

**Minutes of the Investment Committee
University of Kentucky Board of Trustees
12:00 p.m. on December 14, 2015
Charles T. Wethington Building, Room 327C**

IN ATTENDANCE:

Investment Committee Members:	William S. Farish, Jr., Chair Claude A. "Skip" Berry, III James H. Booth William C. Britton Robert D. Vance
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Community Advisory Members:	James F. Hardymon Myra L. Tobin William E. Seale
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Investment Staff & Consultants:	Susan I. Krauss Todd D. Shupp Kimberly C. Lush Becky Gratsinger (RVK) Steve Hahn (RVK) Rob Palmeri (RVK)
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Mr. Farish called the meeting to order at 12:05 p.m. Ms. Lush then conducted a roll call. Mr. Farish made a motion to approve the minutes from the Committee meeting on September 10, 2015. Mr. Farish's motion was moved by Mr. Britton, seconded by Mr. Vance, and approved by all.

Ms. Krauss provided an update on the UK Student Managed Investment Funds ("SMIF") Program. She noted that the program was approved by the Investment Committee on December 16, 2013 with an allocation of up to \$5.1 million from the University's Endowment to the SMIF program. The original SMIF agreement was effective January 1, 2014 through December 31, 2015, and was recently extended through June 30, 2016. Two SMIF portfolios have been established to date. The undergraduate SMIF portfolio was funded with approximately \$650,000 in January 2014, adding to the existing value of \$450,000, which was sponsored by the Tennessee Valley Authority (TVA). The graduate SMIF portfolio was funded with \$1.1 million in August 2014. Three additional graduate-level SMIF accounts, in the amount of up to \$1.1 million each, are expected to be funded in Fall 2016. Ms. Krauss then introduced Brad Jordan, Chair of the Finance department in the Gatton College and the faculty advisor for the current SMIF program. Mr. Jordan provided additional background information regarding the class, noting that the class in equity portfolio management culminates with a stock pitch competition. He then introduced the most recent winning team of the competition. The team consisted of four current students in the program, Ryan Paxton, Jeff Roettgen, Jake Walker and Tyler Axman, and they provided their winning presentation to the Committee on why CVS is a good stock to purchase.

Ms. Krauss introduced the next agenda item, the preliminary results of an endowment forecasting study recently conducted by RVK. The study assessed the viability of increased spending and management fees while protecting the corpus, with the increases supported by higher potential returns projected for

alternate target asset allocations of the fund. Ms. Gratsinger continued with a discussion of the study. She began by noting that RVK ran 25-year Monte Carlo projections for the study, adjusting the factors of portfolio asset allocation, hybrid policy weights, hybrid spending rates, rolling average market value period, management fee, and endowment gifts. Results were compared to a Base Case scenario, and the biggest drivers of the results were portfolio asset allocation, hybrid spending rate and management fee. She stated that the analysis is supportive of an increase in the spending rate over the term of the analysis if a higher expected return/greater expected risk portfolio structure is chosen and implemented. A higher management fee can be supported during an interim period, but an incrementally higher risk portfolio would be needed to support a permanent increase in the management fee in order to protect the corpus.

A review of historical effective spending rates of the University of Kentucky compared to NACUBO institutions for the time period of fiscal year 2002 to fiscal year 2014 showed that UK's 13-year average annual effective spending rate of 4.5% was slightly lower than the average spending rates of 4.6% for total NACUBO institutions and 4.8% for NACUBO institutions with endowments valued over \$1 billion. For fiscal year 2014, the University's effective spending rate was 3.7%, compared to 4.4% for total NACUBO institutions and 4.6% for NACUBO institutions with endowments valued over \$1 billion. Additionally, three different portfolios, labeled Portfolios A, B and C, were created for use in the modeling process. Portfolio A was the most conservative of the portfolios and Portfolio C was the most aggressive, with risk incrementally increased in each portfolio to evaluate return and risk consequences. The Expected Return (arithmetic) increased from 7.31% for the current target allocation to 8.23% for Portfolio C, and the Expected Risk (standard deviation) increased from 12.01% for the current target allocation to 14.91% for Portfolio C. Included in the forecasting were projections for median results at the 50th percentile that could be expected over time. A summary of forecasting results included ending market value, ratio of ending market value to corpus, annual final spending, and cumulative final spending. Ms. Krauss stated additional work will be done in the coming months to explore the possibility of accepting a prudent level of additional risk and illiquidity in order to increase long-term returns and support increased spending needs.

