The Regents of the University of California

INVESTMENTS COMMITTEE
September 19, 2023

The Investments Committee met on the above date at the UCLA Luskin Conference Center, Los Angeles campus and by teleconference at 1200 Taraval Street, San Francisco and 106 E. Babcock Street, Bozeman, Montana.

Members present: Regents Anguiano, Ellis, Makarechian, Matosantos, Robinson, and Sherman; Ex officio member Leib, Advisory members Cheung and Zager; Chancellor May; Staff Advisor Mackness

In attendance: Regents Hernandez, Pérez, Raznick, and Tesfai, Regent-designate Beharry, Faculty Representative Steintrager, Staff Advisor Emiru, Secretary and Chief of Staff Lyall, Deputy General Counsel Drumm, Chief Investment Officer Bachher, and Recording Secretary Li

The meeting convened at 2:05 p.m. with Committee Chair Robinson presiding.

Committee Chair Robinson thanked former Committee Chair Sherman for his service and mentorship. Chief Investment Officer Bachher praised Regent Sherman for his steady and calm approach to investing and thanked him for his guidance, mentorship, and support.

1. **APPROVAL OF MINUTES OF PREVIOUS MEETING**

Upon motion duly made and seconded, the minutes of the meeting of May 16, 2023 were approved, Regents Anguiano, Ellis, Makarechian, Robinson, and Sherman voting "aye."[1]

2. **PUBLIC COMMENT**

Committee Chair Robinson 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. Asiya Junisbai, UCLA student and representative of the UC Divest coalition, called for UC investment in students and workers rather than in defense companies in partnership with Blackrock. Students were struggling to meet basic needs, and one in 20 UC students was unhoused. Ms. Junisbai noted that, for some students, UC was their school, landlord, and employer, and UC investments dictated their quality of life and should be made with accountability. She stated that members of American Federation of State, County and Municipal Employees (AFSCME) and United Auto Workers (UAW) as well as student workers needed a living wage and

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

benefits, and that Blackrock was using profit generated by students and workers to fund war crimes and oppression.

B. Angelica Interiano, UCLA student and representative of the UC Divest coalition, called on the Regents to divest from companies such as Blackstone and Blackrock. Ms. Interiano stated that the University participated in the creation of the atomic bomb and has continued to contribute to war and policing through asset manager Blackrock, which invested in companies like Lockheed Martin, Elbit Systems, and General Dynamics. Students and workers sought to create a future free of worker exploitation, poverty, policing, and housing and food insecurity.

C. Derek DeMarco, UC Santa Cruz staff member and Council of UC Staff Assemblies (CUCSA) delegate, stated that policy-covered staff received no salary increase in 2021, and inflation outpaced salary increases in 2022 and 2023. As a result, these staff have had to make difficult decisions and defer large costs, and increasing staff contributions to the pension would further erode staff's purchasing power. Mr. DeMarco stated that compensation has been the largest driver of all-time high staff turnover. CUCSA strongly encouraged UC to leave retirement contributions unchanged.

D. Kaitlyn LeGros, UC Santa Barbara staff member and CUCSA delegate, reiterated comments made by Mr. DeMarco.

E. Maritza Fuljencio, UCSB staff member, shared that the last two annual pay increases for policy-covered staff were below five percent while inflation exceeded six percent. Policy-covered staff's purchasing power has continued to decline given the rising cost of rent, utilities, health insurance, and more. Ms. Fuljencio shared that, according to recent data, one needed an $80,000 annual salary to afford to rent a one-bedroom apartment. At some campuses, staff were commuting from as far as 50 miles away. Struggling to make ends meet exacerbates burnout and retention issues, and staff who remain are asked to do more for less pay. CUCSA suggested a seven percent increase for all policy-covered staff.

F. Joseph Liesner disputed aspects of the welcome message from Chancellor Christ and Berkeley Mayor Jesse Arreguín in *The Daily Californian*, claiming that it prevented students from understanding the California Environmental Quality Act (CEQA) litigation related to UC Berkeley's planned construction at People's Park. Mr. Liesner stated that the appeals court found the Environmental Impact Report inadequate and stayed the project. He questioned why the campus picked a site that would involve long legal delays and activist protests. He stated that UCB violated the National Historic Preservation Act, thereby jeopardizing federal funding, by cutting down trees in People's Park. He also stated that the campus has not issued a request for qualifications (RFQ) to find a new developer, and that the Hearst family desecrated indigenous graves and stole sacred objects.

