TAMING Investment RISK

Wesleyan's Chief Investment Officer, Anne Martin, is reshaping the institution's approach to endowment management.

BY MICHAEL SANTOLI '92

Wesleyan has at least three endowments, if the word "endowment" is taken to mean any store of collected wealth that can be used to benefit the university over the long term.

The first and oldest endowment is its culture—academic and social—ever evolving but rooted in such values as education for the good of the world. The second is its beautiful campus. Buildings and facilities, paid for over generations, were greatly improved thanks to the university's last capital campaign and are now more extensive than ever.

Much of this second endowment is visible from the suite of offices atop North College where Anne Martin, the university's chief investment officer, oversees the third and most commonly discussed endowment, the university's financial investments.

Nearing her second anniversary in this position, Martin has enlarged and strengthened the professional staff of the Investment Office, while enforcing greater discipline and rigor on the investment process.

In her first completed fiscal year, which ended June 30, 2011, the endowment achieved a 20.9 percent return to $601 million, better than the average gain of 18.8 percent for the same period among college and university endowments in the $500 million to $1 billion range—and one of the top performances among NESCAC endowments. While Martin's transformation of endowment strategy was only partly complete by the middle of last year, it was an encouraging result.

"I feel incredibly lucky" in being appointed to the CIO job, says Martin, who views it as more than just a professional opportunity. Wesleyan runs in her family, creating a strong personal connection to the school and the opportunity for "psychic reward." Martin's brother, Charles, is a member of the class of 1982; a sister, Joanna, graduated in '88, and she has cousins who took diplomas on Andrus Field in '88 and '90. A close uncle, Bob Patricelli, was class of '61, and the Patricelli '92 Theater, a few dozen steps from her office, is named for a great uncle, Leonard Patricelli '29.

"I love the whole investment management business," she says. "It is the perfect job for someone who likes to engage both right and left brain capabilities. I enjoy both the research and theory as well as the creativity you have to bring every day."

Martin attended Smith College, graduating in 1983, where she absorbed a rich liberal arts education. Rather than focusing on finance or economics, she turned to French language and literature with a concentration in mathematics. She later earned an MBA at Stanford Business School, steering her firmly toward her ultimate career.

She came to Wesleyan from the Yale University endowment office, considered best in breed for its investment strategies in recent decades under former Wesleyan trustee David F. Swensen.

The Wesleyan opportunity was made more attractive to a newcomer—and vice versa—because she arrived at a time of renewed focus on the university's financial future, giving her plenty of room to reshape the investment approach while contributing to the broader program of fiscal responsibility under President Michael Roth '78.

When Roth reached South College in 2007, with the endowment heading for its all-time peak above $700 million and investment markets still looking healthy, he quickly determined that Wesleyan could underscore its commitment to student access by lowering loans for students with the most financial need.

Very soon, however, he faced the economic crisis of 2008 and realized that the university needed to set aside two very significant capital projects: a museum and a new science center. "The museum was not essential educationally," he points out. "The science center made sense but was too expensive."

"In the early 2000s the university made great strides in improving its infrastructure and used gifts from donors as well as borrowing supported by endowment spending to finance much needed facilities upgrades." Roth says. "Now we had to spend less, and the amount of spending had to be tied to growth in the endowment."

Wesleyan's endowment had fallen behind those of peer institutions over a number of years. Although the university benefited greatly from the sale in 1965 of American Education Publications for Xerox stock, that advantage was eroded in the 1970s when the university was paying for major construction projects just as the equity markets were tanking. Historically, Wesleyan also had lacked a tradition of earnest fundraising.

In the early 1980s the endowment was about the same size as that of Amherst

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College. Today, Amherst's endowment is triple that of Wesleyan's. John Meerts, vice president for finance and administration, offers another stark example: Pomona College has 10 times the endowment per student as Wesleyan. Alumni who remember the relatively brief moment in the late 1960s when Wesleyan was one of the most richly endowed schools (per student) in the country often express bewilderment over this reversal of fortune.

