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The Endowment Investment Model

An Advanced Investment Strategy for a New Reality

Challenges for Today

- Increasing Lifespans
- Investment Performance Since Turn of Century
- Volatile Markets
- Inflation Expectations
- Low Interest Rates
- Maintaining Purchasing Power

- Traditional Investment Approach

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Traditional Approach

Stocks & Bonds (Often 60% stocks, 40% Bonds)

- Generally Accepted, but Flawed
  - Original Application of Modern Portfolio Theory
- Old, Tired
  - 2000-2010
  - Latest Meltdown
  - Only 2 Asset Classes

- Volatile
- Poor Fixed Income Return Expectations
- Poor Income Generation

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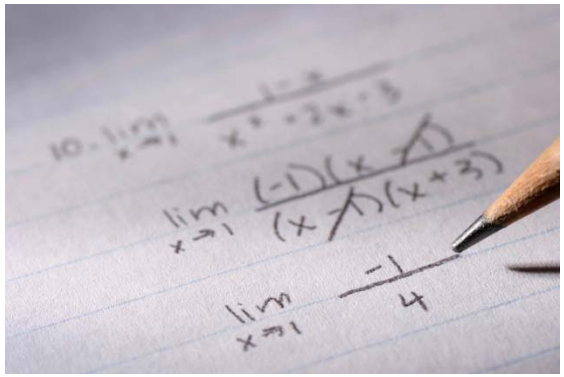
Implementation Challenge

- Requires High Level of Discipline
  - Panic is Punished
- Few Investors Match the Market
  - Model Punishes "Typical" Human Behavior[1]
- Volatile
  - Only 1 Performance Asset and 1 Safer Asset
- Typical to Underperform



1. Course 407, Psychology and Investing, "Selective Memory" Morningstar, http://news.morningstar.com/classroom2/course.asp?docId=145104&page=1&CN

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A Different Approach

- **The Endowment Investing Model**
  - Adopted by endowments, institutions, and family wealth offices.
  - Super-Endowments Have Made Strategy Famous (e.g., Yale, Harvard, Stanford)
- Serious Money Seems to Prefer This Strategy
- Individuals Appear to Be Moving in this Direction

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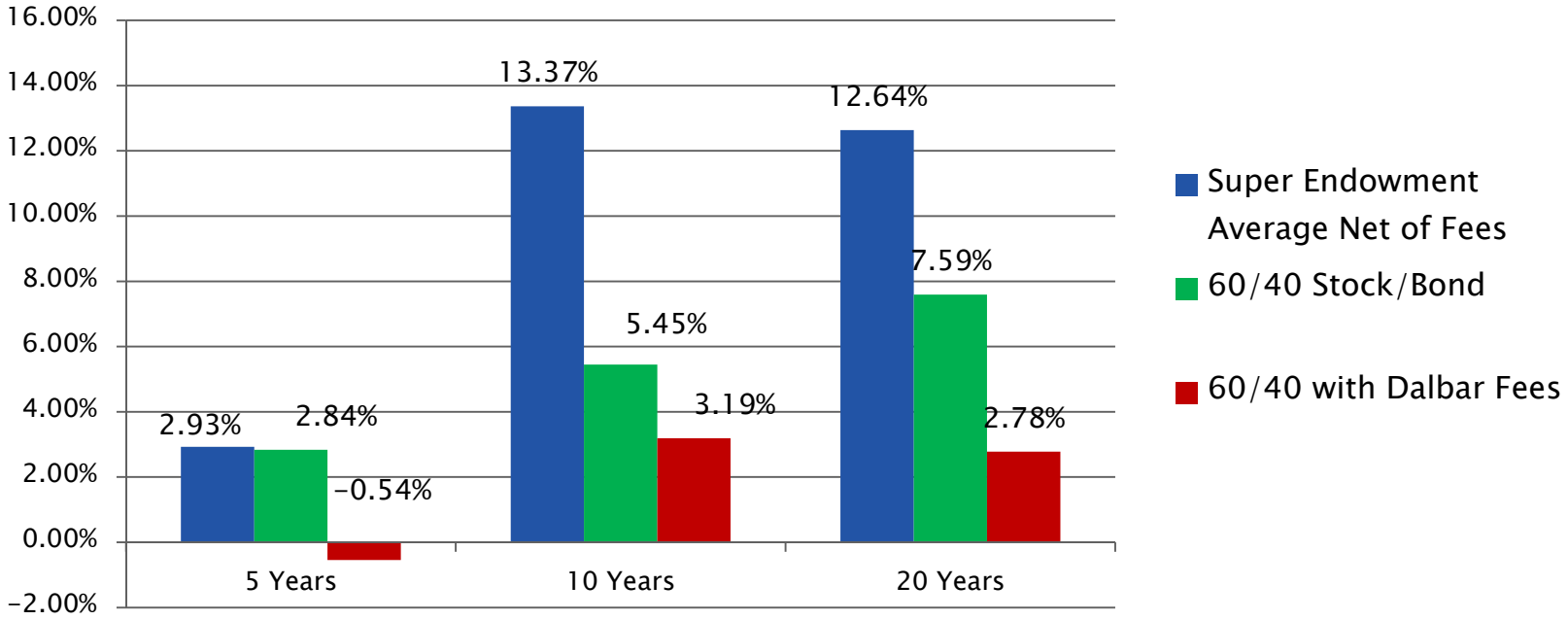
Performance Issues

