Meeting Minutes of the Investment Committee
University of Kentucky
Thursday, June 13, 2024

The Investment Committee of the University of Kentucky Board of Trustees met on Thursday, June 13, 2024, in the Gatton Student Center Harris Ballroom.

A. Meeting Opened

Investment Committee Chair, Elizabeth McCoy, called the meeting to order at 8:15 a.m. and requested a roll call.

B. Roll Call

The following members of the Investment Committee were in attendance: Elizabeth McCoy, Ray A. Daniels, Lance Lucas, Hollie Swanson and Robert Vance.

The following Community Advisory members were in attendance: Tom Abell, M.D., William C. Britton, Kelly Craft, Kathy McMullen and Quint Tatro.

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 Drew Landry.

C. Approval of Minutes for February 22, 2024

Chair McCoy called for a motion to approve the minutes from the Committee meeting on February 22, 2024. The motion was moved by Trustee Vance and seconded by Trustee Daniels. The motion passed without dissent.

D. Cambridge Associates Education Session and Risk Review

Mr. Thornton began the education session and risk review by stating that there is no single definition of risk, instead broadly defining risk as what needs to be accepted in order to earn an adequate return. Given that one of the most important ways to manage risk is through portfolio construction, he talked about the policy portfolio and emphasized the goal of maximizing the odds of achieving primary objectives through asset allocation. He stated that in order for UK to meet its performance objective, a predominance of equities must be present in the portfolio. To smooth the volatile path that equities can take, he noted the importance of diversification. Including high-quality fixed income in the portfolio can protect against a deflationary event, while including real assets can protect in an inflationary environment.

Mr. Thornton then reviewed how the portfolio's target asset allocation has been constructed with various risk and return assumptions across the many asset classes. The overall risk level remains comparable to a simple blend of 75% stocks and 25% bonds. Mr. Britton requested clarification on some of the historical return data included in the materials and asked why a heavier equity allocation is not recommended. Mr. Thornton clarified that the different returns on a couple of slides are due to one set being presented as real and the other set being presented as nominal. He provided two key reasons why they have chosen not to target a significantly higher equity allocation. First, equities come with a high level of volatility that can flow through to uncertainty in endowment spending distributions. Second, there is an element of behavioral risk to consider whereby a large, unexpected drawdown typically results in a panic reaction to pull back from the source of pain, thereby reducing the equity allocation at precisely the wrong time. Mr. Tatro added comments regarding standard deviation, highlighting how this statistic would feel in a real-life scenario whereby the portfolio declines. Ms. Craft asked if election cycles (both US and non-US) are taken into consideration when conducting the annual risk review. Mr. Thornton replied that the question highlights the difference between strategic and tactical portfolio decisions. The meeting's focus is on the former, strategic allocation, which is long-term focused without much regard to current events. In contrast, tactical decisions are regularly incorporated into the portfolio as the Investment Office takes into account opportunities that arise from valuations, yields, elections, wars and so forth.

Mr. Todd Shupp and Ms. Nancy Rohde reviewed stress testing of portfolio liquidity. Ms. Rohde presented the results of the first liquidity 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 over three years of annual spending and capital call requirements. Mr. Shupp then provided the results of a second study that included assets that can be liquidated within one year. After applying the same conservative return assumptions, the liquid and semi-liquid assets are estimated to cover over four years of the same cash needs on an annual basis.

Mr. Thornton next turned the discussion toward a deep dive on UK's public equity portfolio, focusing primarily on geographic exposure. The U.S. is by far the largest allocation in the UK public equity portfolio, anchored with a large allocation to a passive index fund. Active managers are in place within small-cap and non-U.S. areas to take advantage of greater alpha opportunities in less efficient markets. He provided a geographic look-through of UK's public equity portfolio, highlighting that U.S. equities comprise about 24% of the total endowment portfolio, developed non-U.S. equities account for about 11%, and emerging markets equities make up less than 5%. Mr. Tatro stated that the relatively attractive valuation of emerging markets versus U.S. markets is compelling and asked whether a larger overweight should be considered. Mr. Thornton responded that the portfolio is currently tilted toward a modest overweight in emerging markets and noted that discussions are regular and ongoing with the Investment Office regarding the sizing of the position. Mr. Shupp acknowledged that the valuation gap is notable and attractive, but history has demonstrated that valuation is not the most helpful metric with regard to timing investment opportunities.

E. UK Staff Presentation

Mr. Shupp and Ms. Rohde presented the UK Endowment Overview. Mr. Shupp began with some background including the growth in the endowment pool since its inception and the evolution of Investment Office staffing. Next, Ms. Rohde discussed UK's investment philosophy, stressing the importance of diversification and a focus on the long-term. She next conducted a review of accomplishments of Fiscal Year 2024, highlighting an uptick in manager meetings, the ongoing shift toward the most recently approved asset allocation targets, an expansion of the internship program and work around the Endowment Custodian Request for Proposals (RFP). Ms. Rohde provided an update on student engagement as well.

