**Investment and Capital Management**

**Investment Report 2021**

Investment and Capital Management (ICM) invests the donations and bequests gifted to the University. Long term and medium term funds are invested on a bespoke basis to help meet intended academic and research outcomes.

ICM is responsible for managing the University of Sydney’s endowment capital. The University’s short-term operating and philanthropic financial assets are managed by the Financial Control and Treasury team.

Endowment funds are permanent, self-sustaining sources of funding. ICM invests these funds in financial assets to generate pre-defined annual cashflows to meet varying outcomes, while seeking to maintain the real-term (after inflation) value of the capital invested.

ICM employs a well-structured, long-term investment philosophy based on achieving three core objectives:

1. Releasing consistent and reliable annual cashflow to support the University’s annual ‘spend rule’
2. Generating long-term capital growth to preserve the capital in real terms
3. Defending the core cashflow and growth objectives in times of adverse financial conditions and crisis.

### Composition of funds

The investment portfolio comprises three main funds: a Long Term Fund (LTF), a Medium Term Fund (MTF) and a Short Term Fund (STF).

### Composition of the University’s investment portfolio, as at end December 2021

![Pie chart showing the composition of the University’s investment portfolio, with Long Term Fund at 36%, Medium Term Fund at 61%, and Short Term Fund at 3%.]

### Combined value of LTF, MTF and STF, 1997–2021 (A$m)

![Bar chart showing the combined value of LTF, MTF, and STF from 1997 to 2021, with values increasing over time.]

Notes: Total funds under management include cash-at-bank figures and excludes the value of commercial property, rural property and student housing.
The following is a brief overview of each fund:

**Long Term Fund**

**Value as at 31 December 2021:**
$2094.30 million

**Cash flow objective:**
4.5% per annum

**Capital objective:**
Consumer Price Index (real terms capital preservation)

**Total return objective:**
Consumer Price Index + 4.5% after all fees

The LTF consists mainly of bequests and donations that have been gifted to the University for a range of purposes since it was founded in 1850. The portfolio’s objective is close to long-term expectations from global equity markets, which are historically between 5% and 6% per annum after inflation. The return objective and risk profile for the portfolio reflects the need to release sufficient cashflow to meet the University’s ‘spend-rule’ of 4.5% every year.

The LTF’s core objectives can only be met by allocating a substantial proportion of the portfolio to a diversified range of both income-producing and growth investments and strategies across listed and unlisted asset classes. A smaller, more defensive component of the portfolio is designed to provide sufficient liquidity and return uncorrelated with equity markets. This will meet the annual cashflow requirements and ensure continued opportunistic investment activity during adverse financial market conditions.

**Medium Term Fund**

**Value as at 31 December 2021:**
$104.01 million

**Total return objective:**
Bloomberg AusBond Bank Bill + 1.5% after all fees

The MTF is designed to provide a return better than cash for capital earmarked for use over a one-to-four-year time horizon. Providing for a return higher than cash requires the portfolio to adopt some exposure to risk assets such as equities, which can be volatile. Compared with the LTF, the MTF has a greater allocation to defensive investments such as cash and conservative lending to governments and companies to ensure that any potential for capital loss is limited on a three-year view.

**Short Term Fund**

**Value as at 31 December 2021:**
$1210.21 million

**Total return objective:**
Bloomberg AusBond Bank Bill after all fees

The STF represents the University’s pool of financial liquidity, combining philanthropic capital due to be spent in the near term with the operating funds of the University. By amalgamating these short-term funds, the Financial Control and Treasury team gains buying power to obtain wholesale market rates of interest.

Given that these funds may be called at any time, they are invested in Australian dollar-denominated short-term debt securities, including bank bills and term deposits. The short-term funds are managed within a non-unitised investment pool framework.

**Property assets**

The University also holds a portfolio of buildings and farmland with redevelopment potential.

Commercial property, rural property and student housing investments (which are used to support the core teaching and learning function) are managed in conjunction with University Infrastructure and Central Operations Services and other relevant University departments.
Asset allocation

As at 31 December 2021, the asset allocations for the LTF and MTF were as follows:

Long Term Fund asset allocation as at end December 2021

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>21%</td>
</tr>
<tr>
<td>Investment grade debt</td>
<td>14%</td>
</tr>
<tr>
<td>Non-investment grade debt</td>
<td>6%</td>
</tr>
<tr>
<td>Property</td>
<td>14%</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>6%</td>
</tr>
<tr>
<td>Australian shares</td>
<td>4%</td>
</tr>
<tr>
<td>Overseas shares</td>
<td>2%</td>
</tr>
<tr>
<td>Private equity</td>
<td>2%</td>
</tr>
<tr>
<td>Managed derivatives</td>
<td>2%</td>
</tr>
<tr>
<td>Multi-asset investments</td>
<td>4%</td>
</tr>
</tbody>
</table>

