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SlUC Foundation 2003 Endowment Study

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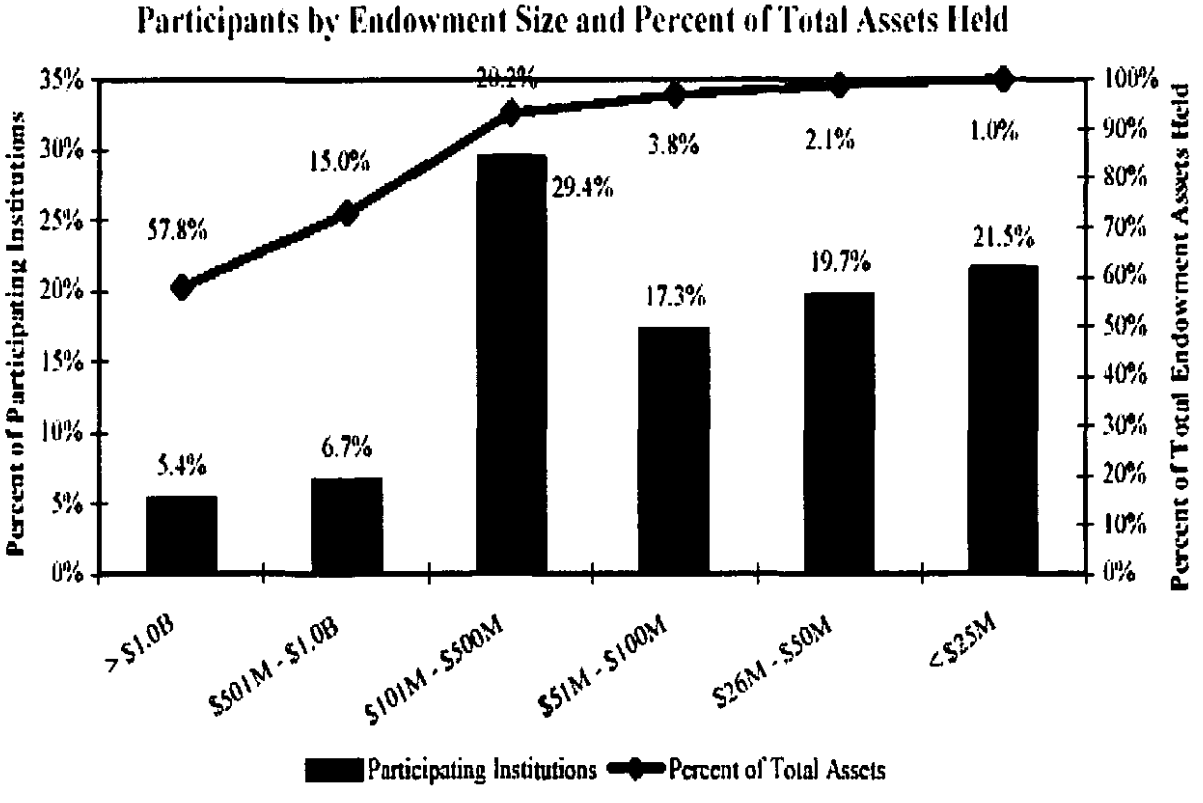
This thesis study has followed the **National Association of College and University Business Officers (NABUCO) Endowment Study**, which is a yearly survey that gathers information regarding investment activities of over seven hundred educational institutions across the United States. The Southern Illinois Foundation has participated in the NABUCO Endowment study for over ten years, and we plan on analyzing the Foundation's performance compared against eight peer institutions, and another five aspiring peers. For confidentiality reasons, we were not allowed to disclose our peers' names; therefore we will number each one of them. This discussion is divided in four main areas: Endowment Size, Rates of Return, Asset Allocation, and Spending Rates.

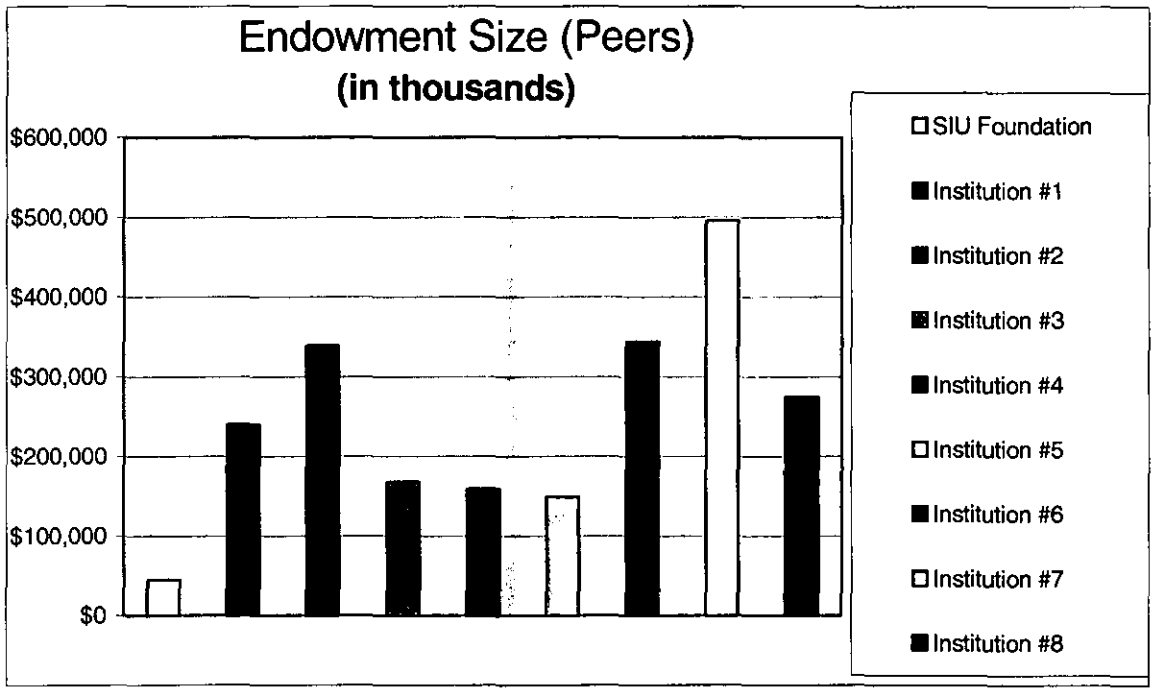
Endowment Size

There were 723 participating institutions in the 2003 NACUBO study, corresponding to over $230 billion in total endowment assets. Out of these 723 institutions, 19.7% had an endowment size within the Foundation's asset class of $26-50 million. These institutions within the Foundation's category represented only 2.1% of the $230 billion total aggregate assets.

