Minutes of the Investment Committee
University of Kentucky Board of Trustees
2:30 p.m. on February 16, 2017
Room 327C, Charles T. Wethington Building

IN ATTENDANCE:

Investment Committee Members:	Mark P. Bryant, Chair Claude A. Berry, III William C. Britton Michael A. Christian Robert D. Vance Barbara S. Young
Community Advisory Members:	Myra L. Tobin
Investment Staff & Consultants:	Susan I. Krauss, Treasurer Todd D. Shupp, Chief Investment Officer Nolan M. Bean, Consultant, Fund Evaluation Group Rebecca S. Wood, Consultant, Fund Evaluation Group

Chair Bryant called the meeting to order at 2:30 p.m. and requested a roll call. Chair Bryant then called for a motion to approve the minutes from the Committee meeting on December 12, 2016. The motion was moved by Mr. Britton, seconded by Mr. Vance, and approved by all.

Mr. Bean provided a summary overview of the 2016 NACUBO-Commonfund Study of Endowments (NCSE). Mr. Bean noted that 805 U.S. endowments and affiliated foundations participated in the NCSE, a comprehensive annual survey in higher education. Survey data was for the period of July 1, 2015 to June 30, 2016 and participating institutions were categorized by size. Groupings included endowments greater than $1 billion, $500 million to $1 billion, $100 million to $500 million, $50 million to $100 million, $25 million to $50 million and less than $25 million. The University's endowment was 83rd in size, ranking in the top 10% of all survey participants. Regarding performance, the University's one-year return of (1.5%) outperformed the average return for all NACUBO institutions of (1.9%). The University's three-year return of 5.4% was also greater than the average of 5.2%. The UK portfolio's five-year return was equal to the average of 5.4% and the ten-year return of 4.0% was less than the average return of 5.0%. Mr. Bean noted that the Russell 3000 index had a one-year return of 2.1%, a three-year return of 11.1%, a five-year return of 11.6% and a ten-year return of 7.4%. Also, the MSCI All Country World Index Ex – US yielded a one-year return of (10.2%), a three-year return of 1.2%, a five-year return of 0.1% and a ten-year return of 1.9%. Regarding asset allocation for endowments greater than $1 billion, the University was mostly in-line with peers, with some minor variations in real estate and private equity. The University's allocation in real estate was greater than the average, 11% versus 7%, and the allocation in private equity was less than the average, 14% versus 21%. Regarding spending, the University's annual effective spending rate of 3.6% was lower than the average rate of 4.3%. Mr. Bean commented that there is a trend for institutions to decrease spending. Ms. Krauss provided background information regarding the history of the University's spending rate, noting that a hybrid spending policy was implemented in FY2015 that calculates a spending rate with 60% based on prior year spending with inflation factored in and 40% based on 4.0% of the trailing 36 month average endowment market value. Ms. Krauss commented the hybrid policy was adopted in order to produce a smooth income stream and distributions have been lower than expected since inflation has remained low. Additionally, a twelve-month delay in spending was incorporated into the investment policy in FY2015.

Ms. Wood continued the NCSE overview with a discussion comparing asset allocation by institution size. She noted that institutions with greater private equity allocations or a greater focus on US equities tended to be high performers during the time period the study was conducted. The University's allocation in private equity was 14%, compared to an average of 21% for endowments greater than $1 billion and 12% for endowments $500 million to $1 billion. The University's 13% allocation in US equity equaled the average allocation of endowments greater than $1 billion and was less than the 20% allocation of endowments $500 million to $1 billion. In real estate, the University had an 11% allocation, compared to an average allocation of 7% for endowments greater than $1 billion and 3% for endowments $500 million to $1 billion. Additionally, the University had 11% in fixed income, compared to 7% for endowments greater than $1 billion and 9% for endowments $500 million to $1 billion. Next, Ms. Wood reviewed allocation by alternative asset class and compared the University's portfolio at 6/30/16 versus 6/30/15. During the year, there was a 4% decrease in the allocation of marketable alternatives from 64% to 60%, a 3% increase in private equity real estate from 14% to 17% and a 1% increase in commodities, energy, and natural resources from 0% to 1%.

Mr. Shupp continued the conversation regarding the NCSE and presented a summary of the twenty-two public institutions with endowments valued at $1 - $2 billion. The University's one-year return of (1.5%) was slightly less than the group's average of (1.3%). The University posted 5.4% for the three-year return, which was equivalent to the group's average. For the five-year return, the University also matched the average of 5.4%. However, the University's ten-year return of 4.0% was less than the average of 4.7%. Mr. Shupp then provided a comparison between the University and benchmark institutions selected by the University Review Committee (URC), with selection for this group being based on a high-quality undergraduate education, a medical center on campus, a land grant mission and a comparable research portfolio. The University's one-year return of (1.5%) outperformed the group's average of (2.1%), but the University's three-year, five-year and ten-year returns all trailed the average returns. The three-year return of 5.4% underperformed the average of 5.9%. The five-year return of 5.4% was less than the average of 5.8%, and the ten-year return of 4.0% trailed the average of 5.1%. Comparing the endowment size of SEC institutions, the University ranked sixth out of 14 schools, the same ranking as the prior year. The University's returns outperformed the SEC average for one-year, three-year and five year, (1.5%) to (2.3%), 5.4% to 5.1% and 5.4% to 5.2%, respectively, lagging only in ten-year returns, 4.0% compared to 4.7%. For Kentucky institutions, the University's one-year return of (1.5%) was less than the average return of (1.3%) of the group. The University's three-year return of 5.4% outperformed the average of 5.1%. The five-year return of 5.4% was less than the average of 5.6% and the ten-year return of 4.0% was less than the average of 5.0%. Mr. Vance asked if the University should consider adopting an equity-focused asset allocation and use a ten year rolling average for spending distribution. Ms. Wood responded that the approach would likely lessen the percentage available to spend. She added that the balancing act of meeting current needs and sustaining long-term growth requires a diverse portfolio comprised of risk mitigating assets and growth assets.

