

# Investment Models for the Management of Small to Mid-Sized Endowments

**S**ome of the largest educational endowments, including those of Harvard, Yale, Princeton, Cambridge and Oxford universities, have developed successful and highly respected investment approaches for protecting and growing investment portfolio assets over the long term. However, the “endowment model” is by no means a panacea for all investors as it has taken its own knocks through the recent financial turmoil. But the three simple principles of 1) embracing a long-term investment approach, 2) with portfolios diversified across a broad range of asset classes and 3) such portfolios being populated by the best of breed asset managers in each asset class remain nearly essential components of any good investment strategy. Many smaller endowments embrace these principles as fundamental to their own investment programs.

This white paper addresses the predicament many small to mid-sized educational endowments face (with assets below \$1bn) as they seek to get the performance benefits of the endowment investment model without the same resources of their richer peers. Nearly all small educational endowments run on tight budgets with all costs generally referenced against such things as how many additional professors could be secured with any savings. As a result, most investment programs are staffed with few internal full time investment professionals. The cost of a qualified Chief Investment Officer and just three staff can run easily well over \$1m. Many smaller endowments attempt to substitute full time staff for an all-volunteer investment committee comprising talented school alumni who are veteran investment professionals willing to donate a few hours a quarter to the endowment. One can look across the hundreds of US and UK endowment committees and see this attempted arbitrage on investment talent in action. This is good news for any endowment.

The bad news is that the volunteers tend to be very busy people who struggle to donate much more than a few hours a quarter to the endowment. For this to work, investment strategies must be constrained to what can be achieved with these short bursts of involvement. Investment committee meetings have to be very effective and nothing can go wrong in-between these meetings that requires additional time that they do not have. In many cases, the constraints put on the investment strategy come in the form of static asset allocations, limiting exposure to more traditional investment opportunities, asset classes and geographic markets and holding onto asset managers beyond their “sell-by” dates.

These constraints generally have portfolio performance implications. Against a backdrop of an increasingly complex and volatile investment environment, more legal, tax and regulatory intervention into the investment world, and greater concerns about the endowment growing sufficiently to cover the school’s spending requirements, the demands on investment committees are outstripping the time Investment Committee (“IC”) members have to deliver the required investment acumen to fulfil their fiduciary responsibility.

When the school approaches this “tipping point” it is normally confronted with a decision on how best to make that step change to a more professionally managed endowment. The key decision is one of hiring in-house investment staff (“build”) vs. outsourcing to independent investment advisors (“buy”). We will discuss these and two other approaches: the “Consultant Model” and the “Hybrid Model” (internal staff plus consultant).

**The “Build Model”:** In the build model, the IC focuses primarily on building and maintaining its own internal capacity to manage the school’s endowment. This includes:

- Recruiting, compensating, housing, and supervising a CIO and adequate investment staff
- Establishing budgets and compensation structures for the investment staff and/or CIO
- Resourcing and supervising investment operations (an array of decisions and actions from establishing trading counterparties to risk control policies and procedures)

The IC may decide to staff up an investment office but not recruit a CIO, which almost certainly means the IC will have to devote some time and energy supervising the staff. In either case the total annual budget is likely to be well over \$1M for even a modest staff and a solid CIO will expect at least a mid-six figure total compensation package. And with the limited staff, the IC must still define what constraints should be placed on the investment strategy. For example, a team of 3-4 should not be expected to be sufficiently expert on all asset classes (equities, private equity, fixed income, absolute return, credit, commodities and property) and all geographic markets for sourcing the best of breed asset managers in each asset class. A \$2m staffing level may start to approach the required team for an unconstrained investment strategy but with, for example, a \$300m endowment this requires the IC to be confident that that team will add more than 0.67% on average to the annual investment returns.

# Intellectual Capital

## Investment Implications of Climate Change

**The “Buy Model”:** In the full version of the “buy model”, the IC focuses primarily on selecting and monitoring an external professional advisory firm to which it outsources the endowment investment function across the full portfolio. The relationship between the IC and that firm can vary across a spectrum. The most typical approach has the IC still setting investment objectives and high-level policy including the long term strategic asset allocation, while the external investment advisor normally inputs to asset allocation debate, but takes responsibility for all the other activities including tactical asset allocation and asset manager identification, due diligence, on-boarding and on-going monitoring. A capable investment advisor will also take primary responsibility for reporting on endowment performance to the IC and main Board including manager-by-manager benchmarking and full portfolio performance attribution. The best investment advisor will bring macro-economic insights and a clear roadmap for navigating through today’s dynamic investment landscape. Its toolkits should look through each asset manager’s portfolio to provide the endowment with an accurate assessment of the collective set of risks that are being taken and should be armed with sensible portfolio overlays to hedge against extreme events which could do lasting damage to the endowment value. The investment advisor’s operational support will include transaction execution, custody management, currency hedging, private equity capital call management, portfolio rebalancing, cash sweep monitoring and other heavy lifting that generally accompanies more sophisticated modern portfolios.

