The Regents of the University of California

INVESTMENTS COMMITTEE
March 15, 2022

The Investments Committee met on the above date at UCSF-Mission Bay Conference Center, 1675 Owens Street, San Francisco and by teleconference meeting conducted in accordance with California Government Code §§ 11133.

Members present: Regents Anguiano, Cohen, Lott, Makarechian, and Sherman; Ex officio members Drake and Leib, Advisory members Blas Pedral, Cochran, and Pouchot; Chancellors Hawgood, Khosla, Muñoz, and Wilcox; Advisory members Lybarger and Zager; Staff Advisor Tseng

In attendance: Regents Hernandez, Torres, and Zaragoza, Secretary and Chief of Staff Shaw, General Counsel Robinson, Chief Investment Officer Bachher, Provost Brown, Senior Counsel Katz, and Recording Secretary Li

The meeting convened at 3:05 p.m. with Committee Chair Sherman presiding.

1. **PUBLIC COMMENT**

Committee Chair Sherman explained that the public comment period permitted members of the public an opportunity to address University-related matters. The following persons addressed the Committee concerning the items noted.

A. Nadia Flamenco, UC Berkeley staff member, asked the Board to respect those who do not wish to be vaccinated. She had a medical condition and did not want to receiver a booster dose of the vaccine after experiencing a serious side effect from the second dose. In Ms. Flamenco’s view, Governor Newsom had his own political agenda regarding vaccines. She stated that children were being deprived of their right to education because they were not fully vaccinated and that this was contributing to the exodus from California.

B. Michael Kennedy, UC San Diego nurse and member of the California Nurses Association (CNA), stated that nurses have advocated for safe staffing, proper personal protective equipment, testing, contact tracing, and stronger patient protections. He highlighted nurses’ and other frontline workers’ contributions to UC during the COVID-19 pandemic, adding that nurses sought a contract with stronger health and safety language, an end to unsafe nurse “floating,” a resolution regarding UC hiring practices, substantial wage increases, and more.

C. Jamille Cabacungan, UCSF nurse and CNA member, spoke about the short-staffing that led her to consider quitting her job. Many nurses completed assignment objection forms to document this lack of staffing. Since 2020, nurses were working in an understaffed unit more than 90 percent of the time, and patients were not receiving the care they deserved. She appealed to UCSF to consider its patients and staff.

D. Monica Nelson, UCSD graduate student, spoke in support of Senate Constitutional Amendment (SCA) 5, which would make the Student Regent-designate a full voting member. Students' voices needed to be bolstered on the Board to ensure that their best interests are prioritized. Students have been calling for improved working and living conditions and for more action to be taken against climate change but have not received a satisfactory response. Ms. Nelson also encouraged the Regents to continue advocating for State and federal funding for campus electrification.

E. Marcos Montes, representative of the Southern California College Access Network, asked that the Board support the Cal Grant Equity Framework in its legislative and budget priorities. There was a college affordability crisis, and this was the right time to reform and invest in the State's financial aid program.

1. APPROVAL OF MINUTES OF PREVIOUS MEETING

Regent Makarechian, referring to the third page of the minutes from November 16, 2021, questioned the accuracy of the statement indicating that about 16 percent of the pension was invested in fixed income and had zero percent returns. Mr. Bachher stated that not all of the 16 percent had zero percent returns and that he could provide the exact data.

Committee Chair Sherman remarked that the statement might have been a generalized comment meant to demonstrate how low interest rates were.

Upon motion duly made and seconded, the minutes of the meeting of November 16, 2021 were approved, Regents Cohen, Drake, Leib, Lott, Makarechian, and Sherman voting "aye."[1]

2. REVIEW OF SECOND QUARTER PERFORMANCE FOR FISCAL YEAR 2021–22 OF UC PENSION, ENDOWMENT, BLUE AND GOLD POOL, AND WORKING CAPITAL

[Background material was provided to Regents in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Chief Investment Officer (CIO) Bachher began his remarks by noting the situation in Ukraine and its impact on the global landscape. As of March 14, the University's total assets under management was $160 billion; UC had $175 billion in assets when equity markets peaked in the first week of January. Total assets were $160 billion in March 2021 and about $120 billion in March 2020. Mr. Bachher explained that these amounts were mark-to-market on a daily basis and not realized numbers. In his view, the current geopolitical shock was unexpected and has created much uncertainty in the markets.

