Meeting Minutes of the Investment Committee
University of Kentucky
Monday, December 12, 2022

The Investment Committee of the University of Kentucky Board of Trustees met on Monday, December 12, 2022, in the Gatton Student Center Harris Ballroom.

A. Meeting Opened

Investment Committee Chair, Ray A. Daniels, called the meeting to order at 3:15 p.m. and requested a roll call.

B. Roll Call

The following members of the Investment Committee were in attendance: Ray A. Daniels, E. Britt Brockman, Todd Case, C. Frank Shoop and Hollie Swanson.

The following Community Advisory members were in attendance: Elizabeth McCoy 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 Director Nancy Rohde.

Cambridge Associates was represented by Eric Thornton and Marc Cardillo.

C. Approval of Minutes for September 16, 2022

Chair Daniels called for a motion to approve the minutes from the Committee meeting on September 16, 2022. The motion was moved by Trustee Swanson and seconded by Trustee Brockman. The motion passed without dissent.

D. Cambridge Associates Private Real Estate Review

Mr. Thornton introduced Marc Cardillo, Global Head of Real Assets at Cambridge Associates, to provide a private real estate review. Mr. Cardillo began with an overview of Cambridge's general views on real estate as 2022 concludes, organized across three themes. These included the role of real estate as an inflation hedge, disruption that arose from the pandemic and technology and innovation drivers that are impacting demand for specialized properties. With that backdrop, he turned to macro fundamentals, noting that cap rates stood at all-time lows as the year began, and while they have increased over the year, they will probably rise higher as the process of price discovery unfolds among investors in a higher interest rate environment.

Mr. Cardillo next provided an update on various sub-sectors. He stated that Multifamily and Industrials are solidly positioned. While fundamentals are decelerating through an uptick in vacancies and a slowdown in Net Operating Income (NOI) growth, apartments are generally a lower-risk pocket of real estate considering that people will always need a place to live, and industrial properties still feature relatively attractive fundamentals. Turning to the Office sector, he classified it as a bifurcated market as some companies are turning to newly refurbished properties to entice employees back to the office while existing older properties continue to struggle. Retail is similar in the sense that it is a sector with clear winners and losers; open air malls are doing well and have rebounded post-COVID, but older out-of-date malls continue to face challenges.

Mr. Cardillo then talked through some real estate areas of interest, the first being data centers. These are well-positioned to outperform long term due to accelerated secular tailwinds and related demand for digital infrastructure. He continued that hospitality is another bifurcated sector; leisure assets have benefitted from post-COVID demand to travel, while the outlook for business-oriented hotels remains uncertain. Another area of interest is healthcare due to favorable demographics as an aging population drives demand for healthcare solutions and senior housing.

Mr. Cardillo concluded with some comments specific to the UK Endowment portfolio. He noted that real estate has been a positive contributor to Endowment returns since inception, across both public and private areas. He provided brief summaries of two recent private real estate commitments in the UK portfolio: the first, KSL Capital Partners, is focused on travel and leisure properties, while the second, Palatine, is focused on lower-middle market, non-gateway metropolitan areas in the U.S. Mr. Tatro asked if Cambridge had a sense of the amount of capital still waiting on the sidelines within the private space, which may lessen the pain as properties get re-priced. Mr. Cardillo replied that it is difficult to say for sure but some research points to as much as $200 – $300 billion. He added that high amounts of dry powder (unallocated capital) had also been waiting in previous cycles, which likely helped the market avoid distress.

E. ICR 1 – Approval of Endowment Investment Policy

Mr. Shupp presented a recommendation that the Investment Committee approve the revised Endowment Investment Policy. The revised policy reflects the adoption of modest changes to asset allocation targets, ranges and indices intended to enhance the Portfolio's expected return while maintaining prudent diversification. Chair Daniels called for a motion to approve ICR 1. The motion was moved by Trustee Case and seconded by Trustee Shoop. The motion passed without dissent.

