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Office of the Executive Vice President for Finance and Administration
December 13, 2021

Members, Investment Committee of the Board of Trustees:

REVISED ENDOWMENT INVESTMENT POLICY

Recommendation: that the Investment Committee of the Board of Trustees approve the attached revisions to the Endowment Investment Policy.

Background: The revised policy reflects the following changes:

- Adoption of the following asset allocation targets intended to enhance the portfolio's expected return while maintaining prudent diversification:

	Current Target Allocation	Proposed Target Allocation	Change
GLOBAL EQUITY	**53%**	**61%**	**+8%**
Public	33%	38%	+5%
Private	20%	23%	+3%
GLOBAL FIXED INCOME	**13%**	**12%**	**-1%**
High Quality/Rate Sensitive[1]	7%	10%	+3%
Public Credit	2%	0%	-2%
Private Credit	4%	2%	-2%
REAL ASSETS	**14%**	**12%**	**-2%**
Public	3%	3%	0%
Private	11%	9%	-2%
DIVERSIFYING STRATEGIES	**20%**	**15%**	**-5%**

[1]Proposed asset class label is "Public Fixed Income" which may include public credit investments.

- Policy benchmark adjustments that correspond with the asset allocation targets and other updates that reflect the recent change in the Endowment Investment Consultant.

Action taken: ☑ Approved ☐ Disapproved ☐ Other ____________________

UNIVERSITY OF KENTUCKY
AND AFFILIATED CORPORATIONS

ENDOWMENT INVESTMENT POLICY

Amended December 13~~4~~, 2021~~0~~

University of Kentucky
University of Kentucky Research Foundation
University of Kentucky Gluck Equine Research Foundation, Inc.
University of Kentucky Humanities Foundation, Inc.
University of Kentucky Mining Engineering Foundation, Inc.

ASSET CATEGORY	TARGET	RANGE
GLOBAL EQUITY	**61~~53~~%**	**35 – 70%~~30 - 60%~~**
Public	*38~~33~~*	
Private	*23~~20~~*	
~~GLOBAL~~ FIXED INCOME	**12~~13~~**	**5 - 25**
Public Fixed Income~~High – Quality/ Rate Sensitive~~	*10~~7~~*	
~~Public Credit~~	*~~2~~*	
Private Credit	*2~~4~~*	
REAL ASSETS	**12~~14~~**	**5 - 20~~25~~**
Public	*3*	
Private	*9~~11~~*	
DIVERSIFYING STRATEGIES	**15 ~~20~~**	**5 - 20~~25~~**

Note: Sub-asset category (e.g., Public Equity) figures reflect working targets. Investment staff has flexibility to adjust sub-asset category exposures within broader, asset category (e.g., Global Equity) ranges, based on market conditions and ongoing research.

Global Equity – The allocation will consist of public and private equity-oriented funds managed by external investment firms. This is expected to be the highest risk, highest return asset category of the four, and the primary driver of portfolio growth over time. ~~.~~The allocation will be diversified by factors including security, sector, geography, market capitalization, and manager style. Private equity investments will be made with the expectation that long-term returns materially exceed those of the public markets.

~~Global~~ Fixed Income –The allocation will consist of ~~–~~obligations of sovereign nations and corporations, mortgage- and asset-backed securities, money market instruments, and bank deposits. The allocation will consist of two broad categories: 1) public fixed income and 2) private credit. The primary role of the public fixed income portfolio is to provide a partial hedge in the event of economic contraction, deflation, and/or severe flight to quality. It is expected that this portion of the portfolio would serve as one of the primary sources of spending during such periods, when the prices of other assets in the Portfolio may decline. Therefore, while the public fixed income allocation may include some investments rated below investment-grade, it is generally expected to have a high quality rating on average (typically "A" or better by a recognized bond rating agency). ~~The allocation will consist of two broad categories: 1) high quality/rate sensitive and 2) credit/distressed. High quality bonds are defined as securities rated investment grade by S&P and Moody's (Baa/BBB and above). These bonds provide equity risk mitigation, deflation protection and liquidity to the portfolio.~~ The private credit allocation may include obligations of any credit quality and is expected to generate long-term returns that materially exceed those of the public credit markets. ~~The credit / distressed allocation will include high yield bonds, bank loans, emerging market debt, structured or asset backed bonds, mezzanine loans and~~

