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THE ROLE OF ENTERPRISE RISK MANAGEMENT IN NOT FOR PROFIT UNIVERSITY AND COLLEGE ENDOWMENT PORTFOLIO STRATEGY

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The role of the endowment portfolio is first and foremost to minimize the probability of negative outcomes that could impede the university in attaining its mission. All aspects of portfolio construction and performance expectations should revolve around this central theme.

As a university board chair, a trustee and investment chair for a university foundation, a professional money manager and a student of risk management, I have been intrigued and disappointed with the assortment of methods employed to structure the "optimal" endowment portfolio and the various approaches to defining portfolio success. Many approaches are unintentionally ill-advised: the definition of risk as the standard deviation of returns, the Sharpe ratio as a relevant measure of risk-adjusted returns, the overriding focus on absolute and benchmark relative rate of return, the seemingly unquestioned adoption of the Yale model, complexity almost to a point of confusion, the tendency to trust that the unknowns can be known with enough hard work and study, and the belief that not-for-profit universities can wait decades for the expected investment returns to materialize. While each of these approaches, at any particular point in time, may have a place at the table, they all miss the mark on what is most important. Unfortunately, governing boards are often lulled into a comfort zone, taking solace that they are perhaps within some industry norm, not understanding the norm is often irrelevant for their institution.

TAKEAWAYS

The enterprise and financial risk assessment provides the foundation on which to make informed judgments as to the appropriate level of performance risk and uncertainty to be assumed in the endowment portfolio.

Expect the unexpected, be prepared for the unexpected and be doubly sure that the unexpected does not put the university's mission at risk.

Given the myriad of challenges facing most universities over the next ten years, few have the financial strength and competitive advantage for the endowment portfolio to assume an aggressive growth driven asset allocation strategy; consequently, most institutions should be resolute on an asset allocation strategy focused on managing potential drawdowns to an acceptable level.

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So what is important and where should the board focus its attention? Each university should have a board approved mission statement with well-defined strategies and tactics designed to guide the institution to its ultimate destination. The mission is the destination, strategies the roadmap, and tactics the means/methods, each of which comes with a set of expected outcomes. The unavoidable possibility of a negative outcome compared to expectations (risk) and the probability (uncertainty) that results will fall short of expectations are always present. The role of the endowment portfolio is first and foremost to minimize the probability of those negative outcomes that could impede the university from attaining its mission. All aspects of portfolio construction and performance expectations should revolve around this central theme.

A CHALLENGING ENVIRONMENT AND AN UNCERTAIN FUTURE

The higher education industry and competitive landscape is complex and will become more so in future years as institutions struggle to maintain market share in an environment where fewer high school graduates fill the enrollment pipeline. Additionally, because many households cannot afford college and those that do are more demanding in their expectations, these students are challenging the cost versus the benefit, especially with murky employment opportunities. Students are demanding greater tuition discounts and scholarships, and universities have to comply in order to maintain current enrollment levels against inflationary cost pressures to retain leadership and faculty, facility and academic quality, and ancillary services. Unrestricted and net operating margins are likely to remain under pressure and for some universities, while relevancy, sustainability and even survivability become major concerns.

Figure 1

The uncertain higher education landscape is not only just an issue to deal with tomorrow, but is also being manifested in today's challenges. Currently, tuition growth in 50% of college and universities is not sufficient to keep up with inflation, forcing many tuition dependent universities into a crisis mode, resulting in few investments in the future, cut back or elimination in programs, faculty layoffs, privatization of student housing and mergers. Houghton President Shirley Mullen best described this predicament saying, "I don't believe there is any going back. I think that whatever happens going forward is something different than what we have seen before. I don't think we know what that is going to look like."

THE ROLE OF ENTERPRISE RISK MANAGEMENT (ERM) – AN OVERVIEW

This article does not purport to provide an in-depth examination on enterprise risk management; rather, it is designed to provide boards with an appreciation of the importance of ERM in developing a sustainable endowment portfolio strategy that meets the unique needs of the institution.

ERM is a formalized process that seeks to optimize desired outcomes while identifying, prioritizing and mitigating those events and occurrences that may inhibit the institution from fulfilling its mission.

It does not take a wizard to understand that the successful attainment of the university mission requires a sustainable business model, balance sheet, operational integrity, profitable revenue growth, and the right leadership, faculty and board governance. Each of these broad objectives carries desired outcomes and a set of key drivers that must be attained to maximize the probability of a successful outcome.

