The Regents of the University of California

INVESTMENTS COMMITTEE
November 12, 2024

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

Members present:	Regents Anguiano, Cohen, Lee, Leib, Makarechian, Matosantos, Robinson, and Sherman; Ex officio member Drake; Advisory members Palazoglu and Wang; Chancellors Hawgood, Khosla, Lyons, Muñoz, and Wilcox; Staff Advisor Emiru
In attendance:	Regents Beharry and Sures, Regents-designate Brooks and Komoto, Staff Advisor Frías, Secretary and Chief of Staff Lyall, Principal Counsel Katz, Chief Investment Officer Bachher, Interim Chancellor Hunt, and Recording Secretary Li

The meeting convened at 4:00 p.m. with Committee Chair Robinson presiding.

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

Upon motion duly made and seconded, the minutes of the meetings of May 14, July 17, and September 19, 2024 were approved, Regents Anguiano, Drake, Makarechian, Robinson and Sherman voting "aye."[1]

2. **REVIEW OF FIRST QUARTER 2024–25 FISCAL YEAR 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 Bachher began his remarks by sharing the passing of Mark MacDonald, Operations Analyst at the Office of the Chief Investment Officer (OCIO), on November 7. Committee Chair Robinson extended the Board's condolences to the OCIO team and Mr. MacDonald's family.

Mr. Bachher stated that, as of July 1, 2024, the University had $180 billion in total assets under management. Since then, the global equity markets have risen 8.7 percent, driving total assets to $188 billion as of the prior day, 62 percent of which was invested in equities. Working capital was roughly flat, and the endowment stood at $30 billion. Out of total retirement assets, the pension grew to nearly $104 billion, and the UC Retirement Savings Program stood at $42 billion.

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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.

Mr. Bachher shared the following returns: eight percent for Blue and Gold Pool, 5.9 percent for the Total Return Investment Pool (TRIP), five percent for the General Endowment Pool (GEP), 5.9 percent for the pension, and 1.9 percent for the Short Term Investment Pool (STIP). While stocks had a return of 8.6 percent, bonds had a return of 2.4 percent. Mr. Bachher predicted that returns on fixed income have peaked and would start to decline. UC's current asset allocation was 62 percent in stocks, 18.4 percent in fixed income, 18.5 percent in private assets, and 1.1 percent in cash. He acknowledged the short-term impact of the U.S. presidential election on the markets. Having noticed a need for liquidity in the marketplace as early as December 2022, he predicted that liquidity could advance future investment opportunities. Stocks were currently earning a return of 8.7 percent instead of the expected six to seven percent. In Mr. Bachher's view, the U.S. economy was strong and resilient, and he reiterated his long-held view that the U.S. was a good place to invest and find opportunities. He believed that keeping a growth mindset would still be a valuable approach in the next decade.

Regent Sherman, noting that the private equity returns lagged those of other assets, asked about the perspectives of UC's private equity partners. Mr. Bachher shared his view that public equity would outperform private assets for the balance of the year; there was creative dealmaking in private equity that was motivated by the earning of fees. If interest rates stay high, small- and mid-cap companies in the U.S. might see some revenue growth if they access debt, but they would not see the double-digit growth of the past. The upticks in private equity might reflect what was occurring in the public markets. Many pension funds and endowments in the U.S. were reaching the upper limit in their allocation and had to sell private equity portfolios in the secondary market in order to add liquidity. Some universities have had to raise debt in the public markets to manage the illiquidity in their private equity portfolios. Mr. Bachher has intentionally kept investments in private assets about seven percent below the asset allocation. There was a disjunction between private equity returns and the behavior of the benchmark; this was something UC might have to endure for the coming years due to the environment in which assets were operating.

