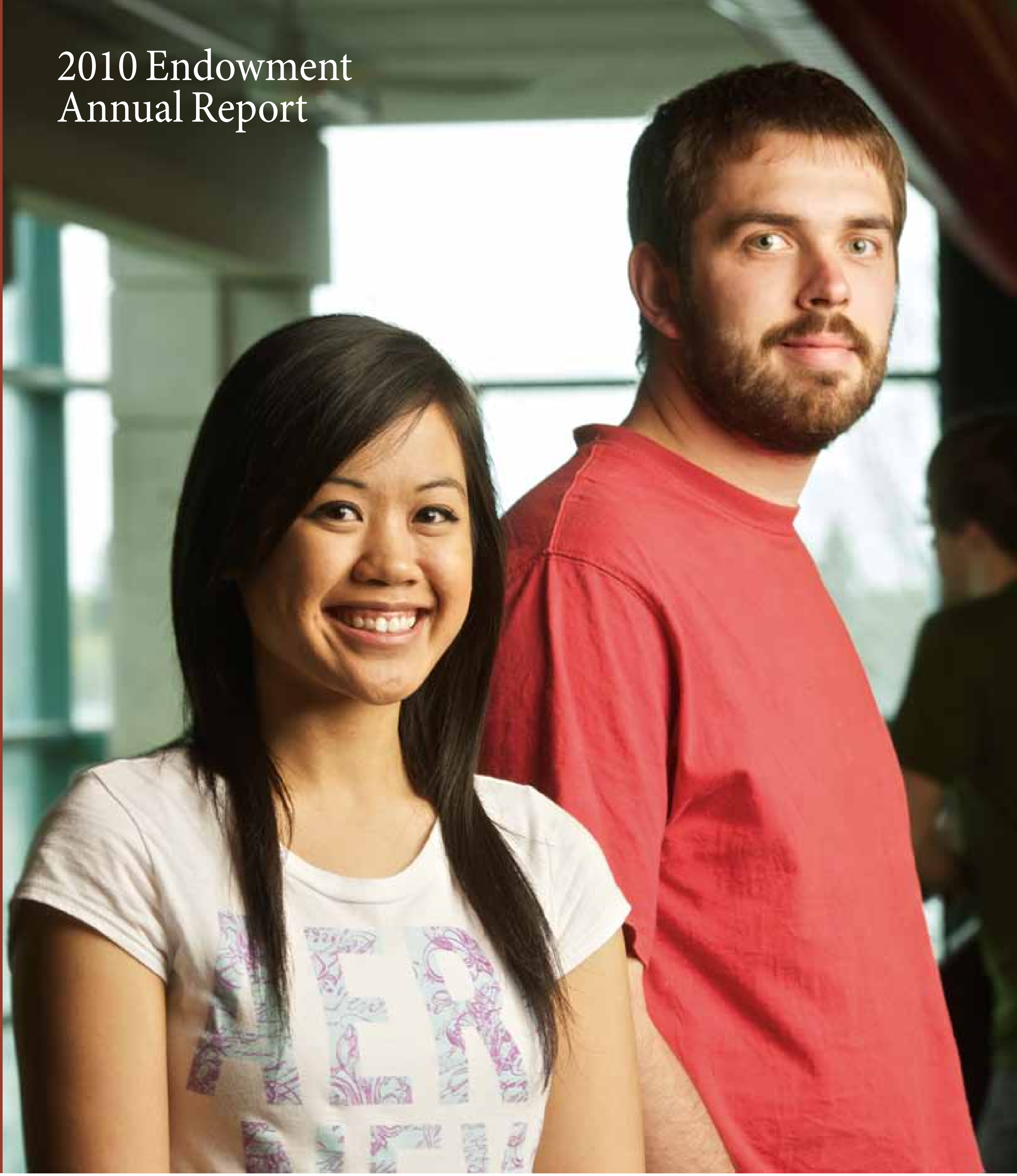
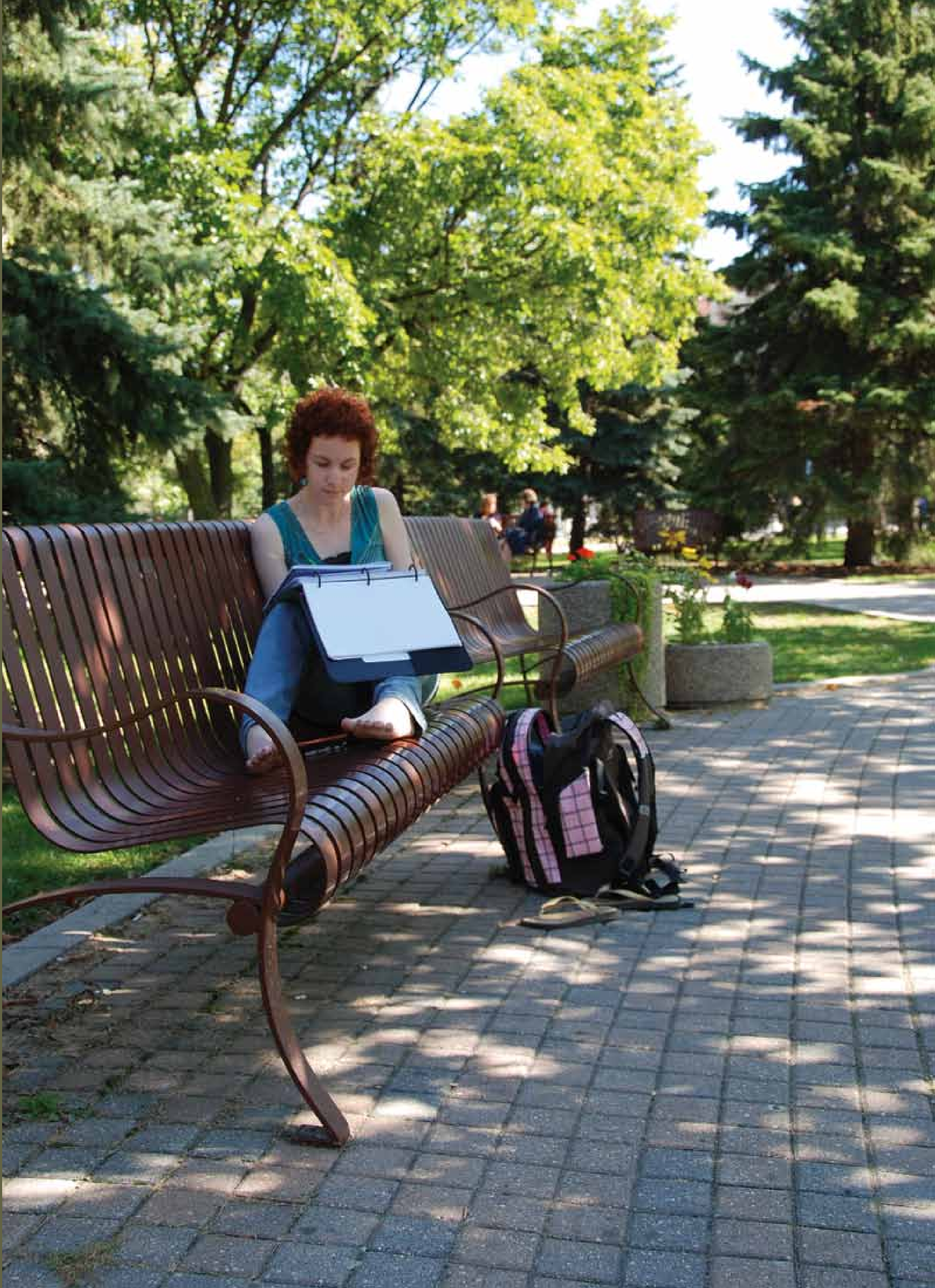
# 2010 Endowment Annual Report