G. Dylan Kupsh, UCLA graduate student and member of UAW Local 2865, expressed strong solidarity with UNITE HERE Local 11 advocating a strong, dignified labor contract. Hotel workers alleged that management were not doing enough to protect workers from being assaulted by guests during the strike. Mr. Kupsh stated that, although Chief Investment Officer Bachher denied this in a statement in September, the head of security at this particular hotel had told a guest that the latter could act as he pleased. He stated that, the next day, a guest assaulted a hotel worker and that the hotel has done nothing in response. Mr. Kupsh noted that UC was investing in this hotel and called for workers to be respected.

H. Kathryn Lybarger, President of AFSCME 3299, stated that ten percent of UCB service workers could afford to live near campus and nearly 70 percent of AFSCME members could not afford a one-bedroom apartment near their workplace. Ms. Lybarger noted that many campuses had budget surpluses due to the high number of unfilled positions and that last year UC issued 104 low-interest home loans, a total of $94 million, to executives and faculty. Ms. Lybarger demanded that UC pay $25 per hour to workers, stop investing in the speculative real estate industry and companies like Blackstone, stop subsidizing executive housing and instead invest in student and worker housing, and to settle the labor contract between UNITE HERE Local 11 and Laguna Cliffs Marriott Resort and Spa.

I. David Yamada, UCLA nurse, urged the Regents to use their authority and influence to quickly resolve the labor dispute between Laguna Cliffs Marriott Resort and Spa and UNITE HERE Local 11. Mr. Yamada stated that the Regents had a moral and fiduciary responsibility to guarantee that a hotel owned by the UC pension fosters a fair and inclusive workplace, negotiates in good faith with workers, and has zero tolerance for union busting, racially dividing workers, and harassment and intimidation. He cautioned that the dispute could damage the value and reputation of the hotel and UC investments.

J. Ruth Zolayvar, UCSD Health staff member and member of AFSCME 3299, stated that thousands of UC workers were dedicated to the institution and wished to hold UC accountable so that they could be proud of where they work. Ms. Zolayvar ran for a position in the UC Retirement System Advisory Board because she cared about the health of the pension and workers' ability to retire with dignity. She asked UC to end the labor conflict at Laguna Cliffs Marriott Resort and Spa, condemning the treatment of striking workers, violence against workers, and racial divisions.

K. Stella Linardi, UCLA law student, criticized Laguna Cliffs Marriott Resort and Spa for hiring Black temporary workers to break a strike while few Black workers were among its permanent staff. Quoting Regents Policy 4400, Policy on University of California Diversity Statement, Ms. Linardi stated that UC must act in a way that is consistent with its values. Nearly 200 students, faculty, workers, and alumni have signed a letter supporting these hotel workers. She called on UC to negotiate a fair contract and hire Black temporary workers as permanent, unionized staff.

L. Parker Shea, representative of UNITE HERE Local 11, stated that the union has pushed Aimbridge Hospitality, which brought in temporary Black workers to break a strike at Laguna Cliffs Marriott Resort and Spa, to hire those workers as full-time, unionized staff. The union has also named Pastor William Smart as its diversity ombudsperson. Mr. Shea noted that elected leaders have contacted UC and spoken at Regents meetings, there has been high-profile media coverage of the labor dispute, and the union has filed an unlawful labor practice charge with the National Labor Relations Board.

M. Jose Preciado, staff member at the Laguna Cliffs Marriott Resort and Spa and member of UNITE HERE Local 11, addressed the Committee in Spanish and explained why UNITE HERE Local 11 voted to strike. Some staff have worked in hotels for decades and were only making $22 per hour, while the cost of living in Orange County was increasing quickly. Workers could not afford to live where they work and did not have time for their families due to hours-long commutes. Mr. Preciado shared that he was getting older and would like to retire, but it seemed impossible. The hotel was bringing in unskilled workers to replace those on strike, and the kitchen chief was insulting workers. Staff worked to make Laguna Cliffs Marriott Resort and Spa a world-class hotel. Mr. Preciado asked UC to direct Aimbridge Hospitality to draft a good contract so that the University does not experience further damage.

