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Office of the Executive Vice President for Finance and Administration
December 12, 2022

Members, Investment Committee of the Board of Trustees:

REVISED ENDOWMENT INVESTMENT POLICY

Recommendation: that the Investment Committee of the Board of Trustees approve the attached revisions to the Endowment Investment Policy.

Background: The revised policy reflects the following changes:

- Adoption of the following asset allocation targets, ranges, and indices:

Asset Category	Target	Range	Index
GLOBAL EQUITY	**64%**	**40 - 75%**	
Public	40%		MSCI All Country World IMI (ACWI IMI)
Private	24%		Cambridge Associates (CA) Private Equity and Venture Capital Indices
GLOBAL FIXED INCOME	**12%**	**5 - 25%**	
Public Fixed Income	10%		Barclays U.S. Aggregate Bond Index
Private Credit	2%		CA Private Credit and Distressed Indices
REAL ASSETS	**12%**	**5 - 20%**	
Public	3%		Bloomberg Barclays U.S. TIPS, NAREIT and Alerian MLP[1]
Private	9%		CA Private Real Estate, Natural Resources, and Infrastructure Indices
DIVERSIFYING STRATEGIES	**12%**	**5 - 20%**	30% MSCI ACWI IMI / 70% Bloomberg Short-Term Government / Corporate Index

[1] Indices weighted at one-third each.

- Adoption of the following liquidity guidelines:

Classification of Asset	**Description**	**Guideline**
Liquid	available within 90 days	no less than 35%
Combined: Semi-liquid and Illiquid	available in 90 days or more but less than 2 years	no more than 65%
Illiquid	available only in two years or more	no more than 45%

- Other minor changes as noted in the attached policy.

Action taken: ☑ Approved ☐ Disapproved ☐ Other ______________________

UNIVERSITY OF KENTUCKY
AND AFFILIATED CORPORATIONS

ENDOWMENT INVESTMENT POLICY

Amended December 12~~13~~, 2022~~2021~~

University of Kentucky
University of Kentucky Research Foundation
University of Kentucky Gluck Equine Research Foundation, Inc.
University of Kentucky Humanities Foundation, Inc.
University of Kentucky Mining Engineering Foundation, Inc.

ASSET CATEGORY	TARGET	RANGE
GLOBAL EQUITY	**64~~61~~%**	**40~~35~~ – 75~~70~~%**
Public	*40~~38~~*	
Private	*24~~23~~*	
FIXED INCOME	**12**	**5 - 25**
Public Fixed Income	*10*	
Private Credit	*2*	
REAL ASSETS	**12**	**5 - 20**
Public	*3*	
Private	*9*	
DIVERSIFYING STRATEGIES	**12~~15~~**	**5 - 20**

Note: Sub-asset category (e.g., Public Equity) figures reflect working targets. Investment staff has the flexibility to adjust sub-asset category exposures within broader, asset category (e.g., Global Equity) ranges, based on market conditions and ongoing research.

Global Equity – The allocation will consist of public and private equity-oriented funds managed by external investment firms. This is expected to be the highest risk, highest return asset category of the four, and the primary driver of portfolio growth over time. The allocation will be diversified by factors including security, sector, geography, market capitalization, and manager style. Private equity investments will be made with the expectation that long-term returns materially exceed those of the public markets.

Fixed Income –The allocation will consist of obligations of sovereign nations and corporations, mortgage- and asset-backed securities, money market instruments, and bank deposits. The allocation will consist of two broad categories: 1) public fixed income and 2) private credit. The primary role of the public fixed income portfolio is to provide a partial hedge in the event of economic contraction, deflation, and/or severe flight to quality. It is expected that this portion of the portfolio would serve as one of the primary sources of spending during such periods, when the prices of other assets in the Portfolio may decline. Therefore, while the public fixed income allocation may include some investments rated below investment-grade, it is generally expected to have a high quality rating on average (typically “A” or better by a recognized bond rating agency). The private credit allocation may include obligations of any credit quality and is expected to generate long-term returns that materially exceed those of the public credit markets.

