Minutes
Investment Committee
May 7, 2015

IN ATTENDANCE:

Investment Committee Members:	Carol Martin Gatton, Chair James H. Booth William C. Britton Mark P. Bryant William S. Farish, Jr. James W. Stuckert Robert D. Vance
Community Advisory Members:	James F. Hardymon Myra L. Tobin
Investment Staff & Consultants:	Susan I. Krauss Todd D. Shupp Kimberly C. Lush Rob Palmeri (RVK) Becky Gratsinger (RVK)

Mr. Gatton called the meeting to order at 12:00 p.m. Ms. Lush then conducted a roll call. Mr. Gatton and Ms. Krauss welcomed and introduced the University's new Chief Investment Officer, Todd Shupp. Mr. Gatton made a motion to approve the minutes from the Committee meeting on December 8, 2014. Mr. Gatton's motion was moved by Mr. Stuckert, seconded by Mr. Farish, and approved by all.

Ms. Krauss discussed the 2014 NACUBO-Commonfund Study of Endowments, noting that 851 U.S. and Canadian institutions participated in the study. She stated that the University of Kentucky was ranked 84th in the group based on an asset size of $1.14 billion, placing in the top 10% of participating institutions. Ms. Gratsinger continued the discussion with a review of the study's summary of investments. She mentioned that the average return for all institutions was 15.5% (net of fees), with larger institutions receiving higher returns, likely reflecting lower exposure to fixed income assets. Among alternative strategies, venture capital had the strongest fiscal year return (23.3%), followed by private equity (16.5%) and energy and natural resources (15.3%). The average annual net of fee returns for the trailing 3, 5 and 10-year periods for all institutions were 9.0%, 11.7% and 7.1% respectively. She noted that UK's annual total return of 16.2% in 2014 outperformed the 15.8% return by institutions between $501 million and $1 billion and slightly trailed the 16.5% return of institutions over $1 billion. When reviewing the average 1, 3, 5 and 10-year total returns, she commented that the University's portfolio outperformed its target allocation index in all of the time periods, with exception of the 10-year period. Regarding average 1-year total returns by traditional asset class, UK outperformed total institutions in 2014 in domestic equity and international equity and trailed in fixed income returns. For average 1-year total returns by alternative asset class, UK outperformed in private equity and marketable alternatives and closely trailed the group average in private equity real estate. She stated that the average annual effective spending rate for total institutions remained 4.4% from fiscal year 2013 to fiscal year 2014. However, UK's average annual effective spending rate decreased from 4.0% in FY 2013 to 3.7% in FY 2014. She added that UK's annual effective spending rate has averaged 4.5% since 2002 while total institutions averaged an effective spending rate of 4.6% during the same period. Also, it was noted that UK's portfolio market value exceeded $1.2 billion as of fiscal year-end 2014.

Ms. Krauss then presented benchmarking summaries for UK compared to URC (University Review Committee) benchmark institutions, SEC institutions and Kentucky institutions, providing information on the average asset allocation and average returns for each benchmarking group. UK experienced comparable returns in the 1, 3 and 5-year time periods, however underperformed in the 10-year time period due to a higher than average equity allocation going into the global recession, resulting in significant losses. Since the downturn, UK has implemented a fully diversified asset allocation, also detracting from performance during the 10-year period due to lower hedge fund returns and the j-curve impact of new private equity commitments. Ms. Krauss reviewed the asset class allocation of the URC investment pool assets at June 30, 2014, noting that the average allocation for alternative strategies was 49.4%, U.S. equities averaged 16.6% and non-U.S. equities averaged 19.9%. It was also noted that the average asset allocation of the SEC institutions was not quite as diversified as that of the URC benchmark institutions. Additionally, the average asset allocation for the Kentucky institutions has much less exposure to alternatives and heavier equity exposure, as compared to the URC benchmark institutions.

The next item on the agenda was the Asset Allocation Study and Portfolio Risk Review by RVK. Mr. Palmeri began with the portfolio risk review. He first explained and discussed thematic investing, which is categorizing similar sub-allocations within the total portfolio into the four broadly defined themes of capital appreciation, capital preservation, inflation and alpha. UK's long-term strategic target asset allocation for 2015 was categorized as 43.0% in capital appreciation, 10.0% in capital preservation, 15.0% in inflation and 32.0% in alpha. He added that another risk element to be monitored is beta exposure.