~~distressed debt. The credit / distressed allocation provides investment opportunities to generate a substantial real return.~~

Real Assets – The ~~the~~ allocation will consist ~~primarily~~ of public and private assets. Public real assets may include Real Estate Investment Trusts (REITs), Master Limited Partnerships (MLPs), natural resource equities, ~~and~~ commodities, and Treasury Inflation-Protected Securities (TIPS). Private real assets may include real estate, natural resources, and infrastructure. Private real assets are expected to generate long-term returns that materially exceed those of public real asset alternatives. Private assets may include real estate near the University campus which is deemed to have strategic value for the University. For diversification purposes not more than 2% of the portfolio will be invested in local real estate as opposed to external managers. The 2% maximum will be defined as the market value of the portfolio at the time of investment. All real assets are expected to provide inflation protection as well as generate positive real rates of return.

Diversifying Strategies – T~~t~~he allocation will consist of ~~investments whose primary source of risk and return is differentiated from the three asset categories listed above. This includes, but is not limited to, hedge funds whose approach can be described as "absolute return," multi-strategy, event driven, relative value, hedged equity, or global macro.~~ a diverse group of managers and strategies with a goal of earning positive returns over time, but with moderate sensitivity to the public equity markets. Included in this category are strategies such as long/short equity, low beta equity, event-driven and special situations investing, merger and capital structure arbitrage, quantitative strategies, global macro, long/short credit, and distressed securities. The diversifying strategies portfolio is expected to generate a long-term return between equities and bonds (closer to equities), with less volatility than equities. Returns should generally be better than equities when equity markets fall significantly, and behind equities when equity markets rise significantly.

Rebalancing

Rebalancing is a term that describes the periodic movement of funds from one asset class or category to another for the purpose of realigning the assets with the asset allocation target. A rebalancing strategy is an important element of asset allocation policy. Systematic rebalancing will ensure that the portfolio's risk profile remains consistent with this investment policy. ~~reduce portfolio volatility and increase portfolio return over the long term.~~ However, excessively tight ranges and frequent rebalancing can lead to unnecessary transaction costs.

The Committee has chosen to adopt a rebalancing policy that is governed by allocation ranges rather than time periods. The ranges, specified in the table above, are a function of the volatility and liquidity of each asset class and the proportion of the total fund allocated to the asset category. While the allocation to all asset categories remains within these limits, Staff will first use cash flows, as available, to prudently manage allocations relative to the target. When an asset category violates the lower or upper limits, public market funds will be actively rebalanced back to the target.

forecasting and make appropriate commitments to reach and maintain the approved policy allocation and liquidity while ensuring diversification across vintage year, strategy, geography, etc.
It is recognized that significant changes in investment market values could cause the portfolio to be positioned outside of these guidelines. If this occurs, Staff will communicate this to the Investment Committee and develop a plan to reposition the portfolio consistent with these guidelines over a reasonable time frame.

Proxy Voting

The Committee delegates full authority for proxy voting to its investment managers for the securities under their discretionary authority and requires the investment managers to vote all proxies in the best interest of the Endowment. In addition, when requested, the managers will report to the Committee on their proxy-voting policies and activities on the Endowment's behalf.

Proxy voting related to governance issues regarding investment managers hired to manage Endowment assets, and their related investment legal structures, terms and conditions, will be voted on by the Staff in the best economic interest of the Endowment. The Staff may solicit assistance of the Consultant on governance issues.

Transaction Costs

The Committee requires the investment managers, in their capacity as fiduciaries, to manage the transactions costs they incur on the Endowment's behalf in the best interests of the University. When requested, the managers will report to the Committee on the transactions costs incurred and the brokers used on the Endowment's behalf.

Transition Management

Transitions between investment managers are an important and inevitable element of portfolio management, typically resulting from manager terminations or changes to the investment strategy of the portfolio. The optimal method to use in executing a transition may vary significantly from one transition to another based on the types of assets involved and the timeframe in question. Generally, the Endowment's objective in a manager transition is to implement the change in a cost-effective, timely manner while maintaining the appropriate market exposure. It is imperative to note that the cost of transition is not commissions alone, but also bid/ask spread, market impact and opportunity cost. The market impact cost is the effect trading will have on the market price of the shares being traded. The opportunity cost, sometimes referred to as implementation shortfall, is the cost of market movements over the time it takes to trade. Efforts should be made to minimize the total cost rather than any single cost component. Selecting a transition manager can be done at the Staff's discretion with the assistance of the Consultant. Use of futures contracts and exchange traded funds may be required in order to maintain appropriate market exposure during a transition.

