

# A Review of Institutional Portfolios over the Last 20 Years



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# Fund Evaluation Group – 20 Years



- Founded in 1988 to provide investment consulting services
- Growth in firm:

	<u>1988</u>	<u>2008</u>
Clients	~30	>200
Assets	<\$2 billion	>\$35 billion
Employees	5	70
Research Analysts	0	12 <sup>1</sup>

<sup>1</sup> Only includes dedicated research analysts; three other professionals contribute greatly to the research effort, but also have other roles within the firm

# Employees

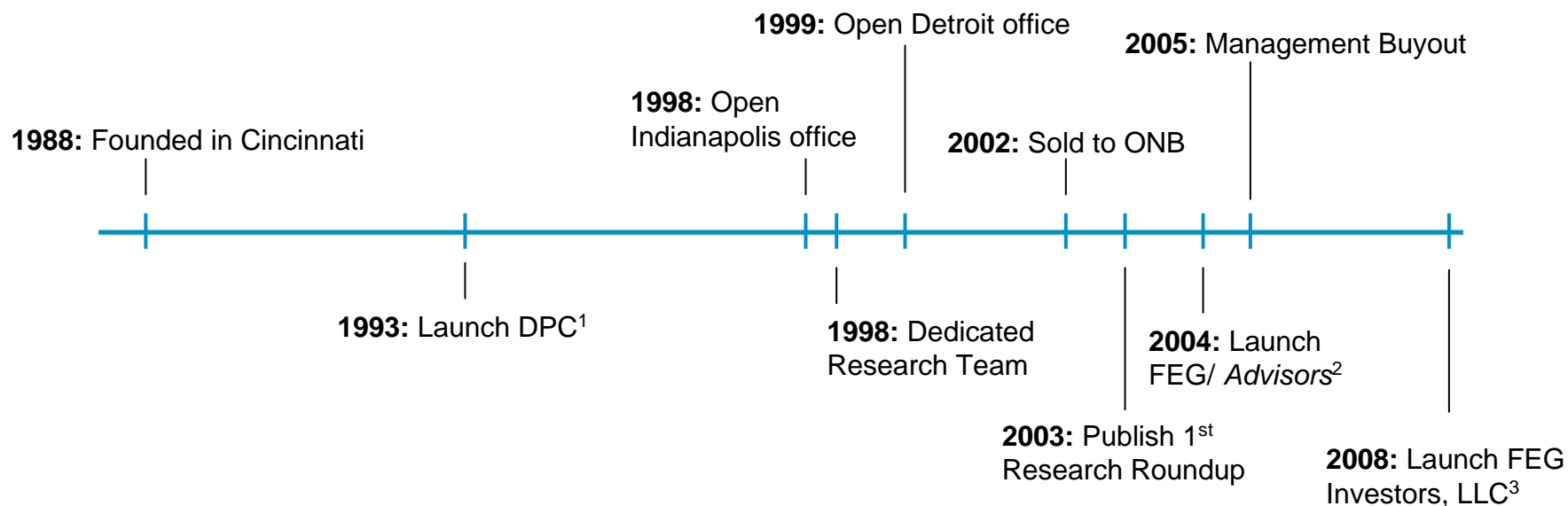


## FEG's Employee Count by Department Structure<sup>1</sup>

<i># of Staff</i>	<i>Department</i>
16	Consultants
12	Research Analysts
17	Reporting/Client Service
7	FEG/Advisors
5	Accounting/Legal and Compliance
7	Office Services
3	Client Development
<u>3</u>	<u>Technology</u>
70	TOTAL

<sup>1</sup> As of March 31, 2008

# FEG Timeline



<sup>1</sup> DPC: Disciplined Portfolio Concepts (later called Fund Evaluation Group Portfolio Services) – investment supervisory service utilizing mutual funds in order to provide broad diversification. Although not discretionary, DPC/FEGPS handled trading/re-balancing

<sup>2</sup> FEG/Advisors: Discretionary investment advisory service

<sup>3</sup> FEG Investors: Provides management services, including advisory services, to a hedge fund of funds

