



BROWN  
UNIVERSITY

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# ENDOWMENT REPORT 2017



# INTRODUCTION

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During the fiscal year from July 1, 2016 to June 30, 2017, Brown University's endowment and other managed assets appreciated by 13.4 percent, representing \$419 million in investment gains. This period was marked by strong performance for a broad array of risk assets, particularly equities.

During the year, Brown's endowment provided \$179 million to the University, representing 18 percent of the annual operating budget and equivalent to approximately \$19,000 per student. The endowment was the recipient of \$91 million in net additions from donors, a strong year for giving. Managed with a dual mandate of both protecting and prudently growing its value over the long term, the endowment and other managed assets now stands at \$3.5 billion at the end of Fiscal Year 2017.



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## THE PURPOSE OF THE ENDOWMENT

The endowment exists today because of the generous and consistent support of benefactors dating back to an original gift of \$4,500 in 1769. Its purpose is to provide financial stability and support to the educational mission of the University and the diverse undertakings of its faculty and students. Because the University is managed as a permanent institution, this mandate extends to future generations of participants in Brown's mission. The funds that comprise the endowment, therefore, must be managed not only for capital preservation, but also to maintain purchasing power indefinitely into the future.

## SPENDING

The endowment provides financial support by contributing a percentage of its value each year to the University's operating budget. Historically, the target policy guideline for that distribution of funds has been between 4.5 percent and 5.5 percent. This creates a hurdle: In order to maintain the value of the endowment, over the long term it must appreciate at a rate equal to or greater than the annual spend over the long term. Moreover, in order to protect the purchasing power of the endowment, it must also outpace inflation. As a result, the necessary rate of appreciation to overcome the hurdle rate is effectively higher. The endowment must outpace the sum of the annual spend plus the rate of inflation, as measured by the Higher Education Price Index (HEPI).

As the risk-free rate has lingered at historic lows for nearly a decade, the required return with an acceptable level of risk has proven a high hurdle to clear. Therefore, during Fiscal 2017, the Corporation of Brown University voted to reduce the target distribution. This will move the endowment closer to Brown's peers in terms of annual spending targets and the additional capital retained will compound its value in the future. This is, in effect, an investment in Brown's future.

### Endowment Income Distribution by Purpose

**32%**

*Scholarships, Fellowships & Prizes*

**20%**

*Professorships*

**20%**

*General*

**16%**

*Other*

**6%**

*Instructional Programs*

**4%**

*Libraries*

**2%**

*Athletics*



## PERFORMANCE

The investment performance should be evaluated in three ways: First, is the endowment achieving its primary mandate of preserving both value and purchasing power after spending? Second, is the endowment matching or exceeding the performance of broad measures of the equity and debt markets? Third, is the endowment keeping pace with peer institutions that pursue similar mandates with similar resources? Each of these comparisons should be made over appropriate horizons.

The performance of Brown's endowment fares well by all three measures. For Fiscal 2017, the endowment far outpaced the required return of spending plus inflation. This is also the case over the trailing 5- and 20-year

terms. The trailing 10-year term includes Fiscal 2009, an exceptionally destructive year for financial assets.

Over 10 years, the endowment has outperformed its global equity benchmark, the MSCI All-Country World Index (ACWI). This is notable because the index represents the performance of only global equity markets, while the endowment is managed with a greater degree of asset diversification. As a result, we also include for comparison a blend of the MSCI ACWI with a broad index of global fixed income markets, the Barclays Global Aggregate.

**The endowment outperformed this 70/30 blend in FY 2017, and over each of the trailing periods.**

Fiscal Year Annualized Returns	FY 2017	Annualized Returns as of June 30, 2017			
	****	3 Year	5 Year	10 Year	20 Year
<b>Brown Endowment</b>	<b>13.4%</b>	<b>5.8%</b>	<b>9.1%</b>	<b>5.2%</b>	<b>8.6%</b>
Aggregate Benchmark	11.1%	4.0%	6.9%	3.7%	N/A
70/30 MSCI ACWI/Barclays Global Aggregate <sup>1</sup>	12.1%	3.4%	7.6%	4.0%	N/A
MSCI All-Country World (ACWI)	18.8%	4.8%	10.5%	3.7%	N/A
MSCI All-Country World (ACWI) ex-U.S.	20.5%	0.8%	7.2%	1.1%	N/A
S&P 500 Index	17.9%	9.6%	14.6%	7.2%	7.2%

