

Meeting Minutes of the Investment Committee  
University of Kentucky  
Thursday, February 18, 2021

The Investment Committee of the University of Kentucky Board of Trustees met on Thursday, February 18, 2021, via Zoom Webinar.

A. Meeting Opened

Chair of the Investment Committee, Elizabeth McCoy, called the meeting to order at 2:00 p.m. and requested a roll call.

B. Roll Call

The following members of the Investment Committee were in attendance: Elizabeth McCoy, Michael A. Christian, Hollie Swanson and Barbara Young. The following Committee members were not in attendance: Joe R. Bowen and 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 Investment Officer, Nancy K. Rohde.

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

C. Approval of Minutes for December 14, 2020

Chair McCoy called for a motion to approve the minutes from the Committee meeting on December 14, 2020. The motion was moved by Mr. Tatro and seconded by Trustee Young. The motion passed without dissent.

D. Public Equity Strategy Review

Mr. Aluise, of Fund Evaluation Group, introduced a strategy review of public equity, with a focus on emerging markets. The Endowment had a 33% target to public equities, accessed through a combination of passive and enhanced index funds as well as active managers. Made up of domestic equities, international equities and private equity, he explained the role of the global equity asset class is to provide total return, while the primary risk is stock market decline.

Mr. Aluise then discussed active versus passive public equity implementation. He described how pure passive provides investors exposure to market beta at a low cost but may also result in biased exposure to the most expensive stocks given the market

capitalization weighted approach. Enhanced indexing allows investors to more deliberately construct portfolios to gain exposure to traits that have been rewarded historically in an effort to outperform pure passive strategies over long periods. He pointed out that active managers attempt to provide alpha from stock selection based on company-specific attributes that go beyond the rules-based factors employed by passive and enhanced indexing. Mr. Aluise concluded this section by noting that the percentage of assets invested in passively managed funds has continued to increase over the last several years. The Endowment has been a part of this trend and has increased passive and enhanced index strategies within more efficient markets.

Director of Global Equity at Fund Evaluation Group, Mr. Brian Hooper, continued with a deeper dive into international and emerging markets. Given the variety of industries driving regional growth across the globe, the sector composition of equity markets varies by region and supports the case for global diversification. In addition to U.S. and emerging markets exposure, the public equity portfolio is also invested in non-U.S. developed markets. This allocation represents approximately one-third of the public equity allocation (or 11% of the total Portfolio) and includes markets in Europe and the Middle East as well as the Pacific and Asia, excluding China and India. Mr. Hooper pointed out that over the long run, FEG expects similar returns from U.S. and non-U.S. equities, with diversification benefits for owning both. The domestic equity markets have outperformed more recently, but valuations suggest that may not always be the case going forward. Mr. Tatro asked whether FEG sees a risk in international markets following U.S. stocks downward should domestic companies sell off. Mr. Hooper acknowledged that since the U.S. is the largest economy globally, it is likely to have an impact on all other economies. He explained the various ways that the relative price-to-equity multiples may converge across regions, while also acknowledging the difficulty in predicting the exact path through which that may occur. Still, he reiterated FEG's confidence in regions with lower valuation multiples given their historical tendency to signal higher future returns.

Next, Mr. Hooper addressed emerging markets explaining how emerging markets represent only 13% of global equity market indices and yet account for over 25% of global GDP activity and approximately 6 billion in population. With over 1,400 securities across 27 countries, diversification by country, sector, and security is important for long-term success in this asset class. He next walked through detailed country reviews of some of the Portfolio's largest exposures within emerging markets, including China, India, and Brazil. In order to further provide context to the space, Mr. Hooper also explained frontier markets, which include developing countries in the early stages of economic development that are less mature and developed than emerging markets.

