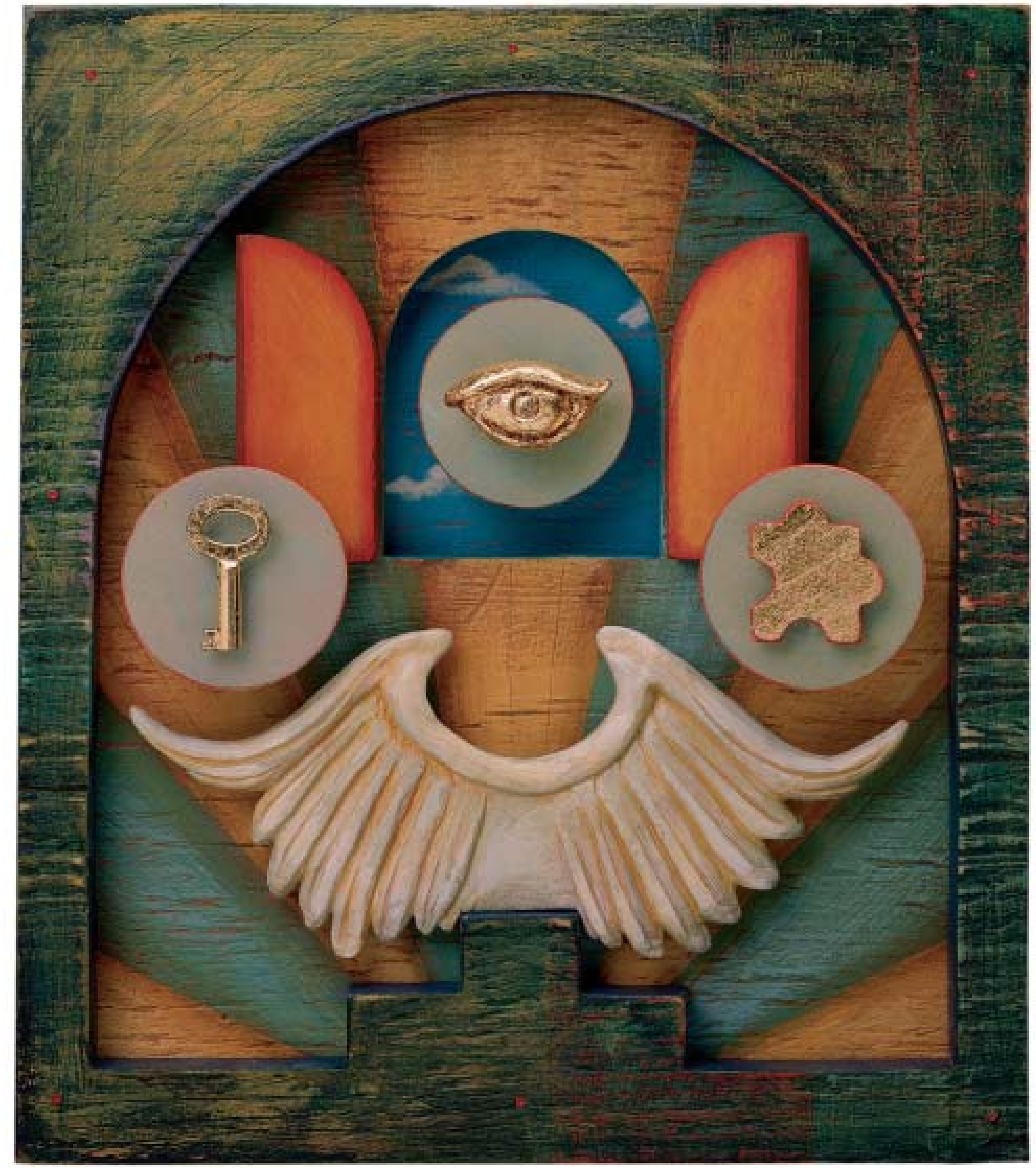
In the Shadow of the '90s

A down market creates new challenges and opportunities for Vanderbilt's endowment.

