

**Minutes
Investment Committee
Board of Trustees
December 9, 2008**

IN ATTENDANCE:

Investment Committee Members:	Ms. JoEtta Y. Wickliffe, Chair Mr. Stephen P. Branscum Mr. James F. Hardymon Mr. Dermontti F. Dawson Dr. Britt Brockman
Community Advisory Members:	Mr. James W. Stuckert Mr. Billy B. Wilcoxson
Board of Trustees Members:	Ms. Mira S. Ball
Investment Staff & Consultants:	Mr. Marc A. Mathews Ms. Susan I. Krauss Ms. Donna Counts Mr. Rob Palmeri (R.V. Kuhns & Associates) Mr. Mike Paolucci (R.V. Kuhns & Associates)
Others:	Mr. Frank A. Butler Dr. Michael Karpf Ms. Barbara W. Jones Mr. John Deans

The Investment Committee meeting was called to order at 8:30 a.m. Ms. Wickliffe asked for a motion to approve the October 13, 2008 minutes. Dr. Brockman made the motion to approve the minutes, Mr. Branscum seconded the motion and all approved.

Ms. Wickliffe stated that the Investment Committee needed to go into closed session in order to hear a report on the evaluation of proposals for the value-added and opportunistic real estate manager search because an open discussion of the firms and deliberations of the committee could jeopardize the retention of the recommended firms. Ms. Wickliffe made a motion to go into closed session pursuant to KRS 61.810 (1) (g), to discuss specific proposals because an open discussion could jeopardize the proposals. Mr. Dawson seconded the motion, all approved, and the committee then went into closed session.

The Chair announced that the closed meeting was concluded and the committee was now in open session. Mr. Mathews referred to a copy of IC1 in the committee notebooks. Ms. Wickliffe asked if there were any questions. There being none Mr. Branscum made a motion to approve IC 1 which authorized the University's Purchasing Division to enter into contract negotiations with four new managers for the management of value-added and opportunistic real estate allocations. Dr. Brockman seconded the motion. The motion was approved unanimously.

Ms. Krauss began discussing the next item on the agenda, an update on the investment strategy implementation plan. She reported that four requests for proposals had been issued and three due diligence reviews of existing managers had been performed. As a result of this process managers had been selected or recommended for contract negotiations for all asset classes outlined in the new asset allocation approved on June 16, 2008.

Ms. Krauss then discussed the transition to the new asset classes by reviewing a chart that summarized the current asset allocation, the target allocation and the transition plan. Phase 1 of the transition is underway as follows:

- On December 1st, \$38.9 million had been moved from State Street's Wilshire 5000 Index fund (Broad U.S. Equity Asset Class) and \$37.5 million moved from Capital Guardian's International MCSI EAFE strategy (Broad Non-U.S. Equity Class) for a combined total of \$76.4 million to Capital Guardian's Active MSCI ACW ex-U.S. – Core strategy (Broad Non-U.S. Equity Class).
- On December 15th, it is planned that \$150.7 million will be moved from State Street's Russell 3000 Enhanced Index fund (Broad U.S. Equity asset class) to State Street's Russell 1000 Index fund (Broad U.S. Equity asset class). Lastly, \$33.1 million will be moved from PIMCO's Core-Plus strategy (Fixed Income asset class) to Mondrian's MSCI ACW ex-U.S. – Value strategy (Broad Non-U.S. Equity).
- On January 2, 2009, it is anticipated that \$17.3 million will be moved from Ream's Core-Plus strategy, with \$5 million added to Mondrian's ACW ex. US – Value strategy and \$12.3 million transferred to Wellington's Real Return strategy.

Phase 2 of the transition will involve the following changes at the appropriate time:

- Reduce the U.S. Equity allocation by approximately \$68 million to partially fund the new Absolute Return manager;
- Reduce the global equity allocation by approximately \$45 million to fund Absolute Return for approximately \$2 million, Non-U.S. Equity for approximately \$12 million, and Real Return for approximately \$31 million; and
- Reduce Fixed income by \$6 million to fund Real Return.

Phase 3 will involve the following changes as the private equity and real estate managers call capital:

- Reduce U.S. Equity by approximately \$16 million to fund Private Equity;
- Reduce Non-U.S. Equity by approximately \$13 million to also fund Private Equity; and
- Reduce Fixed Income by approximately \$5 million to fund value added and opportunistic real estate investments.

Dr. Brockman asked if the target allocations have changed since the policy was approved in June based on the current market. Mr. Mathews responded that the overall allocation policy has not changed and will improve diversification in the future, however, the timing of the transition to the new strategies will be phased as a result of the equity market downturn and uncertainty. He indicated that RVK and staff were interested in seeing some improvements in the equity markets before implementing Phase 2. Mr. Palmeri indicated that RVK will monitor the environment and recommend moving into new asset classes as appropriate and prudent. Mr. Palmeri also commented that RVK and staff will perform an updated asset allocation study based on updated return and correlation data, and that the asset allocation may be tweaked slightly, however significant changes to asset allocation are not expected. Dr. Karpf asked if there would be a different strategy if there was a \$150 million drawdown from the endowment. Mr. Palmeri responded that the drawdown could affect the timing, but not the ultimate asset allocation.

