



# **2015 ENDOWMENT FINANCIAL REPORT**

UNIVERSITY OF WISCONSIN FOUNDATION



# PRESIDENT'S MESSAGE

## **GREETINGS,**

The role of the UW Foundation is to engage with the University of Wisconsin–Madison's alumni and friends. We present them with opportunities to make a positive impact on the people and programs that match their personal interests.

The university just experienced one of the most challenging budget cycles in its history. The UW System took a deep budget cut, and the Madison campus shouldered a big share of that. Along with the cuts, changes to the policies that protect academic freedom added more uncertainty to the environment. Of course, this university wasn't built on a single budget cycle, and it won't be defined by this one.

Generous donors such as you have put a strong wind at our backs, and it is still being felt today. The application, retention, and graduation rates at UW–Madison were better in 2015 than ever before. UW–Madison was named one of the top 25 universities in the country. Our faculty and student research teams continue to innovate and make major breakthrough discoveries, and we were ranked fourth for research spending among American universities. And while other institutions have tried to woo our talented faculty members, retention remains very high, thanks in no small part to the creation of so many new faculty awards as part of the Morgridge Match.

We're grateful for the many amazing leadership gifts made to the recently launched All Ways Forward comprehensive campaign. We're also well aware that our efforts and collaboration to bring new donors into our programs are essential complements to those leadership gifts. The campaign will touch every aspect of the UW–Madison experience.

A total of \$238.7 million was transferred from the UW Foundation to UW–Madison in 2015, and \$593.5 million in new gifts and pledges were recorded: a 20 percent increase over the previous year.

As always, I am thankful to the thousands of alumni and donors who play such a critical role in the ongoing success of this great university. The endowment financial report for your fund(s) is enclosed. Your support has and will touch countless lives — not just on campus, but around the world. *Thank you.*

## **ON, WISCONSIN, AND ALL WAYS FORWARD!**

**MICHAEL M. KNETTER**

President and CEO



The UW Foundation invests its endowment to create a base of perpetual support for UW-Madison.

Private gifts and grants make up the second-largest revenue source for the university — 18 percent of the 2015 budget.



# INVESTMENTS PERSPECTIVE

## DEAR FRIENDS,

In 2015, the financial markets experienced another year of below average global economic growth, causing a broad sell-off across most markets. Concerns centered around a decline in most commodity prices, particularly energy, as well as weak economic growth in China and the uncertainty brought about by the long wait for the U.S. Federal Reserve to raise short-term interest rates. Around the globe, the very low interest-rate policies did not provide the widely expected economic stimulus, and in fact, concerns about deflation and low growth persisted. Spilling into 2016, questions remain regarding the long-term ramifications of an era dominated by central bank market intervention.

The UW Foundation endowment portfolio, focused on a long-term, perpetual, and globally diversified investment strategy, returned -1.2 percent for the year, while the corresponding benchmark returned -0.79 percent. The endowment portfolio's public equity and fixed income investments outperformed their benchmarks while experiencing slight losses. The difference in endowment portfolio performance compared to the benchmark was partially attributable to the energy holdings in the private equity portfolio. Relative to its benchmark, the private equity portfolio had greater exposure to energy holdings, and this sector struggled. Over the long term, investing in private equity has been advantageous, as evidenced by the five-year annualized return of 10.9 percent, as of year-end. The total endowment portfolio returned 6.4 percent for the same five-year period, outperforming its benchmark return of 6.0 percent, annualized.

The University of Wisconsin and the Foundation remain committed partners in the discussion and promotion of ideas intended to have positive outcomes for both Wisconsin and the world. As many of you know, the official launch of the All Ways Forward comprehensive campaign was announced in October 2015. The Foundation remains committed to prudently and carefully investing philanthropic gifts given to fund the initiatives and programs that will contribute to maintaining the university as a world-class institution of higher education. Thank you for making a difference by giving generously to this great university.

## ON, WISCONSIN!

**JULIE VAN CLEAVE, CFA**  
Chief Investment Officer

# ENDOWMENTS AT THE UNIVERSITY OF WISCONSIN FOUNDATION

## *A BASE FOR PERPETUAL SUPPORT*

A cornerstone of private giving throughout the history of higher education, endowments are based on initial gifts of substantial size that distribute annual earnings generated by investment. Endowments not only serve as dependable and relatively predictable resources to help meet new opportunities or recurring costs as they arise, but they are also sustained in perpetuity. They are gifts that truly last forever.

Endowed funds held by the UW Foundation are managed as long-term investments. The Foundation's individual endowment funds are all combined and invested as one portfolio.