By Mardy Fones

Just as the '80s and '90s were lucrative for individual investors, so, too, did well-managed private college and university endowments prosper, and Vanderbilt was no exception.

Take the dot-com boom. It was good for Vanderbilt's endowment. Very good. When a $50,000 investment in Juniper Networks and Yahoo was made in 1997, the deals looked promising. But no one could have anticipated exiting those investments in mid-2000 at $110 million in the black.



Illustrations by Maria Rendon

Ranked 21st based on June 30, 2001, figures by the National Association of College and University Business Officers (NACUBO), Vanderbilt's endowment then was $2.1 billion, a combined figure representing the endowments of all aspects of the University, including the Medical Center. Between 1991 and 2001, it grew from just over $500 million to $2.159 billion.

Ranked among just 41 U.S. colleges and universities whose endowments total in the billions, Vanderbilt's endowment performed well—an average of 16.7 percent annualized rate of return between 1996 and 2001. But the current bear market, events of Sept. 11, the ongoing war on terrorism, and the threat of war with Iraq are challenging all top-performing endowments. Between 2001 and 2002, Vanderbilt's endowment was down 6.7 percent, and the University wasn't alone. Overall, most endowments nationwide ended the year in the red, according to NACUBO. (Among the billion-dollar endowments, only six were in the black.)

It's the first down economic cycle most university endowments have experienced since 1974. For donors, Board of Trust members, and others in the Vanderbilt community, the task is preserving and growing the endowment in what is predicted to be a coming decade of flat to negative growth.

Anatomy of an Endowment

Nothing is ever as simple as it seems, and Vanderbilt University's endowment is no exception.

The endowment consists of about 2,300 individual endowments, and their donors determine each one's purpose. Some are for individual scholarships for graduates from a specific high school or county. Others are for the planting of trees on campus. Some generally are designated for a particular school within the University while others target a program or service within a school.

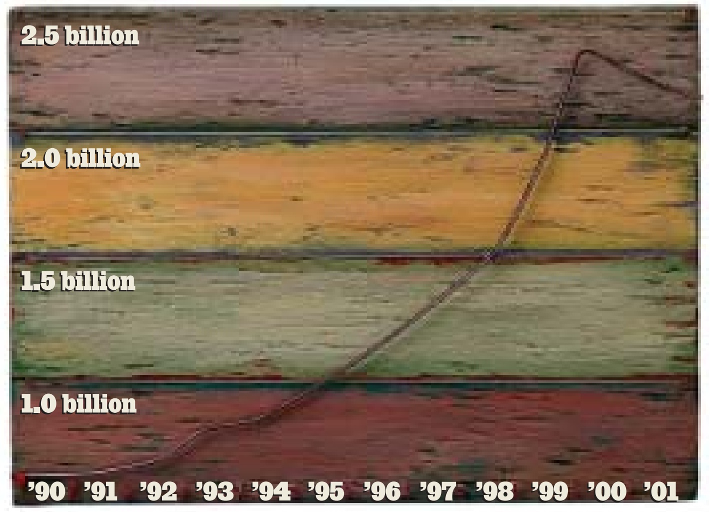
According to William T. Spitz, University treasurer and vice chancellor for investments, 85 percent of the endowment is restricted to a specific purpose. That percentage, he says, is typical nationwide among colleges and universities.

"The endowment functions much like a mutual fund," says Spitz, explaining endowed dollars are used by the entities to which they are designated to "buy" shares in the endowment. "These shares are placed in a large pool (the endowment), and then a dividend per share, based on the endowment's revenues, is paid out." The University is legally accountable for ensuring the endowment's payouts are allocated to the recipients, schools, programs and services donors have designated.

Each year's dividend is based on the average value of the endowment during the previous three years. In 2002 that dividend was about $3.20 per share; in 2001 it was $3.25 per share.

"We had a big year in 2000 (+32 percent), which offset the negative returns in 2001 and 2002," says Spitz, referring to the three-year average. "Next year, the +32 goes away (and the dividend will be based on the averages of 2001–03), which is why the dividend will probably be down about 10 percent."

