

# commonfund



## Problems and Opportunities in Managing Endowments for Nonprofits: *Insight from the Commonfund Benchmarks Studies*

John S. Griswold, Executive Director, Commonfund Institute  
Thursday, May 7, 2009 | 11:30 am – 12:30 pm  
Westin Kierland Resort and Spa  
Scottsdale, Arizona

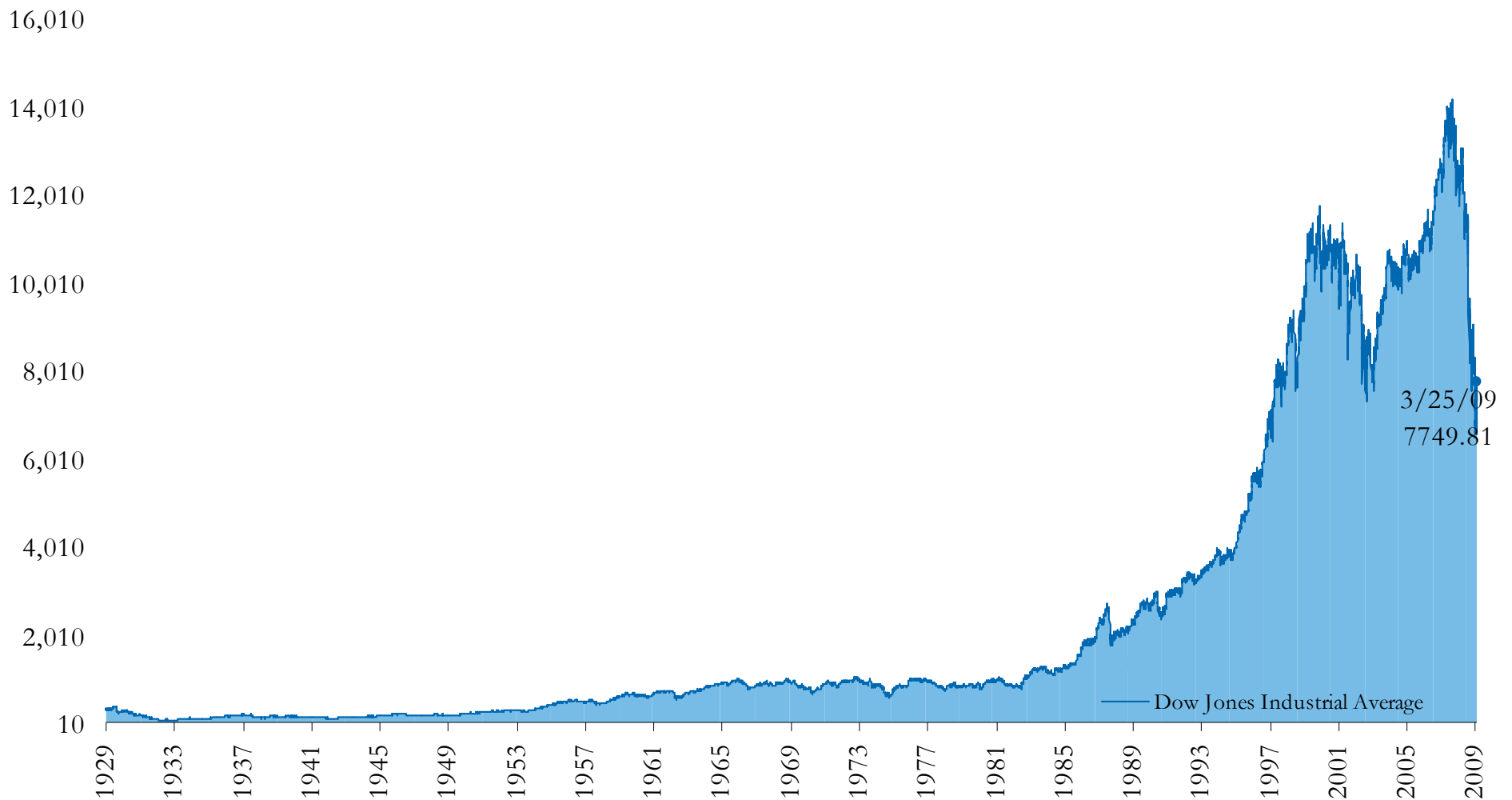
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## The Economic Headlines

- Treasury continues to pump liquidity into the market
- Low-No Growth
- No “near term” fear of inflation (deflation)
- Deceleration in the decline in financial and real assets
- Rising unemployment

Debate on the duration and depth of crisis continues.

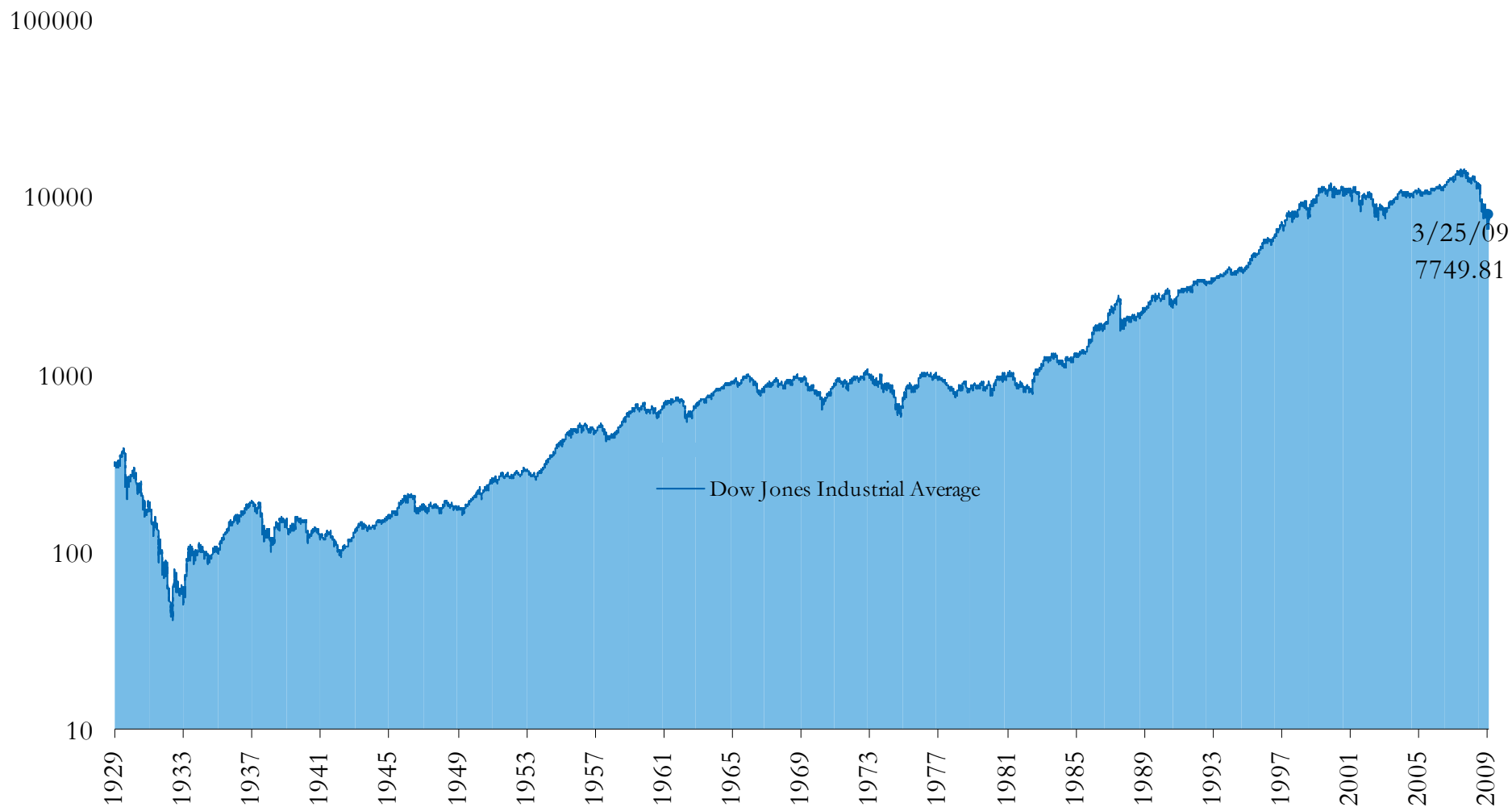
# Historical | Dow Jones Industrial Average



Source: Bloomberg

# Historical | Dow Jones Industrial Average

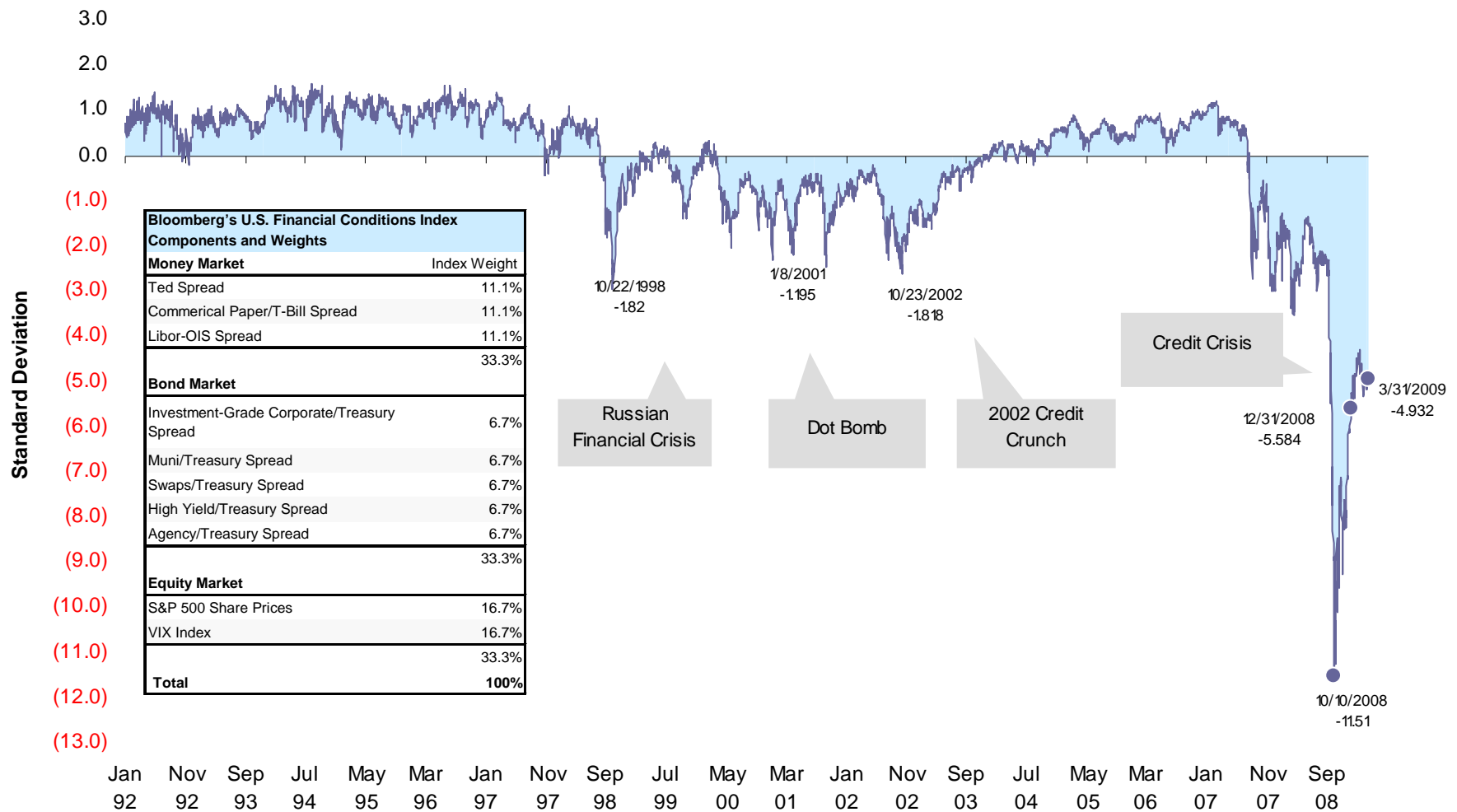
## *Logarithmic Scale*



Source: Bloomberg

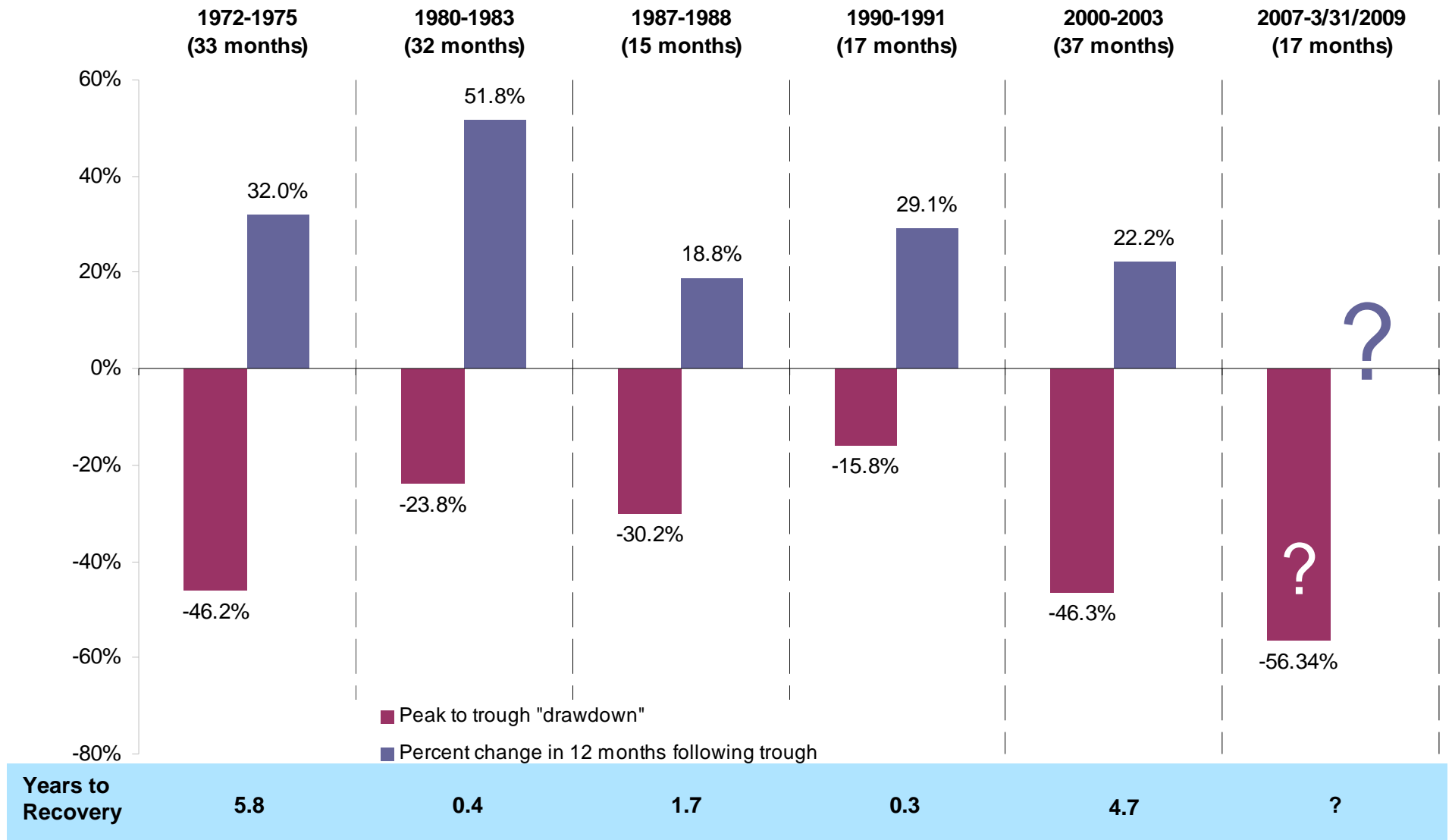
# Financial Conditions Index

January 1992 – March 2009



Source: The Bloomberg Financial Conditions Index. The index combines yield spreads and indices from the money markets, equity markets, and bond markets into a normalized index. The values of this index are z-scores, which represent the # of standard deviations that current financial conditions lie above/below the average from 1992 – 2008.

