Fiscal Year 2012 Highlights

Miami’s investment portfolios produced mixed results for the fiscal year ended June 30, 2012. The combined endowment and foundation managed pools produced a loss of 3.27 percent, a notable decline from the previous year’s average increase of 19.6 percent. Meanwhile, the operating pool earned 1.86 percent after earning 2.79 percent in the previous year.

Investment Pools

As of July 1, 2011, Miami University and the Miami University Foundation entered into a pooled investment agreement. Under this arrangement, the Foundation investment committee provides governance oversight to one unified endowment investment pool. This combination allows the staff to realize operating efficiencies, assists in managing cash flow, and maximizes the resources of our talented and dedicated board members.

As of June 30, 2012, total investments held by Miami University and the Miami University Foundation approached $700 million, up from $657 million at the previous year end. The increase largely represented improved University operating cash flow and sustained giving levels. These assets are allocated among the pools as follows:

<table>
<thead>
<tr>
<th>Pool</th>
<th>Type of Funds</th>
<th>Invested as of June 30, 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>University non-endowment</td>
<td>Working capital and cash reserves to support operating activities</td>
<td>$288,953,000</td>
</tr>
<tr>
<td>University endowment &amp; foundation</td>
<td>Funds donated to the university and the foundation to establish endowments in perpetuity</td>
<td>$387,222,000</td>
</tr>
<tr>
<td>Trusts, annuities, and separately invested assets</td>
<td>Gifts managed independently of the pooled funds</td>
<td>$23,821,000</td>
</tr>
<tr>
<td><strong>Total Investments</strong></td>
<td></td>
<td><strong>$699,996,000</strong></td>
</tr>
</tbody>
</table>

The university non-endowment pool holds the working capital and cash reserves that fund the university’s operating activities. Its balance fluctuates during the course of a year based on the university’s cash flow cycle of receipts and expenditures. June 30 typically marks the low point of this annual cycle.

The endowment pool invests endowed gifts from donors. The pool operates under the philosophy that they are invested in perpetuity to provide benefits to today’s students as well as to the many generations of Miami students yet to come. Miami invests the funds with the confidence that economic cycles will rise and fall but that a diversified portfolio will provide the long-term growth necessary to preserve the value of the endowment across the generations. The investment policy governing the endowment pool recognizes that the portfolio can tolerate year-to-year fluctuations in return because of its infinite time horizon, and looks beyond short-term fluctuations toward an investment philosophy that provides the best total return over very long time periods.

The university and foundation also hold assets given by donors in the form of trusts, annuities, insurance policies, and similar assets. These funds are separately managed in accordance with the donors’ instructions.

Over the last decade, the size of the combined endowment pools has nearly doubled through a combination of generous support from our donors and solid investment earnings. We appreciate the thoughtful guidance of our investment committee and the enduring generosity of our alumni and friends as we continue to navigate the extraordinary challenges present throughout the global capital markets.
Asset Allocation

The non-endowment pool has three components. Operating cash represents the University’s working capital and is invested in short-term cash equivalents, with a target balance of two to six months of average cash needs. Core cash represents short-term reserves and is invested in short-term and intermediate-term fixed income investments, also with the target balance of two to six months of average cash needs. Long-term capital consists of longer-term reserves and represents the remainder of the pool. It is invested in a mix of longer maturity bonds and absolute return hedged strategies. During the year, cash flow generation was again very strong, partly due to much improved budgetary trends. This growth in cash continues to present a challenge, however, as short-term interest rates persist near zero. Actions were taken during the year to reduce cash balances in order to increase earnings potential. The result was one new manager in the absolute return space, with additions to several other managers throughout the pool.

The endowment pool’s asset allocation strategy uses three asset categories: equity, debt, and real assets. Within each category, we can gain exposure through three types of strategies: long-only public, hedged, or private. We employ managers that have broad, unconstrained mandates, allowing them great flexibility to pursue opportunities. Most of our managers have a global mandate. At year-end, total equity related strategies represented about 59% of the combined portfolio, down by about nine percentage points during the year. This decline represented both very poor returns from non-U.S. equity markets, as well as actions taken to reduce exposure. Public equity declined by seven points. Hedged debt increased by three percentage points, and a new position was taken in public real assets at a two percent weighting.