Returns for Super Endowments, 60/40 Portfolio, 60/40 Portfolio with Dalbar Fees



- Sources: Stocks are represented by the S&P 500. Data is from www.msci.com. Bonds represented by Barclays Capital U.S. Aggregate Bond Index. Data supplied by Barclays Capital, Inc. Dalbar Underperformance reported in *DALBAR, Quantitative Analysis of Investor Behavior (QAIB) April 2012* Endowment returns are the average returns of Yale, Harvard, & Stanford. Data from The Yale Endowment Report for years 1992-2011, Harvard University Financial Report for years 1992-2011, The Stanford Management Company Report for years 1992-2011. Past Performance is not a guarantee of future returns. The term "Super Endowments" is used to describe the large size of these funds relative to their smaller peers.

Past Performance is not a guarantee of future returns.

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Endowment Model Origination[1]

- David Swenson, Yale University, 1985
- Intention
  - Increase Returns
  - Lower Volatility
  - Modern Portfolio Theory Using More Tools
- Approach: Include numerous assets with strong performance expectations and low cross-correlation
- Strategy Results
  - Historically Strong Returns
  - Historic Return Consistency

1. *The Ivy Portfolio: How to Invest Like the Top Endowments and Avoid Bear Markets*, Mebane T. Faber & Eric W. Richardson

Past performance is not a guarantee of future results.

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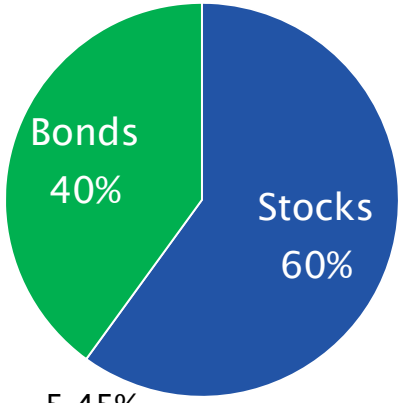
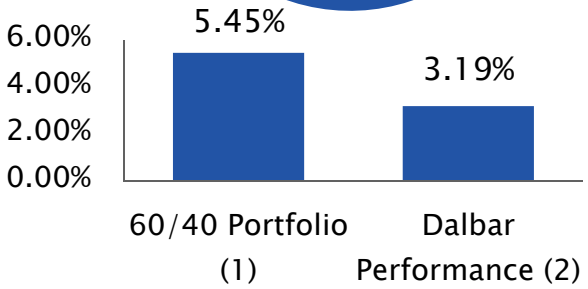
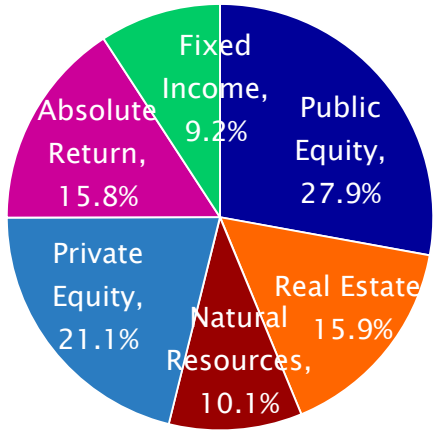
The Traditional Portfolio vs. The Endowment Model
July 1, 2002 – June 30, 2012

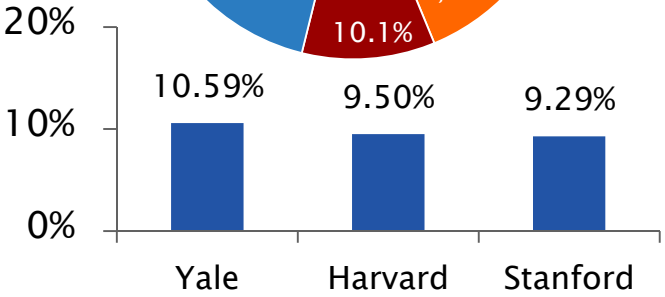
Traditional Individual Investor Allocation