Next, Ms. Gratsinger discussed RVK's asset allocation study, which is conducted annually. UK's 2015 current target asset allocation has an expected arithmetic return of 7.31%, while the potential target allocation has an expected return of 7.47%. The potential target allocation would put the University closer to a rate of return of 7.5%. The key difference between the allocations is a 3% reduction in developed international equity to fund a corresponding emerging market international equity allocation. An additional 3% is added to private equity and 2% to long-biased long/short equity, broad U.S. equity was decreased by 1%, broad international equity was decreased by 3%, custom diversified inflation strategies was decreased by 2%, core real estate decreased by 1% and non-core real estate decreased by 1%. Additionally, another potential portfolio was reviewed that would increase the expected return from 7.31% to 7.38%. As explanation for the process, Ms. Gratsinger described how the asset allocation alternatives were created.

Ms. Krauss then presented proposed changes to the endowment investment policy. There were some minor changes throughout the policy, but the significant changes are a recommendation to increase the management fee from 0.25% to 0.50% and a restructuring of the fixed income allocation. To support the increase in the management fee, she reviewed long-term return and spending targets, which showed a current excess of 0.25%. Next, Mr. Shupp discussed the need to restructure the endowment's fixed income portfolio in light of the current low interest rate environment and high probability of forthcoming rising interest rates. Changes were proposed at the strategy and structure level as a means to enhance the diversification and return potential of the fixed income portfolio. The proposed changes include decreasing unconstrained-liquid from 60.0% to 35.0% and transferring the remaining 25.0% from unconstrained-liquid to unconstrained-less liquid. The core plus allocation would remain unchanged at 40.0%. Mr. Shupp commented that UK investment staff is considering an opportunistic credit strategy managed by Grosvenor for the new 25.0% unconstrained-less liquid allocation and the Grosvenor team will present details on the opportunistic strategy later in the meeting.

Ms. Krauss then presented a summary of the Endowment Asset Allocation and Rebalancing/Transition Activity as of March 31, 2015, noting there have been no rebalancing adjustments in the last five months and that asset allocation classes are within policy target ranges. Mr. Shupp provided an update on the Manager Appointments, Terminations and Due Diligence. There were no appointments or terminations for the period of December 9, 2014 through May 7, 2015. He stated that his goal is to increase the level of independent due diligence at UK and he presented a two-page summary of recent due diligence efforts. Mr. Shupp then provided an update on the custodian search, stating that an RFP was issued in March, proposals have been received and reviewed and finalists will be interviewed in June.

Mr. Palmeri then provided a quick performance review and market update. For the quarter ending December 31, 2014, the portfolio was at 0.52%, underperforming the total fund benchmark by 0.35%. Of the 0.35% underperformance, 0.10% was attributable to asset allocation and 0.29% was from manager underperformance. The category of "other" outperformed by 0.04%. Diversified inflation strategies contributed the most to the underperformance.

Ms. Krauss then introduced the Grosvenor team, consisting of Mark Roman, Director, Client Group, Bradley Meyers, Managing Director, Public Markets Investment Committee Member, and Dianna Di Iorio, Senior Vice President, Portfolio Management. Mr. Roman began with an update on the firm. Grosvenor is one of the world's largest and most diversified allocators to alternative investments, currently investing $27 billion in hedge funds and $23 billion in private equity, infrastructure and real estate. Mr. Meyers continued with a review of Grosvenor's performance in 2014, noting that hedge funds generated positive performance in the year but underperformed headline U.S. equity indices. Although active strategies struggled, hedge funds still demonstrated the ability to mitigate losses during market volatility resulting from geopolitical and macroeconomic uncertainty. Ms. Di Iorio then discussed UK's $121 million Grosvenor See Blue Fund, stating that the portfolio consists of a multi-strategy, multi-manager approach to hedge funds and has produced a 5.8% return since inception in January 2011. She described the portfolio as being 2/3 strategic and 1/3 tactical. She noted that strategic allocations are implemented through core allocations to alternative credit and hedged equity strategies, complemented with allocations to diversifying and lesser correlated strategies, and portfolio construction is enhanced through focused tactical investments designed to capture niche and/or timely market opportunities. She also reviewed Grosvenor's practice of using size and scale to negotiate fee savings that are passed directly to the clients. Ms. Di Iorio also reviewed UK's $65 million See Blue B Fund, which is a portfolio of seven long/short equity funds selected by UK from Grosvenor's list of approved long/short equity managers. Mr. Meyers completed the manager presentation by providing a discussion of Grosvenor's opportunistic credit strategy, reviewing the four investment themes, which include deleveraging and recapitalization of the financial sector, energy sector opportunities, emerging markets stressed and distressed credit, and niche opportunities post credit crisis.

Ms. Krauss made a few concluding personnel announcements. She stated that Donna Counts recently left the University and the position of Assistant Treasurer is currently being filled on an interim basis by the University's Assistant Controller, Mary Fister-Tucker. She also announced that the University hired Sarah Heil in March as a Treasury and Debt Analyst.

The meeting was adjourned at 2:47 p.m.

Respectfully submitted,
Kimberly C. Lush
Office of the Treasurer