Regent Pérez stated that Mr. Preciado was asking for a contract with livable wages and that this was not reflected in the translation.

N. Peter Racioppo, UCLA graduate student and member of UAW Local 2865, spoke in opposition to union-busting at the University. He stated that student conduct charges and arrests were attempts to intimidate and harass, and that Chancellor Khosla should resign for the use of police force against student workers. He added that UC was evading the payment of agreed-upon UAW salaries by deferring payment to departments, cutting teaching assistant and research appointments, and increasing class sizes and workloads while investing billions of dollars in Blackstone. He expressed solidarity with workers from UNITE HERE Local 11, AFSCME, and Service Employees International Union (SEIU). Mr. Racioppo remarked that UC was run more like a corporation than a public institution, which was reflected by the makeup of the Board.

O. Chris Zepeda-Millan, UCLA professor, spoke in solidarity with hotel workers who were asking the Regents to honor the University's stated commitment to equity, diversity, and inclusion. He stated that the treatment of these workers posed a serious risk to UC investments, and that the general public have observed the labor dispute and mistreatment of workers at Laguna Cliffs Marriott Resort and Spa. Mr. Zepeda-Millan stated that UC leadership had the power to right these wrongs, and that UC pensioners were benefitting from workers who received low wages and few benefits. He asked UC to settle the contract disputes.

P. Jeanne Roe Smith, Chaplain and Executive Director of 580 Cafe, remarked that God required a fair, living wage, an adequate pension, health care, affordable housing, and human dignity for all workers. She stated that the Bible demonstrated God's desire for humanity to live in an economy of abundance, in which neighbors love and care for each other and no one lives in scarcity. When workers are treated fairly, they could develop their talents, plan their lives, express their faith, and create community; society must prioritize access to living-wage employment. The UC pension benefitted UC retirees, but the workers at Laguna Cliffs Marriott Resort and Spa did not have a pension. Ms. Roe Smith asked that these workers be afforded the same treatment and compensation as UC pension fund participants.

Q. Greta Carl-Halle, UC Santa Barbara staff member and CUCSA delegate, stated that, with no salary increase in 2021 and inflation outpacing salary increases in 2022 and 2023, policy-covered staff were struggling to afford expenses. Ms. Carl-Halle shared that she spent 70 percent of her take-home pay on rent. Increasing staff contributions to the pension would further erode take-home pay and likely lead to a loss of longtime staff and institutional knowledge, which would affect the ability to support faculty and students. She stated that compensation has been the largest driver of all-time high staff turnover. CUCSA strongly encouraged the Regents to leave retirement contributions unchanged.

