ENDOWMENT PERFORMANCE

Bucknell University 2009 Endowment Report
During the summer, my colleague John Luthi ’04 and I were interviewed by Institutional Investor magazine about the state of endowment funds at colleges and universities. The reporter wanted to know if the endowment model was “broken,” and what sort of changes should be anticipated going forward. It allowed us the opportunity to reflect on a traumatic year in the financial markets, Bucknell’s performance during this period, and how we might do things differently in the future.

The endowment model refers to an investment approach where the time horizon for the assets is very long term (perpetuity in Bucknell’s case), allowing the portfolio to sacrifice near-term liquidity for enhanced longer-term returns. The premise that the model was broken was driven by the dramatic decrease in the liquidity of a multitude of assets during fiscal 2009 – in other words, lots of sellers and few buyers. This created a downward spiral of lower prices, which forced some investors to sell, lowering prices even further. The end result was a year where US stocks were down 26 percent, non-US stocks down 31 percent, and diversifying assets like real estate and commodities down 46 percent and 60 percent respectively.

Within that context, here is what we told the reporter:

• The one-year return through June 30, 2009 for Bucknell’s endowment fund was -16.9 percent, which we estimate will rank us near the first quartile relative to our peer institutions.

• We met all of our liquidity requirements, including paying out nearly $28 million in University support.

• We made no changes to our spending policy, and thus are budgeted to increase spending for University support from the endowment in fiscal 2010 by 6 percent (although without meaningful recoveries in asset prices or substantial new gifts, our spending will decline in the coming years).

• Bucknell has a very strong balance sheet, and we maintained our Aa2 rating.

We expressed our disappointment with the fund’s performance, as there were few places in the markets to preserve capital. When she asked us why we were able to perform well on a relative basis, we told her that we were fortunate to have many asset managers who were able to do better than their benchmarks, but that taking any investment risk last year was not rewarded. As for prospective changes, we talked about the liquidity metric that we added to our investment guidelines, but we thought that prudent risk-taking, especially now that risk was being rewarded with higher expected returns, would continue to be a hallmark of our investment approach.

We concluded the interview by going over the integrated approach to endowment management that the Endowment Office takes with the administration and the Committee on Investments at Bucknell. Many areas of expertise are brought to bear on overseeing the fund, and we are especially grateful for the many volunteer hours that the trustees give to the committee, and to the University.

Fiscal 2009 was an extremely challenging year for the financial markets and for our country. We look to the future with guarded optimism, and will strive to find the optimal blend of diverse assets to achieve our long-term goals.

Best regards,

Christopher D. Brown
Chief Investment Officer
Endowment Activity

Bucknell University’s total endowment market value at June 30, 2009, was $443 million. The net decrease in market value of $112 million since June 30, 2008, consists of $28 million in endowment spending distributions to the University, a $10 million increase from gifts and transfers into the endowment and $94 million in net investment losses.

Total endowment activity – 12 months ended June 30, 2009 (in millions)


**Asset Allocation**

The endowment fund began the 2009 fiscal year with $33 million in cash, the largest cash balance in recent history. This supply of liquidity allowed the endowment to continue to meet funding obligations without being forced to liquidate any investments at depressed prices. We also used this liquidity to make several opportunistic investments between October and February to investment-grade corporate credit, master limited partnerships (MLPs)\(^1\), emerging market equities and senior secured bank loans. As illustrated in the charts below, these investments had a modest impact on our asset allocation. The largest change, a 3% reduction in growth assets, was a result of active portfolio moves as well as the impact from lower prices.

\(^1\) Master limited partnerships, or MLPs, are publicly traded securities. Bucknell University’s investment is in MLPs that own energy infrastructure assets involved in the transportation, distribution and storage of oil and natural gas, such as natural gas pipelines.
Performance

What a difference a year can make — this is especially true as we look back over the past 10 years. A hypothetical endowment gift of $100,000 established on July 1, 1999 and invested in the pooled endowment fund would have distributed over $46,000 in spendable income during the 10-year period. The current market value of the gift would have declined to approximately $90,000. On a relative basis, a similar-sized gift invested in a blended benchmark of stocks and bonds1, while providing the same level of current spendable income, would have shrunk to a market value of approximately $57,000 at June 30, 2009.

The past 10 years have provided a rollercoaster of investment returns. The tech bubble first reached its pinnacle, as the world successfully navigated the Y2K transition. But the bubble burst, and was followed by a 50% decline in stock prices. The subsequent 2003-2007 period of low interest rates and soaring real estate values saw a doubling in equity prices, with the S&P 500 just barely eclipsing the high price it reached in March 2000. Then the real estate bubble burst, and the peak-to-trough decline for equities was 58% this time. The net result for the decade was a US equity market that was lower than where it started. Meanwhile, over the 10-year period ended June 30, 2009, the Committee on Investments began to diversify Bucknell’s pooled endowment and earned an annualized return of 3.5%. On a relative basis, this return places Bucknell’s endowment above the median return for other college and university endowments of 2.9%2 while being below our long-term objective of producing a 6% real net return.