Investment advisors themselves range from very large firms that service pension funds and other substantial institutions as well as school endowments, to more focused firms that specialize in providing a bespoke service to smaller endowments and foundations. The choice along this spectrum presents tradeoffs highlighted by the following questions:

- Are you dealing with the most senior members of the firm?
  - Is your relationship manager also an investor, or just your relationship manager?
  - Does the IC have direct access to other senior investment decision makers in the investment advisor’s firm?
  - Is the service provided as “one size fits all” or designed around the school’s specific needs in terms of its risk and volatility, liquidity and funding profile, appetite for international exposure and currency risk, inflation sensitivity and the like?
- Can the investment advisor “afford” to seek out smaller and niche managers whose AUM best fits their strategies and who are often hungrier and more likely to produce superior returns than their very large brethren who can happily live on their management fees (“afford” in the sense that the large allocators need to align with managers who can scale to the size of the allocator’s client base, often including giant pension funds).

Investment advisors vary in terms of cost from 0.30% to 1.00% of assets advised depending on the breadth of the role and investment strategy focus. They almost always look after the entire portfolio and may not charge fees on certain legacy assets. The longer established investment advisors should be able to demonstrate from auditable track records whether their performance contributions more than pay for their fees.

**The “Consultant Model”:** A third option is the “consultant model”. Consultants normally provide some but not all of the services provided by an investment advisor. The most prominent consultants tend to charge an annual fixed fee, from as little as \$50,000 for a skeleton service to well above \$1m a year for comprehensive services. With a consultant, the decision to “pull the trigger” on a new manager or the redemption of an incumbent manager rests ultimately with the IC. Frequently, consultants will help run screens, coordinate final meetings among managers with the IC, and facilitate decision-making conversations, but stop short of a formal recommendation. Because consultants are normally not “paid for performance” they have less incentive to seek out the more difficult to find or to access managers who may stand a higher probability of producing superior returns. The larger consultants tend to lead their clients toward the large, long-established institutional asset managers that often have raised too much capital, and tend to just track their indices, struggling to outperform. It is difficult to generalize about consultants as they occupy a diverse territory of services and products on offer, but a sophisticated IC can normally observe the difference between a true investor (which a solid investment advisor should be) and a firm that stops short of a full set of investment capabilities, including investment operations, and avoids sharing the performance risk of the endowment through its compensation structure.

**The “Hybrid Model” (Internal Staff plus Consultant):** This model is frequently seen and can work to a degree. However it is imbedded with its own somewhat perverse dynamic: the more assertive the consultant is the

## Intellectual Capital

### Investment Implications of Climate Change

less likely the endowment will be to attract and retain fully capable internal investment talent, and the more assertive the internal team is the more likely the consultant will be marginalized in its value-add to the endowment. The hybrid model will almost inevitably result in paying twice for some degree of overlap in skills and activities. In either case one is feeding two mouths, often with a suboptimal result.

**Conclusion:** So the choice of model for small to mid-sized endowments comes down to weighing the need to have an investment strategy which avails itself to the full range of investment opportunities and the most effective means to serve that need. In what might have in the past been considered a normal investment environment, a perfectly viable endowment investment strategy was one that embraced a fairly static portfolio construction and was concentrated in a small number of asset managers from the traditional equity and bond world. The present investment environment has many sophisticated endowment investment committees concerned that portfolio returns from any investment strategy are unlikely to deliver sufficient returns to fund their school's annual budget and protect capital against the ravages of inflation. Our view is that "normal" returns are more likely to be achieved where investment strategies are more nimble, where decision makers can respond quickly to the changing domains of investment risk to avoid the greatest downdrafts, while exploiting the many opportunities that emerge from chaotic market situations like the present.

At no time in recent history has it been more important to find and access those extraordinarily talented independent asset managers who are best able to profit from what are largely uncharted investment waters. Whether through the "build" or "buy" alternative, this requires relatively large specialist teams who demonstrate deep insights into each asset class and whose scope spans the globe to find the best asset managers.