The Foundation's endowment pool operates much like a mutual fund. Each endowed fund owns a number of units in the pool. The number of units that each fund owns is determined by the value of those units at the time of investment. To preserve the endowment's value in perpetuity, it is invested to provide both spendable income and long-term appreciation of the principal (although depreciation is possible).

Growth of each endowment account comes from two areas: investment returns (less annual distributions) and additional gifts. For the endowment to exist in perpetuity, the investment return must outpace two primary threats to growth: the spending rate and inflation. To achieve this goal, investment of the endowment pool uses a total return concept, in which principal appreciation and income growth are expected to preserve the "purchasing power" of the endowment pool over a long-term horizon.

The Foundation's spending policy for 2015 distributed 4.5 percent of fund value, utilizing a quarterly distribution method that includes a 16-quarter moving average of unitized market values as its base. Because endowment pool performance fluctuates in the near term, the use of a 16-quarter moving average helps to stabilize the income stream. The spending plan is reviewed annually by the Foundation's board of directors. Foundation staff, along with the investment committee of the board of directors, continually review the pool's investment performance, analyze recommendations from professional investment managers, and determine an appropriate asset allocation. The current return objective, also reviewed annually by the Foundation's board of directors, is to achieve an annualized return of 6.5 percent over a complete market cycle (typically a 5- to 10-year period).

## **WHAT IS AN ENDOWED FUND?**

An endowed fund is a permanent, self-sustaining source of income. Endowed assets are invested, and each year, a portion of the value of the fund is paid out to support the fund's purpose. Any earnings in excess of this distribution are used to build the fund's market value. In this way, an endowed fund can grow and provide support for its designated purpose in perpetuity. When an endowed fund is established, a permanent legacy of support is created for the University of Wisconsin–Madison.



Just as important as maximizing total return is the objective of minimizing risk. The Foundation pursues this goal by diversifying broadly across major asset classes, a plan that historically has been shown to minimize investment risk and to enhance investment performance.

By investing in both public and private markets, the Foundation seeks to achieve further diversification benefits. Volatility and risk are expected within any one asset class. However, a well-diversified portfolio is designed to offset those risks over a longer period of time.

Foundation staff and the investment committee remain focused on responsibly stewarding and investing philanthropic gifts received. In addition to the ongoing responsibility to monitor the asset allocation targets and to annually review the current long-term expected return, the Foundation remains committed to a cost-conscious investment operation. The focus continues to be on placing the utmost emphasis on investing gifts received so that their impact is meaningful and transformative for many years to come.

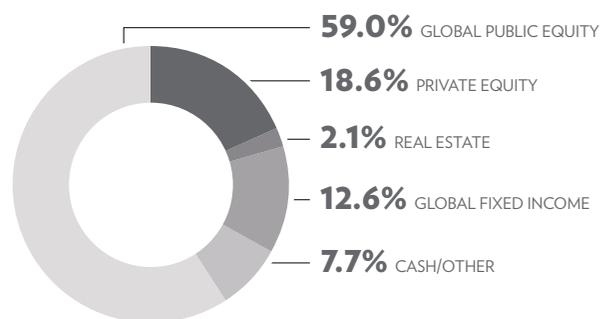
# ASSET ALLOCATION AND INVESTMENT PERFORMANCE

## INVESTMENT PERFORMANCE\*

Annualized for periods ending December 31, 2015

1 YEAR	-1.2%
3 YEARS	6.9%
5 YEARS	6.4%
10 YEARS	5.2%
INCEPTION (6/30/84)	9.1%

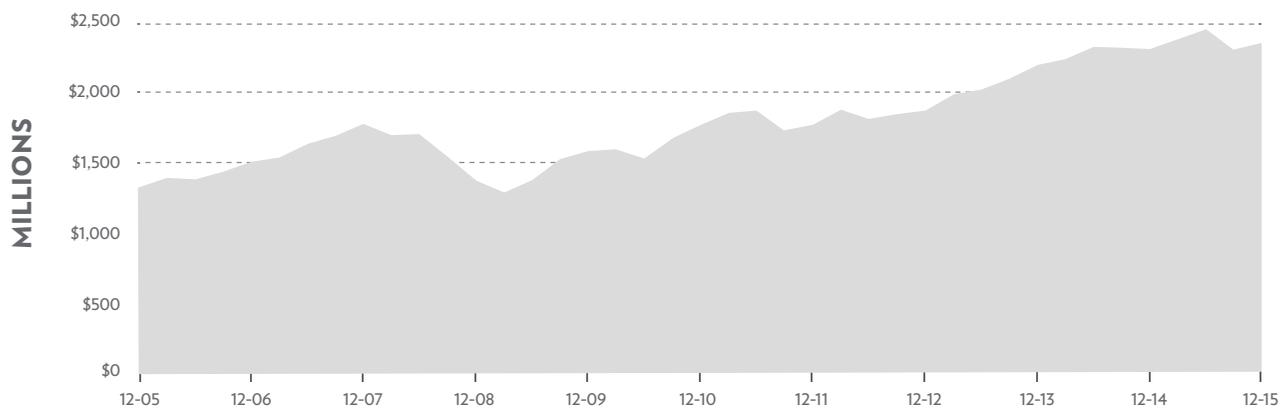
## ASSET ALLOCATION AS OF DECEMBER 31, 2015