[1] Roll call vote required by the Bagley-Keene Open Meeting Act [Government Code §11123(b)(1)(D)] for all meetings held by teleconference.

Of the $160 billion, about $20 billion was in working capital, about $20 billion in the endowment, and about $120 billion in retirement assets. Seventy-five percent of assets were invested in North America, predominantly in the U.S., and 25 percent was invested in Europe and Asia. About 52 percent of assets were in public equities, a quarter in fixed income, about one percent in cash, and about 22 percent in liquid, private assets. The Short Term Investment Pool (STIP) was 100 percent invested in fixed income, and the Total Return Investment Pool (TRIP) was 50 percent in stocks and 50 percent in bonds. The Blue and Gold Endowment was 80 percent invested in stocks and 20 percent in bonds. The pension was 53 percent invested in stocks, 17 percent in bonds, and 30 percent in private markets. The endowment was 40 percent invested in stocks, eight percent in fixed income, two percent in cash, and 50 percent in private markets.

Mr. Bachher recalled global events that occurred when he joined UC in 2014. India and China had elected new leaders, and oil prices peaked at $100 to $120 per barrel. Brazil and Russia were experiencing financial crises, and Russia had annexed Crimea. The world was in the midst of the Zika pandemic, and the first interest rate increase of the Federal Reserve (Fed) was anticipated as the world was emerging from a global financial crisis. The Chinese stock market had crashed and slowed down. Aspects of history have repeated since then. Since 2014, the U.S. economy has grown from $17 trillion to $24 trillion, and the Standard and Poor’s 500 index (S&P 500) has grown from about 1,800 to 4,200. China’s economy has grown from $10 trillion to $18 trillion in that time, and the Morgan Stanley International (MSCI) China index has gone from 60 to 46. India’s economy has grown from $2 trillion to $3 trillion, and its stock market has grown by nearly 100 percent. In the last eight years, some companies, such as Apple, have become the size of some countries. Mr. Bachher stated that economic growth presented UC’s portfolio with both the greatest opportunity and risk. It was difficult to time one’s investments in the stock market, but the Office of the CIO was a long-term investor. He recalled that Regent Makarechian had noted that the inflation rates being posted were not accounting for housing and energy costs. Mr. Bachher believed that inflation was not transitory, which has been the posture of his office.

Regent Makarechian noted that posted inflation rates did not account for food costs as well. Mr. Bachher added that issues with global food supply and commodities around food were amplified even without the COVID-19 pandemic.

David Schroeder, Director of Global Rates and Trading, stated that, prior to the pandemic, inflation averaged about two percent for 30 years. In the early 1980s, the Consumer Price Index (CPI) peaked at 14 percent, and inflation at that time was more related to energy. Currently, inflation was more broad-based. In February, CPI had a year-over-year increase of 7.9 percent; energy prices rose over 25 percent year-over-year, and food prices rose eight percent. Core CPI, which did not include food and energy, rose about 6.5 percent. Service inflation was over four percent, and goods prices rose over 12 percent. Goods inflation had been roughly zero percent for the three decades before the pandemic, but this changed due to broken supply chains and a change in consumer behavior. Demand has increased for household furnishings, cars, and apparel, and their prices have increased dramatically over the past 12 months. The Fed was expected to announce the first of a series of rate increases with a Fed Funds Rate of around 2.75 percent over several years' time. The Fed was also expected to establish a framework for quantitative tightening to reduce assets. Inflation has been persistent. One-year inflation was estimated at around five percent, two-year inflation at around four percent, and ten-year inflation at around three percent. Market estimates for interest rate changes were below the suggested 2.75 percent. Interest rates were rising along the Treasury yield curve, and the markets expected yields to continue rising in the next couple of years. Mr. Schroeder shared various debt yields, noting that fixed income appeared to be a low-returning asset class. The Office of the CIO reduced the interest rate risk in its fixed income portfolio, moving core portfolio benchmarks to one of shorter duration. Fixed income could act as a "liquidity bucket" and should be underweight in the overall asset allocation because it was not generating the returns needed to meet objectives.

