment Committee of the University of Kentucky Board of Trustees met on Thursday, April 28, 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, Michael A. Christian and Hollie Swanson.

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

C. Approval of Minutes for February 17, 2022

Chair McCoy called for a motion to approve the minutes from the Committee meeting on February 17, 2022. The motion was moved by Trustee Swanson and seconded by Trustee Christian. The motion passed without dissent.

D. Student Managed Investment Fund Presentation

Three students from the Graduate Student Managed Investment Fund (SMIF) class presented an update on the portfolio. The Chairman for the Graduate SMIF began the presentation with the fund's investment philosophy. The class focuses on fundamental analysis, seeks to find opportunities in oversold or mispriced companies, and maintains discipline in entering and exiting positions. He briefly discussed the FIN 685-686 class structure which is made up of 33 students from a wide array of backgrounds, abilities and perspectives. Investment decisions are driven by the Portfolio Management Committee (PMC) with stock pitches presented by non-PMC students. The portfolio is invested per Endowment guidelines to be long-only, value-oriented and primarily comprised of stocks of larger companies. The portfolio is benchmarked to the S&P 500 index.

Following this, the students discussed portfolio holdings and reviewed the trade history for the semester, summarizing the key buys and sells. They concluded with commentary on performance and some future thoughts including macro and portfolio management considerations. Trustee Swanson asked how an increase in interest rates from the Federal Reserve might impact the graduate SMIF portfolio, specifically with regard to the impact of rising rates on the housing sector. The students explained that the portfolio's exposure to housing is very minimal.

E. Portfolio Risk Review

Mr. Thornton began by stating the purpose of the portfolio risk review was to provide an idea of what kinds of risk are being taken in the Portfolio and how much. He added that there is no single definition of risk, but the most common types are: variability of returns, sensitivity to equity markets (beta), liquidity risk, behavioral risk, concentration risk, headline risk and shortfall risk (risk of failing to meet the primary objective). He outlined that the risk review was organized into three parts: the first is how the Endowment's Investment Policy itself builds in a buffer against risk, the second is a review of a range of expectations and the third is a specific look at liquidity risk and a stress test of the Portfolio.

Beginning the first part of this discussion, Mr. Thornton noted that a lot of thought is put into the investment philosophy and asset allocation within the Endowment Investment Policy, with the recognition that the Portfolio needs to weather unforeseeable risks. Given that the Portfolio's objective is to achieve a real return of at least 5%, an equity-dominant portfolio is required. However, equities can be very volatile and pose a risk of ruin from two economic scenarios, each of which has a low probability of occurring but potentially catastrophic consequences: one being prolonged economic contraction, and the other being an unexpected spike in inflation. The risk from a prolonged economic contraction can be tempered by having a portion of the Portfolio invested in high-quality sovereign bonds, which tend to do better in such an environment. On the flip side, the risk from an unexpected spike in inflation may be mitigated by investing in a diversified basket of real assets, the value of which should appreciate at least in line with rising inflation. The goal is to build in the right amount of diversifying assets into the policy so that the Portfolio can weather the storm. If we have enough to meet the Endowment's spending needs during a crisis period, then we can maintain a long-term perspective and avoid being a forced equity seller in the short term. In determining how *much* of these assets to hold in the Portfolio, it is useful to know that equities have historically recovered their previous peak within two to three years. With that in mind, it reasons that holding two to three years' worth of spending needs in these more protective assets should allow the Endowment to withstand an equity downturn. Mr. Thornton continued with a discussion of shortfall risk, the risk that the objective will not be met, noting that this is often the most important form of risk for perpetual-lived institutions, including UK. He showed some modeling for the Endowment to evaluate this risk.

The conversation on risk continued with a focus on liquidity risk, specifically the results of liquidity stress tests of the UK Portfolio that were conducted by the investment office. Ms. Rohde stated that industry experts, including investment managers and other research providers were consulted in the data preparation and assumptions utilized in this study. She provided the results of a first study that stressed the most highly liquid assets in the Portfolio, those that can be fully redeemed within one month. Applying very conservative performance assumptions to simulate what may occur in a severe downturn, the most liquid assets were found to cover three years of annual spending and capital call needs. Mr. Shupp provided the results of a second study that included not only the most liquid assets but also semi-liquid assets that can be liquidated within one year. Again, applying conservative assumptions, the liquid and semi-liquid assets are estimated to cover four and a half years of the Portfolio's annual spending and capital call needs. Trustee Christian commented that he appreciated the liquidity analysis being done in order to provide an increased level of comfort.

