CLARE COLLEGE ENDOWMENT

Investment Philosophy and Long- term Asset Allocation

The College is a permanently endowed charity. It aims to preserve and improve the real value of the College's endowment and the income from it over time. The objective of managing the endowment in this way is to ensure an equitable distribution of benefits between current and future generations of beneficiaries.

There are three critical principles that underlie the College's investment approach:

- The College adopts a very long-term time horizon when making investments. The natural investments for the College to hold are titles to real assets, since these assets should preserve their real value over time. Therefore, the Investment Committee has a preference for equities and other real assets.

- To improve long-term risk adjusted returns by maintaining a diversified geographic and sectoral distribution of assets within the endowment.

- To seek to minimise transaction and management costs. The Investment Committee recognises that the vast majority of actively managed funds fail to generate superior returns relative to their benchmarks over the long term. Therefore, the Committee has a strong preference for investing in quoted equities through low cost passive funds. When selecting actively managed funds, it evaluates whether the fees charged by the fund manager are justified by the expected risk-adjusted returns from that manager and asset class.

The Investment Committee relies on evidence which shows that over the long-term equities not only outperform inflation, but also provide a higher return than other financial assets such as bonds or cash on deposit. Hence the long-term investment targets set for the endowment have a relatively high weighting towards equities.

The Committee also believes that the long-term risk adjusted returns on assets such as equities and property, both real assets, will tend to be similar. That said, there is a clear benefit from holding both, since neither their capital values nor their income streams (dividends and rent respectively) move together over medium-term periods of five to ten years. A diversified portfolio that contains both equities and property will be less risky than one invested exclusively in either one of these asset classes.

The Investment Committee has adopted a long-term strategic target allocation for the endowment with the following target weights and acceptable ranges in weights:

	Endowment	Acceptable Range
Global Equity	70%	50-80%
Property	25%	20-30%
Private Equity	5%	0-20%
Absolute Return	0%	0-20%
Cash & Fixed Interest	0%	0-20%

A similar approach to risk reduction has led the Investment Committee to invest in both UK equities and those of other countries, because dividend and capital values in different stock markets do not necessarily rise and fall in unison even in the long-term. The Committee has agreed a target geographic equity allocation for the investments held in regional index funds as shown below:

Geographic Region	%	Acceptable Range	MSCI ACWI Index
North America	35	25-40	54
UK	25	20-30	5
Europe excluding UK	15	12-18	17
Japan	10	7-13	8
Pacific excluding Japan	3	0 - 5	4
Emerging markets	12	8-16	12

The target allocation has been set with reference to the relative market capitalisation of each region as represented by the MSCI ACWI Index. In addition to the long-term target allocation, an acceptable range has been established for each region, which helps to ensure that a policy of regular rebalancing is enforced. The target allocation over-weights the UK equity market, compared its relative market capitalisation. This is because exchange rates can vary greatly over the short to medium-term and a rise in the real value of sterling might place a strain on the income from the non-UK components of the endowment. The target allocation also under-weights North America: adopting the market capitalisation weight of North America which is currently 54% would make it difficult to maintain an appropriately diversified portfolio.

In addition to adopting strategic asset allocation targets, the Investment Committee also makes tactical asset allocation decisions around these strategic targets. The Committee takes into account the relative valuation of each asset class when determining the tactical exposure. When setting the tactical exposure to each of the geographic equity tracker funds, the Committee considers equity valuation metrics such as the cyclically-adjusted PE valuation for each region.

The foreign currency exposures for equities are not explicitly hedged unless there is a specific tactical case for doing so. This is mainly because it is difficult to identify the underlying currency exposure for multinational companies. Academic research, notably by Elroy Dimson, Paul Marsh and Mike Staunton, also shows that currency contributes little to real global equity returns over long-run periods to a sterling investor: hedged and unhedged returns are very similar. All cash is held in sterling unless there is a specific tactical case to do otherwise.

Investment Management

The Investment Committee makes recommendations on asset allocation decisions to the Finance Committee for the endowment. It has adopted an external manager model that relies on low cost index funds to gain market exposure. It selects actively managed funds only when it considers that the fees charged by the fund manager are justified by the expected risk adjusted returns from that manager and asset class.

