Dear Alumni and Friends,

The Baylor Endowment distributed an all-time high of $64 million over fiscal year 2016 in support of scholarships, professorships and other important initiatives of the University. Representing more than 5% of our $1.15 billion Endowment, these funds benefited 3,500 students and 1,100 academic programs over the course of the year.

Financial markets remained on edge throughout the year due to concerns about China (slowing growth and currency devaluations) and the European Union (slowing growth and Brexit). Baylor’s Endowment held steady over the past year despite significant stock market declines in August 2015, January 2016 and June 2016. Our Endowment portfolio was well-positioned for the investment opportunities created by this volatility and is outperforming market benchmarks and the average of other U.S. endowments by a wide margin.

Baylor represents a distinct legacy in higher education as a research university grounded in faith and committed to a caring community. The incoming Class of 2020 is stronger and more diverse than any in our history. Many of these outstanding students require scholarship support to attend Baylor. Your endowed gifts provide this support and better equip Baylor to carry out our mission of developing worldwide Christian leaders.

The future is bright for our university, and your contributions to the Baylor Endowment are greatly appreciated. Endowment contributions benefit students not only today but leave a lasting legacy for generations to come.

With sincere regards,

R. Brian Webb, Ph.D.
Vice President &
Chief Investment Officer
A growing endowment is essential to keeping a Baylor education affordable for deserving students of all economic backgrounds, and it is an important determinant of our long-term competitiveness with other top-tier institutions. Investment returns from the Endowment portfolio and ongoing gifts from alumni and friends are essential to the healthy growth of Baylor’s Endowment. The portfolio is invested with a target return that provides for monthly distributions to support students on campus today while more than keeping pace with inflation to enhance the Endowment’s purchasing power for generations to come.

Baylor’s Endowment was valued at $1.15 billion at the end of fiscal year 2016. The Endowment is essential to both the affordability and quality of a Baylor education. Growing the Endowment is a key initiative of the University.

$64 million was distributed from the Endowment to the University over fiscal year 2016. A little more than 5% of the Endowment’s value is distributed to the University each year in monthly installments.

Distributions from the Endowment support students, professors and academic programs. Of the fiscal year 2016 distributions, 51% went to designated scholarships and professorships, 21% to designated academic and mission-related programs and 28% to undesignated scholarships and other important initiatives of the University.
Endowment Portfolio

The Office of Investments is composed of a strong team of investment professionals who are experienced in investing across all aspects of the globally diversified Endowment portfolio. The team collectively has more than 85 years of investment experience that includes prior leadership positions at various global investment firms and hedge funds.

In coordination with proven investment managers throughout the world, the Office of Investments ensures strategic oversight of the University’s diverse portfolio. Active management provides flexibility to adjust to changing market conditions and balances the maximization of returns with liquidity requirements. Economic trends have created investment opportunities in the areas of cloud computing, emerging markets, oil and gas, healthcare and global real estate.

Endowment Returns
Fiscal Years ending May 31: 2004-2016

<table>
<thead>
<tr>
<th>Year</th>
<th>Managed Endowment</th>
<th>Strategic Benchmark</th>
<th>Average of U.S. Endowments</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>8.6%</td>
<td>7.0%</td>
<td>7.0%</td>
</tr>
<tr>
<td>2005</td>
<td>8.0%</td>
<td>7.0%</td>
<td>7.0%</td>
</tr>
</tbody>
</table>

Source: Cambridge Associates and NACUBO

- Significant outperformance over strategic benchmark returns
- Outperforming the average of U.S. endowments by a wide margin
- Portfolio is positioned to take advantage of market opportunities

Investment managers with specific expertise are identified globally to oversee the Endowment portfolio. Private investment managers offer higher expected returns with less liquidity, while public market managers offer greater liquidity but operate in more efficient markets.

Pockets of opportunity exist within global real estate, including the aggregation of well-located retail centers too small for institutional investors into large portfolios. Buying from local owners and selling to institutional investors is one way to add value. The ability to negotiate leases with national tenants can further enhance value.

