**Minutes of the Meeting**

**of the Investment Committee of the**

**F. M. Kirby Foundation, Inc.**

**October 24, 2023**

A meeting of the Investment Committee of the Board of Directors of the F. M. Kirby Foundation, Inc., was held at 17 DeHart Street, Morristown and via Zoom on October 24, 2023 at 10:00 a.m. The following Committee members participated:

S. Dillard Kirby

Jefferson W. Kirby

William J. Raver

Ward K. Horton (via Zoom)

F. Morgan Kirby, IV (via Zoom)

Evan C. Lorey

Mr. S. Dillard Kirby, Chairman, presided and Ms. Diana L. Kostas, Secretary/Treasurer, recorded the minutes of the meeting. Mr. Justin J. Kiczek, Executive Director, participated in the meeting as a guest. Messrs. Matthew Ruhl, Senior Investment Consultant, and Ralph Ivory, Director, Nonprofit Solutions, also joined the meeting, representing Vanguard Institutional Advisory Services.

The Chairman welcomed Mr. Alex Torrens, Head of Walter Scott North America, and inquired about him no longer being listed as an Investment Team member. Mr. Torrens responded that it was better for him to focus on the client side of the business while based in the United States for the next three years. He still attends periodic Investment Commitment meetings and continues with some investment governance issues. The three investments which he championed, Intuitive Surgical, Disney and Fastenal, have been handed over to other Walter Scott associates.

Mr. Torrens provided a firm update, noting that the Boston team was heading to Edinburgh soon to celebrate the firm’s 40th anniversary. The firm has had approximately $7.0B in client withdrawals in 2023, $3.0B relating to two client terminations (Middle East and Japan sovereign wealth) where interest in long-only managers had waned. At the Board level, Mr. Jimmy Smits retired in June 2023 and Mr. Tom Sneddon, Walter Scott’s Head of Governance and Operations, will be joining the firm’s Board as a Director.

Mr. Torrens noted that travel is back. The research teams have been to China, India, Taiwan, Shanghai, Hong Kong, Singapore, Indonesia, and Malaysia. The access to board members of the various companies (due to the pandemic) has continued. The teams have noticed a difference in the United States versus Europe in terms of return to work. European offices are “buzzing” whereas many large US firms face empty offices and attendance by the C-suite only. They are monitoring the impact on U.S. commercial real estate and believe there is significant risk with revaluations, which could have an adverse impact on small to medium-sized banks.

Mr. Torrens then addressed 2023 performance, noting that the third quarter of 2023 was challenging but that overall, it was still a stronger year than 2022. Three-year performance figures were down due to a difficult 2022 in relative terms. There was a growth/value shift in Q3, 2023. The Asia/China dynamic is pulling non-US returns down. The portfolio faced both a tech headwind (owning only 2 of the 7 big tech firms), as well as financial headwinds (with banks benefiting from the rising rate environment). Walter Scott trimmed its Novo Nordisk position in October to adhere to its policy cap of any individual holding not totaling more than 5% of the total portfolio.

The Committee inquired about Walter Scott’s position on energy. Mr. Torrens stated that Walter Scott had exited its energy investments (CNOOC, EOG, Pioneer) at inopportune times. The firm is open to evaluating and investing in energy again; however, the elevated pricing environment and overall volatility of the category could impact the long-term hold viability and thus dampen enthusiasm. Mr. Torrens also touched on negative China sentiment and how narratives could negatively impact a stock, citing AIA as an example of a company with strong fundamentals yet an all-time low stock price. There is an ongoing debate with the investment team as to whether to continue holding AIA. The firm as a whole has a low turnover approach and spends more time and energy focused on what it wants to buy, rather than sell. The Chairman thanked Mr. Torrens for his time, informed him of the April 23, 2024 meeting date and Mr. Torrens departed at 11:05 a.m.

