

**Minutes
Investment Committee
March 31, 2014**

IN ATTENDANCE:

Investment Committee Members:	Carol Martin Gatton, Chair Mark P. Bryant James W. Stuckert
Community Advisory Members:	James F. Hardymon Henry Clay Owen
Investment Staff & Consultants:	Susan I. Krauss Donna A. Counts Kimberly C. Lush Rob Palmeri (R.V. Kuhns & Associates)

Mr. Gatton called the meeting to order at 1:30 p.m. Mr. Gatton then made a motion to approve the minutes from the Committee meeting on January 30, 2014. The motion was seconded and all approved.

Ms. Krauss presented the Endowment Asset Allocation and Transition Plan. The schedule reflected activity that had taken place in relation to the transition of the new asset allocation, which was approved by the Committee in June 2013. She noted that at the end of February 2014 the endowment pool had a market value of \$1.16 billion, comprised of 33% equities, 10% fixed income and 57% in various alternative strategies. She reviewed the recent phase I transition activity that occurred from January 8, 2014, through February 28, 2014, which included investment of the Prisma redemption proceeds of approximately \$55 million in late January. The Prisma proceeds, along with other residual cash, were invested in the Northern Trust index funds, with \$26 million invested in each of the investable market indices (the U.S. and non-U.S. counterpart). The index funds are being used to hold the under target private equity and private real estate allocations. Ms. Krauss then commented on the future transition activity related to phase I, noting the primary remaining activity is transitioning approximately \$19 million from the See Blue Fund (Grosvenor's absolute return fund) to the See Blue B Fund where direct investments will be made in the long/short equity strategy. Also, the University is currently invested in Grosvenor's Enhanced Long/Short equity fund, but funds will be transitioned from that co-mingled product and directly invested in approved long/short equity managers during a four month transition process beginning in September 2014. Ms. Krauss then began a discussion of phase II activity. She stated that the University will be investing approximately \$32 million in private equity over the next several years. She reminded the Committee that a commitment of approximately \$80 million will be needed in 2014, then again in 2017 and in 2020 in order to reach and maintain the 12% target. She also mentioned that the NB Wildcats Fund is currently about 80% committed, therefore a new commitment to Neuberger Berman is under consideration. Regarding real estate, Ms. Krauss noted that the University plans to invest approximately \$64 million over the next several years to reach the 12% target. She added that Dan Krivinskas of R.V. Kuhns will be attending the May Committee meeting to review the current real estate portfolio and present an updated pacing analysis. Additionally, a real estate manager will be attending the May meeting. She also noted that about \$35 million will be transitioned out of Wellington's Real Total Return fund and moved into private real asset strategies, requiring an RFP to be issued in the summer or fall of 2014. Ms. Krauss presented a new section that has been added to the schedule that lists the various managers with multiple strategies. The University currently has approximately \$230 million in three different index funds at Northern Trust. Wellington is the largest active manager, managing four different strategies that total approximately \$183 million. Grosvenor is also a significant manager, with \$175 million in absolute return and long/short equity strategies. Additionally, Ms. Krauss presented a new

report titled Report on Manager Appointments, Terminations and Due Diligence for the period of January 30, 2014 through March 31, 2014. The report will be provided to the Committee at all future meetings, as required by the Endowment Investment Policy approved in December 2013. For the period being reviewed, there were no manager appointments or terminations and two meetings with managers had occurred. On February 7, 2014, Ms. Krauss met with Berens in New York, NY and discussed the new Global Value Fund the University invested in on January 1, 2014. On February 13, 2014, Ms. Krauss had a conference call with Grosvenor to discuss the implementation plan for the new direct long/short equity investment program.

Ms. Krauss then introduced the next item on the agenda, the 2013 NACUBO-Commonfund Study of Endowments. The 849 institutions that participated in the survey provided data as of June 30, 2013 that represented assets of \$448.6 billion. In terms of endowment size, the University of Kentucky was in the top 10% of participating institutions, ranking 84th with a reported market value of \$992.4 million. Mr. Palmeri then provided some high level comments regarding the survey results, noting that there are six cohorts for categorizing the data, ranging from under \$25 million to over \$1 billion. He cautioned that a possible flaw of this study, as well as other similar studies, is a focus on returns with no mention of risk. A primary statistic from the study was that the average return for the fiscal year ended June 30, 2013 for all institutions was 11.7% (net-of-fees). UK reported a return of 11.6% for the same period. He stated that over the past three and five years, smaller institutions (under \$25 million) generated slightly higher returns (10.6% and 4.9%, respectively) due to their overweight to public market investments (stocks and bonds) and underweight to alternatives relative to their larger peers. Also, over the past ten years, larger institutions (over \$1 billion) generated a higher average annual return (8.3%) relative to their smaller peers due largely to higher levels of diversification. Regarding annual returns, he pointed out that the University's portfolio was down 8.2% in 2008 and 20.9% in 2009 and underperformed the average for all institutions in those years by 5.2% and 2.2%, respectively, primarily due to the higher exposure to equities embedded in the portfolio at that time. He then reviewed survey returns by traditional and alternative asset classes as well as reported spending rates/dollars from the survey. UK's effective spending rate has been more volatile over the last ten years as compared to other institutions, however the average spending rate of 4.5% over the entire ten year period ended June 30, 2013 equals the average rate reported in the survey over the ten year period. Mr. Palmeri concluded the presentation by reviewing the market value of UK's Endowment for the last ten fiscal years, noting the significant rise and fall in assets before and after the 2008 recession, commenting the recent enhancements to the asset allocation should have a positive impact on the Endowment's return and risk profile going forward.