Within this context, risk is the failure to successfully execute, carrying a degree of uncertainty or the probability of a negative outcome to expectations. The ERM process ensures that plans are developed to remediate key driver risks and uncertainties, accountability is assigned and a method is in place to monitor and report on progress. The ERM process must be on-going, all-inclusive, and focus on the future, while learning from the past.

For example, profitable revenue growth (as defined by the university) is dependent on growth in net tuition, gifts and grants, and endowment support all while appropriately managing expenses. Desired and expected outcomes and key success drivers are developed for each strategy and ultimately quantified. In an intensely competitive environment, expected enrollment growth can only be realized if the university meets and exceeds stakeholder expectations and maintains a stellar reputation. Expected growth in gifts and grants is predicated by several forces: reputational excellence; understanding and exceeding donor expectations; sufficient depth, breadth and diversity in the donor pool; and the right technology and leadership in external relations.

Endowment spend is an important revenue source for most universities and endowment earnings an important contributor (or detractor) to the change in net assets and balance sheet integrity. As such the university seeks a growing endowment to provide for current year support and the support of future generations. However, growth cannot happen without the success in growing gifts, the spending policy, the asset allocation strategy and, of course, the uncontrollable market influence.

Successful execution requires the ability to attract and retain quality leadership and faculty as well as sufficient depth and breadth within the board of trustees. Successful execution requires a supportive balance sheet (financial strength and flexibility), and operational integrity (systems, procedures, disaster plans, cybersecurity, donor records, student records, etc.).

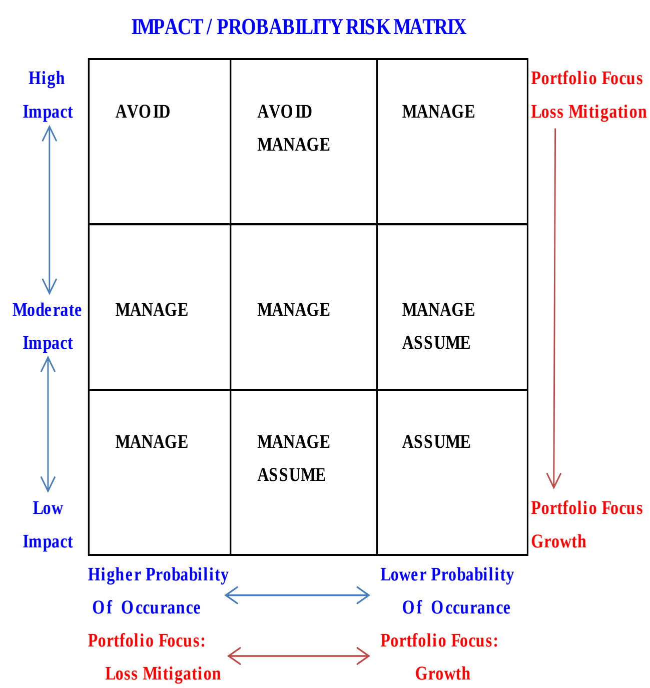
Lastly and perhaps most importantly, success is built on a sustainable and flexible business model. The days of a high tuition, high overhead, one size fits all operating model are long past. Prosperity is built on relevancy, and those institutions who fail to remain relevant are those where survivability rather than sustainability becomes an issue. Relevancy requires the flexibility to adapt to a changing landscape without giving up core principles. Flexibility to adapt requires both the willingness and capacity to do so. Comfortable being comfortable is not an option.

ERM is the glue that binds this complex mosaic. It is the forum to understanding all of the institutional risks and uncertainties and the connectivity and correlation of those risks and uncertainties.

LOW PROBABILITY, HIGH IMPACT; HIGH PROBABILITY, LOW IMPACT

Through the ERM process, the university seeks not only to minimize the probability of a negative occurrence in relation to expectations but to also avoid those high-to-moderately-high probability or high-impact events.

Figure 2 – Impact and Probability



Given the higher education landscape and competitive environment, a majority of enterprise risks in the moderate to high impact zones would be expected. Concern is elevated where high impact risks are associated with a moderate to high probability of occurrence and/or where management's assessment is that the risk is not fully understood, accountabilities are not in place and/or remedial action is weak. For example, acceptable and competitive academic outcomes are non-negotiable if the university is to achieve net tuition growth and growth in gifts and grants. Failure to deliver would be a high impact outcome. A low probability of delivering quality academic outcomes combined with the higher impact would certainly be of greater concern. Those concerns would be heightened further with likely changes in federal financial aid (Pell grants and other forms) tied to affordability, accessibility, and student outcomes.

