The University of Delaware Endowment
Annual Report 2019

Fiscal Year 2019 Performance

I am pleased to report that the University of Delaware’s Endowment gained +7.0% for the fiscal year ending June 30, 2019 which compares favorably to our benchmark return of +5.3% and the average endowment peer return of +5.2%. Leading the way last year were the Endowment’s holdings in US equities which posted a net return of +10.8%. The asset class with the best performance relative to benchmark came from the Endowment’s investments in hedge funds where we achieved a +6.8% return while the benchmark only rose +1.2% during the fiscal year.

The overall performance was consistent with our capital market expectations of mid-single digit returns on endowment assets over the next decade due to low interest rates and elevated valuations. Fiscal year 2019 marked the third straight year that endowment performance exceeded the inflation-adjusted spending rate, allowing for strong growth in endowment assets that will benefit future generations of students at the University of Delaware. Our twenty-three year annualized return of +7.7% surpasses both the +6.9% return for the benchmark and the +7.3% return for our endowment peers. We are very proud of the fact that we have achieved these market beating results while taking less risk than our benchmark and our peers over this period, as seen in the chart below.

The latest fiscal year was a challenging one for investors due to increased volatility. While the global economy continued to grow, signs of a slowdown placed investors on edge. Global stocks posted a reasonable +5.7% return, but this was a marked deceleration from returns seen in the prior two years. Among major stock markets, US stocks led the way with a +10.2% return last year despite concerns that fading fiscal stimulus and the ongoing trade war with China would negatively impact corporate earnings. Indeed, trade tensions between the US and China were the main source of concern for the global financial markets and likely held back global economic growth. The biggest surprise last year came when the Fed shifted gears from raising interest rates to cutting interest rates halfway through the fiscal year. This had a dramatic positive impact on fixed income returns in the second half as interest rates plummeted, but also buoyed stock prices as monetary policy was expected to be more accommodative going forward. Economic conditions in Europe continued to soften with both local and global factors contributing to the slowdown. Given the uncertain economic and political environment today, a defensive portfolio stance seems justified. In the asset allocation section, we outline several changes that we have made to the Endowment portfolio over the last year.

23-year performance for the UD endowment, benchmark and endowment peers as of 6/30/19
The Endowment Mission

The Endowment provides perpetual funding to support the University’s educational goals while preserving real value for future generations. To that end, the University’s Board of Trustees, Investment Visiting Committee, and Administration have a shared mission to maximize the Endowment’s total return consistent with the University’s prudent investment risk constraints. This mission requires an expected long-term return that exceeds the inflation-adjusted annual spending rate. In order to pursue that goal, the University maintains an equity-biased portfolio and seeks to partner with best-in-class management firms across diverse asset categories while also managing some endowment assets in-house. The Investments Office manages the Endowment under the guidance of and within the policies authorized by the Investment Visiting Committee of the University.

The target spending rate for the Endowment is 4% to 5% of the three-year average market value as determined annually by the University’s trustees. In Fiscal 2019, the spending distribution from the pooled Endowment to the University was a record $63.1 million, providing financial support and flexibility to the University’s operating budget. In recent years, the Endowment’s role in supporting the University has become more meaningful as funding from the State of Delaware has declined. This support is likely to become even more important in the coming years given the challenges facing higher education today. The blue line in the chart below shows the decline in operating appropriations from the State of Delaware as a percentage of total operating revenue at the University, while the red line shows the increase in endowment payout to the University over time. The ongoing generosity of our alumni and friends has helped to ensure the long-term financial health of the University through the establishment of endowed gifts. A strong endowment allows the University to fund initiatives that will have a lasting impact on the student experience and the overall institution.

Historical State Operating Appropriations as a Percentage of Operating Revenue

---

**State Operating Appropriations/Operating Revenue (LHS, percent)**

**Endowment Spending Payout (RHS, $thousands)**

---
The Endowment Purpose

The Endowment supports a variety of aspects of University life. There are more than 1,278 endowment accounts that make up the overall University Endowment. The largest number of these accounts were established to support the College of Arts & Sciences. Other schools that enjoy a substantial benefit from having annual support from endowed accounts include the College of Engineering, the College of Health Sciences, the Alfred Lerner College of Business and Economics, the College of Agriculture and Natural Resources, the College of Earth, Ocean, and Environment and the College of Education and Human Development. Other endowments have been established to support our strong Athletics programs and other critical institutions on campus such as the Library.

