



# Endowment Fund Annual Report

April 30  
2011

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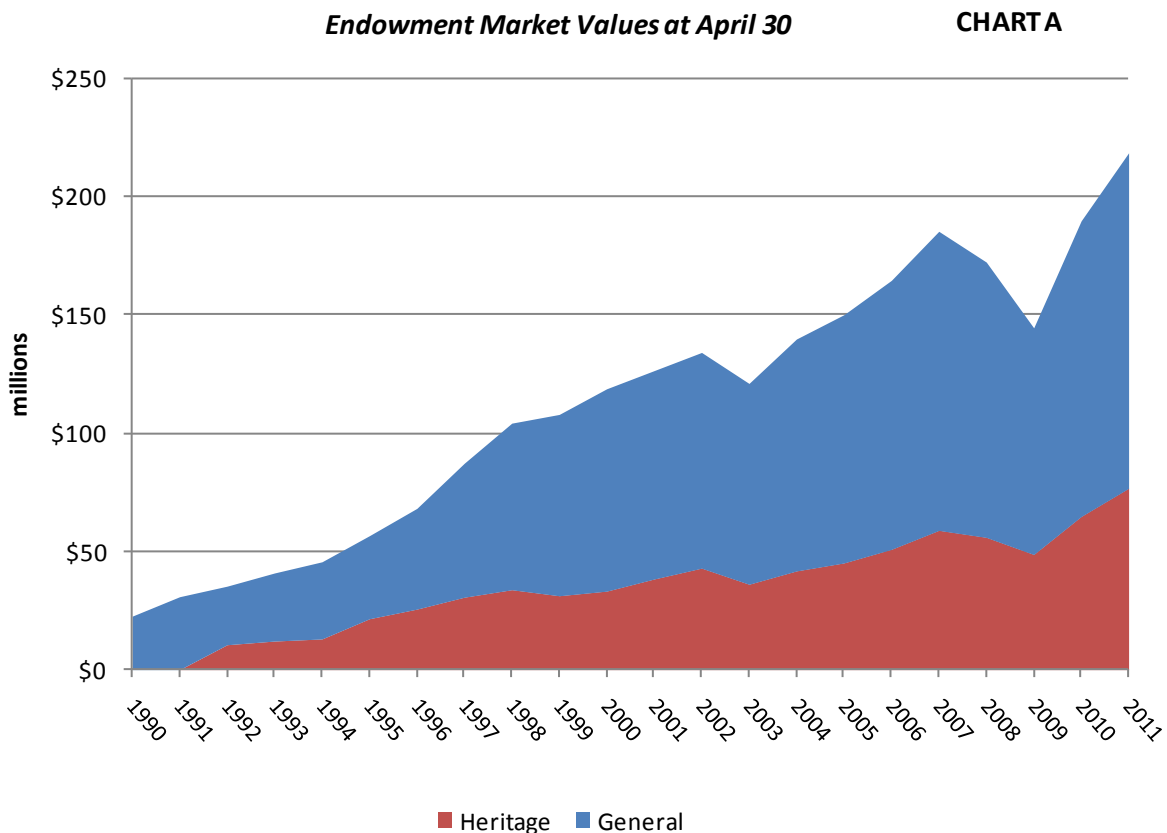
**Summary: Endowment Portfolio, Fiscal 2010-11 (May 1, 2010 to April 30, 2011)**

Note: The purpose of this Annual Report is to improve on the existing reporting of endowment performance and spending for the many stakeholders interested in endowment activities. While the first year of this report, the objective is to prepare this report annually with improvements each year to enhance both transparency and the total information provided on University endowments.

## 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 \$218 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.



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 (\$10.1 million) and the more general fund of (\$66.4 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 \$76.5 million by 2011 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 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 (\$141.7 million market value at April 30, 2011) 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

