

**Minutes of the Investment Committee
University of Kentucky Board of Trustees
4:30 p.m. on June 23, 2016
President's Room, Boone Center**

IN ATTENDANCE:

Investment Committee Members:	William S. Farish, Jr., Chair James H. Booth William C. Britton Mark P. Bryant Carol Martin Gatton Robert D. Vance
Community Advisory Members:	James F. Hardymon Myra L. Tobin William E. Seale
Investment Staff & Consultants:	Susan I. Krauss, Treasurer Todd D. Shupp, Chief Investment Officer Michael J. Aluise, Consultant, Fund Evaluation Group Nolan M. Bean, Consultant, Fund Evaluation Group

Chair Farish called the meeting to order at 4:30 p.m. and requested a roll call. Chair Farish then called for a motion to approve the minutes from the Committee meeting on May 2, 2016. The motion was moved by Mr. Britton, seconded by Mr. Bryant, and approved by all.

Mr. Shupp presented the Investment Staff Report. He began with an overview of the endowment asset allocation as of May 31, 2016, noting that the portfolio remains well within the policy ranges and well diversified across asset classes. He mentioned a small amount of rebalancing activity during May in the form of a \$2.2 million investment with Mondrian in non-U.S. equity, which was funded by distributions in the private equity and real estate asset classes. Another brief update he shared was the recent termination of the Wellington Real Total Return strategy, which resulted in a reduction of concentration in overall exposure to Wellington from approximately 9% to 6%, with reallocation expected in the coming quarter. Next, he provided an update on manager appointments, terminations and due diligence for the period of May 3, 2016 through June 23, 2016. There were no appointments or terminations in the period. During the review of manager due diligence, Mr. Bean commented that notification was received recently regarding the departure of portfolio manager Sam Wilderman from GMO. However, the departure is not considered a concern by FEG and no changes are recommended.

Mr. Shupp then provided a performance overview as of May 31, 2016. For the second quarter to date, which includes the months of April & May, the pool returned 1.25%, slightly ahead of the target index of 1.17%. Included in the report for this period was a line item for a market-based Target Allocation Index (GTAA, DIS mkt BM), which was added as a secondary reference to reflect market behavior and volatility, particularly in shorter term periods, and this index will be included in future FEG reporting. The fiscal year to date return was -2.20%, trailing the policy index by 2.89%. Mr. Shupp noted that positive performance in the first half of calendar year 2016 was offset by declines in the latter half of 2015, and key detractors during the one year period were non-U.S. equities and diversified inflation strategies. Reviewing performance over some of the longer time periods, he stated that the seven year period return of 8.04% was only slightly less than the target of 8.52%, and the return since inception was 7.11%.

Next, a document was distributed that summarized observations relating to a recent article published by Kentucky Public Radio entitled “Big Endowments and Underwhelming Returns at Kentucky Universities.” The intent of the document was to share additional thoughts on the article’s key points and a summary of actions taken by UK geared towards improving the endowment portfolio’s long-term performance. Mr. Shupp noted that the article focused heavily on comparisons of the five year, trailing returns of Kentucky-based institutions. Relating to peer benchmarking, he commented that UK regularly compares performance against peer data reported in the NACUBO-Commonfund Study of Endowments (NCSE) and also prepares custom comparisons against benchmark groups, including Kentucky institutions. Since the goal for UK is to generate long-term performance that is highly competitive on a national level, the returns of Kentucky institutions is not considered the best peer benchmarking group for the University, given the relatively narrow geographic scope and wide disparity of assets overseen by these entities. In regards to benchmarking transparency, he stated that investment staff regularly provides reporting to the Investment Committee of UK returns relative to other schools. Additionally, he commented that the five year time horizon emphasized in the article is a short-term period relative to the University portfolio’s infinite time horizon, as well as a unique period, as it occurred during the second longest US equity market rally in history. Also, he stated that the University’s portfolio is very well diversified across asset classes and portfolios with lower U.S. equity exposure have lagged for much of the five year period. He then discussed measures being taken to address the portfolio’s underperformance, including an expansion of internal investment resources, selection of a new investment consultant and improved implementation of the portfolio.

Next, Ms. Krauss discussed a proposal for an alternative process for conducting searches for endowment investment managers that would allow investment staff and the investment consultant to conduct manager searches without a formal request for proposal conducted by the Purchasing department. She noted that the new search process would offer the University benefits such as significant fee reduction, increased efficiency and return potential, while maintaining core KRS procurement objectives related to cost, transparency, competition, avoidance of conflicts of interest, and achieving best value. She stated that the objective of the search process will be to select the firm that offers the best value for the University and whose strategy is the most advantageous to the University’s ability to fulfill its mission. Additionally, at the conclusion of the search process, investment staff will execute the required contractual documents, in consultation with UK’s Office of Legal Counsel. Ms. Krauss introduced Shannan Carroll, Associate General Counsel, and Bill Harris, Chief Procurement Officer, to provide insight into how the alternative search process complies with Kentucky’s model procurement code. Ms. Carroll noted a formal legal opinion and purchasing memorandum are underway and will be provided to the Committee.

Ms. Krauss then provided a brief report on the University’s operating fund cash and investments which totaled \$1.37 billion as of May 31, 2016. She stated that the total cash and investments subject to the operating fund investment policy was \$501.4 million, with \$342.8 million in overnight and short-term investments and \$158.6 million in other investments. Ms. Krauss commented that overnight and short term investments at the end of May were higher than normal due to liquidation of the \$60 million State intermediate pool investment and several agency bonds called at the end of May. The funds were reinvested during June in various agencies and municipals, and \$55 million was added to the Reams low duration strategy, which has earned 2.15% since its inception in February 2014. The total cash held by the state as of May 31st was \$868.1 million, of which \$415 million is bond proceeds and other funds restricted for construction. Excluding the \$415 million related to construction funds, the total amount available to support operations was \$954.6 million.

The meeting was adjourned at 5:15 p.m.

Respectfully submitted,
Kimberly C. Lush
Office of the Treasurer