

Minutes of the Investment Committee
University of Kentucky Board of Trustees
2:30 pm May 2, 2016
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 Mark P. Bryant 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 Kristina W. Dills Michael J. Aluise (FEG) Nolan M. Bean (FEG) Rebecca S. Wood (FEG)
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Chair Farish called the meeting to order at 2:31 pm. Ms. Dills then conducted a roll call. Chair Farish called for a motion to approve the minutes from the Committee meeting on February 18, 2016. The motion was moved by Mr. Britton, seconded by Mr. Bryant, and approved by all.

Ms. Krauss introduced the next agenda item, the Student Managed Investment Funds presentation. Ms. Krauss provided background information regarding stock pitch competitions held by students in Dr. Brad Jordan's FIN 485 course. She then introduced David Blackwell, Dean of the Gatton College of Business and Economics, and the members of the team that won the most recent stock pitch competition: Will Tirone, Jared Glover, and Peter Townsend. The students presented a pitch for their selected stock, Perrigo (PRGO). They began with a short demonstration of how Perrigo makes money (consumer healthcare, branded consumer healthcare, prescription pharmaceuticals, and specialty services). Perrigo was selected based on the following factors: large scale operations, lower R&D costs, expertise on shelf space management, unique packaging requirements, and retail distribution which discourages other companies from entering. The students reviewed Perrigo's competition, then went through a quick financial analysis of Perrigo versus its competitors including market cap, net debt, cash, forward P/E, and dividend yield. The presentation was concluded with some industry-wide trends, stock valuation, and dividend growth rates.

Mr. Shupp then presented the Investment Staff Report. He began with an overview of the endowment asset allocation as of March 31, 2016, noting that the portfolio remains well within the policy ranges and well diversified across asset classes. Mr. Shupp highlighted rebalancing activity that occurred during the period, a shift of approximately \$12.2M from Wellington Real Total Return to PIMCO IRMAF. This was driven by the unexpected departure of the Wellington RTR portfolio manager and was mentioned in

the March 2016 Flash Report memo. Next, he provided an update on manager appointments, terminations and due diligence for the period between February 18, 2016 and May 2, 2016. On April 27th, UK made a new, temporary diversified inflation strategy investment of \$36M in an equally-weighted blend of liquid, passive TIPS, REIT, and commodity exposures. This investment was funded by the proceeds of a full redemption from Wellington Real Total Return. Due diligence during the period included onsite meetings with the finalists in the Endowment Investment Consultant search as well as a number of routine updates with managers. Mr. Shupp then provided updates on the Endowment Investment Custodian and Endowment Investment Consultant searches. In the Endowment Investment Custodian search, a new contract was executed with Northern Trust, the recommended finalist. Regarding the Endowment Investment Consultant search, a new contract with recommended finalist FEG has been executed and becomes effective July 1, 2016.

Next, Mr. Shupp presented an Asset Allocation Study and Portfolio Risk Review prepared by RVK. He noted that these reports are provided on an annual basis and although UK is in the process of changing its investment consultant, investment staff wanted to share them for reference. Mr. Shupp highlighted that the return and risk forecasts for UK's target portfolio were largely unchanged from last year. Return forecasts have come down across asset classes and investment staff believe this places greater importance on portfolio structure and implementation decisions. Mr. Shupp noted that UK will be taking a fresh look at our asset allocation with FEG and has identified opportunities for improvement, including fee reduction.

Mr. Shupp then presented a performance review and market update. Total market value was \$1.18B as of March 31, 2016. Mr. Shupp then provided a total fund overview of performance as of March 31, based on the RVK monthly flash report. The total fund was up an estimated 3.29% in the month of March, outperforming the Target Allocation Index return of 2.70%. Returns during the month were driven by equities and, reviewing monthly performance by asset class, domestic equity was up 7.01% and international equity was up 8.17%. Fixed income was up 9.63%, diversified inflation strategies were up 0.23%, GTAA was up 5.56%, long/short equity was up 3.65%, and absolute return was up 0.96%.

