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Investment and Capital Management Investment Report 2017
Forest Stewardship Council (FSC®) is a globally recognised certification overseeing all fibre sourcing standards. This provides guarantees for the consumer that products are made of woodchips from well-managed forests and other controlled sources with strict environmental, economical and social standards.

Cover image: A dilution refrigerator in the Quantum Nanoscience Lab, which is part of the University’s Sydney Nanoscience Hub. These instruments reach temperatures a few thousandths of a degree above absolute zero – an environment required for control of qubits and other quantum systems.
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 2017**

<table>
<thead>
<tr>
<th>Year</th>
<th>Short Term Fund</th>
<th>Medium Term Fund</th>
<th>Long Term Fund</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>76%</td>
<td>19%</td>
<td>5%</td>
</tr>
</tbody>
</table>

**Combined value of LTF, MTF and STF, 1997–2017 (A$m)**

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 2017:**
$1360.71 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 percent and 6 percent 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 percent 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 2017:**
$86.77 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 2017:**
$341.46 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 2017, the asset allocations for the LTF and MTF were as follows:

Long Term Fund asset allocation as at end December 2017

Medium Term Fund asset allocation as at end December 2017

Note: Allocations are shown before the impact of currency hedging

Long term investment returns

5 year performance p.a. (%) as at end December 2017

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 2017

As shown in the chart, 2017 was generally a favourable year from an investment perspective, with almost all asset sectors delivering positive returns.

One-year asset class returns (%) as at end December 2017

Note: All returns are in base currency (that is, AUD for domestic assets and USD for overseas assets)
Long Term Fund
The University’s Long Term Fund achieved a return (after external manager fees) of 9.5 percent for 2017. The chart below shows the 2017 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 2017 was 6.6 percent.
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.

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 2017 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.

For more information on the University’s Investment Policy (incorporating ESG considerations), see

- sydney.edu.au/invest_capital_mgmt/esg_resp_invest/index.shtml
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, ICM charges an annual administration fee of 0.4 percent of funds under management.

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

Governance structure

The University of Sydney Act

University Senate

Finance and Audit Committee (FAC)

Investment Sub-Committee (FAC ISC)

Investment and Capital Management (ICM)
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: 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, Mirage Plains Pastoral Partnership  
Chair, Buildcorp Advisory Board  
Chair, Sydney University Rugby Foundation Board  
Chair, Australian Schoolboys Rugby Foundation  
Director, Petsec Energy Limited  
Director, MySale Group Plc

Dr Lisa McIntyre  
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Director, HCF Group  
Chair, HCF Research Foundation  
Director, Studioity Pty Ltd  
Chair, Silex Ltd  
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Member, AICD Corporate Governance Committee  
Member, LBW Trust, Women for Change Committee

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Chairman, Future Generation Global Investment Company  
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