1. 70% MSCI ACWI and 30% Barclays Global Aggregate

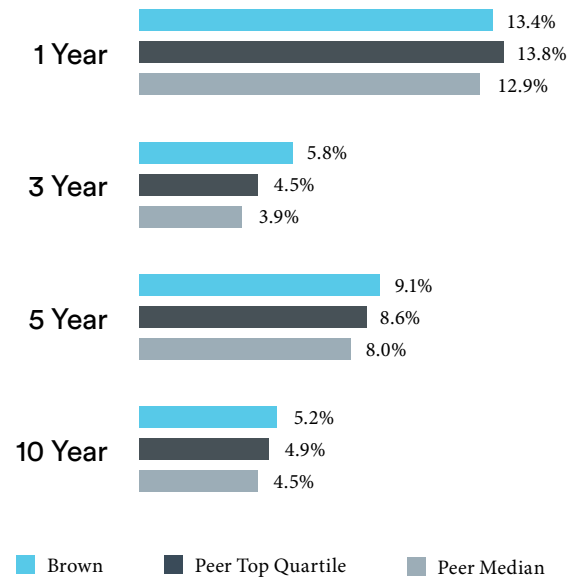


## PERFORMANCE (CONT.)

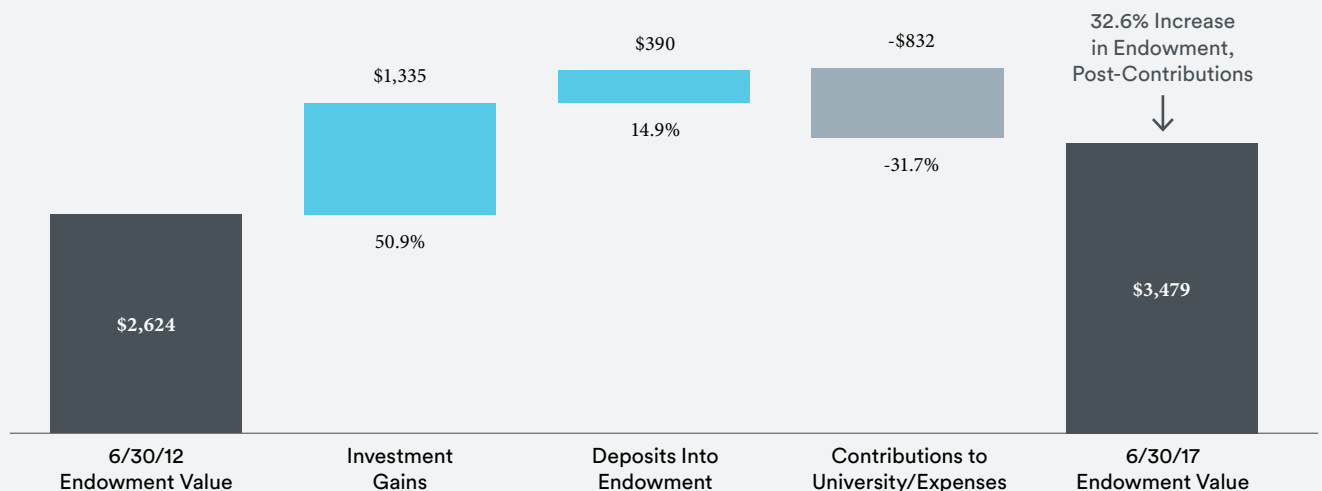
Finally, it is imperative that the endowment is also measured against other educational institutions that share our mission and time horizon. In this case we refer to the returns of 145 colleges and universities maintained by Cambridge Associates. Brown's 13.4 percent return surpassed the mean (+12.9 percent) and median (+12.9 percent) returns of peers for the period in question.

The Investment Office also evaluates performance in the context of University leadership. Fiscal 2018 marks the beginning of President Christina Paxson's second five-year term at Brown. Thanks to a combination of strong financial market conditions and the generous support of the Brown community, the endowment has recorded investment gains of over \$1.3 billion under Brown's current leadership. In addition, in this period since June 2012, the endowment has contributed \$832 million to the University.