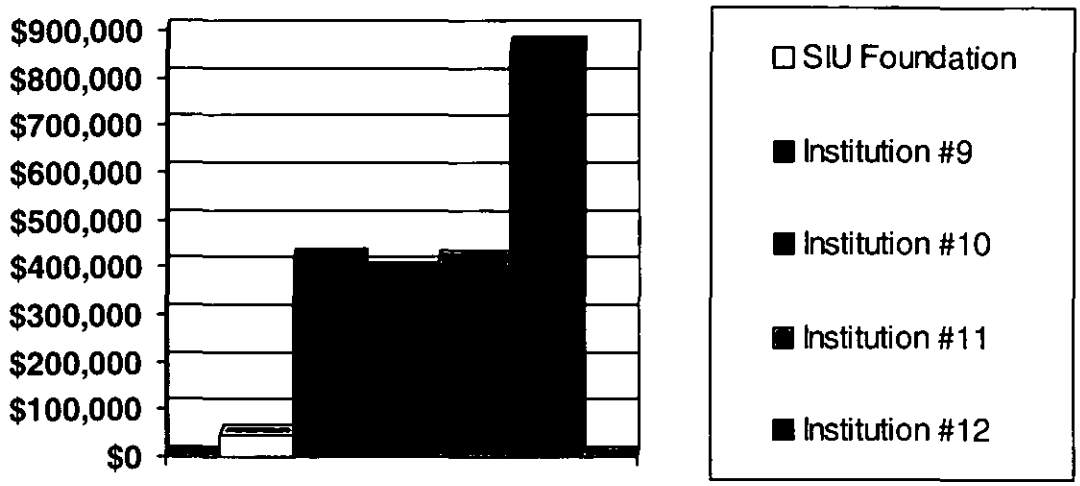


One of the interesting things this graph shows is that, out of the 723 responding institutions, only 5.4% of them were of the endowment asset class of over $1 billion. These institutions, however, were responsible for holding 57.8% of the total aggregate assets claimed in this study. The Foundation's asset class corresponds to 19.7% of the responding institutions. They only hold 2.1% of the total aggregate assets, however.

The Foundation's endowment size is of $45,023 million, which makes it a relatively small endowment when compared to our peers and aspiring peers. The next largest endowment to SIU, Institution #5, is over three times larger than SIU. Our largest peer, Institution #7, has an endowment size just below half of a billion dollars.



The comparison of endowment assets with our aspiring peers seems even more disproportional. The next largest institution to SIU, Institution #11, is over nine times larger than us. The largest aspiring peer institution here has over $900 million in endowment assets, which makes it over twenty times larger than SIU.



Rates of Return

Before we get into the rates of return discussion, we shall first disclose who our benchmarks and managers are for several different areas SIUC is invested in. SIU was invested in three main areas: U.S. Equity, U.S. Fixed Income, and Non-U.S. Fixed Income.

Passive management means having a benchmark and holding the same assets as the benchmark's, to achieve the same performance over the period. Active management holds different assets in order to try to outperform the benchmark. Our U.S. Equity benchmark is the Wilshire 5000 Index, and it returned 1.3% last year. Our passive manager was the Vanguard Total Stock market Index, and it was successful in matching the Wilshire 5000 Index, with a 1.3% return. Our active manager, the Wellington Research Equity, was also successful in beating the Wilshire 5000 Index, with a 4.2% annualized return.

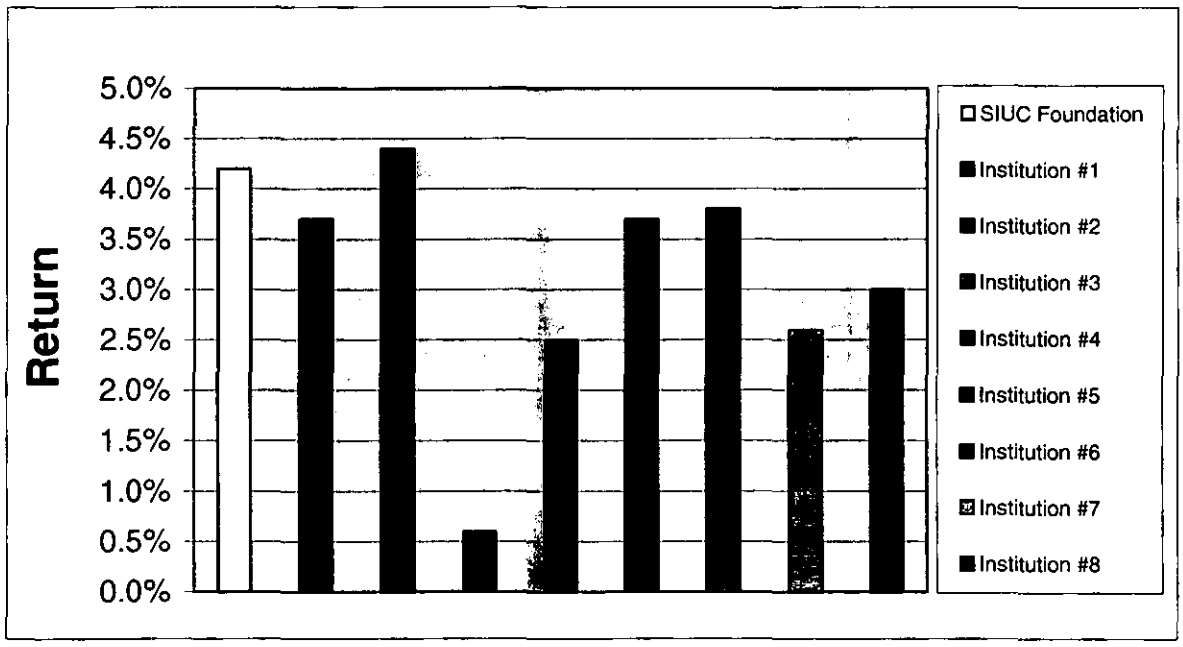
Our U.S. Fixed Income benchmark was the Lehman Brothers Aggregate Index, and it returned 10.4% last year. Our fixed income managers were the PIMCO and the Western Asset Core Plus, which outperformed the benchmark, with an 11.2% and 13% annualized returns, respectively.

Finally, our Non-U.S. Fixed Income benchmark was the MSCI AC World Ex-U.S. Free Index, and it had a negative return of 4.6% in 2003. Our foreign fixed income manager was the EuroPacific Growth Fund, and it also had a negative return of 5.3%.

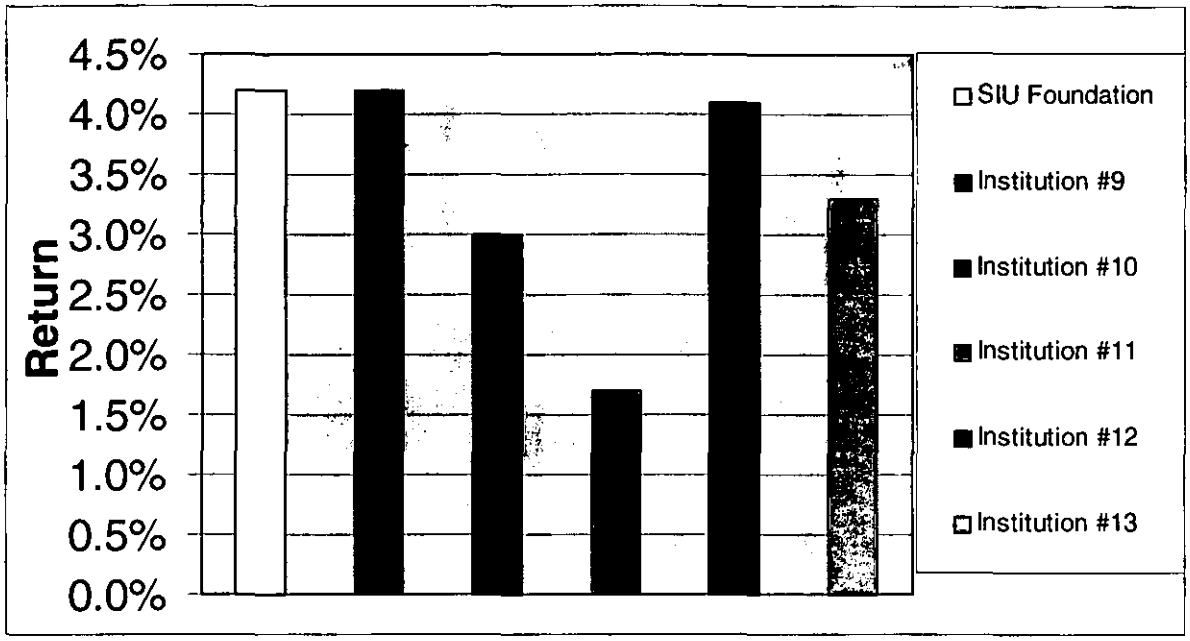
We shall emphasize here that, even though some institutions had more funds allocated in successful sectors such as domestic fixed income, not all them obtained the same return as their benchmark. Each institution decides on its own benchmark, and may not be invested in the same managers as its peers. This difference is even bigger when it comes to domestic equity, since there are innumerous options of equity investing.

