The Year in Review

The endowment fund at the University of Manitoba realized a one-year return of 12.4% for the year ending March 31, 2011, and has grown to $370 million (2010 - $339 million). This amount is comprised of $342 million in the University Investment Trust ("UIT"), and $28 million (2010 - $38 million) in the Specific Trust Funds, making it the 8th largest university endowment fund in Canada. After last year’s return of 18.8%, the UIT continues to recover a good portion of what was lost in the credit crisis and stock market crash of 2008/2009. The drop in value of the Specific Trusts is due to the use of gifts to fund construction of capital projects, most notably the new Pembina Hall Residence.

The primary drivers for the current year’s return were strong performance results from several of the UIT asset mandates. The Canadian equity portfolio returned 21.3% (vs. S&P/TSX Index return of 20.4%); the U.S. equity portfolio earned 11.2% (vs. S&P 500 Index 10.9%); and the Canadian real estate portfolio had a one-year return of 7.7%. The two equity portfolios noted above are managed by the recently hired firms Burgundy Asset Management (Canada) and J.P. Morgan (U.S.), so the Trust Investment Committee is pleased with the early results attributable to these recent changes. The other two UIT asset mandates realized returns of 5.0% (Canadian bonds) and 4.8% (International equities).

Each year the endowment fund also benefits from new gifts received from its many donors, and this year was no exception. A total of $17.1 million in donations were received by the UIT, and a further $5.4 million was gifted to the Specific Trusts. These gifts were either added to existing accounts, or were part of the 65 new individual endowed accounts set up during the year. The ongoing commitment and generosity of donors is a key component to the success of the endowment fund, and the support the fund provides to its beneficiaries. This support helps the fund not only grow in size, but in scope. New programs and initiatives keep the University vibrant and add to both the learning experience of students, and to the knowledge of faculty and researchers. With this support, the University can advance its mission in different and new directions, and also maintain existing funding for many of its long-standing and successful programs.

The endowment fund continues to be an integral part of the University of Manitoba, as it helps the institution achieve its many goals. The University continues in its philosophy to provide access to the best education to all that have the ability to benefit from it. Student financial aid plays an enormously important role in achieving access to education, and the enduring
gifts of the endowment fund help provide for this financial support both today, and tomorrow. In the past five years, over $28 million has found its way to thousands of students through awards from the endowment fund alone. This legacy of support will live on, and grow, for future generations of students. The endowment fund is the single most critical component of student financial aid at the University. In addition, the fund supports faculties and schools, researchers, library resources, athletics, and a variety of other areas that are aligned with the mission and goals of the University.

The Trust Investment Committee oversees and manages the fund with the prudence and foresight necessary to ensure the fund is financially healthy over a very long time horizon. The past few years have been very difficult on endowment funds. Despite the recent rebound in the investment marketplace, most endowment funds are still smaller than they were three years ago (in real terms, and ignoring new gifts). Gone are the days when these funds realistically could expect to earn an overall investment return that would adequately support an annual payout of 4.5% (or more), and still grow the fund. The new reality is the growth of funds and investment returns of the 1980’s and 1990’s are a thing of the past, and the volatile returns of the past decade and more challenging returns going forward have forced endowment managers to re-evaluate asset allocation, and more importantly, spending policy.

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Endowment Highlights

- The endowment fund’s one-year return was 12.4%.
- The endowment provided $14.3 million in new support for beneficiaries in 2011, and has provided $66.7 million in support over the past five years.
- The UIT benefited from $17.1 million in new donations during the year, and another $5.4 million was donated to the specific trusts.
- A total of 65 new individual endowment accounts were established during the year.
- The fund is the 8th largest university endowment in Canada.
Spending Policy

The current spending policy allows the endowment fund to spend a fixed percentage of the market value of the fund. Instead of allowing beneficiaries to spend just the income of the fund (interest and dividends), beneficiaries receive a spending allocation based on the total return of the fund, which includes realized and unrealized income. Since a ‘total market return’ concept is used, the market value of the fund is subject to the volatility of market values of investments, particularly equities. In order to smooth this income to allow for more predictable, or stable, spending levels, the market values for the purposes of calculating spending distributions is stretched over a period of time, in this case three years. The result of this is a spending policy which distributes 4.5% of a three-year rolling average of fund market values. This policy is the most common spending policy for university endowment funds. Some universities employ different spending rates, but the majority of endowments over the past 20 years have used a total market return concept.