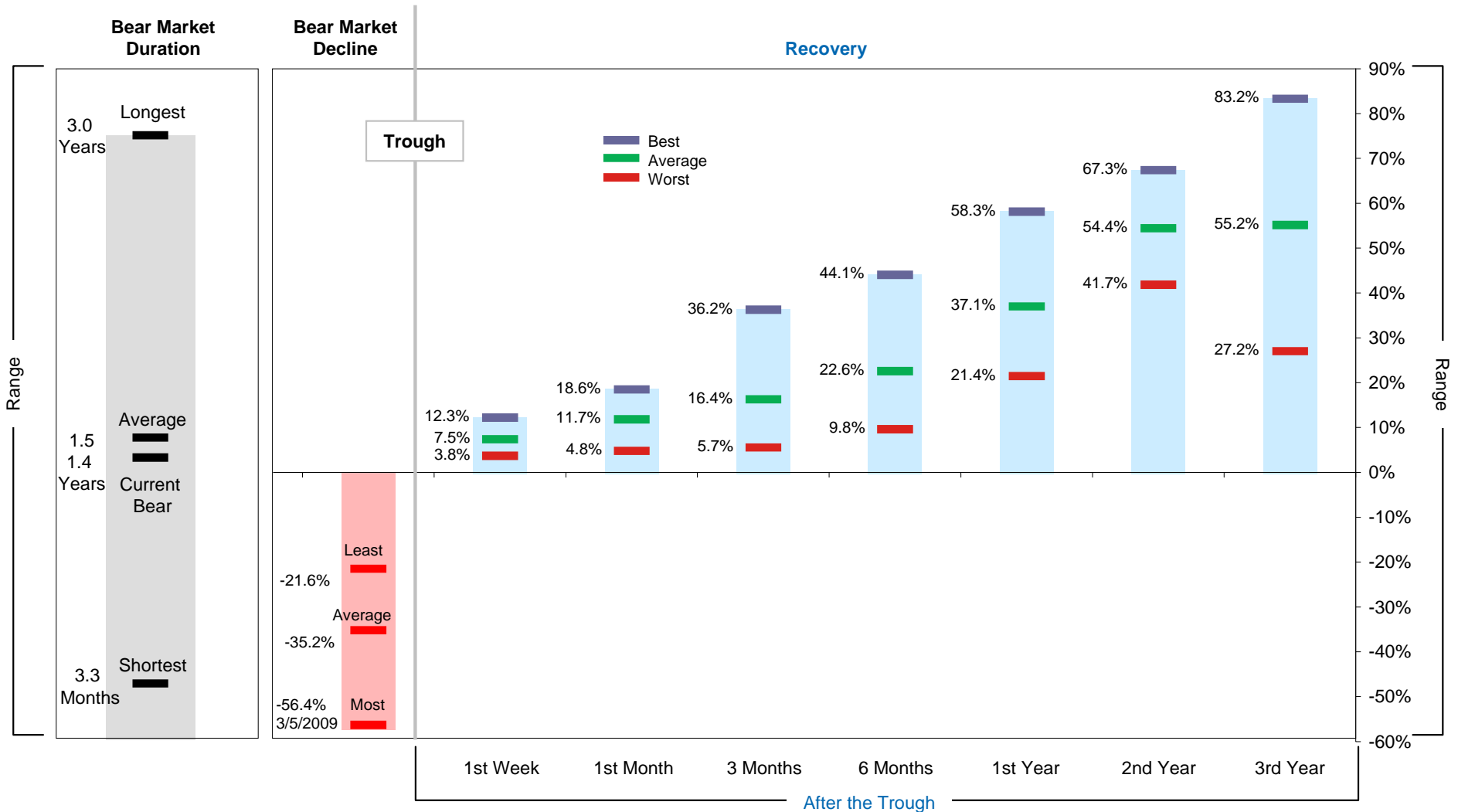
# S&P 500 | Historical Downturns



Source: Bloomberg

# When Bear Markets End

## The Standard & Poor's 500 Stock Index



Data for the Current Bear Market is preliminary through 3/6/2009

NOTE: Data includes post-WWII Bear Markets as defined by the Standard & Poor's 500 Stock Index.

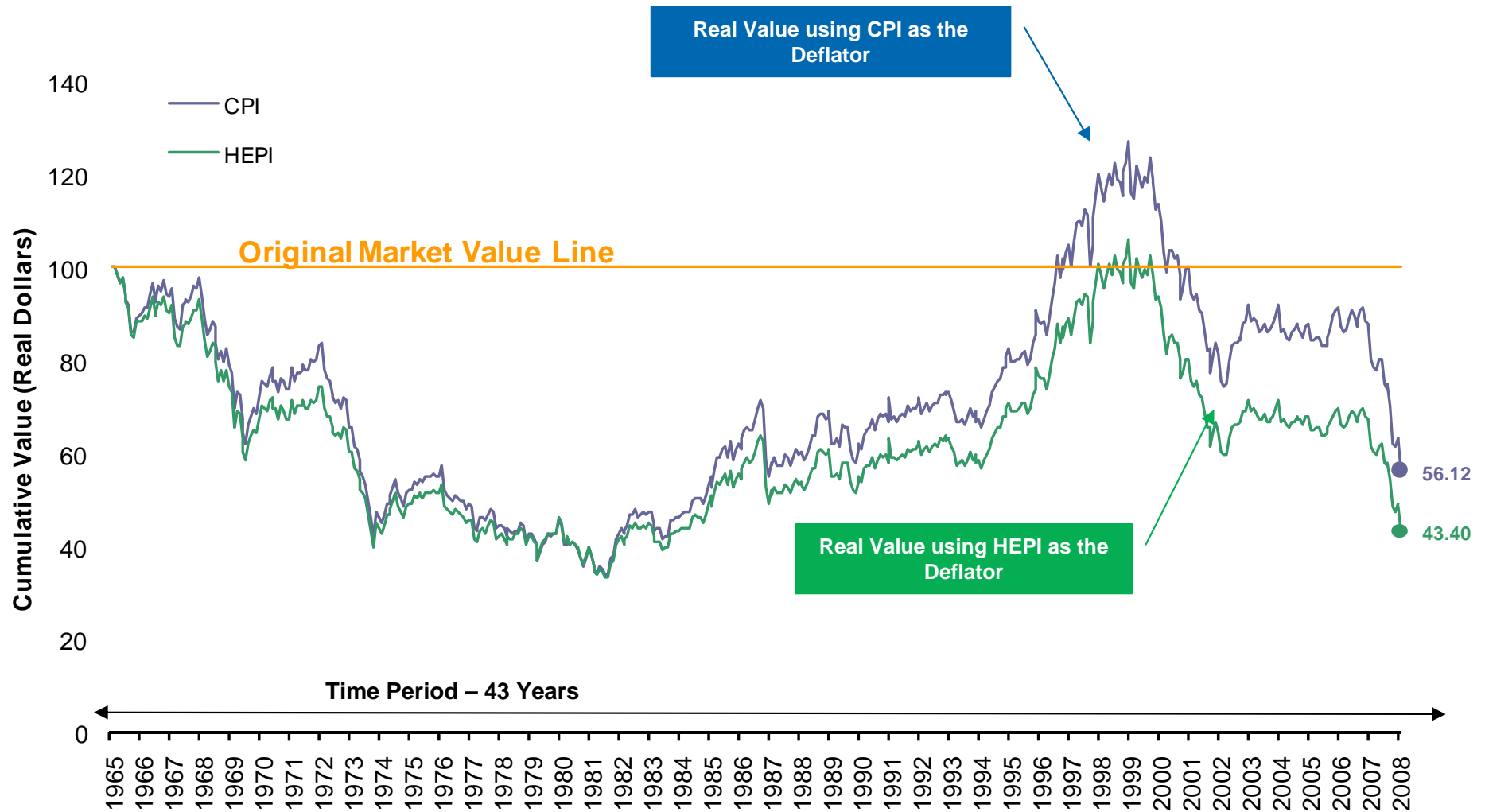
Source: Aronson Johnson Ortiz; Standard & Poor's; Crandall, Pierce & Company

*“The Trustees of an endowment institution are the guardians of the future against the claims of the present. Their task is to preserve equity among generations.”*

*James Tobin – Yale University*

# Cumulative Inflation-Adjusted Performance

70% S&P 500, 30% Lehman Aggregate and 5% Spend

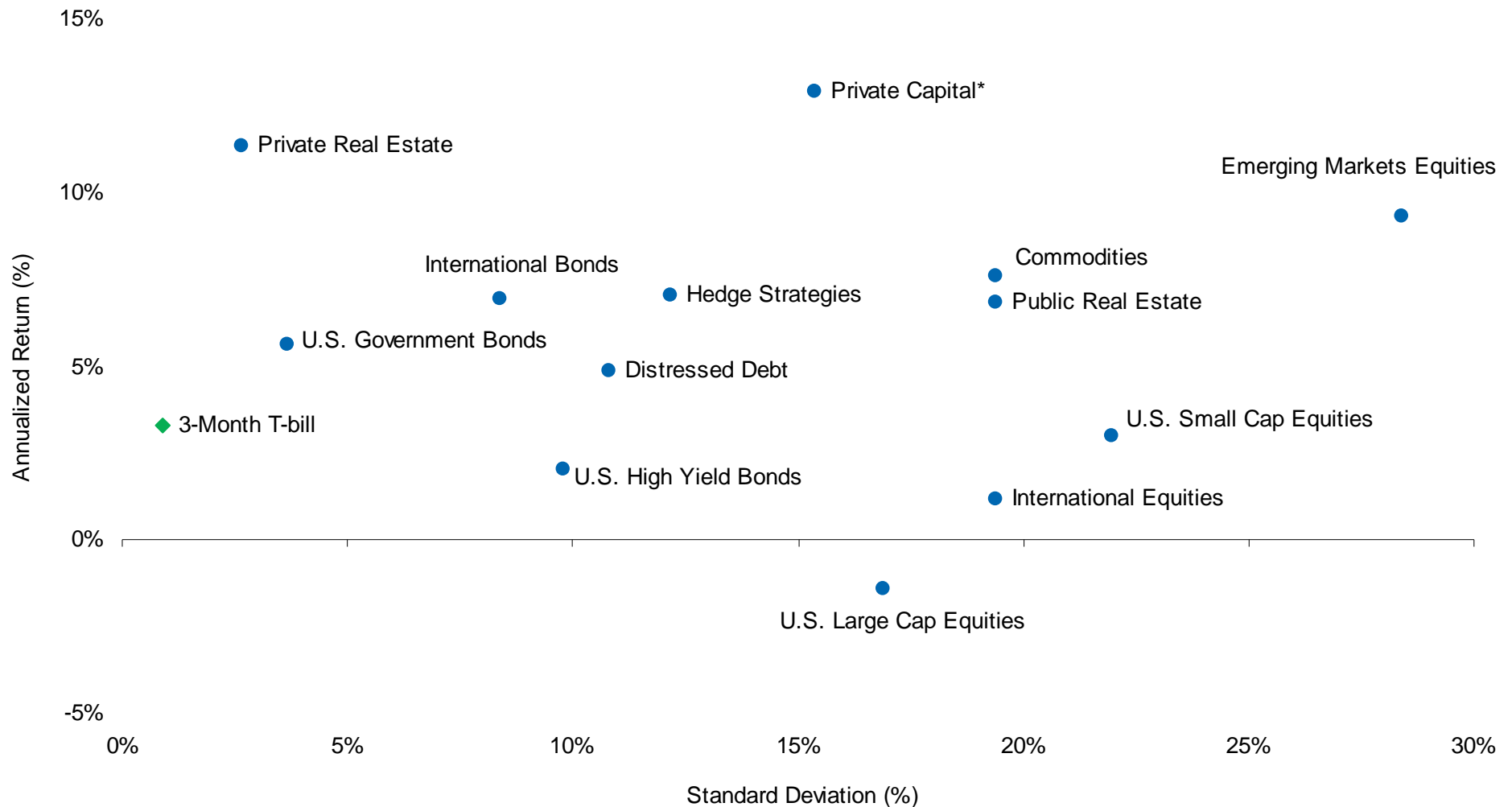


Source: Ibbotson, Bloomberg, Commonfund Institute

The equity portion of the hypothetical portfolio is based on monthly returns of the S&P 500 Index (12/65-1/09), and the fixed income portion is based on monthly returns of the Barclays U.S. Aggregate Index (01/73-1/09) and the Ibbotson Associates Long Term Corporate Bond Index (12/65-12/72). HEPI data from 07/06 to 2/08 is estimated using the Commonfund Institute method based on regression analysis. Returns for this hypothetical portfolio assume that it is rebalanced to 70/30 annually on 1/1/yy and 5% is distributed annually on 1/1/yy.

# Return/Risk

10 Year Period Ending December 31, 2008



Source: Style Advisor;

The following are the indices used by asset class: U.S. Government Bonds, Barclays Capital U.S. Aggregate Bond Index; U.S. High Yield Bonds, Merrill Lynch High Yield Master II; International Bonds, Citigroup World Govt' Bond Index; U.S. Large Cap Equities, S&P 500 Index; U.S. Small Cap Equities, Russell 2000 Index; International Equities, MSCI World Ex-US Index; Private Real Estate, NCREIF; Private Capital, Venture Economics (10 years through 6/30/2008); Emerging Markets Equities, MSCI EMF Index; Distressed Debt, HFRI Distressed Securities Index; Hedge Strategies, HFRI Equity Hedge Index; Commodities, Dow AIG Commodity Index; Public Real Estate, NAREIT