Average of Yale, Harvard, Stanford 2012 Allocations





[1]Stocks are represented by the S&P 500. Data is from www.msci.com. Bonds represented by Barclays Capital U.S. Aggregate Bond Index. Data supplied by Barclays Capital, Inc. [2]*DALBAR, Quantitative Analysis of Investor Behavior (QAIB) April 2012 reports that individual investors underperformed the S&P 500 by 0.53% and the Barclay's Aggregate Bond Index by 4.43% for the 10 year period ending 2011 (20 year performance was worse).* [3]The Yale Endowment Report for years 2003-2012, Harvard University Financial Report for years 2003-2012 & http://www.hmc.harvard.edu, The Stanford Management Company Report for years 2003-2012.

Past Performance is not a guarantee of future returns. Diversification and asset allocation do not assure or guarantee better performance and cannot eliminate the risk of investment loss.

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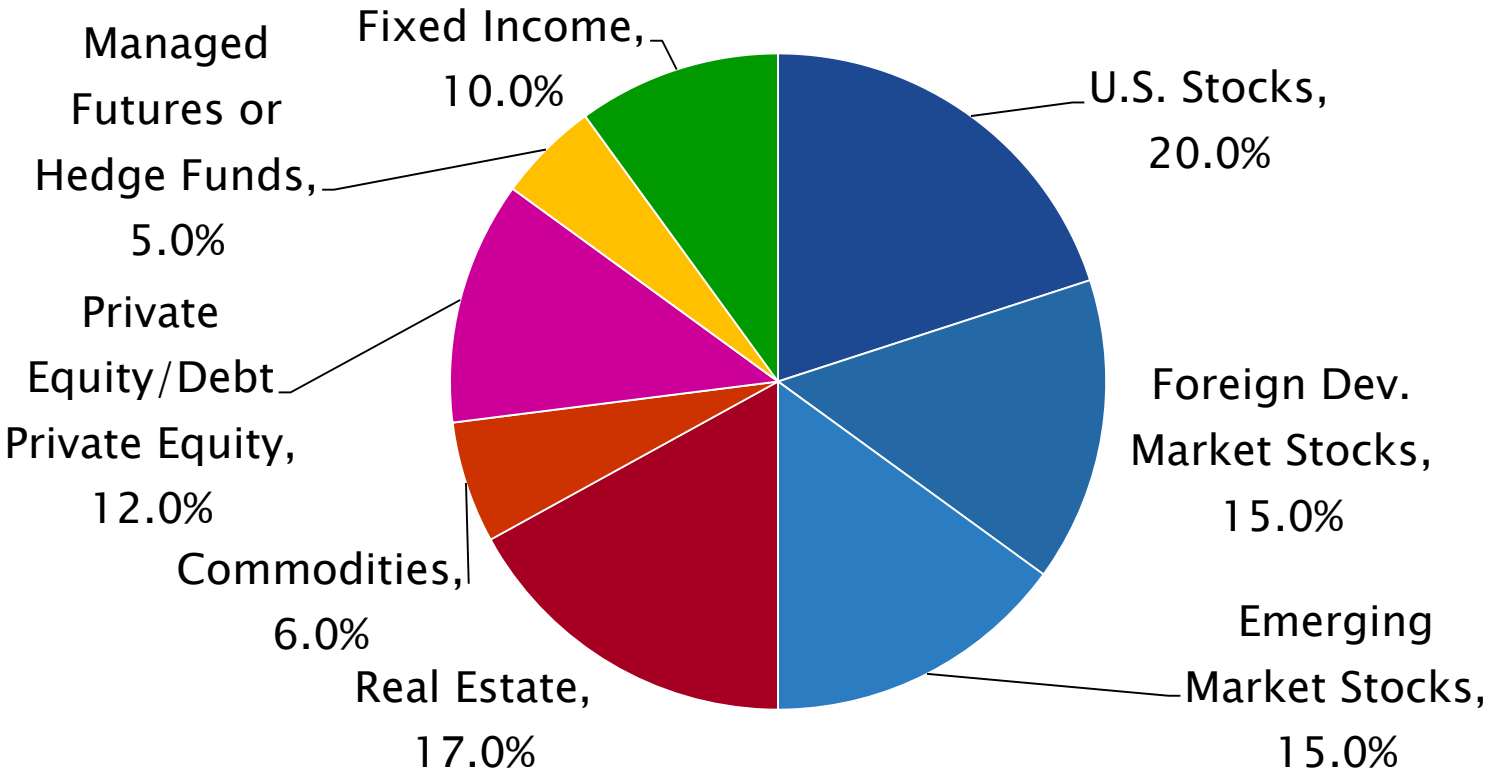
Potential Individual Investor Portfolio



New opportunities and open global markets enable **Individual Investors** to build highly diversified portfolios containing similar asset classes to most endowments.**

**This asset allocation for an individual investor's portfolio is for educational purposes only. Allocations may not be that of the any college endowment including any endowment illustrated in this presentation.