University of Manitoba

ONE UNIVERSITY. MANY FUTURES.



# The Year in Review

The University of Manitoba endowment fund realized a one year return of 18.8% for the year ending March 31, 2010. It was an encouraging year given the crash in the world stock markets the previous year, and the negative effect this economic turmoil had on endowment funds during that period. The recovery over the past year has helped the endowment fund recoup much of what was previously lost. At $301 million, the value of the University Investment Trust ("UIT") crept back over the $300 million mark, and closer to the level where it was two years ago. The Specific Trusts were worth $38 million at the end of the fiscal year, and this growth was related to donations raised for capital projects like the new Pembina Hall Residence. Although the trustees of the fund were glad to see a return to previous market values, the focus remains the long-term horizon, recognizing that volatility in the marketplace will surely cause stakeholders of the fund to become concerned in times of falling markets, but over a period of full market cycles, these bumps in the road will be offset by times when markets are decidedly bullish.

The fund also benefitted from the continuing generosity of donors. During the 2010 fiscal year, the fund received $12.2 million in donations to the UIT, and an additional $9.7 million in gifts to the Specific Trusts. A total of 59 new individual endowed accounts were set up during the year. The fund remains the 8th largest university endowment fund in Canada, due in large part to the incredible support of its many donors over the past 10 years.