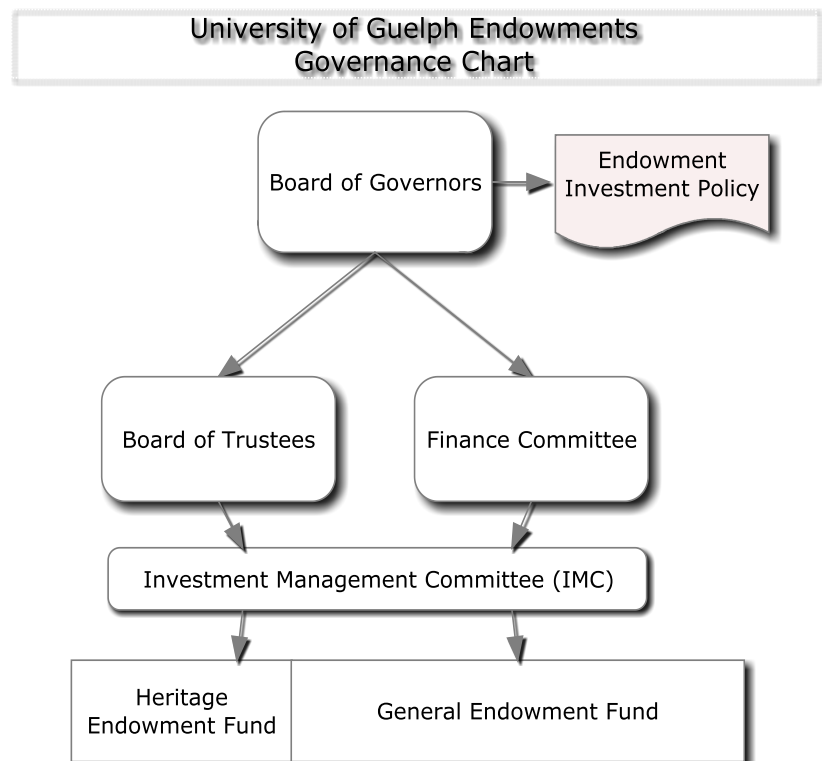
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All of the University of Guelph's endowment assets are managed as a single investment portfolio. Within this portfolio investments are allocated among different asset classes — Canadian and global equities as well as fixed income investments such as cash and government and corporate bonds. The "Endowment Investment Policy" ([Policy web 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 a detailed study performed by an external consultant using statistical techniques to combine expected returns, variances and historical investment patterns. The result of the study 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 management 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, company capitalization and currency exposures. The Office of Investment Management performs procedures that ensure asset allocations are within Policy limits and allocations and reviewed at least quarterly by IMC.

The “Target” and “Actual” asset mix is shown in Table A. The target asset mix “Target” is specified in the Endowment Investment Policy. The “Actual” mix as of April 30, 2011 is within specified policy limits.

**TABLE A**

Asset Class	Policy Target	Actual % 2011	Benchmark Index
<b>Canadian Equities</b>	20%	21%	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%	5%	MSCI Emerging Markets
<b>Fixed Income &amp; Cash</b>	30%	30%	Dex Universe
<b>Total</b>	100%	100%	

In addition to managing a diversified long-term asset mix, the University manages risk by engaging a number of external Investment managers with proven expertise to manage specialty mandates on its behalf. Each of the managers has been selected according to their investment experience and performance in an asset class and is held to account to a documented mandate with limitations on concentrations and in some cases credit quality of investments. The IMC regularly reviews manager performance against expectations and will make changes to managers or their mandates as necessary.

### **3 Investment Performance to April 30, 2011**

In 2011, the University endowment results had a second year of positive returns after two years of negative results linked to the economic downturn in 2008. On a five year annualized basis, while returns are less than 3.5% (our current spending target), gross and net returns have significantly exceeded the benchmark. (Refer to the Table B) The fund performance “Benchmark” is the policy target asset mix times the weighted composite of public market indices representing the asset classes. Each index is a broad representative sample of investable equities or bonds.

TABLE B

ENDOWMENT FIVE YEAR PERFORMANCE						
Annual Rates of Return ( Years ended April 30th )						
	2007	2008	2009	2010	2011	Five Year Annualized
Endowment Return (Gross)	13.3%	-8.5%	-16.4%	20.4%	12.6%	3.3%
Endowment Return (Net <sup>1</sup> )	12.4%	-9.5%	-17.5%	19.2%	11.5%	2.3%
Benchmark Return*	13.6%	-5.9%	-20.2%	20.0%	10.6%	2.3%
Market Value ( in millions)	184.9	171.9	144.2	189.3	218.0	

\* 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.

In terms of allocations to asset classes, in 2010 a new allocation was made to emerging markets in order to enhance diversification and gain more direct access to returns in developing markets. Table C below shows the change in asset allocation over the past five years.