The Committee was then joined by the team from Hamilton Lane: Mr. Timothy D’Arcy, Managing Director, Director of Business Development; Ms. Megan Milne, Principal, Direct Equity; and Mr. Ken Binick, Director, Head of Execution, Direct Equity, as the Committee deliberated on the idea of making a private equity investment. Mr. S. Dillard Kirby reminded the Committee that Hamilton Lane (HL) last presented in April 2023 and invited Mr. D’Arcy to begin. Mr. D’Arcy stated that the firm helps clients gain access to global markets; has a flexible business model that accommodates small to large clients; and builds diversified portfolios of opportunities. Hamilton Lane has 620 employees, 23 global offices and $40 billion committed to markets annually. He introduced colleagues Mr. Binick and Ms. Milne. Mr. Binick is new to Hamilton Lane but worked for Portfolio Advisors for fifteen years. Ms. Milne has worked for Hamilton Lane for eleven years.

Ms. Milne informed the Committee that the firm has been utilizing the co-investment platform for over 30 years in the private equity market. Hamilton Lane invests in middle market direct equity opportunities alongside a leading private equity sponsor with the sponsor typically taking majority ownership. Hamilton Lane has built a team of 40 professionals who perform due diligence on the sponsors and the assets to identify viable investment opportunities. The firm has executed over 560 direct investment opportunities with $13.5 billion in direct equity AUM. The firm only invests in 3% of deals they consider. With co-investment, there are no additional layers of fees which means it is a very fee efficient way to access private equity.

Ten-year performance for the Hamilton Lane Direct Equity Funds as of June 30, 2023 was 30% realized returns on a net basis. The firm is seeing a record level of deal flows, roughly $37 billion in 2023. Approximately 80% of deals are co-investors or proprietary access. There are 592 active GP relationships over the entire platform. Diverse deal flow allows for tactical investing strategy across equity structures. Relationships and information provide due diligence advantages. HL has an experienced and cohesive investment team, with Managing Directors having an average of 22 years of investing experience. All three teams, comprised of 209 professionals (direct investment, fund investment and secondaries) collaborate across the HL platform. The decision on the investment is independent of where it is placed (advisory, SMA, fund). A separate allocation team makes that determination. Mr. Jefferson W. Kirby inquired about emerging managers. Mr. Binick stated that HL is currently going through an evaluation process with the emerging manager team and newer relationships.

Mr. Binick emphasized that utilizing technology during diligence was a key differentiator for HL and stated that the Power BI platform is really where HL stands out. HL leverages their $15 trillion private comparable database, with comparable company analysis and valuation insights. Mr. Binick reviewed HL’s investment approach and portfolio construction philosophy. HL is planning to take a defensive approach with Equity Opportunities Fund (EOF) VI. Valuations are a number one topic. HL wants to ensure assets have a few levers to pull to achieve growth and an ability to improve margins. There is heavy analysis on capital preservation and focusing on growing buyout-oriented businesses. There are typically approximately 40 companies per fund portfolio.

EOF VI is targeting $2.5 billion with a minimum commitment of $5 million. There will be a 5-year commitment period, a ten-year partnership term and 3-year funding period. Fund VI will begin deploying in Q1, 2024 utilizing a credit facility, with the first capital call anticipated to occur in Q2 or Q3, 2024. There will be no management fees until the capital calls commence and investors will have ten days to fund the call. The fee structure will be 1% management fee/10% carry on committed call for the first four years and then on net invested capital for the remainder of the term. The average annual fee on a committed basis is 53 bps. HL is offering a 10% discount as an early closing incentive.

Mr. Binick reviewed performance on Funds IV (2018) and V (2021). Their strongest returns occur in core mid-markets. Fund IV is a top quartile fund with regards to returns with a net IRR of 24.4% versus the MSCI World Net Public Market Equivalent. HL will continue to focus on the middle market for Fund VI, with an emphasis on downside protection and capital preservation. HL should have legal documents and a data room ready in the next month with an anticipated launch in Q1, 2024. The Committee asked a few more follow-up questions, thanked the team for their presentation, and the Hamilton Lane associates left the meeting at 12:20 p.m.

