

Haverford College

Haverford College
Office of Investments
370 Lancaster Avenue
Haverford, PA 19041

November 15, 2014

We are pleased to share our second annual letter to the community on the investment activity and performance of the Haverford endowment. For the fiscal year ended on June 30, 2014, the endowment's investment performance was +15.9% net of fees, representing another year of strong absolute investment performance following the 15.1% increase we enjoyed last year. In addition to the investment gains, the endowment received \$11.9 million in gifts during the year and paid out over \$22 million in support of the College's operations, ending the year at approximately \$491 million, a \$57 million net increase over the prior year.

While pleased by our results, we want to remind everyone of the importance of having realistic expectations for future investment performance. Our statement from last year's letter holds true this year as well: "...there will be future periods of declining markets or market turmoil, resulting in more modest or negative performance at times. Indeed, it is our expectation that returns to the endowment over the long-run will be appreciably lower than last year's strong results." While we're perfectly happy when the equity markets drive strong performance, the statement nonetheless remains true relative to our long-term expectations despite – or, perhaps, especially in light of -- two consecutive years of mid-teens investment returns for the endowment.

Maintaining realistic expectations is one of several points that we'll likely touch on in every letter that we write. Other points that you will hear us repeat over time include the College's very long-term investment horizon; the importance of our community and investment manager relationships; and the importance of understanding all of the components of endowment growth. When it comes to growing the endowment, fundraising is as important as investment performance and we thank all of our donors for another year of very generous giving. In addition to investment performance and philanthropy, the third leg of endowment growth is how much we spend from endowment to support the current operations of the College. Spending is a balancing act – we'd like to spend less today to build the size of the endowment for the future and we'd also like to spend more today to make Haverford the best it can be for the current generation of students. In the end, our goal is for spending to treat current and future generations equally, so endowment spending is designed to maintain the long-term purchasing power of the endowment, while providing significant support for current operations. The balancing act, then, never ends.

Investment Philosophy

Our philosophy centers on a long-term investment horizon, partnerships with high quality investment managers, and the view that market exposure (or "beta") can be accessed inexpensively through passive, index funds. We only want to venture beyond this beta exposure when a type of investment can't be accessed passively, provides a different type of market exposure compared to index portfolios, or is expected to generate significant returns in excess of active management fees.

We provided broader context on the endowment’s philosophy and historical performance in last year’s letter, which can be found [here](#), so instead of repeating ourselves, we’ll simply refer you to that letter and dive into more details on the 2013-14 fiscal year.

Fundraising is as important as investment performance, and we thank all of our donors for another year of very generous giving.

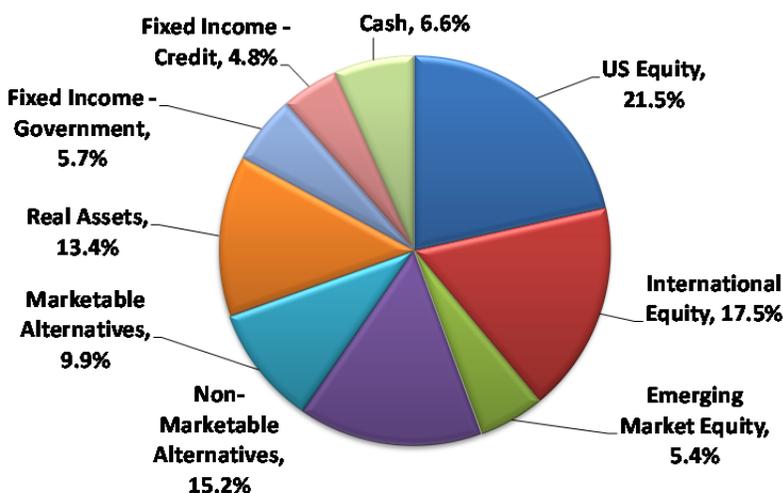
Asset Allocation

The endowment portfolio evolves slowly over time, so we do not expect substantially different allocations from year to year. In 2013-14, there were some incremental changes as a result of market movement and several transactions in the portfolio.

The asset allocation as of June 30, 2014, is shown below, and is categorized based on our policy allocations across global public equities, fixed income, and alternative investments. However, we also consider the function of each investment in the portfolio, such as capital growth, capital preservation, inflation-sensitivity and diversification benefits, as we consider asset allocation and the overall level of equity market exposure in the portfolio.