1 The index is a blended benchmark of 85% Wilshire 5000 and 15% Barclays Aggregate Bond.

2 Based on a study completed by Bucknell’s consultant, Hammond Associates, as of June 30, 2009.
Returns for periods ending June 30, 2009

* Based on a study completed by Bucknell's consultant, Hammond Associates.
** Blended Benchmark consists of 85% Wilshire 5000 and 15% Barclays Aggregate Bond.
One-Year Performance by Asset Class

The pooled endowment fund’s return over the past fiscal year was -16.9%, and it is anticipated that this return will rank near the first quartile of peer institutions. As illustrated in the chart below, each of the endowment’s asset class portfolios outperformed its respective benchmark on a relative basis. The real asset portfolio is compared to an absolute return benchmark, and amid the rapid price deflation of the past year, this portfolio did not meet its absolute return objective. While the relative outperformance of the pooled endowment fund across asset classes and underlying fund managers helped mute the losses in the portfolio, the absolute investment losses experienced across the portfolio will mark the past fiscal year as one of the worst in recent decades.

FY2009 Returns by Asset Class versus Benchmarks

Bucknell’s US equity portfolio finished the fiscal year down 21.5%. The relative outperformance to the broad US equity market indices was helped by an underweight to more cyclical companies as well as the stock-picking abilities of the underlying managers. The non-US portfolio lost 27.4% and was the worst-performing asset class in the portfolio over the one-year period. The fixed income portfolio was led by an allocation to US investment-grade corporate bonds and returned 8.4% for the one year period, outperforming the Barclays Aggregate Bond index return of 6.1%.

With many hedge fund managers making news for all the wrong reasons, we were fortunate that the hybrid asset portfolio steered clear of disaster. The majority of managers in the diversified hybrid asset portfolio were able to perform well through the turmoil of the past year, with the portfolio returning -10.1% compared to -15.1% for the broad hedge fund industry. The focus on low leverage and diversified fund strategies helped the portfolio avoid the illiquidity issues faced by many firms.

The relative return of the private equity portfolio benefited from limited exposure to the “mega” buyout, highly leveraged deals of the past few years as well as increasing exposure to the BRIC\(^1\) economies. Investments across the real asset portfolio were significantly impacted by declining prices of real estate, energy assets and other commodities. However, the low allocation to real assets relative to our peer institutions, including a lack of direct allocations to commodities and REITs\(^1\) in the portfolio, may have helped contribute to the relative outperformance. A tactical allocation to master limited partnerships in December also contributed positively to the real assets return.
Outlook

The unique long-term nature of an endowment fund allows for allocations to less liquid investments. However, leading up to the financial crisis as equity markets ran up and cheap debt financing continued to be available, transaction and partnership prices reached levels where investors were no longer being compensated for accepting illiquidity. The practice in the industry was also to over-commit to illiquid partnerships in order to meet target allocations in future years, and these practices came to a head over the past fiscal year. We continue to be mindful of our liquidity situation, but are also cognizant of the wealth of opportunities that may emerge from the distress faced by other investors as general partners continue to draw down capital.

Entering fiscal year 2010, some economists are beginning to point to data indicating the underpinnings of a fragile recovery across the US and other developed economies, while others are pointing toward the risks of a double-dip recession. Emerging market economies continue to represent a greater share of the news as well as investment dollars, as for the first time the value of A-shares traded in China recently exceeded the combined turnover of the London, New York and Tokyo stock exchanges. Amid the varying outlooks across the globe for economic recovery, growth and inflation, what is clear is that market uncertainty will continue, and the endowment office and the Committee on Investments will continue to be opportunistic risk allocators and prudent guardians of the endowment fund entrusted to our care.

3 BRIC stands for Brazil, Russia, India and China, and is an acronym used to describe these emerging market economies as a whole.
4 REIT stands for Real Estate Investment Trust.
Endowment Spotlight:
Meerwarth Sociology and Anthropology Funds

Tracy Meerwarth Pester ’96 thinks students should have the opportunity to do field research as undergraduates without worrying about money. With that in mind, she and her mother, Lureonna Meerwarth, established the Meerwarth Funds in the Department of Sociology and Anthropology in 2001.

While pursuing her master’s degree in anthropology at Northern Arizona University, Tracy was inspired to give back to Bucknell, where she had developed her foundation in the field with her mentor, Professor Tom Greaves. He helped her plan a fund that would provide important infrastructure and support for undergraduate study.

Since then, more than 70 students have received support for class projects, independent study and study abroad. The fund also allows students to travel to high-level professional conferences, where they present their findings. Carl Milofsky, a professor of sociology who chairs the Meerwarth Undergraduate Research Committee, calls the fund “an important platform for students to begin professional careers as researchers and practitioners.”

Students awarded Meerwarth funding have pursued diverse subjects on both the local and global levels. These topics range from the study of a Latino Mennonite Church near Bucknell and work at a regional AIDS alliance to examinations of socioeconomics in Chile and education in Northern Ireland.

The research fund proved so successful that Tracy and Lureonna established the Meerwarth Speakers Fund in 2006 to enrich students’ understanding of anthropology and sociology by bringing guest speakers to campus.

The Meerwarth programs thrive because of an open and collaborative partnership between the benefactors and the academic department. The key to success, Tracy says, is that her family’s vision for the funds has been aligned with the needs and goals of the University.