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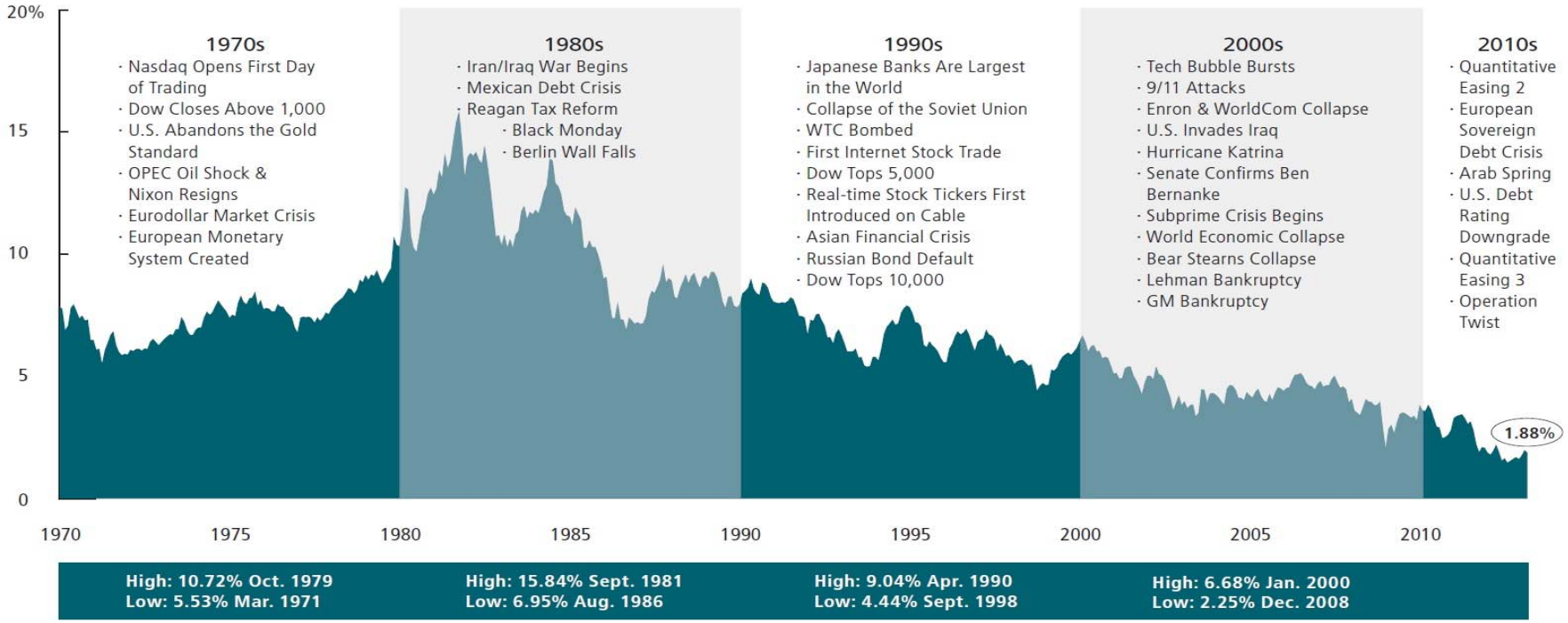
Bonds Poorly Positioned

10 Year Treasury Yield



Source of chart data: FactSet, 2/28/13. Past performance does not guarantee future results.

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Lower Asset Correlations Available

	Large Cap	Small Cap	Value	Growth	EAFE	Bonds	EME	Hedge Funds	Real Estate	Eq Market Neutral*	Cmdty.
Large Cap	1.00	0.94	0.94	0.94	0.91	-0.35	0.86	0.73	0.19	0.26	0.34
Small Cap		1.00	0.91	0.86	0.85	-0.37	0.82	0.67	0.17	0.27	0.25
Value			1.00	0.78	0.88	-0.21	0.76	0.71	0.27	0.35	0.35
Growth				1.00	0.82	-0.44	0.86	0.69	0.09	0.13	0.32
EAFE					1.00	-0.25	0.89	0.79	0.19	0.42	0.46
Bonds						1.00	-0.28	-0.16	-0.14	0.18	-0.14
EME							1.00	0.79	0.11	0.28	0.45
Hedge Funds								1.00	0.27	0.41	0.61
Real Estate									1.00	0.36	0.29
Eq Market Neutral										1.00	0.45
Commodities											1.00

Source: Standard & Poor's, Russell, Barclays Capital Inc., MSCI Inc., Credit Suisse/Tremont, NCREIF, DJ UBS, J.P. Morgan Asset Management.