The Trust Investment Committee ("the Committee") recommended maintaining the spending rate at 4.5% over the past two volatile years, and the Board of Governors endorsed this recommendation. Some universities have reduced their spending rates, while others have chosen not to reduce the rate. Although the crash of 2008 was one of the most significantly adverse economic periods for investors everywhere, there has not been the sustained recession many had feared. There are still many concerns and problems to address, like the issues of sovereign debt in some European countries, but there are also several encouraging signs, such as increasing consumer confidence and job creation. The Committee felt reducing the spending rate based on poor results over a very short period of time would belie the notion that the fund's focus is over a long time horizon.

## *Endowment* Highlights

- The endowment provided $14 million in new support for students and University activities in 2010, and has provided $62.2 million in support over the past five years.
- The UIT benefitted from $12.2 million in new donations during the year, and another $9.7 million was donated to the specific trusts.
- A new investment manager, J.P. Morgan Asset Management, was selected to manage the endowment's US equity investments.
- The fund is the 8th largest university endowment in Canada.
- The fund maintained a 4.5% spending rate.
- A total of 59 new individual endowment accounts were established during the year.

# New Developments

The University's fundamental approach to the management of the endowment portfolio rests upon the principle of diversification, with an emphasis towards equity investments. This weighting towards equities makes sense for investors with long time horizons, but inherent in this philosophy is year-to-year volatility. By diversifying the portfolio with investments in fixed income and real estate, the endowment has a buffer against the large swings in the stock markets, however, for the most part the fund is subject to short-term volatility in favour of meeting long-term objectives.

Having said this, the one year rate of return predictably followed the annual returns of the equity markets, offset by rather flat returns in both the mid-term government bond market and the Canadian real estate market. Some of the slight underperformance is attributable to two large changeovers to new equity managers during the year, and returns of two mandates that lagged just behind their relative benchmarks.

The Trust Investment Committee is very optimistic about the upcoming year and beyond, given the recent changes to the management of the portfolio. The Committee viewed all the recent changes as two significant phases. The first phase was to construct a new diversified asset mix that would allow for favourable risk and return characteristics. The second phase was to find the right group of managers to invest funds for each mandate of the asset mix.

It has taken a few years, but the Committee is pleased with the managers recently hired, and is confident that they will add value to the portfolio by producing excess returns while maintaining an acceptable level of risk.

During the year, there were two significant manager changes to the equity mandates. In April 2009, AMI Partners was replaced by Burgundy Asset Management as the sole investment manager of the Canadian equity portfolio. The Canadian equity mandate comprises 50% of the equity allocation, or 35% of the entire fund. Given the endowment's 70% weighting to equities, and the volatility that can accompany this, Burgundy is an ideal manager in which to invest half of the equity funds. Their value-based investment style and search for companies with outstanding fundamentals and financial characteristics have helped insulate their portfolios from some of the big crashes over the past 10 years. Burgundy's portfolios perform in the top percentiles when markets drop; they do record losses, but not nearly as much as most of their competitors. Essentially, they provide good downside protection, which is very appealing to the Committee.

Early in 2010, J.P. Morgan was hired as the new sole manager of the US Equity portfolio. This portfolio makes up 20% of the overall asset allocation. J.P. Morgan is a research-driven firm where career analysts are an integral part of the investment process. In a large, efficient equity market like the United States, it is hard to exploit the market and find mispriced stocks and undervalued companies. J.P .Morgan has a great track record of doing just that, and the Committee is optimistic they will add value to the US equity portfolio over the upcoming years. Both firms, Burgundy and J.P. Morgan, are welcome additions to the management of endowment assets at the University of Manitoba and help complete the second phase of the asset allocation process.

# Fund Expenses

The endowment fund incurs expenses related to the management and safekeeping of assets. Investment management fees are paid for portfolio management and these fees make up the most significant portion of overall expenses. Custodians are paid for the safekeeping and accounting of shares held in segregated portfolios. Performance measurement fees provide third party analysis of our portfolio as compared to our peers across the country. Performance analytics help track each of the three equity investment managers and allow the Committee to determine if these firms are managing the portfolios consistently and in compliance with their investment philosophies and processes. Finally, there are internal administrative fees that help support the individuals that work with the endowment fund on a daily basis, and these fees also support some of the fundraisers which benefit the fund going forward.

The total investment management fees paid in 2010 were $1,382,000 or .41% of the average market value of the fund over that period. The total expenses of the fund in 2010 were $2,110,000, or .63% of the average market value of the investments for the year. Overall, compared to similar sized endowment funds and foundations, the fee structure is favourable, and the Committee is committed to ensuring that controlling costs is an important objective in the decision-making process.