This failure to keep pace with top-10 liberal arts schools in the *U.S. News & World Report* rankings, though, was not simply a matter of investment results, which admittedly have lagged those achieved by many of Wesleyan's peers. For years, Wesleyan spent too much from its endowment, used too high a percentage of donated funds for operations rather than adding them to the endowment, and until the past two decades, suffered from considerably lower alumni giving levels than its peers. Together, these factors—compounded over time—had a huge impact. Lately, all have been changing for the better.

Roth is determined to "invest, rather than spend, most of what we raise in donations," and in 2010, for the first time in recent memory, Wesleyan raised more dollars for the endowment than for the annual fund. Belt-tightening—more than $25 million has been cut from the operating budget—helped Wesleyan make progress toward achieving a sustainable economic model.

The university has been reducing its draw from the endowment; it currently spends 5.4 percent of the trailing 12-quarter average and is budgeted to spend 5.3 percent in 2013. But the challenge of providing even that level of annual spending in a world of near-zero interest rates and volatile stock markets is daunting. Meantime, higher-education inflation is well in excess of broad inflation (another source of financial pressure), and Roth has publicly stated his desire to move Wesleyan toward smaller tuition increases, which would restrict the single most important lever used to manage the operating budget.

Meerts, who gets credit among his peers for restricting outlays while maintaining funds for curricular support and educational quality, says, "At one point almost 25 percent of our budget came from the endowment, and now it's closer to 15 percent." This was necessary, though he's quick to mention that there is a limit to what can be achieved through spending efficiencies when Wesleyan has to compete with some schools that have the luxury to cover 40 percent or more of their budgets by drawing from their endowments.

Given Wesleyan's spending and endowment per student, "We do just a great job of using our resources to produce as good an education as anyone in the *U.S. News* top 10," he says. At the same time, he cautions that Wesleyan will find it difficult to cut further without affecting the educational experience of its students.

Thus, the imperative for healthier endowment growth and usage becomes obvious, an effort that the administration is collectively focused on.

Barbara-Jan Wilson, vice president for university relations, is the woman with the job—and the zealous energy—to quicken the pace of alumni giving, of which a higher percentage is flowing into the endowment.

"In our last capital campaign we raised $281 million, much of which provided immediate benefit to our financial aid and academic programs. We put about $75 million into the endowment," she says. That campaign also enabled Wesleyan to make extensive improvements to its campus infrastructure, so much so that additional major capital projects are not urgent.

"In the current campaign, now in a quiet phase, we're seeking to raise $400 million from alumni, parents, and friends of Wesleyan, and at least $225 million will go to the endowment—more if we can." With regard to total gift income this year, she expects generous donors to contribute approximately $38 million and "at a minimum" direct $20 to $25 million into the endowment. "That's a huge shift for Wesleyan."

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—President Michael S. Roth '78

Such policies can buttress the endowment as the investment process, under Martin's leadership as CIO, is honed.

"The good news is that we have a first-rate CIO who has built a great team and put in controls to help protect capital. We've made the investment process more rigorous," says Roth.

The search that resulted in bringing Martin to Wesleyan considered a variety of options. Trustee and Investment Committee Chairman Adam Usdan '83 says the first question to settle was whether to maintain an in-house investment office or to outsource the function to one of a growing number of firms that manage endowments for multiple institutions.

The endowment industry has been revolutionized in recent years as former officers from such places as the University of Virginia and Rockefeller Foundation have launched companies for the purpose of allowing higher-education clients, especially those with less than $1 billion under management, to outsource the work for a set fee. The advantage would be to gain the benefit of a larger investment team than any one school could afford.

Usdan says the committee looked closely at all of these firms. "The risk," he says, "is that you might take a lot of the alumni participation out of the process. People like to touch and feel." In particular, those entrusting large donations to a university might relish the occasional opportunity to ask a person about strategies and progress. In addition, the committee felt it could build a high-quality investments office at a lower cost than an outsourced solution.

An executive search firm produced applications from "some incredible people," says Usdan. This included Martin, who was doubly appealing for being "a person of high integrity, and familiar with Wesleyan."

In discussing Anne Martin, pretty much everyone, at some point, mentions that she was a world-class competitive rower. Indeed, she was on the U.S. National Rowing team that won the gold medal at the 1986 world championships, and was a member of the 1988 Summer Olympics team. They mention this both because it is quite impressive and because it suggests something about her character. Namely, that she has energy, focus, and the discipline to repeat technique once it is perfected. Not to mention an abundance of determination and perseverance.

