Endowments now

VT Public Library MONEY minute 8 APRIL 2020

Dear library friend,

The volatility in the financial markets and drops in company valuations are among the current impacts of the "overnight recession" caused by COVID-19 that keep us awake at night. If your library has an endowment, you are likely concerned about what this means for your current and future cash flow. Like a terrorist attack, the COVID-19 assault was swift, taking most of us unprepared. The chart, as of April 7, 2020, demonstrates our market conditions all too graphically: the Dow losing 19% of its value since January 2, 2020.

Do you have an endowment investment and spending policy? If so, you can rest a little easier. You have done the "right thing" in managing these precious assets! An example of an endowment policy can be found at the [UVM public library education Extension website].

Key points about endowments

- I can't stress enough the **importance of professional portfolio management** as part of an endowment policy and strategy. Financial investing is a skill that requires training and experience that most of us do not have.
- General guidance is that the asset allocation – the balance between higher risk assets (like stocks) and lower risk assets (cash and other fixed assets) -- of an endowment be maintained at a target rate of 60% equity securities and 40% fixed income securities, with ranges allowed.
- Having more in fixed assets will earn you less in good times, and lose you less in bad times. Having more in equities will earn you more in good times, and lose you more in bad times.
- The essential reason for an endowment is to provide a stable revenue stream each and every year into the future, preferably matching or beating inflation.
- A distribution from the endowment is generally made annually to meet the needs of the Library.
- The amount drawn annually must permit the endowment to be maintained over the long term. Therefore, we use a formula to provide revenue AND guard our assets!
    - Commonly, endowment funds are distributed annually as a percent of the total asset value, e.g., three to five percent. (4% of a $200,000 = $8,000).
    - Important >> The total asset value is NOT one point in time, like Dec 31, but the **value of each quarter averaged over a sixteen or twelve-quarter "look-back" period.**
    - What this rule does for an endowment is that it averages out highs and lows in the market.

> Since the annual "draw" on an endowment is based on the value of the endowment *averaged over time*, endowments are buffered from highs and lows. When managed properly, this "value averaging" allows endowments to provide reliable income without wild fluctuations over time.

What can you expect from your endowment?

I don't have to tell you that financial markets are strained. The equity market value as measured by the Dow was down more than 19% in the first quarter of 2020. This quarter will affect the trailing average of your endowment's value through the period described in your endowment investment and spending policy. For instance, the 2020 first quarter will be part of your net asset value through the second quarter of 2024 if you look back 16 quarters. Thus this past quarter will depress your endowment's average asset value, and therefore your revenue for the coming fiscal year, to a degree but not savagely. And better times are ahead – at least the Dow always rebounds!

In simplest terms, rely on a good endowment investment and spending policy to get you through thick and thin times. NOW is a good time to check in with your portfolio manager!

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