Mr. Thornton summarized the presentation by emphasizing that there is no single definition of risk and investors should understand the expected risk profiles across different metrics and agree on which forms of risk are most important. Given UK's primary long-term objective to maintain purchasing power after spending, Cambridge's belief is that the highest priority for the Portfolio should be prudently managing long-term "shortfall risk" or the chance of failing to achieve this objective over time. Mr. Hardymon asked which of the historical peak-to-trough scenarios presented in the materials were due to inflation. Mr. Thornton replied that we only have one historical inflationary scenario with good market data, 1972-1976. He added that peak-to-trough the stock market was down around 40% and took about 42 months to recover in that scenario. He noted that while it is nice to have a period to look to, it is important to realize that circumstances are different today than they were in the 1970s, though it is possible to glean information as far as which assets held up and which assets did not.

F. Investment Staff Report

Mr. Shupp presented the Investment Staff Report beginning with an overview of the Endowment asset allocation as of March 31, 2022. He stated the high-level takeaway is that progress was made toward the targets approved in December. The biggest move among the four categories was in global equity, where a modest increase was due entirely to rebalancing the Portfolio into public equities. Fixed income stayed relatively flat, although some capital was shifted from public fixed income to private credit in the form of capital calls. Real assets came down very slightly and some gains were reallocated to global equity. Lastly, the diversifying strategies allocation moved toward our new target given redemption payments being made over time. Turning to March's asset allocation detail, he noted a new value-oriented allocation in international equity intended to provide balance to the existing growth strategy in the active part of the Portfolio. Mr. Shupp concluded by stating that the Portfolio remains well-diversified and well within the policy ranges both for liquidity and asset allocation.

Mr. Britton asked if the international allocation would be pared back somewhat to become more U.S.-based, given what is going on in Ukraine and Russia, and possibly China. Mr. Shupp replied that much thought had been given to that question. While UK still prefers non-US equity over U.S. even in the current heightened risk environment, that bias has been moderated in the portfolio over the past five years. Mr. Thornton added that Cambridge is constructive on China and emerging markets which they acknowledge is a contrarian position. Relative valuations are the key tenet behind that recommendation. As for non-U.S. developed, he conceded that Cambridge is currently reevaluating their overweight recommendation, particularly as it concerns Europe given the geographic proximity to Ukraine and Russia.

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: Artisan International Value Fund, Cordillera Investment Fund III and Neumeier Poma Small Cap Value. On the terminations side, UK redeemed in full from Governors Lane Offshore Fund and Tybourne Equity Offshore Fund. These exits helped move the Portfolio closer to the new, lower asset allocation target for diversifying strategies. Lastly, Ms. Rohde discussed manager due diligence and research during the period which included regular updates with existing managers, including the undergraduate Student Managed Investment Portfolio, as well as some introductory meetings with managers suggested by Cambridge on the private side.

G. Performance Review and Market Update

Mr. Landry began with a discussion of the First Quarter 2022 market performance, stating it was a quarter with much volatility. Themes included persistent inflation as well as the Russian invasion of Ukraine. While most asset classes declined in the first quarter, global natural resources was a positive standout with a 20.5% return for the period. Turning to UK specific performance, the Portfolio's modest decline in the first quarter was in line with the benchmark. For the fiscal year-to-date period, the Portfolio slightly outpaced the benchmark and benefitted from strong performance in public real assets and private investments, particularly infrastructure holdings. Detractors in the period included non-U.S. equity, particularly emerging markets and fixed income on an absolute basis. He concluded that the overall Portfolio held up well during a volatile period.

H. Other Business

Mr. Shupp reviewed the schedule of 2022 Investment Committee meetings and tentative agenda items. He highlighted the Investment Committee Retreat in September which will have an asset allocation review, a strategy overview by one of UK's investment managers and a recommendation of minor changes to the Endowment Investment Policy. In the meantime, Mr. Shupp will conduct calls with each member of the Investment Committee as well as the Community Advisory members to give additional detail on the meeting agenda.

I. Meeting Adjourned

Hearing no further business, the meeting was adjourned at 3:23 p.m.

Respectfully submitted,

Kristina W. Goins
University Financial Services