ENDOWMENT PERFORMANCE

Bucknell University Endowment Report: Spring 2014

A Message from the Chief Investment Officer

P versus E

On July 1, 2013, if someone had offered you a 16 percent return on your global stocks for the upcoming year, would you have accepted?

As with any investment opportunity, you'd perform prudent diligence to determine the merits. At a minimum, you'd analyze the prospects for corporate profits, interest and inflation rates, and review current and prospective valuation levels. In all likelihood, especially if your goal is a 6 percent real return on your portfolio (like Bucknell's), you'd have taken the deal.

Well, the actual results were even better – the public markets returned 16 percent over the last six months. Same return in half the time! Almost seems too good to be true.

Why did this happen?

As a former US equity portfolio manager, I used to query my colleagues on the trading desk about why a stock was moving higher. The typical shorthand answer was "more buyers than sellers" – which is exactly what happened throughout 2013. The demand for equities exceeded the new supply. Investors put more of their capital into equities, as reflected by the first meaningful increase in subscriptions to equity mutual funds in several years. At the same time, investors began to rotate away from fixed income investments and swap some of those dollars into equities. The supply side experienced continued corporate share buybacks, further reducing the supply of equities. Overall, these factors helped equities move higher.

But this supply/demand dynamic can be fickle (remember the lessons from 2008). We want to be sure that the underlying fundamentals are sound and, we hope, improving to justify the material move in equity prices. Prices (P) have risen much faster than earnings (E), which means that the valuation measure of the P/E ratio has risen pretty meaningfully. Some would argue that this higher P/E ratio is warranted as the global economy recovers and interest rates, while having moved a bit higher, are still quite low relative to history.

As for the other due diligence items, the Federal Reserve remains unconcerned about the current rate of inflation, promising to keep interest rates low. But the excess capacity of available labor and manufacturing capabilities are slowly being absorbed, which could be the precursor to higher inflation down the road.

All of this has led us to conclude that there is greater price (P) risk today than there had been in the recent past, particularly in fixed income. As a result, we have reduced our price risk in fixed income by carrying a little more cash than usual, in the event that we are offered any opportunities at attractive entry points.

The Investment Committee of the Board of Trustees and the Investment Office of the University will continue to use prudence and diligence in evaluating investment opportunities — especially when they may seem too good to be true.

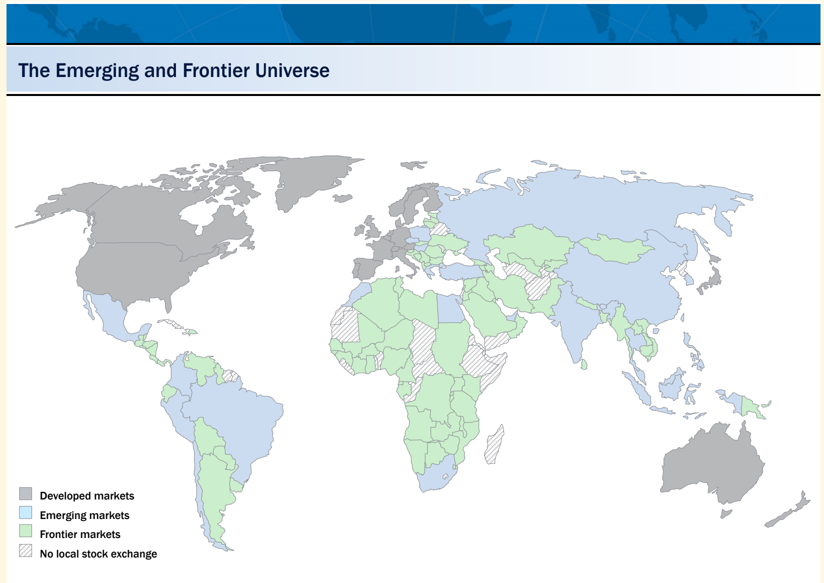
'Ray Bucknell!

Christopher D. Brown

Christopher D. Brown '81, P'12, CFA
Chief Investment Officer

Research and Risk Pay Off for Prince Street

A fundamental principle of successful investing is to invest in markets where fear is excessive and assets are cheap, and avoid areas where greed is inflating prices. Prince Street Opportunities is an investment fund in Bucknell's endowment, and is a prime example of this investment principal in action.



Prince Street seeks to identify investments in developing economies where perceived risks are much higher than the actual risk on the ground. The architect of this strategy is David Halpert, the founder, portfolio manager and chief investment officer of Prince Street. A graduate of the Harvard Business School and the University of California at Berkeley, Halpert worked for many years in Indonesia, currently lives in Singapore, and is conversant in several European and Asian languages. He leverages his extensive knowledge and experience in emerging and frontier markets to identify attractive, risk-adjusted investments through both top-down and bottom-up approaches.

