Investment report

Miami University and Miami University Foundation

June 30, 2015

Investment Pools

Total investments held by Miami University and the Miami University Foundation crossed a significant milestone during the fiscal year ending June 30, 2015, finishing the year in excess of one billion dollars for the first time versus $934 million at the previous year-end. This increase in assets is attributable to continued improvement in University operating cash flow and sustained giving levels, in spite of a difficult investment environment.

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, 2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>University Non-endowment</td>
<td>Working capital and cash reserves to support operating activities</td>
<td>$516,491,000</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>$460,141,000</td>
</tr>
<tr>
<td>Trusts, Annuities, and Separately Invested Assets</td>
<td>Gifts managed independently of the pooled funds</td>
<td>$26,142,000</td>
</tr>
<tr>
<td><strong>Total Investments</strong></td>
<td></td>
<td><strong>$1,002,774,000</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 purchasing power 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 navigate this period of unprecedented transformation in both higher education and 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 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 seventh 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 initiating two new absolute return strategies and adding to one absolute return strategy. No managers were liquidated. As a result, the allocation to long-term capital rose from sixty percent to sixty six percent versus last year. The potential for increases in interest rates have reinforced a bias toward absolute return strategies and low duration bonds.

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 have a global mandate.

At fiscal year-end, total equity related strategies represented about fifty eight percent of the combined portfolio, up by about four percentage points during the year. The increase was due to the addition of capital to hedged equity and coupled with performance experienced in hedged equity and public equity strategies that was relatively stronger than debt and real asset strategies. The reduction in private equity was from the return of capital from mature programs. Real asset exposure decreased by two percentage points primarily due to the impact of falling commodity prices. Over the last five years, the primary allocation shift has been away from public equity and towards public 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).

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 quarterly conversations with each manager to understand their strategic thinking and to monitor their activities. Ongoing oversight tasks 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 27 external managers, some with multiple mandates. During the year, new relationships were established with two global hedged equity managers, one global public equity manager, and one private real assets manager. Two managers, one in hedged equity and one in public equity, were terminated. In addition, two private equity funds made final liquidating distributions.

**Investment Returns**

The University’s non-endowment pool earned 1.6 percent for the fiscal year ended June 30, 2015, down from the 5.2 percent earned in the previous year. Annualized performance for the trailing five years was 3.0 percent, providing annualized added return versus the 90-day Treasury bill over that period of 2.9 percentage points. The recent results were achieved in spite of sustained near zero short-term interest rates that significantly limit the earnings potential of a significant portion of this pool. The absolute return strategies in the long-term capital portion of the pool produced returns in excess of 3.2 percent for the year, and have averaged 8.6 percent over the last three years.
The endowment pools earned an estimated 1.5 percent for the fiscal year. This figure excludes the private capital portion of the portfolio that reports on a significant delay. These results follow two consecutive years of positive double digit returns. Estimated annualized performance for the trailing ten years was 5.9 percent. Hedged equity and hedged debt strategies provided the best returns for the year as managers were able to capitalize on surging volatility. While public real assets provided the highest returns over the last three years, they represented the largest drag on results for the fiscal year due to the significant decline in oil and other commodity prices.

The combined distribution for fiscal year 2015 was about $19.3 million. This amount, about $400,000 greater than the previous year, represents the largest endowment distribution ever for Miami. Over the last ten years, the cumulative distributions have totaled almost $157 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 2015 distributions.

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 annual 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.

Miami’s current fundraising priority, the $100 million Miami Promise Scholarship Campaign, was launched during the fiscal year. It reinforces the institution’s continued focus on attracting high achieving students to Miami, while making the Miami experience more accessible to a wider array of students. Your support of Miami is profoundly impactful in so many ways, and is deeply appreciated by the entire Miami community.