



# Endowment Fund Annual Report

April 30  
2012

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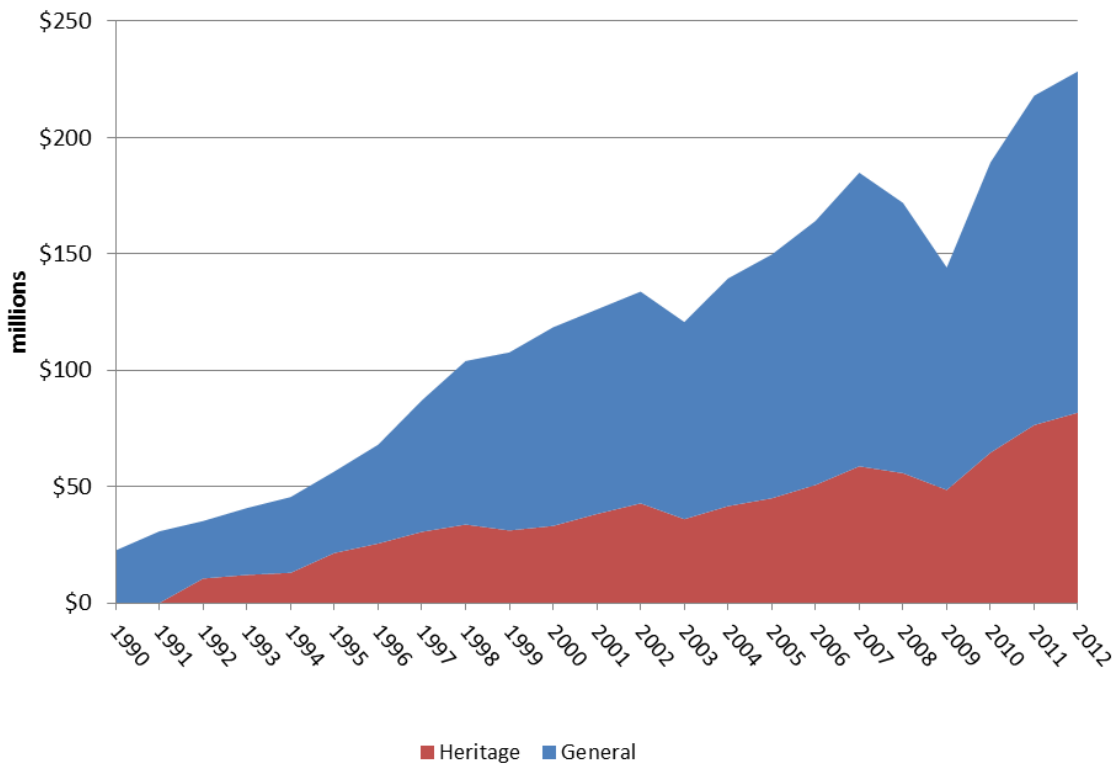
Summary: Endowment Portfolio, Fiscal 2011-12 (May 1, 2011 to April 30, 2012)

## 1 University Endowments

The University of Guelph endowments consist of two major designations; the General Endowment fund (GEF) and the Heritage Endowment Fund (HEF). Since 1990 the University's total endowments have grown from \$22 million to almost \$228 million (refer to the Chart A below). This growth is the result of both contributions and investment returns, net of spending for designated purposes. Contributions to University endowments are derived from a variety of sources including donations, governments and internal University sources such as income derived from Board of Governors designated land assets. Spending from endowments is directed to a number of specific purposes that include student assistance, faculty chairs, research and infrastructure support.

While there are many individual spending designations, for investment efficiencies, endowment funds are co-mingled into one investment portfolio. Each unique allocation or designation within this total portfolio is accounted for separately within the University's accounting system. Income is awarded to each endowment account in proportion to the total earned and the specific spending. There are currently just over 1000 such designations or accounts within the University's single endowment portfolio.

