

Endowment Funds

An endowment fund is an investment fund that makes consistent withdrawals from invested capital. The capital in endowment funds, often used by universities, nonprofit organizations, churches and hospitals, is generally utilized for specific needs or to further the organization's operating process. A successful endowment helps in reducing the financial burden of an organization by generating a consistent flow of income year after year.

Endowment Model

The **endowment model** is a long-term investment strategy that focuses on broad diversification to generate optimal risk-adjusted investment returns. It is a disciplined approach that focuses on lower portfolio volatility through various economic and investment climates. The typical endowment model expands on the concept of Modern Portfolio Theory (MPT) by allocating a significant portion of assets to the nontraditional (and less efficient) alternative investments (asset classes and strategies) in addition to traditional stocks and bonds to further reduce the volatility of the diversified investment portfolio. Many attribute the development of the endowment model to David Swenson who became the Chief Investment Officer of the Yale Endowment in 1985 and immediately diversified the portfolio into alternative asset classes such as private equity, venture capital, real assets, like commodities and real estate, and other alternative strategies like hedge funds.

Optimal Investment Structure and Process

An endowment fund is governed by a board of directors and investment committee who typically retain an investment management consultant for investment policy advice and utilize professional investment managers to implement the various strategies. They adopt the optimal investment structure which separates the roles and responsibilities of the various investment service providers—investment management consultant, investment managers, brokers and custodians.

The investment committee uses a disciplined investment decision-making process to develop and document an investment policy that incorporates time horizon, risk level and expected returns to create a broad diversification strategy that supports the goals of the endowment. The documented investment policy statement provides guidelines that are used for portfolio allocation. The broadly-diversified portfolio allocation is focused on avoiding large losses and generating high enough real returns to take care of yearly withdrawals and inflation. Large endowments focus their attention on the highest impact decisions and believe that the development of the asset allocation strategy is a large value added activity and that “portfolio construction” is an often overlooked opportunity. They use their long-term time horizon to take advantage of unique investment opportunities, sometimes using illiquid investments, while maintaining a focus on managing portfolio volatility.

The endowment model has become the standard portfolio model for nearly all large college endowment funds, pension funds and other large institutional investors because over a long-term time horizon, the endowment model has consistently produced strong risk-adjusted returns with less volatility than many other investment strategies.¹ Endowments routinely document and disclose their investment policy and portfolio allocation so this information serves as a learning opportunity and a role model for others. This information gives the individual investor the opportunity to learn from and emulate the largest institutional investors in the United States.

1. Wildermuth, D. (2018). Is the endowment model relevant for individual investors? Retrieved from <https://www.investmentnews.com/article/20181022/BLOG09/181029995/is-the-endowment-model-relevant-for-individual-investors>