



Carleton College Investment Office Memo

To: Carleton College Community
Subject: Fiscal Year-End 2019 Endowment Letter

Annual Endowment Letter as of June 30, 2019

At \$892.2 million, Carleton College's endowment is a pool of investments that provides a permanent source of income for the college. Funded by gifts to the college as well as investment growth, the endowment is the financial cornerstone of Carleton's excellence. Each year money from endowment earnings is used to support the college's annual operating budget and dramatically affects the amount of financial aid available to students and the quality of our academic programs and facilities.

For fiscal year 2019, the endowment provided 27% of the college's operating budget, and the annual endowment draw of \$42.5 million went to support programs within financial aid (\$23.1 million), learning and teaching (\$17.5 million), and life and careers (\$1.9 million).

Since 2005 the Carleton College Investment Office has been responsible for the day-to-day management of the endowment portfolio. In 2018 the college recruited a new chief investment officer, who subsequently hired three investment professionals over the course of fiscal year 2019, and today they comprise the investment office team. The Carleton College Investment Committee, which is a subset of the Carleton College Board of Trustees, conducts fiduciary and managerial oversight of the Investment Office, sets the policy portfolio benchmark, recommends investment policy guidelines, and monitors performance.

The following sections review the endowment portfolio and associated performance.

Endowment Portfolio

The endowment invests across five primary asset classes: public equity, private equity, real assets, marketable alternatives, and fixed income (including cash). The policy weights, ranges, and endowment weights as of June 30, 2019 follow.

Asset Class	Policy Weights	Acceptable Ranges	Endowments Weights as of June 30, 2019
Public Equity	40%	20% - 60%	35%
Private Equity	20%	10% - 30%	16%
Real Assets	10%	5% - 20%	14%
Marketable Alternatives	20%	10% - 35%	24%
Fixed Income/Cash	10%	0% - 25%	11%

Performance and Risk Review

The endowment returned 3.2% during fiscal year 2019. While the 1-year return was below our long-term target of 5% plus CPI, performance over multiple, longer-term periods has been satisfactory in relative and absolute terms. The endowment's annualized returns, volatilities, and Sharpe ratios¹ as compared to an 80/20 Stock/Bond Portfolio² are displayed in the table below.

	Annualized 3-Year			Annualized 5-Year			Annualized 10-Year			Annualized 15-Year		
	Return	Volatility	Sharpe ¹	Return	Volatility	Sharpe ¹	Return	Volatility	Sharpe ¹	Return	Volatility	Sharpe ¹
Carleton Endowment	8.7%	4.9%	1.76	5.2%	4.9%	1.06	8.6%	5.5%	1.56	6.9%	6.5%	1.07
80/20 Stock/Bond Portfolio²	9.5%	9.5%	1.00	5.2%	9.7%	0.53	8.9%	11.3%	0.79	6.7%	12.7%	0.53

¹ Sharpe ratio, which measures risk-adjusted returns, assumes a risk free rate of 0% and is therefore simply defined as the return divided by volatility.

² Portfolio is allocated 80% to MSCI ACWI IMI (i.e. global equities) and 20% Barclays Global Aggregate Bond Index (i.e. global bonds).

Fiscal Year 2019

The primary drivers of underperformance were centered in public markets and marketable alternatives while private equity and real assets performed relatively well. At a high level, in public equity, the portfolio has been positioned underweight versus the policy allocation of 40% for the past several years. This conservative positioning helped immensely to protect capital throughout the Global Financial Crisis (“GFC”) but has been a headwind since markets started to recover in 2009. Today, we continue to be cautious on equity markets, given elevated valuations and concerns over earnings growth. Due to these factors, we feel a 35% allocation to public equity is appropriate.

In terms of specific performance drivers, the public equity allocation started the year with a meaningful bias towards European and emerging markets, both of which underperformed U.S. markets by more than 6% during the fiscal year. Today, regional exposure is more in line with the public equity benchmark. In marketable alternatives, two underperforming strategies caused a disproportionate amount of loss due to positions in energy and other deep-value equity themes. We have been actively removing capital from these strategies since late 2018. On the positive end, private equity benefitted from large-cap buyouts and middle-market strategies, and real assets generated excess returns from exposure to commercial real estate and energy, traditional and renewable.

