

REGENTS MEETING

EXHIBIT

B³

MAY 23 1952

MOTION *Herbert*
ACTION *Report as whole*
accepted. Recommendations
approved. Commendation
to Griffith for
preparation and
presentation

INVESTMENT OBJECTIVES AND PROCEDURES FOR ENDOWMENT FUNDS

This is the initial review of the investments of the University's endowment funds since the retention of the National Bank of Detroit for consultation and advice. This review covers the nature of the funds involved, current status of the combined investments, and a discussion of the investment objectives and procedure.

1. Investment Characteristics of Endowment Funds

Endowment funds by their nature are expected to endure for a long period of years. It is generally accepted that the principal of such funds must be maintained intact and only the income expended for the particular purpose for which the endowment is created. Thus, it is possible to take a long range approach to the investments of such funds. There is no problem of meeting any future obligations out of the principal, and the fluctuations of security prices are not of great importance except, of course, as they provide opportunities to buy and sell or to switch from one type of investment to another. These characteristics of endowment funds make for considerable latitude in the selection of investments. It is apparent, however, that to accomplish the purposes for which these funds have been established, income is of prime importance, not only from the standpoint of amount but also of stability.

2. Current Status of the Investments of the Endowment Funds

The following table is a summary of the combined investments of the University's major endowment funds as of April 30, 1952. Estimated yields on the book values of the various types of investments are shown, together with an estimated average yield for the total investments as they now stand. In the case of common stocks, the yield shown is based on a conservative estimate of the probable dividends for 1952.

J.O.
Griffith

Summary of Investments
of
Major Endowment Funds
April 30, 1952

<u>Bonds</u>	<u>Book Values</u>	%	<u>Market Values</u> as of <u>4-30-52</u>	<u>Estimated Yields</u> <u>at Book Values</u>
		<u>Total Fund</u> <u>Book Value</u>		
U. S. Gov't & Agencies	\$ 6,968,941	44.97	\$ 6,926,070	
Municipals	347,104	2.24	360,020	
Railroad Eq. Trust Ctf's.	618,995	3.99	604,530	
Public Utilities	1,482,882	9.57	1,434,870	
Industrials	614,432	3.96	599,400	
Finance Companies	600,000	3.87	600,000	
Canadians	741,398	4.79	738,210	
Total Bonds	<u>\$11,373,752</u>	<u>73.39</u>	<u>\$11,263,100</u>	2.48%
<u>Preferred Stocks</u>				
Public Utilities	\$ 290,822	1.87	\$ 302,500	
Industrials	382,366	2.47	383,300	
Total Preferred Stocks	<u>\$ 673,188</u>	<u>4.34</u>	<u>\$ 685,800</u>	4.23%
<u>Common Stocks</u>				
Banks, Insurance & Financial	\$ 514,190	3.32	\$ 625,278	
Public Utilities	508,318	3.28	609,234	
Industrials	968,674	6.25	1,341,616	
Total Common Stocks	<u>\$ 1,991,182</u>	<u>12.85</u>	<u>\$ 2,576,128</u>	6.24%
Total Securities	\$14,038,122	90.58	\$14,525,028	
<u>Mortgages & Land Contracts</u>	\$ 1,109,407	7.16		4.50%
<u>Real Estate</u>	\$ 228,855	1.48		4.00%
<u>Cash</u>	\$ 120,994	.78		.00%
Total Funds	\$15,497,378	100.00%		3.17%

A complete list of the securities held in these funds is included in the back of the folder as Exhibit I, together with a table showing the diversification of common stocks by industries.

3. Investment Objectives

In the following table, the present status of the investments of these funds is compared with two objective patterns. The first of these is labeled "Intermediate Objective" as it represents a pattern that could reasonably be attained over a two to three year period. A distribution of investments that could be considered as a longer-term objective is also shown. Based on present yields, a pattern such as the latter will be necessary if these funds are to produce a return of approximately 4%.

