Endowment overview

Presented to:
Board of Advocates
School of Engineering & Computer Science

Presented by:
Office of Investments

Endowment

♦ Endowment value topped $1 billion in 2007 but is below $1 billion today after recent market turmoil
♦ Endowment value fell 1% in 2010 as slightly positive total returns were not sufficient to cover the 5% spending policy
♦ The Endowment has returned approximately 6% since inception in a 2.5% inflation environment
♦ Investment markets have recently been challenging, but over the long-run the Endowment should be able to maintain intergenerational value while funding the 5% spending policy

Endowment management mix

<table>
<thead>
<tr>
<th>$ millions</th>
<th>Fiscal year-end</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2008</td>
</tr>
<tr>
<td>BU Fund</td>
<td>903.1</td>
</tr>
<tr>
<td>BFT</td>
<td>112.7</td>
</tr>
<tr>
<td>Other Trustees</td>
<td>51.5</td>
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<tr>
<td>Total</td>
<td>1,067.3</td>
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</tbody>
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Source: Office of Financial Services.
Portfolio allocations

- The BU Fund has significant exposure to alternative investments consistent with most large endowment portfolios today.
- The BFT portfolio has a more classic blend of stocks, bonds and real assets.
- Strategies and return objectives for the BU Fund should be established with all assets of the Endowment in mind.

BU Fund allocation history

- BU Fund started in 2002 with a classic blend of public equities and fixed income.
- Alternative investments (hedge funds, private equity and real assets) have become an increasing percentage of the portfolio over the past eight years.
- Endowments in general have embraced alternative investments as a means to access liquidity and risk premiums and to further diversify portfolios.
- Commitments to private equity and real asset funds accelerated in 2006 and 2007.
- Alternative investments in the BU Fund increased to 75% of the portfolio in 2009.
- Relative illiquidity of the portfolio has limited rebalancing efforts over the past two years and will do so for at least another year.
Return expectations

- Equilibrium returns reflect expected returns over the long, long run.
- Return expectations over the next 10 years are generally below long-term equilibrium rates of return.
- U.S. inflation is assumed to average 2.5% over the next 10 years and in equilibrium.
- Illiquid real assets and private equity investments are the only sectors expected to exceed a 7.5% nominal (5% real) total return over the next 10 years.
- A portfolio neutrally weighted to our strategic allocations and earning equilibrium returns across asset classes would yield 5.5% (6% real total return).
- A portfolio weighted to our tactical targets and earning 10-year expected returns is expected to yield 7.8% (5.3% real total return).
- Legacy private market investments in the BU Fund may cause differences in performance relative to these forward looking returns.

Nominal return expectations

- **Equilibrium returns**
  - Public Equity: 8.2%
  - Fixed Income: 5.0%
  - Hedge Strategies: 6.8%
  - Private Equity: 8.0%
  - Real Assets: 12.3%

- **Expected returns (2011-2020)**
  - Public Equity: 7.0%
  - Fixed Income: 7.0%
  - Hedge Strategies: 12.0%
  - Private Equity: 9.5%
  - Real Assets: 10.0%

Strategic allocations

- **Public Equity**: 35%
- **Fixed Income**: 15%
- **Hedge Strategies**: 15%
- **Private Equity**: 15%
- **Real Assets**: 20%

Tactical targets

- **Public Equity**: 30%
- **Fixed Income**: 12%
- **Hedge Strategies**: 20%
- **Private Equity**: 15%
- **Real Assets**: 23%

Liquidity challenge

- Unfunded commitments are declining, but private market investments will continue to be a drain on liquidity for at least the next few quarters.
- Existing private market investments should start generating considerable liquidity by 2012 as investments made in 2005-2007 start to reach their distribution phase.
- Patience and a 10-year perspective will be important as liquidity constraints ease and capital is deployed into private market investments once again.

BUF unfunded commitment levels

- **Private Equity**:
  - 2004: 75
  - 2005: 125
  - 2006: 150
  - 2007: 175
  - 2008: 200
  - 2009: 225

- **Real Assets**:
  - 2004: 50
  - 2005: 75
  - 2006: 100
  - 2007: 125
  - 2008: 150
  - 2009: 175

Private market capital flows

- **Capital calls**
- **Capital distributions**