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Future Strategies for Endowments

By Matthew Favreau, CAIA, C(k)P

Matthew Favreau, client advisor at New Republic Partners, shares perspectives on key strategies endowments should consider for future growth and effectiveness.

Times have changed.

Endowments share in the financial impacts brought on by the COVID-19 pandemic, global economic shifts and demographic trends. At the same time, pressure continues to mount for expanded gifting, a dynamic expected to grow over the coming decade.

These trends are especially pressing in the education sector. The "2020 NACUBO-TIAA Annual Study of Endowments,*" published in February 2021, reports three consistent themes emerged from their interviews of college and university business officers:

- Pressure on spending
- Focus on asset allocation
- Investment returns

Spending policies for institutions are under the microscope as needs have increased and contributions have decreased. Findings from the study indicate year-over-year average institutional spending increased from 4.2% in FY 2015 to 4.6% in FY 2020. The trend is even stronger at private universities where spending peaked at 4.9% last year.

Endowment market values have been impacted by a decline in gifting. The study found year-over-year gifting waned by 16%, an unwelcome measure when needs are great.

These trends are not isolated to the education sector. Non-profits of all types are feeling the squeeze and board room discussions are focused on identifying strategies to counteract the impacts.

Sam Bowles, managing director at New Republic Capital, serves on non-profit boards in the healthcare, arts, culture and religious sectors. He reports similar trends across the board investment committees with which he works.

Bowles says, “The increased need for support from endowments and foundations, especially during the pandemic, is universal. Most institutions are now being called on to distribute 4-5% per year.”

Spending policy, in turn, impacts how endowments allocate capital and consider return targets, risk tolerances and liquidity constraints. Given the dynamics of the current and projected market environment, many endowments are moving to new allocation and risk strategies.

The allocation to fixed income has traditionally been viewed as an investment vehicle to generate income and mute a portfolio’s volatility. As shown in the chart below, larger endowments have maintained significantly lower allocations to bonds (11%) than smaller endowments (31%).

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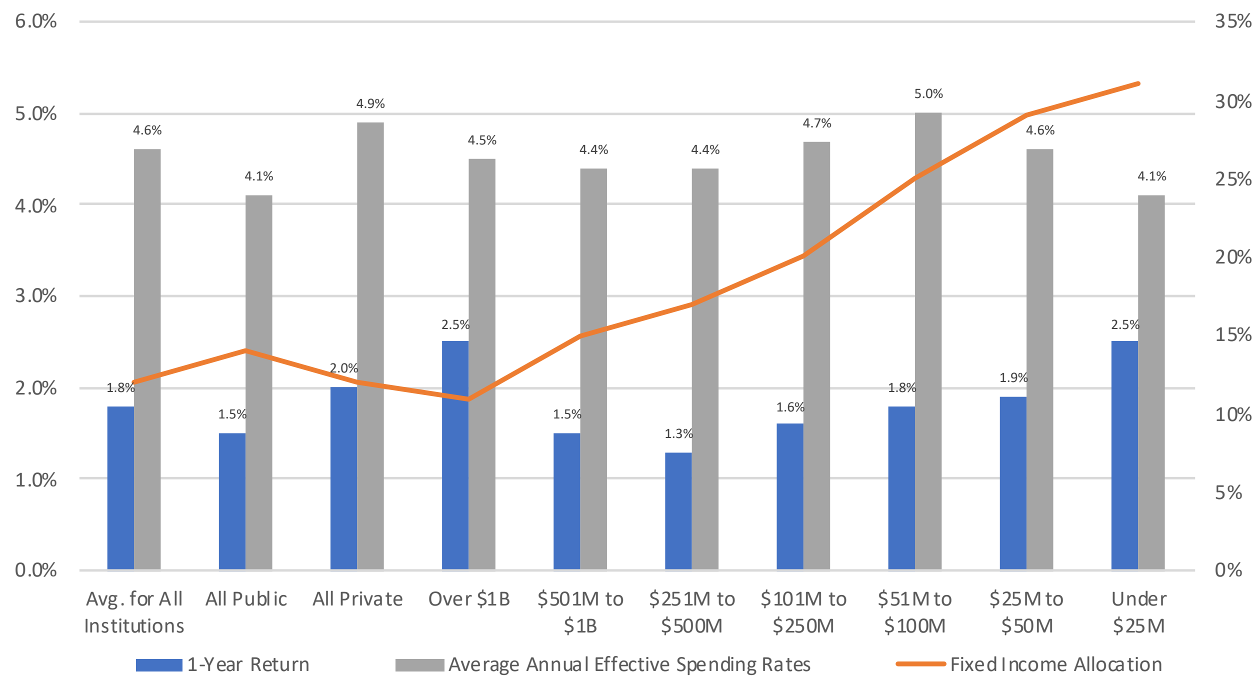
FY 2020 Endowment Data Analysis



Data from the “2020 NACUBO-TIAA Annual Study of Endowments*”

Chart design by Matthew Favreau, New Republic Partners

With ultra-low interest rates forecasted to last for the foreseeable future, most of the non-profit institutions Bowles advises are exploring ways to replace traditional fixed income in their portfolios.

“My clients agree that the role of fixed income in their portfolios has changed as yields have declined and fixed income returns have been very closely correlated with equity returns. Many have moved to private credit to generate higher returns and to absolute return funds to provide a ballast in the portfolio,” says Bowles.

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Just as spending impacts asset allocation, endowment financial performance is closely tied to asset allocation. The NACUBO-TIAA report shows that for the fiscal year ending June 30, 2020, the average and median 1-year return for all institutions was 1.8%. Performance was notably impacted by the COVID-19 pandemic which triggered a significant and rapid price decline in risk assets beginning in late February.

Commenting on return assumptions going forward, Bowles voices concerns, “Generating returns that exceed their distribution policies will become more challenging to these institutions in the future. Asset allocation that includes cost-effective investments in alternative assets and private markets, and has global exposure, will be critical to meet their goals.”

Indeed, times have changed. These challenging market dynamics require endowments to consider new measures to support their short and long-term viability. Well-designed changes in spending policies and asset allocation strategies offer keys to navigating the future.

*NACUBO-TIAA, “The 2020 Study of Endowments,” February 19, 2021.

Matthew Favreau is a client advisor at New Republic Partners. He draws on two decades of experience in financial services as an institutional consultant to endowments and foundations and as a wealth advisor to high-net-worth families and individuals.

To learn more about investment strategies for endowments and foundations, contact Matthew at insights@newrepublicpartners.com.