Mr. Shupp discussed some process enhancements for the year including reviews of past investment and redemption decisions, the creation of a supplemental strategy profile, and leveraging technology to automate reporting of asset allocation and investment manager performance. He next reviewed near-term and ongoing Fiscal Year 2025 initiatives. Near-term focus items include the annual review of the investment policy statement and the implementation of the inaugural summer internship program. Some ongoing efforts include continuing to closely manage service provider fees and pursuing prudent investment opportunities that generate attractive endowment returns.

Mr. Shupp began the fixed income primer with a discussion of current attractive bond yields. He briefly reviewed the history of the endowment's public fixed income allocation, noting that the endowment has been invested in fixed income since its inception, and implementation within the asset class has evolved over time. Ms. Rohde highlighted the protection and diversification benefits of fixed income by comparing UK's public fixed income returns to equities during major market selloffs. She outlined the main types of bonds and reviewed key fundamental concepts within fixed income, including yield, interest rates, prices and duration.

Mr. Shupp elaborated on the concept of duration by highlighting the downside protection that resulted from reducing the duration of the largest actively-managed public fixed income holding in the UK Endowment, Reams, in 2020. He provided some education on yield curves, including three common shapes and their connection to understanding what investors are experiencing and predicting with regard to the economy. Ms. Rohde touched on bond spreads and highlighted that wide spreads are often observed when the market is uncertain and fearful. Mr. Shupp connected that concept to an example in the UK portfolio; as high yield bond spreads widened in the pandemic, an investment was made in the asset class, and later sold when spreads normalized.

F. Endowment Manager Presentation: Reams Asset Management

Mr. Clark Holland, a Portfolio Manager from Reams Asset Management, presented an overview of the firm and provided an update on the Reams Core Plus Fixed Income portfolio.

G. Performance Review and Market Update

Mr. Landry presented a performance review and market update for the calendar year-to-date period ending April 30, 2024. He stated that markets were generally positive during the first four months of the year, with U.S. equity markets continuing to charge higher, led by the "Magnificent Seven" stocks. Fixed income suffered slight losses as investors were forced to adjust downward their expectations of numerous interest rate cuts in 2024 on the back of continued inflation.

Mr. Landry then reported on UK's performance for the calendar year-to-date period. Public equity exposure, particularly large-cap U.S., gains in diversifying strategies, driven by continued strength in hedged equity, and robust performance from Master Limited Partnerships (MLPs) within public real assets were additive to performance. Countering this, fixed income declined as yields rose, and a modest overweight to small-cap and emerging markets equities detracted from relative returns. Mr. Shupp asked Mr. Thornton and Mr. Landry if they could talk about the divergence in the performance of the Dow versus the Nasdaq and the S&P 500 and the driver behind that. Mr. Thornton replied that this comes down to the Dow no longer being very representative of the broader market, tracking only 30 stocks. Broader indexes like the S&P 500 are better measures of the U.S. equity market.

H. Investment Staff Report

Mr. Shupp presented the Investment Staff Report beginning with an overview of the endowment asset allocation as of April 30, 2024. The major changes that took place during this time were to fixed income with some active rebalancing into the asset class from public equity. Real assets declined slightly, due primarily to weakness in the private portfolio, though there was positive performance in public real assets. There was no change in the diversifying strategies allocation as solid performance was offset by ongoing net redemptions to steer toward the portfolio's 12% allocation target. He then touched on the net cash flows by asset category previously mentioned. Mr. Shupp emphasized that the portfolio also remains well within its liquidity parameters. Lastly, he noted the potential establishment of a new quasi endowment for the UK Center of Applied Energy Research, pending Board approval.

Ms. Rohde discussed recent manager appointments, terminations and due diligence for the period. On the appointments side, UK committed $20 million to Kline Hill Partners Solutions Fund II, L.P., $20 million to Digital Alpha Fund III-A, L.P., $3 million to Cordillera Whiskey Fund, L.P., $15 million to Sterling Group Partners VI, L.P. and $11 million to Centana Growth Partners III, L.P. On the terminations side, UK redeemed in full from Pelham Long/Short Fund Ltd. Lastly, Ms. Rohde referenced manager due diligence and research during the period, highlighting that 73 meetings took place since the last Investment Committee Meeting.

I. Other Business

Mr. Shupp reviewed the schedule of the remaining 2024 Investment Committee meetings and tentative agenda items. In addition to routine updates, proposed changes to the investment policy will be brought before the Committee in September. Additionally, there will be an education session led by Libby Cantrill from PIMCO.

J. Meeting Adjourned

Hearing no further business, the meeting was adjourned at 11:08 a.m.

Respectfully submitted,

Kristina W. Goins
University Financial Services