Endowment Growth Over 10 Years



Fiscal Year

New Challenges, New Opportunities

Currently, university endowments nationwide are being measured not in the double-digit gains of the past 20 years, but primarily in single-digit losses. The good news is that this same group soundly outperformed the Standard & Poor's 500 stock index in fiscal year 2002, which was off by -19.2 percent.

Moody's Investors Service, in a report on the outlook for private colleges and universities for 2001–02, applied a long view. "Excellent investment and fundraising success over the past decade left the market-leading colleges and universities in a good position to withstand the poor investment climate," said Moody's, a global credit rating, research and risk analysis fund. "Should negative returns in financial market results persist, operating spending by colleges and universities will eventually have to be scaled back."

It's a foreboding forecast, but one that Eugene B. Shanks Jr., BA'69, who chaired the Vanderbilt Board of Trust's Investment Committee during the go-go 1990s until 2002, understands. "The only free lunch is diversification. You can't insulate yourself completely from market fluctuations, but you can invest across the market," he says. "As a result, while it's true we've been buffeted, it's not nearly to the degree other endowments have experienced."

In fiscal year 2002, Vanderbilt's endowment provided $103.8 million to the University's total operating budget of $1.559 billion. Vanderbilt's financial gurus anticipate little endowment growth in the next few years, which raises the specter of belt-tightening measures within the University's operating budget. At the moment, says Lauren Brisky, vice chancellor for administration and chief financial officer, "We're looking at ways to make central administration more efficient and effective. Savings from such streamlining will be redirected to academic areas."

An Endowment Primer

Commodore Vanderbilt's initial $1 million endowment in 1873 (the equivalent of $14.3 million today) is a foundation upon which the University is still building.

While some view the endowment as a piggy bank waiting to be cracked, the reality is far different. An endowment is a perpetual fund. Endowment gifts themselves are not spent. Rather, the amount given (the corpus) is invested; the income from the corpus is dedicated exclusively to the specific use as defined by the donor.

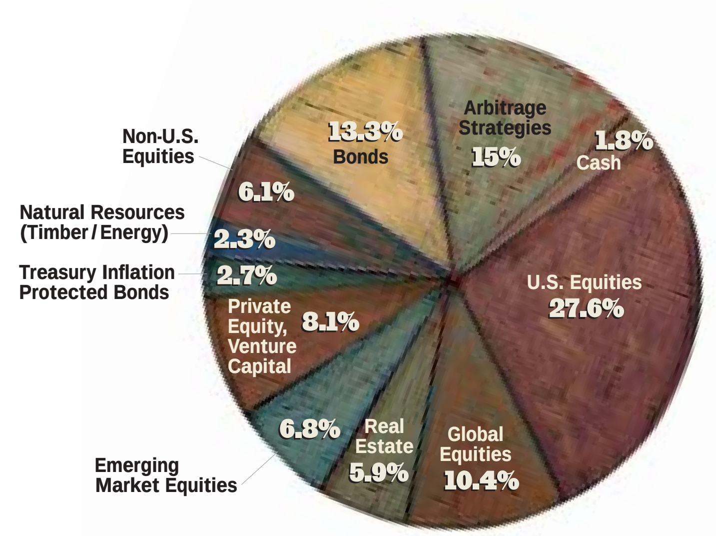
Each year about 4.5 percent (.5 percent less than the national average) of the endowment is paid out to help support faculty salaries, faculty chairs, scholarships, and general and individual school operations. The balance, including the corpus and interest or revenues, is plowed back into the endowment to benefit future generations. (Vanderbilt keeps its payout below the national average to facilitate ongoing endowment growth.)

"The endowment is a long-term horizon for the University. Many people look at the size of an institution's endowment and say, 'Look, they're rich; they could be spending that,'" says Shanks, who regularly is approached by alumni and others asking for endowment dollars to invest in the next "sure thing." "If you start on that undisciplined route, pretty quickly you end up with no endowment at all."