Next, Mr. Hahn provided a private equity portfolio update. Regarding the private equity market environment, he stated that private equity valuations generally follow public equity market cycles, with a significant lag, noting that distribution activity still lags historical averages although it has begun to accelerate. He added that fundraising has recovered since the financial crisis; however, global dry powder (the amount of private equity capital available to be invested) remains steady. Actual net cash flows were compared to estimated net cash flows, and, while somewhat lagging historical averages for distributed capital, the net value created by the portfolio approximates estimates (\$57 million actual versus \$63 million estimated), with distributions expected to continue to improve as investments mature. The results of a pacing analysis showed that if there were no new investments, the allocation level of the portfolio would begin to decline gradually in 2016, with a more rapid decrease commencing in 2019. Therefore, new commitments would need to be made in order to maintain the target allocation. Mr. Hahn then presented a proposed commitment budget, with a proposed schedule of making new commitments in 2017 and 2020. Additionally, regarding manager return comparison, he noted that RVK recommends focusing on IRR as the most accurate measure of private equity performance versus a time weighted calculation due to the irregular nature of private equity cash flows.

Ms. Krauss then introduced the NB Wildcats Investment Coverage Team from Neuberger Berman, which consisted of Brien Smith, Kaci Boyer and Drew Fox. Mr. Smith began with a discussion of private equity's role of generating excess returns that are less correlated to public returns, with performance being measured by positive returns, outperforming liquid indices, and outperforming peers. He continued with an explanation of the program structure of the NB Wildcats \$200 million private equity fund, stating that it is divided into Tranche A and Tranche B. Tranche A consists of \$50 million in the NB Crossroads 2010 fund, which is 100% committed and 87.7% deployed, plus \$50 million in a separate account, which is 100% committed and 64.5% deployed. Tranche B has \$100 million in a separate account and is 63%

committed and 20% deployed. The NB Wildcats portfolio has exposure to 1,256 active companies and is allocated 43% to small/mid-cap buyout, 24% to special situations, 17% to large-cap buyout and 16% to venture/growth capital. Current distribution deployment is \$9.2 million, the total net multiple is 1.26x, and the net IRR since inception for the entire portfolio is approximately 14%. The NB Wildcat portfolio has outperformed both public and private indices since inception. Ms. Boyer continued with a discussion of portfolio development, noting that early performance was driven by co-investments, secondaries and funded primaries. Now, however, the portfolio is generating gains across all asset classes and investment types. She concluded by noting that the NB Wildcats program is well diversified across industries and concentrated within North American investments.

Mr. Shupp then presented the Investment Staff Report. He began with an overview of the endowment asset allocation as of October 31, 2015, noting that the portfolio remains well within the policy ranges and well diversified across asset classes. Next, he provided an update on manager appointments, terminations and due diligence for the period of September 11 through December 14, 2015. There were no appointments or terminations in the period. Due diligence included several calls regarding the diversified inflation strategies search, as well as calls relating to the endowment forecasting analysis. Mr. Shupp then provided updates on the Endowment Investment Custodian and Endowment Investment Consultant searches. A recommended finalist has been selected for the Endowment Investment Custodian, with contracts in the final review stage. Regarding the Endowment Investment Consultant search, eleven proposals have been received and are being evaluated, and the goal is to bring three finalists to the Committee in February.

Next, Mr. Palmeri presented a performance review and market update. He began with a notice that RVK has placed Wellington Diversified Inflation Hedges (DIH) on watch due to considerable underperformance as Wellington continues to weigh additional changes to the strategy. Mr. Palmeri then provided a total fund overview of performance as of 9/30/15. The total fund was down 5.23%, net of fees, for the quarter and the total fund target allocation benchmark was down 2.67%. The total fund underperformed the target allocation index by 2.55%, with 1.93% of the underperformance coming from manager value added. Breaking down the negative 1.93% value added figure, -0.82% came from diversified inflation strategies and -0.64% came from GTAA. Reviewing quarterly performance by asset class, domestic equity was down 7.48% and international equity was down 11.58%. Fixed income was down 0.29%, diversified inflation strategies were down 9.24%, GTAA was down 8.25%, long/short equity was down 6.37%, absolute return was down 2.93%, and real estate returned 1.36%. Mr. Palmeri then provided an overview of total fund performance as of 10/31/15. A rebound in performance was apparent for the month of October, which had a total fund composite return of 3.02%, net of fees, beating the target allocation by 0.58%.

Ms. Krauss then provided a brief performance review for operating fund cash and investments as of October 31, 2015. She stated that the total of operating fund cash and investments was approximately \$1.15 billion. Excluding \$230.6 million of bond proceeds and other construction funds held at the state, the total amount to support operations was \$921.8 million. Also, total cash and investments subject to the operating fund investment policy was approximately \$460.3 million, with \$271 million in overnight and short-term investments and \$189.3 million in other investments.

The meeting was adjourned at 2:43 p.m.

Respectfully submitted,
Kimberly C. Lush
Office of the Treasurer