After a brief break for lunch, Mr. Ruhl proceeded with the Vanguard presentation. He informed the Committee that they have been having an issue with FactSet reconciling performance for the outside holdings, so the performance figures in the Vanguard deck do not include outside holdings. He walked through the new format of the reports. Investment income is rising across the portfolio due to the bond market. Mr. Ruhl noted that approximately 80% of the Vanguard portfolio is actively managed (even some of the fixed income products).

The domestic equities returns for Vanguard are well below the domestic equity benchmark, coming in at 3.63% YTD versus benchmark returns of 12.34%. This is due primarily to strong performance by the Magnificent Seven (Apple, Microsoft, Alphabet, Amazon, NVIDIA, Tesla and Meta). The Windsor Fund has outperformed the Russell 100 Value benchmark by 184 bps YTD, with strong performance by Pzena and Wellington. International equities returns for Vanguard have outperformed the policy benchmark, with returns of 5.85% versus benchmark returns of 5.48%. The International Value Fund had returns of 6.30% YTD and 23.02% for the one-year period, outperforming its benchmark by 96 bps and 299 bps, respectively. Arga and Sprucegrove had strong performance, but Lazard lagged the benchmark. The Total International Stock Fund had strong one-year performance with returns of 20.52% versus benchmark returns of 20.40%.

Mr. Ruhl highlighted a new Portfolio Risk Analysis Report on page 14 of the Vanguard deck. Mr. Jefferson W. Kirby inquired about the portfolio investing in more high-quality fixed income. Fixed income accounts for 17% of the total FMKF portfolio, with over half in the Total Bond Market Index Fund and Intermediate Term Index Fund. The duration of the fixed income portfolio is in the 4- to 5-year range. If the Committee didn’t need to draw down monies from the Ultra Short Bond Fund, they could be reallocated to the Total Bond Market Index Fund. No decision was made.

Mr. Ruhl pointed out that the Magnificent Seven contributed 76% of the Total Stock Market Index Fund return but accounted for only 24% of its holdings. There was a 13-14% spread between the S&P 500 returns versus the S&P 500, equally weighted. It has been a challenging year for growth (outside the Magnificent Seven). The multi-cap growth peer group has lagged significantly and 95% of large cap growth managers have lagged behind Russell 1000 Growth.

 Vanguard’s global economics and markets team published their 10-year market outlook. US aggregate bonds (2/3 treasuries and 1/3 credit) are projected with returns of 4 to 5%. There is more competition for capital with fixed income yields on the rise. More monies are moving into longer duration. The 10-year average yields for non-US equities continue to rise (6.4% to 8.4%) whereas US equity yields trend lower (3.7% to 5.7%). Despite rising interest rates, high inflation, and recession risk, U.S. valuations are above fair value. The June 30, 2023 CAPE was 35% above Vanguard’s estimate of fair value. Value stocks relative to growth stocks are very attractive (with a spread of about 4%).

The Vanguard team ran a total return, risk/return study over a 30-year time horizon utilizing varying private equity investments (5, 10 or 15% allocation) and modeling a 5% spend rate with the June 30 endowment starting value, along with private equity assumptions to forecast ending investment values. Median inflation-adjusted returns ranged from 4.9% with the current 80/20 allocation to 5.53% (with a 15% allocation to private equity). It was noted that the volatility dropped as the private equity allocation increased due to delayed markdowns. Mr. Ruhl stated that they could rerun the model once the Committee determined the private equity allocation and they received cash flow pacing from Hamilton Lane. Both he and Mr. Ivory suggested utilizing a blocker fund to reduce exposure to UBIT. It may result in a drag of 12 to 15 bps but could be offset by tax savings. The Foundation would also receive only one K-1 with a blocker fund structure. They suggested we ask Hamilton Lane for guidance on comparing one structure versus the other. The Vanguard presentation concluded at 1:30 p.m.

