



**Professor David Swensen, Wednesday 1 November 2006:  
“Managing the financial assets of not-for-profit organisations”**

Whilst fundraising remains a primary aim of charities, the effective management of those assets under their control is of the greatest importance.

The Institute for Philanthropy, in the second of a series of lectures on this topic, invited Professor David Swensen, Chief Investment Officer at Yale University, to address an audience of leaders in the fields of law, finance, philanthropy and academia.

Professor Swensen considered that Yale’s highly successful investment policy rested upon two fundamental principles. The first was that, if investing funds over a long period of time, it was far better to own assets than bonds. The second was that diversification was crucial. These two principles he said, should be applied to the three mechanisms that both institutional and individual investors used to generate return: asset allocation, market timing, and securities selection. Although these fundamental principles were almost universally agreed upon, they were seemingly disregarded by the managers of institutional funds.

The portfolios of colleges and universities in the United States attested to this claim. In 1985, when he arrived to take up his position at Yale, he found that on average, colleges and universities had invested 50% of their assets in US stocks, 40% of their assets in US bonds and cash and 10% in a small range of alternatives: a limited diversification, where half of the assets were in a single asset class, and 90% were in marketable securities from the same country. He reviewed the position in 2005, and found that there had been virtually no change: half of the assets were still in US stocks, 30% were in bonds and cash, and 20% were in a small range of alternatives. Yale has gone against this trend: the current allocations of its flourishing portfolio are 4% Bonds, 16% US Equities, 13% Foreign Equities, 25% Real Return, 25% Real Assets, and 17% Private Equity.

He and his team had arrived at this position through careful analysis of the three aforementioned mechanisms. Regarding the allocation of assets, he was greatly supportive of an orientation towards equities, so long as those equities were carefully diversified. By contrast, he was disparaging of “market timing”; that is to say, the practice of discerning when share prices would rise and fall, and then selling and buying accordingly. His advice on this issue was simple: “Don’t do it. Develop a sensible, long-term-policy portfolio, and stick to the cardinals. Because we’re human, we’re driven by fear and by greed, and those emotions don’t really help us when it comes to making high-quality investment decisions.” He cited the example of the stock market crash in 1987, where “colleges and universities had a higher exposure to equities than they’d had for 10 or 15 years, and then all of a sudden in one day the markets worldwide went down by 20, 21, 22%, an incredibly traumatic event. It turns out that colleges and universities, fearful because their stocks had just gone down by 20%, went and sold more. And then they went out and bought bonds, because they knew that with their allocations the bonds would go up by the amount of the rally and then some. And so

they ended up buying high and selling low. And even if you do that with great enthusiasm, it's a very difficult way to make money.”

Finally, he discussed securities selection. Here, he examined the spread between top and bottom quartile performance. In bonds he found it to be 0.24% p.a. – around the level of the fees – and that therefore one should index. At the other extreme, in private equity, the difference between top and quartile performance was 18% p.a. He advised that getting in with the best managers could yield massively better returns, and said that his team at Yale concentrated on finding the best managers in the wider, sometimes called alternative, equity asset classes.

The problems that have arisen in the US in relation to insufficiently diverse portfolios – which have themselves arisen, as stated by Professor Swensen, from recurring and eminently avoidable mistakes - are similarly pressing for charitable institutions in this country. In the UK, there is approximately £60 billion of endowment and charitable assets, which have shown an average return of 7.9% over the past ten years. Yale, with the simple methods described above, has achieved an average return of 17.9 % per annum. If UK charities and endowments had achieved the same results, they would be £80 billion richer today. The Institute for Philanthropy hopes that this lecture, and other similar events that it will hold in future, will go some way to addressing this issue.