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A new study of university endowments reveals that target returns increased significantly last year, just as many investors are expecting actual returns to go down.

By Justin Mitchell

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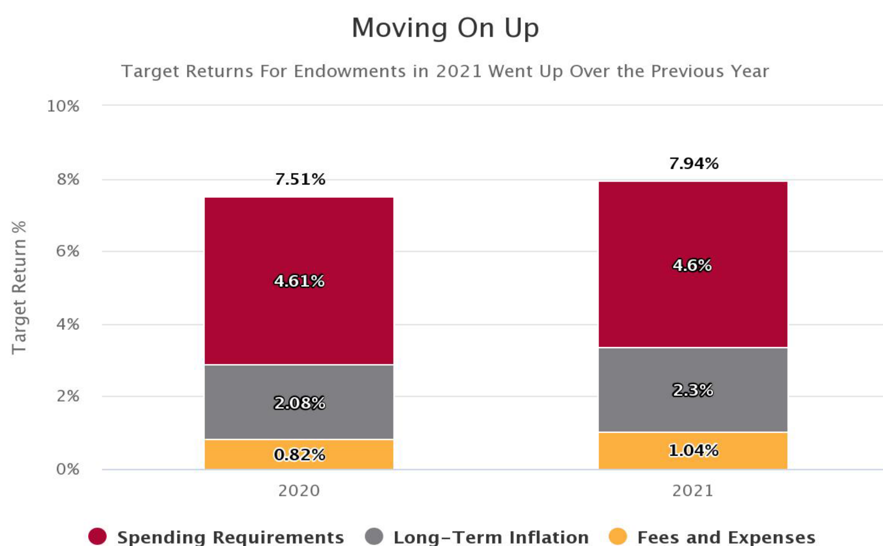
Coming off a blockbuster year, university endowments are facing a tougher road ahead, with higher returns needed to cover inflation and increasing investment fees, according to an annual study of endowments from the National Association of College and University Business Officers, or NACUBO.

“I think most institutions and endowments managers are now fairly convinced that the inflation that we’re seeing now will not just be transitory, but will become a notable feature of the economy going forward,” said **Ken Redd**, senior director, research and policy analysis for NACUBO. “Return expectations are supposed to factor in inflation, so … if your inflation expectations rise, your long-term return targets have to rise as well.”

The average endowment target returns rose to 7.94% at the end of fiscal year 2021, NACUBO found. That compares to 7.51% a year earlier. The 10-year annualized return expectation is usually 7.5%.



The increase was due to an outlook for higher inflation, fees and expenses, while spending requirements stayed the same.

At the same time, endowments are coming off one of the best single years of returns in their history, as reported.

The NACUBO study found the average endowment returned a net annualized 30.6%, as of June 30, towering over the previous year's 1.8%. However, these short-term returns had a limited impact, with longer-term returns much lower.

Moreover, 2022 is already showing more volatility, with the S&P 500 entering a market correction on Wednesday.

"Over the last couple years, we have been blessed with relatively stable market conditions," said Redd. "The expectation is that returns will be a little bit lower as we navigate through the issues that we have right now."

Endowments are preparing for the expectation of lower returns on the short-term horizon by putting more capital into alternatives, including private equity, venture capital, and real assets, said **Jeffrey Mindlin**, chief investment officer of ASU Enterprise Partners, which raises resources on behalf of Arizona State University. Manager alpha across the board will be more important, he added.

"We've gone through a period where in a rising tide lifting all boats there maybe hasn't been as much manager alpha on the public side," he said. "We're shifting into a period where that's going to become really important, where returns are harder to come by."

More alternatives also means more fees, so making those fees "efficient" fees is important, Mindlin said. In private equity, ASU looks for co-investment opportunities, which allows limited partners to invest in a single deal without paying the full fees of a manager's actual fund. Consultants have also helped ASU get preferential terms, he added.

Volatility has increased since the beginning of this year, Mindlin added. "That's probably the biggest change," he said.

While return expectations might be muted moving forward, strong recent returns will have a cascading effect going forward, said **Anna Dunn Tabke**, principal of Alpha Capital Management. The Alpha Nasdaq OCIO index of endowments and foundations that use outsourced chief investment officers showed a 20% one-year return through Sept. 30.

"Those strong returns will bolster longer-term numbers over the coming years, even if the next few years are a challenging return environment," she said in an email. "So, it's not all bad!"

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