It is here that endowment portfolio strategy evolves as a stabilizer, an anchor. Simply, the greater the exposure to higher negative impact, higher probability occurrences, the more the endowment should be focused on the mitigation of both portfolio losses and volatility in spending distributions. This philosophy assumes that risk and uncertainty should be first shouldered in the core business where the potential rewards to mission critical success are greater.

ERM CORRELATION AND CHAIN EVENTS

The correlation of risk and uncertainty should not be underestimated as what may seemingly be a manageable probability on a case by case basis can quickly become a high impact event. This certainly became unexpectedly apparent in the 2008 – 2009 "perfect storm" environment with the concurrent (a) external stress on student enrollment, (b) an increase in tuition discounts to maintain enrollment levels, (c) a reduction in annual fund contributions, (d) a deferral in committed capital campaign contributions, (e) a material reduction in investment value, (f) a subsequent material reduction in endowment distributions (more so for those using historic values), and (g) for many institutions, a notification from the government that student aid was at risk. Some may say that this was a 100 year flood that we will not see again in our lifetime. It would be naïve to ignore history's lessons and naïve to assume that other unanticipated, yet to be imagined, black swans will not be experienced.

Related is the "chain reaction" that likewise should be fully appreciated. While the correlations may not be causal, the chain reaction carries a direct cause and effect.

> **Failure to achieve academic outcomes** > student/parent/family expectations not met > prospective students choose another university and current students transfer > net tuition declines > programs cut or suspended > faculty layoffs > **reputation suffers** > current and prospective donors cancel or defer gifts > further reduction in enrollment …
>
> **Failure to comply with donor intent** > adverse publicity > lower gifts and grants > fewer resources for student scholarships > reduced enrollment …
>
> **Loan covenant breached** > financial integrity of institution questioned > adverse publicity > stakeholder trust deteriorates … The rest of the story

In an instant-communication world, the "blow-up" potential of chain reaction events should not be underestimated.

A WORLD OF PREDICTIONS AND PROBABILITIES

Critics of ERM may suggest that the process presented here is irrelevant in an unpredictable future and just as we try to predict and plan accordingly, an unexpected, high-impact outlier appears, destroying the best of plans. They may also point to the futility of seeking to place mathematical probabilities on uncertainty, given the tendency to overestimate the likelihood of positive outcomes and underestimate the likelihood of negative outcomes. Such positions lose sight of the fundamental nature of the ERM process which (a) does not seek to predict but seeks to understand the myriad of negative outcomes to expectations that may happen and (b) does not seek to place mathematical precision on probabilities but seeks to appropriately mitigate high impact negative outcomes to avoid a high probability. There is a difference.

Most would agree that the 2008 higher education perfect storm was an outlier, a high impact event way outside the norm. Could this event have been predicted? Certainly not. Through an effective ERM process, should an event such as this have been recognized as a possibility? Absolutely! If recognized, would it have been classified as a high impact event? Certainly. If recognized as a high impact, would it have been possible to assign probability with any integrity? Probably not with any mathematical precision, but simply because the possibility and impact was identifiable, this provided the opportunity to implement strategies to avoid a higher probability of occurrence.

TAKEAWAYS

Effective board governance requires a robust enterprise risk management process where impediments to mission success are fully identified and appropriately managed.

Seldom associated with endowment portfolio strategy, the state of the enterprise risk management process has direct and consequential implications to endowment success and must be considered by the board in all decisions concerning the assumption of investment risk.

The level of risk and uncertainty assumed in the endowment portfolio is directly proportional to the amount and degree of risk and uncertainty identified through the ERM process.

A university with a robust ERM process is a university that fully comprehends (a) what it will take to achieve the mission, (b) those mission critical areas that need strengthening, and (c) those areas deserving the allocation of scarce resources. It understands the risks and the associated probabilities of negative outcomes to expectations and plans accordingly, choosing to avoid, transfer or manage selected risks. A university without a robust process manages with a severe handicap. And while the mission may be attained, it is by luck, not skill. Unfortunately, a recent survey by the AGB found that 60% of respondents said that their institution “did not use comprehensive, strategic risk assessment to identify major risks to mission success, and fewer than half of the respondents cited that they mostly agree with the statement “Board members and senior administrators are truly engaged in discussions regarding institutional risks.” How unfortunate!