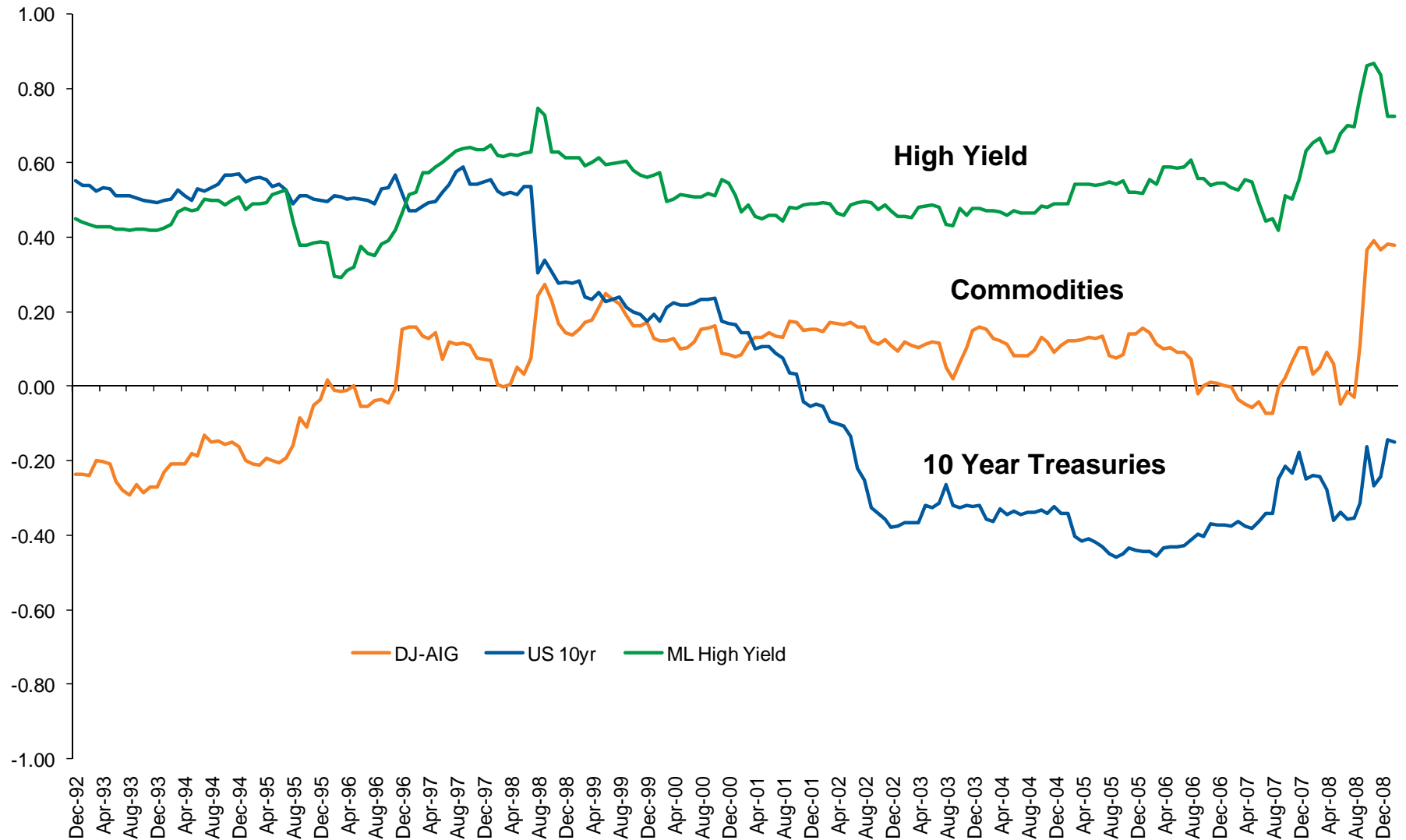
# The Power of Diversification

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Venture capital	49.3%	42.9%	33.1%	26.7%	184.3%	31.8%	13.9%	25.9%	40.0%	31.6%	21.4%	35.1%	23.2%	10.9%
S&P 500 Index	34.1%	35.3%	31.0%	19.0%	71.0%	26.4%	12.2%	19.5%	37.1%	20.8%	21.0%	26.2%	20.7%	5.2%
Private equity	31.9%	34.5%	27.4%	18.8%	44.2%	25.7%	8.9%	10.3%	26.4%	18.1%	15.0%	20.7%	16.2%	5.0%
Hedged Equity	31.0%	24.8%	23.4%	16.0%	28.4%	13.4%	8.4%	7.4%	25.3%	15.4%	12.6%	17.1%	12.9%	1.5%
Global Macro	29.3%	23.2%	21.2%	15.3%	24.3%	11.6%	6.9%	5.4%	23.9%	15.0%	12.2%	15.3%	11.1%	-9.1%
Event Driven	25.1%	21.8%	20.3%	15.0%	24.3%	11.2%	0.4%	3.8%	21.4%	10.4%	10.7%	13.6%	11.0%	-17.5%
Cirigroup World Govt Bond Index	19.0%	20.3%	18.8%	8.7%	19.5%	9.1%	-1.0%	-4.3%	20.5%	9.1%	7.3%	12.4%	10.5%	-21.5%
Barclays Capital U.S. Aggregate Index	18.5%	14.5%	15.9%	6.2%	17.6%	6.7%	-13.0%	-4.7%	17.9%	9.0%	6.1%	11.7%	9.0%	-26.2%
Relative Value Arbitrage	15.7%	9.3%	9.7%	2.8%	14.7%	2.0%	-19.5%	-12.3%	14.9%	7.4%	6.0%	8.5%	7.0%	-35.7%
NAREIT Equity Index	15.3%	7.2%	2.6%	1.7%	-0.8%	1.6%	-20.5%	-15.5%	9.7%	5.6%	3.0%	6.1%	6.6%	-37.0%
Natural Resources (DJ AIG)	15.2%	3.6%	0.2%	-17.5%	-4.3%	-10.1%	-21.2%	-23.4%	6.9%	4.4%	2.4%	4.3%	5.5%	-37.0%
MSCI World (ex-US) Index	11.8%	3.6%	-3.4%	-27.0%	-4.6%	-13.2%	-34.0%	-29.5%	4.1%	4.3%	-6.9%	2.1%	-15.7%	-37.7%

Sources: Bloomberg, HFRI, Venture Economics

# Has the Basic Concept of Diversification Changed?

60 month rolling correlation to S&P 500



Source: The Bloomberg

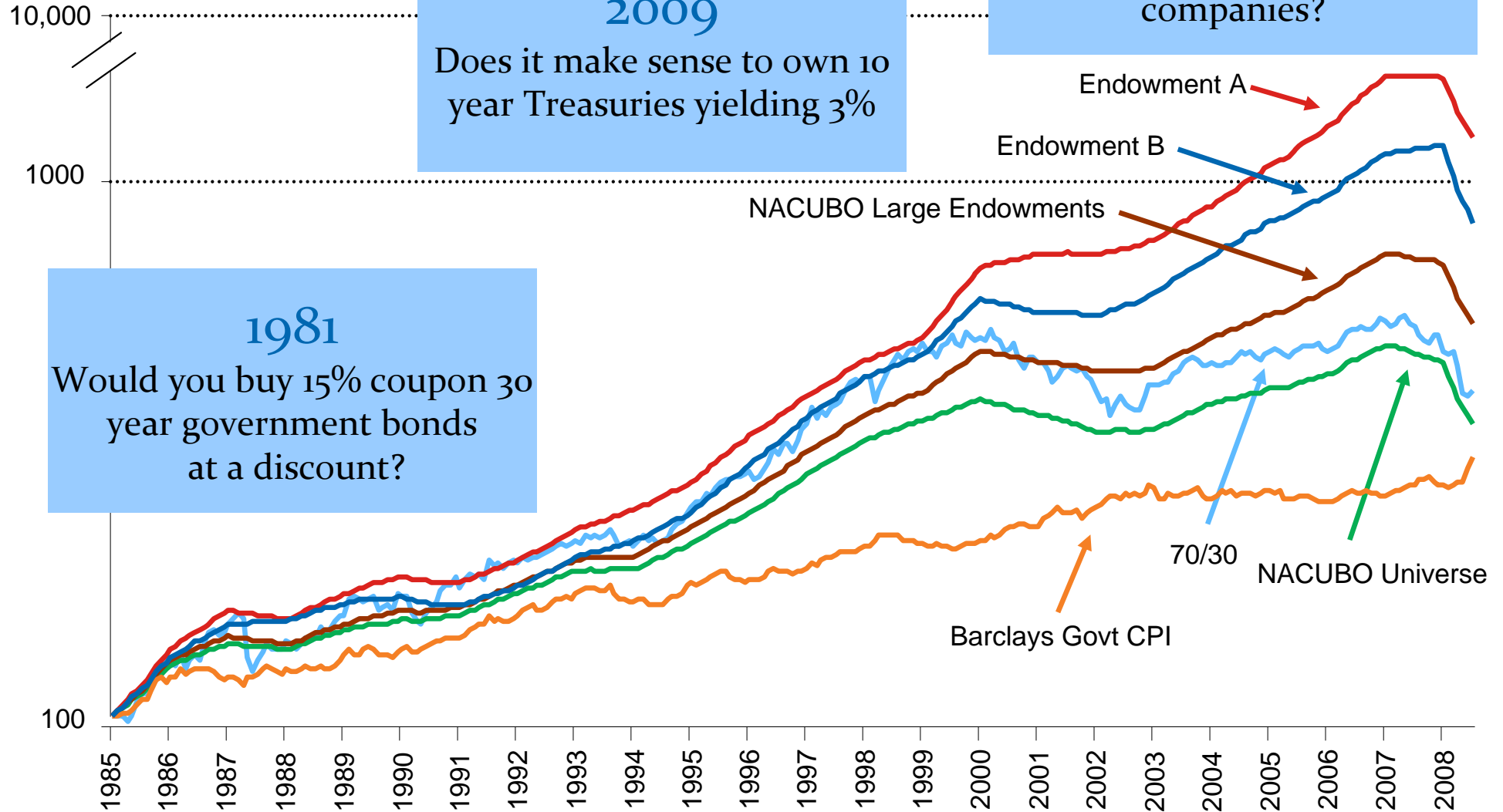
## The Principles of the “Endowment Model”

- Take risk commensurate with your investment objectives  
--without risk there is no return
- Diversify away as much risk as possible
- Time horizons matter – return/liquidity trade-offs
- “Own versus loan” – maintain an equity bias

Do These Principles of the “Endowment Model” Still Hold?

# The Story of the Endowment Model

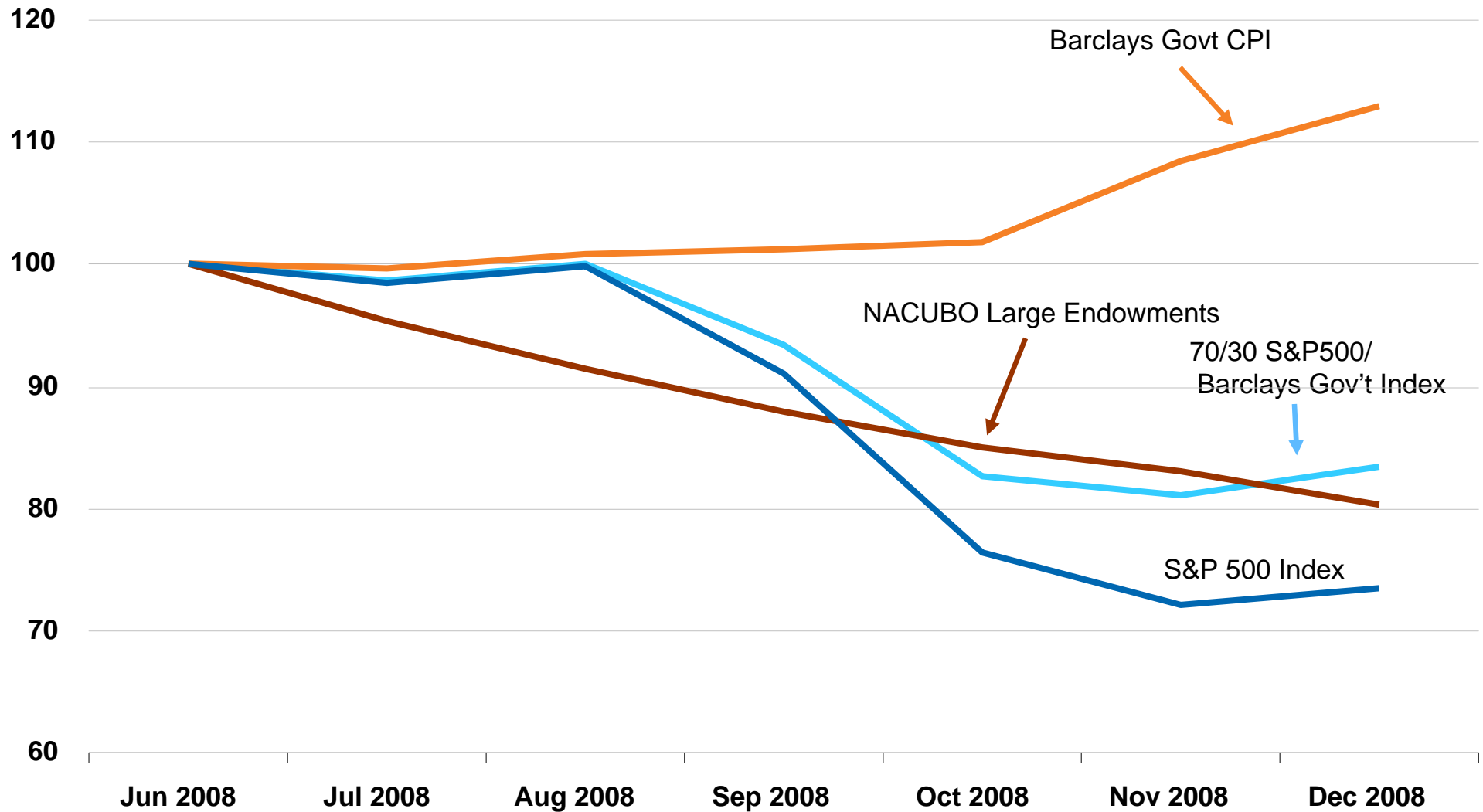
Real Growth of \$100  
(Log scale)



Source: NACUBO, Bloomberg. All data real based on CPI. Endowment A and Endowment B based on actual large university data.

# The Story of the Endowment Model

July 2008 – December 2008



Source: NACUBO, Bloomberg. All data real based on CPI.

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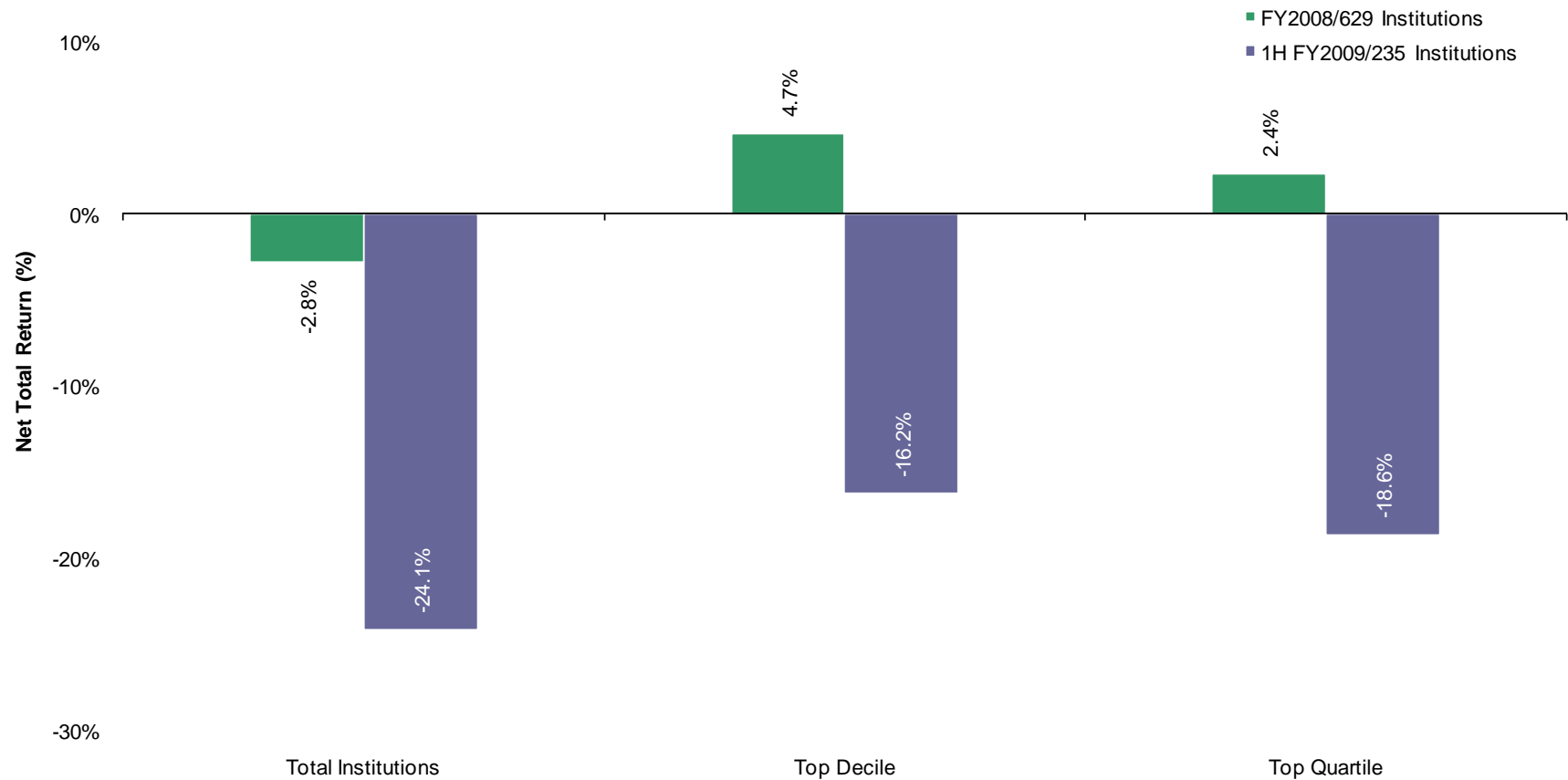


Preview 2010 Commonfund Benchmarks Study®  
*Educational Endowment Report*  
*Mid-Year Update July 1, 2008 – December 31, 2008*

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# The Benchmarks Leaders | Top Decile and Top Quartile Performance