Deciding on Discipline

Discipline is fundamental to endowment growth, says William T. Spitz, University treasurer and vice chancellor for investments. The Investment Committee, based on recommendations from Spitz and his staff, approves targeted levels of exposure for each of the endowment's investment categories. The in-house staff then identifies, screens and closely monitors external firms with expertise in facilitating day-to-day investments in identified sectors. Overall, Vanderbilt's endowment consists of 150 total investment vehicles managed by approximately 60 different organizations.

Current Allocation of Endowment Investments



Even as external managers and firms have daily responsibility for endowment investment, Spitz and his staff have the discretion to adjust investment levels within the parameters set by the Investment Committee, which is made up of five trustee members and three alumni, non-trustee, voting members with finance expertise. No limitations are set on the investments into which endowment dollars

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Into the Fray

Preserving the endowment in a down market

A slam dunk—that's how William T. Spitz, Vanderbilt's treasurer and vice chancellor for investments, describes college and university endowment growth in the past 20 years. Today's modest returns mean finding new options, exploiting niches and taking risks. The objective? Capitalize on undetected segments of the market that are poised for growth.

The marketplace has changed, and Vanderbilt is changing with it. "It's a sloppy market out there," says Joe Roby, BA'61, member of the Vanderbilt Board of Trust and current chair of its Investment Committee. "The biggest challenge lies in making significant growth for the endowment in a market where returns are lackluster." That, says Roby, who is chairman emeritus of Credit Suisse First Boston, calls for new strategies that are outside traditional markets, as well as working strategically with investment managers who can manage both long-term and short-term investments.

Art of Intelligent Risk Taking

Arbitrage, the simultaneous purchase and sale of a security to profit on a differential in price, is one approach because it allows Vanderbilt to benefit from targeted opportunities. "We shouldn't be overly afraid of risk because investing is the art of intelligent risk taking," says Spitz.

"We have a conservative overall approach," says Roby. "We insist on diversification and consistently reject outsized concentrations in particular sectors." University portfolio managers are looking to indexing in more liquid market segments where the relative returns are small but targeted. Indexing is an investment strategy in which a portfolio is designed to mirror the performance of a stock index, such as the Standard & Poor's 500 or other investment class.

We Are Not Alone

John Griswold, senior vice president of Commonfund Group, which manages $29 billion in endowments and cash reserves for 1,600 institutions, says losses have occurred nationwide.

His organization's study in summer 2001 of 617 colleges and universities found that losses of -3 percent were typical; some were as high as -30 percent. "Even smart universities took hits," says Griswold, explaining such economic times call for courage, patience and perseverance. A marketplace where the next big money is increasingly difficult to find demands fresh approaches. According to Griswold, this requires ferreting out and grouping together unrelated asset classes as investments. The net result is reduced risk as these classes tend to move in different cycles.

The bottom line? The party is over. Only those who work hard to grow their endowments will profit, and those profits will be incrementally smaller than in the past two decades.

"Historically, bear markets last from five to 10 years," says Roby. "We're already seeing signs that the market has found its bottom. The Vanderbilt endowment has done well over the long view and we expect it to continue to do well relative to various measures of investment performance."

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before the sprint down the homestretch to final exams and the winter holiday break.

By January, many freshmen—now wise of the ways of the University—contemplate changing their majors while seniors plan the next step. Faculty members and administrative leaders write letters of recommendations for those applying to graduate school and perhaps offer career advice to those they may have closely mentored.

Out of step with much of the rest of the world, spring on a college campus is a time to say goodbye. As the seniors study (or not) for what will truly be their final exams, crews begin pitching huge tents and arranging more than 23,000 chairs weeks in advance of Commencement. Soon some 2,800 graduates will realize the fruits of seeds they planted more than four years ago. By lunchtime on the first Friday of May, empty chairs and discarded programs will litter lawns across campus. By the following morning, the cycle that has come full circle 127 times to date will again have ended—and at precisely the same moment, a new one will have begun. **V**

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are placed, although Shanks says Vanderbilt excludes from its investment portfolio "companies where what's being done isn't completely transparent."

