Introduction

I am pleased to report that for the fiscal year ended June 30, 2015, the return on the University of Delaware endowment was +4.19% placing us in the top quartile among public university endowments and foundations monitored by Cambridge Associates. Global equities once again drove the results, but strong contributions also came from venture capital and real estate investments. The mid-single digit performance in fiscal year 2015 was a result of low interest rates, softer economic growth and generally rich equity market valuations. We expect the markets will continue to produce muted results over the next few years as the normalization of interest rates across the globe starts to take place. For the fiscal year ending June 30, 2015, the pooled endowment portfolio had a value of $1.51 billion, an increase of more than $40 million from the prior fiscal year. We have made a strong recovery since the end of the global financial crisis, with the endowment growing by $609 million since the end of February 2009. According to the 2014 NACUBO-Commonfund Study of Endowments Survey, the University’s endowment per student is ranked as the sixth largest in the nation among public universities.
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 Investment 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 2015, the spending distribution to the University was $50 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.

Historical State Operating Appropriations as a Percentage of Operating Revenue
The Endowment Purpose

The endowment supports a variety of aspects of University life. There are more than 1000 endowment accounts that make up the overall University endowment that have been established by our generous alumni and friends. The majority of these endowment accounts were established for the support of our students 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 department research as well as the general ongoing operational needs of the University.

Number of Endowment Accounts by Purpose as of June 30, 2015

- Student Aid, 62%
- Instruction and Research, 27%
- General Support, 4%
- Other, 7%
Long-term Results

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. Longer term performance has been strong on both an absolute and relative basis despite challenging market conditions. The endowment recorded an annual return of +6.7% in the ten years ended June 30, 2015, exceeding the +6.5% annual return for the policy benchmark and the +6.4% annual return for the average public endowment monitored by Cambridge Associates. As shown in the chart below, a gift invested in the endowment when the current investment program began in 1996 would now be worth more than four times that amount equating to an +8.07% annual return over nineteen years. Most importantly, the returns were comfortably ahead of the University’s inflation-adjusted spending rate, allowing for a real growth in assets to provide for future generations of students at the University.

Growth of $1: University of Delaware vs. LT Benchmark and Peers
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 twelve years, the University has dramatically reduced the endowment’s investments in domestic stocks and bonds by reallocating to international 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, only 40% of assets are invested in U.S. stocks and bonds while 20% are invested in international stocks, 20% in hedge funds and 20% in private investments. These changes can be seen in the chart on the first page of this report. 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. The University has increased the Private Investments target allocation to 25% to take advantage of the superior risk-adjusted returns generated by this asset class. It will take some time to achieve this target because of the long investment periods associated with this asset class. The source of funds for these investments is currently invested in fixed income and cash.

Endowment Asset Allocation vs. Target Allocation

[Chart showing asset allocation]
New Initiatives

The Investments Office is currently working on a number of initiatives that will seek to both improve performance and reduce costs over the next ten years. The largest cost reductions will come from eliminating fund-of-funds investments in alternative assets, the use of index funds for core equity and bringing some reporting and due diligence functions in-house. These initiatives should lead to a 57 basis point reduction in overall costs which would add $180 million in additional endowment assets over a ten year period. To improve performance, the endowment has been repositioned to become more streamlined with a reduction in the number of mandates and a focus on high conviction portfolios. A continual rise in the number of holdings historically led to an over-diversification of our portfolio. Over-diversification occurs when the number of individual investments in a portfolio exceeds the point at which adding an investment asset does not reduce the overall risk of the portfolio. The greater concentration should help us to achieve better returns over the long-term by adding some unsystematic risk back into the program. The reduction of our portfolio holdings will also improve our monitoring capabilities making us better stewards of the endowment.
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. The capital markets have provided the endowment with strong returns over the last few years and we expect this momentum to continue, although at a slower pace.

As a result, we are continuing to manage the endowment with a positive bias toward equity investments due to the gradually recovering global economy and the low interest rate environment. Given the challenges facing higher education today, we will pursue long-term investment returns that will enable the University to continue to achieve its goals and maintain its excellence far into the future.

Sincerely,

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