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YourQ&A: Is Endowment Model Hurt By Poor Alts Returns?

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Question

How has the recently disclosed decline in the value of endowments that were heavily invested in alternative investments affected the perception of these asset classes and the "endowment model?"

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Answer



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The "endowment model" is a relatively complex approach to investing that cannot be interpreted as any investment portfolio with a high allocation to alternative assets. A best-practices "endowment model" should reflect the following:

- A long-term investment horizon
- An asset allocation policy consistent with both financial objectives and resources available for effective implementation
- A high allocation to equity assets to support spending needs without depleting the ability to meet the needs of future generations
- Precautionary hedges against "fat tail" macroeconomic risks
- An adherence to value-based investment principles
- Rigorous and ongoing monitoring of investment results

Such practices have produced consistently superior returns over several decades, and will continue to do so over the long term. However, the severity and breadth of the recent market decline spared few investors in 2008, including even the most exemplary practitioners of the endowment model. As such, investors would be wise to review the fundamental investment principles that shaped their investment plan given their current assets, liquidity constraints, and spending needs, and adjust allocations as appropriate.

Further, one size does not fit all. For example, investors that value short-term capital preservation over long-term growth should adopt a lower strategic allocation to equities, giving greater weight to less volatile investments, such as high quality bonds. They should either spend a lower percentage of assets or accept some capital depletion through spending.

We expect alternative assets to continue to play an important role in diversified portfolios. However, the landscape has changed and so have the skills necessary to succeed. With long-only equities and credit valuations at multi-decade lows, investors should be judicious in determining when to pay higher fees and incur illiquidity associated with alternative assets. Manager selection is a vital consideration.

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