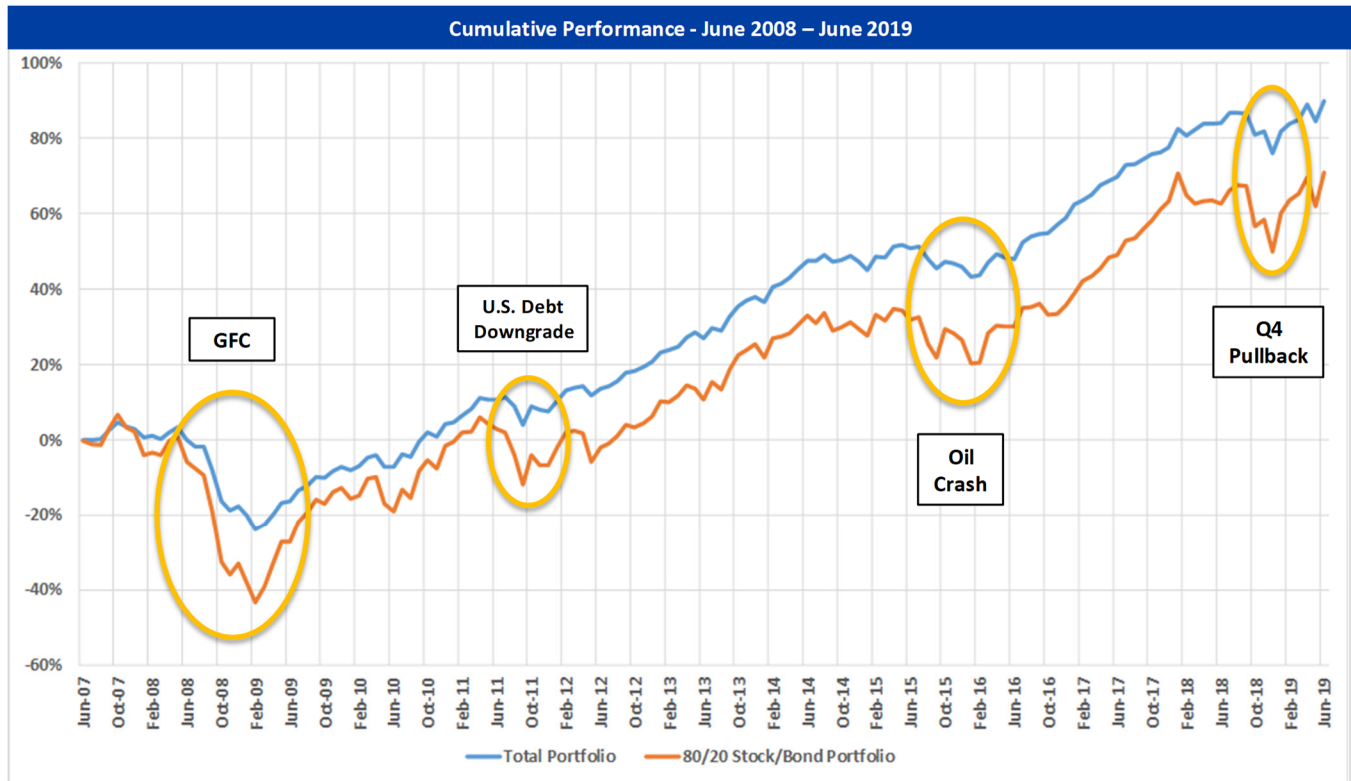
Long-Term Performance

While an assessment of annual performance is an important part of our evaluation process, we believe longer-term, multi-year results are a better representation of our investment approach. Not only does this align better with the long-term philosophy of managing endowed capital, but also it is in line with the multi-year investment horizons of the endowment’s underlying strategies. Specifically, the time horizon of the assets held in the endowment from purchase to realization ranges from approximately two to 10 years.

Over the past decade, risk assets have appreciated strongly post the GFC. While we have been positioned conservatively during this period and generally underweight risk assets, the endowment still benefitted from the market’s growth, primarily through investments in public and private equity. Public equity in the United States drove a great deal of performance, largely on account of large-cap and growth-oriented stocks in consumer and technology sectors. Public equity exposure outside of the United States was less successful as European and emerging/frontier economies remained challenged after the GFC due to sovereign debt crises, currency depreciation, and negative investor sentiment. Private equity benefitted from investments across geographies and sectors, with larger contributions from global buyouts and the software and services sectors. While less influential to long-term performance, real assets have delivered well, mainly on account of investments in multi-family and commercial real estate in addition to private partnerships and royalties in energy (traditional and renewable). Given their uncorrelated profiles, investments within marketable alternatives and cash modestly contributed to long-term performance.

Risk Review

In addition to generating returns, we focus intently on the endowment's risk profile. As exhibited by the Sharpe ratios in the table above, the endowment's returns have been produced by taking far less risk than the 80/20 Stock/Bond Portfolio. We feel that this conservative level of positioning is critical as we encounter higher levels of market volatility. As displayed in the chart below, the endowment's low-risk profile has allowed it to protect capital during market drawdowns and therefore recover from losses more quickly than a passive index, such as the 80/20 Stock/Bond Portfolio. The relatively quick recovery is important as market drawdowns have historically resulted in minimal disruption to the college's operations.



Looking Ahead

As we look forward to fiscal year 2020 and continue the multi-year process of reshaping the endowment portfolio, we are focused on improving the composition of investments in numerous areas. Specifically, our near term priorities include building out the private equity portfolio, in addition to identifying public and private opportunities in China and uncorrelated strategies within marketable alternatives. While generating sustainable, long-term performance is our overriding objective, we are increasingly mindful of risks on the horizon.

In closing, we are ever grateful for the trust and support from the Investment Committee, Board of Trustees, and broader Carleton community.