## *Fiscal Year 2008 and the First Six Months of Fiscal Year 2009<sup>2</sup>*



<sup>1</sup>Dollar-weighted

<sup>2</sup> July 1, 2008 – December 31, 2008

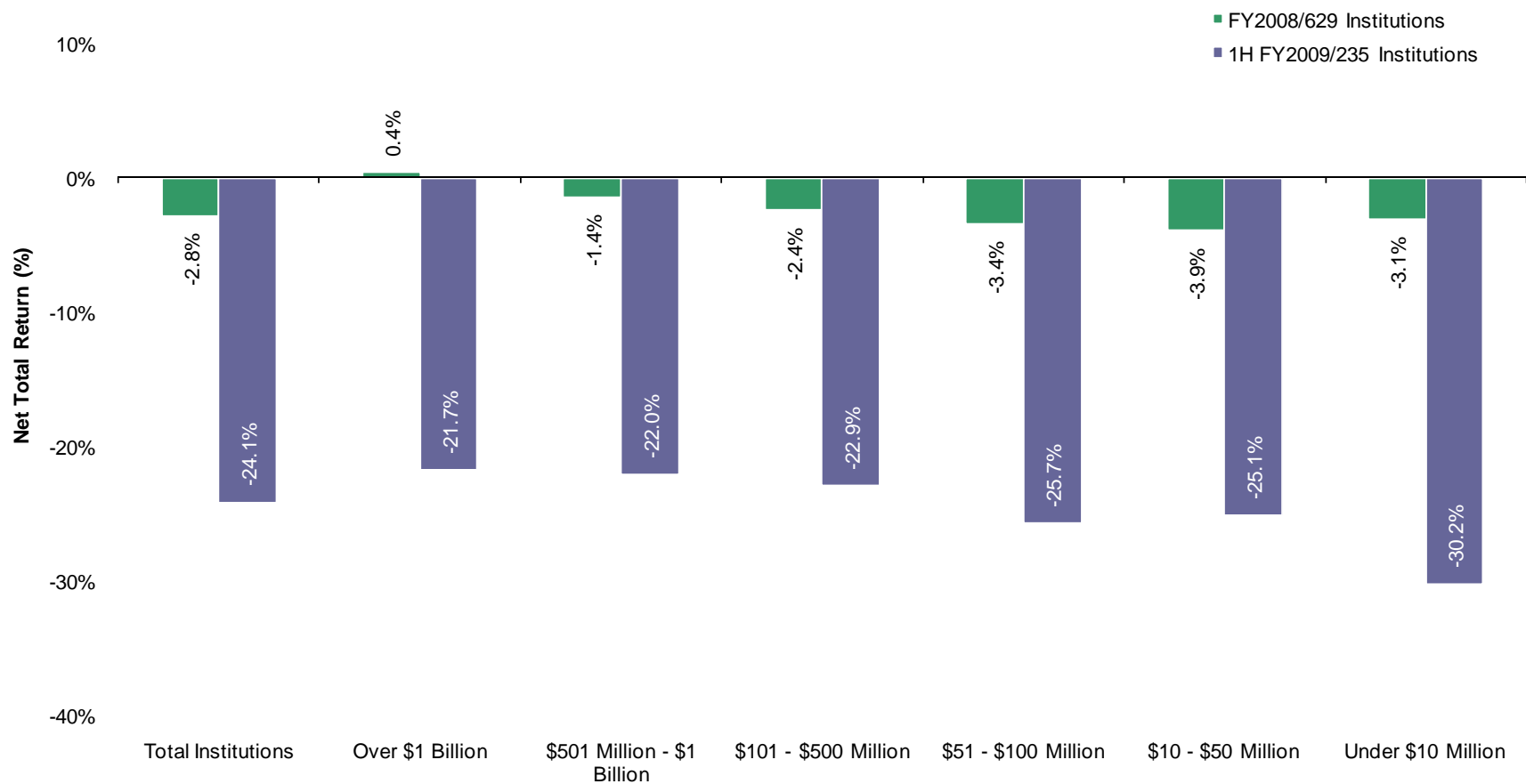
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# Total Return<sup>1</sup> for Institutions by Size

*Fiscal Year 2008 and the First Six Months of Fiscal Year 2009*



<sup>1</sup> Net of fees

<sup>2</sup> July 1, 2008 – December 31, 2008

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# Allocations to Asset Classes<sup>1</sup>

## Fiscal Year 2008 and the First Six Months of Fiscal Year 2009<sup>2</sup>

	Total Institutions		Over \$1 Billion		\$501 Million - \$1 Billion		\$101 - \$500 Million		\$51 - \$100 Million		\$10 - \$50 Million		Under \$10 Million	
	628	235	49	25	37	20	188	74	92	41	191	64	71	11
Fiscal Year	'08	1H09	'08	1H09	'08	1H09	'08	1H09	'08	1H09	'08	1H09	'08	1H09
Asset Class														
Domestic equities	23%	17%	20%	14%	24%	20%	29%	23%	38%	35%	42%	39%	48%	39%
Fixed income	12%	13%	10%	11%	13%	15%	15%	15%	17%	19%	22%	21%	27%	26%
International equities	18%	15%	17%	15%	19%	16%	19%	16%	17%	16%	13%	13%	9%	8%
Alternative strategies	46%	51%	52%	57%	42%	46%	34%	39%	25%	27%	17%	21%	8%	18%
Short-term securities/cash/other	1%	4%	1%	3%	2%	3%	3%	7%	3%	3%	6%	6%	8%	9%

| \* Dollar-weighted

<sup>1</sup> Dollar-weighted

<sup>2</sup> July 1, 2008 – December 31, 2008

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# Alternative Strategies Asset Mix<sup>1</sup>

*Fiscal Year 2008 and the First Six Months of Fiscal Year 2009<sup>2</sup>*

	Total Institutions		Over \$1 Billion		\$501 Million - \$1 Billion		\$101 - \$500 Million		\$51 - \$100 Million		\$10 - \$50 Million		Under \$10 Million	
	543	212	47	21	36	19	174	69	82	38	150	56	53	10
Responding institutions	'08	1H09	'08	1H09	'08	1H09	'08	1H09	'08	1H09	'08	1H09	'08	1H09
Type of Investment														
Private equity	19%	18%	20%	18%	19%	20%	14%	17%	10%	15%	7%	8%	0%	3%
Marketable alternative strategies	42%	40%	38%	38%	51%	42%	53%	46%	55%	52%	64%	59%	70%	66%
Venture capital	7%	9%	7%	10%	7%	8%	5%	6%	3%	6%	2%	3%	0%	0%
Private equity real estate	16%	12%	18%	12%	9%	11%	11%	11%	13%	15%	14%	17%	7%	10%
Energy and natural resources	14%	14%	15%	15%	11%	13%	14%	14%	15%	5%	6%	5%	1%	0%
Distressed debt	2%	7%	2%	7%	3%	6%	3%	6%	4%	7%	7%	8%	22%	21%

<sup>1</sup> Dollar-weighted

<sup>2</sup> July 1, 2008 – December 31, 2008

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2009 Commonfund Benchmarks Study®  
*Educational Endowment Report*  
*Fiscal Year Ending June 30, 2008*

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# Study Demographics

*As of June 30, 2008*

Ninth annual study

628 institutions with \$262.5 billion in assets

- 307 Private college and university endowments
- 159 Independent school endowments
- 55 Public system funds
- 107 State institution-related foundations (SIRF)

Smallest: Under \$10 million

Largest: Over \$1 billion

Interviews conducted in the third and fourth calendar quarters of 2008

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# Study Demographics

*As of June 30, 2008*

Largest	Over \$1 Billion	49
Very Large	Between \$501 Million and \$1 Billion	37
Large	Between \$101 Million and \$500 Million	188
Mid-Size	Between \$51 Million and \$100 Million	92
Small	Between \$10 Million and \$50 Million	191
Smallest	Under \$10 Million	71
<b>Total</b>		<b>628</b>

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# Study Contents

*As of June 30, 2008*

- The Benchmarks Leaders
- Performance – one, three and five years
- Asset allocation
- Spending rate
- Staffing levels
- Investment committee demographics
- Operating budget
- Underwater funds
- Higher Education Price Index (HEPI)
- Gifts and donations
- Debt exposure and policy

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# Headlines

- Returns for FY 2008 were at -2.7%, down sharply from 16.9% in last year's study and foreshadowing much larger losses suffered toward the end of calendar year 2008. Follow-up study shows endowments had average investment returns of -22.5 percent in the first five months of FY 2009. 3-year returns are 8.4% and 5-year returns are 10.1%.
- Total returns for the top decile at 4.7% and 2.4% for the top quartile.
- Secular asset allocation shift to alternatives continues, jumping four percentage points to 46 percent.
- Negative returns led by a -10.2% return for domestic equities and a -7.6% return for international equities. Best returns are from a diverse group of alternative strategies, led by a 27.6% gain by energy and natural resources, commodities and managed futures.
- Overall spending rates unchanged at 4.4%, but 69% of study participants increased their spending in dollars.
- Average gifts to endowment rose to \$10.2 million, driven by increase at the largest endowments.
- 24% of institutions plan to increase debt in the next two years
- Endowments used slightly more direct alternative managers, up from 7.6 to 8.8 on average; manager use for other asset classes remained relatively stable.
- Professional staffing of the investment function remained low, declining slightly to an average of 1.2 full-time equivalents (FTEs) from 1.4 FTEs.

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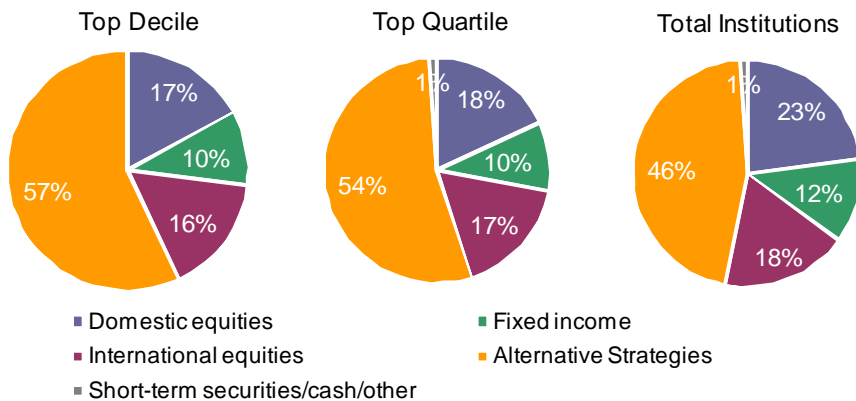
# The Benchmarks Leaders

## Top Decile and Top Quartile performers

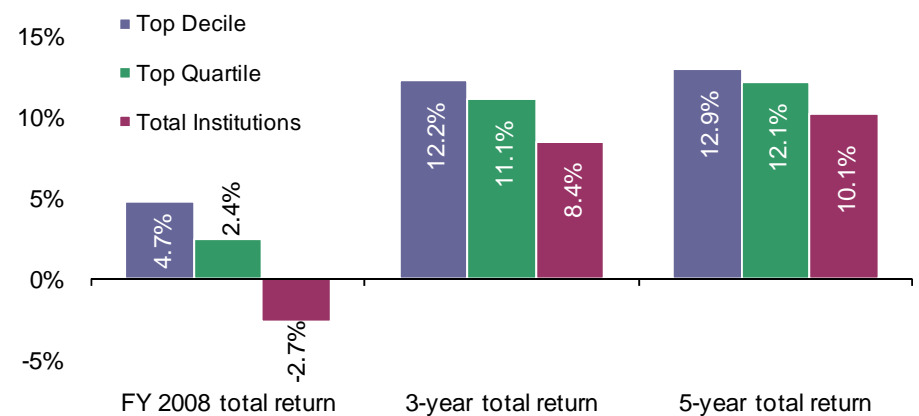
Demographics | Fiscal Year 2008

	Top Decile	Top Quartile	Total Institutions
Number of Institutions	63	148	628
Private	36	83	307
Independent	16	27	159
All Publics	11	38	162
<i>Public only</i>	3	12	55
<i>State Institution-Related Foundations (SIRF)</i>	8	26	107

### Asset Allocation<sup>1</sup> Comparison | Fiscal 2008



### Performance | 1-Yr, 3-Yr and 5-Yr



<sup>1</sup>Dollar-weighted

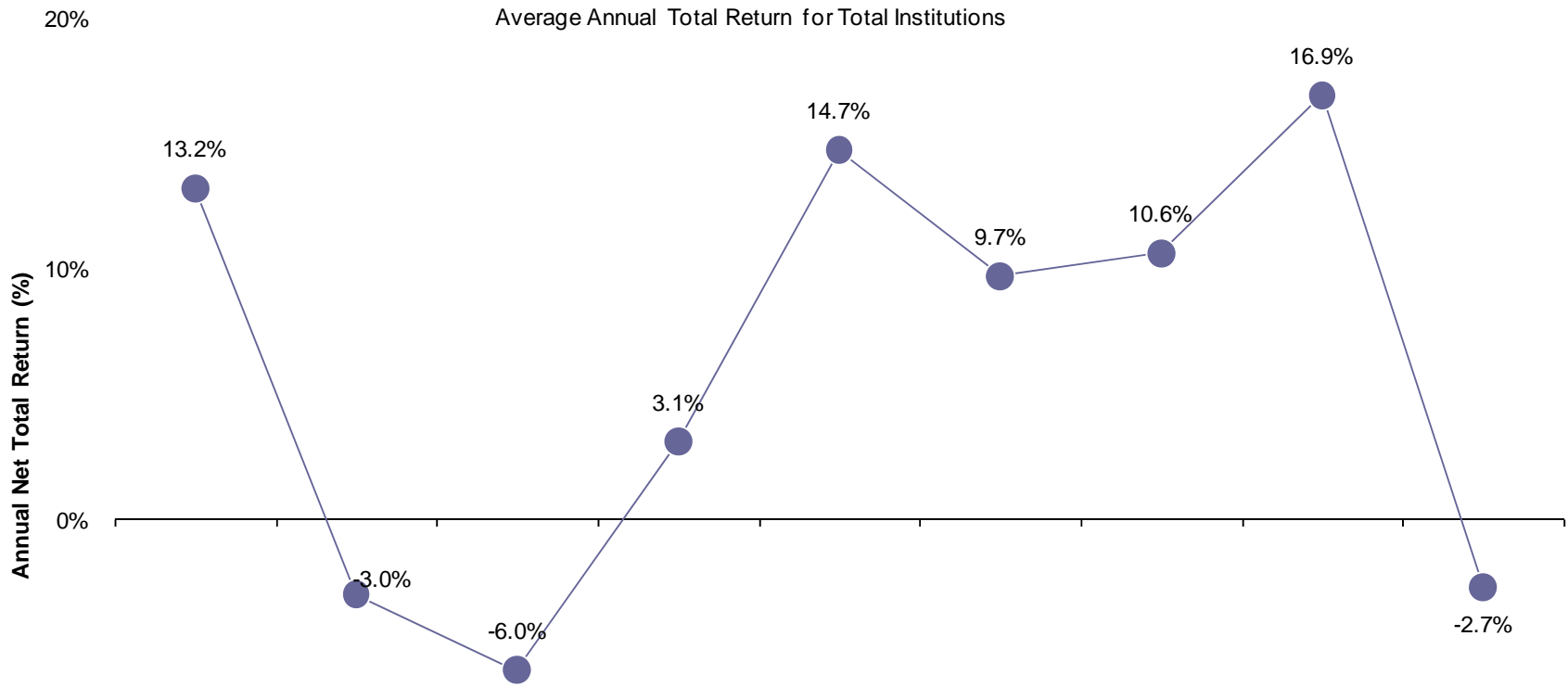
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# Average Annual Total Return<sup>1</sup> for Total Institutions

*Fiscal Years 2000-2008 ending June 30*



Number of Institutions	2000	2001	2002	2003	2004	2005	2006	2007	2008
	563	617	637	657	707	729	741	767	628