Wesleyan's investment office doesn't select specific investments itself but rather "manages managers," selecting and shuffling among outside investment management firms based on the investment committee's broad investment policy, manager performance, and the opportunities created by financial-market ups and downs. In conversations with alumni, Martin points out that top funds are often willing to consider Wesleyan as an investor despite the relatively small size of its endowment because the university is seen as a well-respected, long-term investor.

What disciplined habits Martin might not have learned on the river were picked up at the Yale investment office. Under Swensen, Yale had turned in fabulous returns by emphasizing non-traditional investment areas such as buyout funds, venture capital, and commodities at levels well in excess of standard investment practice.

Those aspects of the Yale approach have been widely emulated. Martin notes that being highly selective in the alternative assets sector is key to success. For example, in the private-buyouts area she focuses on smaller, specialized funds that can produce returns by operating a company better rather than simply using lots of debt to juice returns.

At Yale, Martin honed her abilities to distinguish good managers and was inculcated with the importance of having a detailed investment policy for building a diversified portfolio and proper execution of strategy by "re-balancing" regularly and unwaveringly. This involves taking some funds from managers and asset categories when they've done extremely well and re-allocating the money to others that have trailed. This works to return the overall fund to its targeted asset mix, maintain proper diversification, and take advantage of the natural tendency of different markets to operate on separate cycles; it is a disciplined way to enforce the principle of "buying low and selling high."

In order to facilitate her rebalancing, Martin uses a Vanguard account holding efficient exchange-traded index funds that simply track underlying markets. This account acts as a store of cash, allowing her to pivot deftly in the rebalancing process. "I consider myself a super-pragmatist," Martin says. "Answers sort of jump out at you and you ask, 'Why are we not doing this?'" Vanguard with its low-cost ETFs, low trading costs (zero for Vanguard ETFs), great service, and not-for-profit structure was one of those obvious answers.

As quickly as Martin has moved to re-engineer the endowment portfolio, she is loath to run too fast in a direction that should have been taken years ago. For instance, Wesleyan was for years underexposed to the fast-growing emerging markets and "missed a decade of very high annual returns," she says. Rather than running after past returns, however, Martin wants to "go slowly," taking perhaps two-and-a-half years to build a full stake. This, it would seem, is another necessary discipline of both the rower and the investment practitioner: knowing how to maintain the proper pacing of one's exertions.

Relying on public and private equity markets for extra return and using bonds as a source of liquidity are other pieces of the Swensen philosophy followed by Martin. She centers Wesleyan's equity exposure on managers who differentiate themselves by focusing on specialized and difficult-to-understand areas such as biotechnology, energy, and smaller technology investments, where a tightly focused strategy can add lots of value.

And, finally, it's imperative to maintain a long-term time horizon, a stance that takes advantage of an endowment's purpose as a perpetual pool of capital that should be built to ride out and even take advantage of interim market setbacks.

Usdan, a career investment manager, says he was impressed by the thoroughness of the reports produced by Martin and her staff on prospective and existing managers. "Anne is a real taskmaster," he jokes.

Martin notes that when she got to Wesleyan, "The endowment was diversified and also very concentrated." That is, it was diversified across asset classes but concentrated within these classes among very few managers. These two tenets remain in the current investment philosophy. She underscores what is often said in finance theory, "Diversification is the only free lunch." Concentration is helpful in focusing capital on the very best people and ideas. The trick, of course, is locating and tracking the very best managers.

"We control risk by knowing our managers very well, and knowing that at times things will go awry for all of them. Then we can decide whether to put in more capital, or whether something more serious is wrong."

With her typical energy and rapid but precise way of speaking, Martin said what she loves about her role is its blend of "the quantitative, analytical, and other issues, like the psychology and incentives of managers. Are they fearful or arrogant? Lucky or smart?"

Martin does not row anymore, but she's applied the same intensity to bike riding, covering 80 to 100 miles most weekends. In volatile times, a smart, determined champion who plans for the long haul would seem to be just what Wesleyan needs.

Michael Santoli is senior editor for Barron's, *the Dow Jones business and financial weekly.*

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