

Meeting Minutes of the Investment Committee
University of Kentucky
Thursday, September 10, 2020

The Investment Committee of the University of Kentucky Board of Trustees met on Thursday, September 10, 2020, via Zoom Webinar.

A. Meeting Opened

Chair of the Investment Committee, Elizabeth McCoy, called the meeting to order at 1:00 p.m. and requested a roll call.

B. Roll Call

The following members of the Investment Committee were in attendance: Elizabeth McCoy, Joe R. Bowen, Michael A. Christian and Barbara Young. The following Committee member was not in attendance: Carol Martin "Bill" Gatton.

The following Community Advisory members were in attendance: William C. Britton, James F. Hardyman, Quint Tatro and Myra L. Tobin.

The University Investment Staff was represented by Chief Investment Officer, Todd D. Shupp, and Senior Investment Analyst, Nancy K. Rohde.

Fund Evaluation Group (FEG) was represented by Michael J. Aluise and Rebecca S. Wood.

C. Approval of Minutes for June 18, 2020

Chair McCoy called for a motion to approve the minutes from the Committee meeting on June 18, 2020. The motion was moved by Trustee Young and seconded by Trustee Bowen. The motion passed without dissent.

D. UK Endowment Overview

Mr. Todd Shupp opened the retreat with an overview of the UK Endowment, including a review of the background and investment philosophy, and a recap of Fiscal Year 2020. His discussion began with a snapshot of historical endowment values, flows and returns. Mr. Shupp also covered a breakdown of total UK endowment assets by type, purpose and entity. Next, he reviewed the Investment Objectives, stating the main objectives are to preserve the purchasing power of endowment assets and related revenue stream (intergenerational equity), and to earn an average annual return, after expenses, of at least 7.5% over full-market cycles. He also discussed the history of the Endowment's target asset allocation, with the most significant takeaway being that the changes made following the Great Financial Crisis have been additive.

Next Mr. Shupp reviewed the university's investment philosophy. He stated that diversification is the university's best strategy for achieving long-term objectives. Focus must be on long-term results, which requires both patience and diligence. Markets are cyclical and valuation matters over the long term. Humility is important, and a blend of passive, active and less-liquid strategies is needed to reach UK's long-term goals. In managing the Endowment, UK seeks to avoid trying to time the market, making hasty decisions or extreme moves, being complacent and allowing past results to anchor expectations for the future. Some issues to consider with regard to the investment philosophy are that diversified portfolios underperform in certain markets, great investments often require discomfort, short-term performance dominates headlines, valuations can remain elevated for long periods and behavioral biases can challenge a long-term strategy.

Mr. Shupp concluded with a review of Fiscal Year 2020. Following guidelines in the investment policy that were developed with consideration of bear markets, the portfolio played offense prudently and adjusted defense during the year. Other key accomplishments included detailed portfolio liquidity analysis, a minor adjustment to the Endowment's spending policy calculation methodology, continued Environmental, Social and Governance (ESG) research and enhanced endowment transparency. Finally, peer benchmarking studies were conducted on endowment management practices, including Student Managed Investment Fund (SMIF) portfolio allocations and spending policies. His final comments included investment staff observations, including a key 2020 reminder that markets are full of surprises. Rather than attempt to predict the future, focus should remain fixed on what can be controlled. Some of these factors include diversification across and within asset classes, maintaining a disciplined, consistent investment approach, capitalizing on the Endowment's perpetual investment horizon, ensuring adequate liquidity to take advantage of opportunities, communicating clearly on our expectations and results, closely monitoring and managing service provider fees and maintaining perspective.

Trustee Ramsey asked how long it took the portfolio to recover to the 7.5% long-term targeted return following the Great Financial Crisis. Mr. Shupp replied that the environment following the Great Financial Crisis has been challenging for the portfolio because it is diversified and did not have a dominant allocation to the top-performing asset class over the period, U.S. equities. He pointed out that a lot has been done over the past five years to enhance the Endowment's prospective return, but patience is required to see results of this work. Trustee Blonder asked about the outlook and strategy for real estate investment trusts (REITs) given the shift to remote work in 2020. This question was noted for a later part of the discussion.

E. Fund Evaluation Group Education Session and Asset Allocation Study

Ms. Becky Wood, with Fund Evaluation Group, began the education session and asset allocation study with a summary of the Investment Committee (IC) survey responses. The results were compiled from 13 participants, most of which identified themselves as Investment Committee members. Ms. Wood reviewed aggregated

responses to the survey questions covering the topics of investment objectives, risk tolerance, liquidity management and responsible investing.