**Endowment Market Values at April 30** **CHART A**



Regardless of funding source or purpose, in managing all endowments the University has made the real (inflation protected) long-term spending capacity of each endowment the primary objective. The most important means to achieve this objective is to establish a disciplined long-term spending rate of investment income that balances capital protection with current spending demands. The Board of Governors has established both policies and a governance

structure that ensure the necessary oversight is in place to realize this outcome. While both of the University major endowments (General and Heritage) have different spending policies, they both share this fundamental principle.

### The Heritage Fund

The **Heritage Endowment Fund (HEF)** was created in 1991 by the Board of Governors through, a declaration of trust with the intention that the capital of the fund be held in perpetuity for University strategic purposes. The main sources of growth for the fund are the proceeds of sales, leases from Board-designated University owned properties and investment income earned on the capital of the fund. Distributions for spending from the Heritage Fund endowment are made in accordance with a formula prescribed in the trust agreement. The formula is based on a five-year average of market returns after providing for inflation protection and growth. Oversight of the fund was delegated by the Board of Governors to a Board of Trustees ([Reference Link](#)). The distribution of funds for spending from the Heritage Fund currently contains two designations; one for student assistance designated as the Keefer Fund (\$10.2 million) and the more general fund of (\$71.5 million) which is restricted for major strategic initiatives such as large information technology systems or infrastructure investments. Since its creation 20 years ago in 1991 with total initial capital of \$10 million, the HEF has grown to \$81.7 million by 2012 while having provided \$20 million for major University strategic purposes over the same time period.

### The General Endowment Fund

The University of Guelph's **General Endowment Fund (GEF)** consists of a pool of invested funds created from external or non-operating sources that are restricted or designated to provide long term financial support for a specific purpose. A large majority of GEF funds are allocated for student assistance in the form of scholarships and bursaries. Other designations include research support, equipment or library acquisitions, special academic activities such as endowed faculty positions and on-going support toward the operating costs of academic facilities.

The total GEF (\$146.5 million market value at April 30, 2012) is managed as part of total university endowment portfolio, with each designation or restriction (e.g., donor agreement) is accounted for separately within the University's financial systems. There are currently about 1000 of these accounts within the GEF where the capital, investment income and expenses are recorded. (Refer to Section 4 for more on the GEF)