The Foundation's heavy allocation in domestic fixed income and equity played a great role in achieving the returns it did last year. Other institutions who were overly diversified in lagging sectors found themselves trailing the returns of the more conventional institutions.

Over the past ten years, the SIU Foundation improved from the 375th to the 186th overall NACUBO ranking on annual returns. With a 4.2% annualized return for 2003, the Foundation only performed worse than one of its peers (Institution #2, with 4.4%). Keep in mind that SIU was at least three times smaller than its peers as of June 30th, 2003.



Compared with its aspiring peers, the Foundation tied with Institution #9, and outperformed all other institutions, which is a great accomplishment.



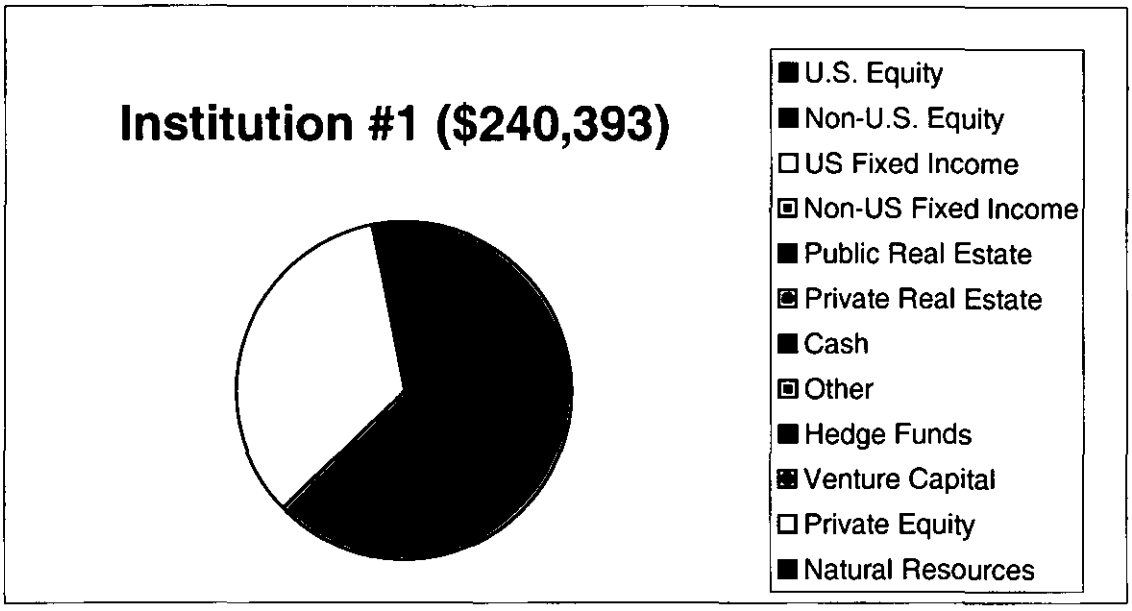
Asset Allocation

The study has found that in general, as total institutional assets increase, so does the percentage of holdings in alternative assets (such as hedge funds, private equity, venture capital, and real estate). Meanwhile holdings in conventional investments such as equity, fixed income, and cash decrease.

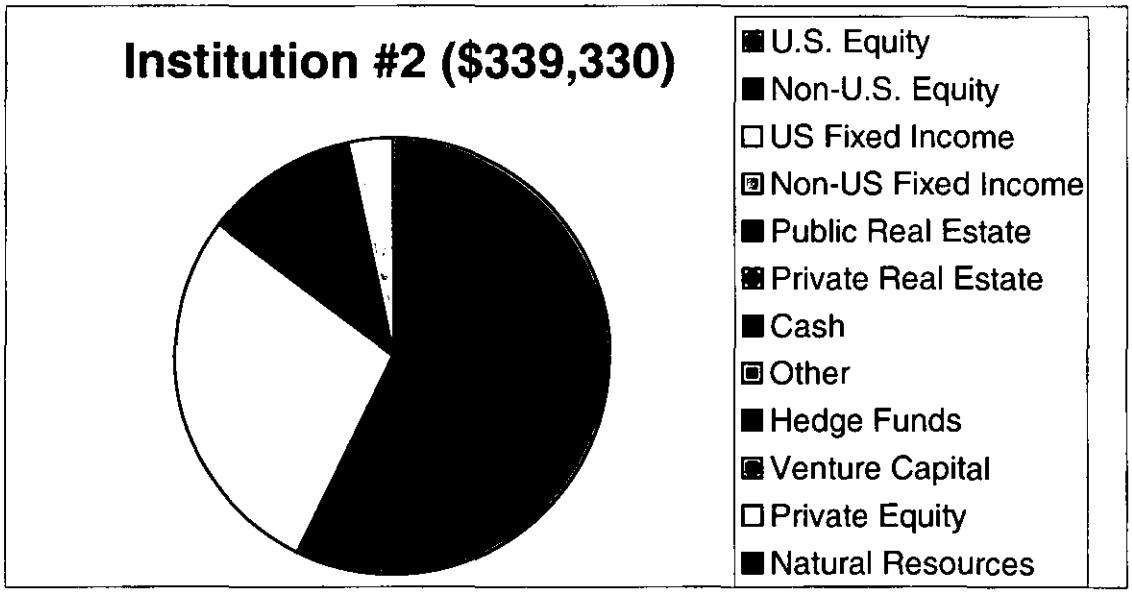
Hedge funds are the most widely used of alternative classes in 2003, with investment pools holding an equal-weighted average of 6.1%, up from 5.1% in 2002.

Participating institutions within the Foundation's asset class hold, on average, the largest portion of equity in their portfolios (60.2%).

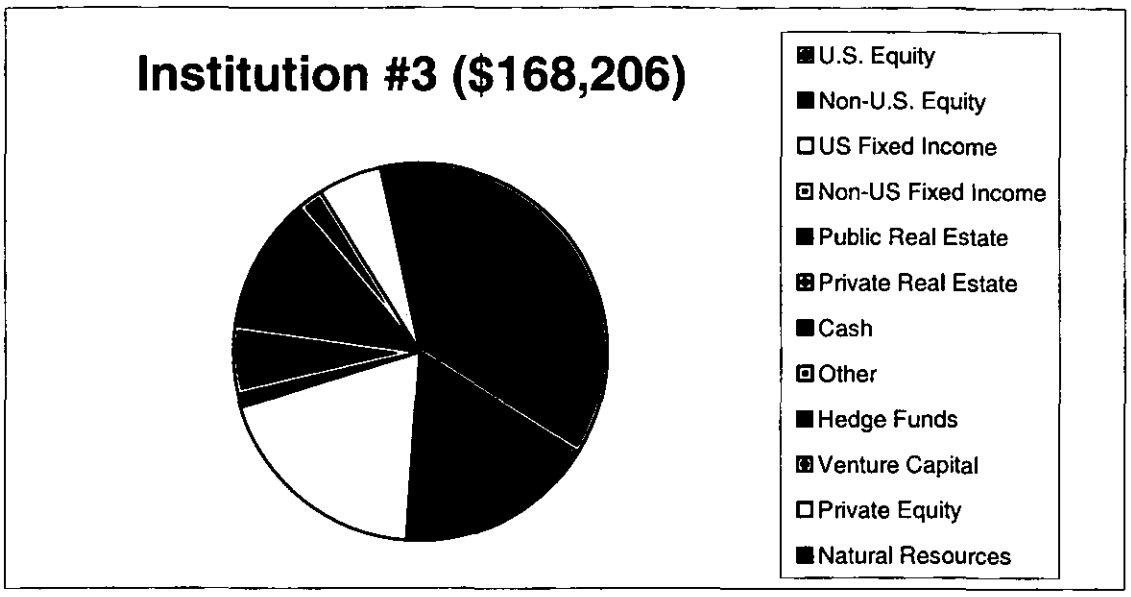
We shall illustrate in the following pages each individual institution's investment breakdown:



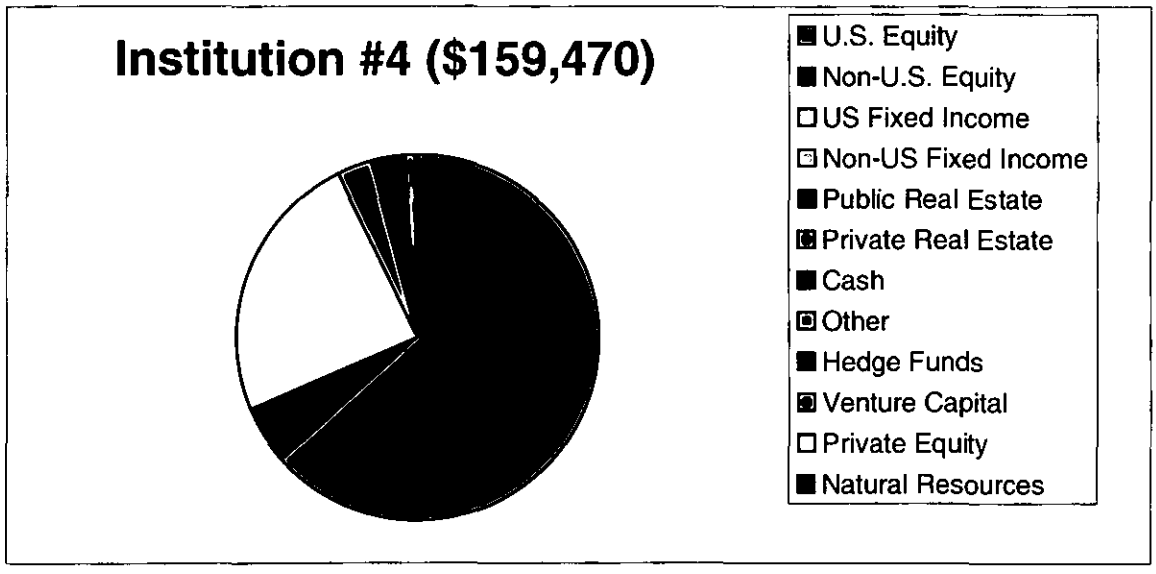
This institution had a similar amount of its investments in domestic fixed income as SIU did. They held 14% less international equity, and 12% more domestic equity also.



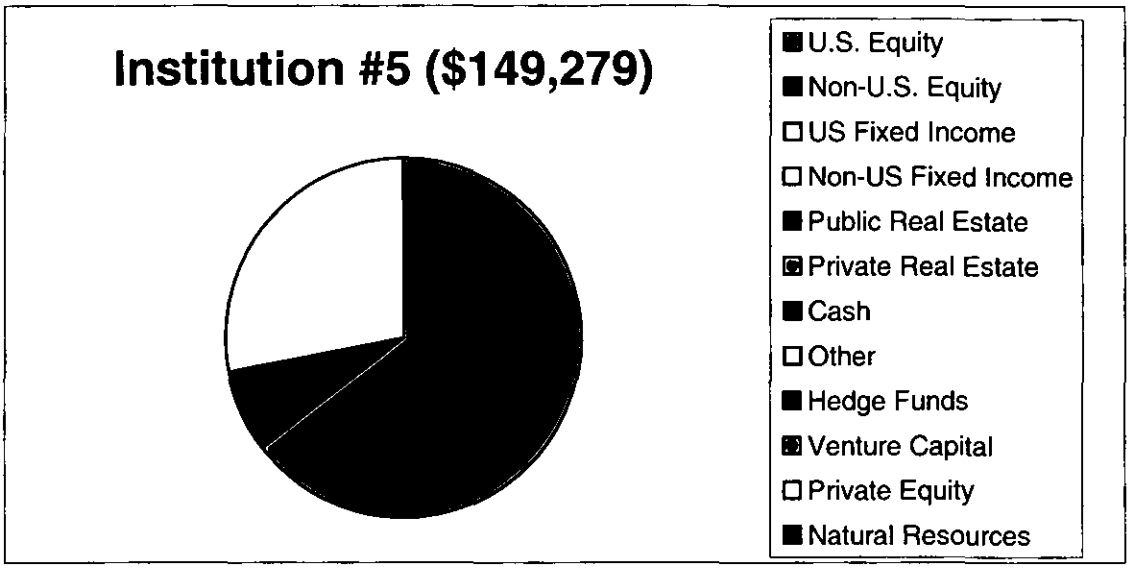
Institution #2 had a similar amount of domestic equity and fixed income as SIU. They held 8% less foreign equity than SIU, and also had 6.7% of their portfolio invested in hedge funds. They also held a small amount of private equity.



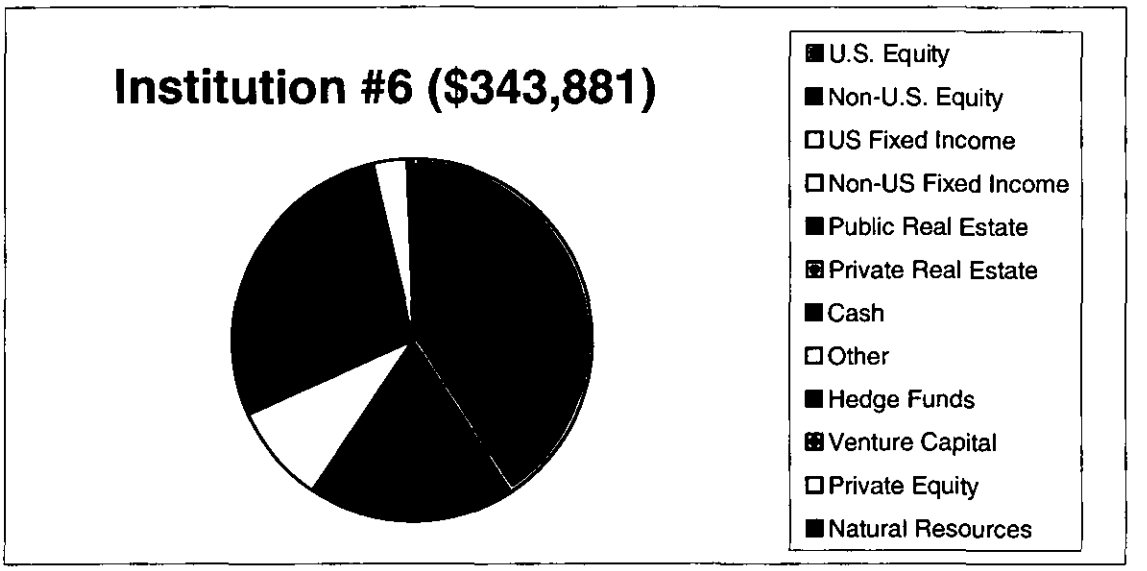
Institution #3 had a similar amount of foreign equity compared to SIU. However, they held 31% less domestic equity and fixed income. This way, they could have their portfolio well diversified within alternative assets, such as 10.4% in hedge funds, 7% in both private and public real estate, and 5.5% in private equity.