Next, Mr. Aluise presented the proposed asset allocation. The portfolio's asset allocation targets are reviewed on an annual basis, and the most recent changes were approved in December 2018. Slight modifications are proposed to the current asset allocation including a modest increase to public equity, a modest reduction of hedge funds and public real assets, and a minor reduction in private capital. He noted that research has shown that asset allocation is the primary contributor to a portfolio's return variation over time and maintaining market exposure at predetermined asset allocation ranges is an important component of a portfolio's long-term returns. Mr. Aluise briefly reviewed a chart projecting FEG's seven-to-ten-year capital market assumptions, which were key inputs to the asset allocation study. In addition to modest changes in asset allocation targets, a streamlined framework is being proposed to better capture the portfolio's hedge fund exposures, re-categorizing them all within "Diversifying Strategies." Historically, some hedge fund exposure was included in other asset categories: hedged equity has been included in "Global Equity", and hedged credit has been reported within "Global Fixed Income and Credit." FEG and Investment Staff believe this will be an improved framework for reporting the portfolio's asset allocation, managing underlying strategy exposure and framing return expectations across asset classes. Trustee Blonder pointed out that four of the 13 survey respondents were at least "slightly interested" in divesting the Endowment of fossil fuel exposure, and she asked if an educational presentation could be made on this topic in the future. Chair McCoy responded that the Committee had seen a presentation on this topic last year, but that it could potentially be revisited as a future meeting topic.

F. Proposed Changes to Endowment Investment Policy

Mr. Shupp discussed key proposed changes to the Endowment Investment Policy. The Investment Staff section in the document was updated to reflect the Investment Office's new reporting line to the Executive Vice President for Finance and Administration, Eric Monday, as well as the addition of Senior Investment Analyst, Nancy Rohde. The policy also reflects the proposed asset allocation changes previously discussed by FEG. Mr. Shupp noted that the sub categories under the main asset classifications reflect working targets, providing flexibility to work around these ranges. He also noted that the language was updated regarding the diversifying strategies definition given the proposed addition of hedged equity and credit managers to that category. Finally, Mr. Shupp highlighted proposed changes to some of the sub-asset class policy benchmarks as a result of the asset allocation target updates.

G. Endowment Manager Presentation: PIMCO

Ms. Libby Cantrill and Mr. Chase Haymond from investment manager PIMCO, provided a brief update on their firm as well as an economic and policy outlook.

H. Investment Staff Report

Mr. Shupp presented the Investment Staff Report beginning with an overview of the Endowment asset allocation as of July 31, 2020. Overall, there were not any major changes to the top-level asset categories. However, within global equity there was some shifting at the sub-asset class categories, including an increase in the portfolio's public equity allocation due to the market's strong second quarter rebound, as well as a reduction in private equity as a result of the lagged nature of performance marks in the private space. There was also a slight increase to diversifying strategies due to redemption proceeds that were returned and temporarily housed in that asset class bucket. Rebalancing over the period included outflows from equity reallocated to public real assets and elsewhere. Additionally, within emerging markets, some assets were shifted from a value-oriented semi-passive strategy to a new active manager.

Next, Ms. Rohde discussed recent manager appointments, terminations and due diligence for the period. Within diversifying strategies, \$15 million was allocated to GMO Systematic Global Macro Fund and within public equity, \$16 million was allocated to Sands Emerging Markets Growth Fund. On the termination side, a full redemption was made from PIMCO All Asset All Authority, and a full redemption was made from the Vanguard FTSE Emerging Markets ETF. Reporting on due diligence, Investment Staff continued to stay very active during the summer months with manager calls and Zoom meetings continuing with both investment managers and FEG.

I. Performance Review and Market Update

Mr. Aluise began the performance review and market update with an overview of Fiscal Year 2020. The portfolio finished the year ending June 2020 on a strong note, bouncing back from the first quarter's market selloff and outperforming its benchmarks. Still, the quarter's rebound was not enough to push the portfolio ahead of its primary benchmark for the full fiscal year as an overweight to international equities curbed relative returns in another stand-out year for U.S. equities, and diversifying strategies lagged the benchmark. Mr. Aluise next highlighted the divergence in 2020 returns among various stock market sectors with most finishing the year-to-date period negative, but consumer discretionary and information technology being notable positive outliers. Mr. Aluise provided additional commentary on the unique nature of the second quarter S&P 500 rally, including the increasing concentration of the five largest companies in that index.

He next turned to the portfolio's fiscal year performance across each of the four main asset categories: global equity, fixed income, real assets and diversifying strategies. In his remarks concerning real assets, Mr. Aluise addressed Trustee Blonder's question from earlier in the meeting regarding REITs. He stated that the primary adjustment made in 2020 in response to the coronavirus pandemic was to shift from a passive to an active approach within REITs. In conclusion, Mr. Aluise summarized that the portfolio navigated Fiscal Year 2020 well, and the focus going forward will be on prudently transitioning to the recommended asset allocation targets if they are approved by the Investment Committee. Trustee Swanson asked to what extent market performance is being driven by stock buybacks by large corporations. Mr. Aluise replied that although this is difficult

to quantify, it has certainly been a driver of market performance of large U.S. companies over the last five years in particular.

J. Other Business

Mr. Shupp reviewed the 2020 Investment Committee meeting schedule and tentative agenda items. He highlighted that December's meeting would include a real assets strategy review by FEG.

K. Meeting Adjourned

Hearing no further business, the meeting was adjourned at 3:32 p.m.

Respectfully submitted,

A handwritten signature in blue ink, appearing to read "Kristina W. Goins".

Kristina W. Goins
University Financial Services