STREAM OF FUNDS FUELS
QUEST FOR KNOWLEDGE

Many move beyond
often-risky stocks
and bonds in favor
of other strategies.

By MARK DAVIS
The Kansas City Star

B
irds lose their hearing just like people do. Birds, however, can get it back.

“Most recover spontaneously and quickly,” said Hope Karnes Nicely, as she was preparing to slice up a chicken’s brain.

The 26-year-old Leawood native hopes to find genetic clues to solving human hearing problems.

She is one of 27 students who aspire to become physician-scientists through the seven-year M.D.-Ph.D. Program at the University of Kansas Medical Center in Kansas City, Kan.

Each personally relies on a stipend from the KU Endowment. It’s a privately funded $1 billion nest egg on an endless mission to generate money for students, professors and educational needs.

“That’s really what we’re here to do, to provide private support to KU,” said Jeff Davis, chief financial officer of the endowment.

Rising college costs have focused greater attention on university endowments. One U.S. Senate committee is studying responses it got from 136 universities about tuition, enrollments and endowments’ role in financing a greater portion of higher education.

One discovery is that many endowments have moved beyond traditional stocks and bonds in their investment portfolios.
M.D.-Ph.D. student Hope Karnes Nicely studies changes in a chicken’s brain after hearing loss at the University of Kansas Medical Center campus. She relies on a stipend from the KU Endowment.
HIGHER ED:
Spending endless

FROM DI

They’ve embraced alternatives such as real estate, private capital pools, hedge funds and commodities.

Endowments value these ventures as a way to take some of the sting out of Wall Street’s periodic tough times without sacrificing long-term gains.

The success of endowments' new strategies is important to students who rely on their support now and in decades to come. It also will tell donors whether their gifts can continue to support education beyond the current semester.

Endless mission

David Weaver remembers stepping somewhat naively into his post at the Kansas State University Foundation.

“When I took this over 15 years ago, my thought was, ‘Yeah, I’ll run the endowment. How hard can that be?’” said Weaver, now chief investment officer.

The endowment was invested roughly half in stocks and half in bonds. Today, it’s a $340 million collection of investment strategies designed much like the heralded and considerably larger endowments at Harvard and Yale universities.

“I’m glad you noticed that,” Weaver said. “It tells me it’s working.”

University endowments are increasingly embracing a universe of investments, from hedge funds to timberland partnerships. Each new holding is, of course, intended to make money but sometimes loses money, as do stocks and bonds.

It’s the mix of their various returns that suits endowments’ unique mission the most.

Endowments don’t save money for a rainy day or sock it away to support their golden years. They spend it constantly and plan to spend it forever.

Davis defined success for the KU Endowment as achieving the maximum sustainable spending it can muster. To do that, its investments have to accomplish two important tasks.

First, they have to keep up with inflation, just as someone saving for retirement needs investments to do. Donations made in 2008 won’t buy as much education in 2026, when today’s infants will want the same support as they attend college.

Second, the investments need to earn enough to fund the endowment’s annual spending goals, usually set at about 5 percent of the total endowment.

Although 5 percent doesn’t sound like much, endowments cannot count on stock market returns to beat inflation and provide that 5 percent spending target each and every year. Over many years, they can, because stocks generate large returns in some years.

Then there are years like 2008, when the Dow Jones industrial average already has fallen about 14 percent.

Spending 5 percent on top of a 14 percent drop in the size of the endowment would leave too few investments to support spending and overcome inflation in future years.

It’s a problem workers saving for retirement don’t have.

“If you had a classic buy-and-hold portfolio, you can take the volatility because you’re not taking money out during downturns,” said Brian Kaufman, who advises Rockhurst University’s endowment at Prairie Capital Management in Kansas City. “So for endowments, it’s critical to minimize the downside volatility.”

That’s why university endowments increasingly look like a complex collection of investment strategies rather than a hefty bet on the U.S. stock market.

Portfolio smoothie

What endowments want from all these new investments is steadier returns, not higher returns.

The idea is to move some money into investments whose returns tend to zig when the stock market zags, or at least don’t zag at the same time.

Over time, the returns tend to even out so the endowment won’t give up any gains. But the smoother performance thanks to a diverse investment mix makes endowments’ unique mission easier to achieve.

For example, the combined $1 billion endowments supporting the four campuses of the University of Missouri system first looked for some zig against U.S. equity zags by investing in foreign stocks, said Nikki Krawitz, vice president of finance and administration.

Increased economic globalization, in which companies do business worldwide regardless of where they are based, means foreign and U.S. equity markets tend to move more in tandem.

Krawitz said the combined Missouri endowments turned to stock markets in emerging economies, such as Eastern Europe and Asia, to put some diversification back into their pooled portfolios.

They now own not only bonds but also Treasury Inflation Protection Securities, or TIPS. They are in real estate investments and hedge funds and are moving money into private equity funds.

Krawitz said the system’s effort to diversify its investments has progressed as new opportunities have come along.

“The markets have gotten more mature and more diversified in terms of the types of products you can invest in,” she said. “It’s been an evolution.”

That is partly because the new investments are more complex and harder to understand than the more familiar public stock market.

Krawitz said commodities may be the next new investment. Many endowments have gained this exposure through partnerships and other indirect investments in timberland, energy and other commodities and natural resources.

“We should be doing some of that, in my opinion,” she said.

Such shifts mean that endow-
Endowments now rely considerably less on U.S. stocks than they did 20 years ago. Bonds have also taken a lesser role.

Davis said the KU Endowment had been a more traditional split of 60 percent equity and 40 percent bonds two decades ago. Now its bond exposure is closer to 20 percent, and some of its peers have cut that even further, he said.

“We still believe 20 (percent) is the right number for us, and it certainly helped us in this last year,” he said.

Endowments also are reporting their investment mixes differently, paying more attention to why it owns them than what they’re called.

Instead of reporting its bonds, the Kansas State endowment reports its “deflation hedge” of $40 million. Bonds always have provided protection against a broad decline in general prices but were simply reported as bonds.

Similarly, the KU Endowment reports a $170 million “inflation hedge” that consists of real estate, commodities, energy and natural resource investments.

Davis said the endowment also looks at some stock holdings as providing inflation protection — shares in energy- or timber-related companies, for example.

“It tends to be more about strategy than a particular stock or bond,” Davis said.

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Source: Morningstar Inc.
M.D.-Ph.D. student Timothy Donohue prepares slides of tissue from a rat heart at the University of Kansas Medical Center campus. All 27 students in the seven-year M.D.-Ph.D. program receive KU Endowment stipends.