# Asset Allocation Last 20 Years



- The following chart analyzes the change in asset allocation for colleges/universities who participated in the NACUBO (National Association of College and University Business Officers) Survey
- Although this analysis includes only colleges and universities, the data capture the trends that have occurred for all institutional investors, including other not-for-profit organizations and pension plans

# Asset Allocation Changes

	U.S. Stocks	Int'l Stocks	Fixed Income	Real Estate	Hedge Funds	Private Capital <sup>2</sup>	Other	Cash
<b>1989</b>	47.0%	1.7%	31.7%	2.9%	0.0%	0.9%	2.9%	12.9%
<b>1990</b>	47.5	2.3	35.6	2.9	0.3	1.0	0.1	10.3
<b>1991</b>	47.5	2.3	36.0	2.8	0.3	1.0	0.0	10.1
<b>1992</b>	48.1	3.0	35.9	2.4	0.4	0.9	0.0	9.3
<b>1993</b>	48.1	4.2	34.9	1.6	0.7	1.1	2.1	7.3
<b>1994</b>	46.2	7.4	31.8	1.9	1.4	1.2	2.7	7.4
<b>1995</b>	46.9	7.9	30.0	2.1	1.6	1.2	3.8	6.5
<b>1996</b>	51.8	9.4	27.7	2.0	1.9	1.3	0.5	5.4
<b>1997</b>	52.5	11.2	25.7	2.0	2.2	1.3	0.5	4.6
<b>1998</b>	53.1	10.9	25.5	3.4	1.6	2.6	0.7	2.2
<b>1999</b>	53.9	10.5	23.8	1.9	3.1	2.2	0.7	3.9
<b>2000</b>	50.7	11.6	23.4	1.9	0.7	3.7	4.0	4.0
<b>2001</b>	49.6	10.0	24.9	2.1	0.6	2.8	6.0	4.0
<b>2002</b>	46.4	10.1	27.0	2.6	5.6	2.6	1.7	4.0
<b>2003</b>	47.4	9.7	25.8	2.8	6.3	2.6	1.5	3.9
<b>2004</b>	48.7	11.1	21.9	2.8	7.5	2.8	1.6	3.6
<b>2005</b>	45.7	12.7	21.5	3.2	8.9	3.4	1.2	3.4
<b>2006</b>	44.2	13.5	20.2	3.5	9.6	4.3	1.3	3.4
<b>2007</b>	42.5	15.1	18.6	3.4	10.6	4.7	1.6	3.5