Haverford College Asset Allocation as of June 30, 2014

Asset Category	Allocation	Policy Target	Policy Range
US Equity	21.5%	22%	18% - 26%
International Equity	17.5%	18%	15% - 21%
Emerging Market Equity	5.4%	6%	4% - 8%
Non-Marketable Alternatives	15.2%	12%	6% - 18%
Marketable Alternatives	9.9%	14%	8% - 17%
Real Assets	13.4%	12%	5% - 18%
Fixed Income - Government	5.7%	8%	6% - 10%
Fixed Income - Credit	4.8%	6%	4% - 8%
Cash	6.6%	2%	1% - 10%



Our asset allocations have moved incrementally closer to our long-term policy targets over the past year, and we are now fairly close to our policy targets across the entire portfolio. Public equity remains slightly below its policy target, compensating for a minor above-policy-target-weight in non-marketable

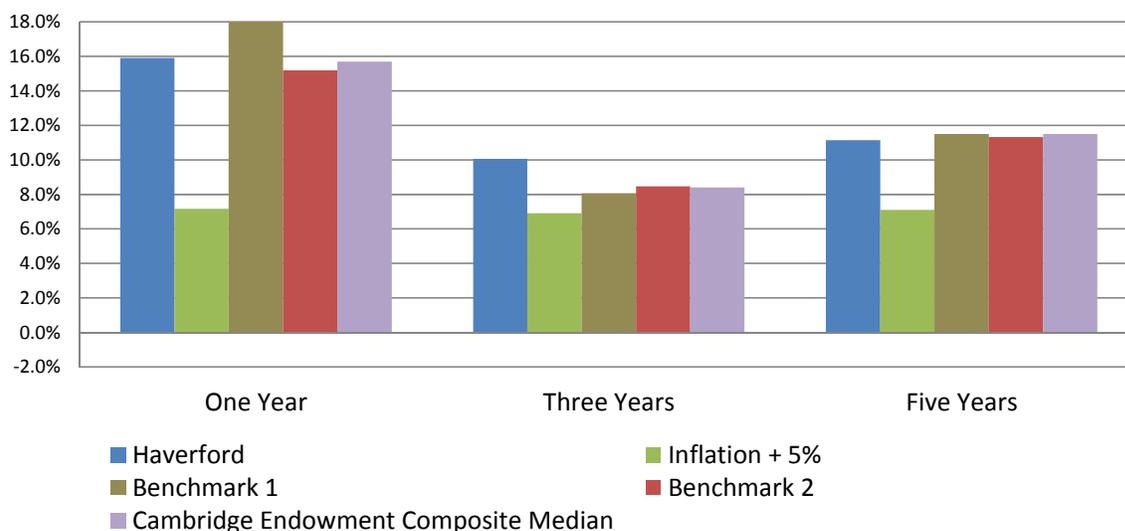
alternatives, principally private equity. Private equity continues to decline from the high levels we carried after the global financial crisis, due to funds distributing significant amounts of capital in recent years. Our private equity allocation is mostly held in legacy positions incepted prior to the global financial crisis, a point to which we'll return in the Investment Performance section below. We are also now actively exploring and making new allocations to private equity funds that meet our investment criteria. We also continue to invest in new hedge funds at a measured pace, as we carefully evaluate their ability to generate attractive returns in both stable and turbulent financial environments--something that has been difficult for many hedge fund managers to achieve in recent years.

Whereas last year our allocations were additive to performance across the portfolio, our allocation differences from policy had little effect on the overall return in 2014. This is largely due to the fact that we were very close to policy targets for the year, and performance was strong across different asset classes. You might also notice the overweight position in cash, which is not a result of a tactical investment decision in the portfolio. Rather, the overweight is a result of the heightened pace of private equity distributions we've received recently. We are willing to have some excess cash when there are no obvious places offering compelling value in the markets. At the same time, excess cash can be a drag on performance when markets rise, but with underweights in fixed income given the current interest rate environment, our overall allocation to both high-quality fixed income and cash is only slightly above their combined policy target. Nevertheless, we are actively working to find places to put our excess cash to work, and have made new commitments to funds since the end of the fiscal year.

Investment Performance

As a reminder, we evaluate endowment performance versus several benchmarks. A primary goal in managing the endowment is to preserve its purchasing power for future generations, which requires us to generate a net return equal to or in excess of our spending rate from the endowment plus inflation. We approximate this "Spending Benchmark" to be Inflation + 5%, given that spending over time has tended to be in the range of 5% or less. We also compare performance to a simple global benchmark of 70% equity / 30% fixed income (Benchmark 1 in the figures below), which is reflective of a traditional, balanced allocation, and to a benchmark that is representative of our strategic policy targets across asset classes (Benchmark 2 in the figures below).