### Brown Performance versus Cambridge Associates Peers through FY 2017<sup>2</sup>



### 5-Year Growth of the Endowment





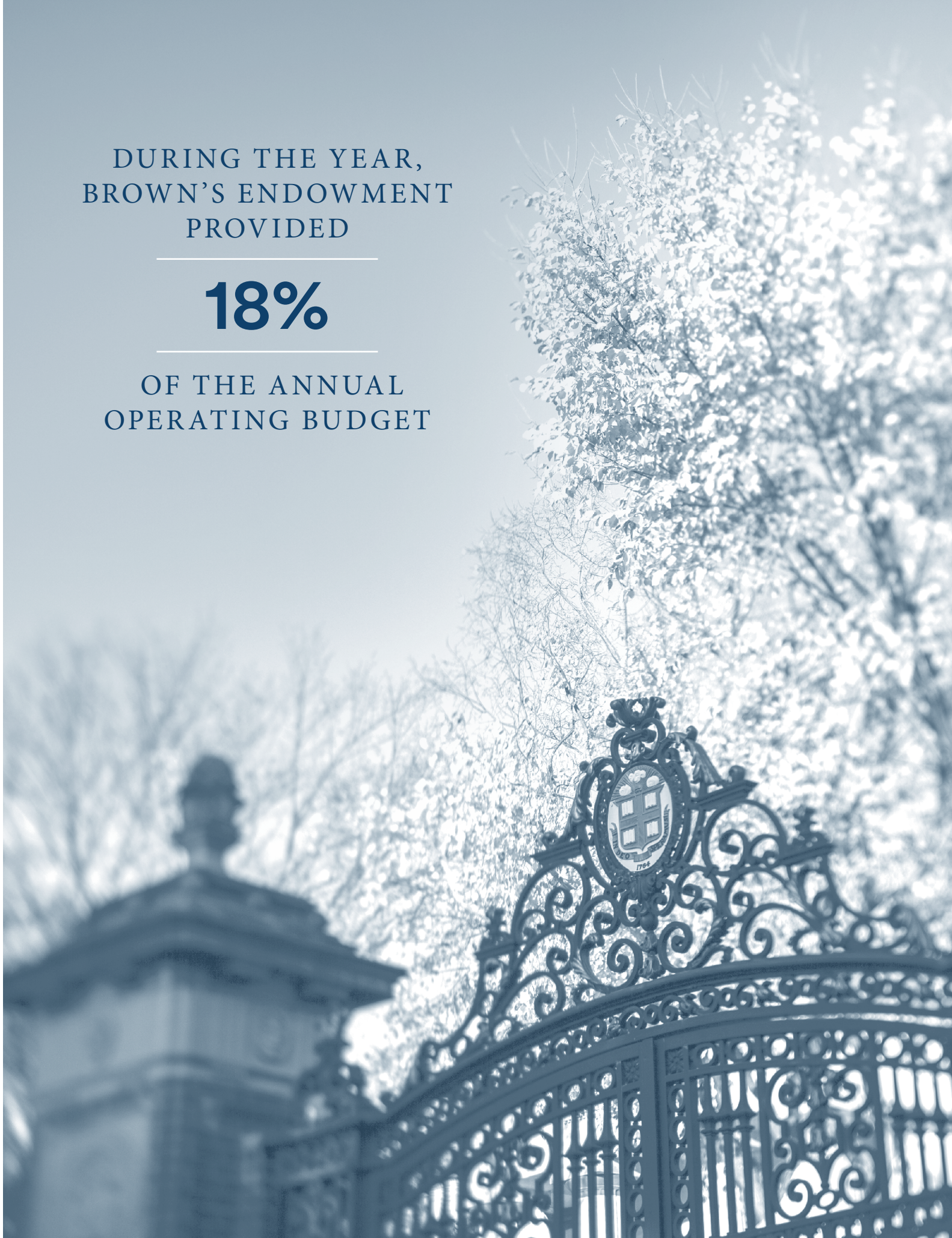
DURING THE YEAR,  
BROWN'S ENDOWMENT  
PROVIDED

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**18%**

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OF THE ANNUAL  
OPERATING BUDGET