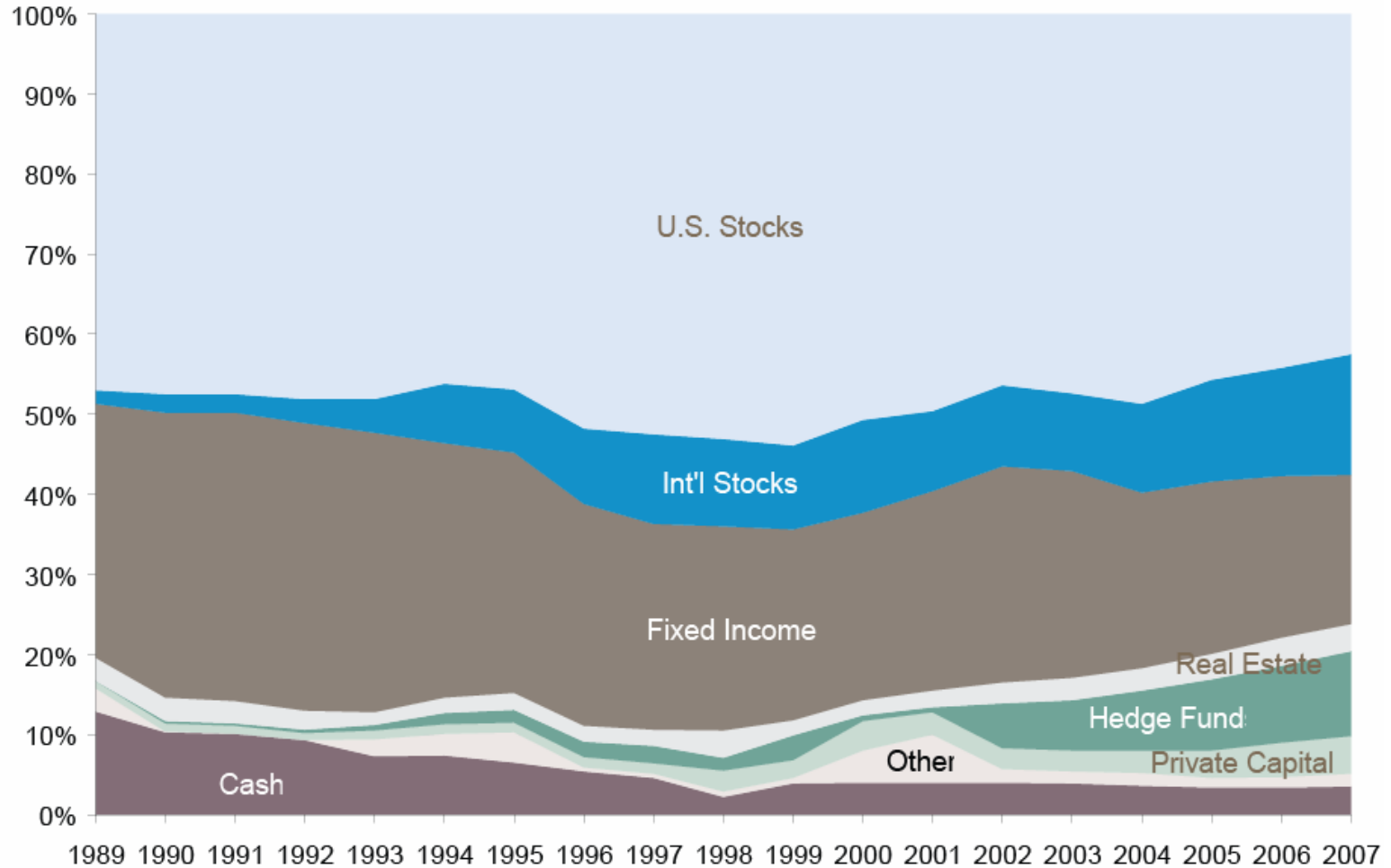
<sup>1</sup> Equal-weighted average, as of June 30 of each year

<sup>2</sup> Private Capital includes venture capital, private equity, and natural resources

# Asset Allocation Changes



Asset Allocation 1989-2007  
NACUBO Endowment Study



# Asset Allocation Findings

- U.S. stocks have always been the largest allocation
  - Increased during the bull market in the late 1990s
  - Have recently decreased in favor of alternative investments
- International stock exposure rose from under 2% in 1989 to 15% today
- Fixed income and cash comprised over 40% of these portfolios 15-20 years ago, but have declined to under 25% today
- Real estate has averaged 2-4% over all time periods
- Hedge fund exposure rose from virtually nothing to over 10% today (most of this growth has come in last 5 years)
- Private capital allocations slowly increased over time
- Cash comprised over 10% of portfolio allocations 20 years ago, but less than 4% today

# Services/Investment Philosophy



- In 1988, FEG provided traditional investment consulting services, including:
  - Performance reporting
  - Manager searches
  - Investment policy statement review
  - Some advice on portfolio structure
- Over time these services were enhanced and FEG's investment philosophy developed
- The following pages provide an overview of the evolution of FEG's investment philosophy

# Investment Philosophy



## 1988 Focused on performance reports

Most portfolios managed by Balanced Managers (60% stocks/40% bonds)

FEG would assist in manager searches

Recommended small cap and international mutual funds to provide diversification

Focused on specialist (growth/value) managers

Recommended dedicated equity and fixed income managers

## 1994 Conducted asset allocation studies using historical data

## 1995 Recommended moving fixed income from intermediate-term to core-plus strategy

## 1996 Separated mid cap from large cap

# Investment Philosophy

1997 Recommended indexing U.S. large cap

Recommended Real Estate Investment Trusts (REITs)

1998 Began actively recommending alternative investments with the hiring of a dedicated research analyst

1999 Focused on understanding sub-styles (deep value, relative value, growth-at-a-reasonable-price, momentum) and fit within portfolio