As the chart below illustrates, the majority of these endowment accounts were established for the support of our students through student aid so that young people of every background can attend the University of Delaware. Diversity is a core educational value and a guiding principle of the 2015 Delaware Will Shine Strategic Plan. Research shows that campus communities with meaningful diversity practices significantly increase the quality and value of education for all students. These transformative learning experiences enhance critical thinking, promote civic responsibility, enrich formal and informal exchanges amongst students from various backgrounds, and prepare our students to navigate in an increasingly diverse and global world.

Other endowments have been created for instruction and departmental research as well as the general ongoing operational needs of the University. Since the Endowment is a permanent pool of capital, it is designed to provide a reliable source of income in perpetuity for the various causes that each account was established to support.

Number of Endowment Accounts by Purpose as of 6/30/19

- Student Aid, 62%
- Instruction & Research, 28%
- General Support, 4%
- Other, 7%
Compounding Growth Over the Long Term

Due to the perpetual nature of the investment program, the long-term performance results are a true reflection of the Endowment’s long-term investment horizon. Long-term performance has been strong on both an absolute and relative basis despite challenging market conditions. The Endowment recorded an annual return of +7.7% in the twenty-three years ended June 30, 2019, exceeding the +6.0% annual return for a passive portfolio of 60% global stocks and 40% global bonds. This annual outperformance confirms that the Endowment model’s long-term investment approach has worked well for the University of Delaware.

The chart below illustrates that the compounding of excess returns can have a significant impact on the University over time. An endowment of $1 million established twenty-three years ago would have grown to a compounded value of $5.5 million compared to a value of only $3.8 million invested in a global portfolio of 60% stocks and 40% bonds. At first glance, the difference between the +7.7% annual return for the Endowment and the +6.0% annual return for a passive portfolio of 60% global stocks and 40% global bonds may seem trivial, but due to the power of compounding that excess return has created $1.7 million in additional assets over the twenty-three year period. This difference is represented by the yellow area in the chart below. For this reason, the Investments Office actively manages endowment assets in order to achieve incremental positive returns. Large endowments are better able to achieve incremental positive returns from active management than smaller investors due to their access to top-performing investments and lower management fees. Continued excess returns on the Endowment will allow the University to make life changing investments in the education and development of a greater number of University of Delaware students.

Growth of $1 Million Invested in the UD Endowment as of 6/30/19
Growth of Endowment Assets

The Endowment has seen tremendous growth over the years. While there are references to an endowment at the University of Delaware prior to the 1850s, our current records date back to 1974 when the University of Delaware had the 17th largest endowment in the country according to the 1974 NACUBO Survey. The $106 million market value on the Endowment that year has ballooned to a current market value of $1.64 billion thanks to strong performance, generous contributions from alumni and friends and a prudent distribution policy. The $1.64 billion market value for fiscal year 2019 represents an increase of nearly $49 million over the prior fiscal year. This growth is also net of a record $63 million in distributions to the University’s operating budget in fiscal year 2019. The Endowment continues to grow in importance each year to the strength of the University’s balance sheet while the annual distributions make up a larger slice of the University’s operating budget.

The pooled Endowment portfolio is made up of permanent endowment funds as well as operating funds invested for the long-term. The yellow bars in the chart below illustrate the investment of these operating funds into the pooled Endowment portfolio. The decision to invest operating funds into the long-term portfolio was first made in 1997 in order to achieve a return on the University’s excess liquidity that was above what could be achieved in short-term fixed income investments. Occasionally, additional funds have been added to the long-term portfolio over the years as excess liquidity was identified. We are pleased to report that returns on the pooled Endowment portfolio have significantly exceeded returns on short-term fixed income investments over this period which has further strengthened the balance sheet of the University. Starting in the fiscal year just ended, the University has begun to redeem a portion of the operating funds invested in the long-term portfolio in order to further support the current operating budget and make important capital investments on the University of Delaware campus.