Mr. Bachher asked what Mr. Schroeder would change in STIP. Mr. Schroeder replied that STIP was serving as a high-quality money market portfolio and distributing a yield of around 20 basis points. The Office of the CIO believed that adding longer-maturity paper to the portfolio while maintaining money market funds to meet short-term cash needs would increase the payout to stakeholders. Mr. Bachher stated that requested changes to the STIP guidelines would be presented to Regents at a future meeting. Until then, the Office of the CIO was considering adding two-year Treasury paper.

Committee Chair Sherman asked about the current duration in the fixed income portfolio. Mr. Schroeder responded that the portfolio had a mix of active and passive investments. Working capital's passively managed core portfolio that was indexed against the 1–5 Year Government/Credit Float Adjusted Index, which had a duration of 2.75 years. Similarly, the endowment was also passively managed and indexed against the same index. A portion of the UC Retirement Plan (UCRP) portfolio was actively managed by two external managers, and the high-yield duration was about 3.75 years. The duration for emerging market debt in the UCRP portfolio was over six years.

Committee Chair Sherman asked why, given rising interest rates, the Office of the CIO did not opt for shorter duration to prevent mark-to-market losses. UC could invest in higher rates in the future. Mr. Schroeder replied that the Office of the CIO preferred to hold more cash and be tactically short in the core portfolio where possible, and generate 25 to 30 basis points in alpha against combined benchmarks. Holding less sensitive instruments in the fixed income portfolio could mitigate negative returns. Mr. Bachher explained that this was why the Office of the CIO moved from the Aggregate Bond Index to the 1–5 Year Government/Credit Float Adjusted Index. He agreed that UC should opt for a shorter duration in light of the current environment.

Committee Chair Sherman asked about productivity in light of current inflation. Mr. Schroeder replied that current inflation could be attributed to a severely broken supply chain, a change in consumer behavior, and a shock to energy prices. Productivity has risen but was still low. In Mr. Schroeder's view, globalization provided an inexpensive source of production, and advances in the technology sector have resulted in products of better quality.

Committee Chair Sherman, noting the absence of UC investments in South America and Central America, asked if there were investment opportunities in those regions and whether those opportunities were being avoided. Mr. Bachher responded that the political landscape in Latin America was improving, but it has been a difficult place to invest. The Office of the CIO has chosen not to invest in Latin America, Saudi Arabia and the Middle East, and Africa. Europe's slow growth could be further challenged by current events. Over the last eight years, targeting investments in India and making overweight investments in China were the right decisions for UC. Given how commodities, food, and Europe were faring, Mr. Bachher might consider investing in Latin America.

Regent Makarechian disclosed that he had investments of his own in South America. He noted how much energy and transport costs were contributing to inflation and suggested that UC consider investing in South America, which was in close proximity to the U.S. and offered inexpensive labor. He asked which countries were considered emerging markets. Mr. Bachher replied that Latin America would be regarded as an emerging market, but not China. UC has not invested in some regions because it has been more challenging to understand those markets; a single geopolitical event could dramatically affect investments. UC could seek out more opportunities in commodity-producing countries like Canada and Australia.

Regent Makarechian projected that recent Fed announcements could create a substantial liquidity crisis and present investment opportunities. Mr. Bachher agreed that this level of uncertainty presented much opportunity. For instance, a line of credit that the Office of the CIO recently provided to a major corporation has been weighted as investment-grade debt.