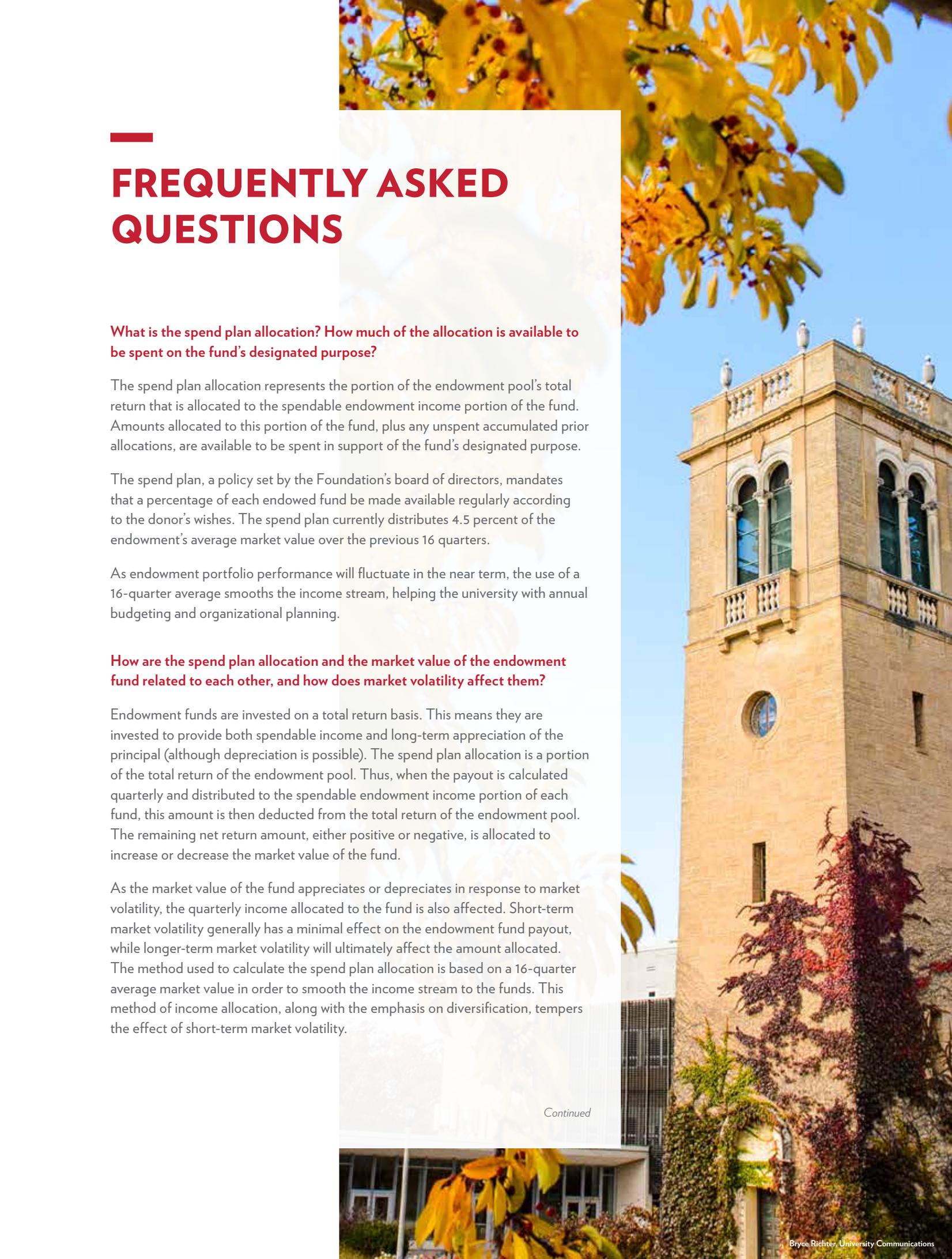
The University of Wisconsin Foundation endowment portfolio's current asset allocation is shown in the graph above. The asset allocation strategy has been established by the Foundation's board of directors and is reviewed at least quarterly to ensure that the portfolio's investment and diversification objectives are met.

