IN DEFENSE OF THE ENDOWMENT MODEL (YET AGAIN)

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This article is relevant to financial professionals who are considering offering model portfolios to their clients. If you are an individual investor interested in WisdomTree ETF Model Portfolios, please inquire with your financial professional. Not all financial professionals have access to these Model Portfolios.

I have been writing about, advocating for and defending "the endowment model" for more than 10 years.[1] And periodically I have to accept being smacked around for doing so. But I tend to be a long-term, strategic investor. With the recent and sad passing of endowment model proponent David F. Swensen of Yale University, let me try again.

First, let me define terms. In the endowment world that Swenson worked in, there are no taxes and time horizons are infinite; therefore, illiquidity is not an issue. This results in an endowment model that holds very little bonds, only enough public equity to make a difference and lots and lots of private and alternative investments, plus real assets.

2020 NACUBO-TIAA Study of Endowments

Summary Asset Allocations for U.S. College and University Endowments and Affiliated Foundations, Fiscal Year 2020*

Size of Endowment	U.S. Equities %	Non-U.S. Equities %	Global Equities %	Marketable Alternatives+ %	Private Equity %	Private Venture Equity %	Fixed Income++ %	Real Assets %
Over $1 Billion	10	13	7	21	15	11	11	13
$501 Million to $1 Billion	22	16	5	17	11	5	15	9
$251 Million to $500 Million	20	15	9	18	10	3	17	8
$101 Million to $250 Million	29	15	8	13	6	2	20	7
$51 Million to $100 Million	31	14	9	9	5	1	25	6
$25 Million to $50 Million	38	14	6	6	2	#	29	5
Under $25 Million	42	12	5	4	2	#	31	3
Type of Institution								
All Public Colleges and Universities	**16**	**16**	**7**	**18**	**12**	**7**	**14**	**11**
College, University, or System	*14*	*17*	*5*	*19*	*13*	*8*	*12*	*12*
Institution-Related Foundations	*19*	*14*	*14*	*15*	*9*	*4*	*18*	*7*
Combined Endowment/Foundation	*24*	*17*	*3*	*15*	*9*	*7*	*13*	*12*
Private Colleges and Universities	**11**	**12**	**8**	**21**	**14**	**10**	**12**	**12**
All Others**	**26**	**21**	**3**	**11**	**16**	**2**	**19**	**1**
All Institutions								
Dollar-weighted Average	13	13	7	20	14	9	12	11
Equal-weighted Average	27	14	8	13	7	3	21	7

*Average asset allocations as of June 30, 2020. Data rounded to nearest whole number. Due to rounding, details may not sum to 100%
#Less than 1 percent.
**Includes education-related non-profit organizations.
+Marketable alternative strategies include hedge funds, absolute return, market neutral, long/short, 130/30, and event-driven and derivatives.
++Includes cash and short-term securities. All data are dollar-weighted unless otherwise specified.

Sources: National Association of College and University Business Officers and the Teachers Insurance and Annuity Association of America, as of fiscal year 2020.

Of course, in the world of tax-paying high net worth and affluent retail investors, who do not have infinite time horizons, things are different. Does that mean the endowment model doesn't translate? I don't think that is true. Adjusting for the realities of human behavior and taxes, I believe that an appropriate endowment model for individuals means the following:

- Broad and global diversification

- Intelligent use of active vs. passive investment strategies (e.g., a cost/benefit optimization of active management fees or, to use WisdomTree's phrase, Modern Alpha®)
- A prudent use of non-traditional or lower correlation investments in an attempt to improved overall portfolio diversification (e.g., real assets and alternatives)
- A long-term time horizon
- Investment discipline through full market cycles

We manage our different risk-banded **Endowment Models** in exactly this way, and we believe they deserve more attention as long-term solutions for many advisors and end clients. Financial advisors who are registered on the WisdomTree website can learn more about them in our recently launched Model Adoption Center.

All these Models are multi-asset, with allocations to global equities, fixed income, real assets and alternative investments. Somewhat uniquely, we believe, we are able to fund the less-traditional asset class positions because we allocate to NTSX, the U.S. version of our Efficient Core strategies, which takes a leveraged 90/60 position in large-cap U.S. equities and U.S. Treasuries. This provides us with a "core" allocation to stocks and bonds while leaving capital to allocate to other strategies.

On the real asset side, we have allocations to energy MLPs, infrastructure and, via our own GCC, a dynamically managed broad basket of commodities.

On the alternative investment side, we have allocations to a short-biased strategy and two variations of hedged equity strategies, including our own put-writing strategy, PUTW.

Going forward, we will consider additional diversifying strategies, including **managed futures**, **long/short equity**, **global macro** and **diversified arbitrage**.

The explicit purpose of these Models seeks to to deliver consistent, absolute return performance, regardless of underlying market conditions. And, to date, they have performed as expected. They will not keep up with a raging bull equity market, but they are designed to not lose as much in down or disruptive markets. And, historically, that's what they've delivered.[2]

In addition to our Endowment Model, we also offer an explicit **Volatility Management** Model Portfolio. This is one of our "outcome-focused" strategies, designed with explicit investment objectives in mind. In this case, to be used as a complement to existing, more traditional portfolios when the advisor and/or end client wants a more "endowment-like" portfolio experience.

In addition to the short-biased and hedged equity strategies that are embedded in our Endowment Model, the "Vol Man" Model also has explicit allocations to diversified arbitrage and interest rate volatility/inflation hedge strategies.

As with all WisdomTree Model Portfolios, our Endowment and Volatility Management portfolios share certain common characteristics:

1. They are global in nature
2. They are ETF-centric, seeking to optimize fees and taxes
3. They are "open architecture" and include both WisdomTree and third-party strategies
4. They charge no strategist fee[3]

Conclusions

It is incorrect to say, as some people have, that the "endowment model is dead." It is more accurate to say, given the years-long bull run in traditional U.S. stocks and bonds, that it has been "sleeping" for a while (just like the cicadas that now cover my backyard).

But, with interest rates and credit spreads where they are, and with equity market valuations stretched to all-time highs, we definitely are receiving more questions from advisors about less-traditional and/or more-diversifying portfolio solutions.

We think both the Endowment Model and the Volatility Management Model can be appropriate solutions to those questions.

We hope you will take a look.

[1]Scott Welch, "In Defense of the Endowment Model," IMCA Investments & Wealth Monitor, May–June 2010, 32-26. https

://investmentsandwealth.org/getattachment/75a77ec3-2a97-44f7-bae8-196e6c52b895/IWM10MayJun-EndowmentModel.pdf

[2]Past performance is no guarantee of future results.

[3]Other fees and expenses may apply

Important Risks Related to this Article

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DEFINITIONS

Illiquidity : The state of a security or other asset that cannot easily be sold or exchanged for cash without a substantial loss in value. Illiquid assets also cannot be sold quickly because of a lack of ready and willing investors or speculators to purchase the asset. The lack of ready buyers also leads to larger discrepancies between the asking price (from the seller) and the bidding price (from a buyer) than would be found in an orderly market with daily trading activity.

Fixed income : An investment security that provides a return in the form of fixed periodic payments and the eventual return of principal at maturity.

Master limited partnership (MLP) : Investment structure where holdings typically must derive most of their cash flows from real estate, natural resources or commodities, combining the tax benefits of a partnership—taxes occur when holders receive distributions—with the liquidity of a publicly traded company.

Managed futures : An alternative investment strategy in which futures contracts are used as part of the investment strategy.