The reason for a three-year average market spending policy is to smooth the level of income distributed by reducing the impact of any significant short-term market fluctuations by blending it into returns from a longer period of time. By stretching the investment return period over a period of years, the theory is this will reduce the volatility of spending related to returns in a shorter period, and it would also ensure that spending was tied to the investment returns of the fund. However, the period of returns from 2001-2010 were so volatile that the three-year investment time horizon resulted in fluctuations that kept beneficiaries of the fund concerned with how much they would receive from year-to-year. These beneficiaries have had a hard time budgeting for upcoming expenses when the income distributions from the endowment fund are neither stable nor predictable.

The Trust Investment Committee feels the moving average market calculation worked effectively during the 1990’s, where the stock markets were generally bull markets, and endowment beneficiaries saw increases in distributions that were inflationary and beyond. However, this method has been flawed over the past 10 years, where we have seen two significant market crashes. The sheer depth of the crash in 2008/2009 has caused unstable drops in spending allocations ever since. Market crashes are not the only concern. In an extended period of strong market returns, the current spending allocation distributes income well in excess of inflationary increases, therefore encouraging beneficiaries to spend more than is prudent.

After the stock market crash in late 2008 and early 2009, beneficiaries of the University of Manitoba endowment fund braced themselves for the worst.
The endowment fund saw a decline in value of 20%, which was very similar to most other Canadian universities. However, when the spending allocation was calculated, the drop wasn’t as high as most beneficiaries had anticipated. The 4% average decline in allocations was due to the three-year rolling calculation, which included two years of relatively strong returns from January 2006 to December 2007 in the calculation. This is what the rolling average calculation was intended to provide – a cushioning of income over a longer term such that any one year of poor returns would not have a significant adverse effect on spending.

In the second year after the crash, spending allocations dropped again (another 4%), which was due to the 2006 year falling out of the calculation, and being replaced by the 2009 year, which saw some recovery, but not enough to prevent the rolling average method from calculating another drop in spending. This past year presented a significant problem. The 2008 – 2010 three year period is represented by a huge market crash, some recovery, and now generally sideways (or range bound) markets. This resulted in an 8% reduction in spending, which comes on the heels of two years of 4% declines in distributions. This represented a major setback for beneficiaries of the endowment fund. Students, faculties and schools would all feel the effect of another cut, particularly at 8%. The formula calculated reduction doesn’t match expectations because the fund has generated positive returns which, intuitively, should produce increased allocations.

The decision was made to reduce the 8% spending cut to a 4% cut, but more importantly, the Committee agreed that an alternative spending policy needs to be considered for adoption. Many universities in both Canada and the U.S. are either reviewing their spending policy, or have already transitioned to a new method of determining the annual spending distributions. The Committee is analyzing a new policy that will focus more on inflationary increases and be less tied to market returns, thus removing much of the volatility from the equation. The goal is a predictable stream of income from the fund that satisfies beneficiaries and at the same time does not adversely affect the fund. Depending on the new policy adopted, there may be a change to the asset mix of the fund. These two decisions are intertwined, and will be reviewed together. Nevertheless, it is the right time to review the benefits of making these changes.
Purpose of the Endowment

The endowment fund is a permanent fund established to support specific purposes at the University of Manitoba. Each year, a portion of the investment return is used to support current year programs and therefore contributes to the quality of teaching, student accessibility, research, athletics, and public service at the University.

Each individual endowed account is pooled for investment purposes and tracked using unit accounting, similar to a mutual fund. The use of a pooled fund ensures new gifts purchase units and receive a pro-rata share of earnings, while existing account holders maintain their equitable ownership in the pool. The pooled fund concept also allows all endowment account holders to take advantage of the diversification benefits available to large institutional investors like the University of Manitoba.

