

# University endowment reduces complexity, improves oversight while implementing sophisticated alternative investing program

## THE ORGANIZATION

A private health sciences university comprised of multiple colleges, schools and a nationally ranked hospital. With more than 7,000 employees and 1,100 medical staff, these constituent organizations work together to provide patient care as well as education to future healthcare professionals. The Investment Office is led by the chief investment officer (CIO) and a small staff overseeing five different pools of capital totaling roughly \$3 billion. A portion of the assets are held in the longterm pool, which functions as an endowment supporting the financial needs of the overall organization.

## Challenge 1: Improve the alternative portfolio

While the Investment Office had a solid understanding of the important return and diversification functions that alternative investments played in their current investment strategy, they knew that an improved alternative program could play a key role in helping deliver on the key objectives the University had established for the endowment portfolio. These objectives included:

- › A target return for the portfolio that would support an annual 4-5% spend, net of inflation
- › An increased allocation to asset classes with greater diversification and alpha potential than those in the existing portfolio
- › Reduced portfolio draw-downs
- › A high degree of transparency into underlying investments
- › Improved oversight of the alternatives portfolio without increasing the investment staff

The Investment Office also wanted to implement a more dynamic investment structure positioned to capitalize on potential market opportunities.

## Challenge 2: Resource constraints

The University was highly concerned about their ability to meet the new portfolio objectives given resource constraints. They wanted to increase diversification, increase potential returns, deliver a high degree of transparency, and ensure proper oversight of a growing, sophisticated alternatives portfolio without increasing their investment staff.

## Multiple objectives to manage

The University considered the breadth and depth of the alternatives investment landscape in the hopes of accomplishing three primary objectives:

- › Improve ability to meet investment return goals—given the University’s expectations for rising interest rates and a lower-return environment.
- › Enhance portfolio construction and strategy selection—allocate additional capital to market sensitive hedge fund opportunities, and develop a long-term commitment strategy for diversifying private capital investments.
- › Stronger portfolio oversight—build a more formal process that includes cash flow management as well as due diligence on new—and existing—investments.

Given internal resource constraints, the University needed a more deliberate and holistic solution to allocate and manage exposures across the overall alternatives program.

## A complete alternatives solution: from advice to implementation

Having served as the University’s investment advisor for many years, Russell Investments understood the complex needs and end goals of their investment program and was able to work with the Investment Office to develop an integrated solution from portfolio design through construction and management—all crucial to achieving the desired outcomes for the total portfolio.

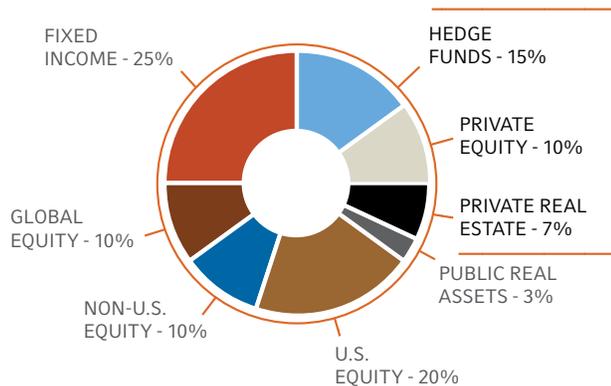
### Portfolio Strategy

Russell Investments conducted a strategic review of the existing investment policy and evaluated various allocation scenarios and their trade-offs with the Investment Office. To support an annual 4-5% spend net of inflation and reduce portfolio draw-downs, Russell Investments recommended a policy increase of 10% to hedge funds and private capital. Implementing this new portfolio mix was intended to:

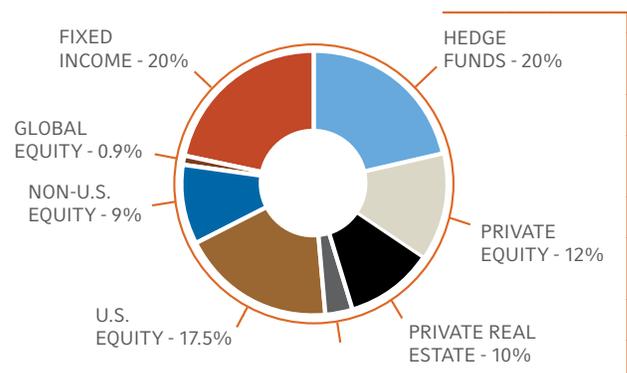
- › Improve diversification by reallocating a portion of fixed income to hedge funds. This would reduce exposure to interest-rate sensitive fixed income while providing a potential source of reasonable returns with historically low volatility (compared to equity markets).
- › Increase return potential by reducing public equity and increasing private equity.
- › Diversify sources of return by establishing a more meaningful position in private real assets alongside private equity.

### EXHIBIT 1: PREVIOUS AND PROPOSED ASSET ALLOCATIONS

Old policy allocation



New policy allocation



### Fund of One

While only available to investors above a minimum asset size, the fund of one structure offers important benefits, including consolidated reporting and full transparency to underlying investments.

Exposures are managed across underlying strategies and can be reported in aggregate or at more detailed levels—by strategy or fund.