THE BOARD'S ERM RESPONSIBILITY AND KEY QUESTIONS FOR THE BOARD

Because ERM can be a formidable and time intensive process, a university board should fully understand the outcomes. To fulfill governance responsibilities, board members should be fully knowledgeable of key strategic issues, desired outcomes, drivers of those outcomes, management's assessment of the risk and uncertainty of associated negative outcomes and remediation plans. While the board may delegate ongoing oversight to a standing committee, it is the board's responsibility to ensure a functioning and effective ERM process, a responsibility that cannot be delegated. Among the more pertinent questions are the following:

> Does the university have a functioning ERM process? Is the process comprehensive and does it adequately identify those key events that could impair attainment of the mission? Are accountabilities in place and action plans developed to remediate shortfalls? Does a standing committee of the board periodically review the process, conclusions and action plans? At least annually, is the plan presented to the full board?
>
> Are correlation and chain reaction events thoroughly understood and appropriately weighted?
>
> Does the university have a board approved mission, vision and strategic plan (periodically evaluated and revised for changing conditions) providing specific milestones, guidance and direction over the next 10 years? Is the mission and are the strategies realistic? Are the institution's core competencies reflected in the mission and strategies?
>
> Does successful execution of the mission and strategic plan ensure institutional relevancy? Does management fully understand the current and anticipated competitive and industry landscape? Does the institution have the ability to adapt quickly to a highly competitive and rapidly changing environment?
>
> Are there any outstanding current or potential issues associated with accreditation or retention of the university's non-profit status?
>
> Does the university have committed and qualified management and faculty leadership to successfully execute the plan? Are retention plans in place? Are current compensation and benefits plans sufficiently competitive? Is the university culture accommodative to acquisition and retention?
>
> Do current academic and housing facilities meet or exceed student expectations and thus support enrollment goals?

Is the university keeping pace with student curriculum demands and competitive pressures particularly in areas of the university's core competencies? Are established academic outcomes attained?

Is the university "self-sufficient" as measured by the net unrestricted operating margin or does the institution rely heavily on temporarily restricted and non-operating activities? How volatile is the operating and net operating margin? Are the historic trends positive? The expected trends?

Is the net revenue stream sufficiently diversified or does the current and expected profile have a high reliance on uncertain and often volatile gifts/grants and investment (returns allocated to temporarily restricted operating income)?

If the revenue stream is gift/grant reliant, are external relations efforts sufficiently strong to ensure continued success? Is the donor pool sufficiently broad and deep?

If the revenue stream is tuition reliant, does the university's reputation provide for tuition pricing power? Is the university meeting or exceeding the program, academic quality, facilities, and delivery platform expectations of stakeholders?
If endowment spend is reliant, what is the expected volatility of the spend distribution?

Has the growth in net assets kept pace with the growth in expenses (a proxy for institutional growth)? Or has the university relied heavily on debt to finance growth? If so, is this additional leverage manageable as measured by loan covenants, coverage and leverage ratios? How sensitive is the debt-cost-of-carry to an increase in interest rates?

Has the growth in core revenue kept pace with growth in core expenses? Can expenses be adjusted quickly to account for a decline in revenue without cutting muscle?

How sensitive is the university's balance sheet and operating results to that perfect storm?

Is technology keeping pace with student demands, faculty needs, and the competition?

Are cyber-security measures sufficient to protect student and faculty records?

The less affirmative the answers to these sample questions, the greater the probability of negative occurrences to expectations.

BACK TO THE ROLE OF THE ENDOWMENT PORTFOLIO

Thus far, little has been said about the endowment portfolio, and that is by design, as effective endowment management is not accomplished in isolation and must complement the overall risk and uncertainty profile of the entire organization.

TAKEAWAYS

The Board is the final authority on setting spending, preservation of purchasing power and asset allocation objectives, a responsibility that cannot be delegated.

Spending and preservation decisions must complement the university's ERM and financial profiles. The greater the risk and uncertainty embedded in ERM and the financial profile, the less uncertainty should be assumed in expected endowment outcomes

Traditional wisdom looks to the endowment portfolio as a source of income to support current operations and growth in purchasing power (net of spending distributions and excluding new gifts), often conflicting and unattainable objectives under most reasonable capital market assumptions. The board's responsibility is to ensure the appropriate strategic focus between spending and preservation, a responsibility that cannot be delegated. How much of the endowment should be spent to support current year operations? How much should be retained and reinvested to support future generations? How should the distribution or spending rate be calculated? Should the spending formula be applied to underwater accounts? Obviously, answers to these questions depend on a university's unique needs and circumstances.