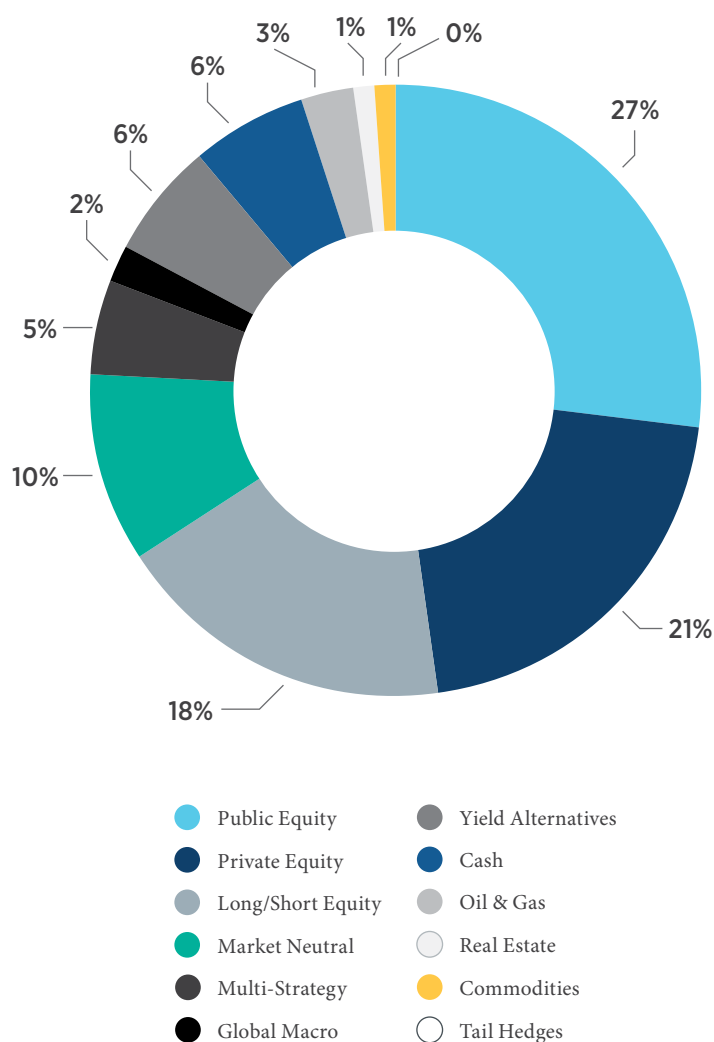
## ASSET ALLOCATION REVIEW

The endowment is managed with a diversified approach to asset allocation. The mix of assets – and the associated risk that is assumed – is not tailored to one specific version of the future, nor to achieve maximum appreciation in the next fiscal year. Rather it is designed to anticipate multiple future scenarios that develop over many years, and to include multiple engines of return that should compensate for each other in a diverse array of circumstances. As the future unfolds and new data becomes available, the course is modified.

For the purposes of this discussion, the endowment's allocation of investments are grouped into three broad categories: public equities, private investments and absolute return strategies. Historically a fourth category – fixed-income investments – would have merited attention. In today's low interest-rate environment, however, the Investment Office has winnowed Brown's fixed-income investments to a handful of opportunities where the likely reward justifies the assumed risk.

**Public Equities:** Fiscal Year 2017 was a strong 12-month period for public equities. The S&P 500 climbed 17.9 percent, and for the first time in nine years, that broad measure of U.S. stocks was bested by overseas stock markets, which appreciated 20.5 percent as measured by the MSCI All-Country World ex-U.S. index. Emerging Markets awoke from a multi-year slumber; the MSCI Emerging Markets Index generated a 23.7 percent return.

Endowment Asset Allocation 6/30/17





## ASSET ALLOCATION REVIEW (CONT.)

For years, Brown's endowment has had an explicit bias in favor of U.S. assets. This allocation has been a tailwind for several years as U.S. markets have outperformed global markets. Whether FY 17 is an aberration in this pattern or a reversal thereof will only become known in hindsight. We are pleased to report, however, that despite Brown's limited exposure to international developed and emerging markets, the return from the public equity portfolio kept pace with international markets and outperformed domestic markets. This is attributed for the most part to the skill of Brown's investment managers.

At this stage of the market cycle, a bull market in equities is well-advanced and broad valuation measures stand at high levels. In preparation for an inevitable change to this favorable environment, the Investment Office has undertaken an effort to improve the liquidity profile of the public equity portfolio. This effort includes negotiating improved liquidity terms with managers and selectively using low-cost, passive instruments to achieve desired exposure. As a result, the public equities portfolio is more liquid than in recent years, and we expect further progress in this regard.

**Private Equity:** Though not a steadfast rule, there exists in the marketplace for financial assets an illiquidity premium. In properly functioning markets, with all other

factors being equal, a higher rate of return will be awarded to investments where the invested capital is unavailable to its owners for re-investment or re-allocation. For the most part, the longer the duration, the better the returns. This higher expected return, which comes at the cost of liquidity, is the primary appeal of private investments, a category that encompasses leveraged buyouts, venture capital and real assets such as real estate.

As one of the endowment's core advantages is a long-term investment horizon, Brown expects to capitalize by taking advantage of the illiquidity premium. The practical application, however, is more complex than simply making investments until the endowment reaches a target allocation. It takes considerable time to adjust course with a portfolio of long-term investments, and the Investment Office does so judiciously.

A portfolio of private investments must be diversified by year, such that the risks that characterize each year, or vintage, are layered. As a result, building a diversified portfolio requires many years of steady execution. In addition to this primary task, the Investment Office is concurrently taking other actions to optimize the endowment's private equity portfolio. Partnering with managers on co-investments and participating in the secondary market for fund interests both play a role.