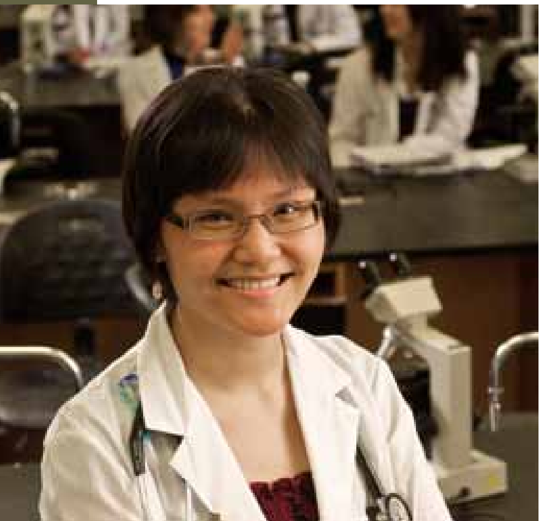
# Investment Policy

The investment policy centers on building a portfolio of investment assets designed to meet the long-term objective of the endowment. The long-term objective of the endowment is the preservation of capital to ensure inter-generational equity. The concept of inter-generational equity is to ensure current university students are neither advantaged nor disadvantaged relative to future students. This is achieved in part by setting a realistic spending policy that will allow the portfolio to grow at least by the rate of inflation over complete market cycles.

The most critical element of the investment policy is the asset allocation decision. Since investment management involves as much art as science, the Committee uses both qualitative considerations and quantitative techniques in determining the asset mix. The Committee uses statistical simulations and analyses to estimate the expected risk and return profiles of various asset allocation alternatives, but also uses market judgement to help incorporate factors that quantitative analysis cannot measure. This results in the following asset allocation:

| Asset Class | Target |
|---|---|
| Cdn Fixed Income | 15% |
| Cdn Real Estate | 15 |
| Cdn Equities | 35 |
| US Equities | 20 |
| EAFE Equities | 15 |

The current asset mix relies heavily on equity holdings, with the portfolio having a target weighting of 70%. Equities have historically outperformed other asset classes like bonds and cash equivalents. Even in light of recent events that saw stock markets around the world fall, the Committee feels equities still represent the primary asset class in which to invest endowed funds and realize long-term financial returns. The return objective of the fund is to earn a real return at least equal to the current spending rate of 4.5%. This means investment assets must earn a rate of return of 4.5%, plus inflation, over a period of years. For example, as measured by the Consumer Price Index over



the past 4 years, inflation was 1.6%, which indicates the fund must earn 6.1% over that same period to ensure the capital (or original donations) is preserved and inflation protected. Both the quantitative and qualitative measures the Committee has employed over the past years indicate that to achieve these same returns over full market cycles, an equity oriented strategy must be used.

Equity markets represent very large, liquid, and heavily researched markets. Given that many analysts and economic forecasters consider the equity markets to be range bound markets over the next few years, active management and stock selection become even more critical to the success of the equity asset mandates and their ability to outperform the market. Thus, manager selection is a critical piece of the process. The Committee has spent considerable time over the past few years searching for, and hiring, a group of equity managers that have sound investment philosophies and proven track records. In the past three years, Legg Mason, Burgundy Asset Management and J.P. Morgan have all been hired to invest endowed assets in equity markets.

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 maintaining a hedge against financial market crashes are the two primary reasons these bonds are held in the portfolio. Canadian real estate also provides a financial hedge, 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, so there exists greater opportunities through active management to add value to the overall portfolio. Real estate offers higher expected returns than bonds, and provides these returns through both capital appreciation and net income from properties. Together, these two asset classes comprise 30% of the portfolio.

All of these elements make up the pieces of a complex puzzle, which is investing endowed funds in complicated and often volatile financial markets. Because of this, managing market risk is critical for the fund to meet its return objectives and to preserve the capital of donated funds. It is important to identify and manage risk at the portfolio level, individual mandate level, and within the active management of each mandate. The degree of added value achievable above market index returns will vary depending on the efficiency of individual markets of securities, and the degree of risk specified in the manager mandate to exploit individual security and sector risk. Individual manager mandates will address the market risk and the degree of added value that can be reasonably achieved.

# Beneficiaries of the Endowment Fund

The annual distributions from the endowment fund provide support for a wide range of beneficiaries, as designated by donors. The fund continues to grow due to the generosity of these same donors, and in the past year, 59 new individual endowed accounts were set up (for a total of 1,937 accounts), and a total of $12.2 million in new gifts was 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.