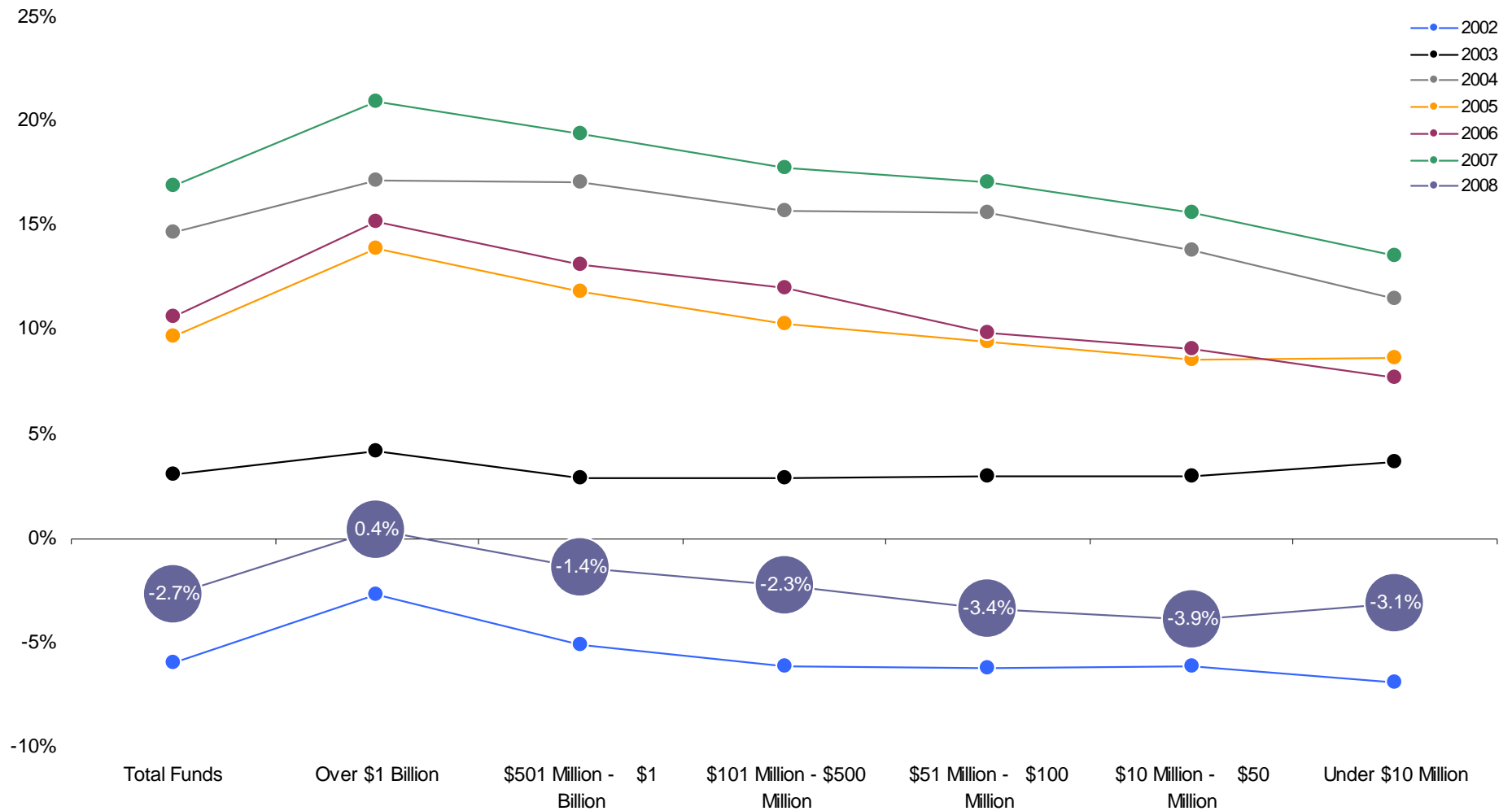
<sup>1</sup> Net of fees

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# Average Annual Total Return<sup>1</sup> by Size of Fund

Fiscal Years 2002-2008 ending June 30



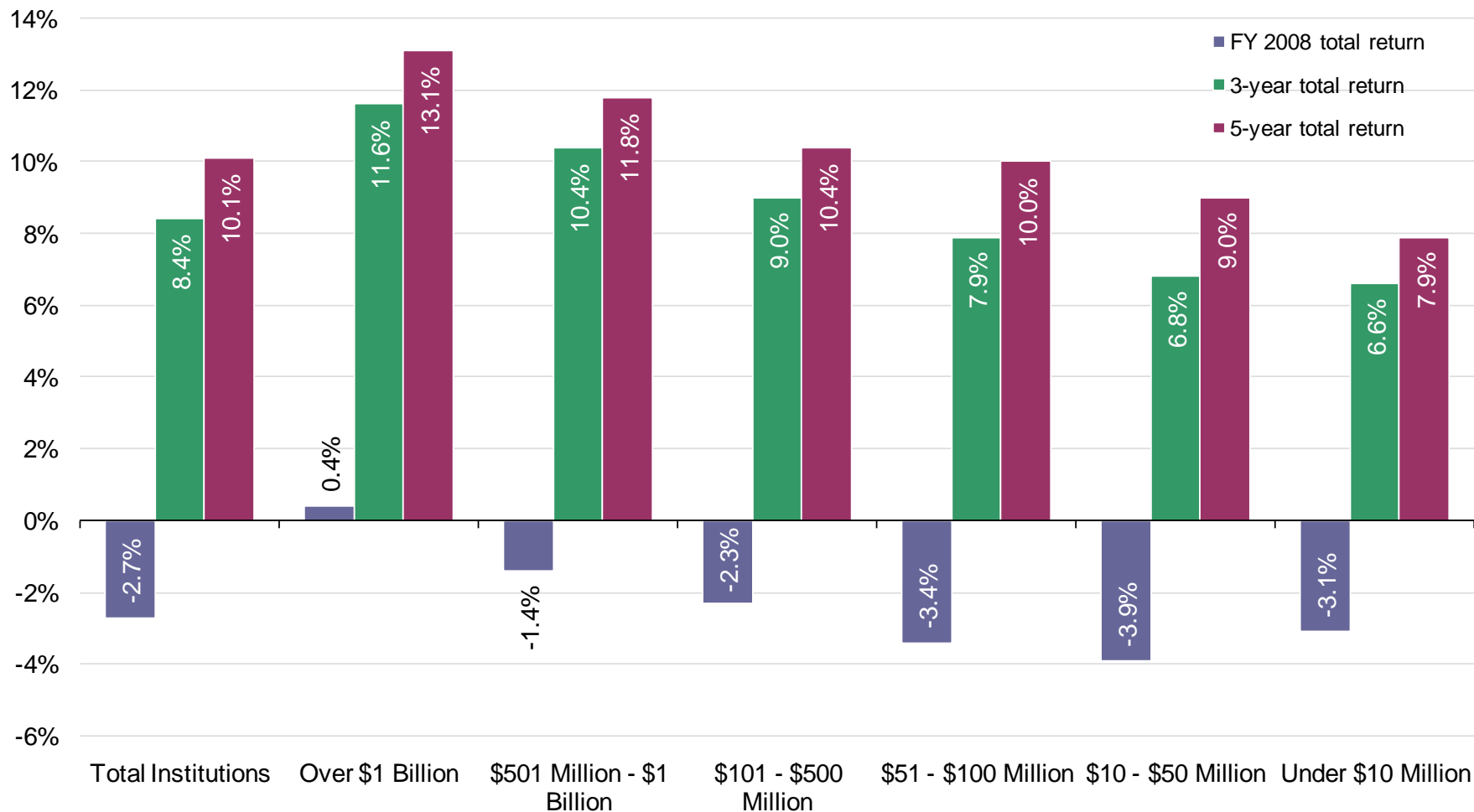
<sup>1</sup> Net of fees

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# Average Reported One-, Three- and Five-Year Returns<sup>1</sup>

*Fiscal Year 2008 ending June 30*



<sup>1</sup> Net of fees. 590 institutions provided return data for the most recent fiscal year, 482 institutions provided three-year data and 448 institutions provided five-year return data.

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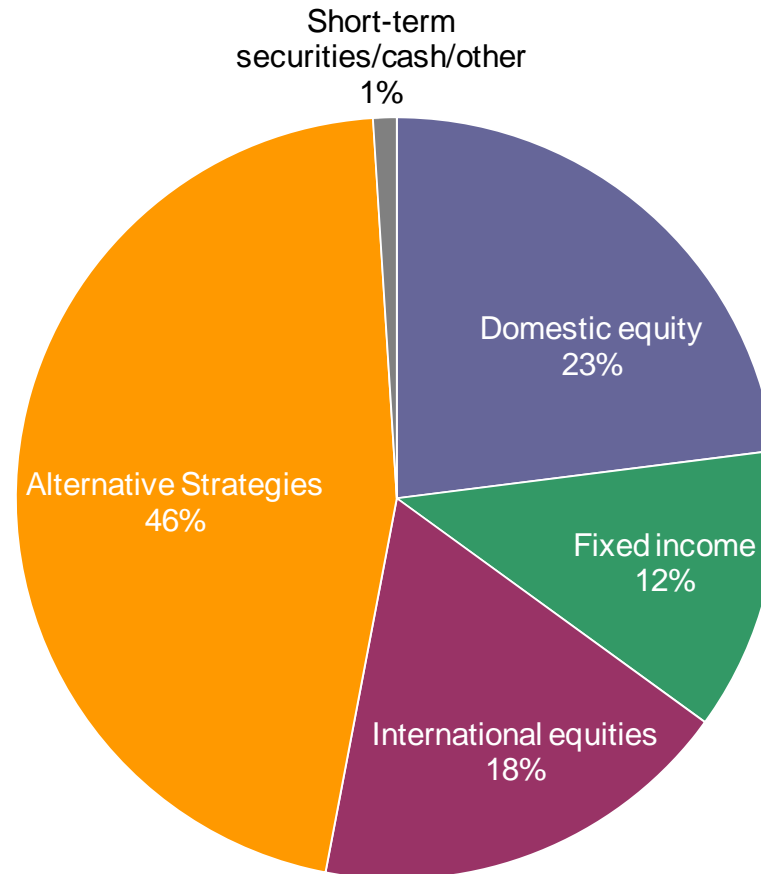
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# Asset Allocation for Total Institutions

*As of June 30, 2008*

## Total Institutions

Dollar-weighted Asset Mix | Fiscal 2008

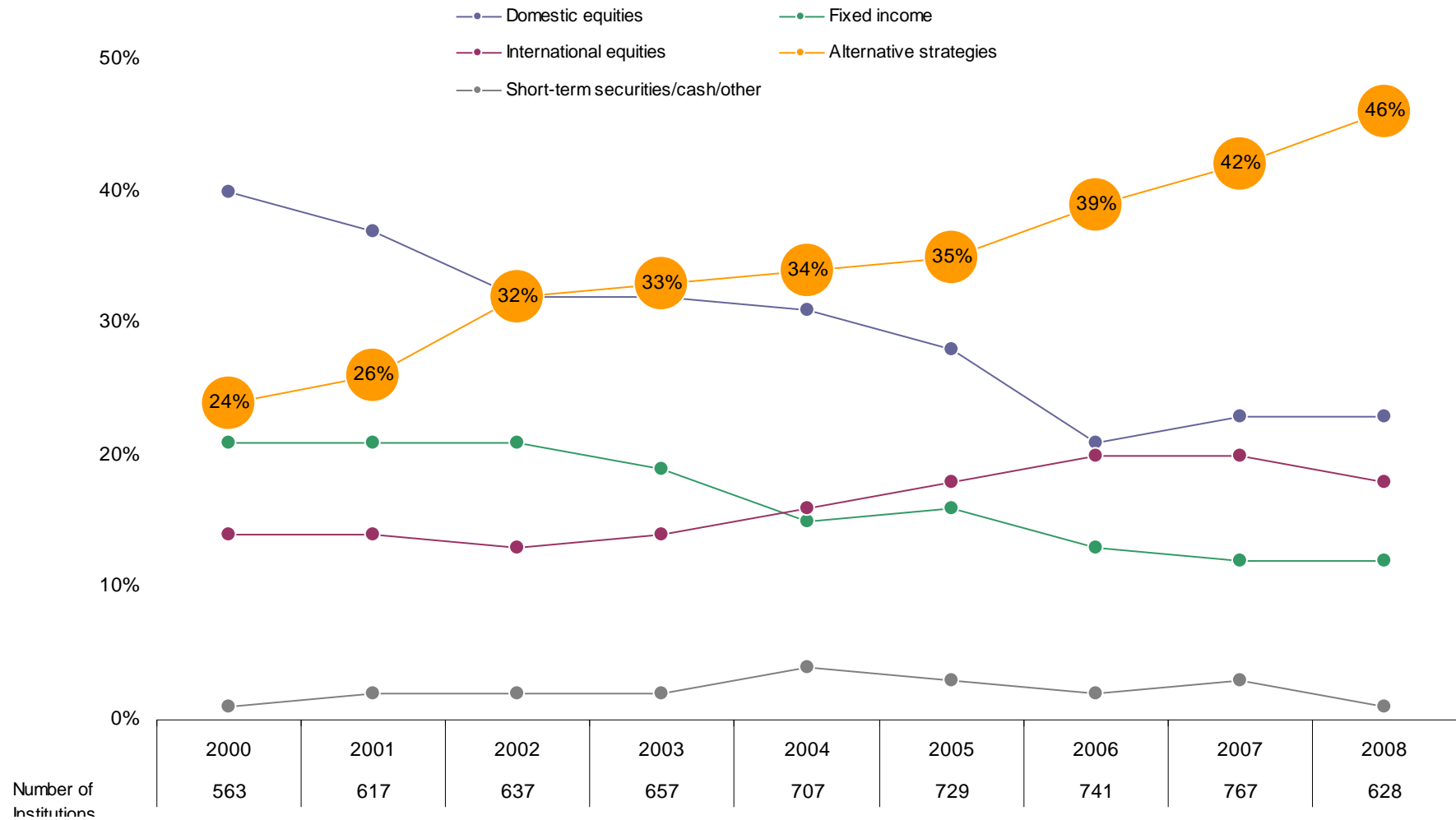


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# Asset Allocation Trend for Total Institutions

*Fiscal Years 2000-2008 ending June 30*



<sup>1</sup> Dollar-weighted

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# Allocations to Asset Classes<sup>1</sup>

*Fiscal Years 2007 – 2008*

	Total Institutions		Over \$1 Billion		\$501 Million - \$1 Billion		\$101 - \$500 Million		\$51 - \$100 Million		\$10 - \$50 Million		Under \$10 Million	
	767	628	56	49	44	37	210	188	106	92	246	191	105	71
Fiscal Year	'07	'08	'07	'08	'07	'08	'07	'08	'07	'08	'07	'08	'07	'08
Asset Class														
Domestic equities	23%	23%	19%	20%	29%	24%	34%	29%	45%	38%	45%	42%	49%	48%
Fixed income	12%	12%	11%	10%	12%	13%	14%	15%	17%	17%	20%	22%	26%	27%
International equities	20%	18%	21%	17%	20%	19%	20%	19%	17%	17%	14%	13%	10%	9%
Alternative strategies	42%	46%	47%	52%	35%	42%	28%	34%	18%	25%	15%	17%	7%	8%
Short-term securities/cash/other	3%	1%	2%	1%	4%	2%	4%	3%	3%	3%	6%	6%	8%	8%

| \* Dollar-weighted

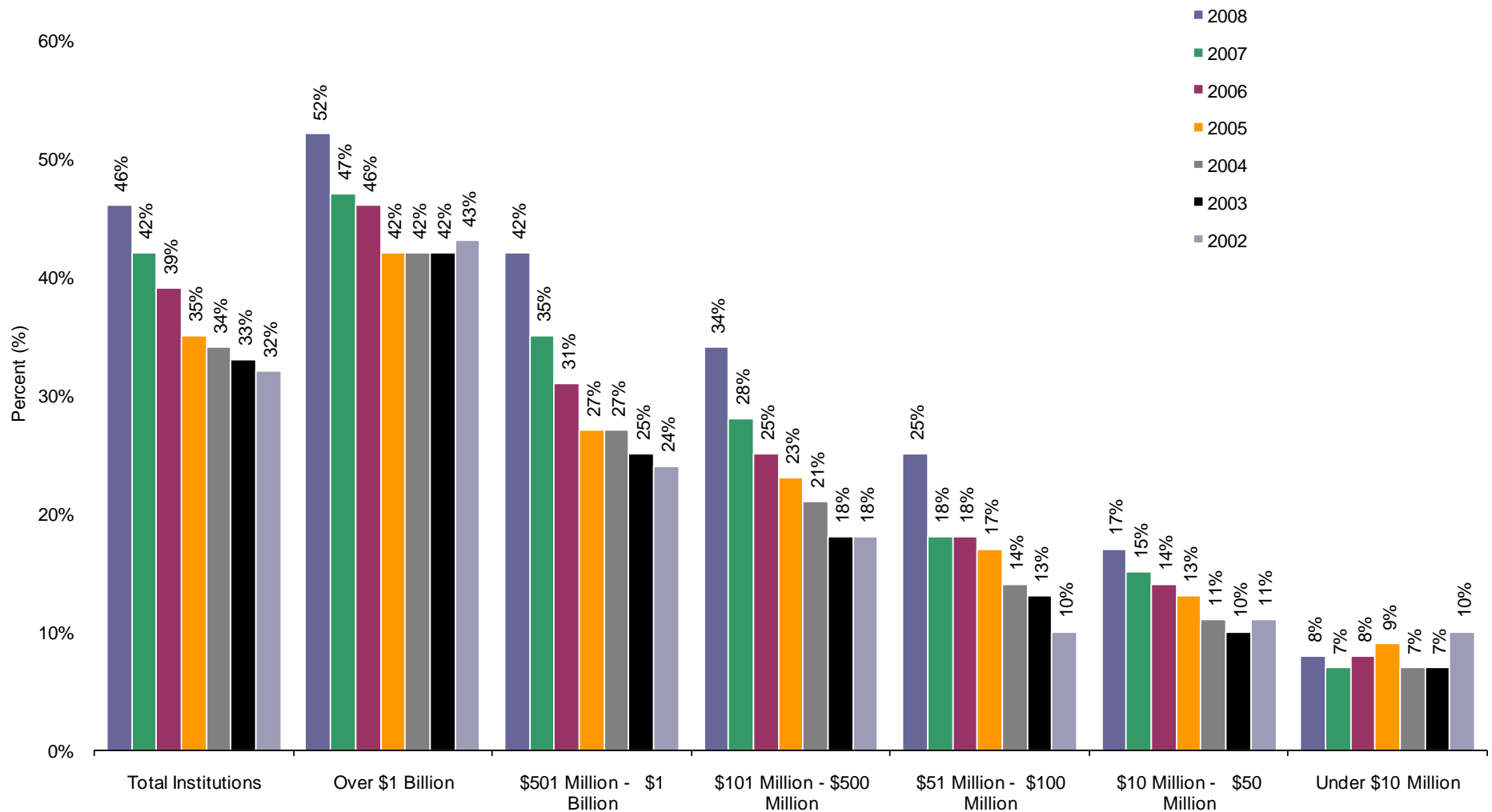
<sup>1</sup> Dollar-weighted

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# Growth of Alternatives within Segments

