

# Investment and Capital Management Investment Report 2018

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# Investment and Capital Management

## Investment Report 2018

Investment and Capital Management (ICM) invests selected 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 value of the capital invested after taking inflation into account.

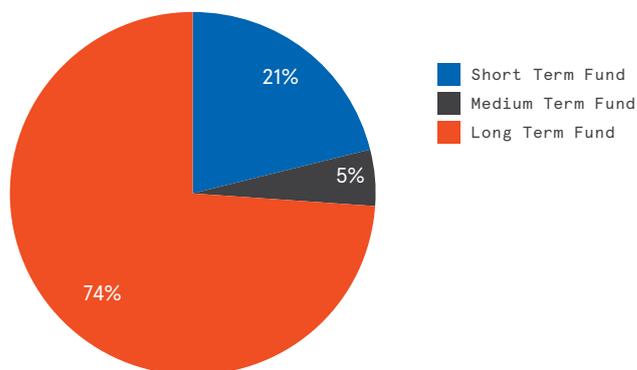
ICM employs a well-structured, long-term investment philosophy based on achieving three core objectives:

- releasing consistent and reliable annual cashflow to support the University's annual 'spend rule'
- generating long-term capital growth to preserve the capital in real terms
- defending the core cashflow and growth objectives in times of adverse financial conditions and crisis.

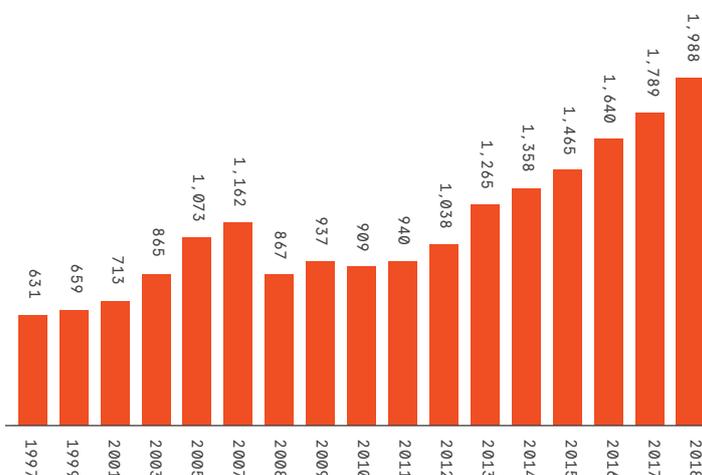
### Composition of funds

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 2018



Combined value of LTF, MTF and STF, 1997-2018 (A\$m)



Note: Total funds under management as reported by the University's custodian. The value of commercial property, rural property and student housing is excluded.

The following is a brief overview of each fund:

### Long Term Fund

#### Value as at 31 December 2018:

\$1467.35 million

#### Cashflow 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% after inflation. The return objective and risk profile for the portfolio reflect 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 2018:

\$94.38 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 2018:

\$425.80 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.

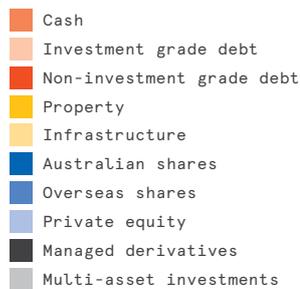
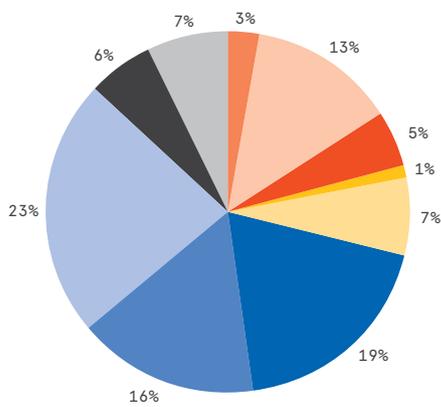
Commercial property, rural property and student housing investments (which are used to support the core teaching and learning function) are managed in conjunction with Campus Infrastructure Services and other relevant University departments.