Ronnie Swinkels, Managing Director of Public Equity Investments, stated that, of the $82 billion UC was investing in public equities, about $65 billion was invested passively in the MSCI All World Country Index (ACWI), the S&P 500, and the Russell 3000. The remaining $17 billion was actively managed by fewer than 20 external managers. A correction of last fiscal year's strong performance was occurring this quarter. Since July 1, the MSCI ACWI has declined eight percent, and the S&P 500 has declined one to two percent. As long-term investors, the Office of the CIO tolerated risks and volatility, and regarded equities as attractive investments compared with fixed income. The U.S. economy and stock market were faring well, and the unemployment rate was low. Companies were expected to perform well despite slower earnings expectations, and they had cash and could buy back shares. If equities could decline further, the Office of the CIO would likely add to its equity allocation. However, longer duration and global conflict presented risks.

Mr. Bachher predicted that up to $500 billion would go back into the equity markets at the end of March as large pension funds and endowments try to rebalance. Despite significant volatility and risk, UC was staying invested and paying attention to opportunities.

Satish Ananthaswamy, Senior Portfolio Manager of Asia Investments and Global Rates and Trading, raised concerns that the U.S. could return to the inflation rates complex of the 1970s. He stated that UC needed to be nimble in its investing, given the uncertainty surrounding inflation and energy prices. With decent economic growth projected in the

U.S., Mr. Ananthaswamy did not believe that the U.S. would go into stagflation. The country was experiencing demand-pull inflation; people wished to spend money coming out of the pandemic. The European Central Bank (ECB) planned to raise interest rates, and Christine Lagarde, President of the ECB, predicted that Europe would see low growth in 2022 because of the conflict in Ukraine. Germany planned to spend hundreds of billions of dollars on its defense system.

Regent Makarechian asked if UC should be more active in choosing opportunities instead of taking a "less is more" approach. Mr. Bachher expressed agreement. This was a time to be selective and seek opportunities. One's approach could change as the situation changes. The Office of the CIO could take a "less is more" approach in its diversity, equity and inclusion efforts, as there were many smaller investment opportunities.

Regent Makarechian asked about the pension ratio. Mr. Bachher replied that the pension ratio was in the mid-80 percent on a market value basis. Positive returns in the market were needed in the next 100 days to bring the pension and endowment to zero percent returns.

Advisor Zager asked about the risk of recession and about the bond market. Mr. Schroeder replied that the bond market did not anticipate interest rate increases to be as high as projected. If the market were more bearish in response to Fed action, forward rates would be more substantial. Intermediate-term yields were very low, and five-year real yields were still below zero.

Regent Makarechian suggested an off-cycle meeting to review asset allocation in light of what had been presented. Mr. Bachher proposed a separate conversation about asset allocation after the meeting.

Chancellor Hawgood asked what assumptions, in terms of escalation and interest rates, should be made for capital project scenario planning. Mr. Bachher noted that real estate projects were adding three to five percent cost escalations in light of labor shortages and construction costs. Mr. Ananthaswamy added that rising long-term interest rates were affecting debt service coverage ratios. Mr. Bachher and Mr. Ananthaswamy offered to have a separate discussion about UCSF's capital needs and external debt management.

Mr. Bachher presented a chart of UC's investment allocation by country and discussed where UC could invest more. Regent Makarechian suggested investing closer to the U.S. borders in the next year given uncertainty in Europe and investing less in China. Mr. Bachher stated that, in the last quarter, the Office of the CIO chose to reduce UC's exposure to China.

Mr. Bachher presented the target asset allocation for the pension: 53 percent in stocks, 17 percent in fixed income, and 30 percent in private assets. The Office of the CIO could consider more active management in public equities, and the liquidity in fixed income was available to meet obligations and for new opportunities. The Office of the CIO could increase the allocation to private assets by adding real estate and real assets. Private lending and private equity also presented opportunities.

