



The
Notre Dame
Endowment

University of Notre Dame

Introduction

The Endowment Fund of the University of Notre Dame has experienced tremendous growth since the late 1960s when governance of the University and oversight of the Endowment was transferred to a predominantly lay Board of Trustees. Since the unitized investment pool began in 1969 with assets totaling \$60 million, the Notre Dame Endowment has grown to more than \$3.5 billion as of the fiscal year ended June 30, 2005, placing it among the 19 largest educational endowments in the country. This significant growth in the Endowment is a tribute to the enduring generosity of benefactors and alumni and to prudent fiscal management. The period 1985 to the present was particularly important for the Endowment with increased diversification of assets and opportunistic investment allocations resulting in Endowment returns being among the highest in higher education. Continued sound Endowment investment and spending policies assist the University in pursuing its unique academic mission with vigor.

Purpose of the Endowment

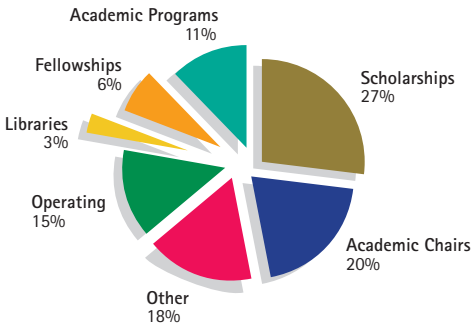
Endowment funds have played a vital role in American higher education for hundreds of years. Historically, endowments have provided a growing but stable source of operational support that often provides 10 percent or more of a college's or university's operating budget. Private colleges and universities are even more dependent on endowment because they typically do not have access to state funding that supports public educational institutions. Consequently, private institutions of higher learning rely more heavily on other sources of revenue, such as endowment, to maintain the quality and integrity of academic programs. The Notre Dame Endowment permits the achievement of some of the most fundamental aspects of Notre Dame's mission.

Endowments represent permanent funds to be used in accordance with donor wishes for the programs of their choice. Endowments restricted to a specific purpose ensure that the activity has financial support in perpetuity. Some endowments are unrestricted and may be used for any legitimate purpose of the University. The permanent nature of an endowment creates a financial challenge that is easy to describe but difficult to implement. Specifically, the goal of all endowments is to preserve the purchasing power of assets in perpetuity. Preservation of purchasing power against inflation ensures intergenerational equity, which means that existing endowments can continue to support the same set of activities for future generations. Endowment spending at levels that are inconsistent with investment returns will either diminish or enhance the financial condition of the endowment. Too much current spending will erode financial support available to future generations; too little current

spending will allow endowment to grow at a faster rate but at the expense of current recipients.

The Notre Dame Endowment is actually a collection of some 4,300 individual endowments, each with a specific purpose, which can be grouped as indicated in the chart below. Each individual endowment receives its pro rata share of earnings and funds are distributed in accordance with the University's spending policy. \$115 million in earnings was distributed for the benefit of endowment programs last year to provide financial support of endowed chairs, undergraduate scholarships, graduate fellowships and a variety of other endowed programs. Each endowment supports an enduring academic activity that relies on endowment as a source of perpetual financial support.

Notre Dame Endowment Programs



Endowment Management

The Notre Dame Endowment is managed by the University's Board of Trustees whose fiduciary responsibility is to establish prudent investment policies and guidelines that will ensure perpetual financial support to individual programs. The Board of Trustees operates through a subcommittee of the Board, the Investment Committee, which is supported by the internal investment staff headed by the University's chief investment officer.

Individual endowments are commingled in an investment pool and tracked with unit accounting in a mutual fund-type structure with each endowment owning shares or units in the pool. New contributions to the pool purchase units at the prevailing net asset value in much the same manner as shares are purchased in a mutual fund. The primary benefit of a pooled approach is that, collectively, the funds can take advantage of the diversification and economies of scale available to only the largest and most sophisticated institutional investors. Diversification is achieved by investing in various types of investment asset classes such as domestic and international stocks and bonds, marketable alternatives, real estate, energy, commodities, timber and private equity.