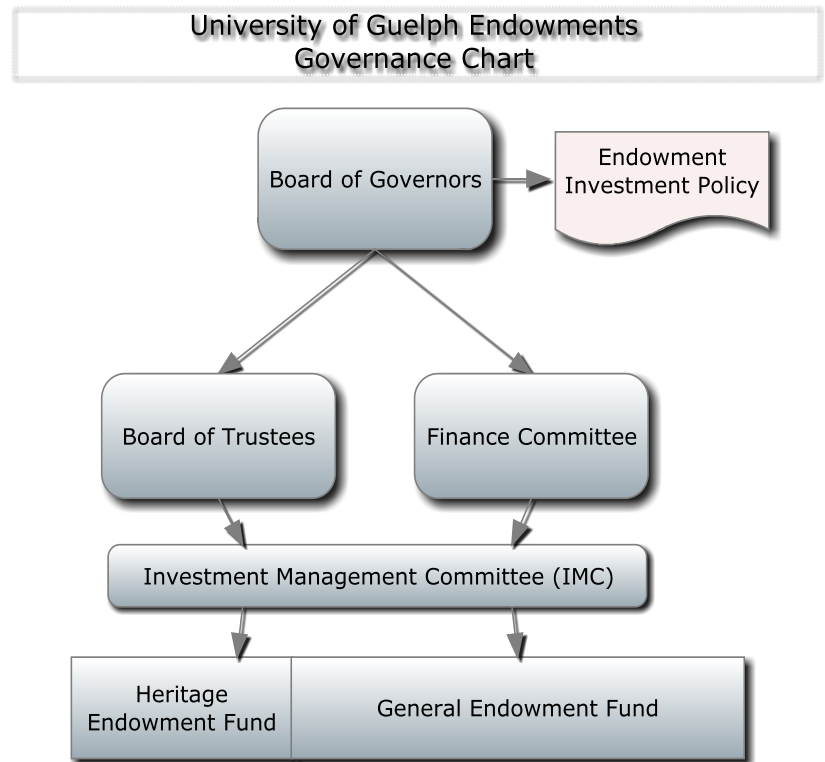
## 2 Endowment Policy and Governance

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All of the University of Guelph's endowment assets are managed as a single investment portfolio. Within this portfolio investments are allocated among different asset classes — Canadian and global equities as well as fixed income investments such as cash and government and corporate bonds. The "Endowment Investment Policy" ([Policy Link](#)) under which endowment assets are managed was approved by both the University's Board of Governors and Board of Trustees in 2010. As part of the governance process, this policy is reviewed annually to ensure that it is current and meeting the objectives set by the Board of Governors for endowment management. Endowment assets are invested by the terms and constraints specified in this policy. Major objectives of the policy are to not only ensure transparency and accountability of the Board's oversight of endowment assets but to provide an investment framework that balances endowment objectives with investment market opportunities.

While overall oversight of endowment assets is the responsibility of the University’s Board of Governors, investment-related operational responsibility of the University’s endowment assets has been delegated by the Board of Governors, through the Finance Committee ([Terms of Reference Link](#)) to the Investment Management Committee (IMC) ([Terms of Reference Link – IMC](#)). Refer to the “Governance Chart” below. IMC also has been delegated equivalent responsibility for HEF assets by the Board of Trustees of the Heritage Fund. The IMC, which is composed of external independent members with expertise in the investment business, is responsible to ensure the effective implementation of the approved investment strategy.

Key IMC activities include regular monitoring of fund assets and performance, oversight and selection of portfolio managers, ongoing development of the investment policy and asset mix and regular reporting to the Board of Governors. In fulfilling its responsibilities, the IMC is supported by University administration through the Financial Services - Office of Investment Management. In addition the IMC may rely on independent external experts and consultants for certain aspects of the Endowment Funds operations where additional expert knowledge is required or where a perceived or actual conflict of interest exists.



**Investment Risk Management**

In managing its endowments, University of Guelph strives to provide inflation-protected funding in perpetuity by protecting the purchasing power of each endowment. The realization of this objective is achieved in two ways: first by spending only a portion of total investment returns and second, investing in asset classes (e.g., equities) that yield sufficient investment returns to provide inflation-protected spending. It is generally accepted in the investment field that asset allocation is the primary driver of a portfolio’s total returns over the long run. Consequently, development of the appropriate asset mix to meet the long term objectives of the endowment fund is one of the most important tasks in managing the portfolio.

Investment asset classes are defined by differences in their expected response to economic conditions such as inflation or changes in interest rates, and are weighted in the Endowment portfolio by considering risk, total returns and correlations (i.e., how returns in one asset class compare to returns in others) . The University combines these assets in such a way as to provide the expected return at an acceptable level of risk (e.g., return volatility), over the long-term. This strategy is well-accepted for managing endowments. In determining the asset mix (and associated

investment risks), the University periodically undertakes detailed studies performed by an external consultant. These studies uses statistical techniques to combine long term expected returns, variances and covariance’s of investment assets to estimate the expected risk and return profiles of asset classes. The result of the studies is presented to IMC which in turn recommends to the Board of Governors (through the appropriate committees) an allocation of investments across various asset classes. Included in this recommendation are additional risk mitigation procedures such as limitations on the concentration of investments (e.g., limitations on investments in any one company), and investment characteristics such as credit quality, market capitalization and currency exposure. The approved allocation of investments and other risk control measures are documented in the Endowment Investment Policy. The Office of Investment Management ensures that asset allocations are within approved limits and allocations are reviewed at least quarterly by IMC.