Regent Sherman asked if UC's largest private asset investment was in Blackstone Real Estate Income Trust (BREIT). Mr. Bachher responded in the affirmative. Regent Sherman asked about the performance of this investment. Mr. Bachher replied that BREIT's actual rate of return was less than the contractual 11.25 percent. The BREIT portfolio included data centers, which could perform well due to the rise of artificial intelligence. Real estate made up two-thirds of the BREIT portfolio, but rental growth has declined since the COVID-19 pandemic. Mr. Bachher remained optimistic but monitored the collateral. Blackstone was liquidating assets to make room for new opportunities. Other real estate income trusts were less attractive due to liquidity challenges in the real estate market.

Committee Chair Robinson, remarking that the strong performance of public equities was suppressing UC's investment in private equity, asked how public equities affected how OCIO considered private sector opportunities. He noted that Berkshire Hathaway was reducing its public equity portfolio. Mr. Bachher stated that the OCIO's private asset target was difficult to reach, and he had been playing catch up for the last decade. Irrespective of public asset growth, UC was intentionally underweight in private assets. UC had different obligations from those of Warren Buffett, Chief Executive Officer of Berkshire Hathaway, who did not believe in private equity and only bought public assets or whole companies. Mr. Bachher did not wish to sell public equities and hold cash for opportunities, because UC should remain invested in the long term. In addition, Berkshire Hathaway only owned five stocks while UC invested in the index. Due to short duration fixed income investments, UC had the equivalent of about $34 billion in cash, which Mr. Bachher believed was more than enough liquidity. He did not see many urgent private market opportunities. Managing Director Matt Webster expressed agreement. The University did not lack deal flow, or the rate at which it is presented with investment opportunities. Sponsors were testing the traditional process in the secondary market, and companies were hesitant to go public. There were opportunities, but not great ones. Mr. Bachher emphasized the difficulty of refusing offers, which could affect relationships. He reminded his team that activity could be harmful if timed poorly. The BREIT investment was an example of the fruits of OCIO’s patience.

Committee Chair Robinson remarked that, in the past fiscal year, the one-year and ten-year return of the endowment exceeded that of other private endowments, even those from top institutions. Mr. Bachher underscored the role of humility and luck when investing and attributed successes to asset allocations approved by the Regents and a “less is more” philosophy. In his view, maintaining simplicity would be effective for the next ten years.

Regent Beharry noted that funds were shifted from working capital to the Blue and Gold Pool. He asked for assurances that UC had sufficient liquid assets that could be used to cover operational costs resulting from a reduced State budget allocation or emergencies, and that long-term investment of the Blue and Gold Pool would not be compromised. Mr. Bachher stated that working capital was not invested to outperform the equity markets. He credited the Office of the Chief Financial Officer for optimizing working capital in partnership with the ten campuses. The Blue and Gold Pool was an additional tool for optimizing performance where possible. Mr. Bachher stated that one should have confidence that OCIO monitored working capital closely and frequently. In his view, the best stress tests of the working capital have been the financial crisis and the COVID-19 pandemic.

Regent Beharry asked if OCIO had strategies for mitigating potential risks resulting from the proposed economic policies of the incoming U.S. presidential administration and how these risks might affect the portfolio. Mr. Bachher noted that Scott Bessent, who was rumored to become the next U.S. Secretary of the Treasury, was once a financial manager of UC assets. Mr. Bachher opined that it was too soon to tell; the new administration had not yet been put in place. Although he was optimistic, he acknowledged that tariffs could increase inflation, and that the national deficit could increase if inflation stays high and interest rates do not come down. He expressed hope that the new administration could ease geopolitical tensions with decisiveness and observed that the economy was one of the top issues of the election. Mr. Bachher believed that inequality was the global risk that must be addressed. The election results in India, for instance, signaled people’s desire for jobs and a reduction in inflation and inequality. Still, the U.S. economy was doing better than the economies of other countries.