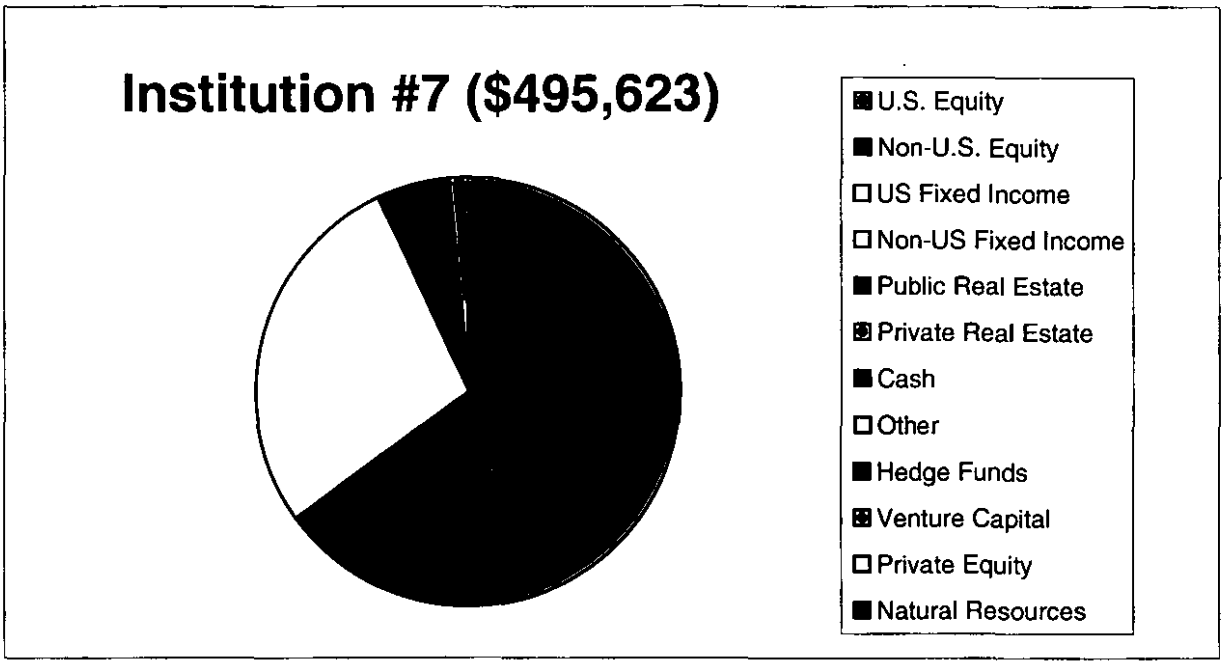
Institution #4 had nearly 93% of their portfolio allocated in the three major conventional holdings (domestic equity, foreign equity, and domestic fixed income). They held 2.9% of private real estate, and a small share of hedge funds, venture capital, and private equity.



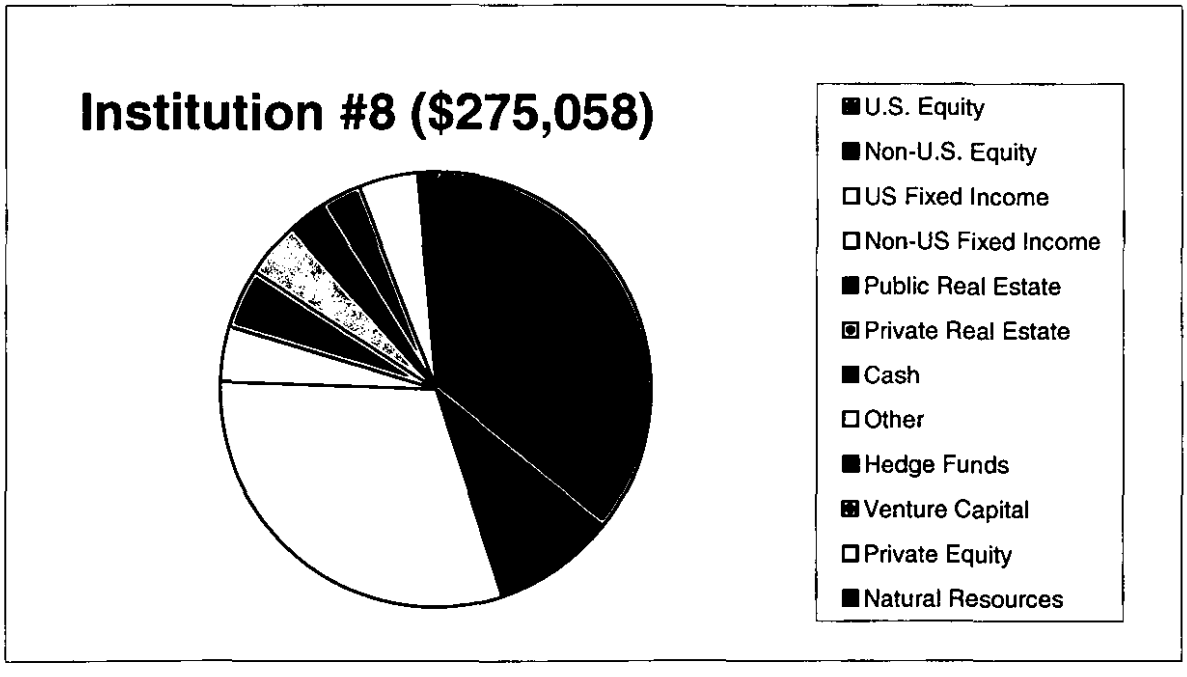
This is an institution that holds only the three major conventional assets, which is similar to the foundation's policy. They had 13% more domestic equity, and 13% less foreign equity and domestic fixed income compared to SIU.



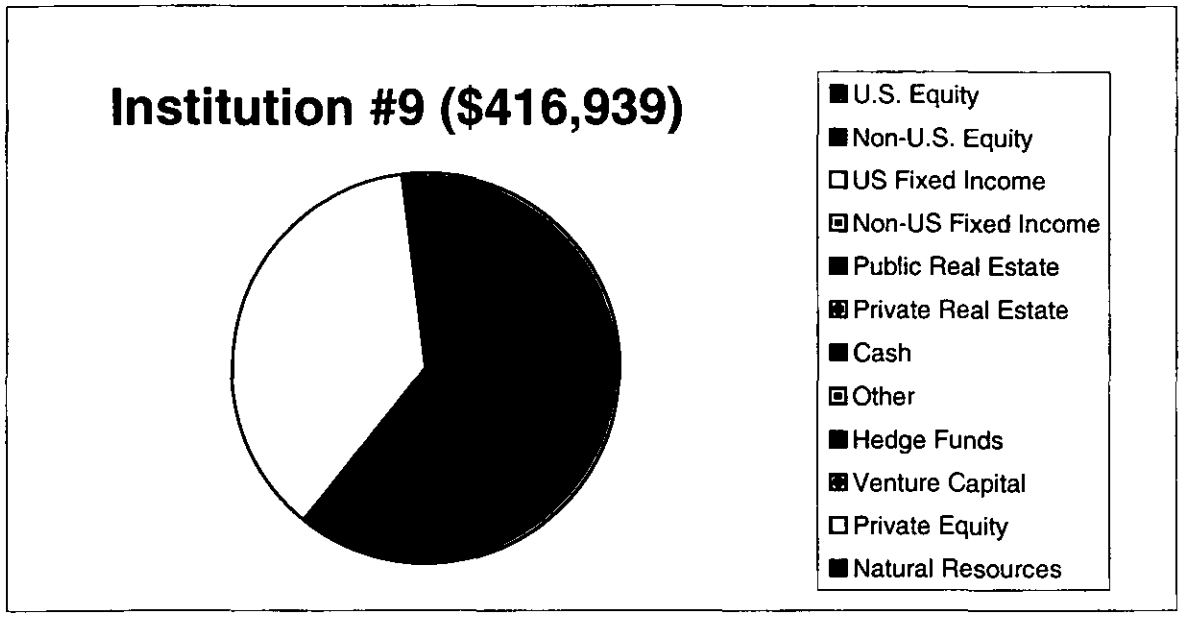
This is an example of a well-diversified institution. They had 36% less domestic equity and fixed income, compared to SIU. Some of their allocations are 7% in public real estate, 14.1% in hedge funds, and also allocated a small share in private equity and natural resources. Institution #6 had an unusual large amount of cash in their portfolio at the end of the year. That could be due to the amount of contributions most universities receive at year-end, and the inability of investing those moneys in such a short time frame.



