Fiscal Year 2020 Performance

The arrival of the COVID-19 pandemic was the defining moment of the fiscal year just ended. It has brought economic and physical disruption on a scale not seen in our lifetimes. The University of Delaware has responded to the challenges that this crisis has brought upon us with resilience, positivity, and inspiration. In a recent study by Professor Scott Galloway of NYU, the University of Delaware was ranked in the top-quintile of colleges and universities based on our ability to survive the coronavirus pandemic. Our high score came from our attractive tuition, student success after graduation and our strong financial stability. The University’s assets, anchored by our large endowment, are the main contributors to this financial stability and the Aa1 and AA+ overall ratings from Moody’s and Standard & Poor’s. The COVID-19 pandemic has certainly put this financial strength to the test.

In the face of this crisis, the University of Delaware’s pooled investment portfolio was able to manage a small (+0.1%) positive return in the fiscal year ending June 30, 2020 thanks to a strong stock-market recovery in the April through June period. However, due to increased support to the University, the pooled investment portfolio assets shrunk by $70 million during the year. The Investments Office is committed to distributing between 4% and 5% of assets each year regardless of disruptions in the capital markets, and last year was no exception. While we were disappointed with the results last year, we remain focused on the long-term. Over the last 20 years, the endowment has achieved an annual return of +6.4% which is above our long-term benchmark return of +4.9% and the +6.0% average return for endowments with assets greater than $1 billion calculated by Cambridge Associates. 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 uncertainty of the COVID-19 pandemic on the operations of the University pushed us in two directions. First, we wanted to make sure that we had enough liquidity to meet the University’s needs as we managed through this crisis. We made investments in short-term investment-grade bonds that were sufficient to make payouts for the next two fiscal years. With comfort around our liquidity needs, we then were able to confidently make more than $100 million in long-term commitments to alternative investment funds. We expect that these long-term investments will be well-positioned to take advantage of the dislocations arising from the COVID-19 pandemic.

20-year performance for the UD endowment, benchmark, and endowment peers as of 6/30/20
A new state-of-the-art Esports Arena glows blue on the first floor of the University of Delaware Perkins Student Center. Photo by Evan Krape

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 2020, the spending distribution from the pooled investment portfolio to the University was a record $63.3 million, providing financial support and flexibility to the University’s operating budget. In recent years, our 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 distributions 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 1,330 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 6/30/20

- Student Aid, 62%
- Instruction & Research, 30%
- General Support, 4%
- Other, 4%
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 +7.4% in the twenty-four years ended June 30, 2020, exceeding the +5.9% 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-four years ago would have grown to a compounded value of $5.5 million compared to a value of only $4.0 million invested in a global portfolio of 60% stocks and 40% bonds. At first glance, the difference between the +7.4% annual return for the endowment and the +5.9% 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 $1.6 million in additional assets over the twenty-four 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 6/30/20

N’Dea Irvin-Choy is a doctoral student in the College of Engineering’s biomedical engineering program who is working with nanoparticles and recently started a blog.

Photo by Evan Krape
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 $1.57 billion on the pooled investment portfolio thanks to strong performance, generous contributions from alumni and friends and a prudent distribution policy. 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 investment 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 show the operating funds in 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. Recently, we have begun to redeem a portion of these operating funds on an annual basis to support important strategic initiatives at the University of Delaware. These funds are also being used to offset the impact of the COVID-19 pandemic on the University’s operating budget.

Annual Market Value of the Pooled Investment Portfolio as of 6/30/20

UD Endowment Assets
Operating Funds in the Endowment

The Ammon Pinizzotto Biopharmaceutical Innovation Center — on the University’s growing Science, Technology and Advanced Research (STAR) Campus — houses the headquarters of the UD-led National Institute for Innovation in Manufacturing Biopharmaceuticals (NIIMBL).

Photo by Evan Krape
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.

We have seen dramatic changes to our asset allocation over the last twenty-four years with the allocation to domestic stocks and bonds falling from more than 80% of endowment assets to less than 40% today. These funds have been redeployed into the international equity markets and alternative assets which should not only provide higher returns in a greater variety of investment environments but also help to control overall risk.

We made our first foray into private investment funds in 2000. Now, twenty years later we have reached our 25% target allocation to this important asset class. While our legacy fund-of-funds still represent more than one-third of these investments, we are very excited about the return potential on our new private investment fund commitments. In the latest fiscal year, those assets with the strongest relative performance in the endowment were Chinese equity investments. In last year’s annual report, we described how we were excited about the long-term return potential of investing in China, but we had no idea that we would be rewarded so quickly. One of our dedicated Chinese equity managers posted a return of +62.8% last year despite the negative impact of the COVID-19 pandemic. The highest absolute returns in the endowment last year came from fixed income investments as interest rates fell to record lows. The Bloomberg Barclays US Aggregate Index posted a +8.7% return, which is remarkable considering that the yield-to-maturity on this benchmark at the start of the year was only 2.3%. As a result of today’s record low interest rates and the liquidity needs of the University during this uncertain time, we have increased our cash allocation to the highest level in more than twenty years. We want to make sure that we have the financial flexibility to continue to meet our obligations to the University and our capital commitments to private investment funds while also having dry powder to opportunistically deploy capital in the event of another market downturn.
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.
The Geltzeiler Trading Center is a 2,200-square-foot facility designed to replicate the trading floors in investment banks, brokerage houses and hedge funds on Wall Street.

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-four years later, I am pleased to report that the club is stronger than ever with a record fund balance of $2.49 million as of the end of June 2020. 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 offers 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 370 basis points above the S&P 500 Index benchmark due to strong stock selection in Consumer Staples, Financials and Health Care by the student analysts. This was the best relative performance by the club in its 24-year history and built upon the success from the previous year. The students also set a philanthropic record through their Charitable Grant Committee by donating over 1% of the portfolio’s value to a variety of student organizations. 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. Last year was another great example of how the BHIC has made meaningful long-term impacts on the lives of our Lerner College students. Next year will be the 25th anniversary of the BHIC so we are looking forward to seeing the students maintain their strong momentum.

Blue Hens beat the S&P 500

Blue Hen Investment Club members Ryan O’Donnell (right) and Anna Perrotta analyze stock picks with club advisor Richard Jakotowicz (left). Photo by Kathy F. Atkinson
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. 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.

Fiscal year 2020 was a challenging one on many fronts, but the investments that we have made put us in a stronger position to meet future challenges as they arise and to deliver on our commitment to support the University of Delaware. The best illustration of this commitment can be seen in the fact that over the last twenty years, we have distributed 100% of the earnings on endowment assets after adjusting for inflation and expenses. Our generous alumni and friends can have confidence that we are properly balancing the needs of future generations of University of Delaware students against the needs of current students while also preserving the purchasing power of their original gift. 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.
The University of Delaware strictly follows all current health protocols, including the wearing of masks and appropriate physical distancing. Some images in this newsletter may have been taken before these rules were implemented.

The University of Delaware is an equal opportunity institution. For the full Notice of Non-Discrimination, Equal Opportunity and Affirmative Action, see www.udel.edu/home/legal-notices