Diversification Serves the Endowment Well

The Corporation's strategy of broadly diversifying its investments paid off well during the 1990s bull market and kept losses to a minimum in the bear market of fiscal 2001, which ran from October 1, 2000, to September 30, 2001. Over the past 10 years, the market value of the Corporation's portfolio soared from $967 million to $1.71 billion in September 2001—equaling an annualized increase of 5.9 percent, or more than twice the rate of inflation. This was quite remarkable, given that the portfolio's $743 million growth in value occurred above and beyond paying all investment fees, spending $683.4 million on grants and administration—and weathering the recent storm in the capital markets caused by the bursting of the NASDAQ bubble, recession, terrorism and war preparations.

Apart from showing how quickly markets change, fiscal 2001 demonstrated the powerful benefits of diversification in the Corporation's portfolio. For the first 11 months of the fiscal year, the portfolio's value had essentially been flat, posting a 0.5 percent loss that was, given the circumstances, an outstanding performance for a dismal year. However, with the events of September, the public equity markets were devastated, ultimately resulting in an annual loss of 7.8 percent for the portfolio.

The downturn in capital markets has created a challenging environment for philanthropy and its grantees, but the Corporation's losses could have been much worse. Had the portfolio been invested exclusively in global equities, its market value would have plummeted by almost 30 percent. As it was, the portfolio's assets were allocated into seven major types of investments, including alternative asset classes that did well despite the difficult market environment. For example, the Corporation's investments in real estate and absolute return strategies produced annual returns of 14.4 percent and 10.0 percent, respectively.[1] The Corporation's fixed income portfolio, which is designed to have high credit quality, also contributed substantially to performance with an annual return of 14.9 percent. When all of the portfolio's investments are compared with their respective market indices, the Corporation's loss of 7.8 percent was less than our policy benchmark's loss of 9.8 percent.[2]

The Corporation's spending policy helps sustain its grantmaking efforts in bad times as well as good.

A survey of foundations and endowments with more than $1 billion in assets also provides some perspective on the portfolio's overall performance for the year ending September 30, 2001. The survey, by Cambridge Associates, indicates that last year's loss of 7.8 percent compared favorably with that of its peers, where the average return was a loss of 9.3 percent.

However strong the Corporation's relative performance was, it is not comforting when the benchmark indices slide into troughs of red ink. In dollar terms, the Corporation's 7.8 percent loss translates into a $145 million loss in the endowment's market value. In addition, the Corporation made cash expenditures of $75 million on grants and administration, causing the overall market value of the portfolio to decline to $1.71 billion, from $1.928 billion a year earlier.

Despite the financial setback experienced during fiscal 2001, the Corporation's spending policy supports a stable flow of funds for the foundation's programs and offers a sense of security for our grantees. The policy, which calls for spending 5.5 percent of the average market value of the endowment during the prior 12 quarters, dampens large swings in valuation. This helps sustain the Corporation's grantmaking efforts in bad times as well as good, helping us fulfill Andrew Carnegie's legacy of using private wealth for the public good in perpetuity.

1 Absolute return strategies use marketable securities to generate equity-like returns, but with lower volatility and a low correlation with the public markets. Examples of absolute return include event-driven strategies such as risk arbitrage and distressed security investing as well as hedged equity strategies.

2 The target policy benchmark provides a way to compare the performance of the Corporation's portfolio with appropriate market indices. Each of the portfolio's asset classes (stocks, bonds, real estate, etc.) has a benchmark; the policy benchmark is calculated by multiplying the actual return of an appropriate market index (such as the S & P 500) for each class of assets by the percentage of the Corporation's portfolio that is allocated to that class. The total policy benchmark, the sum of these benchmark calculations, provides an overall measure of actual performance relative to market indices.