Fiscal Years 2002 – 2008 ending June 30



<sup>1</sup> Dollar-weighted

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# Alternative Strategies Asset Mix<sup>1</sup>

*Fiscal Years 2007 – 2008*

	Total Institutions		Over \$1 Billion		\$501 Million - \$1 Billion		\$101 - \$500 Million		\$51 - \$100 Million		\$10 - \$50 Million		Under \$10 Million	
	'07	'08	'07	'08	'07	'08	'07	'08	'07	'08	'07	'08	'07	'08
Responding institutions	644	539	55	47	42	36	194	174	92	82	190	149	71	51
Fiscal Year	'07	'08	'07	'08	'07	'08	'07	'08	'07	'08	'07	'08	'07	'08
Type of Investment														
Private equity	19%	19%	20%	20%	16%	19%	12%	14%	8%	10%	6%	7%	3%	0%
Marketable alternative strategies	48%	42%	46%	38%	54%	51%	60%	53%	64%	55%	70%	65%	73%	73%
Venture capital	7%	7%	7%	7%	7%	7%	4%	5%	3%	3%	2%	2%	0%	0%
Private equity real estate	14%	16%	15%	18%	9%	9%	10%	11%	13%	13%	11%	14%	9%	8%
Energy and natural resources	10%	14%	10%	15%	10%	11%	12%	14%	10%	15%	6%	7%	2%	2%
Distressed debt	2%	2%	2%	2%	4%	3%	2%	3%	2%	4%	5%	5%	13%	17%

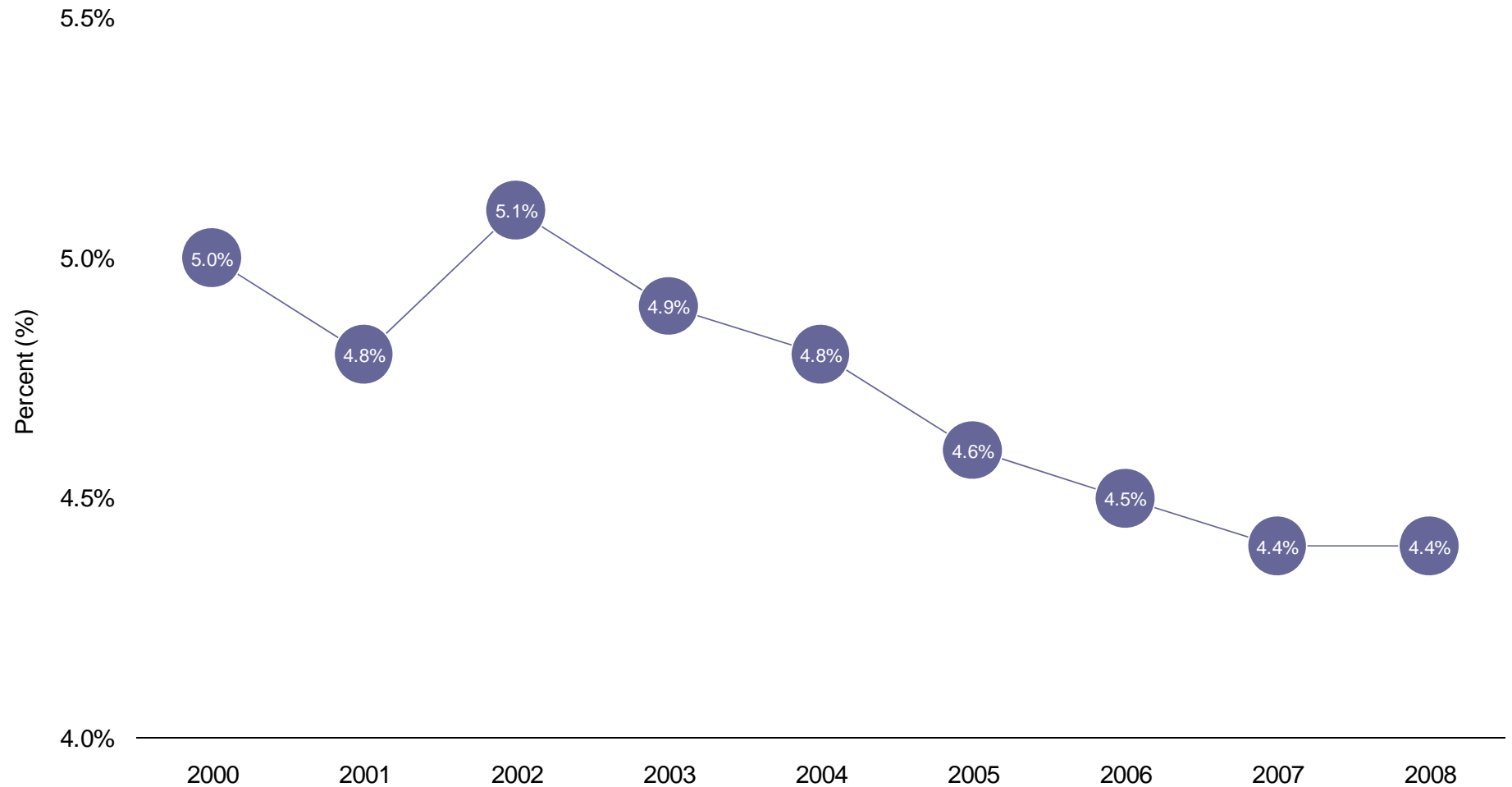
<sup>1</sup> Dollar-weighted

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# Spending Rates Remain Steady

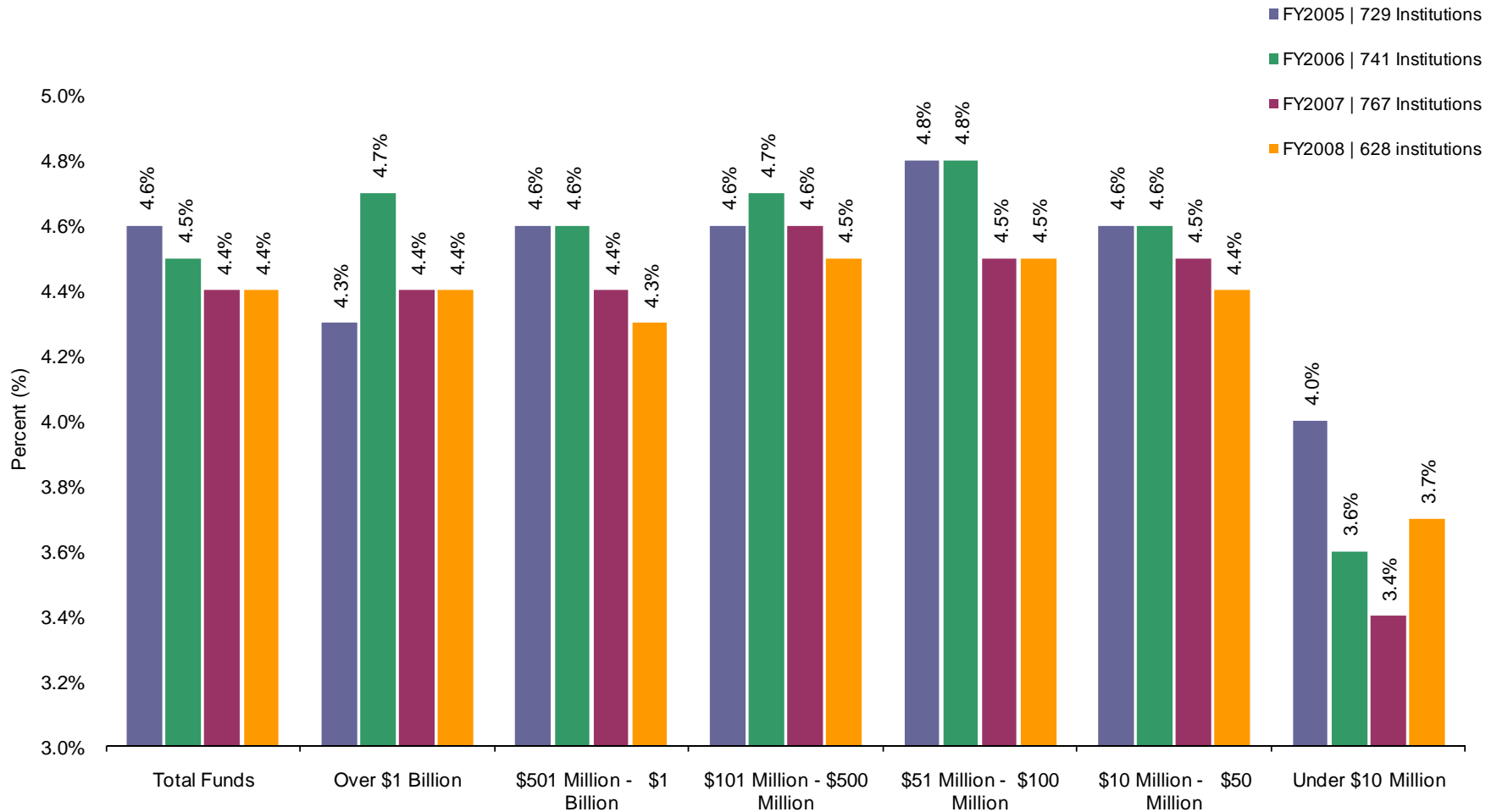
*Fiscal Years 2000 – 2008 ending June 30*



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# Spending Rates

Fiscal Years 2005 – 2008 ending June 30

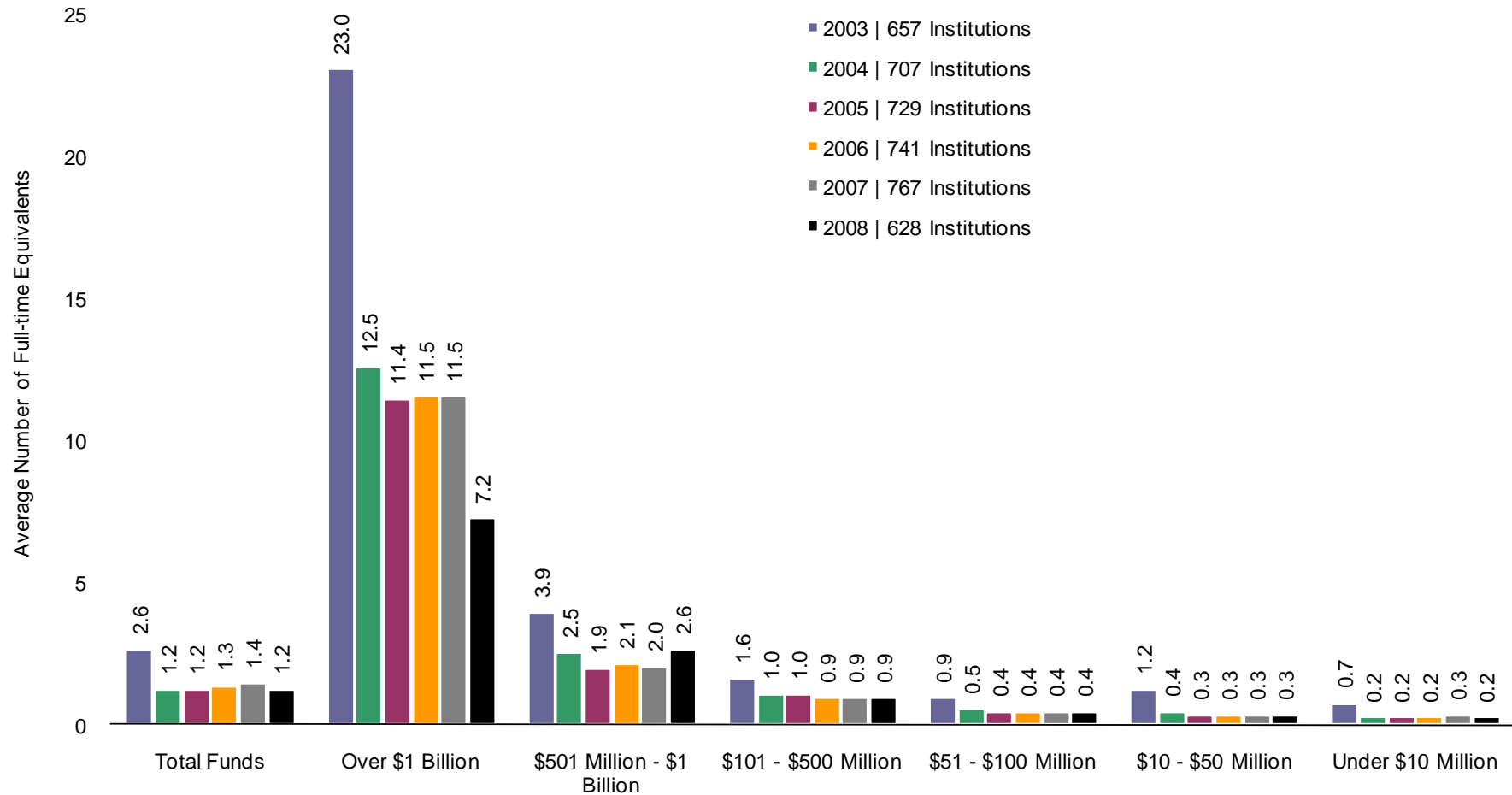


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# Professional Staffing of Investment Function

*Fiscal Years 2003 – 2008 ending June 30*

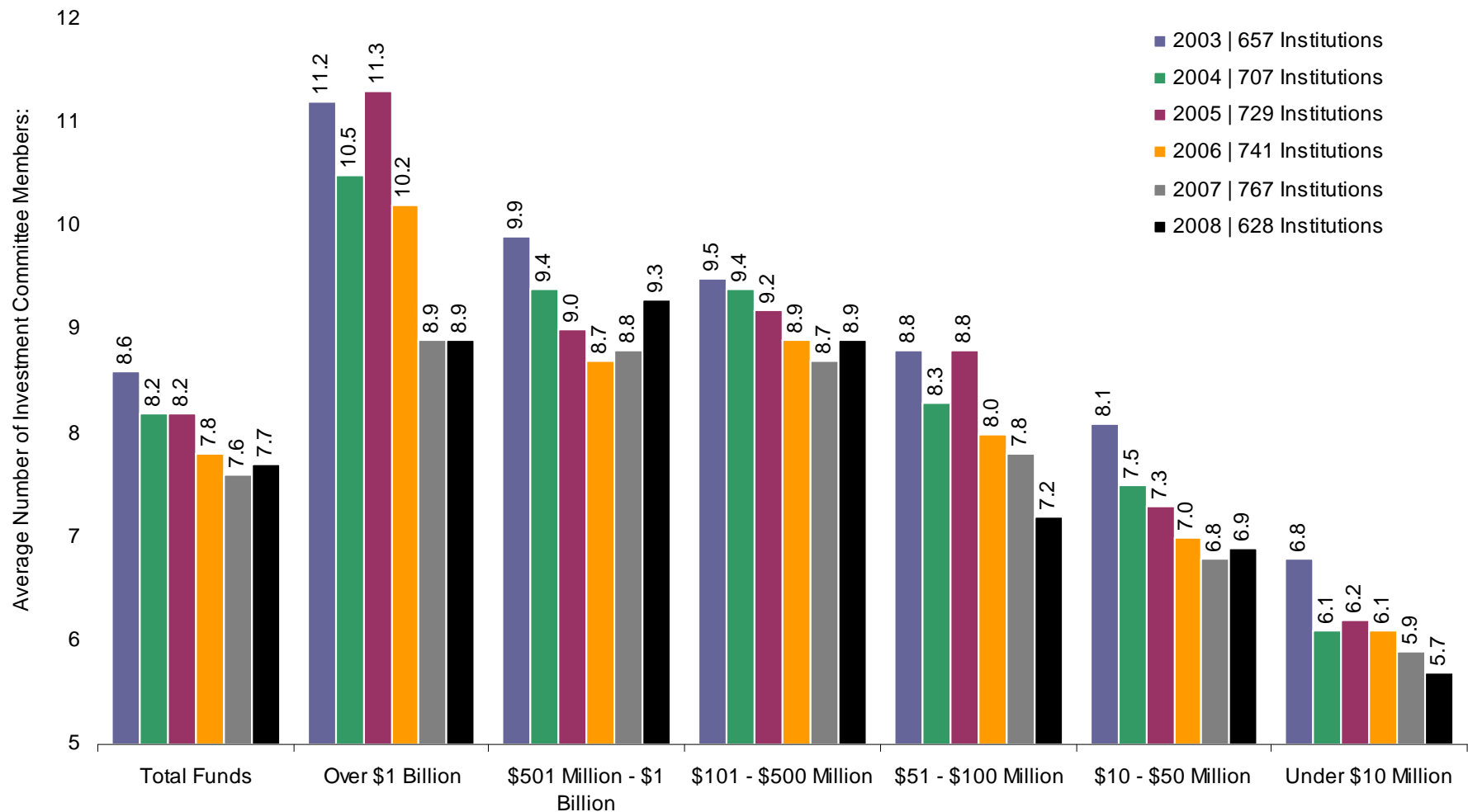


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# Average Number of Investment Committee Members<sup>1</sup> by Size of Fund