The annual spending allocation distributed to beneficiaries was $14 million, and over the past five years, these allocations have provided a total of $62.2 million for spending purposes. This ongoing funding enables the University to provide student support, attract faculty and researchers, provide programs in faculties and schools, support chairs and professorships, and add to library resources.

The value of every donation made to the fund, and invested in perpetuity, will provide an ongoing benefit to education in Manitoba. For example, a single donation to a scholarship fund of $10,000, made 10 years ago, will have provided $4,980 in scholarships over that 10 year period. Furthermore, assuming a 2% real growth rate for the fund over the next 25 years, that donation will provide an additional $15,950 in scholarships over that time frame. The compounding effect of the endowment fund helps ensure a legacy of support that will benefit student education and research for years to come.


### Investment Managers - UIT

AMI PARTNERS
Canadian Fixed Income

BURGUNDY ASSET MANAGEMENT
Canadian Equities

GWL INVESTMENT MANAGEMENT
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

| | Fiscal Year | | | | |
|---|---|---|---|---|---|
| **Values (in thousands)** | **2010** | **2009** | **2008** | **2007** | **2006** |
| Market Value of UIT | $300,965 | $249,779 | $307,069 | $312,372 | $277,298 |
| Return of the UIT | 18.8% | -20.0% | -4.2% | 8.8% | 16.4% |
| Market Value of the Specific Trusts | $37,747 | $32,565 | $35,211 | $26,054 | $24,309 |
| **Asset Allocation** (as of March 31) | | | | | |
| Canadian Fixed Income | 14.5% | 20.8% | 18.9% | 25.3% | 27.1% |
| Canadian Equity | 37.7 | 30.1 | 35.5 | 35.3 | 34.5 |
| US Equity | 18.9 | 18.6 | 20.0 | 20.2 | 18.8 |
| International (EAFE) Equity | 14.3 | 13.1 | 15.1 | 17.5 | 19.6 |
| Canadian Real Estate | 14.6 | 17.4 | 10.5 | 1.7 | 0.0 |
| **Donations** (in thousands) | | | | | |
| - to the UIT | $12,157 | $23,179 | $19,505 | $12,147 | $17,668 |
| - to the Specific Trusts | 9,714 | 5,923 | 9,600 | 7,938 | 10,770 |
| **Spending Allocation** | $14,027 | $13,569 | $13,163 | $11,659 | $9,794 |
| By Purpose: | | | | | |
| Faculty and School Support | 38.9% | 39.8% | 40.0% | 41.6% | 41.8% |
| Student Awards | 35.9 | 35.7 | 35.4 | 34.4 | 34.0 |
| Chairs and Professorships | 9.9 | 10.0 | 9.3 | 8.0 | 8.5 |
| Research | 7.0 | 7.4 | 7.5 | 7.8 | 7.6 |
| Library Support | 4.1 | 3.2 | 2.6 | 2.6 | 2.7 |
| Other | 4.2 | 3.9 | 5.2 | 5.6 | 5.4 |
| **Actual cash disbursed, including unspent allocations from previous years:** | | | | | |
| - to support student awards | $5,870 | $5,743 | $5,451 | $4,392 | $4,066 |
| - to support faculties, teaching, libraries, and other | 6,223 | 5,437 | 4,809 | 4,104 | 3,662 |
| - to support research | 1,102 | 1,159 | 1,490 | 718 | 953 |
| - to support capital projects | 3,214 | 4,697 | 4,375 | 633 | 1,591 |
| **Expenses of the Fund** (in thousands) | | | | | |
| - Investment management | $1,382 | $974 | $740 | $548 | $540 |
| - Custodial, performance, consulting, and administrative | 728 | 450 | 340 | 317 | 290 |
| total as a % of average market value | 0.63% | 0.51% | 0.33% | 0.27% | 0.27% |


# THE TRUST INVESTMENT COMMITTEE IN 2010

## University Staff and Members of the Board of Governors

DAVID BARNARD
President and Vice-Chancellor
University of Manitoba

PAT BOVEY
Board of Governors
University of Manitoba

TOM HAY
Comptroller
University of Manitoba

RICHARD LOBDELL
Vice-Provost (Programs)
University of Manitoba

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

LANCE MCKINLEY
Manager of Treasury Services
University of Manitoba

RICHARD SIGURDSON
Dean of Arts
University of Manitoba

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RON QUECK
Director of Investments
HEB Manitoba

JOHN SMITH
President
GWL Investment Management


BACKGROUND: Welcome Centre. Photos: Public Affairs