Annual Market Value of the Pooled Endowment as of 6/30/19
Asset Allocation

The University has developed asset allocation guidelines based on its total return objectives, income requirements, and capital market expectations. These guidelines are long-term oriented and are consistent with the Endowment’s risk posture and investment objectives. Over the last twenty-three years, the University has dramatically reduced the Endowment’s investments in domestic stocks and bonds by re-allocating to international stocks and nontraditional asset classes. In 2000, more than 80% of endowment assets were invested in US stocks and bonds with 20% in international assets and 0% invested in hedge funds and private investments. Today, less than 40% of assets are invested in U.S. stocks and bonds while 21% are invested in international stocks, 16% in hedge funds and 24% in private investments. As a result, the Endowment is now more diversified across asset classes. The broader opportunity set should not only provide higher returns in a greater variety of investment environments but also help to control risk.

We made additional progress toward our asset allocation targets in the latest fiscal year by reducing our allocation to public equities and increasing our allocation to private investments to better compete with endowment peers with assets of greater than $1 billion. As the chart below shows, we still have more work to do to get these allocations in-line with targets. The increasing allocation to private investments coupled with the extended duration of the current economic cycle have increased our focus on the risk and liquidity profile of the Endowment. In the last year, we have reduced the risk profile of the Endowment by reducing the equity market sensitivity of our hedge fund holdings, selling almost all of our exposure to below investment-grade bonds and dramatically increasing our allocation to high quality short-term government and corporate securities. Our cash and short-term investments allocation of 6.5% is well above that of peers and is the highest fiscal year-end cash balance for the Endowment in more than twenty years. We expect that these changes will provide the Endowment with the financial flexibility to continue to meet our future obligations to the University and our commitments to our private investment funds while also providing us with dry powder to opportunistically deploy capital in the event of a market downturn.

Endowment Asset Allocation vs. Target Allocation as of 6/30/19
**Capital Market Expectations**

Developing risk and return assumptions for the various asset classes offers a guide to the range of possible investment performance over a given period. These assumptions help the Investment Visiting Committee to guide the asset allocation and risk levels that are chosen to meet the University’s investment performance goals over the long-term. In prior annual letters we have noted that we expect capital market returns to become more subdued over the next decade due to lower interest rates, lower economic growth, heavy debt loads, the unwinding of accommodative monetary policy and inflated market valuations. These same challenging conditions are still with us today as we look at the investment landscape for opportunities. We believe that setting realistic capital market expectations leads to good asset allocation decisions and a better performance outcome for the Endowment.

The chart below can provide some guidance as to where the University of Delaware’s Endowment will be looking in the future in order to achieve strong risk-adjusted returns. The outlook for private investments still suggests that this is the area with the most performance potential for the Endowment which is why we are actively making commitments to increase our overall exposure to this asset class. Global equities also have strong return expectations, but increased volatility in this asset class suggests that we will maintain a more neutral position going forward. Hedge funds continue to provide diversification benefits to the Endowment, but return expectations have diminished compared to historical averages.

Despite generally lower return forecasts across most asset classes, we maintain our positive view on the capital markets. Our analysis suggests that the Endowment will produce a 7.4% annual return over the next ten years. We will continue to invest for the long-term and make strategic adjustments to the asset allocation based on changes to our capital market expectations.

**Ten-year Capital Market Expectations for Major Asset Classes**

![Graph showing ten-year capital market expectations for major asset classes]
Notes from the Road

We have established relationships with seventy different investment partners in our efforts to invest the Endowment for the University. While this number may seem high at first glance, it is important to remember that we are investing across multiple asset classes, geographies, economic sectors, market capitalizations and investment styles. According to a recent study, endowments with assets greater than $1 billion had 117 external managers, on average. We are proud to have significantly fewer managers and a more concentrated investment program than the average endowment after many years of over-diversification. In addition, we want our managers to run their portfolios in a more concentrated way so that their highest conviction ideas can flow through to our performance results. We will continue our efforts to increase our portfolio concentration so that we are putting ourselves in a position to be able to create investment returns that exceed both our peers and our benchmarks. Another benefit to this reduction of our portfolio holdings will also improve our monitoring capabilities making us better stewards of the Endowment. The Investments Office spends a lot of time each year on the road meeting with our external investment partners as well as conducting due diligence on new investment ideas.

