

# ENDOWMENT REPORT 2017

## PERFORMANCE

The College tracks and measures the results of its investment decisions—asset allocation, manager selection and costs—over time. The appropriate time horizon for an endowment’s investment program is much longer than for an individual investor or a pension plan. Endowments are unique; their perpetual nature creates an ultra-long time horizon for investment considerations—decades, not just years or “market cycles.” Focusing on the long term, the College sets asset allocation targets, management strategies and spending policy and measures investment performance of these variables using modern portfolio tools, benchmarking to the best practices of the largest, most successful endowments as well as to the overall securities markets.

The College’s return for fiscal 2017 was 13.1%. Because the investment return more than offset annual spending for programmatic support, endowed account balances increased over 8.0% this year. Our Managed Investment Portfolio (“MIP” or “endowment”) benefitted from strong markets in US and international public equities. However, our active managers had a difficult time keeping up with the indexes, leading to underperformance versus the market benchmark. Private investments and real estate had good returns this year, while fixed income’s performance was ahead of the benchmark but well below the other assets.

Our longer term performance continues to be very good compared to both market benchmarks and our peers, as shown in the tables. The College has beaten the market over the longer term by astute manager selection and successful, tactical changes in asset allocation. And for those same reasons, based on the latest comparative data shown above, the College ranks among the top 9% of all U.S. college and university endowments for five-year returns, and in the top 14% for ten-year returns. The College and its Investment Committee are dedicated to maintaining top tier investment performance by structuring the portfolio so that future returns will meet our long-term needs while maintaining appropriate levels of risk and liquidity.

### Returns for the Period Ending June 30, 2017 (annualized, net of fees)

	One Year	Three Years	Five Years	10 Years	Inception to Date
<b>Baylor College of Medicine</b>	13.1%	5.2%	9.6%	5.7%	10.4%
<b>Market Benchmark</b>	16.1%	5.6%	9.7%	4.9%	9.6%

### Ranking vs. Other Endowments\*

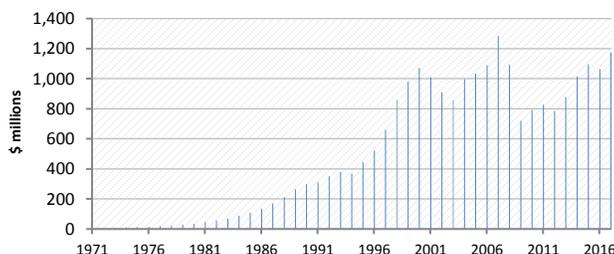
	One Year	Three Years	Five Years	10 Years
<b>Baylor College of Medicine</b>	top 35%	top 20%	top 9%	top 14%

\*latest data available - period ending June 30, 2017

## MANAGED INVESTMENT PORTFOLIO

Baylor College of Medicine’s endowment assets total approximately \$1.2 billion as of June 30, 2017. The endowment consists of hundreds of accounts with a variety of purposes. Donors make endowed gifts funding general College expenses or specified purposes, such as scholarships, department chairs, research projects or other designated programmatic support. Although distinct in purpose and restrictions, the moneys in all accounts are commingled in a single, large investment pool to facilitate efficient management of the assets. The endowment’s growth is highlighted below:

Endowment Total Assets



Within the MIP, each individual account holds a proportionate interest in the pool and is tracked with unit accounting, much like a mutual fund. Therefore, investment performance for each account is identical. Each receives its proportionate share of investment returns and bears its proportionate share of costs, such as management fees, custody fees and consultant fees. Twenty-two outside investment managers, like Fayez Sarofim & Co., J.P. Morgan, Oaktree and others, manage allocated amounts of the MIP.

## MANAGEMENT AND OVERSIGHT

The Investment Committee of the Board of Trustees of Baylor College of Medicine is responsible for oversight of the endowment. The Committee sets investment policies and guidelines, determines asset allocation and sets the spending policy. Nine Trustees currently make up the Investment Committee, chaired by Thomas R. Powers. The Investment Office, led by Chief Investment Officer, William Walker, recommends policies and strategies for consideration by the Investment Committee, implements approved strategies and manages the day-to-day activities of the investment portfolio.