Ms. Krauss then presented three benchmarking summaries based on institution-specific data from the 2013 NACUBO-Commonfund Study of Endowments. The first was a summary of the University Review Committee (URC) benchmark institutions. The benchmark set includes eleven other institutions selected in 2012 by the URC based on the attributes of a high-quality undergraduate education, a medical center on campus, a land grant mission, and a comparable research portfolio. The University of Kentucky ranked tenth out of twelve institutions based on endowment size. The one-year average return for this group was 11.6%, which was identical to UK's return for fiscal year 2013. The average ten-year return for the group was 7.5% compared to UK's average of 5.8%. High equity exposure contributed to the University's lower return. She noted that for the one, three & five year periods, UK's returns were comparable to the group. She also noted that the average asset allocation of the group included very heavy exposure to alternatives at 48.1% and that there was a slight non-US equity tilt. The next summary included only SEC institutions. Of this group, the University of Kentucky was ranked sixth based on size of the endowment. The final summary compared institutions within Kentucky. UK was ranked second out of sixteen institutions based on size, behind Berea College. Ms. Krauss noted that this group has a much more traditional asset allocation.

Ms. Krauss then introduced Susan O'Connell, President of Wellington Hedge Management, and Lee Cohen, Wellington's Director of Endowments and Foundations Strategies, and noted that Wellington currently manages four different strategies for the University and is one of the University's largest

managers. Mr. Cohen began the presentation by reviewing the relationship between Wellington and the University of Kentucky. The total market value of the portfolio as of March 31, 2014 was \$183.1 million, comprised of \$13.2 million in Emerging Companies, \$45.7 million in Diversified Inflation Hedges, \$65.8 million in Real Total Return and \$58.4 million in the custom equity long/short portfolio. He noted that the Emerging Companies' return since inception is 12.5%, the Diversified Inflation Hedges' return since inception is 9.9% and the Real Total Return portfolio has yielded 1.8% since inception. Ms. O'Connell then provided an overview of the hedge funds managed by Wellington. The University of Kentucky invests \$56.2 million in a Wellington Hedge Management custom equity long/short portfolio. The investment approach is allocated with 22.5% in contrarian, 17.5% in capital appreciation, 20.0% in financial services, 20.0% in health care, 20.0% in technology and 5.0% in energy. Ms. O'Connell stated that Wellington's sustainable, competitive advantage is their culture. She also added that approximately 20% of Wellington's business is endowments and foundations.

Mr. Palmeri provided the performance review and market update. He began by reviewing three memos recently sent to the University of Kentucky from R.V. Kuhns related to management changes at PIMCO. The first two memos were dated February 27, 2014 and described PIMCO's recent announcement that Mohamed El-Erian, CEO and co-CIO of PIMCO, would be leaving the Firm, followed by PIMCO's subsequent announcement that the deputy CIO position would be shared among six senior portfolio managers. Also, PIMCO had announced two departures and one hire for their portfolio management group. The third memo was dated March 11, 2014 and was an update on the PIMCO Unconstrained Bond Fund ("UBF"). PIMCO had announced that Chris Dialynas, portfolio manager for the PIMCO UBF, would begin a sabbatical during the second quarter of 2014. Bill Gross, Founder and CIO of PIMCO, had assumed primary leadership on the UBF mutual fund portfolio effective December 6, 2013. Mr. Palmeri concluded that while this represents significant changes at PIMCO, R.V. Kuhns does not recommend that UK take any action related to the changes in management. Mr. Palmeri then provided a performance review of the endowment portfolio for the period ended December 31, 2013. The quarter-to-date performance net of fees was 4.5% and the calendar year-to-date performance was 14.35%. He stated that the portfolio was doing very well and the driver of 2013 returns for the University was exposure to equities.

Ms. Counts presented the Operating Fund Cash and Investment Report. She stated that the total of operating cash and investments for the month ending February 28, 2014 was \$681 million. Of that amount, the University managed \$363 million. She also noted that the University began investing in a \$60 million operating portfolio with Reams in February 2014, increasing the share of the operating portfolio invested in intermediate term investments.

Ms. Krauss concluded by reviewing the 2014 Investment Committee Meetings and Tentative Agenda Items. She noted that standard asset allocation and performance reviews will be presented at the May 8, 2014 meeting. Also, there will be a real estate update at that meeting with a presentation by one of the real estate managers. She added that the June 9, 2014 meeting will be brief as it will take place after the Healthcare Committee retreat that day. She informed the Committee that Grosvenor will be invited to the September 4, 2014 meeting and the December 8, 2014 meeting will include an annual review of the investment policy. Additionally, she commented that RFP's will be issued during the latter part of the year for real assets, real estate and a custodian and updates on the RFPs will be provided at the September and December meetings.

The meeting was adjourned by Mr. Gatton at 3:31 p.m.

Respectfully submitted,
Kimberly C. Lush
Office of the Treasurer