Perpetual Private

Investing in uncertain times:

Insights into university investment decision making

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Universities are complex organisations which operate utilising a range of funding and income sources. Student fees are an important component of this but so are donations, bequests, government funding, and research funding. Where possible, universities will use this money to build foundations to create in perpetuity sources of income that can be used for generations. Where capital needs to be earmarked for nearer term spending, investing is still utilised, it just needs different investment risk and return objectives.

Regardless of where each university sits on the funding spectrum, balancing risk and return is vitally important to optimise income; both in the short term and over the longer term, so it can be utilised to finance different operational costs and capital expenditures as required. To add to the challenge, university finance and investment teams are often small and so need the support of external partners and advisers to help with their decision making. Balancing inhouse and external expertise comes with its challenges, but it can also be an effective way of maximising returns for any given level of investment risk.

This paper explores how Australian universities are making investment decisions, where and how they seek advice and what their focus areas are for the next 1-3 years – drawing on survey responses from universities across Australia. The aim is to provide insights and uncover key trends to help the education sector with future decision making.

Based on the survey responses, there are four questions that we think could help not only education organisations, but also not-for-profit organisations more broadly:

1 Have you reviewed your investments lately?

Over the last 10 years investors have been chasing returns in the lower yield environment by moving further up the risk curve. With highly favourable economic tail winds up until recently, most asset classes have performed well regardless of implementation approach. Whilst yields remained low and growth was strong, this paid off for many investors. However, looking forward there are many factors that would suggest the next ten years will not mirror the last. Therefore, it might be time to revisit your strategic asset allocation and implementation approach if you haven't done so recently.

2 Is your cash management strategy effective and efficient?

Universities maintain significant levels of cash on their balance sheet to cover working capital expenses and shorter-term spending needs. However, over 60% of the organisations we spoke to still manage their cash off a spreadsheet; likely utilising only a few deposit taking institutions. By diversifying the banks you invest with, you can achieve a material uplift in returns. However, the onboarding process with a new bank can become burdensome. This is why larger organisations are increasingly looking to automated cash and fixed income platform solutions. These can absorb a lot of the administrative burden whilst providing you with access to a broader range of opportunities. Helping you manage risk and generate better returns.

3 How diversified is your income?

There are multiple ways to think about income, particularly for complex organisations. Philanthropy, major donors, bequests and fundraising are all important aspects of a diversified income strategy for any not-for-profit.

With AU$2.3 trillion of wealth expected to transfer in Australia through inheritances by 2040, it is vital that organisations review and update their bequest programs now to ensure they are in a strong position to benefit from this intergenerational wealth transfer over the coming decades. As bequest income makes up a significant proportion of donor income for many universities, this becomes even more important for organisations in this sector. It is important in this context to consider income diversification from both a sustainability perspective and also from the perspective of alumni and major donors who will be approached by many organisations also looking to capitalise on this bequest opportunity.

The non-profit sector is currently seeing inflation and the cost of living negatively impact public fundraising and regular giving, and as such, all aspects of fundraising must be considered holistically. It is therefore important to consider not only where your income is coming from and its sustainability but also, how inflation is going to impact your spending needs over the coming years.

4 Has your approach to responsible investing evolved?

Universities have been at the forefront of responsible investing for decades; however, 40% of respondents are still looking to develop their strategies. This makes sense as it is very much an evolving landscape. As data and reporting improves, how investors incorporate Environmental, Social and Governance (ESG) factors into their portfolios can also evolve and there are multiple ways you can look to achieve this. Screening out "bad" companies or sectors is only one tool in the kit bag and the myth that investors must give up return to invest responsibly has been busted by experts globally.

Methodology

Perpetual surveyed 10 universities across Australia in February and March 2023, representing billions of dollars in assets under management, to explore different investment themes. This group of universities utilise a range of funding structures including foundations, endowments, philanthropic trusts and bank debt.

Investment landscape

No two universities were identical when it came to how they were thinking about and implementing their investment strategies. However, with rising inflation, political instability, and recessionary fears; capital losses and income stability were of concern to the majority.

> **“Interestingly, despite inflation being an identified issue from an investment perspective, only one organisation was expecting spending or withdrawals to increase over the next 1-3 years. This could turn into an unpleasant surprise if inflation remains at elevated levels when compared with the low levels we had become accustomed to.”**

The current expectation is that inflation will come down to the target range (2-3%) by 2025 but it could also remain at higher levels fuelled by factors such as deglobalisation, the low carbon energy transition and the impacts of an ageing population.

Outside of these broader investment risks, there are plenty of other topics keeping decision makers busy. This included more operational concerns such as spreadsheet risk, lack of automation and the implementation of investment recommendations in a timely manner. Organisations have also been looking at ways of diversifying their income sources through fundraising advice.

