Return Targets and Tolerance for Variable Returns

Endowment
Business Board
November 1, 2010

Endowment Characteristics

- Perpetual funds (legal)
- Inflation protection required (policy 2000)
- No minimum payout mandated (unlike foundations)
- Invested in LTCAP - unitized pool
- Value $1.4 bn; more than 5000 underlying trusts

Drivers of return targets

- Desire to pay as much as possible to support the program/purpose
- High payout to encourage donors (donor dilemma)
- Cover inflation
- Cover expenses
- Desire for stability of payout

Current payout policy

- Target payment of 4% within a range of 3 to 5%
- Based on start of year value of assets

Current return target

- 4% real return (net of inflation and expenses)
- 10 year time horizon

Current risk/volatility tolerance

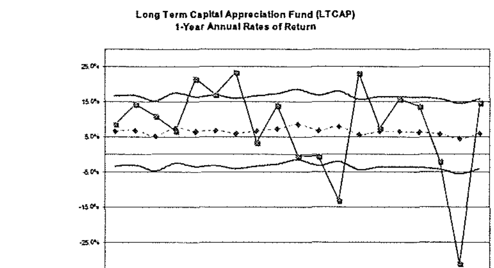
- +/- 10% with one standard deviation over a ten year horizon
- Real returns between -6% and +14%, six or seven years out of ten
- Returns outside the range three or four years (above or below)

Creation of targets in 2003

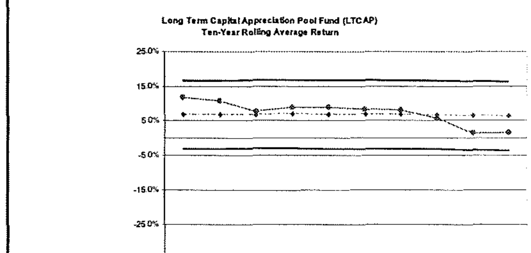
- Range of portfolios created with various return and risk characteristics
- Selected the real 4% and +/_10% because:
  - Probability of having to fund endowment payout from operating budget by more than $10 mm was low

Recent Events

- During growth years to end 2007, built a significant cushion resulting in pressure to increase payout level
- By end 2009, cushion gone, as was inflation protection
- Payout resumed in 2010, added back some inflation protection, but no cushion



	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Actual investment return	6.6%	14.2%	10.9%	8.7%	21.6%	17.1%	23.4%	3.4%	14.0%	-0.4%	-0.6%	-13.0	23.1%	7.4%	15.8%	12.7%	-2.0%	-31.0	14.7%
Target return*	6.6%	6.6%	5.2%	7.5%	6.4%	6.7%	5.9%	6.6%	7.2%	8.5%	6.7%	7.9%	5.6%	6.4%	6.4%	8.2%	5.7%	4.4%	5.6%
Standard deviation +10%	16.6%	15.8%	15.2%	17.5%	16.4%	15.7%	15.9%	16.6%	17.2%	18.5%	16.7%	17.9%	15.6%	16.4%	16.4%	16.2%	15.7%	14.4%	15.8%
Standard deviation -10%	-3.4%	-3.2%	-4.8%	-2.5%	-3.6%	-3.3%	-4.1%	-3.4%	-2.8%	-1.5%	-3.3%	-2.1%	-4.4%	-3.6%	-3.6%	-3.6%	-4.3%	-5.6%	-4.2%



	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Ten-Year rolling average return**	11.7%	10.7%	7.8%	8.9%	9.0%	8.4%	8.1%	5.6%	1.5%	1.5%
Ten-Year rolling Standard deviation +10%	16.7%	16.7%	16.9%	16.9%	16.8%	16.8%	16.7%	16.7%	16.5%	16.4%
Ten-Year rolling target return*	6.7%	6.7%	6.9%	6.9%	6.8%	6.8%	6.7%	6.7%	6.5%	6.4%
Ten-Year rolling Standard deviation -10%	-3.3%	-3.3%	-3.1%	-3.1%	-3.2%	-3.2%	-3.3%	-3.3%	-3.5%	-3.6%

History of results

- Over the last 19 years, annual results have been outside the target range 6 times (4 above, 2 below)
- Since 2001, ten year rolling results have always been in the range
- Most years results were above the target level; below it only the past two years

Problems with previous method

- Communication was not clear – too technical, too quantitative
- Communication did not focus on why we wanted the return level of 4% real (ie to be able to make a payment of 4%)
- Risk parameters not explained clearly
- Communication of results has been focused on one year performance instead of 10 year

Reassessing return targets

- Hewitt engaged to create portfolios and assess probability of achieving various target levels within risk tolerances
- Cambridge Associates engaged to facilitate consultation with broad stakeholder community to identify key drivers of risk and return

Stakeholder consultations

- Recognize ability to withstand variability
  - But ability varies across units
  - Depends on frequency and duration of negative
- Preference for capital preservation over payout
- Preference for stable earnings over bragging rights

Alternatives to 4% return

- Increase target to 5% - increases risk
- Decrease target to 3% - requires cut in payout
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- Recommendation is **no change**
- Reviewed with Investment Advisory Committee October 12 – they concur.