

Meeting Minutes of the Investment Committee  
University of Kentucky  
Monday, May 3, 2021

The Investment Committee of the University of Kentucky Board of Trustees met on Monday, May 3, 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, Joe R. Bowen, Michael A. Christian, Hollie Swanson 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 and Quint Tatro.

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, Greg Houser and Rebecca S. Wood.

C. Approval of Minutes for February 18, 2021

Chair McCoy called for a motion to approve the minutes from the Committee meeting on February 18, 2021. The motion was moved by Trustee Bowen and seconded by Trustee Swanson. The motion passed without dissent.

D. Student Managed Investment Fund Presentation

Students Scott Schoeffler, Elena Messuro, Erin Howell and Ryan Scanlon from the undergraduate Student Managed Investment Fund (SMIF) class presented a portfolio update. Mr. Schoeffler began with an overview of the class structure, as well as a portfolio breakdown including the top ten holdings, sector breakdown and market cap breakdown. Next, Ms. Howell reviewed portfolio performance comparing the UK SMIF Fund, S&P 500 Index, and Russell 1000 Value Index since the Fund's inception in 2014. Next, Ms. Messuro discussed the recent market rotation from growth to value stocks. Through the rotation, the class structure allowed for timely moves among stocks to capitalize gains and trim risks when necessary. The Fund's main objective remains to find value in companies that the rest of the market is overlooking. Mr. Scanlon reviewed two of the

portfolio's key holdings, Intel Corporation and LKQ Corporation, including the investment theses and financial model summaries for each. In conclusion, Ms. Messuro shared macro views around reflation that are shaping the portfolio going forward and stated that the SMIF portfolio is well positioned for this shift. Trustee Swanson asked the students to reflect on the most important thing they learned while managing the SMIF portfolio. Ms. Messuro responded that for her it was the real-world connection to the market as she observed the Portfolio on a daily basis. Mr. Shupp asked if the students could elaborate on the decision to reduce the Portfolio's allocation to the healthcare sector. Mr. Schoeffler responded that the class had some uncertainty around the shift to telehealth and what that shift may mean for the sector going forward. He stated that they remain underweight in this category but may reevaluate going forward.

#### E. Portfolio Risk Review

Mr. Aluise began with key takeaways for the focus of the day's discussion, the process for total portfolio risk budgeting and risk monitoring. He stated risk budgeting is a collaborative effort between the Investment Office, Investment Committee and FEG. There is no all-encompassing standard measure of investment risk; therefore, the risk is monitored through a myriad of statistical measures.

Mr. Houser then discussed risk measurement. He stated most measures of risk tend to focus on exposures and/or sensitivities to either market risk, a benchmark, or manager skill. He defined some commonly referenced risk metrics including standard deviation, beta, Sharpe Ratio and liquidity. Some other types of risk that may need to be considered include operational risk, behavioral risk, concentration risk and headline risk. Mr. Houser provided some examples of each risk type.

Next, risk budgeting was discussed, specifically balancing market risk and shortfall risk, two dominant and highly related risks to investors' portfolios. Shifting to the UK Endowment, Mr. Aluise referenced the investment strategy survey conducted in 2020 to assess stakeholder views of portfolio objectives and risk profile. He pointed out when respondents were asked which risk is most significant for the Endowment, most respondents considered shortfall risk as the most significant. Accepting enough market risk to achieve the objective is of primary importance.

Mr. Houser and Mr. Aluise then discussed risk monitoring and provided observations of recent and current risks in various asset classes. They noted the COVID-19 pandemic produced high volatility in the equity markets in 2020 but also had an impact on bond yields in the fixed income markets. In response to the prospect of rising rates, the Endowment has been positioned with a lower duration than the core bond index.

The conversation on risk monitoring continued with a focus on liquidity risk, specifically the results of liquidity stress tests of the UK Portfolio that were conducted by the investment office. Ms. Rohde stated industry experts, including investment managers and other research providers, were consulted in the data preparation and assumptions utilized in this study. She provided the results of the first study that stressed the most

highly liquid assets in the Portfolio, those that can be fully redeemed within one month. She reported, applying very conservative performance assumptions to simulate what may occur in a severe downturn, the most liquid assets were found to cover three years of annual spending and capital call needs. Mr. Shupp provided the results of a second study that included not only the most liquid assets, but also semi-liquid assets that can be liquidated within one year. He reported, again applying conservative performance assumptions, the liquid and semi-liquid assets are estimated to cover 4.6 years of the Portfolio's annual spending and capital call needs.