## DISCLAIMER

Copyright © 2023, Partners Capital Investment Group LLP

Within the United Kingdom, this material has been issued by Partners Capital LLP, which is authorised and regulated by the Financial Conduct Authority of the United Kingdom (the “FCA”), and constitutes a financial promotion for the purposes of the rules of the Financial Conduct Authority. Within Hong Kong, this material has been issued by Partners Capital Asia Limited, which is licensed by the Securities and Futures Commission in Hong Kong (the “SFC”) to provide Types 1 and 4 services to professional investors only. Within Singapore, this material has been issued by Partners Capital Investment Group (Asia) Pte Ltd, which is regulated by the Monetary Authority of Singapore as a holder of a Capital Markets Services licence for Fund Management under the Securities and Futures Act and as an exempt financial adviser. Within France, this material has been issued by Partners Capital Europe SAS, which is regulated by the Autorité des Marchés Financiers (the “AMF”).

For all other locations, this material has been issued by Partners Capital Investment Group, LLP which is registered as an Investment Adviser with the US Securities and Exchange Commission (the “SEC”) and as a commodity trading adviser and commodity pool operator with the Commodity Futures Trading Commission (“CFTC”) and is a member of the National Future’s Association (the “NFA”).

This material is being provided to clients, potential clients and other interested parties (collectively “clients”) of Partners Capital LLP, Partners Capital Asia Limited, Partners Capital Investment Group (Asia) Pte Ltd, Partners Capital Europe SAS and Partners Capital Investment Group, LLP (the “Group”) on the condition that it will not form a primary basis for any investment decision by, or on behalf of the clients or potential clients and that the Group shall not be a fiduciary or adviser with respect to recipients on the basis of this material alone. These materials and any related documentation provided herewith is given on a confidential basis. This material is not intended for public use or distribution. It is the responsibility of every person reading this material to satisfy himself or herself as to the full observance of any laws of any relevant jurisdiction applicable to such person, including obtaining any governmental or other consent which may be required or observing any other formality which needs to be observed in such jurisdiction. The investment concepts referenced in this material may be unsuitable for investors depending on their specific investment objectives and financial position.

This material is for your private information, and we are not soliciting any action based upon it. This report is not an offer to sell or the solicitation of an offer to buy any investment. While all the information prepared in this material is believed to be accurate, the Group, may have relied on information obtained from third parties and makes no warranty as to the completeness or accuracy of information obtained from such

third parties, nor can it accept responsibility for errors of such third parties, appearing in this material. The source for all figures included in this material is Partners Capital Investment Group, LLP, unless stated otherwise. Opinions expressed are our current opinions as of the date appearing on this material only. We do not undertake to update the information discussed in this material. We and our affiliates, officers, directors, managing directors, and employees, including persons involved in the preparation or issuance of this material may, from time to time, have long or short positions in, and buy and sell, the securities, or derivatives thereof, of any companies or funds mentioned herein.

Whilst every effort is made to ensure that the information provided to clients is accurate and up to date, some of the information may be rendered inaccurate by changes in applicable laws and regulations. For example, the levels and bases of taxation may change at any time. Any reference to taxation relies upon information currently in force. Tax treatment depends upon the individual circumstances of each client and may be subject to change in the future. The Group is not a tax adviser and clients should seek independent professional advice on all tax matters.

Within the United Kingdom, and where this material refers to or describes an unregulated collective investment scheme (a “UCIS”), the communication of this material is made only to and/or is directed only at persons who are of a kind to whom a UCIS may lawfully be promoted by a person authorised under the Financial Services and Markets Act 2000 (the “FSMA”) by virtue of Section 238(6) of the FSMA and the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 (including other persons who are authorised under the FSMA, certain persons having professional experience of participating in unrecognised collective investment schemes, high net worth companies, high net worth unincorporated associations or partnerships, the trustees of high value trusts and certified sophisticated investors) or Section 4.12 of the FCA’s Conduct of Business Sourcebook (“COBS”) (including persons who are professional clients or eligible counterparties for the purposes of COBS). This material is exempt from the scheme promotion restriction (in Section 238 of the FSMA) on the communication of invitations or inducements to participate in a UCIS on the grounds that it is being issued to and/or directed at only the types of person referred to above. Interests in any UCIS referred to or described in this material are only available to such persons and this material must not be relied or acted upon by any other persons.