The cornerstone of Prince Street's research process is trips to the countries, where Halpert and his team of analysts meet with political leadership, economists, company management, and competitors. Armed with this information, Prince Street develops themes and gauges progress/regression on corporate governance, economic reforms, competitive landscapes and political regimes. The firm does not track the broad market indexes, and it will invest in countries that may be classified as emerging, frontier or in some cases, even developed markets. Without the constraints of a benchmark, Prince Street can allocate capital to the best market opportunities and potentially generate strong returns, even when the broad market indexes are down.

Emerging markets have historically been extremely volatile, cycling through periods of wealth destruction and creation. Prince Street does not attempt to mute this volatility through hedging. Instead, it seeks to take advantage of instability by investing when capital is in very short supply and raising cash when markets are overpriced.

A prime example of this process is Prince Street's investments in Greece. Prince Street began establishing a position in Greece in the summer of 2012 after several trips to the country. The Athens Stock Exchange (ASE) had lost more than 80 percent of its value since the credit crisis began in 2007, and the Greek economy was still viewed as financially unstable and politically uncertain. Nonetheless, Prince Street began to add to its positions after the Greek elections and European Central Bank interventions in mid-2012, which it saw as significant game-changers. The ASE is now up more than 100 percent from its mid-2012 lows, and some of the companies Prince Street identified through its bottom-up analysis have risen three to five times in value. At the time they began buying, Greece was still considered a developed market by the index constructors, but has since been "downgraded" back to an emerging market.

Prince Street's ability to identify underpriced stocks and gain conviction through experience and extensive research has led to significant investment results for the firm as well as for Bucknell's endowment fund.

Commentary for the Six Months Ended Dec. 31, 2013

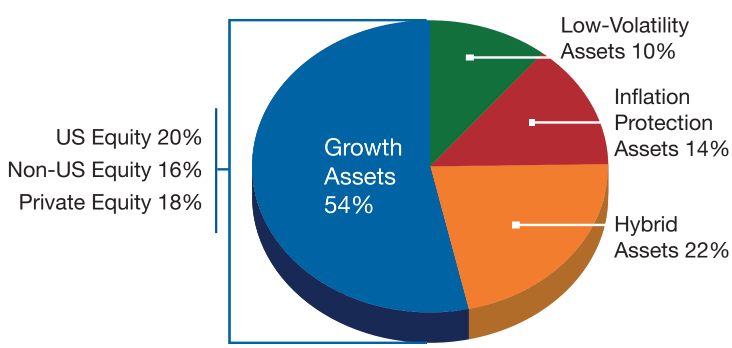
The first six months of the fiscal year were characterized by strong returns and limited volatility as risk assets steadily climbed throughout the period. US equities rose to new highs as the markets cheered mostly positive economic data in housing, labor and manufacturing as well as the relatively uneventful confirmation hearings for new Federal Reserve chair Janet Yellen. In December the Federal Open Market Committee announced a much-anticipated $10 billion reduction to its $85 billion-a-month asset purchase program, and bond prices fell as the 10-year Treasury yield finished the year above 3 percent for the first time since 2011.

Global economic data continued to support a modest but positive growth environment, and developed equity markets in Europe and Japan rallied amidst continued monetary policy support. While characterized by increasing divergences, emerging markets continued to struggle with concerns over currency weaknesses and deteriorating profitability, as well as the impact of the Fed's tapering of its quantitative easing program.

- For the six months ended Dec. 31, 2013, US equities as measured by the S&P500 index returned a positive 16.3 percent. Smaller capitalization US equities slightly outperformed, with the Russell 2000 index up 19.8 percent over the same period. Master Limited Partnerships (MLPs) were up 4.5 percent, significantly trailing the broader equity market.
- Non-US equities also posted double-digit returns as the Morgan Stanley international equity index (MSCI ACWI ex US) returned 15.6 percent. The MSCI Emerging Markets and MSCI Frontier Markets indexes trailed the developed markets, returning 8.0 percent and 13.3 percent, respectively.
- US Treasury bond yields increased over the six-month period, with the yield on the 10-year bond rising from below 2.5 percent at June 30 to end the year at 3.0 percent. The six-month total return on the Barclays US aggregate bond index was 0.4 percent. Credit markets performed better as defaults remained low. Those markets saw a tremendous tailwind from yield-seeking investors, with the high yield and leveraged loan indexes generating 6 percent and 3 percent returns, respectively. Emerging market debt managed a slight positive return over the six-month period, gaining 1.8 percent as measured by the JP Morgan EMBI index.
- Hedge funds as measured by the HFRI Fund of Funds index were up approximately 5.2 percent over the six-month period, in line with credit markets but trailing the strong global equity rally.

At Dec. 31, 2013, Bucknell's endowment fund was valued at $721.8 million, up from $666.6 million at June 30, 2013. Over the six-month period, distributions totaling $17.5 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 $11.9 million and posted net investment gains of approximately $60.8 million.

Asset Allocation Dec. 31, 2013



Total Endowment Activity

Six Months Ended Dec. 31, 2013 (in millions)