Indexes used – Large Cap: S&P 500 Index; Small Cap: Russell 2000; Value: Russell 1000 Value; Growth: Russell 1000 Growth; EAFE: MSCI EAFE; Bonds: Barclays Capital Aggregate; EME: MSCI Emerging Markets; Hedge Funds: CS/Tremont Multi-Strategy Index; Real Estate: NCREIF Property Index; Equity Market Neutral: CS/Tremont Equity Market Neutral Index; DJ UBS Commodity Index.

*Market Neutral returns include estimates found in disclosures.

All correlation coefficients calculated based on quarterly total return data for period 3/31/00 to 3/31/10.

This chart is for illustrative purposes only.

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Key Portfolio Attributes

- Alternatives: Low Performance Correlation & Strong Performance Expectations
  - Real estate, hybrid debt/private equity, private equity, commodities, managed futures and hedge funds. [1]
- International Equities[2]
- Inflation Protection[3]
- Illiquidity of Some Assets
- Reduced Fixed Income
  - Inflation Risk
  - Poor Return Expectations

1. These types of investments may not be suitable for all investors and may be illiquid.
2. Investing in International equities, including emerging markets, may present more risk than U.S. equities and may not be suitable for all investors.
3. Past performance is not indicative of future returns.

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Risks and Concerns

- Tax consequences
- All investments involve risk and could involve loss.
- Investments presented may not be suitable for all investors.
- Investments in foreign markets entail special risks such as currency, political, economic and market risks.
- Alternative investments may be illiquid.
- There is no assurance that any investment strategy will meet its objectives.
- Diversification and asset allocation do not assure better performance and cannot eliminate risk of investment loss.
- May require larger minimum investment to properly diversify.

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Disclosures

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The information contained in these slides was taken from third-party sources that we believe to be reliable, but cannot guarantee its accuracy or completeness.

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Definitions

The **S&P 500 Index** is a composite of the 500 largest companies in the United States.

The **FTSE NAREIT US Real Estate Index Series** is designed to present investors with a comprehensive family of REIT performance indexes that span the commercial real estate space across the US economy, offering exposure to all investment and property sectors. In addition, the more narrowly focused property sector and sub-sector indexes provide the facility to concentrate commercial real estate exposure in more selected markets.

MSCI EAFEMSCI EAFE (Europe, Australasia, and Far East) index is a market-capitalization-weighted index of 21 non-U.S., industrialized country indexes, and is widely accepted as a benchmark for international stock performance. The index is unmanaged and does not represent the performance of any particular investment. You cannot invest directly into the index.

West Texas Intermediate (WTI), also known as Texas light sweet, is a grade of crude oil used as a benchmark in oil pricing. This grade is described as light because of its relatively low density, and sweet because of its low sulfur content. It is the underlying commodity of Chicago Mercantile Exchange's oil futures contracts.

Barclays Capital U.S. Aggregate is a broad bond index covering most U.S. traded bonds and some foreign bonds traded in the U.S.

Standard deviation is a statistical measurement that sheds light on historical volatility. For example, a volatile stock will have a high standard deviation while the deviation of a stable blue chip stock will be lower. A large dispersion tells us how much the return on the fund is deviating from the expected normal returns.

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Definitions Continued

Correlation is a statistical measure of how two securities move in relation to each other. Correlation is computed into what is known as the correlation coefficient, which ranges between -1 and +1. Perfect positive correlation (a correlation co-efficient of +1) implies that as one security moves, either up or down, the other security will move in lockstep, in the same direction. Alternatively, perfect negative correlation means that if one security moves in either direction the security that is perfectly negatively correlated will move in the opposite direction. If the correlation is 0, the movements of the securities are said to have no correlation; they are completely random.

Cross-correlation is a statistical measure timing the movements and proximity of alignment between two different information sets of a series of information. Cross correlation is generally used when measuring information between two different time series. The range of the data is -1 to 1 such that the closer the cross-correlation value is to 1, the more closely the information sets are.

Modern Portfolio Theory is a financial theory on how risk-averse investors can construct portfolios to optimize or maximize expected return based on a given level of market risk, emphasizing that risk is an inherent part of higher reward.

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