Real Assets – The allocation will consist of public and private assets. Public real assets may include Real Estate Investment Trusts (REITs), Master Limited Partnerships (MLPs), natural resource equities, commodities, and Treasury Inflation-Protected Securities (TIPS). Private real assets may include real estate, natural resources, and infrastructure. Private real assets are expected to generate long-term returns that materially exceed those of public real asset alternatives. Private assets may include real estate near the University campus which is deemed to have strategic value for the University. For diversification purposes not more than 2% of the portfolio will be invested in local real estate as opposed to external managers. The 2% maximum will be defined as the market value of the portfolio at the time of investment. All real assets are expected to provide inflation protection as well as generate positive real rates of return.

Diversifying Strategies – The allocation will consist of a diverse group of managers and strategies with a goal of earning positive returns over time, but with low ~~moderate~~ sensitivity to the public equity markets. Included in this category are strategies such as long/short equity, low beta equity, event-driven and special situations investing, merger and capital structure arbitrage, quantitative strategies, global macro, long/short credit, and distressed securities. The beta (sensitivity to equity markets) of the diversifying strategies allocation is generally expected to fall between 0.25 and 0.35 when measured over a multi-year period. The diversifying strategies portfolio is expected to generate a long-term return greater than a passive blend of equities and fixed income with a commensurate risk profile~~between equities and bonds (closer to equities), with less volatility than equities~~. Returns should generally be better than equities when equity markets fall significantly, and behind equities when equity markets rise significantly.

Rebalancing

Rebalancing is a term that describes the periodic movement of funds from one asset class or category to another for the purpose of realigning the assets with the asset allocation target. A rebalancing strategy is an important element of asset allocation policy. Systematic rebalancing will ensure that the portfolio's risk profile remains consistent with this investment policy. However, excessively tight ranges and frequent rebalancing can lead to unnecessary transaction costs.

The Committee has chosen to adopt a rebalancing policy that is governed by allocation ranges rather than time periods. The ranges, specified in the table above, are a function of the volatility and liquidity of each asset class and the proportion of the total fund allocated to the asset category. While the allocation to all asset categories remains within these limits, Staff will first use cash flows, as available, to prudently manage allocations relative to the target. When an asset category violates the lower or upper limits, public market funds will be actively rebalanced back to the target.

When any one of the public market asset categories hits a trigger point, the entire fund may be rebalanced back to asset category target allocations with the understanding that it may be impractical to return the private asset categories precisely to target in the short term. Accordingly, qualitative considerations (e.g., transaction costs, liquidity needs, investment time horizons, etc.) will be considered in determining the potential timing and extent of rebalancing.

Staff is responsible for developing and implementing a rebalancing plan that is appropriate for existing market conditions, with a primary objective of minimizing transaction costs and portfolio disruptions. In the event an allocation trigger point is not reached, Staff may still make minor changes among asset categories and within individual asset categories, as needed, to more effectively implement the program and to maintain proper exposure to the approved asset allocation and asset category portfolio structures. Staff will report the results of all rebalancing activity to the Investment Committee at the regular meetings.

Liquidity

The Endowment is intended to provide a reliable and steadily growing revenue stream to support the mission of the University in perpetuity. As a result, the Endowment has a long-term orientation. In addition, the withdrawal rate from the Endowment fund is well defined, predictable, and of modest size relative to the total assets. Staff, assisted by the Consultant, is responsible for managing the liquidity of the portfolio to fund spending distributions and capital calls while maintaining the appropriate market exposure.

Certain appropriate investment options, particularly in alternative asset classes, involve fund structures with liquidity constraints that align with less liquid portfolio holdings. The tradeoff between return opportunities and liquidity will be considered throughout the portfolio construction process.

Sufficient liquidity should be maintained to fulfill the spending distributions and operating objectives of the Pool. Portfolio liquidity will be monitored using a three-tier system:

Liquid: available within 90 days
Semi-liquid: available in 90 days or more but less than 2 years
Illiquid: available only in 2 years or more

Classification of Asset	Guideline
Liquid	no less than 35%
Combined: Semi-liquid and Illiquid	no more than 65%
Illiquid	no more than 45~~40~~%

New commitments will be made to illiquid/private capital investments with the intent to keep the current market value of liquid holdings above 35% of the total Fund. Illiquid percentages will be calculated based on current market value. Staff, assisted by the Consultant, will complete annual forecasting and make appropriate commitments to reach and maintain the approved policy allocation and liquidity while ensuring diversification across vintage year, strategy, geography, etc.