Endowment Performance as of June 30, 2014



We're pleased that performance over the last three years is approximately 200 – 300 basis points above these benchmarks, as this time frame is more representative of our post-financial-crisis approach to

managing the portfolio and reflective of the current policies that are in place. The five-year number extends back to immediately after the crisis, when the portfolio was being re-positioned and was under-invested in equity assets during this transitional period. However, while we focus solely on exceeding our benchmarks that pertain to Haverford's specific institutional goals rather than comparing to other endowments, our results over the past five years are competitive with the endowment universe.

As mentioned in the prior section, our asset allocation was close to neutral versus our long-term policy targets during the year. However, our managers added value broadly in 2014 with the exception of our legacy private equity portfolio. In fact, our performance attribution showed that the public equity and private equity allocations were mirror images of each other during the year. The slight underweight to public equities proved to be a minor detraction from return, given the strong overall equity market performance, but our active managers exceeded their benchmarks.

With respect to the non-marketable allocation, principally private equity, our overweighting was a positive contributor given the overall strong performance of the sector, but our mostly legacy portfolio of funds lagged their asset class benchmark. After several years of limited new commitments to private investments, as we sought to improve our liquidity position following 2009, the majority of our private holdings now date from prior to 2009 and even as far back as 2000. Unfortunately, these older, more seasoned funds did not experience as large improvements in valuations as the overall market enjoyed during the past year. As those holdings continue to distribute cash and run-off in the portfolio, we're actively pursuing new private investments and working on developing relationships with private equity managers we believe are well positioned to generate strong results.

At the individual fund level for marketable investments, the indexed portfolios performed in line with their benchmarks, as expected. In addition, every active manager exceeded its relevant benchmark, except for one. Our hedge fund portfolio returned just over 11%, not quite as strong as last year's 14% return, but well in excess of the 7.6% return of the HFRI Fund of Funds Index. So overall, we're pleased to see the investments of the past several years adding value. In addition, over the long-term, the legacy private equity portfolio has performed around the median for the universe. Overall, we believe that the results for FY14 further support the view that we are on the right path forward.

We believe that the results for FY14 further support the view that we are on the right path forward.

The Positives and Negatives of Endowment Size

With an endowment of just under \$500 million as of June 30, 2014, we are one of the smaller players in the broader institutional investment world generally, and compared to our peers' endowments, in particular. However, Haverford's endowment supports a much smaller student body than larger institutions. Based on the 2013 NACUBO Endowment Study, Haverford has the 43rd largest endowment per student in the country, so our "smaller" endowment is less of a disadvantage than it may appear, and Haverford is extremely fortunate to have such a resource. There are positives and negatives to our smaller size. Of course we want to obtain sufficient economies of scale to be able to devote the necessary resources to endowment management, for which we currently apply an effective combination of Board Investment Committee resources, Investment Staff and external resources (consultants, alumni, etc.). As the endowment grows and the portfolio evolves, we'll continue to revisit our level of resources. In terms of how size affects our ability to invest in the most attractive investment managers, we've run into situations where we're either too small to reach investment minimums, or where we don't get the attention we want as a smaller client. However, there are many talented investment managers that limit the amount of capital they manage and we sometimes find attractive firms that don't have room for

another \$100 million investment from a larger institution, but can accommodate \$5 million from us, so we try to take advantage of our size where it is beneficial.

Our Community

Haverford is a community of students, faculty, alumni, staff and many other friends who share common values and a deep devotion to the College and its mission. The endowment is a key part of that community – the community supports the endowment (after all, the endowment would be much smaller if it were not for the generosity of our donors), and the endowment, in turn, supports the community by providing almost 30% of the College’s revenues year after year, with large portions of that revenue going to support financial aid and the academic program. We are also fortunate to have an experienced, knowledgeable and well-connected Investment Committee whose members can provide insight into the markets and investment managers and leverage their industry relationships to help Haverford access leading investment managers. We thank the Committee for their efforts. All of these relationships are extremely important to us given our small internal investment team and smaller alumni base compared to peers, and we welcome engaging in discussions with alumni, our investment manager partners, and all members of our community, as we look to forge new relationships and expand our reach.

As always, we very much appreciate the support and generosity of the Haverford community. We hope these communications provide meaningful insight into our endowment management practices, and we will continue to steward carefully the funds you have entrusted to us, in order to support the entire Haverford community.

Thank you for your continued support,

Michael H. Casel, CFA, CAIA
Chief Investment Officer
Haverford College

Seth P. Bernstein ‘84
Chair of the Investment Committee of the Board of Managers
Global Head, Asset Management Solutions
JP Morgan Asset Management