<u>Type of Security</u>	<u>Present Diversification</u>		<u>Intermediate Objective</u>		<u>Possible Long-Term Objective</u>	
	<u>% of Funds</u>	<u>Est. Yield</u>	<u>% of Funds</u>	<u>Approx. Yield</u>	<u>% of Funds</u>	<u>Approx. Yield</u>
Bonds	73%	2.48%	50%	2.60%	40%	3.00%
Mortgages & Real Estate	9	4.41	10	4.50	10	4.50
Preferred	5	4.23	5	4.00	5	4.00
Common	13	6.24	35	5.00	45	5.00
Avg. Yield	100%	3.17%	100%	3.70%	100%	4.10%

An increase in yield from 3.17% to 3.70% will provide an additional annual income of \$80,000, and from 3.17% to 4.10% an additional income of \$141,000.

The intermediate objective of 35% in common stocks has been previously discussed and approved by the Board. Preferred stocks at 5% is a continuation of the existing ratio. If there is any substantial change in the yields from high-grade preferred stocks, consideration can then be given to increasing the percentage of such stocks in these funds. The ratios of bonds and mortgages and real estate at 50% and 10% respectively should be taken together. If it is possible to secure satisfactory mortgages or real estate investments in excess of 10% of the total investments, the bond portion would correspondingly be reduced.

In considering the diversification of the investments of these funds by type, a study of twelve large endowment funds of educational institutions was presented at a meeting of the Central Association of College and University Business Officers last month. The endowment funds included in the survey range in size from Dartmouth's at \$21,800,000 to Harvard's with \$240,300,000. The unweighted averages of the percentage diversification of the investments of the twelve funds follows:

<u>Diversification at Market Values, 12-31-51:</u>	<u>Average Per Cents</u>
Bonds	32.9%
Preferred Stocks	6.5%
Common Stocks	42.7%
Mortgages and Real Estate	15.9%
Miscellaneous	<u>2.0%</u>
Total	100.0%

Average Rate of Return for Year Ended 6-30-51:

On Book Values	4.9%
On Market Values	4.2%

The details of the investment diversification of these various endowment funds is included at the end of this report as Exhibit II.

4. Common Stock Purchase Program

Using the intermediate objective of 35% in common stocks, the total amount eventually invested in commons will be approximately \$5,250,000, based on the present size of the funds. As the funds now hold about \$2,000,000 in commons, it is necessary to think in terms of additional purchases to the extent of about \$1,000,000 per year over about a three-year period in order to reach the intermediate objective. As shown in the schedule of bond maturities that follows, approximately this sum of money is available from the two to five year maturities now held. These short-term bonds will be the source of the money for the stock investments.

Schedule of Bond Maturities

	<u>Face Value</u>	<u>Per Cent</u>
Within 1 year	\$ 149,000.00	1.32
2 - 5 years	3,128,000.00	27.81
6 - 10 years	3,838,000.00	34.13
11 - 15 years	1,709,000.00	15.20
16 - 20 years	1,746,000.00	15.53
21 - 30 years	551,000.00	4.90
Over 30 years	<u>125,000.00</u>	<u>1.11</u>
Total	\$11,246,000.00	100.00

In addition to the shifting of existing investments, it will be necessary to invest about 35% of any large amounts of new money coming into these funds in commons in order to reach the goal previously described.

5. Approved List of Common Stocks

Since the early part of 1951, the University has had an approved list of common stocks which could be purchased without prior approval of the Board under certain conditions and with certain limitations. The National Bank of Detroit also has a list of stocks considered satisfactory for the investments of its trust funds. This list is somewhat broader than the University's. It is believed advisable to bring the two lists together by adding to the University's list those names that are approved by the Bank and by eliminating certain stocks now on the University's list which at present are not regarded as candidates for increased purchases. The combined list would be as follows, with the stocks not now on the University's approved list indicated by an asterick.

COMMON STOCKS

Automobiles

*Chrysler Corporation
General Motors Corporation

Auto Parts

*Bower Roller Bearing

Banks

*Bankers Trust Co., New York
Chase Nat'l Bank, New York
Guaranty Trust Co., New York
Manufacturers Trust Co., New York
National City Bank, New York

*Continental Illinois Nat'l Bank, Chicago

*First National Bank of Chicago

Detroit Bank
Manufacturers National Bank, Detroit
National Bank of Detroit - See Note

Building & Construction Materials

Johns-Manville Corp.
*Minneapolis-Honeywell Regulator
National Lead
*Pittsburgh Plate Glass
*Sherwin-Williams
U. S. Gypsum

