Carleton College Investment Office Memo

To:	Carleton College Community
From:	Carleton College Investment Office
Subject:	Fiscal Year-End 2020 Endowment Letter

Annual Endowment Letter
As of June 30, 2020

At $868.6 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 2020, the endowment supported 28% of the college's operating budget, and the annual endowment draw of $44.8 million went to support programs within financial aid ($24.9 million), learning and teaching ($17.1 million), and life and careers ($2.8 million).

Endowment Oversight
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 professionals, a director of investments, an investment associate, and an investment operations and risk manager over the course 2018 and 2019. Together, the four team members, along with a student intern, comprise the Investment Office staff.

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, oversees asset allocation, recommends investment policy guidelines, and monitors performance.

Environmental, Social, and Governance (ESG)
One noteworthy development that occurred in fiscal year 2020 is the endowment's formal adoption of incorporating environmental sustainability, social responsibility, and governance (ESG) factors into the investment manager selection process.

As part of this effort, the Investment Office assesses each investment manager's hiring practices and policies, ethics and integrity, partnership structure, and governance, as well as understanding the manager's philosophy and process on ESG investing and conducting a general review of the manager's underlying holdings from an ESG perspective.

The following sections review the endowment portfolio and associated performance.

Endowment Portfolio
The endowment invests across five primary asset classes, including public equity, private equity, real assets, marketable alternatives, and fixed income/cash. The policy weights, ranges, and endowment weights as of June 30, 2020 follow.

Asset Class	Policy Weights	Policy Benchmark	Acceptable Ranges	Weights at June 30, 2020
Public Equity	40%	MSCI All Country World Index IMI (USD)	20% - 60%	35%
Private Equity	20%	Cambridge Associates - Private Equity	10% - 30%	17%
Real Assets – Real Estate*	5%	Cambridge Associates - Real Estate	2.5% - 10%	6%
Real Assets – Natural Resources*	5%	Cambridge Associates - Natural Resources	2.5% - 10%	7%
Marketable Alternatives	20%	HFRI Fund of Funds Composite Index	10% - 35%	26%
Fixed Income/Cash	10%	Barclays US Treasury and ICE BoA ML 3m Tbill	0% - 25%	9%

*Acceptable range of Real Assets in total is 5% to 20%.

Performance and Risk Review

For the fiscal year 2020, the endowment returned +0.2% with private investments market as of June 30, 2020 (i.e. "unlagged") or -1% with private investments market as of March 31, 2020 (i.e. "lagged"). While the 1-year return was below our long-term target of 5% plus CPI, performance over longer-term periods has been satisfactory in relative and absolute terms. The endowment's annualized returns, volatility, as measured by standard deviation, and Sharpe ratios[1] as compared to an 80/20 Stock/Bond Portfolio[2] are displayed in the following table.

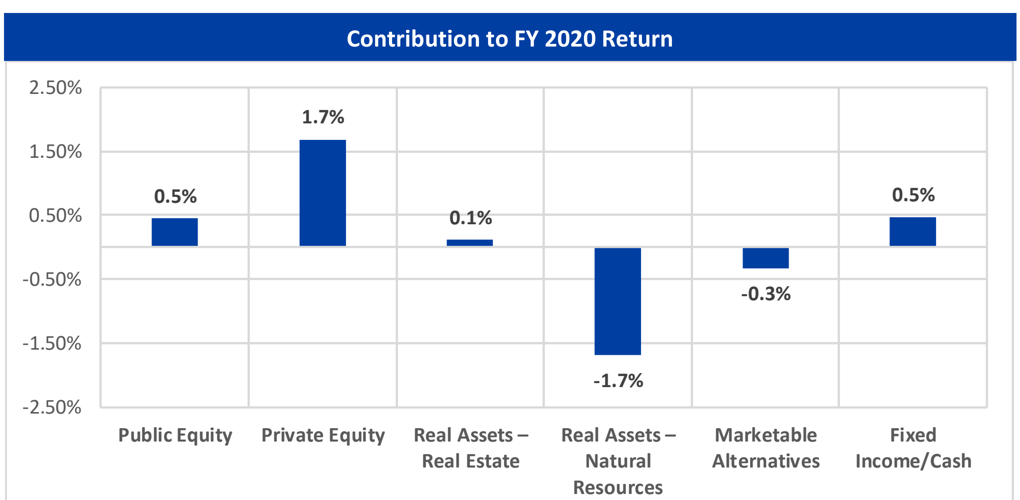
	Annualized 3-Year			Annualized 5-Year			Annualized 10-Year		
	Return	Volatility	Sharpe[1]	Return	Volatility	Sharpe[1]	Return	Volatility	Sharpe[1]
Endowment - Unlagged	4.0%	9.3%	0.47	5.0%	7.6%	0.68	7.4%	6.8%	1.10
Endowment – Lagged	4.5%	7.4%	0.63	6.5%	6.2%	1.05	7.2%	5.9%	1.22
80/20 Stock/ Bond Portfolio[2]	5.3%	13.6%	0.45	5.7%	12.1%	0.52	7.9%	11.8%	0.71

[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).