*Fiscal Years 2003 – 2008 ending June 30*



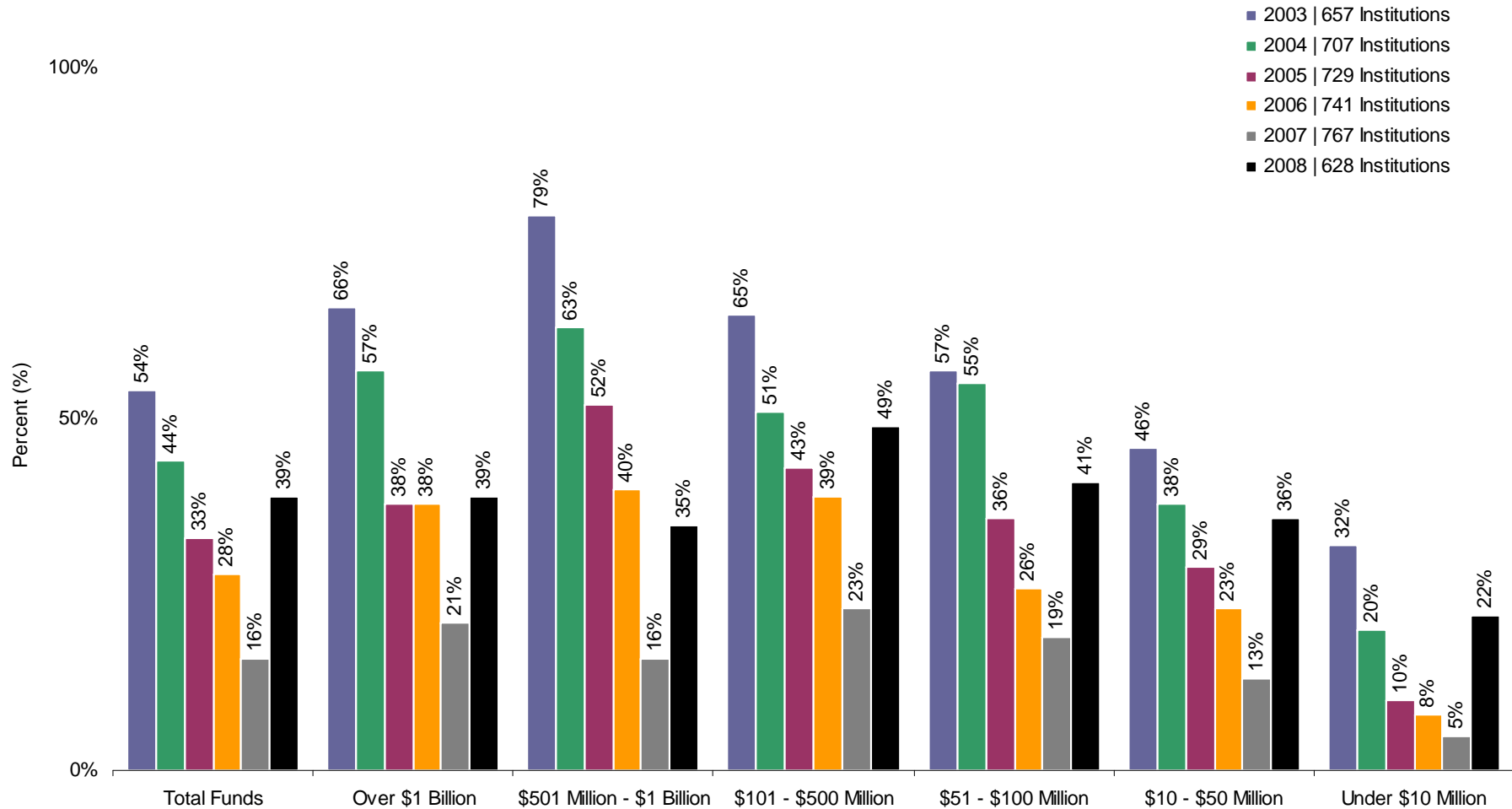
<sup>1</sup>FY2007- FY2008 answers reflect number of **voting** members.

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# Institutions Reporting Underwater Funds

*Fiscal Years 2003 – 2008 ending June 30*

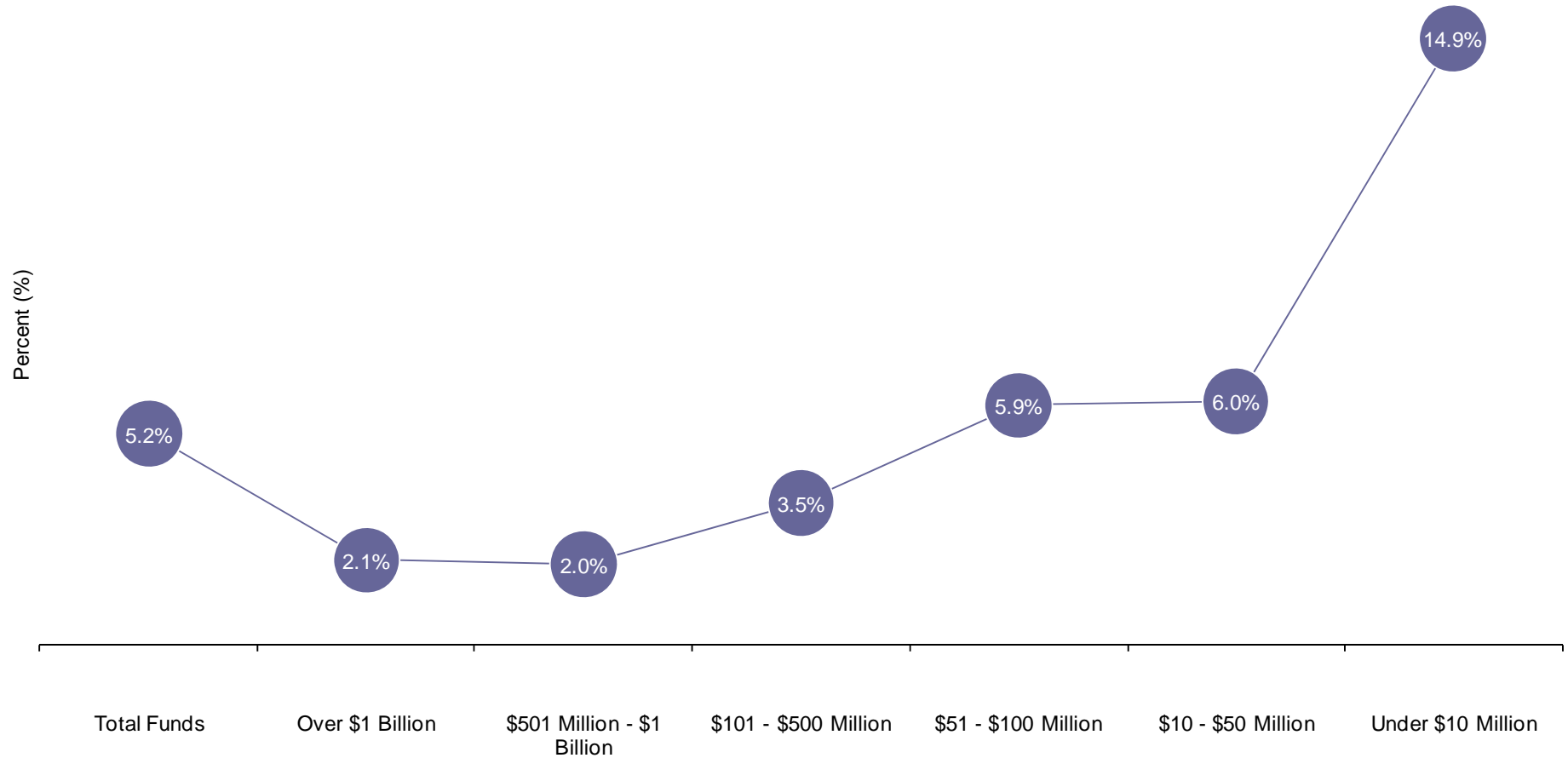


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# Percent of Endowment Underwater<sup>1</sup>

*Fiscal Year 2008 ending June 30*



<sup>1</sup> Based on 247 institutions reporting underwater funds

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# How Institutions Use the Higher Education Price Index (HEPI)

*As of June 30, 2008*

Numbers in Percent (%)	Total Institutions	Over \$1 Billion	\$501 Million - \$1 Billion	\$101 - \$500 Million	\$51 - \$100 Million	\$10 - \$50 Million	Under \$10 Million
	628	49	37	188	92	191	71
Use HEPI	27	37	41	34	27	21	11
<b>Use for:<sup>1</sup></b>							
<i>Setting spending rate</i>	20%	33%	13%	21%	28%	10%	13%
<i>Budget process</i>	56%	50%	60%	52%	52%	65%	50%
<i>As investment benchmark or hurdle rate</i>	24%	44%	40%	27%	16%	15%	0%
<i>Setting tuition</i>	7%	11%	7%	3%	4%	10%	13%
<i>Other</i>	11%	0%	7%	11%	16%	10%	25%

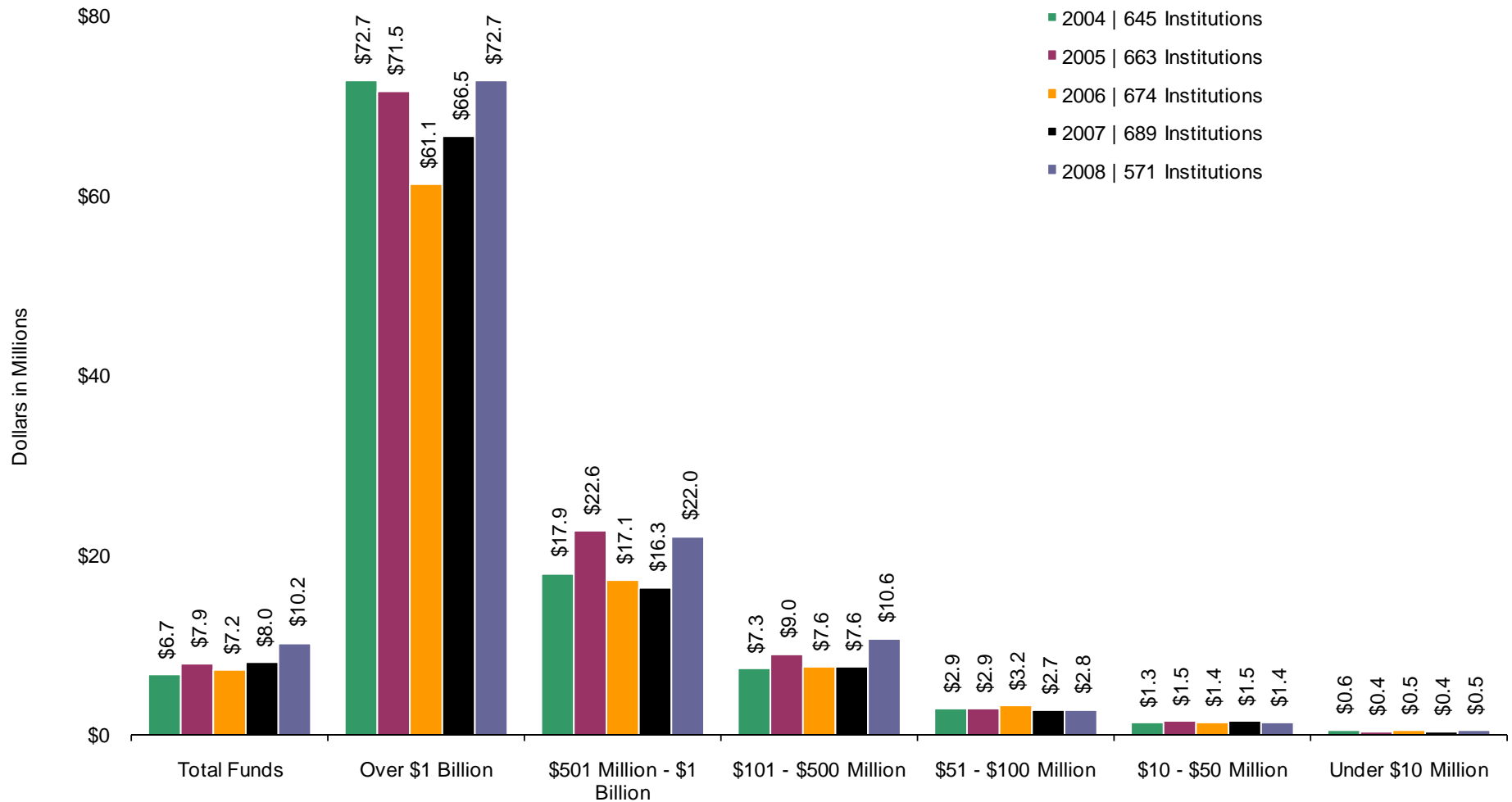
<sup>1</sup>Multiple responses allowed

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# Average Total Amount of New Gifts to Endowment

*Fiscal Years 2004 – 2008 ending June 30*

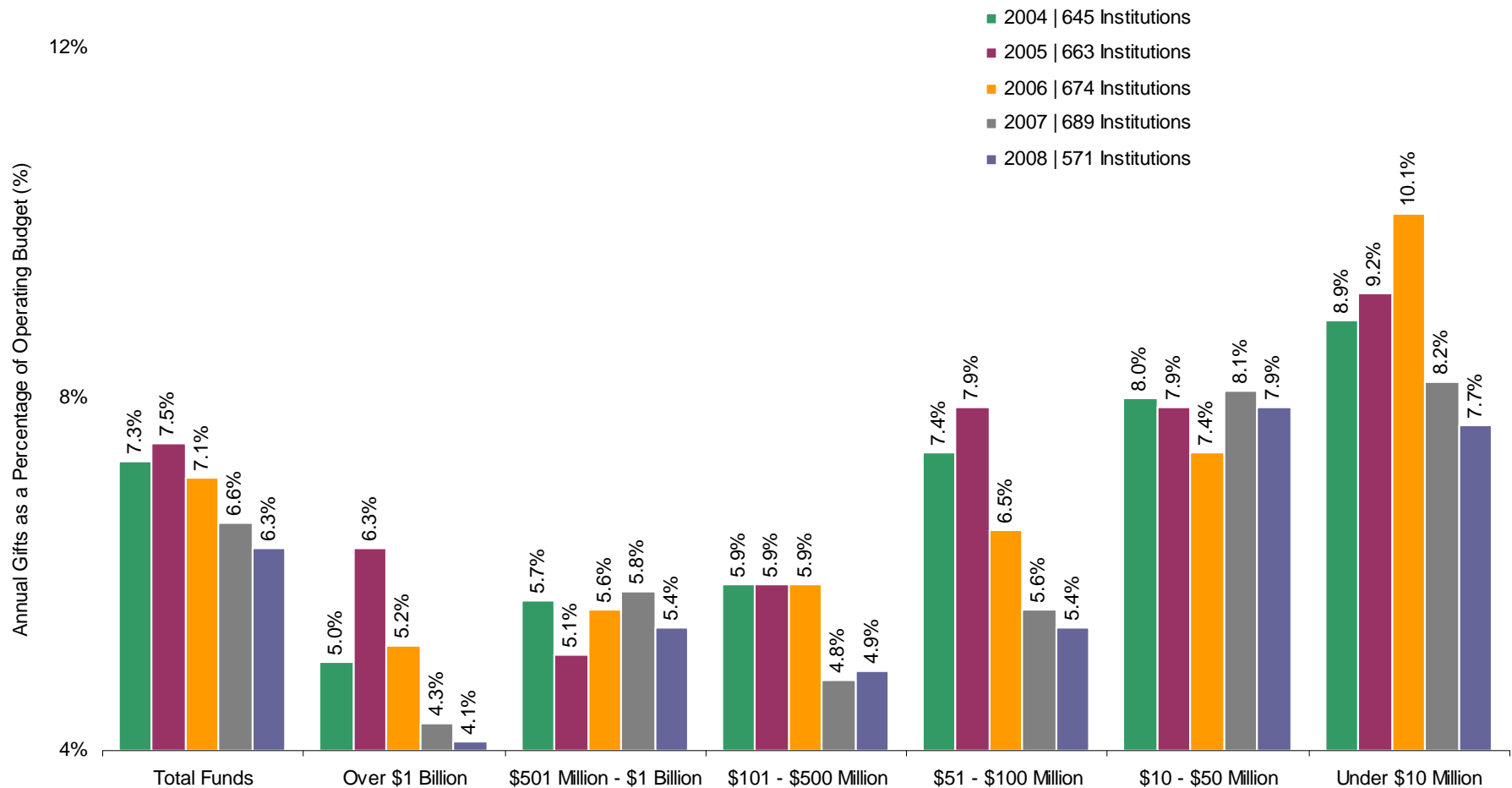


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# Annual Gifts as a Percentage of Operating Budgets