Mr. Aluise and Mr. Houser briefly discussed FEG's in-house risk monitoring tool, FEG Vigilance, which provides risk forecasting, scenario analysis and stress testing on portfolios. Mr. Houser concluded the presentation by reviewing FEG's current capital market assumptions, highlighting the expected returns for major asset classes looking forward over a 7-10 year horizon. Trustee Swanson asked how FEG thinks about asset class returns after the pandemic considering that "boom years" transpired following the last global pandemic a century ago. Mr. Houser responded that with a strong economic upswing, the thing to consider is how much of the optimism is already reflected in asset prices. He stated FEG considers valuations to be a long-term return driver for equities and they are extraordinarily high right now, historically speaking. Mr. Houser stressed the importance of remaining cognizant of how equity markets have performed over the long term at similar valuation levels. Trustee Bowen asked if the markets are being driven by fundamentals or rather other emotional components in the market today such as social media, politics, etc. Mr. Houser replied that ultimately, he thinks the market is currently being driven by investors' expectations of fundamentals. That said, he noted other influences do weigh on the markets, especially in the short term.

#### F. Investment Staff Report

Mr. Shupp presented the Investment Staff Report beginning with an overview of the Endowment asset allocation as of March 31, 2021. He stated that the Portfolio remains well-diversified and within the established asset allocation targets. He stated in late March, there was a \$35 million addition to the operating quasi-endowment. A large portion of this was allocated to public equity and public credit, and these asset classes were also the destination for redemption proceeds from diversifying strategies. Public equities also increased given an uplift in the markets. He noted that real assets remained relatively flat, though there was a substantial distribution from one of UK's private real asset managers in January. Lastly, Mr. Shupp turned to the March asset allocation file highlighting the liquidity tier breakdowns. Relevant to the earlier liquidity risk discussion, he noted 51.4% of the university's Endowment assets fall within the most liquid category.

Next, Ms. Rohde discussed recent manager appointments, terminations and due diligence for the period. She reported, beginning with manager appointments, UK made three new investments. Within private real assets, a \$2M commitment was made to Cordillera ECP Co-Investment and a \$1M commitment was made to Cordillera GSC Co-Investment. Within private equity, UK committed \$7.5M to Primus Capital Fund IX. Regarding terminations, a full redemption was made from Rimrock Structured Product

Fund. This redemption was related to a slight 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 the standard manager due diligence meetings as well as discussions with investment consulting firms as part of the Request for Proposal (RFP) process.

#### G. Performance Review and Market Update

Mr. Aluise began the performance review and update with a review of major asset class market returns for the period ending March 31, 2021. He stated that the first quarter of 2021 saw a continuation of the strong performance demonstrated in the last quarter of 2020. He continued that domestic markets produced the highest returns over the quarter, driven by value-oriented sectors and smaller cap securities. Moving on to UK Portfolio-specific performance, he highlighted that the strong relative and absolute results in the fiscal year to date period were driven by U.S. equity, particularly small cap, value-oriented non-U.S. equity, and public credit. Headwinds to performance were diversifying strategies, high quality fixed income, and public real assets which delivered strong absolute performance but weaker relative results.

Mr. Aluise then briefly commented on some macroeconomic topics, including the immense size of Covid-related fiscal and monetary stimulus and the market's concerns that the stimulus could lead to increased inflation. He concluded by stating that although stimulus and demand have fueled inflation concerns, the pandemic has been strongly disinflationary, with a substantial decline in the labor force participation rate and the economy running below potential.

Trustee Christian asked how UK compares with other endowments in terms of liquidity. He also asked if there was any recommendation for the portfolio liquidity ratios to stay the same, be more aggressive, or be more conservative. Mr. Shupp stated the average length of time it has taken for the market to reach a bottom after a bear market is approximately three years, which is the rationale for using three years for the coverage ratio. Mr. Aluise added that when compared to other institutions, UK's liquidity coverage is in the range of reasonableness and estimated that the Endowment is slightly more liquid than comparable peers. Trustee Young asked for additional insight in terms of increasing inflation being transitory. Mr. Aluise replied that while the Fed has signaled their view that inflation is transitory, there is no way to be certain. Mr. Shupp agreed that UK should expect to see an uptick in inflation in the short term. He also noted that the labor market remains below full capacity so there is still some slack in the economy. He added as far as the UK Endowment is concerned, allocations to real assets help protect against inflationary risk.

#### H. Other Business

Mr. Shupp reviewed the 2021 Investment Committee meeting schedule and tentative agenda items. The two remaining regular meetings will be the annual retreat in September and the December meeting. There will also be a Special Meeting on June 15<sup>th</sup>

to discuss the investment consultant RFP.

I. Meeting Adjourned

Hearing no further business, the meeting was adjourned at 3:31 p.m.

Respectfully submitted,



Kristina W. Goins  
University Financial Services