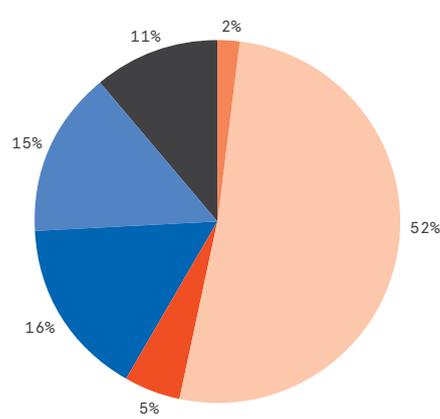
## Asset allocation

As at 31 December 2018, the asset allocations for the LTF and MTF were as follows:

**Long Term Fund asset allocation as at end December 2018**



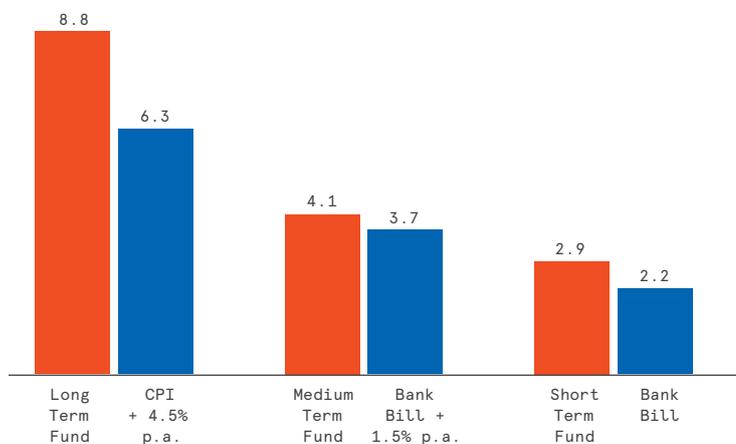
**Medium Term Fund asset allocation as at end December 2018**



Note: Allocations are shown before the impact of currency hedging

## Long term investment returns

**5 year performance p.a. (%) as at 31 December 2018**



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

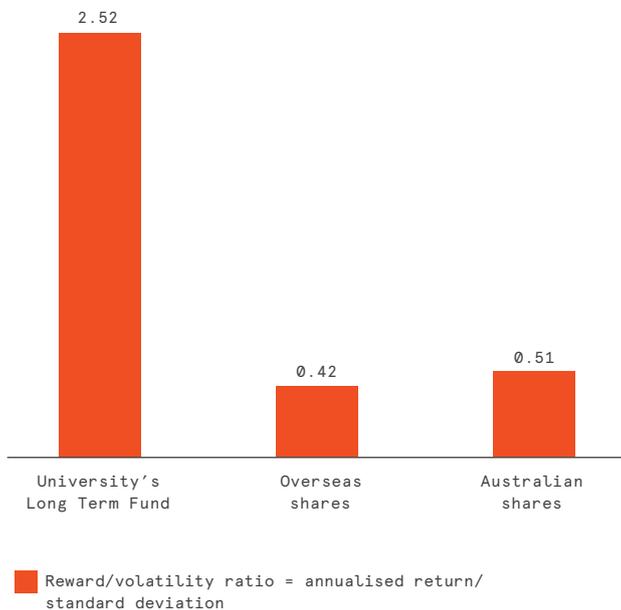
## Risk management

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 per unit of volatility than Australian and overseas shares.