The endowment is managed by the Trust Investment Committee ("the Committee), which is an advisory committee to the Board of Governors, and as such makes recommendations on all matters related to the investment and distribution of endowment assets. Members of the Committee are appointed under authority of the Board, and are accountable to the Board through the Finance, Administration, and Human Resources Committee. The Committee establishes guidelines for investing assets, and is responsible for hiring and reviewing investment managers. This includes establishing the investment mandates for each asset class and the review of performance for each mandate, as well as the overall portfolio, to ensure that the goals and objectives of the endowment are being achieved.

The endowment fund is comprised primarily of gifts from donors to provide long-term funding for designated purposes. Donors generally specify a particular purpose for their gifts, creating endowments that fund faculty and school support (39%), student awards (37%), chairs and professorships (10%), research (7%), library support (4%), and various other areas (3%). The annual distributions from the endowment fund provide for this support, with $14.2 million being allocated for the current year, and a total of $66.7 million allocated over the past 5 years.

The fund continues to grow due to the generosity of these same donors, and in the past year 65 new endowed accounts were set up (for a total of 2,002 individual accounts), as a total of $17.1 million in new gifts were received by the UIT. These gifts are invested in the UIT and will grow over the long-term. The key objective is ensuring a gift made today will not be eroded by inflation in the future, yet at the same time the gift distributes income to support the beneficiaries of the fund.
Investment Policy and Strategy

The most critical element of the investment policy is the decision of asset allocation. Since investment management involves as much art as science, the Committee uses both qualitative considerations and quantitative techniques in determining the asset mix. Statistical simulations and analysis are used to estimate the expected risk and return profiles of various asset allocation alternatives; whereas market judgment is used to help incorporate factors that quantitative analysis cannot measure. In order to meet the return objectives of the endowment fund, the asset allocation is biased in favor of equities, and consequently, to reduce volatility and diversify against adverse equity markets, the fund has allocations towards government bonds and Canadian real estate.

Each asset class selected is judged not only on its ability to deliver long-term investment returns, but also the correlation of that asset class with the other classes is a key consideration, as this provides the benefits of diversification to the portfolio. Equities are still the largest asset class in the portfolio due to their long-term return potential. Since the endowment fund’s goal is twofold; to provide income to fund current needs while maintaining the purchasing power of the fund for future generations of students, an equity oriented asset mix is required. Furthermore, inflation is always a concern as a highly inflationary environment has a particularly adverse effect on the endowment, so the asset mix will always favor equity-like returns over fixed income –like returns.

The last decade has been disappointing for equities mostly due to the performance of U.S. and International stocks converted into Canadian dollars. The 10-year return for the S&P 500 index (U.S. equities) was -1.6%, and the return for the MSCI Index (Europe, Asia, Far East equities) was 0.4% over that same period of time. Much of this poor performance is due to the appreciation of the Canadian dollar versus other currencies, particularly the U.S. dollar. In early 2002, the Canadian dollar was $0.63 versus the U.S. dollar; at the end of March 2011 it was $1.03, thus U.S. investments values depreciated significantly over that period. Only Canadian equities fared well, as the S&P/TSX Composite index returned 8.8% over this same 10-year period. Despite disappointing returns over this timeframe, equities have not fallen out of favor as an asset class. The Canadian dollar, as it stands today, is very strong, but also likely closer to the peak of its comparative value against other major currencies, thus mitigating currency risk related to non-Canadian equities as we go forward.
With equities, the challenge will always be finding the right managers that add value while controlling risk. Burgundy Asset Management invests the endowment's Canadian equities in a concentrated portfolio with general indifference to typical sector allocations of other managers and the S&P/TSX index. They seek the best businesses in Canada through in-depth bottom-up research, and buy the stock only when the price warrants investment. The result of this is a portfolio that will deviate from short-term market returns, but be well positioned to provide longer-term success and also help insulate the portfolio during times of poor market returns as the high-quality stocks in the portfolio provide much needed downside protection.