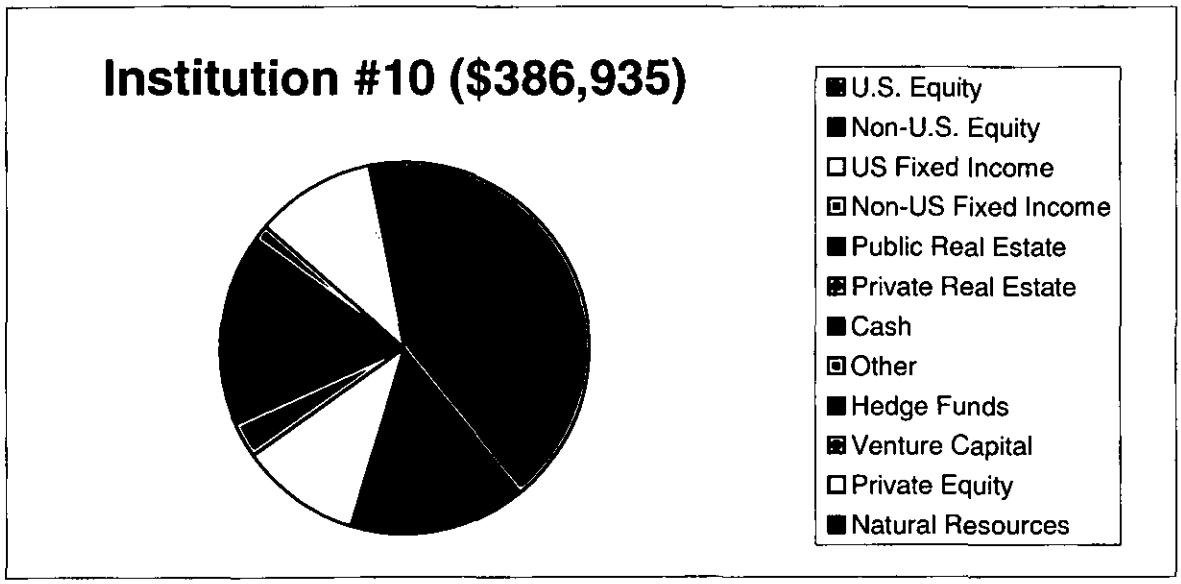
Institution #7's investment breakdown also looks very similar to the Foundation's. They had 1.4% of their portfolio in venture capital, and also held a little more cash than we did.



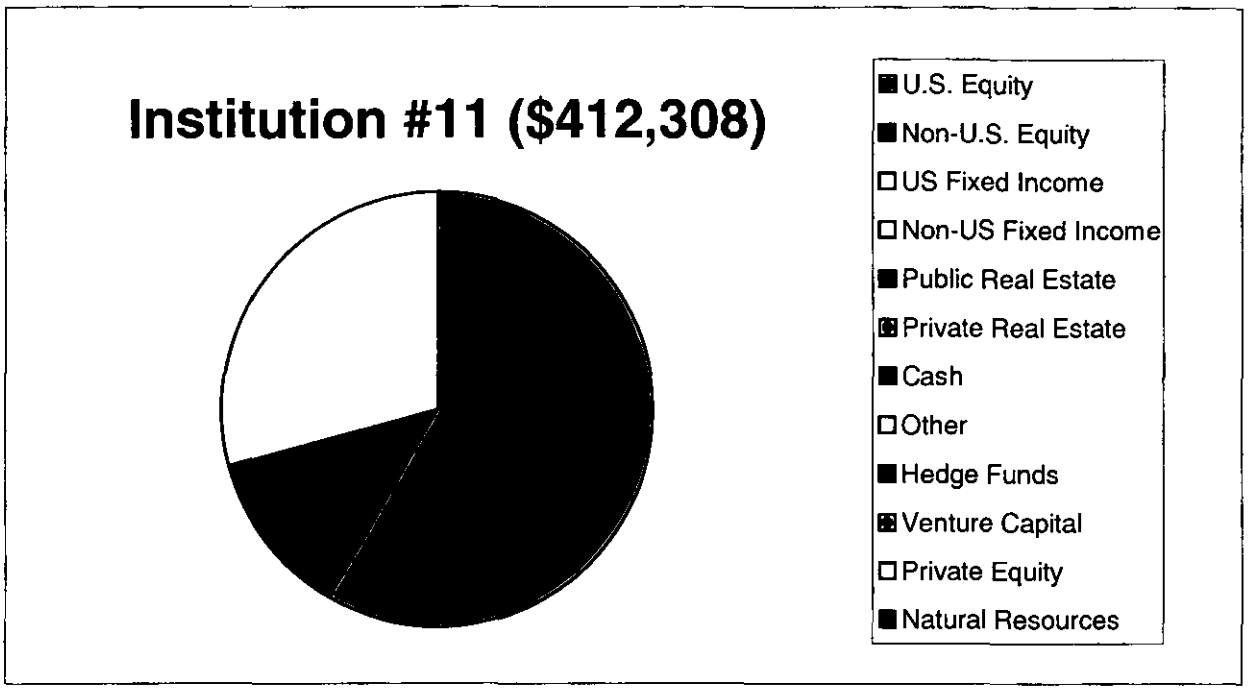
This institution had 75% of their holding in the three major conventional assets. The other 25% was well diversified in alternative assets, mainly in private real estate, other investments, and private equity.