The Board of Trustees, supported by the internal investment staff, has established a five-step investment management process to ensure proper stewardship of the Endowment:

1) Identify the Basic Objectives of the Fund

The primary objectives of the Notre Dame Endowment are:

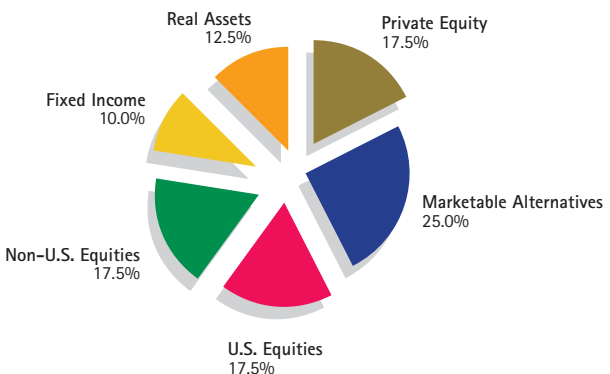
- To support the purposes of the University and its mission over the long-term,
- To achieve a total rate of return equal to inflation plus 5.5 percent,
- To maintain and preserve the real value of the Endowment, and
- To spend a predetermined portion of the investment return each year in order to provide operating support for individual programs.

These basic objectives are similar for all educational endowments. The rate of return objective recognizes that a minimum return equal to inflation — to preserve purchasing power — plus 5.5 percent to provide for spending is required to ensure perpetual operation of the Endowment.

2) Establish Investment Policies

The primary investment policy decision is the selection and weighting of the various types of investments that are to be part of the Endowment portfolio. Long-term asset allocation targets are indicated in the chart below.

Long-Term Asset Allocation Targets



The need for both current spending and maintenance of asset purchasing power requires investing for high returns, causing the Endowment to be biased toward equity. In addition, the University's vulnerability to inflation dictates more of an emphasis on equity rather than fixed income investments. Analyses of historical and expected capital market returns show that a substantial weighting in higher returning asset classes, such as domestic and international stocks, is necessary for the Endowment to achieve its return objective of inflation plus 5.5 percent. The role of domestic and global equities is to provide long-term returns in excess of inflation. Other equity asset classes, such as real estate, energy, commodities and private equity, and alternative investment strategies, serve to diversify common stock holdings. Domestic and global bonds provide additional diversification, are a source of current income, and act as a hedge against deflation.

3) Implement Investment Policy

The Notre Dame Endowment is managed by external investment management firms throughout the country and the world that are specialists in their respective asset classes. The University's internal investment staff is instrumental in recommending new investment ideas and investment management firms for review by the Board of Trustees.

4) Monitor and Evaluate Investment Managers

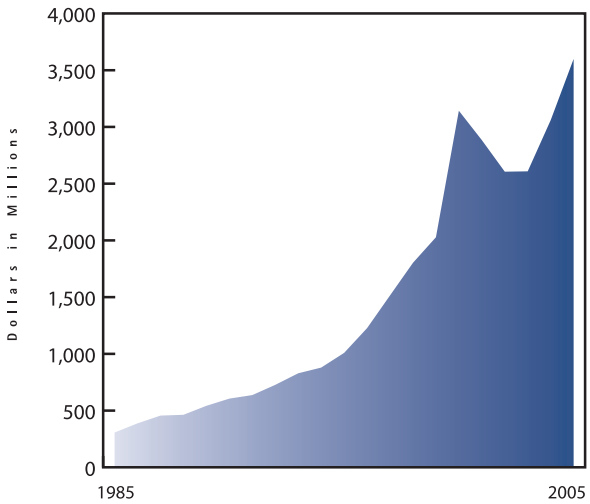
The investment results of each investment manager are evaluated on a quarterly basis and compared to the appropriate market benchmarks and against other managers with a similar investment style. Results are compiled by the Investment Office and reported to the Board of Trustees. The University strives to retain investment managers who consistently outperform their assigned market benchmark, and who are in the top group of managers with a similar investment style.