Regent Makarechian asked how OCIO viewed global political, technological, and financial changes in order to take advantage of extensive growth rather than rely on legacy investments. He recalled that, many years ago, the University invested in Google and saw huge returns, and he noted the current growth of companies such as Bitcoin and MicroStrategy. Mr. Bachher predicted that the U.S. would engage in more oil drilling and that fossil fuel prices would go down, which could delay climate action and energy transition. One might also see an infrastructure boom, as deregulation might facilitate construction. Energy has underperformed but might need to be assessed in the future. Mr. Bachher also observed a growth in retail investors seeking more yield and predicted a consolidation amongst asset managers, which would affect how UC deploys money. Wall Street firms wanted to access the money in defined contribution plans. The OCIO public equities team has begun exploring utilities, as insufficient infrastructure to meet the demand for energy presented a growth opportunity. Deregulation might also lead to mergers and acquisitions, which could also create opportunities. In Mr. Bachher's view, apartments and rentals were not an attractive investment opportunity yet. He invited members of his team to share their observations.

Senior Managing Director Steven Sterman shared his projections. "America first" policies might make overseas business and investment difficult and would lead to onshoring and nearshoring; the construction of plants, factories, and infrastructure; and the demand to fill resultant jobs. New immigration policies might compel companies to achieve more with fewer people, which would present opportunities in technology, robotics in particular. Lower corporate taxes could mean profits and opportunities for shareholders, which could benefit equities. Government spending, tax reduction, and deficit might translate to higher interest rates and inflation, so companies would have to determine how to address inflation and import prices, possibly using technology.

Senior Managing Director Satish Ananthaswamy stated that interest rate cuts by the Federal Reserve (Fed), the markets pricing in a further cut, and the election have led to higher long-term interest rates: the two-year rate rose 80 basis points, the ten-year rate rose 80 basis points, and the 30-year rate rose 60 basis points. Rate cuts were not helping the housing market; mortgage rates were now higher than before the Fed cut interest rates. The insurance industry was making a comeback, given the large amount of annuity underwriting, and there was a demand for higher-yield fixed income assets. Markets have adjusted and repriced based on Fed action and the economy, with a gross domestic product growth rate of 2.8 percent, but OCIO did not anticipate inflation dropping to the Fed's target of two percent in the near future. The markets were pricing in a federal funds rate of close to four percent, two percent away from Fed's mandate. Mr. Ananthaswamy anticipated a greater supply of fixed income instruments in 2026, when the U.S. Treasury refinances and issues fixed income assets.

Mr. Bachher noted that there were many opportunities to invest in debt instruments but warned that one must be careful. Wall Street firms were accumulating debt from banks, and the private lending market has ballooned. There was an abundance of financial products with low yield; credit spreads were as tight as ever. Private fixed income was also becoming more popular. Mr. Bachher concluded that there was much liquidity for very few good opportunities. Past performance was not indicative of the future, and one must determine what the good opportunities were.

Regent Makarechian opined that high government deficit would pressure interest rates into going down. He asked if OCIO would propose a different asset allocation given current knowledge, and when it would do so. Mr. Bachher replied that the current performance of UC investments was such because OCIO proposed a change in the asset allocation in 2020. He posited a simplified allocation of 60 percent stocks, 19 percent stocks, 19 percent bonds and about the same in private assets, and a little cash. Interest rates must come down eventually, so there might be a limit to public fixed income returns in the near term. To earn more, one must take risks and invest in private assets. The amount invested in stocks and private assets could be toggled, but Mr. Bachher did not foresee increasing the fixed income allocation, and he did not want to increase private asset exposure. He asked Regent Makarechian how he would set the asset allocation. Regent Makarechian replied that it would depend on the stocks being chosen. He suggested considering companies such as Nvidia, MicroStrategy, and Bitcoin, as well as alternative energy such as fusion energy.

Mr. Bachher shared that OCIO received input about investments from faculty, staff, and students. He recalled that a UC Berkeley student shadowing him had praised Nvidia. UC reached its current exposure to Nvidia of $3 billion to $4 billion over a period of time. Fidelity’s Growth Company Fund, one of the products available to participants of the UC Retirement Savings Program, has been investing in Nvidia for some 15 years.

The meeting adjourned at 5:00 p.m.

Attest:

Secretary and Chief of Staff