It is recognized that significant changes in investment market values could cause the portfolio to be positioned outside of these guidelines. If this occurs, Staff will communicate this to the Investment Committee and develop a plan to reposition the portfolio consistent with these guidelines over a reasonable time frame.

Proxy Voting

The Committee delegates full authority for proxy voting to its investment managers for the securities under their discretionary authority and requires the investment managers to vote all proxies in the best interest of the Endowment. In addition, when requested, the

Performance Benchmarks

The total Endowment performance will be measured against two principal benchmarks:

1. The primary performance objective of achieving a long-term total return, net of fees and expenses, of at least 7.5%. It is expected that portfolio performance will vary significantly from this benchmark over shorter periods. Therefore, performance compared to this benchmark will be evaluated only over very long periods (ten years or more).

2. A Policy Benchmark consisting of market indexes reflecting the Endowment's "strategic target" asset allocation percentages. Performance compared to this benchmark will be evaluated over rolling three- to five-year periods. The current Policy Benchmark appears in the following table:

ASSET CATEGORY	TARGET	INDEX
GLOBAL EQUITY	**64~~61~~%**	
Public	40~~38~~	- MSCI All Country World IMI Index (ACWI IMI)
Private	24~~23~~	Cambridge Associates Private Equity and Venture Capital indices
FIXED INCOME	**12%**	
Public Fixed Income	10	Barclays Aggregate Bond Index
Private Credit	2	-Cambridge Associates Private Credit and Distressed indices
REAL ASSETS	**12%**	
Public	3	1/3 each Bloomberg Barclays U.S. TIPS Index, NAREIT Index and Alerian MLP Index
Private	9	CA ~~Cambridge Associates~~ Private Real Estate, ~~and~~ Natural Resources, and Infrastructure -indices
DIVERSIFYING STRATEGIES	**12~~15~~%**	**-30% MSCI ACWI IMI / 70% BBG Short-Term Govt/Corp Index~~HFRI Fund of Funds Composite~~**

In addition to these principal benchmarks, performance may from time to time be compared to a peer group of similar institutions.

The asset class performance will be measured against:

1. The asset class index.

2. A peer group universe of similar asset classes.

The individual manager performance will be measured against:

1. The manager's specific market indexes.

2. A peer group universe of similar investment styles.

Long-Only Active Managers
Managers will be measured against their primary benchmark and their peer universe.

Long/Short Managers (Hedge Funds)
Managers will be measured against their primary benchmark. Secondary benchmarks will also be used, including relevant asset class benchmarks and absolute return measures (T-bills + X%).~~Most hedge funds do not have good benchmarks for performance measurement, especially over short time periods. Managers will be measured relative to peer benchmarks such as the various style indices tracked by HFRI. Secondary benchmarks will also be used, including relevant asset class benchmarks (such as the S&P 500 for U.S. focused long/short equity funds) and absolute return measures (T-bills + X%).~~

Private Capital Managers
The majority of private equity, private real asset, and private credit funds will be invested with private partnerships. These partnerships typically range from 7-15 years in life, during which time the Fund may not be able to sell the investment. Additionally, the partnership may not produce meaningful returns for 3-5 years (depending on the strategy). New investments will create a drag on fund performance in the early years (3-5 years) until these investments begin to mature. This drag on performance is often referred to as the J-curve, due to the shape created by plotting a line graph with performance on the y-axis and time on the x-axis. Private, illiquid manager performance will be measured utilizing internal rate of return (IRR) calculations, and Multiple of Invested Capital (MOIC), and will be compared to an appropriate peer group. An IRR calculated from the inception of the partnership will be the primary performance measurement tool utilized for all private capital managers. Performance will be measured relative to the best available benchmark, understanding that some investments may not have entirely comparable indices.

Performance Expectations

It is expected that, at each level, the Endowment, the asset class, and the individual active managers should exceed the index return and should be above the median against the appropriate peer group universes over full market cycles. It is expected that risk (and risk adjusted returns) will be in line with the risk associated with the specific market benchmarks over full market cycles.