TABLE C

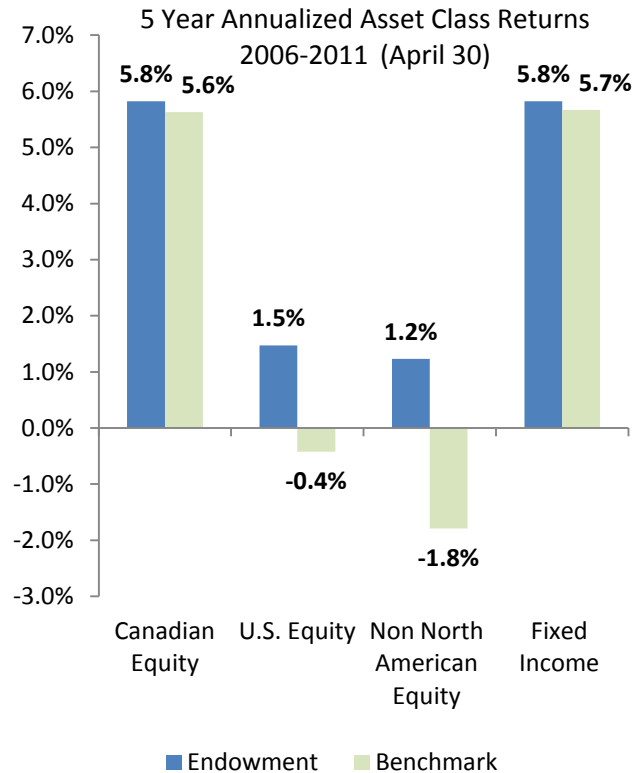
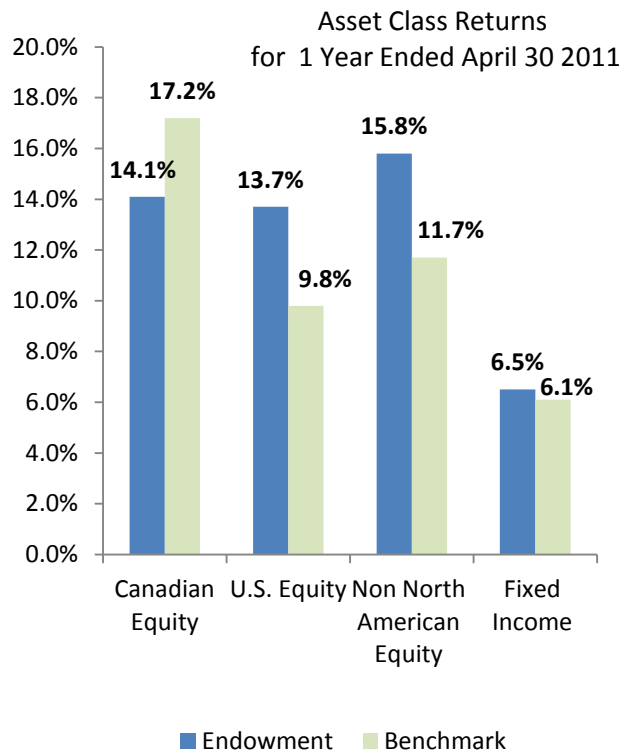
Asset Allocation (as of April 30)					
	2007	2008	2009	2010	2011
Canadian Equity	19%	19%	18%	19%	21%
U.S. Equity	41%	31%	30%	32%	26%
Non North American Equity	15%	25%	21%	19%	18%
Emerging Market Equity	-	-	-	-	5%
Fixed Income	23%	23%	25%	23%	27%
Cash	2%	2%	6%	7%	3%
Total	100%	100%	100%	100%	100%

### Asset Class Returns

During the 12 months ending April 30<sup>th</sup> 2011, the S&P TSX composite index was up 17.2% and the Dex bond universe was up 6.1%. The endowment fund's return was driven by a diverse set of assets that performed well during this period, including US (United States) and international equities.

During the more recent one year period, Canadian equity underperformed the S&P TSX composite index by 3.1%, while US and non-North American equity outperformed by 3.8% and 4.2% respectively. Domestic bonds also outperformed the Dex universe index by 0.4%. In fiscal 2011, endowment equity investments were dominated by value-oriented managers that as a group tended to avoid the higher risk securities (relative to the market as whole) and thus missed some of the more rapid upward swings seen in the last 2 years of the economic recovery. During this period more volatile holdings were minimized, particularly in the Canadian

markets resulting in a relative underperformance (refer to the chart on the left below). However over a longer five-year period the endowment fund performance exceeded the benchmark index (refer to the chart on the right below). In all cases, US and non-North American asset classes exceeded their benchmark indices mainly due to careful stock selection by the Fund's investment managers.



## 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 \$111.2 million to 141.7 million. This reflects the combined effect of total contributions into the fund (\$31.0 million) payments out of the fund (\$15.6 million) and net annualized rate of returns of 2.3% over the period. The GEF contains 1,000 accounts each reflecting donors' individual contributions and designations. In terms of numbers 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 2010-11, the spending rate was set at 3.5% by 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. Of the 1000 endowment accounts some that are well established (created many years ago) had 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. The table below indicates the impact on spending particularly as it relates to student assistance.

**TABLE D**

<b>History of Spending from the GEF (at April 30)</b>					
<b>(\$ millions)</b>					
	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
Scholarships and Bursaries	3.2	3.3	3.6	1.6	1.8
Other Designations	0.6	0.7	0.8	0.1	0.3
Total Spending From Endowments	3.8	4.0	4.4	1.7	2.1
<b>GEF Policy Spending Rate</b>	<b>4.5%</b>	<b>4.5%</b>	<b>4.5%</b>	<b>3.5%</b>	<b>3.5%</b>
Total University Spending on Student Scholarships and Bursaries (all sources)	22.9	24.3	26.7	26.5	28.9
% Total University Spending on Student Scholarships and Bursaries from Endowments	14%	14%	13%	6%	6%

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 over the last two years, 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.



## 5 WEB Page References

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1. Board of Trustees Overview: <http://www.uoguelph.ca/secretariat/bog/trustees.php>
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):  
<http://www.uoguelph.ca/secretariat/bog/download/bot/invest.pdf>
5. GEF Management Policy: <http://www.fin.uoguelph.ca/policies/treasury-policies>