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THE ENDOWMENT IS ESSENTIAL TO THE UNIVERSITY'S  
COMMITMENT TO ENSURING THAT NO STUDENT WHO ASPIRES  
TO ATTEND BROWN WILL ENCOUNTER COST AS A BARRIER.

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## ASSET ALLOCATION REVIEW (CONT.)

Brown's Private Equity portfolio today remains a mix of outstanding managers that are long-term partners of Brown, and some legacy investments that will eventually roll off as they mature or are liquidated. Improving the quality of this mix – through new investments, re-investments, co-investments and secondary transactions – is among our highest priorities.

**Absolute Return Strategies:** The endowment's allocation to absolute return strategies is the product of an ongoing search for engines of return that have a low correlation to each other and to the market overall. It is a broad category that encompasses a diverse set of investments with individual characteristics.

Brown has a substantial allocation to this group of strategies, but this grouping masks significant diversification. The portfolio's return in FY 17 exceeded the pace the University would expect based on the aggregate "look-through" market exposure of the group. In aggregate, Brown's managers executed well during the year.

Although the allocation to the Absolute Return asset class represents a diverse set of investments, the common thread that runs through each is a set of selection criteria that emphasizes partnership and alignment. The Investment Office focuses its research on managers that value Brown's qualities as an investment partner, and endeavor to treat the University as such. The Investment Office thinks carefully about the alignment of interests for Brown with those of its investment managers, and strictly manages the incentives that exert influence over the behavior of these partners. This is true of all of Brown's investment managers, regardless of strategy.

The robust performance of financial markets over the last 12 months has only served to reinforce our conclusions about prospective returns. Identifying investment opportunities that combine an adequate return with a low correlation to the market is an exceedingly challenging task that often proves fruitless. Nonetheless, it is a priority for the Investment Office; we're turning over a lot of stones.



## BROWN'S COMPETITIVE ADVANTAGE

The endowment enjoys certain natural advantages, and the Investment Office works to accentuate these advantages in order to fulfil its mandate.

The first is the ability to invest for the long term. Few institutions enjoy the flexibility to consider investments that mature over years and even decades. In Brown's case, contemplating such time horizons is imperative, and the impact of doing so is significant and diverse. One key implication is the profound importance of developing partnerships with world-class investment managers that can be productive for many years to come. When investing over long time horizons, people are paramount.

The second advantage is related in that it is rooted in people, but truly unique to Brown. Brown's alumni, investment managers and strategic partners, faculty,

staff, parents and students comprise an exceptionally knowledgeable and supportive network with a clear and common cause. This community helps the endowment partner with some of the world's most exceptional investment managers. It grants access to and supports the evaluation of myriad investment opportunities. It is a significant and rare asset that the Investment Office, as well as the Investment Committee of the Corporation of Brown University works to utilize increasingly each year.

These advantages help us evaluate and select responsible stewards for the endowment's capital. Without deviating from the dual mandate of preserving and prudently growing the endowment, the Investment Office is increasingly extending the concept of responsible stewardship to include our partners' attention to issues of environmental and social impact, governance and sustainability.

## RISK AND RETURN

The investment return over any time period is not the result of an effort to simply achieve the highest possible number. Rather the goal is to maximize the growth of the endowment within the context of a specific constraint. That constraint is an acceptable level of risk. Risk, unlike return, does not easily avail itself to precise measurement.

With the benefit of hindsight, the markets for financial assets in Fiscal Year 2017 accommodated a level of risk appetite that was higher than investors largely expected. In this environment, a more aggressive posture would have generated a higher return. What cannot be determined with certainty, however, is whether that higher return would have been worth the increased risk.

Looking forward, financial assets appear richly valued. Uncertainty about the future course of events is abundant. In each case, the condition is amplified from a year ago. The approach of the Investment Office is to assess the risk of each opportunity and ask: Is the endowment being appropriately compensated for assuming such risk?

The Investment Office, with oversight from the Investment Committee, endeavors to be disciplined about the appropriate compensation for each risk assumed. The Office will utilize the unique advantages granted by the Brown community, and will pursue the endowment's goals with integrity and the spirit of partnership.

## IN CLOSING

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In closing, we wish to express – on behalf of the University – our gratitude to several contributors that we feel should have a pride in ownership of the work the endowment supports. We are grateful to the members of our Investment Committee for their oversight and counsel. We are grateful to the faculty members and University staff at all levels who collaborate to support our efforts. We are grateful to our talented and hard-working investment managers and strategic partners. Finally, we are grateful to the benefactors of the University.

Ever True,  
The Brown Investment Team



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