3. REVIEW OF FISCAL YEAR 2022–23 PERFORMANCE FOR UC RETIREMENT, ENDOWMENT, AND WORKING CAPITAL ASSETS

[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 provided an overview of the performance of UC investments during the 2022–23 fiscal year. As of June 30, 2023, assets under management totaled $164 billion, an increase of $12 billion since the last fiscal year and a growth of 73 percent from 2014. There was $88.3 billion in the pension and $33.7 billion in the UC Retirement Savings Plan (UCRSP). There was $23.4 billion in the endowment, with $20.7 billion in the General Endowment Pool (GEP) and $2.7 billion in the Blue and Gold Pool. There was $18.7 billion in working capital, with $5.2 billion in the Short Term Investment Pool (STIP) and $13.5 billion in the Total Return Investment Pool (TRIP). Fiscal year to date, the pension returned 10.1 percent, the endowment returned 8.8. percent, the GEP returned 8.2 percent, the Blue and Gold Pool returned 13.3 percent, TRIP returned 8.6 percent, and STIP returned 3.9 percent. Mr. Bachher presented a chart comparing returns over a 30-year period. The GEP's annualized return was 8.8 percent, the pension's annualized return was eight percent, and STIP's annualized return was 3.6 percent. The ten-year annualized return for TRIP, established in 2008, was 5.3 percent. Mr. Bachher presented a chart of asset growth from 1993 to 2023. Assets grew by $80 billion from 2013 to 2023, compared with $30 billion from 1993 to 2003 and 2003 to 2013, which Mr. Bachher attributed to asset allocation. In FY 2022–23, global equities increased 16 percent, and 50 percent of assets were invested in equities. Stock market growth in the last two to three months reflected a rising interest in artificial intelligence (AI). Currently, ten companies made up 34 percent of the Standard and Poor's (S&P) 500 and had an average price-to-earnings ratio of 50. In Mr. Bachher's view, the U.S. remained a relatively good source of investment. He observed an economic divergence between the U.S. and the rest of the world following the COVID-19 pandemic. Also in the last fiscal year, real estate investments declined by ten percent, while information technology and energy were the strongest sectors.

Senior Managing Director Satish Ananthaswamy remarked that the Federal Reserve (Fed) increasing interest rates from zero to nearly 5.5 percent has not led to a recession, and the Fed could further increase rates in response to inflation, which was declining but not at target levels. While the economy was slowing down, macroeconomic dynamics were different from what they had been when the Fed raised rates some 50 years ago. The U.S. economy has been able to withstand increasing deglobalization and rising incomes because of a 3.5 percent mortgage interest rate, which placed consumers in a better position than before. The housing market continued to perform well due to very low supply and corporations locking in a lower funding rate when interest rates decreased. Jobs have been added primarily in the education and healthcare sectors but were of lower quality. The UC fixed income portfolio could withstand higher interest rates because of reduced price sensitivity in shorter maturity bonds. These bonds also enabled UC to monetize cash flows that were maturing into higher-yielding and higher-return investments. Mr. Ananthaswamy predicted that the yield curve would remain high, and that the Fed was not likely to lower interest rates in the next nine months to one year. Mr. Bachher contrasted current returns in fixed income with zero percent returns of previous years.

Mr. Bachher presented charts comparing asset allocations in 2014, 2022, and 2023. The Office of the CIO grew investment assets by increasing the public equity allocation from 34 percent to 52 percent. The Office of the CIO also reduced the fixed income allocation to 22 percent from 49 percent, increased the allocation to private equity from four to nine percent, and maintained a cash position. Mr. Bachher presented a table of asset allocation based on FY 2022–23 market value. The Office of the CIO was investing its cash in STIP. In 2023, the Office of the CIO had 33 key partnerships, with which UC has invested at least $500 million in assets. The Office of the CIO has grown $30 billion in passive investments to $117 billion and reduced $65 billion in active investments to $47 billion. The Office of the CIO charged two basis points in management fees, compared with 30 basis points in the industry, and has saved UC $3 billion in fees since 2014.

Over the last three years, the Office of the CIO sold 45 real estate assets for a total of $4 billion and invested $4.5 billion in Blackstone Real Estate Income Trust (BREIT) for an annualized return rate of 11.25 percent over seven years. Previously, UC's annualized return rate for real estate was six percent. Currently, 74 percent of UC assets were invested in North America and 12 percent in Europe. With regard to risk in the near term, the Office of the CIO was concerned about U.S. politics, the relationship between the U.S. and China, the conflict between Russia and Ukraine, the likelihood of recession, inflation, interest rates, AI, climate change, demographics and aging, and deglobalization. Countries were no longer cooperating as they had done in response to the 2008 financial crisis. The growth of the endowment was the result of a greater allocation to private equity and $10 billion in campus deposits. Mr. Bachher predicted that the Blue and Gold Pool, 80 percent of which was allocated to stocks and 20 percent to bonds, would outperform the GEP and be a better solution for the campuses, and there was a plan to move $4 billion from TRIP and STIP to the Blue and Gold Pool. The pension supported about 260,000 members, half of whom were active, and had a net cash outflow of $1 billion annually for the last decade. Contributions and investment returns were the only means to make up for outflows. The pension was 83 percent funded, but returns were not guaranteed. In the last ten years, the largest shift in asset allocation in the pension was from 22 percent to 14 percent in bonds.