## GROWTH OF ENDOWMENT PORTFOLIO

\$2,357,145,783 as of December 31, 2015



\*Net of external manager fees



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# FREQUENTLY ASKED QUESTIONS

## **What is the spend plan allocation? How much of the allocation is available to be spent on the fund's designated purpose?**

The spend plan allocation represents the portion of the endowment pool's total return that is allocated to the spendable endowment income portion of the fund. Amounts allocated to this portion of the fund, plus any unspent accumulated prior allocations, are available to be spent in support of the fund's designated purpose.

The spend plan, a policy set by the Foundation's board of directors, mandates that a percentage of each endowed fund be made available regularly according to the donor's wishes. The spend plan currently distributes 4.5 percent of the endowment's average market value over the previous 16 quarters.

As endowment portfolio performance will fluctuate in the near term, the use of a 16-quarter average smooths the income stream, helping the university with annual budgeting and organizational planning.

## **How are the spend plan allocation and the market value of the endowment fund related to each other, and how does market volatility affect them?**

Endowment funds are invested on a total return basis. This means they are invested to provide both spendable income and long-term appreciation of the principal (although depreciation is possible). The spend plan allocation is a portion of the total return of the endowment pool. Thus, when the payout is calculated quarterly and distributed to the spendable endowment income portion of each fund, this amount is then deducted from the total return of the endowment pool. The remaining net return amount, either positive or negative, is allocated to increase or decrease the market value of the fund.

As the market value of the fund appreciates or depreciates in response to market volatility, the quarterly income allocated to the fund is also affected. Short-term market volatility generally has a minimal effect on the endowment fund payout, while longer-term market volatility will ultimately affect the amount allocated. The method used to calculate the spend plan allocation is based on a 16-quarter average market value in order to smooth the income stream to the funds. This method of income allocation, along with the emphasis on diversification, tempers the effect of short-term market volatility.

*Continued*

# FREQUENTLY ASKED QUESTIONS, CONTINUED

## What is the endowment book value of a fund?

When a gift is made to establish an endowment, it is invested in the Foundation's endowment pool. The gift value, or value of the proceeds if the gift is noncash, is invested in the endowment pool and becomes the book value, also called principal, of the endowment fund.

## Why would the endowment book value be different from the original gift value?

There can be a few reasons why a difference exists between the book value and the gift value of the endowment fund. The primary reasons include:

- **Proceeds from a noncash gift may differ from the donor's gift value.**  
When the Foundation receives a noncash gift, such as stock, the goal is to receive a value, upon the sale of the item, as close to the gift value as possible. The proceeds realized can be higher or lower than the gift value. The Foundation also incurs expenses related to the sale of noncash items. These expenses are deducted from the proceeds of the sale. Thus, the net proceeds may be higher or lower than the initial gift value. These net proceeds are invested into the endowment fund. Therefore, the book value is different from the gift value.
- **The spend plan allocation is reinvested into the principal of the fund.**  
Some donors wish to increase the value of their endowment fund through the reinvestment of the spend plan allocation. When doing this, less income, or in some cases, no income, is available for immediate spending. Ultimately, the reinvestment of income should produce growth to benefit future recipients.
- **Current awards are made from the original gift.**  
In some cases, a donor wants an immediate award made in support of the fund's purpose. If the donor authorizes this expenditure, this reduces the amount of the investment into the endowment pool and thus the book value.

## Why do stock gifts appear as other additions and not gift additions?

When the Foundation receives a gift of stock, the securities are sold as soon as administratively possible. After the Foundation sells the stock, the net proceeds are deposited into the appropriate account within the fund. Due to market fluctuation and broker sale costs, the proceeds will differ (either higher or lower) from the initial gift value for which the donor is receipted.

## WHOM SHOULD I CONTACT IF I HAVE FURTHER QUESTIONS?

For general questions about your fund, contact Brian Hettiger at 608-308-5464 or [brian.hettiger@supportuw.org](mailto:brian.hettiger@supportuw.org).

For questions about investments, contact David Golden at 608-308-5212 or [david.golden@supportuw.org](mailto:david.golden@supportuw.org).



1848 University Avenue | Madison, WI 53726-4090 | 608-263-4545 | [supportuw.org](http://supportuw.org)