The minutes from the July 25, 2023 Investment Committee meeting were approved. Ms. Kostas shared key highlights from the investment reports which were sent to the Committee in advance of the meeting. Items noted included:

* Total portfolio returns of -4.4% versus 75% ACWI/ 25% Global Aggregate benchmark of -3.4% (for 3-month period ending September 30)
* The total portfolio outperformed the benchmark for the 3-year and 5-year periods.
* For the three-month period ending September 30, all three broad asset classes had negative returns, with only fixed income providing positive alpha against the broad Bloomberg Global Agg benchmark.
* Equities was the top asset class in terms of absolute returns (+22.4%) for the 12-month period, with non-US equities returning 22.1% and US equities providing returns of 22.0%.
* The Foundation outperformed its Callan peers for the 1-year (384 bps), 3-year (146 bps) and 5-year (71 bps) periods ending June 30, 2023, and the Alpha Nasdaq OCIO Endowment & Foundations peer group for the 1-year (421 bps), 3-year (97 bps) and 5-year (11 bps) periods.
* The expense ratio as of September 30, 2023, was 56.4 bps (up from 56.9 bps as of March 31, 2023).

Ms. Kostas addressed cash needs through January 31, 2024, noting that the Foundation would require approximately $4.6M for grantmaking and administrative expenses. Between anticipated year-end dividends and cash in the money market, Ms. Kostas requested latitude to liquidate up to $1.0M depending on the timing and magnitude of the dividends. The decision on where to source the funds was tabled until the Committee discussed the manager presentations.

Mr. Raver expressed disappointment that Mr. Torrens was departing the investment side of Walter Scott and was neutral on Mr. Alan Lander as Head of Research. He felt Walter Scott should be placed on a watch list due to recent poor performance and that Sprucegrove could be a future contender.

Each committee member weighed in on the potential investment in the Equity Opportunities Fund VI. Positives included potential higher returns; access to top quartile managers; downside protection; advantageous fee structure; the 40-50 company diversification per fund; and smoother valuations than the Private Assets Fund. Concerns/questions included: return to higher manager fees with investment in private equity; lack of a published policy on the internal financing vehicles; and weak value proposition with regards to their technology platform. The Committee agreed to move forward with the Hamilton Lane investment and the Chairman was authorized to inform Hamilton Lane that the Foundation was targeting a $16M (approx. 5% allocation) private equity investment, with a likely late first quarter 2024 written commitment. Mr. Ivory suggested the Committee request the Private Placement Memo, inquire about the level of information provided on the specific investments, and what type of support would be provided. Mr. Ruhl suggested that Hamilton Lane model cash flow scenarios.

The conversation shifted to asset allocation and the endowment’s equity overweight. The question of de-risking the portfolio by drawing funds from Walter Scott and the Vanguard Total International Stock Fund and reinvesting in fixed income was considered. Mr. S. Dillard Kirby compared 5-year returns from the managers (Walter Scott +8.0%, Vanguard +5.5%, PIMCO +4.1%, JPM Global Allocation Fund +2.8%, Total Portfolio +5.1%).

The Committee reviewed the various sources of funding and suggested liquidating $1.0M from JPM Global Allocation Fund and investing the proceeds into the J. P. Morgan Prime Reserve Money Market account for liquidity flexibility. Mr. Jefferson W. Kirby asked if the Committee was prepared to update the Investment Policy Statement (IPS) to reflect an 80/20 asset allocation target. It was decided to discuss this at the April 23, 2024 meeting when the IPS is typically reviewed.

Mr. Kiczek provided an update on the Director of Finance search, noting that after an extensive search there were four finalists and he hoped to make an offer by the end of the week. Mr. Tom Bianchini has offered to step in during the transition. Mr. S. Dillard Kirby offered gratitude for Ms. Kostas’ more than six years at the Foundation, highlighting her dedication and her collaboration with both Investment Committee Chairs. Ms. Kostas expressed her sincere gratitude and pleasure in working with the Committee. The meeting ended at 2:45 p.m.