Over the last five years, the asset allocation has evolved to reflect perceived changes in the opportunities available in the global capital markets. The portfolio has emphasized a shift away from the highly volatile public equity space and toward credit and natural resources strategies.
Geographically, the portfolio emphasizes managers that invest globally. The concept of geography is often difficult to quantify, since a company we invest in might be domiciled in one country, trade in another, derive its current revenue globally, and perceive its future earnings growth to be in places it does not yet conduct business. The following chart depicts the total portfolio’s exposure over the last five years by broad geographic region.

Over the last decade, we have taken many actions toward a goal of reducing portfolio volatility. The result of these actions can be seen in the chart tracking the standard deviation for the Foundation portfolio versus the Russell 3000, a proxy for the broad U.S. public equity market. During the first half of this period, the general domestic equity market was also experiencing a period of relative tranquility, as measured by the standard deviations. When volatility spiked during the financial calamities of 2008, both standard deviations increased, but the portfolio volatility rose to a much lower extent. Since 2008, public equity volatility has continued to climb, while the portfolio has leveled out. We attribute this relative calm to the success of the implementation of these volatility mitigating strategies.

Miami treats each investment manager relationship like a partnership and, along with its external advisors, expends considerable effort on the due diligence process. The consultants focus on manager research, including back office due diligence, and conduct regular statistical reviews to examine the role each manager is playing in the portfolio. Staff has regular quarterly conversations with each manager to understand their strategic thinking and to monitor their business activity. Ongoing oversight activities include making manager site visits, attending investor conferences, reading trade publications, tracking government filings, and monitoring the managers’ service providers.

In total, the endowment employs 22 external managers, some with multiple mandates. During the year, new relationships were established with three equity long/short managers, a global public equity manager, and a master limited partnerships manager. Three public equity managers were terminated. In addition, the exposure levels to several managers were adjusted.
**Investment Returns**

The university’s non-endowment pool earned 1.86 percent for the fiscal year ended June 30, 2012. Annualized performance for the trailing ten years was 4.04 percent, providing annualized added return versus the 90-day Treasury bill over that period of 2.32 percentage points. The recent results were achieved in spite of sustained near zero short-term interest rates that significantly limit the earnings potential of the majority of this pool.

The endowment pools fell 3.27 percent for the fiscal year, ending two consecutive years of positive double digit returns. Annualized performance for the trailing ten years was 6.20 percent. The pool’s public equity managers, with a collective majority of their capital deployed outside of North America, encountered the most difficulty during the year, with a combined loss of over eleven percent. The balance of the pool posted positive returns, with the best results coming from our various private equity, debt, and real assets managers.

The formula used to calculate the spending distribution is a blend of two elements: an inflation component (70 percent of the formula) that increases the prior year’s distribution by the rate of inflation, and a market factor (30 percent of the formula) that ties the distribution to the market value of the investments. This formula was adopted in fiscal year 2004 and is intended to reduce volatility caused by various market conditions, while maintaining intergenerational equity and preserving the purchasing power of the endowed principal.

For the fourth year, the University and Foundation boards decided to continue the practice of making full distributions only from those funds that have accumulated earnings in excess of the gift value. Partial distributions, representing dividends and interest, were distributed from the funds that otherwise would not have made a distribution.

The following chart shows the types of programs supported by the 2012 distributions. The combined distribution was about $15.9 million, more than double the amount in 2003. Over the last ten years, the cumulative distributions have totaled over $125 million and have provided an important source of funding to help offset reductions in state support.

**Program Support**

Endowments provide a lasting legacy for Miami because their principal is invested in perpetuity, and an annual distribution is made to support a variety of activities of the university. The spending policies of the university and foundation are intended to achieve a balance between the need to preserve the purchasing power of the endowment principal in perpetuity and the need to maximize current distribution of endowment earnings. Fulfilling these dual objectives is often referred to as achieving "intergenerational equity," in which no generation of college students is advantaged or disadvantaged in relation to other generations.

The fund-raising campaign, For Love and Honor, continues to play a major role in shaping Miami’s future. Through the generous support of our faithful alumni and friends, as of August 2012 the campaign had raised over $456 million, with a significant portion pledged to the endowment. Scholarships are among the top fund raising priorities. Improved financial aid resources are expected to enhance student recruitment success, reduce dependence on raising tuition rates, and help alleviate the impact of dramatically lower state subsidies. Your sustained support is appreciated and will continue to be vital to Miami’s future.