However, seldom does the investment committee, investment advisor or board consider the university's ERM profile in the decision process. Clearly, the endowment portfolio exists for reasons other than the isolated rate of return or risk adjusted return objectives that drive so many boards to an ill-advised sense of security. The board's fiduciary responsibility requires a holistic view of the institution's risk and uncertainty profiles which in turn drives endowment portfolio strategy. A non-existent or weak ERM process and/or a higher probability of negative outcomes to expectations uncovered in the ERM process, the less outcome uncertainty should be assumed in the endowment portfolio strategy.

So, how is endowment portfolio uncertainty defined? As with any analysis, it should reflect the probability of a negative outcome to expectations, generally based on expectations in spending distributions and growth in purchasing power.

Based on the ERM assessment, how much variability in endowment principal can be shouldered before balance sheet integrity and margins are negatively impacted to the extent that the mission would be at risk? Can the balance sheet and margin shoulder a 30% cumulative loss of principal (drawdown due to investment returns and spending distributions) over a consecutive three year period? Two consecutive years and 15%? 8%? Absent new donations, what is the target compounded growth in principal to support future generations and over what time horizon?

Based on the ERM assessment, how much variability in year over year spending distributions can be shouldered? Can the institution live with any one year over year decline of 20%, 11%, 5%? Can the institution absorb three consecutive years of spending declines?

Does the Board approved spending policy complement the ERM risk profile? Is the focus on maximizing the current spend to support current operations or investing a portion of that spend to support future generations? Is it important that growth in the spending distribution keep pace with growth in operating revenue and expense?
Is the Board approved asset allocation policy compatible with the university's tolerance for drawdown? Is the asset allocation scheme supportive of the university's position on intergenerational equity?

All of these questions and ultimate decisions are directly or indirectly influenced by the university's overall ERM and financial profiles. A brief but deeper dive into the spending, preservation and volatility/drawdown issues is in order.

THE IMPACT OF VOLATILITY AND DRAWDOWNS

Most universities have a moderate to high degree of reliance on spending distributions from the endowment to support the mission. The amount of the distribution, the year-over-year stability of that distribution, and the longer term growth of the distribution are all important, particularly for spending-reliant universities. Endowment growth (excluding new donations) is necessary to provide growth in spending, while stability in the endowment value is necessary to minimize year over year and consecutive year declines in spending.

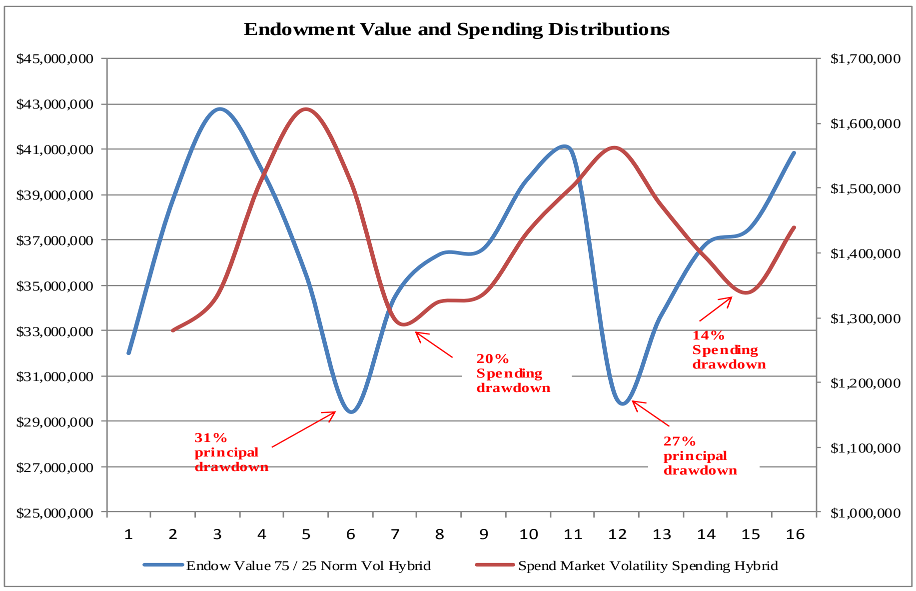
The size of the endowment relative to net assets significantly influences balance sheet integrity. Universities experiencing stress in key metrics such as the primary reserve, capitalization and viability ratios would seek to minimize the year over year and consecutive year endowment drawdowns. This would be particularly important for spending-reliant universities.