The growing middle class in emerging markets is a pervasive long-term macro trend, and supplying products favored by this growing demographic can provide outsized returns. Serving emerging markets from countries with strong rules of law and stable currencies can reduce risk and be particularly rewarding.
Cloud computing and cyber security are two areas creating investment opportunities. Accelerating advances in technology have long-term implications for investments. Robust returns on investments relative to downside risk are key to driving outperformance.

Recent declines in oil prices have created volatility and opportunity in this sector, with lower cost points recently made available in both public and private markets. Upstream and midstream investments in equity and/or credit provide diversified exposure.

The healthcare sector has encountered major disruptions across the globe in recent years. Technology continues to improve service delivery and reduce costs. Identifying winning innovations with barriers to entry is key to maximizing investment returns.

- Equity investments have greater long-term return potential
- Equity exposure is evenly split between private and public market investments
- Credit exposure includes cash, fixed income and higher yielding credit opportunities
- Portfolio allocations are actively managed to balance the maximization of returns with liquidity needs

Endowment Portfolio Breakout

- Public Equity 35%
- Private Equity 35%
- Fixed Income 15%
- Credit Alternatives 10%
- Equity Alternatives 5%
- 75% EQUITY
- 25% CREDIT

Equity investments have greater long-term return potential
Equity exposure is evenly split between private and public market investments
Credit exposure includes cash, fixed income and higher yielding credit opportunities
Portfolio allocations are actively managed to balance the maximization of returns with liquidity needs
Financial markets held up relatively well despite a year with negative-yielding bonds, a slowing Chinese economy, the British departure from the European Union and a global race to devalue currencies. Global stocks mimicked a roller coaster ride, with three major drops followed by partial recoveries, ending the year within 10% of where they started. The inability of GDP growth to gain traction has Central Banks and financial markets concerned.

Investors’ search for income in this low-growth, low-interest-rate environment made utilities the top-performing sector in the stock market by a wide margin. Chasing returns in this type of market environment can lead to a portfolio with greater downside risk than upside potential. Remaining disciplined and taking advantage of opportunities created by volatile markets becomes increasingly important.

**World GDP Growth**

- The U.S. economy fell into recession every time GDP grew by less than 2% over the past 50 years
- Global economic growth has managed to stay just above 2% for each of the past four years
- Monetary policies around the globe have been extremely accommodating since the great recession in 2008-2009

**Negative Yielding Bonds**

- Japan and Germany have had bonds trading at negative yields for almost two years
- More than $12 trillion in bonds in Japan, Germany and other European countries are now trading at negative yields
- Negative yields are unprecedented, and low interest rates strain the ability of markets to efficiently allocate capital

**Global Stocks**

- Global stocks declined 15% in the second half of 2015, 16% in early 2016, and another 8% in June 2016
- Stocks have been resilient given the low/negative interest rate environment and recovered a significant portion of the loss each time
- Low annual returns with increased volatility are likely to persist as long as global growth remains slow, corporate profit margins remain stretched and price/earnings ratios remain above historic averages
Looking to the Future

The affordability of a Baylor education and the long-term competitiveness of our university are dependent on a growing endowment. Past gifts and strong investment returns have contributed to a Baylor Endowment that now stands at over $1.15 billion. An endowment of twice this size is a prerequisite for assuring Baylor’s viability for generations to come. Doubling the size of the endowment is an ambitious goal, but one that is necessary to keep Baylor in a strong competitive financial position relative to peer universities in Texas and beyond.

The return objective of the Endowment is designed to replace the 5% annual endowment distributions that support current students and programs while maintaining the value of past endowed gifts for future students (i.e. maintaining the purchasing power of the endowment over its infinite life). This objective is a tall task in today’s low interest rate and expected return environment, making gifts even more essential to increasing the effective size of the endowment.

We continue to be grateful to those who have given to Baylor’s Endowment. With your support, Baylor will continue to educate men and women for worldwide leadership and service by integrating academic excellence and Christian commitment within a caring community. Thank you for your thoughtful generosity as we look to the future and build a bright tomorrow for Baylor and its students.
Strategic opportunities for students are central to a transformational Baylor education that applies classroom knowledge to real-world endeavors of service and leadership. Domestic and global mission activities facilitated by the University cultivate leadership skills, deepen understanding and illuminate calling for the benefit of students and those they serve.