Successful Endowment Fundraising and Management in Today’s Environment

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The Generations

**Traditionalist**
Born 1945 and earlier (age 71+ as of 2016)
27.1MM donors in the U.S.
$1,367 avg. annual giving

**Boomers**
Born 1946–1964 (age 52–70 as of 2016)
51.0MM donors in the U.S.
$1,212 avg. annual giving

**Generation X**
Born 1965–1980 (age 36–51 as of 2016)
39.5MM donors in the U.S.
$732 avg. annual giving

**Millennials**
32.8MM donors in the U.S.
$481 avg. annual giving

Boomers Are the Wealthiest Generation

Net Wealth, All Generations ($ Trillions)

Enrollment in Institutions of Higher Education
1950–1980

Estimated Age Today

What Shaped the Boomers’ Attitudes?
Boomers as Donors
Boomer Objectives

- Philanthropic
- Financial Planning
- Personal and Family
Boomer Objectives

- Personalized appeals
- Want to see the impact
- Want to participate
- Belief in their ability to effect change
Boomer Objectives

- Financing their own retirements
- See themselves as young
- Longer life expectancies
- Worry about outliving assets
- More complex assets
- Skeptical of stock markets
- Using more advisors
Boomer Objectives

- Different family structures
- Started families later
- Launching children later
- Cost of higher education
Ways to Encourage the Funding of Endowments

- Planned gifts
- Blended gifts
- Class endowments
- Matching programs
- Endowed annual fund gifts
How Are Boomers Different as Donors?

Identify

Steward

Readiness

Cultivate

Ask
Changing Donor Attitudes

**How are you making the case for endowed gifts?**

“I think I can invest these assets better than you.”

“I don’t want an endowment. I don’t believe in stock-piling money.”

“How will you demonstrate your results?”
Alternatives to Pure Endowments

Term
Quasi by donors
Virtual
Current State of E&F Market
# Muted Endowment Returns

## Periods Ending 6/30/16

<table>
<thead>
<tr>
<th>NACUBO Results</th>
<th>1 Year</th>
<th>3 Years</th>
<th>5 Years</th>
<th>10 Years</th>
</tr>
</thead>
<tbody>
<tr>
<td>25&lt;sup&gt;th&lt;/sup&gt; percentile</td>
<td>-0.7%</td>
<td>6.1%</td>
<td>6.2%</td>
<td>5.6%</td>
</tr>
<tr>
<td>50&lt;sup&gt;th&lt;/sup&gt; percentile/median</td>
<td>-2.1</td>
<td>5.1</td>
<td>5.2</td>
<td>4.9</td>
</tr>
<tr>
<td>75&lt;sup&gt;th&lt;/sup&gt; percentile</td>
<td>-3.3</td>
<td>4.2</td>
<td>4.5</td>
<td>4.2</td>
</tr>
</tbody>
</table>

4.3% is the average annual effective spending rate for all institutions

Source: Comparative endowment returns provided by the 2016 NACUBO-Commonfund Study of Endowments (NCSE). Returns are annualized. The 6/30/16 NACUBO data are the most recent available.
7.4%

The amount the median institution needs to earn in order to maintain the purchasing power of its endowment after spending, inflation, and investment management costs.

Pressures Facing Endowments

- Muted Investment Returns
- Current Spending vs. Growth
- Underwater Endowments
- Concerns About Fees
- Public Perceptions
Looking Forward: What Do We Expect?
Forward Looking Return Expectations

We believe that endowments and foundations should carefully consider their current strategic asset allocation given recent and projected investment returns.

<table>
<thead>
<tr>
<th>US Fixed Income</th>
<th>3.8% nominal</th>
</tr>
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<tbody>
<tr>
<td>Global Fixed Income</td>
<td>4.3% nominal</td>
</tr>
<tr>
<td>Public Equity</td>
<td>7.6% nominal</td>
</tr>
<tr>
<td>Private Equity: Buyouts</td>
<td>10.6% nominal</td>
</tr>
<tr>
<td>Private Equity: Venture</td>
<td>12.6% nominal</td>
</tr>
<tr>
<td>Overall PE</td>
<td>11.2% nominal</td>
</tr>
</tbody>
</table>

Disclosures:
Capital Market Assumptions (CMAs) were empirically derived for all relevant asset classes. CMAs were then qualitatively adjusted where deemed necessary to incorporate Covariance’s market views. CMAs reflect Covariance’s real return forecasts for several asset categories as of Q3 2014 and for a period of 20 years (Asset Allocation Period). These assumptions are passive only – they do not include the impact of active management or fees and expenses (including trading costs and taxes). The Expected Return and the Expected Risk figures set forth above are based, in part, upon the historical return of each of the indices listed on the next slide and anchored on their relationship with the MSCI ACWI Total Return index. These figures also incorporate Covariance’s market views. These CMAs are forward-looking statements based upon Covariance’s reasonable beliefs. There can be no assurance that these returns can be achieved. Actual returns are likely to vary. Strategic long-term assumptions are subject to high levels of uncertainty regarding future economic and market factors that may affect future performance.