"Our goal is to maintain or increase the inflation-adjusted value both of the corpus and the annual transfer to the operating budget," says Spitz. "Fundamentally, it's about providing for future generations the same purchasing power that current generations enjoy, to earn the minimum return to preserve the inflation-adjusted value."

Moody's Investors Service has observed that in the past three years, private philanthropy increasingly favors colleges and universities that already are well endowed. In effect, success begets success. In that sense, Vanderbilt is well positioned and will continue to benefit from its ranking among institutions that measure their endowments in the billions.

At the same time, in 2001, Vanderbilt ranked 51st among like institutions based on the value of its endowment per student, widely acknowledged as a more targeted measure of an endowment's impact. Endowment-per-student is an indication of how much of the full cost of a student's education can be underwritten by the endowment. A larger number indicates a university could cover a higher percentage of a student's cost. In Vanderbilt's case, according to the 2001–02 annual report, that was $211,851 for each of its 10,194 total students. By comparison, Duke was at $278,023 for each of its 11,263 students, and Harvard was at $971,225 per each of its 18,012 students.

"The best measure of an institution isn't the total of its endowment, but rather endowment assets per student," says Spitz. Vanderbilt's relatively low endowment-per-student ratio is just one of many challenges that keepers of the University's endowment face in the coming decade.

"Are we fat and happy? No. It's one of the reasons we must be diligent. And we must continue to be good stewards of our money," says Shanks. "The next 10 years will be different. The period we saw in the '90s won't repeat itself, so it will be hard to have the kinds of endowment gains we've enjoyed. Having said that, we're fast followers of viable market trends." **V**

In Class *continued from page 28*

"The National Association for the Advancement of White People," says Reno Wolfe, the president of the group, "was set up to get us back to the point where everyone is seen as created equal. … We just want to return to the ideal in which racially based policies of affirmative action and special privileges and special programs of any kind which are given to anybody, no matter what their race, are viewed as contrary to the best interests of race relations here in America."

Swain believes that for many white nationalists, something more sinister lies beneath the veneer of sweet reason. There are extremists who dream of a racial holy war, or a white-only nation where people of color are no longer welcome. But Swain is worried less about the lunatic fringe—the people who make no secret of their hate—than about the new-style leaders on the radical right who have found a set of issues to broaden their appeal.

The most volatile of those issues is affirmative action—those race-based preferences in hiring, government contracts and college admissions that have been a part of public policy since the 1970s. White Americans overwhelmingly see the policy as wrong, a violation of the promise of Martin Luther King that the fundamental goal of the civil rights movement was a color-blind society where people were judged "not by the color of their skin, but the content of their character." As Swain believes, social and economic forces are at work that add a level of urgency to the issue. Whites are a minority in many large cities, and according to current demographic projections, they will be a minority in the nation by the year 2050. Add to that a layer of economic uncertainty, and Swain is convinced that many white people are primed and ready for the message of extremists.

"The issues that the new white nationalists champion are also those that are on people's minds," she says. "They paint a picture that is very frightening, and my worry is that if whites get caught in identity politics—if they see themselves as a distinct racial group whose interests are ignored by their leaders and the government—they may be drawn to the more extreme elements. They may feel like they have no other place to go."

Swain's solution is simple—and shocking to many white liberals and blacks who still see affirmative action as essential. She wants to abolish all race-based preferences, and more than that, she sees the need for a new way of thinking. She is impatient with African-Americans who are spending their energy on symbolic issues like the banning of the Confederate flag in public places. She also opposes the call for reparations, an idea that seems to be gaining momentum among an important segment of the black population. Swain says she understands the shameful history of slavery and the impulse to seek compensation. But those issues, she says, are bitterly divisive and ultimately irrelevant to the most urgent needs still facing black Americans.

In poor neighborhoods especially, there are life-and-death problems of crime and drugs and single-parent homes where children drift too often into trouble. But instead of searching for creative solutions, Swain main-

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