Managing Director Marco Merz reported that the UC Retirement Savings Program (UCRSP) grew by over $4 billion in the last fiscal year, driven chiefly by equity market returns. Nearly 40 percent of UCRSP assets were in the UC Pathways Fund, a target date fund with a diversified asset allocation that allows risk reduction over time, and UCRSP was almost 80 percent passively invested. In 2014, the default UC Savings fund, which returned a little over one percent, was changed to Pathways, which averaged six percent returns. Assets in the target date fund have grown from $3 billion to over $14 billion in the last nine years. There were 14 investment choices, and the management fee was five basis points, which made the Office of the CIO about 50 percent more cost-efficient. In the future, the Office of the CIO planned to launch a short-duration bond portfolio for UCRSP participants that would be similar to that of the pension, and certificates of deposit (CDs) that were insured by the Federal Deposit Insurance Corporation (FDIC) would also be available. The Blue and Gold Pool would be offered to participants who were close to retirement as a draw-down vehicle. Mr. Bachher noted that half of the participants were under 40 years of age.

Managing Director David Schroeder noted that payroll and benefits flowed through STIP, which he described as a short-term money market fund with an average maturity of two to three months. About 60 percent of STIP was invested in commercial paper, 28 percent in U.S. government securities, 11 percent in CDs, and the rest in money market funds, with a running yield of over five percent. Mr. Schroeder projected that STIP would continue to produce income for campuses for the foreseeable future.

Regent Makarechian, referring to the written materials, asked why there were more UCRSP participants than pension participants and what their contributions would generate for their retirement. Mr. Merz replied that about 45,000 to 50,000 seasonal workers participated in UCRSP but were not eligible for the pension, and some UCRSP participants had worked at UC for less than five years and were also not eligible for the pension. The average 403(b) plan account balance had about $100,000 per participant. Under Savings Choice, the participant is required to save seven percent, and UC matches at eight percent for a total of 15 percent. Half of participants were voluntarily saving an extra ten percent. Mr. Merz remarked that UC had a healthy savings rate, and even participants who were not eligible for the pension were saving at a sufficient rate to ensure a dignified retirement.

Regent Makarechian asked whether UCRSP was returning the same as the pension. Mr. Merz responded that UCRSP, which did not include investment in private assets, was expected to return about 6.25 percent over a full cycle compared with 6.75 percent of the pension. Regent Makarechian asked about UCRSP returns the prior year. Mr. Merz replied that returns ranged from four to nine percent, which were close to pension returns. Mr. Bachher added that the returns depended on when the participant was set to retire, and higher returns meant more fixed income in the portfolio. He did not believe that the lack of private assets has necessarily been a detriment to UCRSP. Mr. Bachher noted the pension contribution holiday and emphasized the need for savings.

Regent Makarechian asked what the 83 percent funded ratio was based on. Mr. Bachher replied that the funded ratio was based on market and actuarial value. Regent Makarechian asked if the actuarial valuation was due in November. Mr. Bachher replied in the affirmative.

Regent Makarechian asked what caused the decrease in working capital. Mr. Bachher replied that money from working capital was transferred to the Blue and Gold Pool over the last year and a half, and working capital was used to pay down commercial paper.

Regent Makarechian noted that working capital dropped from $20.8 billion to $18.7 billion. Mr. Ananthaswamy replied that this reflected the transfer of money to the Blue and Gold Pool. Mr. Bachher added that this decline was also the result of paying down debt. UC payroll totaled $1.2 billion per month.

Regent Makarechian remarked that it would be difficult for employees to increase their contribution to the pension when inflation is so high, likening it to a salary reduction, and suggested raising salaries as a possible solution. In his view, UC was ultimately penalizing future employees, who would contribute more due to current insufficient contribution. The University must bring balance to outflows and not wait for market returns. Mr. Bachher explained that the Office of the CIO had relaxed employee contributions when the actuarial and market value of the funded ratio was over 100 percent, which led to the outcomes that were being addressed. In 2011, the pension had a net cash outflow of $1.3 billion, which could be roughly the amount that UC investment assets decrease if markets are flat. Mr. Bachher stressed that UC must first make up for the assets it was paying out and then earn returns. The UC pension did not receive the same level of State contribution as other State agencies, having received about $500 million in the last decade. Investment returns were unpredictable, and steps were being taken to grow employee contributions.