Committee Chair Sherman noted that numbers could be different with mark-to-market valuations from the private equity position. Mr. Bachher stated that this was to be expected, and that UC's private equity marks might be ten to 20 percent higher due to a lag.

Regent Cohen asked if targets limited the Office of the CIO's ability to pursue opportunities. Mr. Bachher replied that the Office of the CIO has never felt restricted by the asset allocation in the last eight years. His current comments focused on opportunities based on the environment, such as real estate around campuses. He took a conservative approach to private equity for the pension and endowment, because rising interest rates could hurt private equity as well. There was still flexibility within current ranges.

Regent Cohen cautioned against revising long-term asset allocation targets on an ad hoc basis or whenever there was volatility in the markets. Mr. Bachher stated that targets have been revised twice in eight years. The Committee could discuss possible changes during the May meeting and make a decision during the July meeting. In Mr. Bachher's view, the current geopolitical landscape warranted a review of asset allocation.

Regent Hernandez stated that UC could consider investing in Middle Eastern countries such as Qatar, Kuwait, and the United Arab Emirates. Mr. Bachher clarified that UC did have passive exposure in Saudi Arabia and other countries. The Office of the CIO has not actively sought opportunities in the Middle East, where investments would predominantly be in fossil fuels.

3. **RESTRICTIONS ON INDIVIDUAL REGENTS AND ADVISORY MEMBERS SHARING INVESTMENT OPPORTUNITIES WITH UC INVESTMENTS**

[Background material was provided to Regents in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

General Counsel Robinson stated that this presentation pertained to a rule in Regents Policy 6104, Policy on Conflict of Interest Regarding Assets Managed by the Chief Investment Officer, as well as the Investments Committee Charter, that limited the Regents' ability to recommend specific investments to the Office of the Chief Investment Officer. He requested that this item be added to the agenda due to changes to both the policy and to Committee membership. This rule was designed to give the public confidence in the University.

Principal Counsel Mark Morodomi stated that State law and Regents policy regulate how Regents or advisory members may share investment opportunities. The exchange of advice that was prohibited by Regents policy prior to 2018 was now permitted by Regents Policy 6104 and the Committee Charter so long as possible conflicts of interest are reviewed. Regents have the authority to set overall investment policy, and the Office of the CIO implements Regents policy by making specific selections of companies. Regents Policy 6104 prohibits influencing an investment decision through advice or recommendation if the Regent or advisory member has a financial interest in that recommendation. When Regents or advisory members contact the Office of the CIO to recommend investments, investment managers, or investment firms, Regents Policy 6104 requires that this contact be reviewed using a questionnaire and certification form. The definition of "financial interest" per the Political Reform Act included an investment of $2,000 or more in a company. He suggested contacting the Office of the General Counsel (OGC) if one might have a financial interest in an investment opportunity. The Committee Charter prohibits directing or attempting to direct the Office of the CIO regarding specific investment funds or managers, regardless of financial interest. Once a Regent makes a recommendation, the Office of the CIO is free to decide whether and how to proceed. He suggested that Regents and advisory members complete the certification form if they wish to share investment opportunities with the Office of the CIO.

Regent Leib noted that he has been approached by minority investment managers who felt excluded in the past. He asked if he could pass on the names of managers to the Office of the CIO if he did not have a financial relationship with them. Mr. Morodomi replied that this would be decided on a case-by-case basis, and the certification form would help confirm that there is no financial interest. Mr. Robinson suggested consulting with OGC due to the complexity of the rule. President Drake reiterated Mr. Robinson's suggestion, citing a recent time-intensive and expensive investigation into a Regent's recommendation because of how it was perceived by the press and the public. The University did not want to miss valuable information but must make sure that it comes through channels that do not raise questions about conflict.

