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 2019

Combined value of LTF, MTF and STF, 1997–2019 (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 2019:**
$1621.58 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 2019:**
$95.62 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 2019:**
$468.79 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 2019, the asset allocations for the LTF and MTF were as follows:

**Long Term Fund asset allocation as at end December 2019**

- Cash: 17%
- Investment grade debt: 10%
- Non-investment grade debt: 14%
- Property: 58%
- Australian shares: 4%
- Overseas shares: 25%
- Private equity: 3%
- Managed derivatives: 2%
- Multi-asset investments: 1%

**Medium Term Fund asset allocation as at end December 2019**

- Cash: 14%
- Investment grade debt: 17%
- Non-investment grade debt: 1%
- Australian shares: 6%
- Overseas shares: 1%
- Private equity: 16%
- Managed derivatives: 7%
- Multi-asset investments: 3%

Note: Allocations are shown before the impact of currency hedging.

Long term investment returns

5 year performance p.a. (%) as at 31 December 2019

- Long Term Fund: +9.2%
- CPI + 4.5% p.a.: +6.2%
- Medium Term Fund: +4.8%
- Bank Bill + 1.5% p.a.: +3.4%
- Short Term Fund: +2.6%
- 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 per unit of volatility than Australian and overseas shares.

Market conditions in 2019

The markets for risky asset classes reversed course in 2019 after a difficult 2018. Early in the year the Federal Reserve Bank in the United States made clear that it would adopt a more supportive stance for asset prices, halting interest rate increases and reasserting its role as a provider of liquidity through the use of its balance sheet. Over the course of the year, 49 central banks around the world implemented 71 interest rate cuts. These conditions, combined with some late-year optimism that the Sino-US trade war was reaching some rapprochement, significantly bolstered the investment environment.

1 year asset class returns (%) as at 31 December 2019

Note: All returns are in base currency (that is, AUD for domestic assets and USD for overseas assets)
2019 investment performance
1 year performance (%) as at 31 December 2019

Long Term Fund
The University’s Long Term Fund achieved a return (after external manager fees) of 12.0% for 2019. Exposure to listed equity markets both domestically and overseas made the strongest contribution, helped along by favourable currency positioning.

The chart below shows the 2019 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 2019 calendar year was 10.1%. The sizeable rebound in listed equity markets over the year pushed the fund’s result into double digits, a welcome but highly unusual outcome for a portfolio with this risk profile.

Long Term Fund, Medium Term Fund and a selection of core asset classes 1 year to 31 December 2019
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 Subcommittee of the Senate 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 Subcommittee of the Senate 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 here in the Investment Policy statement, or please search for Investment Policy at www.sydney.edu.au

Governance structure

The University of Sydney Act

University Senate

Finance and Audit Committee (FAC)

Investment Subcommittee (FAC ISC)

Investment and Capital Management (ICM)
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’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 2019 showed that the portfolio was comfortably meeting its policy objective. It should be recognised that uncertainty in energy markets has meant fund managers have been shy in making aggressive allocations to that sector, which has contributed to the reduced carbon footprint. The University actively engages with all its external managers on ESG issues. An annual survey tracks managers’ views and activity around a range of concerns, including climate, diversity in businesses and on Boards, voting and modern slavery.

Evolution of carbon footprint measures 2014–2019

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

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.

Click here for more information on the University’s Investment Policy (incorporating ESG considerations), or please search for Investment Policy at www.sydney.edu.au
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.


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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Director, Studiozy Ltd
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Member, LBW Trust / Women for Change Committee
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