Committee Chair Robinson asked whether the Office of the CIO projected the funded ratio into the future based on certain variables. Mr. Bachher responded in the affirmative. The Office of the CIO considered the probability of achieving or maintaining a 100 percent funded ratio or at least the current funding ratio. Currently, the pension would need to earn 7.5 percent returns to maintain a funded ratio of 83 percent.

Regent Makarechian asked that the next discussion about actuarial value include more detail about the retirement benefits UC was paying and the future makeup of contributing participants. He recalled that, several years ago, UC had been paying a large amount in retirement benefits despite a smaller number of participants making a larger contribution.

Mr. Bachher noted that, in the last decade, the University borrowed about $5.2 billion from STIP to place into the pension. In the last fiscal year, UC borrowed another $500 million.

Regent Anguiano asked how passive and active management were distributed among the 33 partnerships. Mr. Bachher responded that the University's primary passive managers were State Street and Blackrock.

Regent Anguiano asked what portion of the $80 billion in asset growth in the last decade was additional inflows and what portion was outperformance. Mr. Bachher replied that $3.5 billion of the growth was value added. The rest were equity returns from asset allocation. The dot-com crash occurred during the period 1993 to 2003, the global financial crisis occurred in the following decade, 2003 to 2013, and the COVID-19 pandemic occurred in the decade after that, 2013 to 2023. Mr. Bachher regarded these as existential events in each decade. However, in the last decade, UC changed its asset allocation and increased the allocation equities.

Regent Anguiano asked if inflows remained the same during that time. Mr. Bachher replied in the affirmative. He offered to provide Regents with net cash inflow data, noting that the pension experienced a net cash outflow. The endowment did not receive inflows, as donors gave locally and not to the GEP, and the payout has been about $3 billion over the last ten years. Inflows came from tuition, housing, the medical centers, and what was going to working capital. The Office of the CIO sometimes borrowed from these inflows.

Regent Sherman stated his understanding that there was no difference between the funded ratio based on actuarial value and the funded ratio based on market value. Mr. Bachher replied that this was correct. In response to a comment made by Regent Sherman, Mr. Bachher clarified that the actuarial assumption for earnings was 6.75 percent.

Regent Sherman noted that the pension has returned eight percent over the last 30 years as did the S&P 500. He asked about the likelihood of achieving eight percent returns or in excess of actuarial assumptions in the next 30 years. Mr. Bachher replied that there was a 50 percent probability of obtaining an equity risk premium versus the bond market in the short term while investing in a mix of stocks and bonds if one could reduce risks and the economy was relatively soft. This would also depend on global performance, as 25 percent of UC assets were invested outside of the U.S.

Regent Sherman asked if this assumed that rates would remain stable in order to achieve positive equity returns. Mr. Ananthaswamy responded in the affirmative. Wages would likely remain elevated, but the employment market was undergoing a shift as those who left the work force might want to return. In response to Regent Sherman's previous question, Mr. Ananthaswamy stated that higher returns in fixed income were taking pressure off the equity and private assets portfolios because risk premiums in these areas would continue. He predicted that eight percent returns were possible in the next five to ten years if there is an inflection point in interest rates.

Regent Sherman asked why the entire GEP has not been transferred into the Blue and Gold Pool. Mr. Bachher replied that he was open to the idea and noted that this would be a long-term investment with fluctuations in earnings. Regent Sherman suggested that this could be a discussion for another Committee meeting. Mr. Bachher stated that the Blue and Gold Pool served a variety of needs during a market crash. During the pandemic, many colleges and universities were unable to meet their operating expenses and shut down.

Regent Sherman noted that post-retirement health benefits, which were unfunded, exceeded the underfunded aspect of the pension.