There is neither no universal answer to how much volatility (drawdown) in spending and endowment value can or should be shouldered, nor is there a universal answer to the "right" amount of spending and endowment growth. The "right" amount of volatility and growth and the tradeoffs between these often conflicting objectives must be determined based on the unique needs of the university as defined through the ERM process. While there may be no universal answer, the uncertainty embedded within the industry landscape would certainly suggest an endowment strategy built around stability.

An example may be in order. Figure 3 provides "expected" endowment value (from a beginning value of $30 million) and spending distributions based on a 75% equity/25% fixed income asset allocation, a hybrid spending methodology, and the past 15 years of market equity and fixed income investment performance.

Some may strongly argue that history is not the best proxy for the future; however, this is a period that includes multiple highs, low, periods of stability, and several significant performance outliers, so for illustrative purposes, it is acceptable.

Figure 3 – Endowment Value and Spending Distributions



Average annual ROR	6.42%	CGR Principal	1.64%
Std Deviation Returns	13.05%	CGR Spending	0.84%
		Avg Annual Spend Rate	3.95%

One is immediately drawn to the degree of variability in both the endowment value and spending distributions. From the beginning value of $30 million, the endowment growth to $43 million only took a few years due to investment returns. This growth was the primary contributor to the rapid growth in spending. Surely, management, the investment committee, the investment advisor and the board would have been pleased and likely in a celebratory state of mind, perhaps to the point of believing that the sky would be blue forever. But, then the realities of volatility hit with three consecutive years of negative investment returns. The endowment value declines to $29 million, a 31% drawdown. Due to the hybrid spending methodology, the 20% drawdown in spending is not reflected until one year later. This cycle was repeated beginning in year 11, resulting in a 27% drawdown in endowment value and a 14% drawdown in spending. For this full period, the compounded annual growth rate (CAGR) in endowment value and spending was 1.64% and .84%.

Would results such as these be acceptable? Again, it depends on the ERM profile of the university; however, it is unlikely that drawdowns of this magnitude would be acceptable even for the strongest of institutions, particularly given the expected higher education landscape and the likely correlation of drawdown periods with other balance sheet and operational stress.

The 2008 – 2009 perfect storm raised the warning flags for many boards. Concurrent with core business challenges faced during this period, investment performance added to the woes, and for many universities the recovery has been longer and more painful than ever expected. The most important takeaway from this experience is that volatility matters -- volatility in the core business and volatility in investment returns -- and the probability and severity of these negative occurrences can be far greater than expected. A university should expect the unexpected, be prepared for the unexpected and be doubly sure that the unexpected does not put the university's mission at risk.

If the 75% equity/25% fixed income allocation does not meet the university's tolerance for risk and growth, are there asset allocation alternatives that would? The answer to this question is well beyond the scope of this article but, in general, the answer would be "yes."

TAKEAWAYS

Expect the unexpected.

Successful endowment management is about controlling losses, minimizing those less frequent but high impact negative performance events. Successful endowment management is about staying in the game and sticking with the game plan when it seems that the world is falling apart.

Ensuring the optimal asset allocation mix is perhaps the board's most important endowment decision as it directly impacts spending, preservation of purchasing power and properly constructed complements the university's ERM and financial profiles.

The Board must be resolute on an asset allocation mix focused on managing potential drawdowns to an acceptable level

FINAL THOUGHTS

Optimal endowment portfolio construction must be based on an Enterprise Risk Management Assessment. The greater the uncertainty and correlation of negative outcomes within the enterprise, a higher level of certainty in outcomes should be reflected in the endowment portfolio strategy. Portfolio strategy should never be about the following:

A primary focus of maximizing investment returns

Absolute or risk adjusted performance better than some benchmark

Absolute or risk adjusted performance better than the peer composite

Yet that "noise" is what most boards are provided. Boards are well advised to ignore this noise and listen to the unique needs of the university.