When it comes to managing these risks, organisations have been proactive. Looking to protect portfolios from downside risk, be it tactically or more strategically, and building more robust operational processes. From an investment perspective, there have been asset allocation reviews, including moves into more defensive asset classes, as well as broader shifts.

All organisations were investing across a broad range of asset classes including more complex alternative strategies such as unlisted property, unlisted infrastructure, absolute return strategies, private equity and private debt. These types of assets can be a great way of stabilising income when more liquid investments, such as listed equities, real assets and bonds are experiencing higher than usual levels of volatility.

Investment implementation approaches

Over the past 10 years we have seen significant inflows into passive investments. With passive investing having enjoyed a long period of supportive economic conditions, providing strong returns for investors, this is no surprise and has raised questions for many investors around the competitiveness of active management. We were therefore interested to find out how universities were thinking about the implementation of their investment strategies.

Of the universities surveyed only one utilised entirely passive investment options with another using a majority of passive. However, somewhat bucking the trend, none of the organisations we surveyed were looking to increase the amount of passive investment within their portfolios and two were considering increasing their allocations to active management.

We think this makes a lot of sense. With significant shifts in the economic landscape and a vastly different outlook for the future, the tailwinds enjoyed by passive investors may become headwinds and we believe active management could be better placed to drive outperformance.

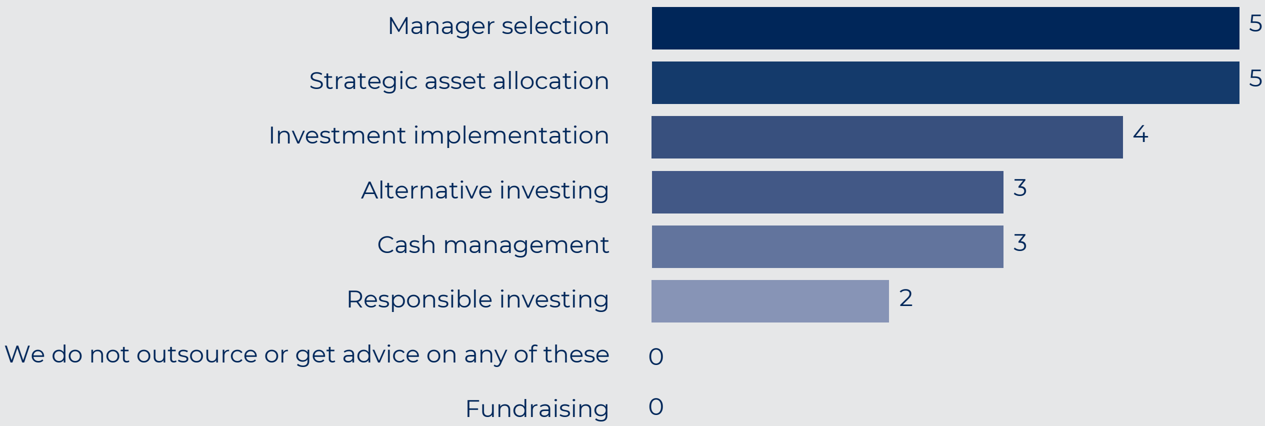
When it comes to active management, we believe it should be focussed on areas within the portfolio where there is conviction that it is possible to sustain returns above the benchmark and/or deliver a better risk-adjusted outcome than a passive investment approach on a net of fee basis. Where this conviction does not exist, passive or more quantitative strategies could be more appropriate.

At Perpetual Private we believe a well-structured blend of different investment styles across multiple markets and geographies can achieve better portfolio diversification, reduce downside risk, and deliver better risk-adjusted outcomes over the long term.

Investment decision making and advice

Investment and finance teams at universities, as well as other education and not-for-profit organisations, tend to be small. It was therefore unsurprising to find out that all the universities surveyed obtained external advice or support in some areas of their investment decision making. Importantly though, no organisation entirely outsourced this decision making – this is good governance. The chart below highlights the areas where the universities seek advice:

What areas of investment decision making do you outsource or get advice on?



We believe balancing internal expertise with external advice is critically important. You need individuals within your organisation that understand your investments from a governance perspective, but doing everything yourself, or outsourcing it to a single investment manager, is probably inefficient and ineffective. Without a large investment team, it is important to partner with organisations that can help plug knowledge gaps and provide the manpower and analysis to support decisions making.