The next item on the agenda was the performance review and market update by RVK. Mr. Palmeri briefly reviewed the endowment performance against benchmark and peer data for the period ending

September 30, 2008. He then reported on the endowment portfolio for the year ended October 31, 2008. The total fund decreased 30.31%, compared to the UK policy benchmark of 28.43%.

Mr. Hardyman asked if our performance below benchmark and peer data was due to allocation or manager performance. Mr. Mathews responded that it was a result of both, some poor manager performance and asset allocation. Mr. Palmeri noted that asset allocation is what is really going to drive returns in the long run. Mr. Stuckert requested information on cash inflows, outflows, gains and losses and market value. Ms. Krauss stated that information is currently provided annually and could be provided quarterly.

Mr. Stuckert also requested information on which investments are subject to theoretical mark to market valuations. Mr. Palmeri indicated both Real Estate and Private Equity would fall in that category. Mr. Stuckert requested that information be presented in the future.

Mr. Palmeri commented on the overall market conditions stating that October was the worst recorded market performance. He stated that the last few months had been clearly unprecedented times in the financial markets and market intervention by the Federal Reserve and the U.S. Treasury. Fannie Mae and Freddie Mac were taken over by the government, Lehman Brothers filed for bankruptcy protection, the government took control of AIG in exchange for a loan and Washington Mutual was seized by federal regulators. Credit markets froze resulting in a credit crisis and panic selling. This resulted in the \$700 billion bailout plan approved by Congress on October 2nd which will result in more regulation and more transparency. As a result of the poor performance and market upheavals the number of hedge funds will be reduced. Mr. Palmeri stated they believe this process will be a cleansing process and good for the hedge fund market. Mr. Palmeri reported that the steps being taken to change allocations as approved in the June meeting will reduce the risk in the portfolio and increase the return through diversification into new asset classes. Members of the committee discussed the investment performance and requested benchmarking information. Ms. Krauss stated that benchmarking analysis from the 2008 NACUBO Endowment Study will be presented at the March 2009 meeting.

The next item on the agenda was a review of the Cash, Overnight and Short-Term Investment Report. Ms. Counts reported that as of October 31, 2008 the total portfolio subject to the short term investment policy was \$366.4 million. Overnight investments totaled \$55.5 million. Of this, \$52.0 million was invested in the Kentucky Office of Financial Management (OFM) overnight repurchase agreement with an annualized monthly return of 0.73%. Short term investments totaled \$310.9 million, of which \$65.2 million was invested in the OFM short term investment pool with an annualized monthly return of 2.36%, \$60.0 million was invested in the OFM intermediate pool with an annualized monthly return of 1.59%. \$70.4 million was invested in the Fidelity Government Fund, with an annual return of 1.83%, \$21.0 million was invested in the Dreyfus Governmental Fund with an annual return of 1.42% and another \$90.3 million was invested directly in federal agencies and instrumentalities having yields ranging from 2.76% to 4.05%. Ms. Counts reported that investment returns compared favorably to the market performance indices of the three month T-bill rate of 0.47%, the fed funds yield of 0.30% and the 2 year Treasury note rate of 1.57% as of October 31, 2008.

With no further business the meeting adjourned at 10:00 a.m.

Donna Counts
Office of the Treasurer

IC 1

Office of the Treasurer
December 9, 2008

Members, Investment Committee

AUTHORIZATION TO ENTER CONTRACT NEGOTIATIONS WITH
FOUR NEW MANAGERS FOR THE MANAGEMENT OF VALUE-ADDED
AND OPPORTUNISTIC REAL ESTATE ALLOCATIONS

Recommendation: that the Investment Committee authorize the University's Purchasing Division to enter into contract negotiations with four new managers for the management of value-added and opportunistic real estate allocations. One manager is subject to final approval by staff and RVK prior to the fund's final close in mid-2009.

Background: The Investment Committee approved a revised asset allocation and manager structure on June 16, 2008, which includes new value-added and opportunistic real estate allocations of 4% each. Investment staff and R. V. Kuhns & Associates ("RVK") issued a Request for Proposals for value-added and opportunistic real estate managers in September 2008 and received proposals from 25 firms on 27 different strategies. Staff and RVK performed the evaluation of proposals and selected two value-added managers for a 2.5% total allocation, one manager for a 1.5% allocation and one manager for a 1.0% allocation. Staff and RVK also selected two opportunistic managers, one manager for a 1.0% allocation and one manager whose allocation has yet to be determined pending final approval by staff and RVK prior to the fund's final close in mid-2009. Staff and RVK plan to issue another RFP in the next two years to search for additional value-added and opportunistic real estate managers/strategies. The objective is to build the value-added and opportunistic allocations over a period of years to ensure appropriate vintage year diversification.

The recommendation of the four managers, along with a description of the RFP process, is included in a confidential memo from RVK dated November 21, 2008, which was distributed to the Investment Committee. Disclosure of the names of the managers could jeopardize the contract negotiations with these firms.

Action Taken: Approved Disapproved Other _____