In fiscal year 2019, the highlight of our time on the road was a trip to mainland China and Hong Kong. We spent time visiting with several of our investment partners and also travelled with them as they conducted due diligence on the companies in our portfolios. We wrote at length in last year's annual report about how we are very excited about the prospects for the Chinese economy and how most investors today are under allocated to this country. Our trip to China solidified our conviction that China will continue to be an important player in the global investment landscape and the Endowment will continue to increase our exposure to China. We are asking ourselves where China's equity market will be in ten years and allocating toward that goal. In addition, we are now considering China alongside the US, Europe and Japan rather than mixing China into the emerging markets category as most investors do. When you consider the technological improvements, rapid economic growth and dynamic market conditions in China, it is easy to see why it is a good idea to have a meaningful allocation to this market.
Blue Hen Investment Club ("BHIC")

One of the benefits of working in the Investments Office at the University of Delaware is that we are the administrative advisor for the BHIC which gives us the opportunity to work with our talented students. The BHIC is a student-run investment fund that invests University money in the stock market and provides a valuable experience to its members by allowing them to manage a real world investment portfolio. The BHIC was founded in 1996 when the University’s Board of Trustees entrusted the club with $500,000 to learn how to manage a real investment portfolio, making it one of the oldest and largest student-run investment clubs in the country. Twenty-three years later, I am pleased to report that the club is stronger than ever with a record fund balance of $2.42 million as of the end of June 2019. BHIC members learn about the most important aspects of finance and investing while developing strong teamwork, public speaking and analytical skills. The Executive Committee of the BHIC presents its results annually to the Investment Visiting Committee of the University of Delaware. I am always amazed at the professionalism with which the club is run and the sophisticated investment tools that the students use to manage the portfolio. These students are getting a leg-up on the competition as they leave the University to interview for sought-after positions in the investment management industry because they are already developing the skills that they will need to be successful in the future. The Investments Office has a former BHIC member on staff in the analyst role and we offer a paid internship opportunity to juniors looking to learn more about the investment management industry and further develop their investing skills. Last year was a successful one for the BHIC on many fronts. The investment portfolio returned 189 basis points above the S&P 500 Index benchmark due to strong stock selection in Consumer Discretionary, Financials and Health Care by the student analysts. This was the best relative performance for the BHIC in almost a decade. As in prior years, the BHIC instituted several new initiatives that will strengthen the educational aspects of the club while also deepening their understanding of the companies in the portfolio. Another important development was that the BHIC placed 100% of their seniors in full-time financial industry jobs and had a record high placement of underclassmen in summer internships. Last year was a great example of how the BHIC has made meaningful long-term impacts on the lives of our Lerner College students.
Looking Ahead

The Endowment is designed to provide the University with greater independence, increased financial stability and the means to become a center for academic excellence. Understanding this fundamental purpose is important to understanding the long-term nature of the Endowment’s investment process. This global multi-asset class investment framework has proven to be able to exceed public benchmarks over the long term, despite the occasional short-term underperformance. While we are pleased with the recent performance results, we are prepared for a more challenging market environment in the years ahead. We expect that the markets will rise at a mid-single digit pace over the next ten years as interest rates continue to rise globally and economic growth rates stabilize at a lower rate. Given the challenges facing higher education today, we will pursue long-term investment returns that enable the University to achieve its goals and maintain its excellence far into the future.

Sincerely,

Anthony Bartocci – UD class of 2002
*Investment Officer*

Christopher LeRoy – UD class of 2013
*Investment Analyst*

Dr. Dennis Assanis
*University President*

John Long
*EVP and Chief Operating Officer*

Keith Walter
*Chief Investment Officer*

Greg Oler
*Vice President, Finance*