Consolidated reporting is provided to the Investment Office across a broad range of key measures including:

- › Performance
- › Risk measures (standard deviation, up and downside capture, beta)
- › Portfolio exposures (geography, industry, type)

## Implementation benefits

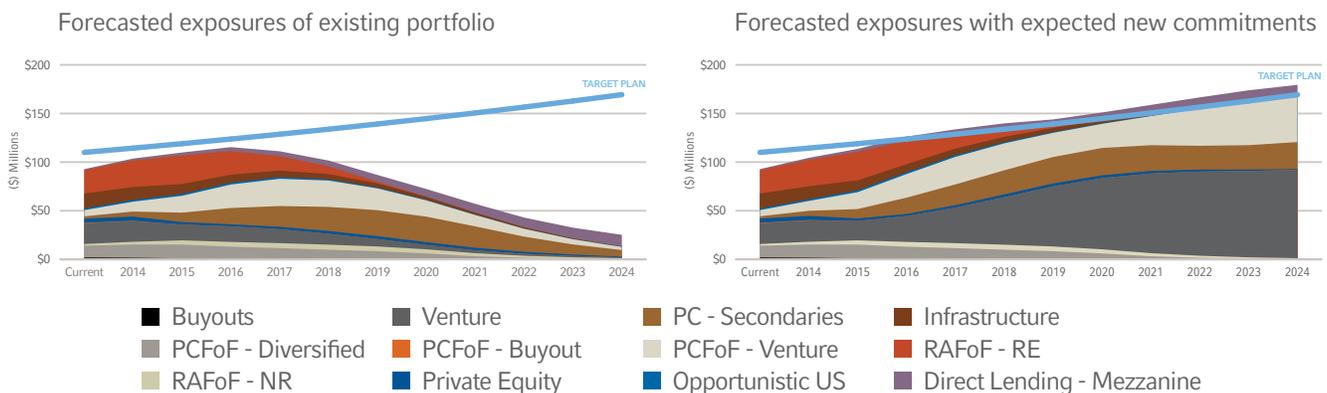
To meet the University’s specific portfolio objectives, Russell Investments created two discretionary investment vehicles—one dedicated to hedge funds and one to private capital. This approach provided a number of benefits:

- › Customization: Russell Investments was able to customize 1) a portfolio of hedge fund exposures designed to improve total risk-adjusted returns and 2) a private capital portfolio intended to further enhance the total portfolio return potential.
- › Implementation Flexibility: Russell Investments employs a wide variety of implementation options depending on client needs and portfolio size. In this case a Fund of One structure was chosen due to the University’s specific requirements (see sidebar on previous page).
- › Expertise and access: To make well-informed investments in either hedge funds or private capital requires breadth and depth of expertise, access to opportunities, and significant resources to conduct due diligence. In hedge fund space, having a deep understanding of the dynamics of equity hedge, event-driven, relative value and tactical trading strategies is critical. Within private capital, expertise is essential in navigating the wide spectrum of available opportunities and investment options (e.g., buyout, venture, private natural resources, infrastructure, etc.).
- › Dynamic portfolio management and timely allocation of capital: Many hedge funds and private investment strategies allow only narrow windows for commitment. With implementation discretion delegated to Russell Investments (within clearly defined boundaries), the University would be able to quickly invest in time-sensitive investments without waiting for the next Investment Office meeting.

As seen in Exhibit 2, the new structure addresses several important issues:

- › Managed growth of private capital exposures with new commitments and cash flow expectations.
- › Diversification of the portfolio within private equity and across private capital strategies based on market dynamics.
- › Integration with legacy portfolio: Our solution was designed to complement the University’s existing portfolio without the need to make drastic changes. This approach allowed a gradual adoption of the new policy allocation and was particularly helpful for investments that could not be easily liquidated.
- › Reduction of administrative overhead and risk: By delegating discretion for portions of the University’s portfolio, the Investment Office was able to relinquish many day to day operational and administrative duties to Russell Investments, leveraging the firm’s extensive middle- and back-office infrastructure. This transition also helps reduce risks associated with managing frequent cash flows.

## EXHIBIT 2: STRATEGIC PORTFOLIO CONSTRUCTION ACROSS PRIVATE CAPITAL STRATEGIES



## RESULTS

By working with Russell Investments, the Investment Office was able to create a common platform for decision-making with Russell Investments acting as a virtual extension of staff. Specifically, the University's investment program was improved by:

- › A customized alternatives program with an increased likelihood of:
  - a) reducing portfolio drawdowns, and
  - b) meeting the portfolio's stated aim of funding an annual 4-5% spend net of inflation.
- › An investment portfolio designed with slightly lower expected volatility and an expected return of 43 basis points higher than the University's existing portfolio.
- › A fund of one structure that enables consolidated reporting and full transparency into hedge fund and private capital investments.
- › A dynamic portfolio management structure positioned to take advantage of fleeting market opportunities between investment committee meetings.
- › Reduced administrative and operational burden for the Investment Office.
- › Reduced risks associated with managing frequent cash flows.

Our unique integration of strategic advice, alternative market insights, research and implementation capabilities, and operational and administrative support has enabled the University to more effectively evaluate alternative investment opportunities and implement them in a timely fashion.

## ABOUT RUSSELL INVESTMENTS

For more than 35 years, Russell Investments has been integrating investment advice, strategy, portfolio construction and implementation to help our non-profit clients better serve their communities. Working with us is simple. We start by gaining a deep understanding of your organization. We consider goals, investment requirements, liquidity needs and risk tolerances, and then work with you to customize an investment solution to help you achieve those goals. Once the plan is agreed upon, we then get to work, implementing your comprehensive investment solution.

### FOR MORE INFORMATION:

Call Russell Investments at **855-771-2966** or visit [russellinvestments.com/nonprofits](http://russellinvestments.com/nonprofits)

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