



[Print](#) | [Close Window](#)

## YourQ&A: Are Endowments Prepared for Lower Spending?

YourQ&A published on Jun 29, 2009

**Discuss this YourQ&A**

### Question

It is widely assumed that investment returns will be lower in the period ahead. If you expect lower returns, you must either take on more risk or lower your spending rates. Are CIOs and investment committees adjusting investment approaches to put asset allocations in line with lower spending rates?

**Senior Investment Officer, Foundation**

### Answer



**Celia Dallas** is head of published research and a managing director at [Cambridge Associates](#)<sup>1</sup>.

The fundamental purpose of a rational spending policy is to mediate between the competing demands of present and future generations. This is done by enabling an endowed institution to spend as much today as is compatible with the preservation of purchasing power for tomorrow.

If an institution spends more than the real (that is, inflation-adjusted) return on investments, then obviously the endowment will be steadily depleted and the ability to spend as much tomorrow as today will be impaired. If it spends less than the real return on investment, then the endowment fund will grow, and tomorrow's inflation-adjusted spending may exceed today's.

When bear markets are severe enough to reduce the amount of endowment spending prescribed by market value-based spending rules, the solution should not be to increase portfolio risk in search of higher returns. Rather, prudent spending should be predicated on relatively conservative long-term inflation-adjusted return assumptions. This should be carefully derived from capital markets history and equity risk premiums.

For an institution with a high reliance on its endowment to support operating budgets, and with relatively inflexible budgetary needs, it's particularly difficult to spend less if the endowment suffers a shortfall in returns. Spending rules for such an institution should be designed to allow it to spend at a lower rate when times are flush so that it can spend at a higher rate when times are lean.

Over the long-term this should result in a rate of spending that is consistent with long-term inflation-adjusted return objectives. For those that did not have the foresight to set up such a spending policy, the choices are unappealing. Institutions must then either cut spending at the expense of current programs, or maintain spending at the expense of future purchasing power.

YourQ&A is your opportunity to get your pressing questions answered by industry leaders.

#### **FundFire**

FundFire is a copyrighted publication. FundFire has agreed to make available its content for the sole use of the employees of the subscriber company. Accordingly, it is a violation of the copyright law for anyone to duplicate the content of FundFire for the use of any person, other than the employees of the subscriber company.

An Information Service of **Money-Media**, a Financial Times Company

Links

1. <https://www.cambridgeassociates.com/>