Investing for the Future

Fiscal 2008 was a challenging year for global markets and the University of Miami's endowment. Despite a strong finish (+4.1 percent for the three months ending May 31, 2008), the Growth Pool realized a total return of -1.8 percent (net of fees) for the year. This represented a modest shortfall, compared to the benchmark, of -.9 percent and only the fourth time in the past 11 years that the portfolio did not exceed its benchmark. Increased diversification away from traditional U.S. publicly traded equities helped lessen the pain significantly, as the S & P 500 index declined 6.7 percent during the same period. In particular, alternatives strategies rose 8.1 percent. Within that category, real assets earned 26 percent, long-short equity hedge funds earned 4.1 percent, and private equity investments produced IRRs ranging from 4.9 percent to 22 percent for the year. Both high-yield bond managers (+1.9 percent) and traditional fixed income (+7.7 percent) showed strong results in an otherwise tough bond market.

In June 2007 investors enjoyed "the best of all possible worlds," with an environment of unlimited liquidity, ubiquitous economic growth, low risk, and easy credit. The ongoing and well-publicized weakness in the housing and mortgage sector was a growing source of investor unease as several high-profile hedge funds imploded. Nevertheless, the crisis was deemed manageable with limited negative repercussions on the general economy. Commodities, especially oil, were high but most experts thought they would neither derail the overall stability of the U.S. economy nor presage a period of prolonged inflation. Developing economies were robust and, with a weak dollar, exports would help prop up the U.S. economy.

What a difference a year makes! What began as a "sub-prime" mortgage phenomenon spread to other sectors of global debt and equity markets. Headline inflation reached 5 percent in June, or 2.4 percent without the impact of energy and food. Liquidity at any price is scarce, indicating high-risk aversion among providers of capital. Although central banks around the world have acted swiftly to provide liquidity to banks and other financial institutions, their actions to date have been only partially successful: Central bankers cannot force banks to extend credit and make loans. The credit "crisis" is now officially a credit "crunch," as bank credit declined by over $200 billion in the past quarter. Finally, what was originally perceived as an isolated problem in an arcane part of the U.S. housing market (sub-prime) is having a real impact on the U.S. and global economies as growth has moderated in the past six months. Is the U.S. economy at the end of a long period of solid, non-inflationary growth financed by cheap credit from emerging economy surpluses? The next cycle, although not yet clear, will certainly be different and pose a new set of challenges.

GROWTH POOL STRATEGIC ASSET ALLOCATION

	Allocation (%)		
Asset Class	Policy Target	Operating Target	May 2008
U.S. Large/Mid Cap Equity	17.5	32.0	29.6
U.S. Small Cap Equity	5.0	8.0	8.7
International Equity	20.0	18.0	18.3
Emerging Markets Equity	2.5	N.A.	0.7
Fixed Income	12.0	15.0	13.4
Hedge Funds	30.0	17.0	20.0
Private Equity	5.0	5.0	4.0
Real Assets (including real estate)	8.0	5.0	5.3

**The Policy Targets listed above were adopted in April 2008. Although progress towards these new targets has already begun, it is expected to take between one to three years to achieve. As additional capital is invested in slower to fund areas such as hedged equity and real estate, their target allocations will mirror the Policy Targets more closely.*

		Benchmark Returns			
Time Period	Growth Pool Returns	Total Portfolio	S&P 500	Lehman Aggregated Bond Index	CPI Increase Rate
10 Year	6.3%	5.9%	4.2%	5.8%	2.9%
5 Year	10.6%	10.5%	9.8%	3.8%	3.3%
3 Year	9.8%	9.0%	7.6%	4.3%	3.5%
1 Year	-1.8%	-0.9%	-6.7%	6.9%	3.7%

ENDOWMENT GROWTH - AT MARKET (in millions)

	One Year	Five Years	Ten Years	Fifteen Years
Beginning Balance	$ 741.3	$ 413.7	$ 417.8	$ 228.3
Return, including unrealized appreciation	(13.1)	269.3	314.8	528.9
Distributions to operations, etc.*	(31.9)	(127.8)	(230.1)	(292.7)
Net increase (decrease)	696.3	555.2	502.5	464.5
Gifts and other net additions	39.9	181.0	233.7	271.7
Ending Balance	$ 736.2	$ 736.2	$ 736.2	$ 736.2

**This is pursuant to University policy, which is to distribute 5 percent of the three-year moving average of the corpus of most endowment accounts.*

The Board of Trustees' Investments Committee regularly reviews the Growth Pool's asset allocation and its performance against both a custom benchmark and its peer institutions' performance. It also tracks the performance of individual managers against the market indices and comparable investment managers.

The first chart illustrates the Growth Pool's asset allocation as of May 31, 2008. After an in-depth review and analysis, the Board of Trustees' Investments Committee approved meaningful changes to the strategic (or long-term) asset allocation of the Growth Pool. These changes will be implemented gradually over the next one to three years, with the timetable dictated largely by our ability to identify the best possible investment managers in each area. These new policy targets are listed along with the operating and actual allocations as of fiscal year end.

The second chart displays the Growth Pool returns versus key indices over a variety of time horizons. It shows that, with the exception of fiscal 2008, the Growth Pool has outperformed.

The third chart shows that over time the endowment's growth has been fueled by investment return and gifts. Although 2008 was a disappointing year, in the longer term the investment return has more than covered the University's spending policy that provides a distribution of 5 percent of the three-year moving average of the corpus. The policy's objectives are twofold. First is to smooth income available for endowment-supported operations, so that program support is stabilized in good years and bad—at $31.9 million in 2008. Second is to grow the corpus at least at the expected rate of inflation, thus maintaining real purchasing power.

This past year demonstrated the clear benefit of a well-diversified portfolio in the Growth Pool. With the recent modifications to the long-term asset allocation, we believe the portfolio will be well positioned to deal with the uncertainty of global economic conditions.

Diane M. Cook
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