The “Target” and “Actual” asset mix at April 30, 2012 is shown in Table A. The target asset mix “Target” is specified in the Endowment Investment Policy. The “Actual” mix is within specified policy limits.

**TABLE A**

Asset Class	Policy Target	Actual % 2012	Benchmark Index
<b>Canadian Equities</b>	20%	18%	S&P TSX Composite
<b>U.S. Equities</b>	25%	26%	S&P 500
<b>Non- North American Equities</b>	20%	18%	MSCI EAFE
<b>Emerging Market Equities</b>	5%	4%	MSCI Emerging Markets
<b>Fixed Income &amp; Cash</b>	30%	33%	Dex Universe
<b>Total</b>	100%	100%	

Manager selection is also an important source of risk control. The University engages a number of external investment managers with proven expertise to manage specialty mandates on its behalf. We not only assess a manager’s according to their investment experience and performance in an asset class, but also conduct thorough operation due diligence on their organization and operational processes. This is done with the assistance of external consultants. The IMC regularly reviews manager performance against expectations and will make changes to managers or their mandates as necessary.

In addition to tracking total fund return, investment performance is also reported against a “Benchmark” portfolio. The fund performance “Benchmark” is the Policy Target asset mix times the weighted composite of public market indices representing each asset class (noted in Table A). Each index is a broad representative sample of investable equities or bonds.

### 3 Investment Performance to April 30, 2012

Another very challenging year for investment portfolios is the best way to describe 2012. Underlying this performance were two common themes: the European debt crisis and, concerns about the state of the global economy. The endowment fund’s gross return over the last 12 months was 1.7%, outperforming the policy Benchmark rate of return of 0.7%. Table B presents these returns with the previous five years. While the Fund returns have exceeded the

Benchmark over this five year period, the recent positive year returns have just managed to cover negative returns of 2008 and 2009, without allowing for inflation.

TABLE B

ENDOWMENT FIVE YEAR PERFORMANCE						
Annual Rates of Return ( Years ended April 30th )						
	2008	2009	2010	2011	2012	Five Year Annualized
Endowment Return (Gross)	-8.5%	-16.4%	20.4%	12.6%	1.7%	1.1%
Endowment Return (Net <sup>1</sup> )	-9.5%	-17.5%	19.2%	11.5%	0.6%	0.0%
Benchmark Return*	-5.9%	-20.2%	18.9%	10.6%	0.7%	-0.1%
Market Value ( in millions)	171.9	144.2	189.3	218.0	228.5	171.9

\* Endowment Policy Benchmark = 30% DEX Bond Universe + 20% MSCI EAFE Index + 20% S&P/TSX Capped Composite Index + 25% S&P 500 Total Return Index + 5% MSCI Emerging Markets Index

Note 1: Net expenses include all direct investment management fees and internal University costs. Total expenses and fees charged to the endowment fund in 2012 were \$2.05 million or 0.9% of the total portfolio year end value (in 2011 total fees and expenses were \$1.77 million or 0.8% of the total portfolio value).

In terms of allocations to asset classes, in 2011 a new allocation was made to emerging markets in order to enhance diversification and gain access to growth in developing markets. Table C below shows the change in asset allocation over the past five years. The changes in actual asset weights from the prior year are a function of several factors, including cash inflows and outflows, foreign exchange rates and the differing performance of various asset classes.