For the direct property investments within the investment portfolio, the College takes external advice. Advice on these individual commercial property investments is provided by Bidwells. The College also invests in actively managed property investment funds. These funds allow the College to diversify its property investments by type of property, tenants and geography.

Investments are made into alternative investment products such as private equity and venture capital, when the expected risk-adjusted net returns from such funds, net of all fees, is superior to those from equities. Typically, the Investment Committee targets a return from such funds that is greater than in public equities. Hedge funds typically have a low correlation to public equities and for this reason the Investment Committee may accept a slightly lower return from Hedge fund strategies because they act as a very good diversifier within the endowment. Tactically the allocation to alternative investments will change over time as the expected risk-adjusted return from alternatives change relative to those from property and equities.

Endowment Drawdown

At the heart of the College's financial strategy is the 'spending rule' which provides the fiscal discipline for the use of the endowment income. This rule balances two competing objectives. The first objective is to release substantial funds, in a stable stream, to cover operational expenditure. Stability is important because large fluctuations are difficult to accommodate in the College's activities. The second objective is to maintain the real value of the endowment assets after allowing for inflation. The College's spending rule attempts to meet these two objectives by using a long-term spending rate of 3% of the average value of the endowment over the three previous financial years.

The 2048 Fund

In October 2008 the College borrowed £15 million in the form of a conventional loan from Santander and an inflation swap contract with HSBC, structured to provide 40 year index-linked funding. The interest payments on the Santander loan are set at 4.4% per annum and the HSBC swap contract converts this into a real rate of 1.1% per annum. Through this structure the College was able to take advantage of its ability to invest over the very long term at a time of very low real interest rates. The £15 million was invested in global equity tracker funds and will be left to accumulate over the 40 year period in a ring-fenced fund.

During the first 10 year period of the 40 year inflation swap, from October 2008 to December 2018, the level of RPI has risen by 32%, with the result that the College's liability to Santander and HSBC at December 2018 has increased to £19.8 million. At December 2018 the market value of global equity tracker fund investments held amounted to £29.1 million, the outstanding cash balance stood at £1.1 million and the total value of inflation swap investments amounted to £30.2 million.

Current Asset Allocation

The asset allocation as at 31 December 2018 was as follows:

	Endowment	2048 Fund
Global Equities	61.4%	96.6%
Private Equity	3.6%	-
Absolute Return	2.0%	-
Property	24.0%	-
CU Endowment Fund	5.2%	-
Cash & Fixed Interest	3.8%	3.4%

The current asset allocation is set with reference to the long-term strategic allocation targets, but also reflects tactical deviations from the targets that evolve over time. Asset class valuation data is the principal driver of these tactical changes, which are made within the acceptable ranges that have been established for the endowment. The cash and fixed interest weights are an outcome of the other tactical allocation decisions.

Governance

The Investment Committee reports to the College's Finance Committee which periodically reviews the Investment Policy and its implementation. The agreed policy is implemented by the Investment Committee while having regard to the need to adhere to the requirements of charity law. The College thus seeks to ensure that it does not engage financially with any Investment Manager or advisor whose practices are considered to be in conflict with the purposes or aims of the College as a place of education, religion, learning and research, or whose practices it believes are likely to alienate a sizeable proportion of the members or benefactors of the College.

Socially Responsible Investment (SRI) Policy

When the Finance Committee and Investment Committee review the Investment Policy and the philosophy upon which it is based, due consideration is given to responsible investment behaviour. The guiding principle that underlies the College's SRI policy is that all equity investments are held in low cost country and regional equity index funds. Hence, the main endowment does not hold individual shares in listed companies and we do not take active management decisions on individual companies. When investments are made in index tracker funds the Investment Committee considers the SRI credentials of the company that manages these funds. State Street Global Investors has been selected as the main index fund provider at Clare and the Investment Committee evaluates highly the approach to corporate engagement and the SRI policies adopted by State Street.

The Investment Committee believes that it is more fruitful to engage with companies rather than adopt policies that force divestment. Divestment often results in companies being owned by private investors who allow companies to continue to do what they wish, without any pressure from public shareholders to change strategy. The Investment Committee encourages all of the index fund managers who are appointed by the College to adopt the highest governance and corporate engagement standards when they invest the College's assets.