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Appendix A - Case Study

Table 1

Metric	University South	University East	University West
Effectiveness of ERM Process	B	D	A
Business Model Sustainability	A	C	A
Net Tuition Growth	C	C	A
Growth in Gifts and Grants	C	D	A
Endowment Support	B	C	C
Expense Management	A	D	A
Leadership, Management and Faculty	A	D	A
Balance Sheet Integrity	B	C	B
Operational Integrity	C	C	B
Primary Reserve Ratio	0.47	0.28	0.77
Viability Ratio	1.10	0.53	1.89
Return on Net Assets	8.74%	4.44%	6.44%
Physical Asset Reinvestment	2.05	0.65	1.00
Age of Facilities Ratio (Yrs)	19.06	19.06	19.06
Net Operating Margin (Net Income Ratio)	1.49%	-3.68%	-10.34%
Net Margin	14.58%	7.03%	12.48%
Net Tuition Coverage	80.59%	86.51%	54.24%
Instruction Demand Ratio	76.02%	85.79%	57.18%
Investment Return Dependency Ratio	58.35%	66.25%	96.39%
Gifts and Grants Dependency Ratio	52.49%	19.07%	147.18%
Spending + Gifts & Grants / Change in Net Assets	98.20%	37.21%	138.97%
Spending Dependency Ratio	51.75%	17.43%	58.20%
Spending / Net Tuition	2.22%	1.20%	11.07%
Endowment / Net Assets	46.61%	41.84%	52.35%

A case study may help bring the interactions together. Table 1 provides a summary financial profile for three hypothetical universities.

University West represents a university with a stellar reputation, superior academic offerings and delivery channels, and a distinct competitive advantage – all providing enrollment stability even in the toughest of times and significant tuition pricing power. Its external relations effort is strong with a deep and broad donor pool as reflected in the stable gifts and grants dependency ratio. West is far less tuition-reliant with net tuition and fees representing just 33% of revenue while gifts, grants and investment returns total 40% of revenue. The negative net operating margin may be of concern but is more a reflection of the large temporarily restricted gifts and grants exclusion. West is a university many may aspire to become. The lower probability of negative balance sheet and operating occurrences to expectations may provide the opportunity for the endowment to place a greater focus on long term returns and the assumption of greater interim principal drawdown exposure.

University East, on the other hand, may be considered a troubled university. Due to low academic quality and the lack of compliance with donor intent, the university's reputation is poor, resulting in declining enrollment, poor tuition pricing power and declining private gifts. The university has failed to keep up with competitive demands in technology and delivery platforms, putting additional pressure on enrollment. In an attempt to preserve cash flow, the physical plant has not been properly maintained and faculty salaries frozen, the latter resulting in significant turnover and difficulty in attracting qualified instructors. The debt burden is high and all debt is on a variable rate basis. Expendable net assets are alarmingly low and due to the low cash level and operating cash flow, the line of credit has been accessed far more than lenders would desire. While new leadership has been brought in to solve the multitude of problems, resolution will take time. Without a significant turnaround, East is on the verge of being irrelevant and perhaps out of business. Low expectations, the multitude of uncertainties and probabilities of negative occurrences to expectations suggest that the endowment must be a stabilizing influence, particularly to spending and the change in net assets. Of course, one alternative to accomplishing this stability would be to move to a portfolio totally invested in short-term government bonds where the return and volatility profiles are relatively certain. Doing so, however, would push the operating and net margins further into negative territory and virtually eliminate spending support for scholarships, further compounding an already tenuous situation. A middle of the road approach may be the simple 60/40 equity fixed income allocation to generate close to sufficient spending potential (and within the equity bucket a purposeful bias to a diversified portfolio of lower volatility positions).

University South Several years ago, University South faced an uncertain future as a niche university with declining national demand for its academic and student offerings. Recognizing the realities of the future, the university embarked on an ambitious program to introduce accelerated entry programs, online capabilities, evening and weekend classes, and new degree programs in the most highly sought after disciplines. Technology platforms were upgraded, academic facilities procured, the geographical presence expanded, and new faculty leadership acquired. Enrollment trends are favorable and the new brand is being recognized and acknowledged with the geographies served. (While the future appears bright, the outcome of South's recent strategy is very dependent on the success of new academic programs and initiatives where substantial investments have been made. Due to a delay in accreditation, the programs will not begin producing student revenue for at least another year and while current program demand is high, there are no guarantees that demand will remain high nor that the university will be successful in capturing program market share.) Until success is validated, a lower volatility endowment profile is warranted.

For more commentary, we invite you to visit our website at www.wicinvest.com.

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