Medium Term Fund asset allocation as at end December 2021

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>57%</td>
</tr>
<tr>
<td>Investment grade debt</td>
<td>4%</td>
</tr>
<tr>
<td>Non-investment grade debt</td>
<td>6%</td>
</tr>
<tr>
<td>Property</td>
<td>5%</td>
</tr>
<tr>
<td>Australian shares</td>
<td>2%</td>
</tr>
<tr>
<td>Overseas shares</td>
<td>1%</td>
</tr>
<tr>
<td>Multi-asset investments</td>
<td>57%</td>
</tr>
</tbody>
</table>

Note: Allocations are shown before the impact of currency hedging

Long term investment returns

5 year performance p.a. (%) as at 31 December 2021

- Long Term Fund: 11.0%
- Medium Term Fund: 6.4%
- Bank Bill: 4.6%
- Short Term Fund: 1.8%
- Bank Bill: 1.1%

10 year performance p.a. (%) as at 31 December 2021

- Long Term Fund: 11.4%
- Medium Term Fund: 6.5%
- Bank Bill: 6.7%
- Short Term Fund: 2.7%
- Bank Bill: 1.9%

Note: the University’s returns are after underlying external manager fees and inclusive of franking credits
Risk management

Investment strategies and decisions are made within a closely monitored risk management framework to ensure the University delivers a suitable return across the investment portfolio over time. Risk management is focused on ensuring adequate short-term liquidity, maximising diversification and managing the potential for capital drawdown during times of adverse financial conditions, including crisis.

The concept of ‘volatility’, or the standard deviation of returns, is often used as a proxy for measuring portfolio risks. While ICM does monitor this measure, it is important to note that this represents only one way of viewing the risks being taken.

The five-year reward-to-volatility ratios shown in the chart to the right demonstrate that the University’s portfolio has earned a greater return than Australian and overseas shares when using volatility as a proxy for risk.

Market conditions in 2021

2021 will be remembered as among the strongest calendar years for investment returns. Responding to the ongoing challenges of the global pandemic, Central Banks and governments around the world continued to lend strong economic support which flowed through to asset prices. Increasing concentration in a small number of large-scale US-listed companies assisted benchmark returns as investors preferred equities to bonds, but sought out liquidity and psychological comfort in corporate growth and solidity.

1 year asset class returns v/s USYD performance (%) as at end December 2021

Note: All returns are in base currency (that is, AUD for domestic and overseas assets)
Long Term Fund

The University’s Long Term Fund returned 24.8 percent in 2021, after taking into account external manager fees. The portfolio benefited from its equity positioning, including in private markets, along with its systematic approach to currency, which meant the portfolio was well-exposed to the US dollar throughout the year.

The chart below shows the 2021 return of the LTF and MTF alongside various key asset classes. The returns are cross-referenced with the standard deviation of those returns, which is a measure of volatility and used as a proxy for the risk taken.

Medium Term Fund

The return on the University’s Medium Term Fund (after external manager fees) for calendar year 2021 was 4.8 percent. This has more than met expectations for University funds invested in this product, which have a one to four year spending time horizon and so are looking for returns better than cash.

Long Term Fund, Medium Term Fund and a selection of core asset classes 1 year to 31 December 2021
The University’s investment advantages

The University has a series of key investment advantages that the ICM team seeks to exploit in its management of the portfolios. They include the following attributes:

- sought-after investment partner, representing long-term patient capital and a strong institutional reputation
- preferred investor status with many managers who are offering capacity-constrained strategies
- tax-free status, including the ability to reclaim franking credits
- sophisticated investment committee
- ability to invest in opportunities on a bottom-up basis and depart significantly from benchmark positions if it makes sense to do so on a return-for-risk basis
- flexibility to construct portfolios that are counter-cyclical and contrarian
- sufficient scale to meaningfully access niche asset classes and high-performance strategies
- after-fee return focus.

Management of the investment portfolio

The ICM team possesses a considerable breadth of experience, with key members each having spent more than 20 years analysing and selecting professional fund managers and building diversified portfolios for a range of different client types. Funds invested are externally managed by professional security analysts and portfolio managers. This ensures the University has a broad-based and robust team of highly skilled experts working to achieve the stated objectives.

The University’s external custodian plays an important role in the compliance-monitoring function. Furthermore, a global consultant is employed to provide an annual actuarial review of the portfolio to assist the Investment Sub-Committee of the Finance Committee (FC ISC) with its fiduciary oversight of the portfolio. The same consultant also provides analysis and advice to assist the University in meeting its Environmental, Social and Governance (ESG) policy objectives.

Governance

ICM is overseen by the Investment Subcommittee of the Senate Finance Committee. Its terms of reference extend to the management of the University’s investment portfolios and approval for capital projects funded from the University’s Future Fund.

