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Institutions Stay The Course In Perfect Storm

Simply put, the markets are a mess. Even billion-dollar endowment investment officers, lauded for being the pioneers of investing in alternative strategies throughout the years, have been scratching their heads over the past two months.

With the exception of a 900 point swing on Tuesday, the market fluctuations have brought historic lows and not nearly as substantial highs to provide any relief. As the rollercoaster ride continues, institutions contend that sticking to their long-term approaches while remaining opportunistic may be the best formula to cushioning the downturns that they have experienced as of late.

"Clients need to understand this is something we haven't seen for a very long time," said **Bradford Stephan**, investment director for **SEI Investments**' Global Institutional Group in Oaks, Pa. "You can't model this, (the market performance) falls outside the realm of a normal event."

Is There A One Size Fits All Approach?

The possible solutions to easing the pain have been varied among endowments and its consultants, ranging from increasing investments in dislocated credit strategies to decreasing international exposure and even refraining from touching the portfolio at all. What many in the sector have agreed upon at this point though, is that there are little to no consistent themes in the markets that can give anyone a place to hide from the volatility.

"Things have changed, but anyone really knows, you have to stay in the game," said **Michael Jaszka**, v.p. of administration at **Niagara University**, reiterating the words of the endowment's consultant, **Rogerscasey**, at a recent investment conference.

Jaszka said that the investment committee, which is now meeting monthly as opposed to on a quarterly basis, has always looked at the $70 million endowment over the long haul, but given the increase in fluctuations, they will move slowly to rebalance the portfolio.

He said that one of the decisions being discussed is whether to lean towards domestic equity and take away from international equity, which has been down about 30% for the endowment.

Brian Falco, senior v.p. and principal at Atlanta-based advisor **LCG Associates**, said that problems arise when clients jump out of the market during turbulent times, but don't know when to jump back in to take advantage of buying opportunities. Larger endowments do not appear to be scaling back equity investments, he said, since it appears historically that this might be the best time to slightly increase the allocation by 1% or 2%.

He said that despite the size of an endowment, it's often the ones that are most actively involved in their portfolio, in good times or bad, that end up taking advantage of new opportunities. "The ones that are really dialed in and willing to talk often" will benefit, he said, adding that sometimes, taking chances will produce better results as well.

Stephan said that multi-strategy hedge fund managers may prove to have the most flexibility in times like this, along with distressed equity managers that the endowment sector has flocked to over the past few months.

“Now’s a time when you’re really seeing the managers who actually have skill,” he said. “The hood has been lifted on the alternative arena.”

He said that new and potential clients have emerged as well, with many committees taking a step back and reevaluating the decisions made by their advisors, despite the uniqueness of the market crisis the sector is experiencing.

In an open conference call in October, **NEPC**, which consults to a substantial number of larger endowments, advised clients to maintain discipline by focusing on the long-term and rebalancing within policy bands and to diversify by adding strategies that perform in different markets.

The **University of Chicago** endowment, even with its large endowment and top-tier managers, could not hide from the market volatility. The fund, which stood at $6.2 billion as of June 2007, has healthy allocations of 30% to absolute return and 12% private equity strategies. But like other funds their size, they still have seen low, nonexistent or negative returns the past few months.

In regards to its hedge fund investments, University Spokesman **Steve Kloehn** said that the endowment’s relationships with its managers give it a high confidence that the various strategies will work well in the long run. Kloehn added that so far this year, the hedge fund portfolio has performed better than many other asset classes, declining to provide specific figures.

“We have an advantage over other kinds of investors because we have a very long time horizon and because we concentrate on diversification all the time,” he said. “Even in these times we remain confident that our portfolio is well structured for long-term success.”

Last week, **Northern Trust** announced that most U.S. institutional investment plan sponsors reported a fourth consecutive quarter of negative results for the period ending September 30, 2008, according to data in the Northern Trust Universe.

Foundations and endowments reported median returns -8.5% for the quarter. On a three-year basis, foundations and endowments’ are still positive, but not by very much, returning 2.8%.

"In addition to extreme market volatility, plans in all segments were hampered by the underperformance of fixed income programs," said **William Frieske**, performance consultant, in a statement. "The median return for Total Fixed Income Programs in the Northern Trust Universe was -2.8% in the third quarter, compared to a -0.5% return for the **Lehman Aggregate** Bond Index. Two primary factors—duration and credit exposure—were responsible for fixed income program underperformance relative to the bond market index.”

Long-Term Effects On Institutions

Even in prosperous financial times, universities are strapped by a slew of spending obligations that often take big chunks out of their endowment.

Just last month, numerous colleges and universities took a large hit on their short-term investments as **Commonfund**’s $9 billion Short-Term Fund closed due to the resignation of **Wachovia** as its trustee, creating anxiety for officials who had to rely on alternative sources of liquidity to make payroll and fund ongoing construction costs.

“We would hope that things would be getting better with what the government is doing to fix things,” said **David Kandel**, cfo for **Lindenwood University** in St. Charles, Mo., which was not affected by the closing of the short-term fund.

As of Sept. 30, the endowment stood at $75 million, he said, adding that it was down about $7 million from the previous few months. Kandel said that the fund, which handles investments in-house, recently moved some of its funds to cash because the investment committee didn’t like what it was seeing, declining to comment further.

Several weeks ago, institutional consultant **Hartland & Co.** arranged a conference call with clients to convey the message that this is a severe economic and capital market crisis, and that they need to prepare themselves for the volatile environment by calculating their cash flow needs for the upcoming years.

"Nonprofit clients are devastated by the impact this will make on future spending needs," said CEO **Thomas Hartland**. "To get their heads around the psychological aspect of it is a tough thing, but philosophically and process-wise, it makes sense to set money aside to make sure it's going to be there down the line."

Hartland said that the clients that have moved toward the alternatives space over the years were spared from some, but not all, of the volatility of recent months. He said the firm has chosen specific hedge fund-of-funds that will serve as a risk-controlled investment, in addition to bringing in solid returns.

The **University of Chicago**'s president, **Robert Zimmer**, said that the current and rapidly evolving financial and economic situation has created new challenges and uncertainty for organizations and individuals. In a statement to the university community, he said that the institution is evaluating the next steps to take in addressing the financial crisis.

"…There will inevitably be delays in some efforts and possibly some need for setting further priorities. However, it is essential that we remain focused on our ambition for investment in the long-term excellence of the university and the ongoing planning and execution that this entails," he said.

Niagara's endowment not only supports the day-to-day functions of the university, but also supports scholarships and facilities, Jaszka said. He admits that while there is no real impact on the university right now because its spending is on a three-year average, more issues may arise next year depending on the type of rebound the markets receive.

Kandel of Lindenwood said that overall, he is taking the stance of many of his peer institutions, which is staying put until things start to make more sense.

"We're just holding the course, the damage has been done," he said.