Our U.S. equity manager J.P. Morgan faces the challenge of adding value in the very efficient U.S. investment marketplace. They do so by focusing on intensive research which allows them to identify companies that are leaders in each industry. Research analysts at J.P. Morgan are as important as portfolio managers, thus career analysts can analyze different companies in the various industries over long time horizons. The portfolio is large, robust, and very conscious of managing risk.

The other two asset classes are fixed income and real estate. The current fixed income mandate focuses on midterm issues of government bonds. Predictable cash flows and a low return volatility are the two primary reasons these bonds are held in the portfolio. Although the expected returns of bonds as an asset class are comparatively low, bonds provide liquidity, and more importantly, add diversification to the overall portfolio. In a portfolio biased towards equities, bonds help reduce risk as they respond to market conditions differently than equities. AMI Partners manages the bond portfolio with an emphasis on quality and liquidity, and have generated returns this year that are very close to corporate returns without any of the corporate risk.

Finally, Canadian real estate provides further diversification, as it has low correlation to both equities and bonds, and the market for real estate is less efficient than that of the stock markets. Real estate offers higher expected returns than bonds, and provides these returns through both capital appreciation and net income from properties. When constructing a large diversified portfolio, endowment funds in Canada have traditionally looked first to equities and bonds, given the large, liquid and intensively research markets they operate within. Increasingly over the past several years, in order to further diversify a portfolio, and add value, alternative investments have been added as assets to Canadian endowment funds. Such mandates as real estate, hedge funds, and private equity have been adopted by many funds. The University’s investment in the Great West Life Real Estate Fund was to further diversify the portfolio and add higher expected returns to the portfolio. The fund is well diversified across both region and property type, which allows the University to invest in real estate, while tempering the risk of investing in any one market segment.

The committee will continue to review the asset allocation, particularly in the likelihood of changing the spending policy. Potential new asset classes will be judged on their relative merits. The difficulty in investing in private equity, hedge funds, and infrastructure is the scale of these investments; finding reputable managers whose interests are aligned with our interests; high fees; lack of liquidity; and currency risk (as many of these investments are foreign). Whether it is the adoption of new mandates, or changes to the policy target allocations, the role of asset classes and diversification will always be the most important building block in the foundation of the endowment fund.
Expenses of the Fund

The Committee is focused on meeting the long-term investment objectives of the fund, and this includes controlling expenses. Over the past few years, two main factors have influenced the expense ratio. First, the endowment is now partially funding new staff in the University’s Philanthropy Office. This is an important initiative as the dedicated effort of fundraisers has a direct benefit on the fund, as new gifts are a key component of a healthy and growing endowment. Also, strategic restructuring of how we invest has resulted in higher investment management fees. Actively managed portfolios have replaced exchange-traded funds for both the U.S. and EAFE equity mandates, resulting in higher fees; and both the Canadian equity and Canadian real estate mandates have higher fees than previous managers and mandates. The Committee, however, is very pleased with the performance of these new managers and mandates, and the improved performance of the overall fund warrants the increase in investment management fees. The Committee is also mindful of the performance of other similar endowments. In relative terms, the overall expense structure of the University of Manitoba’s endowment fund is comparable to the median levels of universities in Canada with endowments over $100 million in market value.
Investment Managers - UIT
AMI PARTNERS
Canadian Fixed Income
BURGUNDY ASSET MANAGEMENT
Canadian Equities
GLC ASSET MANAGEMENT GROUP
Canadian Real Estate
J.P. MORGAN ASSET MANAGEMENT
US Equities
LEGG MASON GLOBAL CURRENTS
International Equities

Investment Managers – Specific Trusts
BMO NESBITT BURNS
Canadian Fixed Income and Cash Equivalents
JARISLOWSKY FRASER
Canadian Fixed Income, Canadian and Foreign Equities

Other
BROCKHOUSE COOPER
Performance Analytics and Transition Management
CIBC MELLON
Custodian
RBC DEXIA
Performance Measurement
TD CANADA TRUST
Corporate Banking
### University of Manitoba Endowment Fund