TABLE C

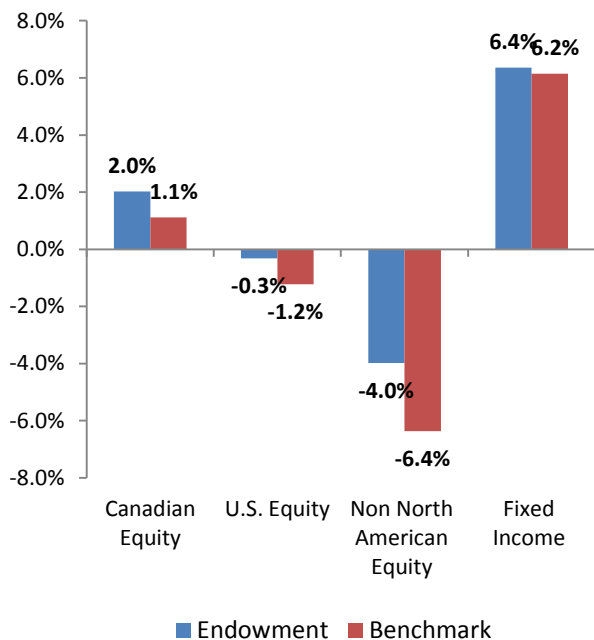
Asset Allocation (as of April 30)					
	2008	2009	2010	2011	2012
Canadian Equity	19%	18%	19%	21%	18%
U.S. Equity	31%	30%	32%	26%	26%
Non North American Equity	25%	21%	19%	18%	18%
Emerging Market Equity	-	-	-	5%	4%
Fixed Income	23%	25%	23%	27%	28%
Cash	2%	6%	7%	3%	5%
Total	100%	100%	100%	100%	100%

### Asset Class Returns

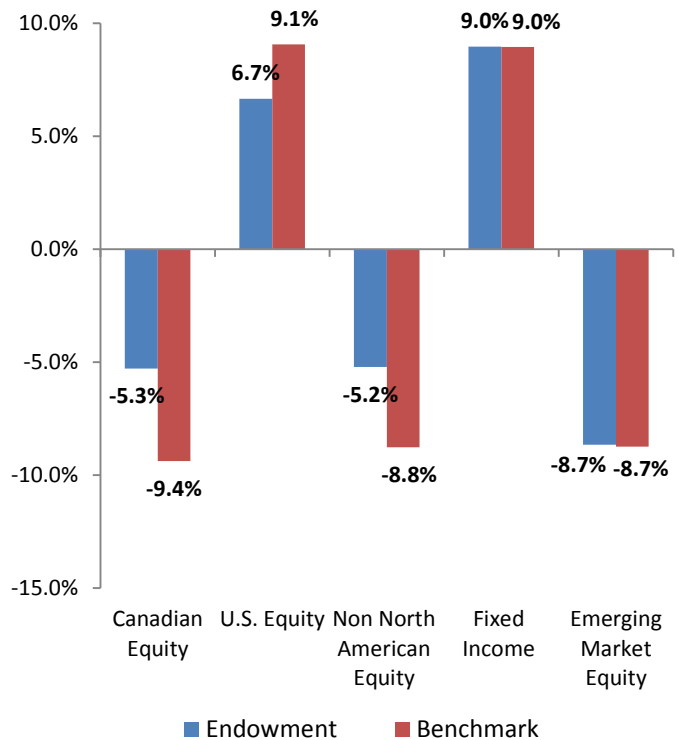
Looking at broad asset class returns, the year just ended was a challenging one for all but US equity and fix income investors. The University endowment fund's equity investments are dominated by value -oriented managers that as a group tend to provide better downside protection in volatile markets. This is reflected in both short term and five year results in which the fund's equity managers have had better returns that their passive benchmark indices. Over the longer five year period (annualized), fixed income and Canadian equities were the two asset classes with positive

returns. Chart B and C show the performance of various asset classes relative to their benchmarks in fiscal 2011/2012 and over the most recent five year period. Over the last 12 months US equity underperformed the S&P 500 index by 2.4 %, while Canadian and non-North American equity outperformed by 4.1% and 3.6% respectively (Refer to Chart C). Domestic bonds and emerging market equity asset classes had returns in line with their respective benchmarks. Over a longer five-year period all asset classes outperformed their benchmark indices (refer to the Chart B).