Within Hong Kong, where this material refers to or describes an unauthorised collective investment schemes (including a fund) (“CIS”), the communication of this material is made only to and/or is directed only at professional investors who are of a kind to whom an unauthorised CIS may lawfully be promoted by Partners Capital Asia Limited under the

Hong Kong applicable laws and regulation to institutional professional investors as defined in paragraph (a) to (i) under Part 1 of Schedule to the Securities and Futures Ordinance (“SFO”) and high net worth professional investors falling under paragraph (j) of the definition of “professional investor” in Part 1 of Schedule 1 to the SFO with the net worth or portfolio threshold prescribed by Section 3 of the Securities and Futures (Professional Investor) Rules (the “Professional Investors”).

Within Singapore, where this material refers to or describes an unauthorised collective investment schemes (including a fund) (“CIS”), the communication of this material is made only to and/or is directed only at persons who are of a kind to whom an unauthorised CIS may lawfully be promoted by Partners Capital Investment Group (Asia) Pte Ltd under the Singapore applicable laws and regulation (including accredited investors or institutional investors as defined in Section 4A of the Securities and Futures Act).

Within France, where this material refers to or describes to unregulated or undeclared collective investment schemes (CIS) or unregulated or undeclared alternative Investment Funds (AIF), the communication of this material is made only to and/or is directed only at persons who are of a kind to whom an unregulated or undeclared CIS or an unregulated or undeclared AIF may lawfully be promoted by Partners Capital Europe under the French applicable laws and regulation, including professional clients or equivalent, as defined in Article D533-11, D533-11-1, and D533-13 of the French Monetary and Financial Code.

Certain aspects of the investment strategies described in this presentation may from time to time include commodity interests as defined under applicable law. Within the United States of America, pursuant to an exemption from the US Commodity Futures Trading Commission (CFTC) in connection with accounts of qualified eligible clients, this brochure is not required to be, and has not been filed with the CFTC. The CFTC does not pass upon the merits of participating in a trading program or upon the adequacy or accuracy of commodity trading advisor disclosure. Consequently, the CFTC has not reviewed or approved this trading program or this brochure. In order to qualify as a certified sophisticated investor a person must (i) have a certificate in writing or other legible form signed by an authorised person to the effect that he is sufficiently knowledgeable to understand the risks associated with participating in unrecognised collective investment schemes and (ii) have signed, within the last 12 months, a statement in a prescribed form declaring, amongst other things, that he qualifies as a sophisticated investor in relation to such investments.

This material may contain hypothetical or simulated performance results which have certain inherent limitations. Unlike an actual performance record, simulated results do not represent actual trading. Also, since the trades have not actually been executed, the results may have under- or over-

compensated for the impact, if any, of certain market factors, such as lack of liquidity. Simulated trading programs in general are also subject to the fact that they are designed with the benefit of hindsight. No representation is being made that any client will or is likely to achieve profits or losses similar to those shown. These results are simulated and may be presented gross or net of management fees. This material may include indications of past performance of investments or asset classes that are presented gross and net of fees. Gross performance results are presented before Partners Capital management and performance fees, but net of underlying manager fees. Net performance results include the deduction of Partners Capital management and performance fees, and of underlying manager fees. Partners Capital fees will vary depending on individual client fee arrangements. Gross and net returns assume the reinvestment of dividends, interest, income and earnings.

The information contained herein has neither been reviewed nor approved by the referenced funds or investment managers. Past performance is not a reliable indicator and is no guarantee of future results. Investment returns will fluctuate with market conditions and every investment has the potential for loss as well as profit. The value of investments may fall as well as rise and investors may not get back the amount invested. Forecasts are not a reliable indicator of future performance.

Certain information presented herein constitutes “forward-looking statements” which can be identified by the use of forward-looking terminology such as “may”, “will”, “should”, “expect”, “anticipate”, “project”, “continue” or “believe” or the negatives thereof or other variations thereon or comparable terminology. Any projections, market outlooks or estimates in this material are forward-looking statements and are based upon assumptions Partners Capital believe to be reasonable. Due to various risks and uncertainties, actual market events, opportunities or results or strategies may differ significantly and materially from those reflected in or contemplated by such forward-looking statements. There is no assurance or guarantee that any such projections, outlooks or assumptions will occur.

Certain transactions, including those involving futures, options, and high yield securities, give rise to substantial risk and are not suitable for all investors. The investments described herein are speculative, involve significant risk and are suitable only for investors of substantial net worth who are willing and have the financial capacity to purchase a high risk investment which may not provide any immediate cash return and may result in the loss of all or a substantial part of their investment. An investor should be able to bear the complete loss in connection with any investment.

All securities investments risk the loss of some or all of your capital and certain investments, including those involving futures, options, forwards and high yield securities, give rise to substantial risk and are not suitable for all investors.