Reward-to-volatility, January 2014 – December 2018

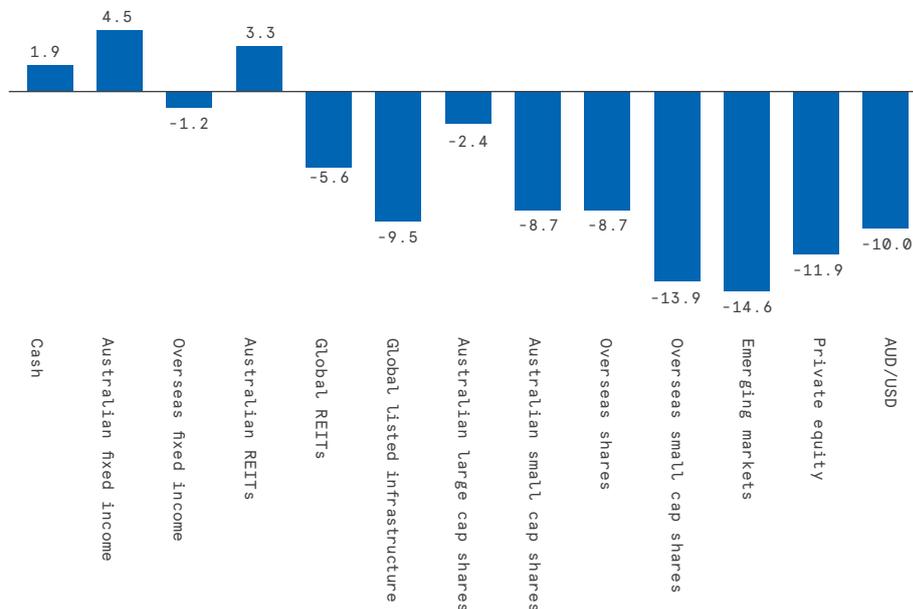


## Market conditions in 2018

As shown in the chart below, 2018 was a difficult year for most risky asset classes after several years of positive results. Market concerns focused on the impact of central banks withdrawing liquidity and raising interest rates. Ironically, this created a flight

to safety, which bolstered the returns of interest rate sensitive bonds, which in turn drove interest rates down. This market tussle between the interest rate outlook and market valuations is likely to be an ongoing market theme in 2019 and beyond.

1 year asset class returns (%) as at 31 December 2018

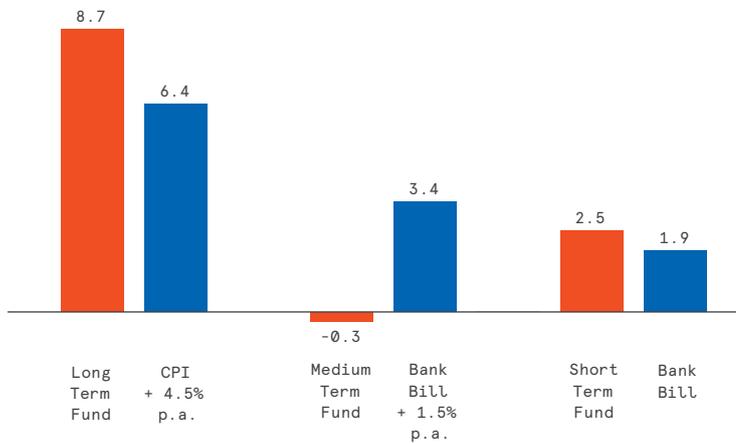


Note: All returns are in base currency (that is, AUD for domestic assets and USD for overseas assets)



## 2018 investment performance

1 year performance (%) as at 31 December 2018



### Long Term Fund

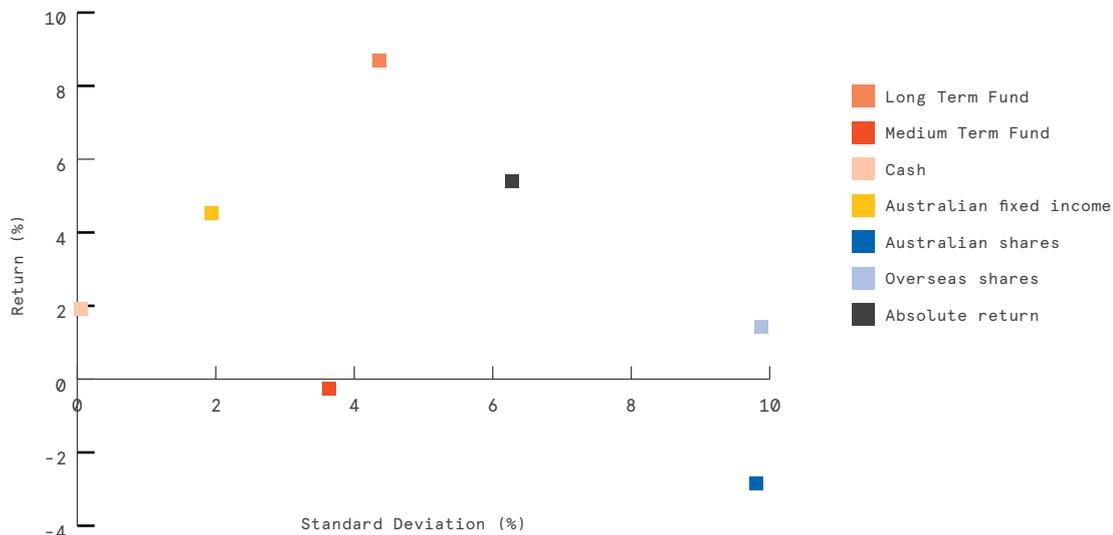
The University's Long Term Fund achieved a return (after external manager fees) of 8.7% for 2018. Exposure to unlisted assets like private equity along with favourable currency positioning assisted the fund's return for the year.