## INVESTMENT GOALS FOR ENDOWED INSTITUTIONS

The College's Investment Committee recognizes that the twin goals of any endowed institution are:

- **Preserving the Purchasing Power of the Assets** – Over time this requires a return at least equal to the percent of assets spent each year, plus the inflation rate.
- **Providing Stable Support for Current Programs**

These goals frequently conflict, as the current financial needs of an institution may discourage the saving and investment necessary to provide future generations with the same level of support (after inflation) being provided to the current generation. The primary focus of the Investment Committee is properly structuring the College's investments and endowment spending to balance the needs of both current and future generations of scholars, scientists, patients and teachers. The College's current annual spending from the endowment (~4.5% of assets), plus inflation (expected to be 2.0–3.0%), combine to create a minimum target return of 6.5%-7.5% for the portfolio. To meet, or exceed, this target over the long term, the Investment Committee has adopted certain key investment principles.

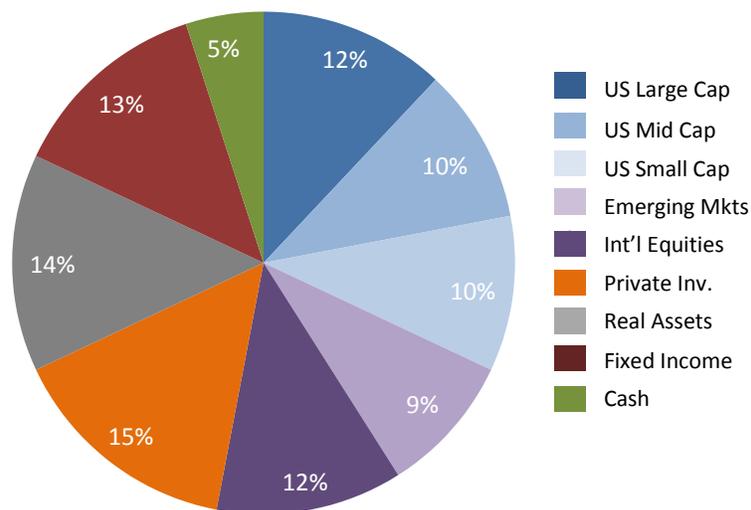
## KEY INVESTMENT PRINCIPLES

- **Invest in Equity Assets** – Equities have preserved the purchasing power of assets over the long term while bonds, although more stable than equities, have not.
- **Broadly Diversify** – Enhances stability, lowers risk, without reducing returns.
- **Use Some Illiquid Assets** – Long-term investors can take advantage of markets' preference for liquid investments by buying assets more cheaply in illiquid markets.
- **Adopt a Contrarian Approach** – Investing in out-of-favor assets is difficult to do, but is a proven way to acquire long-term exposure with a built-in margin of safety and/or to enhance returns.

The Investment Committee began implementing these principles by adopting an asset diversification program more than a decade ago. As market conditions warrant, the MIP's target asset allocation has expanded to reach its current broad and balanced allocation as shown on the pie chart. Asset

allocation changes have been accompanied by successful money manager selections, resulting in substantial value added to the endowment, and a reduction in risk.

## BCM CURRENT ASSET ALLOCATION (AS OF JUNE 30, 2017)



## SPENDING POLICY

The current Endowment Spending Policy is to spend each year 5% of the trailing 28-quarter average asset value of each endowment account. Prior to a fiscal year, distributions are determined for each endowment so that departmental spending can be planned. Each month, one-12<sup>th</sup> of the annual distribution is transferred into a separate Spending Account associated with the individual endowment. If actual spending (for scholarships, research projects or chair stipends) is less than the amount distributed, then at the end of a quarter or year the Spending Account balance is eligible for reinvestment in the endowment's Managed Investment Portfolio. The Investment Committee of the Board of Trustees determines the Spending Policy and approves the annual distribution amount for each endowment unit.

## Levels of Endowment

Minimum levels to establish a named endowment

Lectureship	\$150,000	Professorship	\$1 million
M.S. Scholarship	150,000	Term Chair	1 million
M.D. Scholarship	150,000	Chair	2 million
Doctor of Nursing Scholarship	150,000	Presidential Chair	4 million
Physician Assistant Scholarship	150,000	Laboratory*	5–10 million
Ph.D. Scholarship	400,000	Academic Department/Divisions*	10–25 million
M.D./Ph.D. Scholarship	400,000	Centers*	10–75 million
Fellowship	750,000		

The minimum level to establish a separate named endowment fund is \$25,000. Contributions at any level may be added to established endowments. The donor's wishes with respect to Baylor College of Medicine's administration of endowed gifts are normally set forth in a separate agreement called an Endowed Fund Agreement.

\*Based on size and complexity