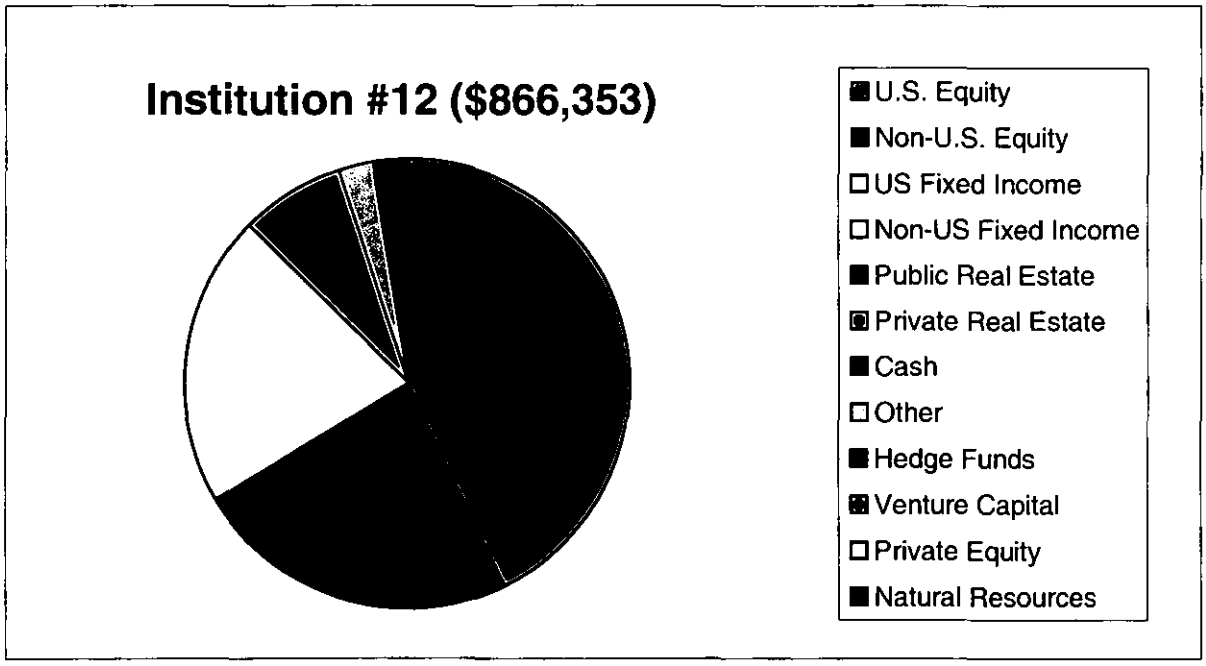
Institution #9 held 7% less foreign equity, and nearly 7% more domestic equity and fixed income compared to SIU.



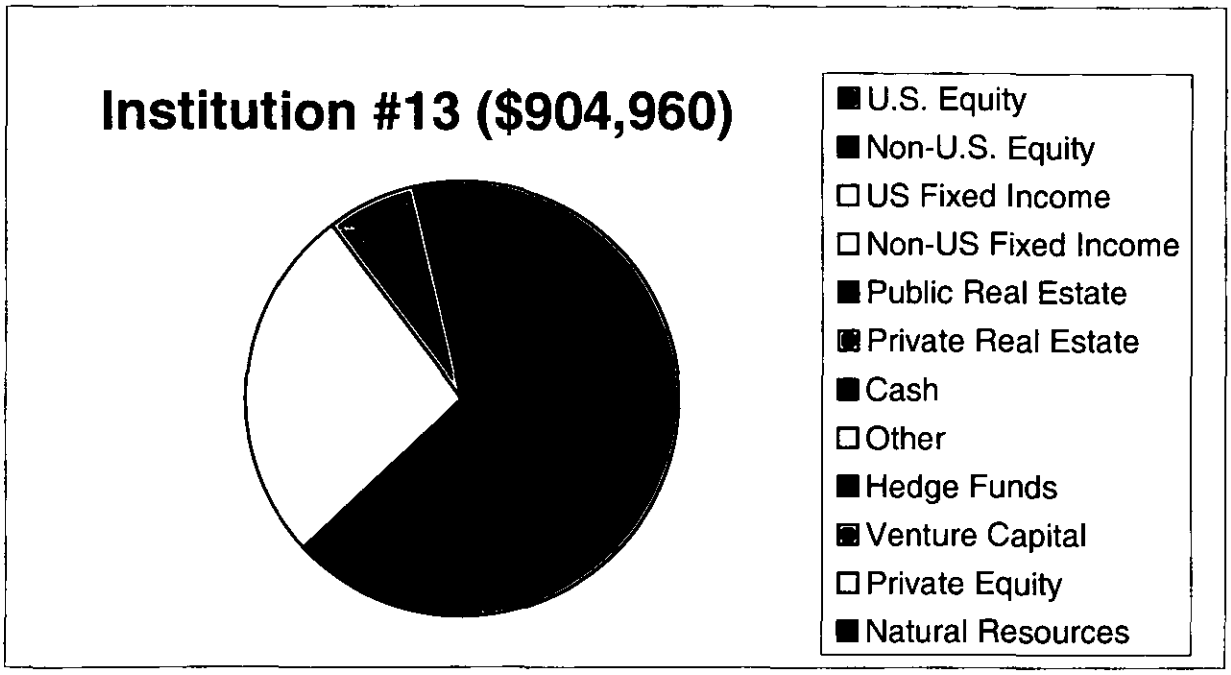
Institution #10 had around 65% of their portfolio allocated in conventional assets. They had a considerably large amount of hedge funds (16%) and private equity (10.5%). They also had 3.1% in each private real estate and natural resources.



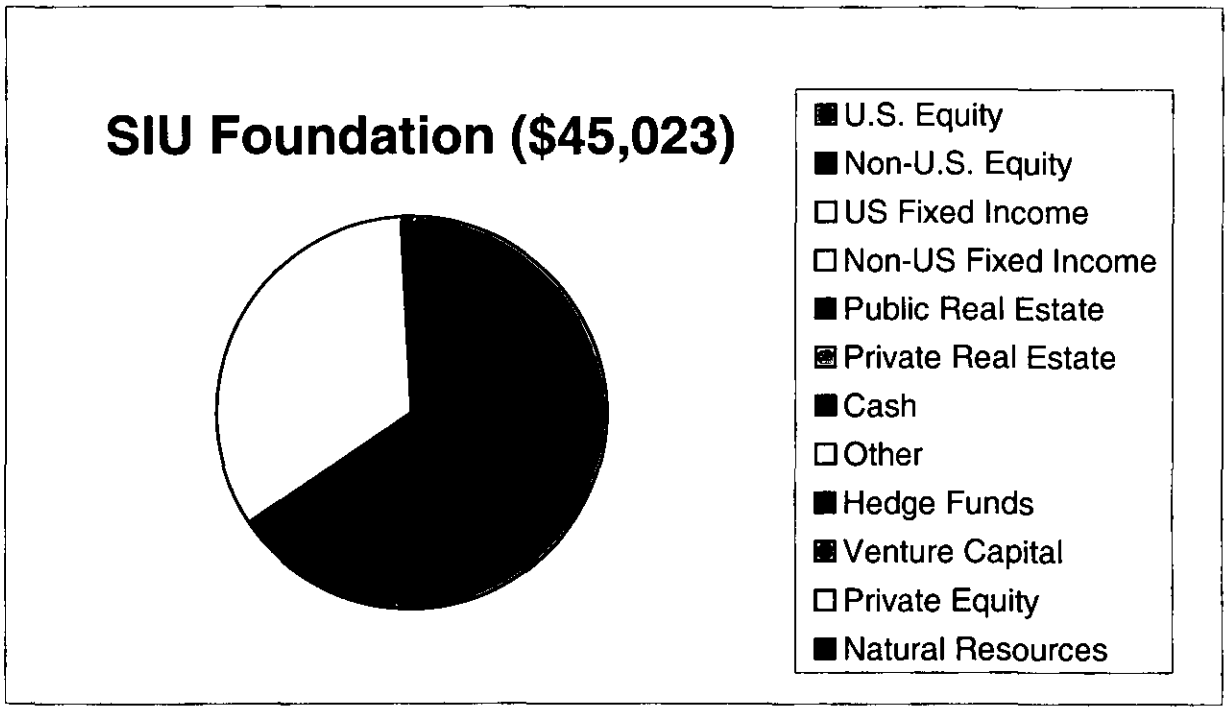
Here's another institution with a very similar investment policy compared to SIU. They had 7% more domestic equity, and 7% less foreign equity and domestic fixed income, compared to us.



The interesting thing about this institution is that it had no investments in domestic fixed income. They held 21.1% more foreign fixed income than SIU. They were also diversified in private real estate, other investments, and hedge funds.



This institution had nearly 90% of their portfolio invested in conventional assets, 6.6% in private real estate, 3.3% in hedge funds, and the remaining in cash.