#### Financial Highlights for the Past 5 Years

<table>
<thead>
<tr>
<th>Values (in 000's)</th>
<th>2011</th>
<th>2010</th>
<th>2009</th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market Value of UIT</td>
<td>$342,284</td>
<td>$300,965</td>
<td>$249,779</td>
<td>$307,069</td>
<td>$312,372</td>
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<tr>
<td>Return of the UIT</td>
<td>12.4%</td>
<td>18.8%</td>
<td>-20.0%</td>
<td>-4.2%</td>
<td>8.8%</td>
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<tr>
<td>Market Value of the Specific Trusts</td>
<td>$28,187</td>
<td>$37,747</td>
<td>$32,565</td>
<td>$35,211</td>
<td>$26,054</td>
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</table>

<table>
<thead>
<tr>
<th>Asset Allocation (as of March 31)</th>
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<tbody>
<tr>
<td>Canadian Fixed Income</td>
</tr>
<tr>
<td>Canadian Equity</td>
</tr>
<tr>
<td>US Equity</td>
</tr>
<tr>
<td>International (EAFE) Equity</td>
</tr>
<tr>
<td>Canadian Real Estate</td>
</tr>
</tbody>
</table>

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<thead>
<tr>
<th>Donations (in 000’s)</th>
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<tbody>
<tr>
<td>- to the UIT</td>
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<tr>
<td>- to the Specific Trusts</td>
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</table>

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<thead>
<tr>
<th>Spending Allocation (in 000’s)</th>
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<tbody>
<tr>
<td>By Purpose:</td>
</tr>
<tr>
<td>Faculty and School Support</td>
</tr>
<tr>
<td>Student Awards</td>
</tr>
<tr>
<td>Chairs and Professorships</td>
</tr>
<tr>
<td>Research</td>
</tr>
<tr>
<td>Library Support</td>
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<tr>
<td>Other</td>
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</table>

Actual cash disbursed, including unspent allocations from previous years:

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</thead>
<tbody>
<tr>
<td>- to support student awards</td>
<td>$6,656</td>
<td>$5,870</td>
<td>$5,743</td>
<td>$5,451</td>
<td>$4,392</td>
</tr>
<tr>
<td>- to support faculties, schools and teaching</td>
<td>6,570</td>
<td>6,223</td>
<td>5,437</td>
<td>4,809</td>
<td>4,104</td>
</tr>
<tr>
<td>- to support research</td>
<td>974</td>
<td>1,102</td>
<td>1,159</td>
<td>1,490</td>
<td>718</td>
</tr>
<tr>
<td>- to support capital projects</td>
<td>3,615</td>
<td>3,214</td>
<td>4,697</td>
<td>4,375</td>
<td>633</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Expenses of the Fund (in 000’s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Investment management</td>
</tr>
<tr>
<td>- Custodial, performance, consulting, and administrative</td>
</tr>
<tr>
<td>total as a % of average market value</td>
</tr>
</tbody>
</table>
THE TRUST INVESTMENT COMMITTEE IN 2011

University Staff and Members of the Board of Governors

DAVID BARNARD
President and Vice-Chancellor
University of Manitoba

DAVID COLLINS
Vice- Provost (Academic Planning and Programs)
University of Manitoba

TOM HAY
Comptroller
University of Manitoba

DEBORAH MCCALLUM, CHAIR
Vice-President (Administration)
University of Manitoba

LANCE MCKINLEY
Manager of Treasury Services
University of Manitoba

RENNIE ZEGALSKI
Board of Governors
University of Manitoba

Community Members

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President
St. Boniface Pallet Co. Ltd.

ALAN BROWN RIDGE
Retired Managing Partner
Investors Group Investment Management Ltd.

NORMAN LONG
Retired Comptroller
University of Manitoba

RONALD QUECK
Director of Investments
HEB Manitoba

JOHN SMITH
Senior Vice-President
GLC Asset Management Group