Investment Pools

Total investments held by Miami University and the Miami University Foundation experienced significant growth during the fiscal year ending June 30, 2014, finishing the year in excess of $934 million versus $791 million at the previous year-end. This advance in assets is attributable to continued improvement in University operating cash flow, solid investment performance, and sustained giving levels.

The Miami University Foundation’s investment committee provides governance oversight to one unified endowment investment pool for the University and the Foundation, while the University maintains oversight of the non-endowment pool. The fiscal year-end asset values among the pools are as follows:

<table>
<thead>
<tr>
<th>Pool</th>
<th>Type of Funds</th>
<th>Invested as of June 30, 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>University Non-endowment</td>
<td>Working capital and cash reserves to support operating activities</td>
<td>$444,880,000</td>
</tr>
<tr>
<td>University &amp; Foundation Endowments</td>
<td>Funds donated to the university and the foundation to establish endowments in perpetuity</td>
<td>$459,762,000</td>
</tr>
<tr>
<td>Trusts, Annuities, and Separately</td>
<td>Gifts managed independently of the pooled funds</td>
<td>$29,745,000</td>
</tr>
<tr>
<td>Invested Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Investments</strong></td>
<td></td>
<td><strong>$934,387,000</strong></td>
</tr>
</tbody>
</table>

The University’s non-endowment pool holds the working capital and cash reserves that fund the University’s operating activities. Its balance fluctuates significantly 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 combined endowment pool invests endowed gifts from donors. The pool operates under the philosophy that the funds 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 well 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, real estate, and other assets. These funds are managed separately from the endowment pool.

Over the last decade, total investment assets have nearly doubled. The pools have increased in value through a combination of prudent fiscal management, generous support from donors, and solid investment earnings. We appreciate the enduring generosity of our alumni and friends, along with the wisdom and leadership of our trustees and directors, as we continue to traverse this period of unprecedented transformation in both higher education and the global capital markets.

The most significant change for the investment operations during the year involved the transition to a new external investment consultant. This conversion process is expected to continue throughout the next year.
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 high quality 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 due to sustained improvements in University operating efficiency. This growth in operating cash continues to present a major challenge, however, as short-term interest rates enter their sixth year near zero. Several rebalancing actions were taken during the year to reduce operating cash balances and increase the pool’s earnings potential. These moves were accomplished by adding to several existing positions. No new strategies were initiated and no managers were liquidated. As a result, the allocation to long-term capital rose from 52 percent to 60 percent versus last year. The potential for increases in interest rates have reinforced a bias toward absolute return strategies versus traditional bond strategies.

The endowment pool’s primary asset allocation strategy uses three asset categories: equity, debt, and real assets. Within each category, exposure can be attained through three types of strategies: long-only public, hedged, or private. Managers employed tend to have broad, unconstrained mandates, allowing them great flexibility to pursue opportunities. Most of these managers also have a global mandate.

At fiscal year-end, total equity related strategies represented about 55 percent of the combined portfolio, up by about two percentage points during the year. The increase was due to the continued strength experienced in global public equity markets. Elsewhere, hedged debt strategies and public real assets exposure each increased by about two percentage points, while public debt declined by three percentage points. Over the last five years, the primary allocation shift has been away from equity and towards real asset strategies.
Another way to consider the endowment’s asset allocation is through geographic diversity. The portfolio emphasizes managers that invest globally, usually allowing the manager to determine the most opportune places in the world to allocate capital. The concept of geography is often difficult to quantify, since an investment might be domiciled in one country, trade in another, derive its current revenue globally, and perceive its future earnings growth to be in completely new markets. The following chart depicts the total endowment’s estimated exposure by domicile in four broad categories: North America, Europe, Asia, and LAMA (Latin America, Middle East, and Africa).

The third measure of the endowment’s asset allocation is liquidity, or how quickly the exposure to a particular manager can be redeemed and turned into cash. Approximately one third of the portfolio could be converted to cash within seven days, while about one fifth is in various limited partnerships that are considered to be illiquid.

Miami treats each investment manager relationship like a partnership and, along with its external advisors, expends considerable effort on the due diligence process. The investment 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 activities. 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 25 external managers, some with multiple mandates. During the year, new relationships were established with two global public equity managers. One global public equity manager was terminated. In addition, the exposure levels to several managers were adjusted.

**Investment Returns**

The university’s non-endowment pool earned 5.2 percent for the fiscal year ended June 30, 2014, an improvement over the 3.5 percent earned in the previous year. Annualized performance for the trailing five years was 3.7 percent, providing annualized added return versus the 90-day Treasury bill over that period of 3.6 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 absolute return strategies in the long-term capital portion of the pool produced returns in excess of 11.5 percent for the year.
The endowment pools earned an estimated 14.6 percent for the fiscal year. This figure excludes a portion of the private capital that reports on a significant delay. These results mark the second consecutive year of positive double digit returns, as well as four of the last five, and seven of the last ten fiscal years. Estimated annualized performance for the trailing ten years was 7.1 percent. All investment strategies reported positive returns for the year, with public real assets setting the pace with returns in excess of 26 percent.

**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 in relation to other generations.

The formula under which spending distributions are calculated 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.

The combined distribution for fiscal year 2013 was about $18.9 million. This amount, about $1.1 million greater than the previous year, represents the largest distribution ever for Miami, and is 59 percent more than distributed in 2009. Over the last ten years, the cumulative distributions have totaled over $147.8 million and have provided an important source of funding to help offset reductions in state support. The following chart shows the proportion of programs supported by the 2014 distributions.

The For Love and Honor capital campaign officially concluded during the fiscal year. Strong new commitments allowed the tally to surge past its $500 million goal to reach over $535 million, thanks to the contributions of over 105,000 alumni, friends, parents, corporations, and foundations. This outstanding commitment to Miami included 586 new scholarships, 33 new professorships, and several new and renovated buildings. The impact of these enhancements is already being realized through nationally recognized academic accolades and the improving quality of the student body. Moving forward, the primary fundraising priority continues to be enhanced financial aid resources to help make Miami even more accessible and competitive. The entire Miami community expresses our deepest appreciation for helping to make so many dreams become reality.