VII. Performance Evaluation

Endowment performance will be monitored and reviewed over short and long-term time periods, with an emphasis on longer-term periods in order to include full market cycles and reflect the endowment's long-term investment strategy. Performance will be evaluated at three levels; total Endowment, asset class and individual manager. All three levels will include a market index and peer group measurement review. Performance will be reviewed on a gross and net return basis and will include risk metrics and risk-adjusted returns.

Performance Benchmarks

The total Endowment performance will be measured against two principal benchmarks:

1. The primary performance objective of achieving a long-term total return, net of fees and expenses, of at least 7.5%. It is expected that portfolio performance will vary significantly from this benchmark over shorter periods. Therefore, performance compared to this benchmark will be evaluated only over very long periods (ten years or more).

2. A Policy Benchmark consisting of market indexes reflecting the Endowment's "strategic target" asset allocation percentages. Performance compared to this benchmark will be evaluated over rolling three- to five-year periods. The current Policy Benchmark appears in the following table:

ASSET CATEGORY	TARGET	INDEX
GLOBAL EQUITY	**61~~53~~%**	
Public	38~~33~~	MSCI All Country World Index
Private	23~~20~~	~~-~~Cambridge Associates Private Equity and Venture Capital indices ~~Thomson Private Equity~~
~~GLOBAL~~ FIXED INCOME	**12~~13~~%**	
Public Fixed Income~~High Quality/ Rate Sensitive~~	10~~7~~	Barclays Aggregate Bond Index
~~Public Credit~~	~~2~~	~~50/50 ML High Yield/Bloomberg Barclays U.S. Credit Index~~
Private Credit	2~~4~~	Cambridge Associates Private Credit and Distressed indices~~50/50 Thomson Mezzanine/Distressed Debt~~

REAL ASSETS	**12~~14~~%**	
Public	3	1/3 each Bloomberg Barclays U.S. TIPS Index, NAREIT Index and Alerian MLP Index
Private	9~~11~~	Cambridge Associates Private Real Estate and Natural Resources indices ~~70/30 Thomson Natural Resources/Private Real Estate~~
DIVERSIFYING STRATEGIES	**15~~20~~%**	**HFRI Fund of Funds Composite**

~~3. A peer group universe of similar plans.~~

In addition to these principal benchmarks, performance may from time-to-time be compared to a peer group of similar institutions.

The asset class performance will be measured against:

1. The asset class' index.
2. A peer group universe of similar asset classes.

The individual manager performance will be measured against:

1. The manager's specific market indexes.
2. A peer group universe of similar investment styles.

Long-Only Active Managers

Managers will be measured against their primary benchmark and their peer universe.

Long/Short Managers (Hedge Funds)

Most hedge funds do not have good benchmarks for performance measurement, especially over short time periods. Managers will be measured relative to peer benchmarks such as the various style indices tracked by HFRI. Secondary benchmarks will also be used, including relevant asset class benchmarks (such as the S&P 500 for U.S. focused long/short equity funds) and absolute return measures (T-bills + X%).

Private Capital Managers

The majority of private equity, private real asset, and private credit funds will be invested with private partnerships. These partnerships typically range from 7-15 years in life, during which time the Fund may not be able to sell the investment. Additionally, the partnership may not produce meaningful returns for 3-5 years (depending on the strategy). New investments will create a drag on fund performance in the early years (3-5 years) until these investments begin to mature. This drag on performance is often referred to as the J-curve, due to the shape created by plotting a line graph with performance on the y-axis and time on the x-axis. Private, illiquid manager performance will be measured utilizing internal rate of return (IRR) calculations, and Multiple of Invested Capital (MOIC), and will be compared to an appropriate peer group. An IRR calculated

APPENDIX 1

Memorandum Regarding Selection of Investment Managers

NOTE for September 10, 2021 Investment Committee Meeting: The Office of Legal Counsel will update the 2016 Opinion of General Counsel to acknowledge the change in Investment Consultant prior to the Committee's vote on the amended Investment Policy at the December 2021 meeting. Purchasing will also update its memorandum as needed, too.