Issued first quarterly research presentation, *Building Blocks of Equity Returns* – analyzed impact of lower price-to-earnings ratios on stock returns

# Investment Philosophy

2000 Issued first “call to action” research presentation, *Should Fiduciaries Overweight Growth Stocks in Investment Portfolios?* Recommended re-balancing growth overweight back to 50/50 growth value weight

Issued first of many research presentations, *Manager Performance Expectations* that explained that even top quartile managers experience 3-5 year periods of underperformance

- 2001 Introduced 6 tenets to manager due diligence:
1. **Conviction** – willing to make bets; put investment decisions > business decisions
  2. **Consistency** – do not change style to conform to current market sentiment
  3. **Pragmatism** – understand market efficiency/focus on competitive edge
  4. **Investment Culture** – passionate; proper organizational/compensation structure
  5. **Risk Control** – not blind risk takers; acknowledge mistakes; appropriate controls
  6. **Active Return** – identify opportunities; long-term positive information ratios

# Investment Philosophy

2002 Recommended reducing core fixed income (typical client had a 30% exposure) in favor of:

- High yield
- Treasury Inflation Protected Securities (TIPS)
- Real estate
- Absolute return hedge funds
- Equities

# Investment Philosophy



## 2003 Shifted focus:

<i>From</i>		<i>To</i>
Long-term strategic focus Re-balance back to target asset mix	⇒	Complement with opportunistic focus Active asset allocation
Equal-weight growth and value	⇒	Strategic value overweight
Majority of assets in large cap and fixed income	⇒	Reducing large cap and fixed income
Diversify among asset classes	⇒	Diversify among and within asset classes e.g., small cap and emerging markets within international equity  Dedicated high yield and TIPS within fixed income
Modest alternative investment exposure	⇒	Increasing alternative investments
Value added: Relative Alpha	⇒	Value added: Relative Value (in areas where there is a high probability of success) Absolute Alpha (for diversification) Alpha Transport

# Investment Philosophy

- 2005 Recommended bank loans
- 2006 Recommended international real estate securities
- 2007 Recommended Master Limited Partnerships (MLPs)
- 2008 Recommended credit-focused hedge funds and distressed partnerships to take advantage of opportunities due to the credit crisis
- 2009 Investment philosophy will continue to evolve (next pages)

# Investment Philosophy 2010s



- Focus on broad global categories, not specific boxes
- Integrate, rather than separate, illiquid and alternative investments
- Maximize illiquidity premium
- Focus on diversification by risk factor (equity, credit, interest rates, inflation, etc.)
- Build portfolios based on risk tolerance and ability to endure volatility
- Minimize fees for market (beta) exposure
- Reduce constraints (market cap, style, sectors, credit quality, ability to short)
- Allow for tactical and strategic shifts
  - Bottom up – opportunistic managers
  - Top down – tactical shifts of beta portfolio
- Utilize mean variance model to support rather than determine weights

**David Salem, President and CIO, The Investment Fund for Foundations**

***Endowment Management Circa 2007: Art, Science or Craft? – Winter 2007***

Model-based approaches to asset allocation tend to be highly flawed – the old garbage in, garbage out problem – and that they're therefore best used for descriptive rather than prescriptive purposes. In other words, they're best used to analyze the potential impact of asset allocation decisions reached by more intuitively appealing means.