1Based on Covariance Capital’s Capital Market Assumptions. Past performance is no guarantee of future performance.
Investment Returns Going Forward

We believe that the Endowment model is an approach that can be used to improve LT returns.

Implications for budget and spending.
Why Invest in Private Markets?
Why Invest in the Private Markets?

Long-term investors, such as endowments and foundations, benefit from the ability to take on illiquidity to provide potential return enhancement and inflation protection.

However, Private Markets investing requires thoughtful investment theses, processes, discipline and deep networks.
Key Considerations for Investing in Private Markets
A Private Markets Value Framework

1. Buying Power
2. Expertise
3. Diversification
4. Economies of Scale
5. Access
Active vs. Passive Management Today
Active or Passive Management?

As many active managers have failed to outperform passive products during the recent equity bull market and as flows into passive vehicles have dramatically increased, Investment Committees are re-examining the role of active managers relative to passive investments.
History and Near-Term Future of Alpha

Endowments have also handily outperformed the two most prevalent passive equity/fixed income benchmarks over the long term. It is important to remember the idiosyncratic and uncorrelated nature of alpha which serves as both an absolute return driver and also a risk mitigation tool.

### Long-term Alpha of Endowment-Style Investing

<table>
<thead>
<tr>
<th>Portfolio</th>
<th>As of FY 2016</th>
<th>As of FY 2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>70% MSCI ACWI / 30% Barclays US Aggregate</td>
<td>4.9%</td>
<td>6.2%</td>
</tr>
<tr>
<td>60% MSCI ACWI / 40% Barclays US Aggregate</td>
<td>5.1%</td>
<td>6.1%</td>
</tr>
<tr>
<td>Endowments &gt; $1 billion in AUM (NACUBO)</td>
<td>5.7%</td>
<td>7.2%</td>
</tr>
</tbody>
</table>

In general, active management has the often hidden benefit over passive approaches of providing rational limits to company-, sector- and industry-level concentration.
Why Active Management Now?

- Divergent central bank policies and economic outlooks
- Interest rate normalization and increasing dispersion between individual stocks and sectors
- Massive inflows to passive products
- Rich equity valuations
- Extremely low equity volatility
Evaluating Spending Policies
A Clearly Defined and Thoughtfully Applied Spending Rule is Critical

- Need for a sustainable policy
- Need consistent flow of income to operating budget
- Must safeguard real value of endowment over time
Choosing a Method

Two prominent policies in use today:

**Moving Average Payout Method**
The spending model calculates the actual payout based on a moving average, typically over three years.

**Snake in the Tunnel Payout Method**
The spending model aims to maintain budgetary stability by simply increasing the annual payout each year by a certain inflation-linked rate.
Model Comparison

The nature of the SIT paradigm provides much more stable, persistent, and predictable payout streams, which is valuable to budgetary offices and investment committees alike.

Comparison of Snake in Tunnel and Moving Average Models

<table>
<thead>
<tr>
<th></th>
<th>Nominal Terminal NAV at Year 30 ($)</th>
<th>Total Pay over 30 years ($)</th>
<th>Prob. of Real Asset Value &lt; $100 at Year 30</th>
<th>Prob. of Reducing Real Pay (Average Yr 5-30)</th>
<th>Total Pay Present Value ($) r = 3.0%</th>
</tr>
</thead>
<tbody>
<tr>
<td>5% of 3-Year MA</td>
<td>297</td>
<td>257</td>
<td>33%</td>
<td>23%</td>
<td>155</td>
</tr>
<tr>
<td>SIT 3%-7%</td>
<td>319</td>
<td>254</td>
<td>32%</td>
<td>3%</td>
<td>153</td>
</tr>
<tr>
<td>4% of 3-Year MA</td>
<td>402</td>
<td>243</td>
<td>18%</td>
<td>19%</td>
<td>144</td>
</tr>
</tbody>
</table>

Effect of Different Return Assumptions

By looking at real-pay risks across different equity return assumptions, we find that the MA model is also much more sensitive to expected return reductions.
Transitioning to an SIT spending policy may present an easier way to downshift spending from 5% target, as it requires little short-term practical changes and does not entail an abrupt stepdown in spending.
Conclusion

Downshift Spending

Implement SIT Policy

Predictable Annual Payout
Questions?
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