5) Make Portfolio Adjustments

Adjustments to investment objectives and policies, asset allocation guidelines, or changes in investment managers are made to reflect changes in market conditions, asset class valuations, or investment manager performance.

These five basic steps provide the necessary discipline required to persevere with sound long-term policies despite short-term volatility in the capital markets. This systematic approach to endowment management has led to steady if not spectacular growth in the Notre Dame Endowment over the past 20 years as seen in the chart on the next page.

Growth of the Endowment (1985-2005)



With this growth in the Endowment has come the ability to invest in a broader spectrum of investment opportunities leading to greater diversification and higher expected risk-adjusted returns.

Endowment Spending Policy

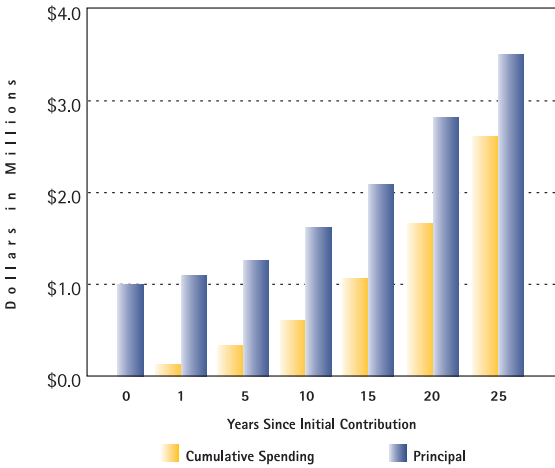
Notre Dame, like most endowed institutions, must balance the many important needs of current students, faculty and staff with those of future generations. A sound spending policy is therefore critical to ensuring that a portion of investment return is distributed for current expenditure with the remainder reinvested to shield against inflation and increase the base from which future spending is made. In order to accomplish this, the Board of Trustees has established a spending policy for the Endowment which has two primary objectives:

- 1) To allocate total earnings from endowment in a manner which balances current and future spending requirements, and
- 2) To provide a predictable and growing stream of earnings to endowment programs.

The first objective recognizes and addresses the dual needs of providing current income for spending and preserving real purchasing power of the Endowment in perpetuity. The second objective addresses the need for endowment programs to be able to anticipate earnings that will be available for spending in order to prepare annual budgets. The University continually monitors spending requirements and investment performance to ensure that the long-term dual spending objectives are being achieved.

Sample Growth of \$1 Million Contribution

By making some reasonable assumptions about key factors that affect the financial condition of the Endowment, it is easy to demonstrate how prudent management preserves the purchasing power of the initial contribution and provides meaningful financial support to the beneficiary. For example, the chart below shows the growth in both the market value *and* the cumulative spending generated by a \$1 million contribution, given certain assumptions about performance results, inflation and the spending rate¹:



¹ Assumes a 10 percent total rate of return, a 5 percent rate of inflation, and a spending rate of 5 percent. In this example, the spending rate is set equal to the real rate of return — i.e., the difference between the total rate of return and inflation. Assumes all cumulative spending to date has been removed from the principal.

Some interesting observations can be made from the information presented in the chart. First, the initial \$1 million contribution doubles in value by the 15th year, while at the same time providing over \$1 million in cumulative spending. By the 25th year, the combined value of principal and cumulative spending is in excess of \$6.1 million, more than six times the initial contribution! The real purchasing power of the contribution has been maintained because we assumed only investment returns in excess of inflation were made available for spending. All other investment returns were reinvested in principal to preserve purchasing power in perpetuity.

The University has become a leader in endowment management, prudently allocating assets and responding to an increasingly global investment environment. Endowment remains the lifeblood of the University, and it is only through new contributions and continued growth in existing endowments that Notre Dame will continue to rank among the nation's leading universities.

Please refer questions you may have about information in this pamphlet to the Investment Office as follows:

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