RICHMOND CAPITAL MANAGEMENT
Experience, Knowledge, Service

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"Unsexy" Revisited

Five years ago, we wrote a commentary piece in defense of the "unsexy" (bonds) versus the onslaught of the "sexy" (alternative investments). At that time, an article in the *Wall Street Journal*, "Ivy League Endowments Finally 'Dumb'" (June, 2009) caught our attention. The crux of the article was that, after the 2008 financial crisis, the performance of the largest endowments ($1 billion and up) was expected to lag the performance of smaller endowments. The reason: the bigger the endowment, the bigger the bet on the "Yale Model" – allocations to nontraditional asset classes such as hedge funds and private equity. Looking back at the performance of $1 billion and up endowments over the past five years, the WSJ thesis was correct. According to the 2013 NACUBO Study of Endowments, the five year performance of the $1 billion-plus endowments (as of 6/30/13) lagged that of smaller endowments (see Table 1).

Table 1

2013 NACUBO-Commonfund Study of Endowments	
(As of 6/30/13)	**Annualized**
Size of Endowment	**5 Year**
Greater than $1 Billion	3.8%
> $500 Million to ≤ $1 Billion	4.0%
> $100 Million to ≤ $500 Million	3.8%
> $50 Million to ≤ $100 Million	4.0%
> $25 Million to ≤ $50 Million	4.3%
Less than $25 Million	4.9%
Average (equal-weighted)	4.0%

Source: Nat'l Assoc. of College and University Business Officers

Coming back to the "sexy versus unsexy" discussion, a more dramatic comparison can be made between the performance of the $1 billion endowments and a simple 60% stocks/40% bonds allocation over the past five years. Indeed, the Yale Model investors (who often avoid bonds completely) lose out to a 60/40 allocation over the past five years. In Table 2, we compare the biggest endowments from the NACUBO study with the performance of the Vanguard Balanced Index Fund (VBIAX) which is invested 60% in the MSCI Broad Market Index and 40% in the Barclays U.S. Aggregate Index.

Table 2

Performance as of 6/30/13*		
	$1 Billion-Plus Endowments	**60/40 Balanced Fund (VBIAX)**
1 Year	11.7%	12.2%
3 Year	10.5%	12.7%
5 Year	3.8%	7.1%
10 Year	8.3%	7.0%

**All Income Reinvested*

Asset allocation decisions are always very plan specific. Many would argue that a 40% allocation to bonds is overly conservative for their own particular needs. Furthermore, in today's "low yielding" bond environment, many investors fear the risk/reward proposition of bonds as they anticipate the possibility of higher interest rates in the future. Both points are valid. However, we think the last five years serve as an important reminder that simple is not a bad thing in investing. In fact, when markets become volatile, simple can become preferable. The big surprise of the 2008 cycle was the finding by investors that asset classes expected to be diversifiers were not. Many supposedly uncorrelated asset classes turned out to be correlated. In Table 3, we illustrate that point with a correlation matrix as of June 30th that shows asset correlations to the S&P 500. There is only one negatively correlated asset class – core bonds. The "unsexy" asset class has its place in a portfolio.

Table 3

Correlation to the S&P 500 as of 6/30/2014				
Description	**3 Year**	**5 Year**	**7 Year**	**10 Year**
Standard & Poor's 500	1.00	1.00	1.00	1.00
Barclays Aggregate	-0.55	-0.39	-0.32	0.02
MSCI EAFE Net	0.84	0.88	0.91	0.89
Citigroup High Yield Market	0.84	0.79	0.79	0.73
Credit Suisse Hedge Fund Index	0.87	0.90	0.84	0.74
Merrill Lynch All US Convertibles	0.92	0.93	0.90	0.88
MSCI US REIT	0.71	0.73	0.81	0.76

Source: Informa Investment Solutions