**Asset Class Returns 2007-2012 ( Annualised)**  
Chart B



**Asset Class Returns 2011-2012**  
Chart C



#### 4 More on the General Endowment Fund (GEF)

Over the past five years the GEF, which comprises two thirds of total University endowments, has grown from \$126.2 million to 146.5 million. This reflects the combined effect of total contributions into the fund of \$31.1 million and payments out of the fund of \$15.0 million (net annualized return was flat over the period. Refer to Table B). The GEF contains 1,000 accounts each reflecting donors’ individual contributions and designations. In terms of the number of accounts, 85% are designated for student assistance, with the remainder supporting endowed chairs (6%) and special programs (9%).

**GEF Spending:**

University policy limits annual spending from GEF accounts at no more than 5% of the recent four-year average of the fund’s value in any year. For 2011-12, the spending rate was set at 3.5% by the University in consultation with the Finance Committee of the Board of Governors. Annual investment earnings after spending accumulate in each account, growing that endowment’s value and protecting long-term spending stability. For the University’s endowment spending policy (the Policy), please visit: [GEF Management Policy](#). With market fluctuations, annual disbursements sometimes exceed the annual investment income and so, to the extent possible, investment income accumulated in prior years is used to support spending. Under the Policy, spending from any account may be curtailed in any endowment account if there are insufficient accumulated returns to support spending. The decision to suspend spending in an account may be reviewed in the context of donor intentions, current spending commitments and future contributions.

With the 2008 dramatic downturn in financial markets, overall endowment spending was significantly curtailed. Endowment accounts that are well established (created many years ago) have had time to build up sufficient accumulated earnings to absorb both the market down turn and maintain spending. However for those created in more recent years that did not have a significant build-up of accumulated net earnings (greater than the initial donated capital), spending was suspended. This difficult but deliberate decision was taken to protect the longer term strength of those endowments and to enable a more speedy return to targeted spending once markets recovered. As markets have recovered somewhat since that period, spending from many of these accounts has been restarted. The table below indicates total spending from endowments, particularly as it relates to student assistance.

**TABLE D**

<b>History of Spending from the GEF (at April 30)</b>					
<b>(\$ millions)</b>					
	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
Scholarships and Bursaries	3.3	3.6	1.6	1.8	2.3
Other Designations	0.7	0.8	0.1	0.3	0.3
<b>Total Spending From Endowments</b>	<b>4.0</b>	<b>4.4</b>	<b>1.7</b>	<b>2.1</b>	<b>2.6</b>
<b>GEF Policy Spending Rate</b>	<b>4.5%</b>	<b>4.5%</b>	<b>3.5%</b>	<b>3.5%</b>	<b>3.5%</b>
Total University Spending on Student Scholarships and Bursaries (all sources)	24.3	26.7	26.5	28.9	31.2
<b>% Total University Spending on Student Scholarships and Bursaries from Endowments</b>	<b>14%</b>	<b>13%</b>	<b>6%</b>	<b>6%</b>	<b>7%</b>

Despite having a significant curtailment of spending from endowments, funding from other sources, mainly the University’s operating budget, assisted in maintaining the total level of support. As markets have recovered somewhat since 2009, spending from endowments has increased. The market remains volatile, however, the University will continue with its long term investment strategies and to hold paramount, the protection of endowment capital both in real and nominal terms.



#### 4 WEB Page References

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1. Board of Trustees Overview: <https://www.uoguelph.ca/secretariat/offices/bog/board-trustees>
2. “Endowment Investment Policy”: <http://www.fin.uoguelph.ca/policies/treasury-policies>
3. Finance Committee Terms of Reference:  
<https://uoguelph.civicweb.net/Documents/DocumentDisplay.aspx?ID=4698>
4. Investment Management Committee (IMC):  
<https://uoguelph.civicweb.net/Documents/DocumentDisplay.aspx?ID=5037>
5. GEF Management Policy: <http://www.fin.uoguelph.ca/policies/treasury-policies>