The Foundation's holdings were 51.3% in domestic equity, 14.3% in foreign equity, 33.6% in domestic fixed income, and 0.8% in cash.

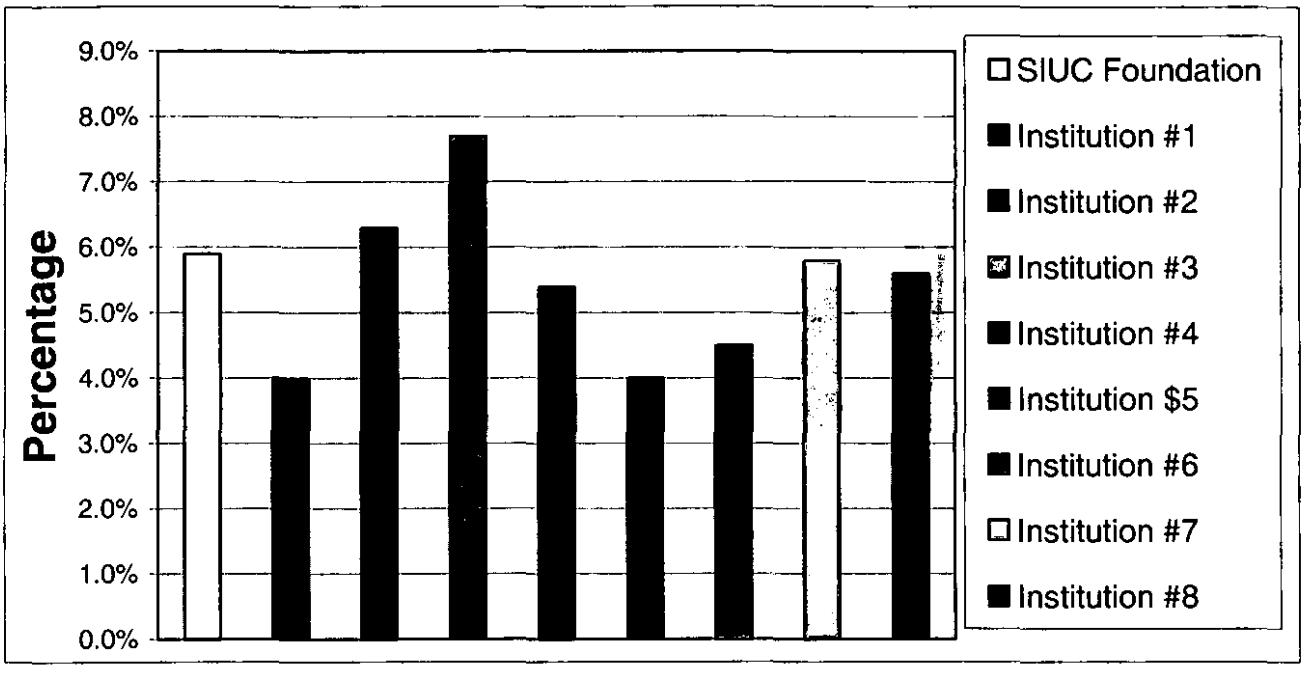
Spending Rates

Given seven choices of spending strategies, institutions across all endowment categories are far more likely to base their spending policy on a pre-specified percentage of the moving average of market values than any other strategy, with 82.4% making this selection. Within the Foundation's asset class this number was even higher, with 86.5% of the institutions selecting on this policy.

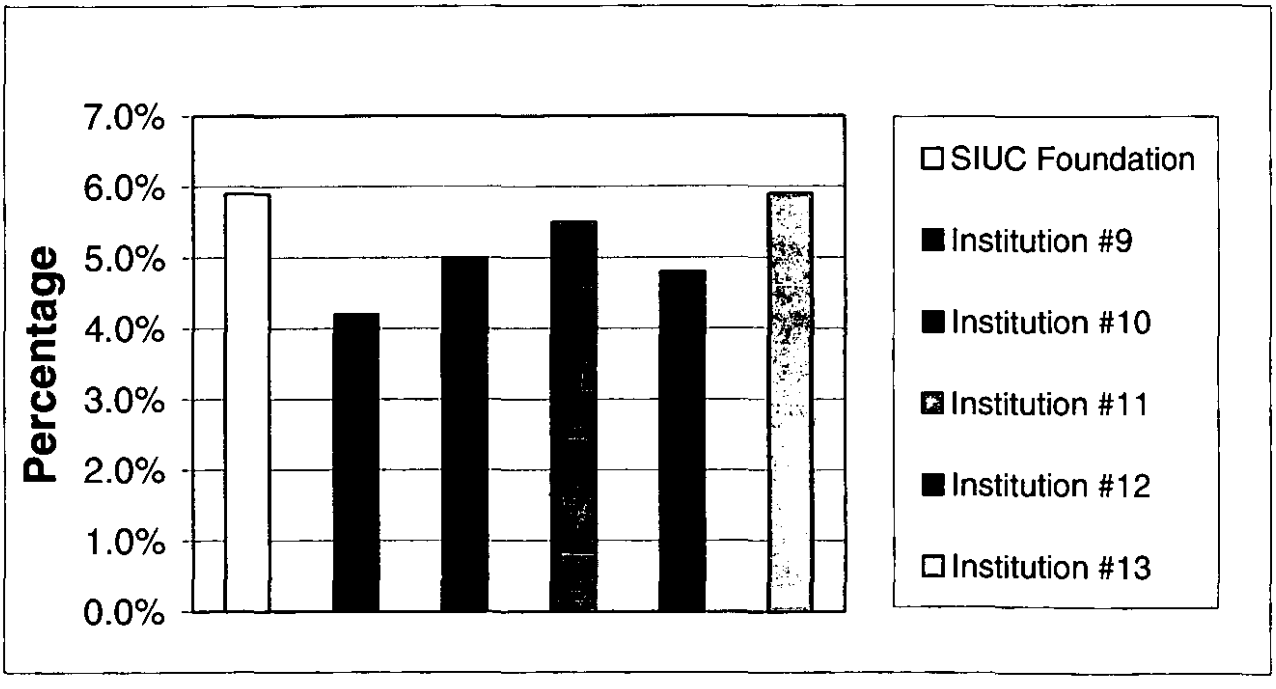
SIU Foundation's calculated spending rate came out considerably higher than average. This is due to a pre-specified percentage of the moving average, which was higher than the market value for the period. We shall present two examples to illustrate how a larger or lower moving average compared to the beginning market value affects the actual spending rate.

- Example 1: Our beginning market value as of March 31st, 2003 was of $40.6 million. The moving average of the pool for the time period was of $44.8 mi. With fixed spending rate is of 4%, and we obtain our distributable amount by multiplying this 4% by the moving average. Our distributable amount to accounts was a close to $1,793,000. Putting this calculated figure against the beginning market value will bring the actual spending rate to 4.41%, which is higher than the fixed spending rate of 4%.
- Example 2: The beginning market value as of March 31st, 2004 is at almost $55 million. The 2004 moving average of the pool is at $44.6 mi., which multiplied by the fixed 4% gives a $1,785,000 distribution to accounts. Note that this calculated figure is almost identical to the figure calculated in the past example. This calculated distribution, combined to a higher beginning market value brings our spending rate down to 3.25%. Therefore, we come to the conclusion that at similar

moving average figures, the changes in market value determine whether the actual spending rate will be higher or lower rate.



The Foundation's spending rate, as of June 30th, 2003 was of 5.9%, which is considerably higher than the fixed 4%. The Foundation's spending policy, however, has also another 1% above the fixed 4% due to an endowment fee. The rest of the difference is due to inequalities between the moving average and beginning market values.



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