

**Minutes
Investment Committee
September 4, 2014**

IN ATTENDANCE:

Investment Committee Members: James W. Stuckert, Acting Chair in absence of Chair Gatton
William C. Britton
Mark P. Bryant

Community Advisory Members: James F. Hardyman
Henry Clay Owen
Billy B. Wilcoxson

Investment Staff & Consultants: Susan I. Krauss
Donna A. Counts
Kimberly C. Lush
Becky Gratsinger (R.V. Kuhns & Associates)
Rob Palmeri (R.V. Kuhns & Associates)

Mr. Stuckert called the meeting to order at 1:25 p.m. and asked for a roll call. Mr. Stuckert then made a motion to approve the minutes from the Committee meeting on June 9, 2014. Mr. Hardyman commented that the minutes need to be revised to include his attendance at the meeting. Ms. Krauss stated that the minutes would be updated. Mr. Stuckert's motion was moved by Mr. Britton, seconded by Mr. Bryant and approved by all.

Ms. Krauss presented a review of the Endowment Asset Allocation and Transition Plan dated July 31, 2014, noting that Phase I involves implementation of the liquid strategies and Phase II involves implementation of the illiquid strategies. She stated that there has been no transitioning or rebalancing activity since May 1, 2014. She noted that implementation of a new direct long/short equity hedge fund program is planned with Grosvenor as part of future Phase I activity, adding that Grosvenor is an existing manager of an absolute return strategy and a long-biased long/short equity strategy. Currently, the University is invested in Grosvenor's co-mingled product and is moving into a direct portfolio of seven individual hedge funds. A three month implementation period of the direct portfolio will begin October 1, 2014. Funding of the Grosvenor long-biased long/short equity strategy will include \$17 million from the Grosvenor See Blue Fund and \$4 million from other managers, in addition to the \$38 million currently invested in the co-mingled product. Transitioning to the new direct portfolio will generate an approximate annual fee savings for the University of \$350,000 with the elimination of the 60 basis point fund-of-fund management fee currently assessed for the co-mingled vehicle. Additionally, Ms. Krauss mentioned the recent \$1.1 million implementation of the University's second Student Managed Investment Fund. Relating to Phase II implementation, Ms. Krauss commented that Private Equity is still under the 12% policy target, currently at approximately 10%, adding that a commitment of \$100 million to Neuberger Berman is planned. The current agreement with Neuberger Berman will be amended to add to the first commitment from September 2011, which was also \$100 million. As a result of the amended agreement, favorable fee terms have been negotiated, including management fees of 23.6 basis points agreed upon for the next twelve years. Regarding Real Estate, the portfolio is under the 12% target at approximately 7%. As a result, due diligence is being performed on successor funds of existing managers, with additional commitments anticipated in 2015. Ms. Krauss stated that the real return/diversified inflation strategies asset class has a 10% policy target with a 3% target to illiquid

strategies, noting an RFP for an illiquid private real assets manager is planned for early next year. Overall, with the exception of private equity and private real estate, all asset classes are within their respective target ranges. Next, Ms. Krauss reviewed the Report on Manager Appointments, Terminations and Due Diligence for the period of June 10, 2014 through September 4, 2014. Three commitments were made during that time period. A commitment of \$20,000,000 was made to Wheelock Street Capital on April 28, 2014. Meyer Bergman received a commitment of \$8,669,440 as of July 17, 2014, and a commitment of \$202,295.69 was made to Chrysalis as of August 8, 2014. There were no manager terminations. Regarding due diligence, conference calls with PIMCO and with prospective long/short equity managers were conducted, on-site visits with prospective long/short equity managers occurred, and there was a meeting with William Blair. Ms. Krauss concluded with an update on the search process for the University's first Chief Investment Officer. The goal is to have the CIO hired on or about January 1, 2015. The University received eighty-nine applications for the position. That group has been narrowed down to five prospective candidates with plans to narrow further and conduct on-campus interviews in late September.

