A Message from the Chief Investment Officer

Divergent

As financial market prognosticators prepared their outlook pieces for 2015, a common theme emerged: divergence. The thesis was that the world’s central banks had all been on the same course and trajectory of lowering interest rates and easing monetary conditions in an effort to stimulate economic growth and combat the prospect of deflation (or falling prices). But the New Year was ushering in a time of less symmetry and more divergence for monetary policy.

Unlike its international counterparts, the Federal Reserve had determined that emergency liquidity measures were less necessary than they had been in recent history, especially with the unemployment rate falling below 6 percent. In 2014, the Fed had begun a process of methodically winding down the quantitative easing program, and charted a course toward the first increase in interest rates since before the global financial crisis of 2008.

Meanwhile, other central banks around the world, particularly the European Central Bank and the Bank of Japan, were diverging from the US by starting or continuing their quantitative easing programs. This divergence from a globally coordinated easing regime has created significant changes in the relative values of currencies (that European vacation you are planning just became 20 percent cheaper than last year!). This means that unhedged investments in non-US currency assets, like European equities, will have been negatively impacted when their returns are translated back into US dollars.

The dramatic decline in oil prices during the second half of 2014 and early 2015 presented global markets with another significant example of divergence. After spending almost four years near or above $100 per barrel, the price fell by nearly 50 percent as supply began to overwhelm demand. A debate raged over whether this was good or bad for the economy as curtailed capital spending in the oil patch was offset by cheaper gasoline prices, meaning more money for consumers to spend.

Financial markets are almost never in a state of tranquility, so the challenges of divergence are nothing new. How have the Investments Committee of the Board of Trustees and the Investment Office handled these divergent times? In the same way we always have – by sticking to the fundamental disciplines of investing:

• Focusing on the long term
• Maintaining a diversified portfolio of non-correlated assets, and
• Seizing investment opportunities when the risk/return tradeoff looks compelling.

Sometimes those opportunities can be chances to sell assets that offer uninteresting return prospects and then swap the proceeds into more favorably positioned investments. We are evaluating a process to reduce exposure to a series of private partnership assets and, if successful, to redeploy the proceeds into other assets that offer far superior risk/reward tradeoffs.

The Investments Committee and Investment Office remain singularly focused on the perpetual future of the University. The divergent paths of global economic policy will not cause Bucknell to veer from our mission of protecting and growing the endowment fund for many future generations of Bucknellians.

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Chief Investment Officer
Investment Spotlight: Otonomy, Inc. (OTIC)

“Blindness separates people from things; deafness separates people from people.”
– Helen Keller

Anyone who has suffered from hearing loss can relate to the feeling of isolation that Helen Keller’s now-famous quote elicits. Bucknell invests in a company that works to eliminate it.

Dr. Jay Lichter founded Otonomy with the vision of developing therapies to address the unmet medical needs of millions of people suffering from hearing deficiency. The company develops drugs to treat individuals with Ménière’s disease, tinnitus and chronic hearing loss. Before Otonomy was launched, there was not a single pharmaceutical company addressing therapies for hearing loss. Since nearly 30 million Americans have hearing deficiencies, Dr. Lichter recognized the enormous need for commercial ontology therapies.

The company has created a broad portfolio of drugs. One of the product candidates in development is AuriPro, an injectable treatment for fluid buildup in the middle ear administered to pediatric patients before they undergo tube-placement surgery. After Phase 3 clinical trials with 532 pediatric patients, the drug was proven both effective and well tolerated by patients. Otonomy recently announced it has submitted a New Drug Application (NDA) to the U.S. Food and Drug Administration (FDA) for the approval of AuriPro.

Managed by an executive team with decades of combined experience in the medical device and health-care technology fields, Otonomy continues to strive to realize their mission “to develop and commercialize novel and best-in-class therapeutics” for patients suffering from ontological deficiencies. With the potential approval of AuriPro, in addition to their continued therapeutic developments, the young company has already made a name for itself within the biotechnology industry.

Bucknell invested in Otonomy through a venture capital fund at its origin in 2008 and has been involved in each additional round of financing, including its IPO in August 2014. Although it is still early in the company’s lifecycle, Otonomy could become a major player in the emerging ontology field while helping to address the previously unmet medical needs of millions of people.

While there exists a growing risk of a reversal in the momentum of biotechnology valuations in the short term, Bucknell continues to pursue opportunities for long-term investments in partnerships seeking novel approaches to the development and delivery of health care to millions of people.
Commentary for the Six Months Ended Dec. 31, 2014

- US equities as measured by the S&P500 index returned a positive 6.1 percent. While still generating a positive return, smaller-capitalization US equities trailed larger-capitalization stocks, with the Russell 2000 index up 1.7 percent over the same period. Master Limited Partnerships (MLPs) were down 9.9 percent, significantly trailing the broader equity market as concerns over oil and natural gas price declines weighed on MLP investor sentiments.

- Non-US equities struggled as a strong rally in the US dollar wiped away any unhedged returns for US investors; the Morgan Stanley international equity index (MSCI ACWI ex US) was down 9.2 percent. While there was significant dispersion across underlying countries, the broad non-US regional benchmarks suffered equally as the MSCI EAFE and MSCI Emerging Markets indexes lost 7.8 percent and 9.2 percent, respectively.

- US Treasury bond yields continued their strength from the first half of the year, with the yield on the 10-year bond falling from 2.5 percent at June 30 to end the year below 2.2 percent. The six-month total return on the Barclays US Aggregate Bond index was 2 percent.

- Credit markets struggled amidst investor concerns over the impact of cratering oil prices on the fundamentals of energy debt instruments as well as a technical reversal of fund flows in the fourth quarter. The high-yield and leveraged loan indexes were down 2.9 percent and 1 percent, respectively. Emerging market debt also struggled, losing 3.3 percent as measured by the JP Morgan EMBI index.

- Hedge funds as measured by the HFRI Fund of Funds index were up approximately 1.2 percent over the six-month period.

At December 31, 2014, Bucknell’s endowment fund was valued at $732.6 million, down from $750.9 million at June 30, 2014. Over the six-month period, distributions totaling $18.5 million were transferred out of the endowment to help support current scholarships, grants, athletics and other University operations. The fund received gifts and transfers of $8.5 million and had net investment losses of approximately $8.3 million.