Next, was the Relationship Overview and Asset Allocation presentation by UK's newly-selected investment consultant, Fund Evaluation Group. FEG began their presentation by introducing UK's consulting team: Nolan Bean, Rebecca Wood and Michael Aluisse. Nolan Bean outlined a list of five main goals and a proposed action plan for UK. FEG's enterprise management model is made up of: spending policy, endowment support of budgets, endowment management, foundation & development support, and governance/structure. Mr. Bean provided an overview of UK's governance structure and the role FEG plays as an extension of staff. He then reviewed UK's investment goals, FEG's investment philosophy, and their recommended, strategic asset allocation. Mr. Bean briefly described the firm's manager research and due diligence, including their six tenet manager review process which is comprised of: conviction, consistency, pragmatism, investment culture, risk control, and active return. Mr. Bean then outlined top priorities through year-end including a timeline for each. Examples of top priorities include high yield credit within Global Fixed Income, and MLP's within Real Assets. Mr. Britton commented that, based on the FEG timeline, it appears we won't be making any portfolio changes for the next six months. In response, Nolan Bean stated that we have the ability to take action sooner on items that fall within existing, approved asset allocation ranges. Mr. Bean concluded by referencing a slide with detailed asset allocation figures, including UK current targets, NACUBO peers, and FEG recommended targets.

Ms. Krauss then reviewed an updated process proposal for endowment investment manager searches. She began with background on the challenges UK faces with the existing procurement process that involves hiring endowment investment managers through an open request for proposals (RFP) process. Ms. Krauss stated this is not a common practice among peer endowments and UK's endowment is being impaired due to the increased cost associated with utilizing fund-of-funds versus direct investments; the

increased time of completing an RFP process (3-6 months); and a constrained universe of available managers, as many smaller and/or highly successful firms do not seek investors through an RFP process. Ms. Krauss then presented details on the proposed search process which would be conducted by UK investment staff and the investment consultant. While formal RFPs would no longer be issued, the objective of the new search process would be to select the investment manager that offers the best value for the University. Ms. Krauss concluded her comments by stating the proposed process offers UK several benefits, such as significant fee savings, increased efficiency and return potential, while maintaining core KRS statute objectives related to cost, transparency, avoidance of conflicts of interest, and achieving best value. Mr. Britton inquired why we've had to use RFPs for manager searches in the past and would moving to the new process be in violation of a KY law. Ms. Krauss stated the new search process had been developed in consultation with UK's General Counsel and Chief Procurement Officer and that she would invite those individuals to the June Investment Committee meeting to discuss the issue further. Ms. Krauss commented staff had envisioned incorporating the new search process into the investment policy and obtaining Committee approval in June, however we can hold off and include in the policy update planned for December to allow for more review and discussion.

Next, Ms. Krauss provided a brief review of the University's operating fund cash and investments as of March 31, 2016. She stated that the total operating fund cash and investments was approximately \$1.39 billion, with \$481 million managed by UK, subject to the operating fund investment policy, and \$910 million managed by the State as required by state statutes. Excluding \$427 million of bond proceeds and other construction funds held at the state, the total amount available to support operations was \$963 million. Ms. Krauss shared there has been ongoing discussion with State officials over the last year on the need to retain and manage all University cash, versus the current practice of remitting receipts to the State on a monthly basis and obtaining reimbursement based on expenditures. The need for greater autonomy has been heightened by the recent State budget situation, which included the possibility of not having an approved budget by July 1st, potentially impacting our ability to access the cash held by the State.

Finally, Ms. Krauss briefly reviewed the meeting schedule for the remainder of the year, pointing out that the September 8th meeting will take place in Bowling Green, KY.

The meeting was adjourned at 3:50 pm.

Respectfully submitted,
Kristina W. Dills
Office of the Treasurer