Next, Mr. Shupp presented the Investment Staff Report. He began with an overview of the endowment asset allocation as of December 31, 2016, stating that the portfolio remains well within the policy ranges and well diversified across asset classes and noting that asset allocation is now being presented in the following four main categories as defined by FEG: global equity, global fixed income, real assets and diversifying strategies. He then presented a report on manager appointments, terminations and due diligence for the period December 12, 2016 through February 15, 2017. Several manager appointments were made in the Wildcat Alpha fund, a non-discretionary fund of one vehicle designed by UK and FEG to streamline portfolio implementation, including investments of $15 million in Fir Tree Capital Opportunity Fund, $15 million in Rimrock Structured Product Fund, $12 million in Graham Tactical Trend Capped Beta (Equities) Portfolio, $19.8 million in AQR DELTA XN Offshore Fund and $19 million in Governors Lane Offshore Fund. Manager terminations included a full redemption from Berens Global Value, a hedged equity fund of funds, with proceeds partially funding the investment in diversifying strategies, and a full redemption from three hedged equity funds at Wellington, with proceeds also used as a funding source for diversifying strategies investments. Mr. Shupp also noted there had been an extensive amount of due diligence during the period. Next, Mr. Shupp provided an update on FY2017 initiatives. Within global equity, the first phase of reduction was completed in public equity to fund increased credit exposure and the first phase of reduction was completed in hedged equity with due diligence conducted on new, direct managers. Within global fixed income, core plus exposure was reallocated, a dedicated U.S. Treasury investment was established, exposure was increased in public credit with two manager hires and a commitment was made to an emerging markets debt strategy in private credit. Within real assets, the temporary MLP allocation was increased in advance of a planned, active manager investment and a direct commitment was made to a private natural resources manager. And within diversifying strategies, portfolio sub-strategy targets have been established, the first phase of the hedge fund portfolio transition was completed and the allocation was increased towards the new target with multiple investments made across sub-strategies. Ms. Young asked if the total fees paid to investment managers in FY16 could be provided. Mr. Shupp stated that the information is available and he would send it to the Committee. Also, Mr. Christian requested additional detail in future reports to denote active and passive management exposure at the manager, portfolio and asset category level. Additionally, Chair Bryant asked if the fee information for each manager could be provided. Mr. Shupp said he would ensure that information is provided in future reports.

Next, Mr. Bean provided a performance review for the period ending December 31, 2016. He began by noting two memos from FEG to the University. The first memo provided an overview of the rationale for manager additions to the University's diversifying strategies portfolio. The second memo provided the details surrounding the second investment in the public credit sleeve of Wildcat Alpha with Rimrock Structured Products Fund. Relating to performance, he stated that the return for the year ending December 31, 2016 was 5.1%, less than the market-based benchmark of 5.6%. The quarterly return of 0% was equal to the market-based benchmark and the fiscal year to date return of 3.3% outperformed the market-based benchmark of 3.0%. Also, he noted that returns were net of manager fees. Additionally, Mr. Bean provided a snapshot for the month of January 2017. The total portfolio value as of 01/31/17 was $1,276,062,809 and the return for the month was 1.4%.

Ms. Krauss then provided a brief report on the University's operating fund cash and investments which totaled $1.23 billion as of December 31, 2016. She stated that the total cash and investments subject to the operating fund investment policy was $500.4 million, with $244.4 million in overnight and short-term investments and $256.0 million in other investments. The total cash held by the state as of December 31st was $732.0 million, of which $301 million is bond proceeds and other funds restricted for construction. Ms. Krauss commented that she will present a new operating investment policy at the next Committee meeting that outlines a five tier asset structure. The varying tiers are based on liquidity needs and return objectives with different benchmarks established for each of the tiers.

Next, Ms. Krauss reviewed the dates for the upcoming 2017 Committee meetings, along with the tentative agenda items. On May 1, 2017, there will be another SMIF presentation and an in-depth portfolio risk review. On June 15, 2017, a credit strategy review is planned. A retreat is targeted for September 14, 2017 and, on December 11, 2017, there will be another SMIF presentation and consideration will be given to a revised Endowment Investment Policy, following review of proposed changes to the policy at the September retreat. Ms. Krauss reminded the Committee that the policy must be formally reviewed and approved annually.

The meeting was adjourned at 3:47 p.m.

Respectfully submitted,
Kimberly C. Lush
University Financial Services