Regent Makarechian stated that he has never made investment recommendations as a member of this Committee. The Committee has engaged in many candid conversations that were not about specific companies and were not advising and directing. He asked about the role of the Committee if it could not engage in such conversations. Regent Makarechian also expressed concern that the rule language could be construed as limiting a broad range of conversations about investments. He suggested that OGC revise some of the language. Mr. Morodomi clarified that conversations that the Committee had during the previous presentation were within bounds, and it was within the Regents' role to set allocation policy. This particular policy pertained to particular companies, managers, and funds.

Regent Makarechian stated that advisory members were not providing advice and recommendations for their own benefit. In his view, the boundaries of the rule might not be clear. He stated that this rule should be applied to the broader UC community. Mr. Robinson explained that the policy was changed because of the value of information brought by the Committee. The rule was directed toward Regents because the CIO was a Regental office He suggested considering whether one had a financial interest and not providing advice if that was the case. He also cautioned against providing specific directives or naming specific advisors and investments. The purpose of the rule was to avoid circumstances under which UC must undergo a complicated investigation.

Regent Makarechian stated that, while he has never done those things, he did not know what his family members were investing in. Mr. Robinson stated that there was a general rule against influencing University decisions in which one would have a financial interest.

He stated that OGC would review the rule language. UC was trying to strike a balance between allowing appropriate collaboration and avoiding the aforementioned concerns.

Regent Anguiano emphasized Regent Leib's comments about diversifying investments. Regents had access to networks and could introduce women- or minority-owned investment firms to UC. She noted that she did not have a financial interest in these firms. Mr. Bachher cautioned against creating an environment that could potentially exclude smaller, more diverse opportunities and opportunities within the University. Mr. Robinson stated that a possible solution could be requiring that referrals be sent via email or be in writing in case there are questions about what was conveyed and how it was conveyed.

Regent Torres asked when this prohibition ended. Mr. Morodomi replied that it ended one a year after serving as Regent.

Advisor Zager emphasized the need to foster collaboration and co-investment. Committee Chair Sherman stated that the Special Committee on Innovation Transfer and Entrepreneurship could be a feeder for the endowment. UC wished to avoid both conflict of interest and the appearance of conflict of interest. He stressed the importance of consulting with OGC.

Regent Makarechian noted that Regent Cohen was the Chief Financial Officer of the California Public Employees' Retirement System (CalPERS) and asked about potential conflicts. Mr. Robinson replied that this was a fact-specific situation.

Regent Cohen asked what protocols governed the Office of the CIO staff. Mr. Morodomi stated that he provided a training session on conflict of interest and Statement of Economic Interest (Form 700) disclosures to the Office of the CIO staff once or twice a year. Mr. Robinson asked if the training went beyond the provisions in the Political Reform Act. Mr. Morodomi replied that his training included revolving door provisions. Mr. Bachher shared that a culture of compliance was being fostered at the Office of the CIO. The COVID-19 pandemic has been a good test of this; staff were working from home and had to ensure that personal trading did not jeopardize Mr. Bachher's or his leadership team's roles. The Office of the CIO occasionally had access to material nonpublic information and kept internal restricted lists that were not covered by Form 700. Mr. Bachher stated that he would share with Regents the Office of the CIO's internal policy regarding compliance and restricted and material nonpublic information. The policy went beyond Form 700 practices.

Regent Hernandez called for more investment opportunities for women and people of color. Committee Chair Sherman stated that the Office of the CIO has made a concerted effort in this area. He asked that the Committee be provided with an update on the Office of the CIO's diversity, equity, and inclusion efforts at the next meeting. Mr. Bachher stated that there was much that needed to be done. The Office of the CIO was on track to meet its commitment to take 100 meetings in the first six months of 2022 with opportunities from the National Association of Investment Companies, such as from women and diverse managers, by March 31. The Office of the CIO was interested in learning about opportunities that it might have missed in the past. Mr. Bachher suggested that he be contacted about opportunities, adding that the Office of the CIO would decide whether an opportunity was right for the University portfolio. The Office of the CIO was focused on returns, and diversity did drive returns.

The meeting adjourned at 5:15 p.m.

Attest:

Secretary and Chief of Staff