For fiscal year 2021, from July 1, 2020 through November 30, 2020, the endowment has returned +13.9% and +11.3% on an unlagged and lagged basis, respectively.

Fiscal Year 2020

Public and private equity investments performed well throughout the year, while the endowment's exposure to private energy and natural resources lagged significantly, primarily through investments made in 2011-2014, which cost a total of -1.7%. The energy sector declined on the back of crude oil falling precipitously throughout March and April and did not recover in late Q2, as most asset classes did. Marketable alternatives struggled to generate a positive return due to fundamental, value-oriented equity and event driven strategies. A chart displaying contribution to FY 2020 performance by asset class and a brief asset class review follows.



Public Equity

As the endowment managed sub-target exposure in public equity, averaging 35% for the fiscal year, we anticipated a pullback in equity markets at some point during the year. The market drawdown in March was quick and severe and, as part of our rebalancing process, we gradually purchased equities throughout the remainder of the year. The composite's benchmark, the MSCI ACWI IMI Net TR USD, ended the fiscal year +1.2%, while our public equity portfolio returned +0.8%. The -0.4% underperformance is best explained by understanding that a small number of stocks drove a disproportionate amount of the benchmark's return. For example, the vast majority of the +1.2% gain was due to strong performance of Apple Inc. (+71%), Microsoft Corp. (+45%), Amazon.com Inc. (+44%), and Facebook Inc. (+18%), which together represent more than 10% of the MSCI ACWI IMI benchmark that contains over 8,000 companies.

Private Equity

FY 2020 was another strong year for private equity. Consistent with broader equity markets, the largest contributors to returns in the private equity portfolio centered in investments in software-based technology companies. Similarly, the largest detractors to returns were in energy related industries and European distressed credit. The composite's benchmark, Cambridge Associates - Private Equity, ended the fiscal year +7.5%, while the endowment's private equity portfolio returned +9.7%. Compared to the benchmark, outperformance was due to large-cap buyout and growth equity strategies.

Real Assets - Natural Resources

The natural resources sector was significantly challenged during the year. The composite's benchmark, Cambridge Associates – Natural Resources, ended the fiscal year -23.8%, while the endowment's natural resources portfolio returned -19.4%. From 2016-2019, the endowment's investments in traditional energy held up better than the benchmark; however, most notably in March 2020, the combination of a significant fall in commodity prices and a steep decline in valuation multiples resulted in broad-based losses across the energy portfolio. The losses were further exacerbated by the endowment's overweight allocation to the category. Relative outperformance was due to renewable energy strategies that were not affected by the downturn in commodity prices.

Real Assets - Real Estate

Real estate markets are likely to experience a period of transition as tenants adapt to changing real estate needs during and after the pandemic. Reacting to the uncertainty of long-term real estate needs, REIT markets and real estate credit markets sold-off extensively in March and have been slower to rebound than broad equity markets. The composite's benchmark, Cambridge Associates – Real Estate, ended the fiscal year -1.8%, while the endowment's natural resources portfolio returned +1.9%. Carleton's real estate investments fared relatively well driven by value-add multi-family and commercial properties.

Marketable Alternatives

Dispersion was high across marketable alternatives strategies, ranging from strong returns driven by growth/technology-focused and macro-oriented funds to long-biased value funds that generally failed to keep pace. The composite's benchmark, the HFRI Fund of Funds Index, ended the fiscal year +0.4%, while the endowment's marketable alternatives portfolio returned -1.3%. Relative underperformance was due to event driven and long-biased strategies, including the portfolio's largest position, in addition to legacy funds from which we are actively redeeming and will be fully exited by early 2021.

Fixed Income and Cash

The composite's benchmark, an equal split between the Barclays US Treasury and ICE BoA ML 3m Tbill, ended the fiscal year +5.9%, while the endowment's composite returned +4.2%. Underperformance versus the benchmark was due an underweight in exposure to US Treasuries, which returned +10.4% during the fiscal year.

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 two to 15 years.

Over the past decade, risk assets appreciated strongly between the Global Financial Crisis and the most recent downturn due to concerns around Covid-19 in early 2020. In late March 2020, central banks and governments across the globe provided early and significant monetary and fiscal support as it became clear the pandemic was going to wreak havoc on the economy. The market responded positively to the stimulus measures and quickly recovered. The endowment invests across asset classes and has been positioned more conservatively than its policy benchmark and most peers. Therefore, while the endowment experienced a steep drawdown this past spring, performance was in the top quartile versus peers in Q1 2020. However, when markets started to swiftly recover, the endowment benefitted from the upturn, but underperformed peers and its policy benchmark.

Looking Ahead
As we look forward to fiscal year 2021 and continue the multi-year process of reshaping the endowment portfolio, we continue to be focused on improving the composition of investments in numerous areas. Specifically, our near term priorities include continuing to build out the private equity portfolio, adding further to growth equity and venture capital strategies, in addition to identifying public and private opportunities in biotechnology and Asia. We also continue to phase out of traditional private energy strategies and underperforming legacy investments in marketable alternatives. While generating sustainable, long-term performance is our overriding objective, we are always mindful of potential 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.

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