An overview of management and governance of the University’s investment activities is contained in the Investment Policy statement, available by searching online at www.sydney.edu.au, or by following this link: sydney.edu.au/policies/showdoc.aspx-recnum=PD2012/258&RendNum=0

Governance structure
### Sustainability

The University undertook extensive work with a global consultant during 2021 to expand its existing integrated Environmental, Social and Governance (ESG) framework to dovetail with the University’s Sustainability Strategy.

Since 2014 the University’s listed equity portfolio has been routinely measured in the last quarter of every calendar year to assess its carbon footprint in comparison with both domestic and international benchmarks. The results of this assessment in 2021 showed that the portfolio was comfortably meeting its prior policy objective, which was for the carbon footprint to be 20% below a composite benchmark. Referring to the chart below, absolute emissions from the portfolio have declined substantially since the portfolio was first measured in 2014.

ICM has been asked to exclude direct holdings in fossil fuel companies which do not meet stringent management and carbon emissions scores and divested of those companies before the end of the calendar year. ICM is working with its manager cohort to identify those corporate actors around the world most keenly focused on transitioning to a low carbon economy, as well as engaging on a range of ESG issues. An annual survey tracks managers’ views and activity relating to climate, diversity in business and on Boards, voting and modern slavery.

### Management of bequests and endowments

ICM works closely with the University’s Development Office and Trusts Office to ensure proper administration of the endowment and bequest portfolio.

For managing the Medium Term and Long Term Funds investment portfolios, an annual administration fee of 0.4 percent of funds under management is charged.

### Evolution of Carbon Footprint Measures 2014–2021

#### Notes:
- Absolute emissions are measured as tCO2-e; carbon intensity is measured as tCO2-e/USDm revenue.
- The University targets 20% reduction in carbon intensity of the total listed portfolio relative to the listed equity composite benchmark. Source: Mercer, MSCI, the University of Sydney

For more information on the University’s Investment Policy (incorporating ESG considerations), please search for Investment Policy at www.sydney.edu.au, or follow this link:

- sydney.edu.au/policies/showdoc.aspx-recnum=PD0C2012/258&RendNum=0
Investment beliefs

The investment portfolio provides essential funding support for University operations, particularly the teaching and research portfolio.

This support is needed continuously, so it is essential to preserve the portfolio’s purchasing power for the benefit of future generations. Aspiring to achieve a performance that exceeds the rate of inflation by a margin is therefore a core investment return objective.

It is equally important to adhere to core investment beliefs that, in essence, define the investment philosophy and underlying risk appetite of the portfolio.

The following 10 investment beliefs underpin the University’s approach to investment and risk.

1. The principal objective of endowment portfolio management is to maintain the purchasing power of the capital in real terms (that is, after taking inflation into account), while delivering sufficient income to meet spending requirements.

2. A key determinant of investment performance is asset allocation. This describes the relative allocation of the portfolio to different investment asset classes, securities and strategies.

3. All investments are a mixture of opportunity, risk and uncertainty. Taking too little risk makes it hard to meet challenging long-term investment objectives but taking higher risk does not necessarily lead to higher returns. Risk is multi-faceted, its profile changes over time and it needs to be managed dynamically. One technique employed to manage risk is portfolio diversification. Funds are invested across many asset sectors: private equity and venture capital, listed equities, infrastructure, property and fixed income, among others. Some of these assets are by nature illiquid and therefore become long-term holdings.

4. Active specialist managers are capable of generating strong performance. However, this style of management can also lead to short-term underperformance. Passive management can complement active management, particularly in circumstances where there is a broad-based value opportunity in an asset class.

5. Environmental, social and governance opportunities and risks can have a substantial impact on portfolio performance. The most efficient approach is obtained through an integration of these factors into the overall portfolio construction and management.

6. To import extra thinking, it is useful to form strategic partnerships with external managers and advisers, such that they become an extension of the internal team. This also helps to foster best practice in the portfolio’s management.

7. It is best practice to hold the portfolio’s assets in safe custody with a master custodian.

8. Good governance is critical in terms of resourcing, accountability and portfolio outcomes. This involves the production of regular, detailed and informative reporting on the portfolio, side by side with constant monitoring of the portfolio and its managers.


10. The level of fees paid to external parties, such as managers, should be judged by the resulting performance. In this context, performance-based fees are sometimes useful in incentivising managers to achieve desired performance outcomes.
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Chair, L.E.K. Consulting
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Member, AICD Corporate
Governance Committee
Member, LBW Trust /
Women for Change Committee
Non-Executive Director,
Board of Nanosonics
Non-Executive Director, Fisher
& Paykel Healthcare Board

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Director, REA Group Ltd
Director, Wenona School
Director, Coles Group
Member of Advisory
Board, Afinity
Member of Advisory Board,
Jord International Pty Ltd
Controlling Shareholder &
Director, Brurern Pty Ltd
Controlling Shareholder &
Director, Eco Cars Pty Ltd
Controlling Shareholder &
Director, Chippendale Farm
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