F. Investment Staff Report

Mr. Shupp presented the Investment Staff Report beginning with an overview of the Endowment asset allocation as of October 31, 2022 compared to the July 31, 2022 asset allocation presented at the last meeting. He highlighted that there was a slight reduction to global equity while global fixed income remained relatively flat, and both real assets and diversifying strategies increased slightly. Mr. Shupp then briefly detailed the drivers responsible for the movement in each asset category. He highlighted the large volume of rebalancing activity that took place over the period, most notably a $20 million inflow to the Quasi-Operating Endowment in September. These assets were split across equities, real assets and fixed income allocations in an effort to steer portfolio exposures towards investment policy targets. Mr. Shupp concluded that the Portfolio remains well-diversified and well within the policy ranges both for liquidity and asset allocation, a positive in a time when markets have been so volatile.

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: Blue Point Capital Partners V, Aetos AC Carbon, Hillhouse China Value, Palmer Square Ultra-Short Duration Investment Grade Fund and InTandem Capital Partners III. She stated there was nothing to report on the manager terminations side. Lastly, Ms. Rohde referenced manager due diligence and research during the period, highlighting that many private manager annual meetings occurred this past fall.

G. Performance Review and Market Update

Mr. Thornton presented a performance review and market update for the calendar year-to-date period ending October 31, 2022. Markets sold off broadly during the period, leaving investors with few places to hide as inflation spiked and the Federal Reserve tightened policy with higher interest rates. While stocks and bonds declined in tandem, global natural resources were a bright spot in 2022, returning 16% for the calendar year-to-date period. Mr. Tatro asked two questions: the first was if there were plans to take advantage of the significant decline in the bond market and move the Portfolio's allocation to public fixed income up to match the target allocation amount; and the second question was if Mr. Thornton could elaborate on what the yield curve is signaling versus what actions the Federal Reserve has taken.

Mr. Thornton responded that bond rates have moved up a lot in 2022, which in the rearview has meant losses in fixed income but looking forward makes the asset class more attractive given that the best indicator of returns from fixed income is the yield. He added that it is also the only place in the Portfolio, with some small exceptions, that we can rely on to hold up if there is a deeper recession and equities continue to do poorly for that reason. He noted recent discussions between Cambridge and the UK Investment Office about moving duration more toward a neutral posture. Mr. Shupp added that a tactical move was made a couple of years ago to shorten duration which turned out to be a great decision given the historic rise in interest rates. He echoed Mr. Thornton's statement that UK is currently considering extending duration a bit, perhaps by adding a passive long-duration fund to the public fixed income portfolio with the goal being to move overall fixed income duration to be in line with the Barclays Aggregate Index.

Turning to Mr. Tatro's second question, Mr. Thornton stated that the bond market, as signaled by the inverted shape of the yield curve, is messaging a belief that the Federal Reserve has gone too far in raising rates and is risking a recession. Community Member McCoy reminded the Committee that the Federal Reserve has two mandates, full employment and stable prices. Considering that the latter mandate has not yet been achieved, we will need to wait to see additional data before anticipating any easing.

Focusing on UK's calendar year-to-date performance, every major asset class with the exception of real assets was down. Given the broad downturn in most markets, the portfolio declined in the period but managed to outperform the policy benchmark through October 31st. Supporting relative returns was an overweight to real assets and strong performance from Master Limited Partnerships (MLPs), outperformance by active public equity managers, and the below market duration in fixed income amid the rising interest rate environment. Countering those areas of strength, equities and fixed income declined sharply on an absolute basis, diversifying strategies declined and trailed the industry benchmark, and the Portfolio's overweight to emerging markets was not additive.

H. Other Business

Mr. Shupp reviewed the schedule of 2023 Investment Committee meetings and tentative agenda items. The first meeting of next year will take place on Thursday, February 16. In addition to the regular meeting items, the agenda will include an update from the Student Managed Investment Fund (SMIF) as well as an educational session focused on emerging markets.

I. Meeting Adjourned

Hearing no further business, the meeting was adjourned at 4:35 p.m.

Respectfully submitted,

Kristina W. Goins
University Financial Services