The chart below shows the 2018 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 of the University's Medium Term Fund (after external manager fees) for the 2018 calendar year was -0.3%. Exposure to poorly performing asset classes, including Australian shares, caused the fund to register a small fall in value for the year. Despite this, the fund has generated annualised return of 4.1% over the last five years.

Long Term Fund, Medium Term Fund and a selection of core asset classes 1 year to 31 December 2018



## 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 15 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 and Audit Committee (FAC 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.

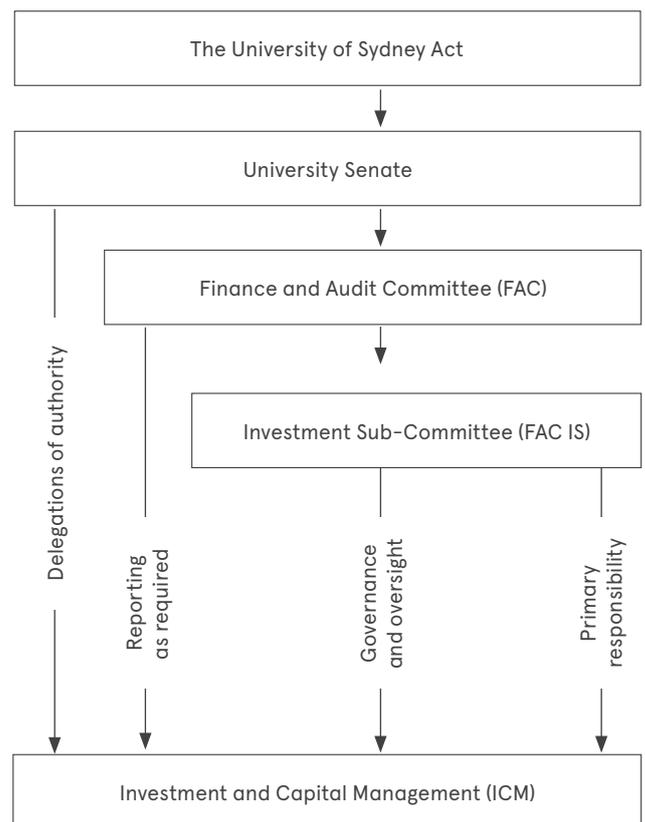
## Governance

ICM is overseen by the Investment Sub-Committee of the Senate’s Finance and Audit 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 at

- [sydney.edu.au/invest\\_capital\\_mgmt/investment\\_policy\\_proc](https://sydney.edu.au/invest_capital_mgmt/investment_policy_proc)

### Governance structure



## Environmental, social and governance (ESG) issues

In 2014 the University undertook extensive work with a global consultant to expand the existing integrated ESG framework to incorporate climate change considerations. The University also became a signatory to the Carbon Disclosure Project. In 2015, the University became a signatory of the Portfolio Decarbonisation Coalition, committing to reduce carbon emissions in the listed equity sectors of the investment portfolio over a three-year period.