# Portfolio Structure

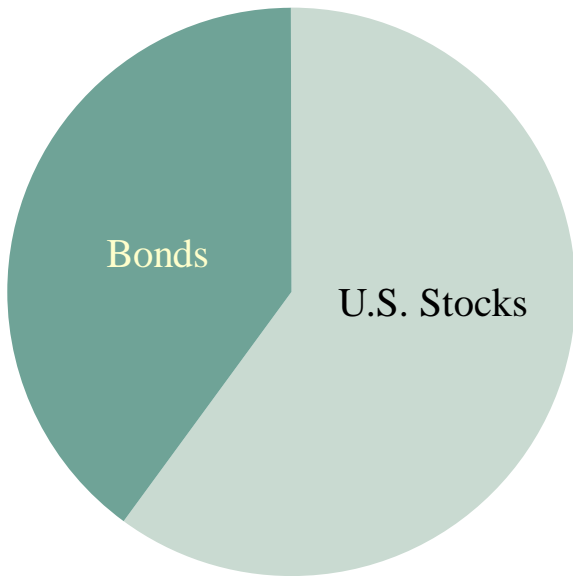


<i>Asset Categories</i>	<i>Primary Risk Factors</i>	<i>Role</i>
<b>GLOBAL EQUITY</b> U.S. and International Market Cap and Style Private and Public Equity Hedge Funds	<b>Equity Market</b>	<b>Total Return</b>
<b>GLOBAL FIXED INCOME/CREDIT</b> Investment Grade TIPS High Yield Bank Loans Private Debt (Distressed and Mezzanine) Credit Hedge Funds	<b>Interest Rates</b>  <b>Credit</b>	<b>Equity Risk Mitigation</b>  <b>Total Return</b>
<b>REAL ASSETS</b> Real Estate (Public and Private) Natural Resources (Timber and Energy) Commodities	<b>Inflation</b>	<b>Inflation Protection (along with TIPS)</b>
<b>DIVERSIFYING STRATEGIES</b> Absolute Return Hedge Funds Trading Strategies Alpha Engines	<b>Active Management</b>	<b>Diversification</b>

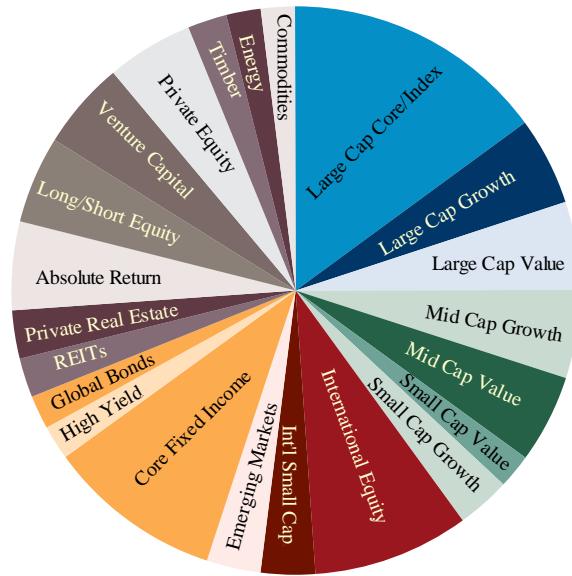
# Evolving View of Asset Allocation



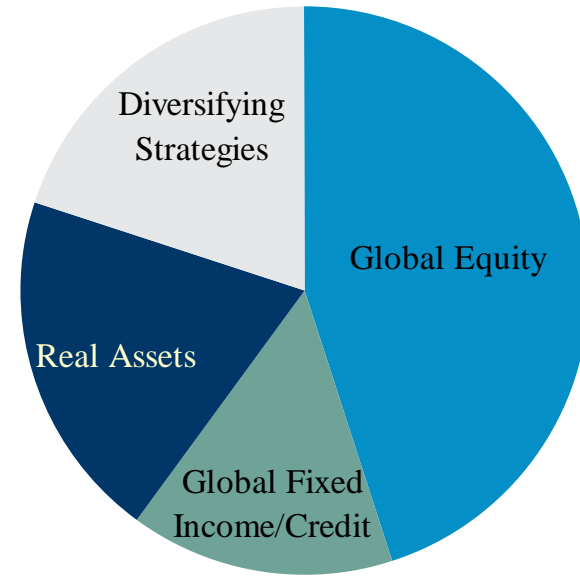
1980s



Late 1990s - 2000s



2010s



# Conclusions

- FEG has experienced significant growth in clients and assets over the last 20 years
- Asset allocation for institutional investors has changed considerably over the last 20 years
  - Fixed income and cash exposure decreased
  - Alternative investment exposure increased
- FEG's investment philosophy has evolved over time and will continue to do so, with a focus on:
  - Embracing illiquidity
  - Integrating alternative investments
  - Allocating to broad asset categories
  - Reducing constraints

# Disclosures

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