The next item on the agenda was the Performance Review and Market Update from R.V. Kuhns. Mr. Palmeri began the fiscal year review by presenting a capital markets review as of June 30, 2014. Regarding domestic equity, U.S. equity markets finished the fiscal year strong as large cap outperformed small cap and growth stocks outperformed value stocks. International equity also had a strong fiscal year, with developed markets indices posting one-year returns upward of 20%. Developed small cap stocks outperformed their large and mid-cap counterparts, while emerging markets equities trailed most developed markets indices. Fixed income markets also performed well with all indices posting positive returns. Emerging market debt and corporate high yield bonds led the way while US treasuries continued to offer low yields. All in all, international debt outperformed domestic fixed income, although the robust international fixed income returns were accompanied by significant volatility as well. For the fiscal year ended June 30, 2014, the total fund returned 15.51%, outperforming the target allocation index by 150 basis points. Gross of fees, the total fund returned 15.86% and ranked in the 58th percentile. The total fund's relative outperformance can be partially attributed to a strong relative performance from all composites with the exception of the fixed income and real estate composites and to an overweight in domestic and international equity. The total fund composite has outperformed its benchmark over the three and five-year periods, but has underperformed over the seven and ten-year periods. Total value added for fiscal year 2014 was 1.5%, with asset allocation and manager value added both being positive for the period. Mr. Palmeri added that the domestic equity composite returned 25.26% for the year, slightly outperforming the Dow Jones Total Stock Market Index, which returned 25.03%. Gross of fees, the domestic equity composite returned 25.39% and ranked in the 43rd percentile. As part of the international equity overview, it was noted that for the fiscal year ended June 30, 2014, the international equity composite returned 23.51%, outperforming the MSCI ACW Ex US Investable Market Index Blend, which returned 21.99%. Gross of fees, the international equity composite returned 24.04% and ranked in the 18th percentile. The fixed income composite returned 2.09% for the year ended June 30, 2014, underperforming the Barclays US Agg Bond Index which returned 4.38%. Gross of fees, the fixed income composite returned 2.60% and ranked in the 97th percentile. Both PIMCO and Reams' unconstrained strategies significantly underperformed their benchmarks due mainly to short duration positioning. The diversified inflation strategies composite returned 10.88% for fiscal 2014, outperforming the Consumer Price Index + 5% Blend, which returned 9.46%. Since inception in January 2014, the GTAA composite has returned 5.7%, outperforming the Consumer Price Index + 5% benchmark, which returned 4.8%. The long/short equity composite was also created in January 2014 and has returned 3.51% since inception, outperforming the HFN Long/Short Equity Index which returned 2.74%. The absolute return composite returned 9.45%, for the year ended June 30, 2014, outperforming the HFN Fund of Funds Multi-Strategy Index which returned 7.62%. The real estate composite returned 10.92% for fiscal 2014, in line with the Real Estate Custom Index, which returned 10.91%. The private equity composite demonstrated strong performance for fiscal 2014, returning 18.07% versus the Venture Economics All Private Equity Index return of 11.78%. Lastly, Mr. Palmeri noted the addition of a new chart that provides

an asset class exposure analysis for the University's endowment portfolio. As of June 30, 2014, total exposure was categorized as 41.06% to equity, 21.76% to fixed income, 2.19% to cash, 13.27% to long/short equity, 6.76% to real estate, 9.95% to private equity and 5.02% to other.

Ms. Counts then provided a review of the Operating Fund Cash and Investment Report for July 31, 2014. Total operating fund cash and investments equaled \$928.4 million at the end of the period. Total cash and investments subject to the operating fund investment policy were \$483.4 million and total state held cash made up the remaining \$445 million. Bond proceeds were \$209 million; therefore, the total operating fund cash and investments less 2014 bond proceeds were approximately \$708.6 million. She concluded by noting that \$292 million was invested in overnight and short-term investments.

Next, Ms. Krauss introduced Todd Thompson and Clark Holland, portfolio managers from Reams Asset Management, to review the three strategies they manage for the University – core plus fixed income, unconstrained fixed income and operating fund investments. Mr. Thompson provided a firm overview, noting that Reams, which is based in Columbus, Indiana, has an exclusive focus on U.S. fixed income portfolios for institutional clients and individual investors through separate accounts and mutual funds. Reams' fixed income products include separate accounts, institutional commingled funds and institutional mutual funds. Assets for Reams total approximately \$18 billion. Mr. Holland reviewed the core plus investment objective and guidelines, with the objective being to exceed the total return of the Barclays U.S. Aggregate Index, net of fees, over three to five year periods, while incurring a similar level of risk. As part of the performance review, Mr. Holland reviewed the portfolio characteristics and returns as of June 30, 2014. For the quarter, the portfolio return was 1.2%, for the year to date, the return was 2.76%, and for the prior twelve months, the return was 3.66%, with all periods trailing the Barclays U.S. Aggregate Index. However, since inception on October 1, 2002, the strategy has produced a return of 5.97% compared to the benchmark return of 4.69%. Regarding the unconstrained strategy, the objective is to maximize risk-adjusted total return by systematically pursuing relative value opportunities throughout all sectors of the fixed income market. The June 30, 2014 return for the quarter was -0.98% and 1.00% since inception on August 7, 2013, compared to benchmark returns of 0.06% and 0.23%, respectively. The benchmark for the unconstrained strategy is the Merrill Lynch three-month LIBOR Constant Maturity Index. For the operating investment strategy, the objective is to exceed the total return of the Barclays 1-5 Year Government/Credit Index, net of fees, over three to five year periods, while incurring a similar level of risk. The University's operating investment relationship with Reams began on March 1, 2014 with an initial investment of \$60.0 million and the portfolio value at June 30, 2014 was \$60.6 million. Since inception, the portfolio has returned 1.07% versus the Barclays 1-5 Year Government/Credit Index return of 0.39%.

The meeting was adjourned by Mr. Stuckert at 3:47 p.m.

Respectfully submitted,
Kimberly C. Lush
Office of the Treasurer