Chemical

*Allied Chemical & Dye
*American Cyanamid
Dow Chemical
du Pont (E.I.) de Nemours
Hercules Powder
Monsanto Chemical
Union Carbide & Carbon

Containers

American Can Company
Continental Can Company
Owens-Illinois Glass

Drugs & Pharmaceuticals

*Abbott Laboratories
*Merck & Company
Parke Davis
*Pfizer (Chas.) & Company
*Sharp & Dohme

Electrical Equipment

General Electric
Westinghouse Electric

Electric Power & Light

Central & South West, Texas

COMMON STOCKS
(cont'd)

Electric Power & Light (cont'd)

Cincinnati Gas & Electric
Cleveland Electric Illuminating
Commonwealth Edison
Consolidated Edison
*Consumers Power
Detroit Edison
Gulf States Utilities
Houston Lighting & Power
Illinois Power
Iowa Power & Light
*Indianapolis Power & Light
Niagara Mohawk Power
*Ohio Edison
Public Service Co. of Colorado
Texas Utilities

Farm Equipment

*Caterpillar Tractor
*Deere & Company
International Harvester

Finance & Investment

*C.I.T. Financial Corp.
Commercial Credit Co.

Food, Beverages & Gum

Borden Company
*National Dairy

General Foods
General Mills

Insurance

American Insurance
Continental Insurance
Fidelity-Phenix Fire Insurance
Fireman's Fund Insurance
*Firemen's Insurance of Newark
Great American Insurance
*Hartford Fire Insurance
Insurance Company of North America
*St. Paul Fire & Marine Insurance

Merchandising

Montgomery Ward
Sears Roebuck

*Green (H.L.)
Kresge (S.S.)

Merchandising (cont'd)

*Kress (S.H.)
*Murphy (G.C.)
Penney (J.C.)

Natural Gas

American Natural Gas
*United Gas Corporation

Non-Ferrous Metals

*Aluminum Company of America
Kennecott Copper Corp.

Office Equipment

*Addressograph-Multigraph
Burroughs Adding Machine
International Business Machines

Oil Production & Refining

Continental Oil
Gulf Oil
*Humble Oil & Refining
*Imperial Oil, Ltd.
Phillips Petroleum
Shell Oil Company
Socony-Vacuum Oil
Standard Oil Co. of California
Standard Oil Co. (Indiana)
Standard Oil Co. (New Jersey)
Texas Company

Paper, Printing & Publishing

International Paper
*Kimberly-Clark
*Lily Tulip Cup
*Scott Paper

Soap & Vegetable Oil

Procter & Gamble

Telephone

American Telephone & Telegraph

Miscellaneous

*Corning Glass Works
Eastman Kodak
*Food Machinery & Chemical
*Johnson & Johnson
*Minnesota Mining & Mfg.
Owens-Corning Fiberglas

Note: The National Bank of Detroit as a matter of policy does not take a position of favoring or disfavoring its own stock. The stock is included in the list because the University officers believe it to be satisfactory.

Stocks now held in the endowment funds that are not included in the preceding list are set forth below. For various reasons these stocks, although satisfactory for retention, are not considered the type that should be added to in the near future. They can be considered as a group that could be sold in exchange for more attractive situations or as possible eliminations from the funds if developments so indicate. If, however, conditions change and they are again regarded as desirable purchases, they can then be recommended to the Board for addition to the approved list. The stocks in this group are as follows:

Bank

Irving Trust Company, New York
First National of Boston

Gum

Wrigley (Wm.) Jr. Company

Food

Corn Products Refining
Standard Brands

Insurance

National Union Fire Insurance
Standard Accident Insurance

Mining

International Nickel

Paper

Sutherland Paper

Public Utility

Iowa-Illinois Gas & Electric

Retail Trade

Kroger Company

Tobacco

American Tobacco
Reynolds (R.J.) Tobacco

6. Approved Bond Issues

The existing authorizations covering the purchase of bonds previously given by the Finance and Property Committee are as follows:

- (a) U. S. Government bonds may be purchased or exchanged in any funds, according to their needs. The obligations of the Federal Intermediate Credit Banks and Federal Home Loan Banks are approved for purchase up to certain over-all totals.
- (b) Public utility or industrial bonds rated "AA" by Moody's Investor's Service are eligible, as are railway equipment trust certificates rated the equivalent of "AA" by two of the three major rating services.