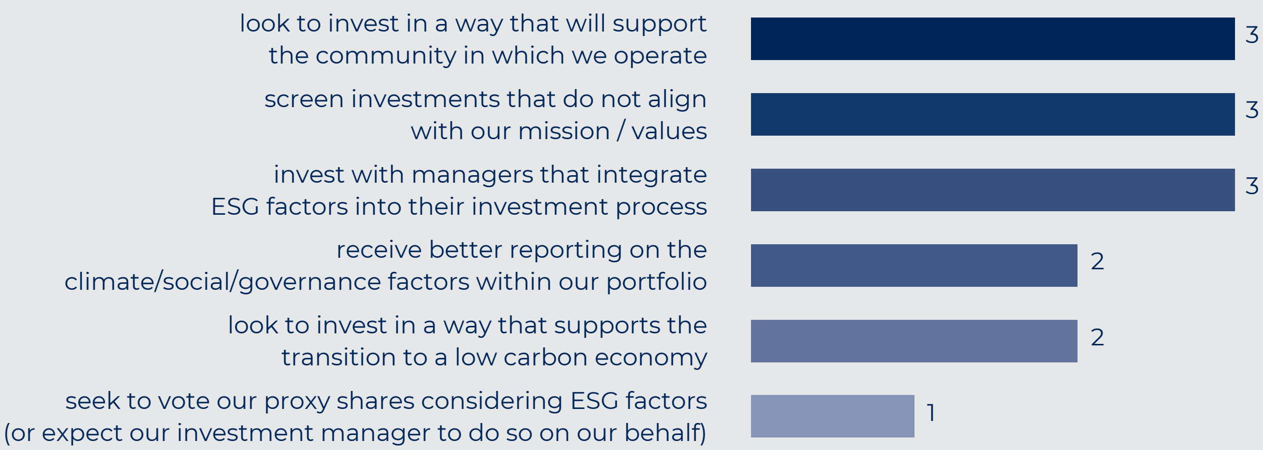
This is particularly true of more time intensive areas such as investment manager due diligence and investment implementation. It is also important for more complex and less liquid asset classes such as alternatives.

Responsible investing can also be difficult to navigate with a broad range of implementation options that are evolving fast and a swathe of organisation being accused of "green washing" by the Australian regulators. This is covered in more detail on the following page.

Responsible investing

Responsible investing was important to all the organisations we surveyed. Whilst 60% were happy with how they were incorporating ESG factors into their portfolios, 40% noted that they would still like to do more and there were different approaches utilised. Most implemented negative screens, removing sectors or organisations that did not align with their values. Some used ESG as a screen in their investment process alongside other factors; whilst others focussed on climate change and reporting.

Looking forward, there were several ways universities were looking to enhance their responsible investment approach. These are outlined in the chart below.



Responsible investing is an area that has been evolving over many decades but has really accelerated in recent years. There are an increasing number of investment strategies available, and reporting continues to improve. It is however a bit of a mine field. For example, many organisations claim to incorporate ESG into their investment process when in reality, it is less material than investors have been led to believe.

Data remains a problem. A lot of ESG reporting is still voluntary and so not always available.

Where it is available, there is limited standardisation which leads to inconsistencies; therefore, decision making based on this data can be difficult. This can be challenging to navigate, particularly as there is no clear ESG reporting or disclosure framework in Australia, (unlike Europe), and there are so many ways you can look to invest responsibly depending on your values and broader investment philosophy. Advice can therefore be important if you do not have inhouse expertise.

How Perpetual can help

The unique mix of capabilities within Perpetual means universities, schools, and research organisations, as well as other not-for-profits, can access a tailored mix of services and advice.

Within Perpetual Private we manage and advise over 140 not-for-profit organisations and thousands of charitable trusts. Which means our services have been developed with the sector in mind. We offer a range of investment solutions from investment governance and management advice through to implementation. This includes strategic asset allocation, tactical asset allocation, manager selection, and responsible investment advice. We also have a dedicated team of philanthropy experts that can provide tailored fundraising advice including how you can best be communicating to a range of trusts, foundations and major donors.

Laminar Capital, part of the Perpetual Group, is a cash and fixed income specialist that can help you make the most of your liquid capital. As well as our broking services, our cloud-based SaaS platform creates enhanced efficiency and governance and removes the risks of running your investment portfolio in spreadsheets. Designed specifically for mid-market investors to simplify the management of their investment portfolio, it delivers end-to-end workflow, audit trail and limit compliance and advance real-time custom reporting. This gives Finance executives confidence they have the tools on hand to help manage a wide range of cash and fixed interest investment types to help improve investment returns, whilst managing all related risks.

If you would like to know more about the information in this report or how Perpetual could help you manage your investment, fundraising and cash management needs please contact:

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To view the Perpetual Private Financial Services Guide, please **click here**. This document is dated April 2023. PL01851_0423

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