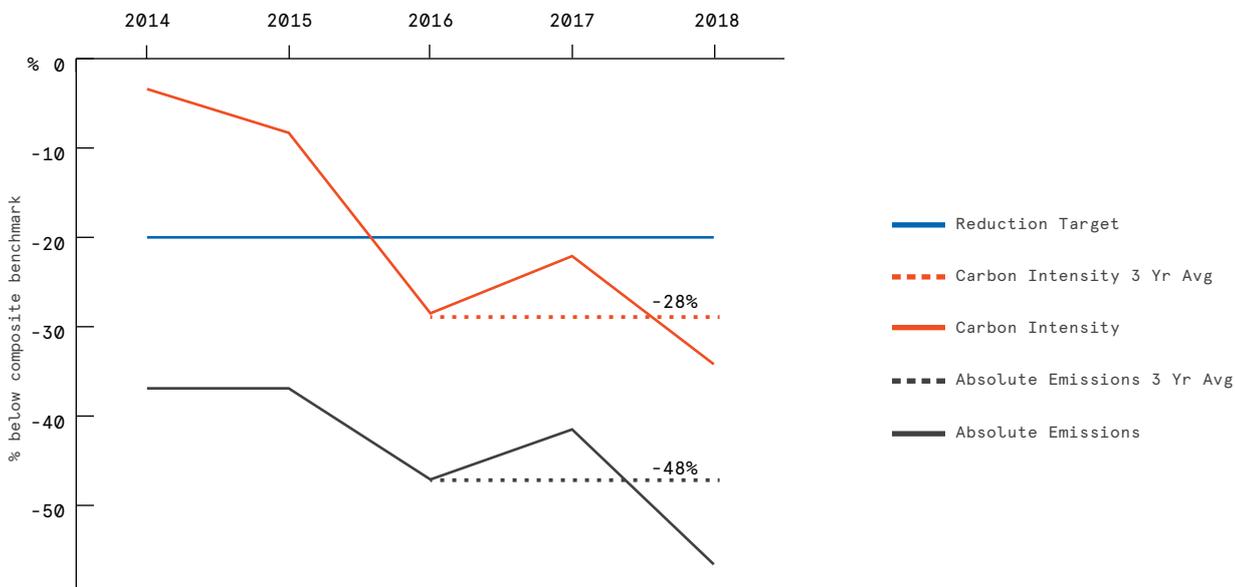
The University's listed equity portfolio is routinely measured in the last quarter of every calendar year to assess its carbon footprint in comparison with both domestic and international benchmarks. The results of this assessment in 2018 showed that the portfolio met its policy objective. The University actively engages with all its external managers on ESG issues, and the University's Investment Policy was amended in the first half of 2017 to incorporate Aboriginal and Torres Strait Islander considerations in the ESG framework.

## 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 Fund investment portfolios, ICM charges an annual administration fee of 0.4% of funds under management.

### Evolution of carbon footprint measures 2014–2018



Notes: Absolute emissions are measured as tCO<sub>2</sub>-e; carbon intensity is measured as tCO<sub>2</sub>-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), see [sydney.edu.au/invest\\_capital\\_mgmt/esg\\_resp\\_invest/index.shtml](http://sydney.edu.au/invest_capital_mgmt/esg_resp_invest/index.shtml)

# 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 multifaceted, 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: listed and private equity, 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.
9. Best practice portfolio management encourages learning and questioning of the status quo.
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.

# Key contacts

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## **Investment Sub-Committee of the Finance and Audit Committee**

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### **David Mortimer AO**

Governor, CEDA  
Chair, FAC ISC, the University of Sydney  
Chair, Opera Australia  
Chair, Tendwine Mirage Operations Pty Ltd  
Chair, Mirage Plains Pastoral Partnership  
Chair, Buildcorp Advisory Board  
Chair, Sydney University Rugby Foundation Board  
Chair, Australian Schoolboys Rugby Foundation  
Director, Petsec Energy Ltd  
Director, MySale Group Plc

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Chancellor, the University of Sydney  
Chairman, Thales Australia  
Chairman, Future Generation Global  
Investment Company  
Director, Qantas  
Director, Australian Philanthropic Services

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Vice-Chancellor and Principal,  
the University of Sydney

### **Richard Freudenstein**

Deputy Chancellor, the University of Sydney  
Director, REA Group Ltd  
Director, Astro Malaysia Holdings Berhad  
Chairman, Selz.com Pty Ltd  
Member of Advisory Board, Afiniti  
Member of Advisory Board,  
Jord International Pty Ltd  
Director, Wenona School  
Director, Coles Group

### **Dr Lisa McIntyre**

Director, Insurance and Care NSW (icare)  
Director, HCF Group  
Chair, HCF Research Foundation  
Director, Studiosity Pty Ltd  
Member, L.E.K. Consulting ANZ Advisory Board  
Member, AICD Corporate Governance Committee  
Member, LBW Trust / Women for  
Change Committee

### **Ms Karen Moses**

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Non Executive Director, Boral Ltd  
Non Executive Director, Orica Ltd  
Non Executive Director, Charter Hall Group  
Non Executive Director, State Super Trustees  
Chair, Sydney Dance Company  
Non Executive Director, Sydney  
Symphony Orchestra

### **Richard Facioni**

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Chair, EziBuy Ltd  
Chair, Eptec Pty Ltd  
Chair, Cheap as Chips Discount Stores Pty Ltd  
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