Fiscal Years 2004 – 2008 ending June 30



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# Formal Debt Policies<sup>1</sup>

Fiscal Year 2008 ending June 30



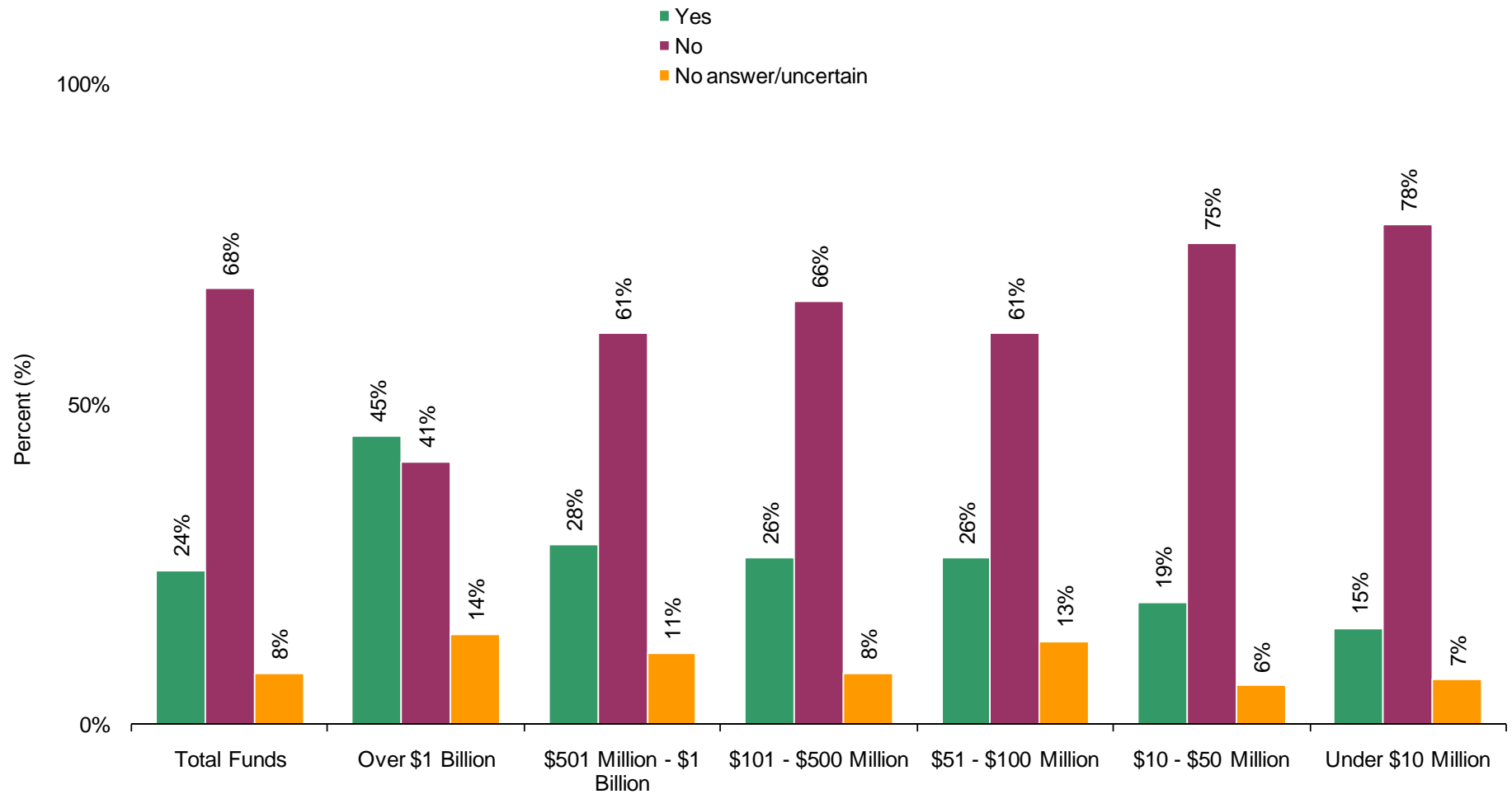
<sup>1</sup>Based on 432 responding institutions

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# Plan to Increase Debt in Next Two Years<sup>1</sup>

*Fiscal Year 2008 ending June 30*

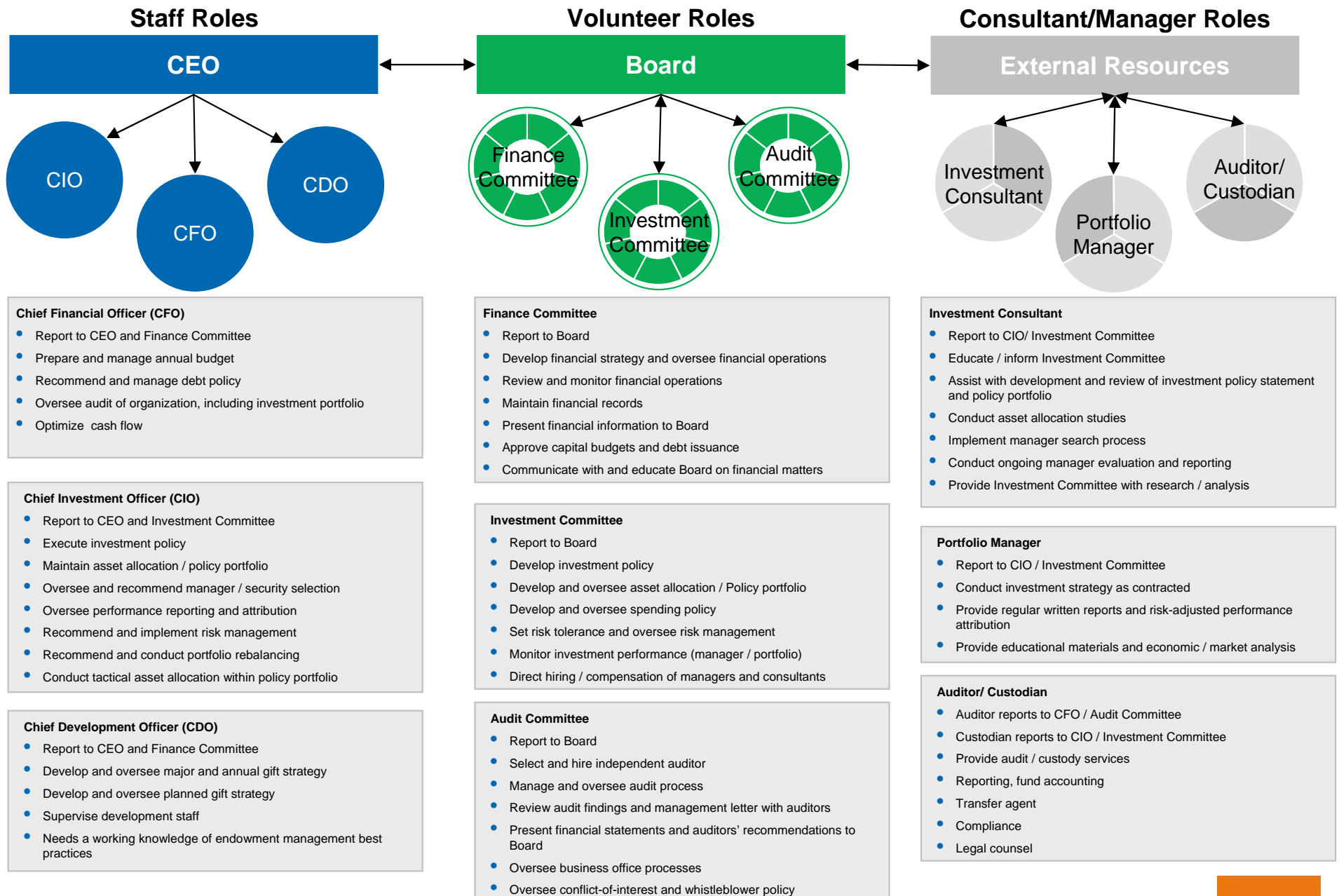


<sup>1</sup>Based on 556 responding institutions

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# Nonprofit Investment Management Governance Model



# Governance Update

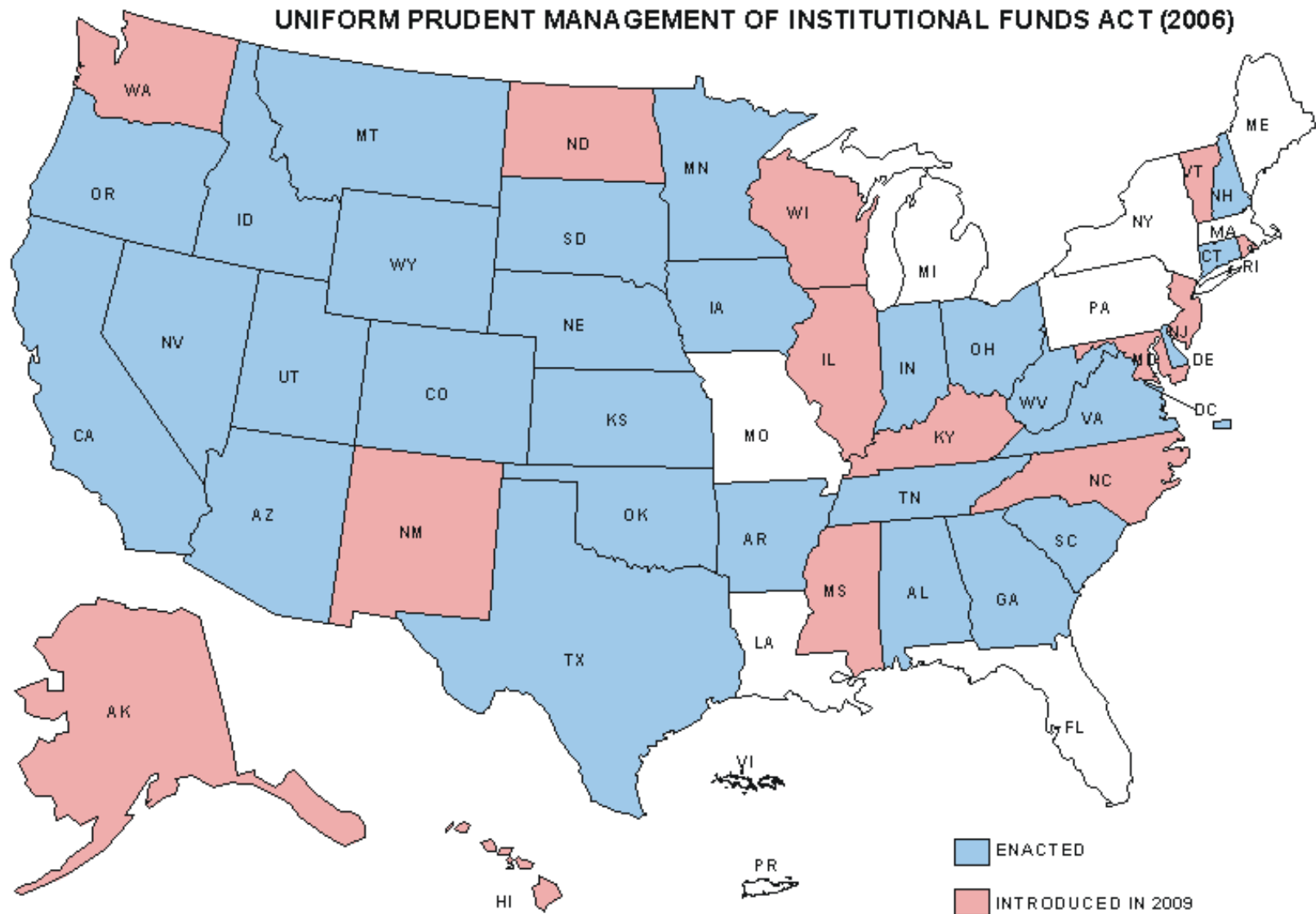
## Redesigned IRS Form 990

- Guiding Principles
  - Enhancing transparency
  - Promoting compliance
  - Minimizing the burden on filing organizations

## UPMIFA

- **Investment freedom.** Portfolio managers are not limited in the kinds of assets that may be sought for the portfolio. (Broader than UMIFA)
- **Costs.** Costs must be managed prudently in relationship to the assets, the purposes of the institution and the skills available to the institution. (Not addressed in UMIFA)
- **Expenditure of funds.** Total return expenditure is expressly authorized under comprehensive prudent standards relating to the whole economic situation of the charitable institution. (UMIFA does not address this standard)
- **Historic dollar value abolished.** UPMIFA abolishes the historic dollar value limitation on expenditure in UMIFA.
- **Seven percent rule.** States may adopt an optional rule that presumes expenditure exceeding 7% of total return is imprudent.
- **Release of restrictions for small institutional funds.** UPMIFA provides new procedures for releasing restrictions on small institutional funds (less than \$25,000) held for a long period of time (20 years), requiring only notice to the Attorney General 60 days in advance of the release. (Not addressed in UMIFA)
- **Application.** UPMIFA applies to funds held in any form, including nonprofit corporate form, except charitable trusts, with a commercial or individual trustee. (UMIFA applies only to endowments held by a charitable institution for its own account.)

# UPMIFA | Enactment Status



March 11, 2009

Source: Uniform Law Commission

# Policy Development Example | Spending Policy Approaches

## Traditional

Pre-specified percentage of moving average of market value – typically 5% of a three year moving average of beginning market values

## Inflation Based

Increase spending each year based on rate of inflation

## Income Based

Spend all current income

## Banded Inflation

Last year's spending plus an inflation rate, but bound by ranges, e.g. – no more than 6.5% nor less than 3.5%

## Spending Reserve

Segregation of 5-10% of market value in separate account, invested in 90 day treasury bills. Reserve is drawn down when endowment performance is less than policy target

## Stabilization Fund

A fund created from endowment returns in excess of the target spending rate which is used to control the long run growth of the total endowment. The stabilization fund is invested alongside the endowment, but with a different (higher) spending rate.













## “Yale Rule”

The amount released under the spending rule is based on a weighted average of prior spending adjusted for inflation (80 percent weight) and the amount that would have been spent using 5 percent of current Endowment market value (20 percent weight).

## “Stanford Rule”

The calculation is an average weighted 60% on the actual payout from the current year and 40% on the target payout rate. This policy results in a “smoothing” of the payout amount, and it is designed to cushion the university from swings in the yearly endowment value due to market fluctuations.

# Policy Issues

	Intergenerational Equity	Median Spend	Volatility of Spending
<b>Asset Allocation</b> (increased diversification)			
<b>Contributions</b> (increased)			
<b>Spending Rate</b> (lower)			
<b>Spending Method</b> (smoothing effect)			

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## APPENDIX

fi360<sup>®</sup>  
global  
fiduciary insights

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