Mr. Hooper then reviewed two of the UK Endowment's emerging markets investments and then concluded his presentation with a performance recap for regional equity markets. He explained though the U.S. market continued to drive performance for 2020, the MSCI Emerging Markets index gained 18% for the calendar year. China is the largest country represented in the index, and their effective COVID containment efforts resulted in some of the strongest global gains at 29%. Mr. Shupp asked what factors "hold back" some of the emerging markets countries such as China from graduating to the

developed markets classification. He also asked if Mr. Hooper could speak to the growth of the middle class in some of the emerging countries and the extent to which that is a case for investment there. Mr. Hooper replied that China has been a fairly closed market and it was historically very difficult to access or invest in China-based businesses if you were not a Chinese national. As China continues to open its markets to foreign investment and diversify away from state-owned enterprises, it comes closer to achieving developed market status. Addressing the second part of the question regarding the middle class, Mr. Hooper replied that the digital and internet revolution has opened up a lot of opportunities for growth and it is expected that we will see ongoing growth in the middle class in these countries. Trustee Ramsay asked about the precautions taken to investing in China as it relates to the country's history of exaggerating or manipulating economic data. Mr. Hooper replied that a key tactic to mitigate this risk is to focus on hiring money managers with an active local presence in China so that potential issues can quickly be identified and addressed. He also noted that these issues are generally trending down as China recognizes the need for businesses to present accurate company information in order to be embraced by international investors.

#### E. Investment Staff Report

Mr. Shupp presented the Investment Staff Report beginning with an overview of the Endowment asset allocation as of December 31, 2020. He stated that the Portfolio remains well-diversified and is very close to the asset allocation targets approved at the December 2020 meeting. He reminded the Committee that in order to streamline the asset allocation, the hedged equity subcategory was removed from global equity and rolled into diversifying strategies. He also noted the gain in the global equity allocation was largely a result of strong performance in the public equity markets. Also supporting that gain were some manager distributions from private equity. Some rebalancing occurred in this area as well which included a significant inflow from diversifying strategies. Mr. Shupp continued by stating that global fixed income remained relatively flat. The downtick in real assets was deliberate, given the new policy has a slightly reduced allocation to this category. Finally, looking to diversifying strategies, UK had some redemption proceeds come in from one of its credit related hedge fund managers leaving the Endowment exactly on target.

Next, Ms. Rohde discussed recent manager appointments, terminations and due diligence for the period. She began with manager appointments, stating that UK made two new commitments within the private real assets Portfolio. The first was a \$10 million commitment to Lime Rock New Energy and the second was an \$8 million commitment to IPI Partners II. Regarding terminations, full redemptions were made from Fir Tree International Value Fund and DW Value Offshore Fund. She stated both were tied to the modest reduction in diversifying strategies in the recently approved asset allocation targets. Lastly, Ms. Rohde discussed manager due diligence and research during the period, which featured investment manager conferences as well as the standard manager due diligence meetings, both taking place via Zoom webinar.

F. Performance Review and Market Update

Mr. Aluise began the performance review and market update with a review of major asset class market returns, drawing attention to the strong year-to-date performance and the impact the month of December had on these values. He stated the UK Portfolio gained 8.0% in the fourth quarter of 2020, 13.7% in the fiscal year-to-date period and 8.5% for the calendar year ending December 31, 2020. He explained much of the strong performance seen in the fourth quarter of 2020 has continued into the first quarter of 2021. Mr. Aluise then summarized what worked well and not as well for the calendar year 2020. Disciplined portfolio rebalancing, high-quality fixed income and public credit, as well as U.S. equity, specifically small cap, were all drivers of performance. Not working as well were the value bias across international equities, diversifying strategies, and real assets which faced a challenging market backdrop despite posting strong relative performance. He then briefly discussed the low level of interest rates, which were cut significantly in March 2020.

G. Other Business

Mr. Shupp reviewed the 2021 Investment Committee meeting schedule and tentative agenda items. He announced the upcoming May meeting will include the annual portfolio risk review as well as the Student Managed Investment Fund presentation. Additionally, the annual retreat will take place in September, with education sessions to be determined. And finally, the December meeting will cover an asset allocation strategy review and the annual review and approval of the Endowment Investment Policy.

H. Meeting Adjourned

Hearing no further business, the meeting was adjourned at 3:27 p.m.

Respectfully submitted,



Kristina W. Goins  
University Financial Services