Committee Chair Robinson asked about the quality of the marks in the private equity portfolio, market conditions, and the Office of the CIO's private equity investment strategy. Matt Webster, Director of Private Equity, responded that, in the last 12 months, the private equity portfolio generated double-digit growth on revenue and earnings before interest, taxes, depreciation, and amortization (EBITDA) bases, and valuation multiples were in the high teens. Returns have been flat or muted over the last two years as valuation multiples were pulled in. Valuation methods used by the Office of the CIO included public comparables and discounted cash flow analysis. If interest rates continue to increase, valuations could continue to contract. The private equity market was slowing down, and the Office of the CIO opted to focus on its existing portfolio. Mr. Bachher added that there was $1 trillion in dry powder amongst equity firms, and fundraising has created opportunities for these firms to trade and mark up assets artificially. However, the high demand for private assets from institutional investors could change in this interest rate environment and given other ways to earn returns.

Committee Chair Robinson asked about the Office of the CIO's approach to return on capital. Mr. Webster replied that the Office of the CIO's underwriting expectations for deals done in 2021 were lower than they would be today, and the duration of the portfolio has extended by about two years. There were indications that the initial public offering (IPO) market was thawing. Mr. Webster shared the private equity returns in the endowment and the pension over the last 30 to ten years. Mr. Bachher remarked that the premium from private equity relative to public equity returns is one reason why the Office of the CIO is not 100 percent passively invested. Mr. Ananthaswamy countered that private markets would struggle to generate returns outside of leveraging due to the end of the low interest rate environment. Central banks were deleveraging their balance sheets, there was less worldwide demand for U.S. Treasury bonds, and the U.S. Treasury must issue a large amount of debt to fund the deficit. Mr. Ananthaswamy observed these as signs of increasing interest rates.

Mr. Bachher noted the debt level of the private equity portfolio relative to the market as a potential risk. Mr. Webster stated that the portfolio was leveraged about five times since it was acquired, and the debt packages had durations of five to seven years. Deal flow has declined because partners have not been able to secure new financing, and the cost of debt has risen. Mr. Bachher foresaw risks associated with real estate debt.

Mr. Bachher noted that private credit offered attractive opportunities. Senior Managing Director Edmond Fong explained that, given current base rates and the retrenchment of banks, there was an increase in spread and greater units of return per unit of leverage. The private credit portfolio was 50 percent loan-to-value (LTV), with 75 percent first lien senior secured debt and 90 percent floating rate debt. This portfolio included corporate debt and collateralized loans from residential real estate and other assets at a low LTV. Many partners secured interest rate floors to in the event that rates drop. The portfolio remained diversified due to confidence in the consumer and should be able to withstand home price depreciation. Mr. Bachher underscored the importance of the quality of an asset and regarded UC's investment in the Blackstone deal as unconventional. He saw investment opportunities in energy transition and distressed real estate.

Advisor Zager, noting current inflation rates and the price of the U.S. Ten-Year Treasury bond, asked whether the Office of the CIO should add duration to its portfolio. Mr. Ananthaswamy shared his belief that interest rates were set to increase more due to massive supply and low demand. China was not as big a buyer, and the U.S. was expected to sell many bonds. Mr. Bachher opined that it was difficult to find the right time to change duration. Mr. Ananthaswamy noted that there was opportunity to monetize in an inverted yield curve without changing duration yet. He would change duration when economic conditions slow down and there is a steeper yield curve.

Mr. Schroeder opined that there was no yield advantage for extending duration, and that trading duration was risky. He did not believe that a decline of 12 basis points in intermediate Treasury yields priced into market was an indication of a further drop in interest rates. Mr. Schroeder would wait for valuations to be more inexpensive before adding duration, and he would wait for the market to be in a short position before adding duration. Sentiment should indicate a short position as well before one buys rates. In Mr. Schroeder's view, now was not the right time to add duration. He added that the Core Consumer Price Index (CPI) has come down due to disinflation in pandemic-sensitive categories. Markets were also indicating that inflation was coming down. Mr. Schroeder projected that inflation would remain around three percent for some time.

The meeting adjourned at 4:45 p.m.

Attest:

Secretary and Chief of Staff