- (c) All direct and guaranteed obligations of the Dominion of Canada, the Province of Ontario, and the City of Toronto are approved, with a limitation on the total holdings in all funds.
- (d) The short and medium term notes of General Motors Acceptance Corporation, C. I. T. Financial Corporation and Commercial Credit Company are approved, also up to certain limits.

In order to bring the University's existing authorizations into line with those suggested by the Bank, the following changes would be necessary:

- (a) All public utility, industrial, railway equipment and railroad terminal bonds bearing a rating of "A" or better by Moody's Investor's Service would be considered eligible. It is probable that the greater portion of bond purchases will always be in the "AA" or better classifications. However, occasionally there are good values available in "A" rated bonds, particularly issues that are on the borderline between "A" and "AA".
- (b) The short or medium term obligations of the following finance companies would be added to those previously approved.

Yellow Manufacturing Acceptance Corporation
Associates Investment Company
General Electric Credit Corporation

- (c) It is suggested that the existing limitations on the total holdings of certain types of bonds in all University funds be removed. These limitations affect holdings of Canadian bonds, railway equipment trust certificates, and the obligations of government agencies mentioned above. Due to the growth of University funds, some of the existing limitations are overly restrictive. The avoidance of undue concentration of bonds of any one type in the various funds is part of proper investment management. If any restrictions are to be set up, they should be in terms of percentages within the different funds.

7. Authority to Sell Securities

Under the University's by-laws, the Regents have delegated to the Finance and Property Committee the power to purchase and sell securities or other property held in the University's investment funds. In the case of sales of securities or other property, after the approval by the Committee certain officers are delegated to execute the necessary documents. In the case of registered securities, the signature of an elected member of the Committee on the assignment is necessary.

The question arises as to whether it would not be advisable to change this procedure. Two out of four designated officers could be given authority to sell without the prior approval of the Committee and without the necessity of securing the signature of a member of the Committee on the documents conveying title. This change would permit prompt action on the sale of securities which is often necessary. Most of the changes that will take place in the investments will probably be in the endowment funds. These are the funds on which the advice of the National Bank of Detroit is available and sales would only be made in the event of an agreement between the Bank officers and the University officers. Any use of authority to sell as outlined above in any of the investment funds would be promptly reported to the Regents at their next meeting.

8. Report to the Regents

All purchases and sales of investments will continue to be reported to the Regents at the next meeting after purchases and sales have been made. In addition, it is planned to have a quarterly review with the Board or with the Finance and Property Committee of the changes made in the investments of the endowment funds.

9. Summary and Recommendations

To summarize, this review has outlined the present status of the investments of the endowment funds; set up intermediate and long-term patterns of investments as objectives in order to increase the yield of these funds; discussed the steps necessary to reach these objectives; and suggested certain changes in the current procedures regarding investments that would fit in better with conditions as they now exist.

It is recommended that the Regents approve or authorize the following:

- A. An intermediate objective for the diversification of the investments of the major endowment funds that would over a two to three year period place them in the following position. This actually is a reaffirmation of the presently approved policy. It is expected that when this objective is reached, the next objective can be established in more detail.

Bonds	50%
Mortgages & Real Estate	10%
Preferred Stocks	5%
Common Stocks	<u>35%</u>
	100%

- B. That the common stocks set forth in the list on pages 5 and 6 of this review constitute an approved list of issues that may be purchased for endowment funds provided there is agreement between the National Bank of Detroit and University officers on the advisability of the investment.
- C. That additions to or deletions from the approved list be submitted to the Board for approval.
- D. That the existing authorizations covering bond purchases be extended to cover the following:
 - 1. Purchase of all public utility, industrial, railroad equipment and railroad terminal bonds bearing a rating of "A" or better by Moody's Investor's Service.
 - 2. Purchase of the short and medium term obligations of Yellow Manufacturing Acceptance Corporation, Associates Investment Company and General Electric Credit Corporation in addition to the finance company obligations previously approved.
 - 3. Removal of the existing restrictions as to the dollar amount of total holdings of certain types of bonds.
- E. That the By-Laws be revised to permit two of the following officers to sell securities or other property held in investment funds and to execute the necessary documents to effect transfer - President or Vice-President and Dean of the Faculties, and Vice-President in Charge of Business and Finance or Investment Officer.