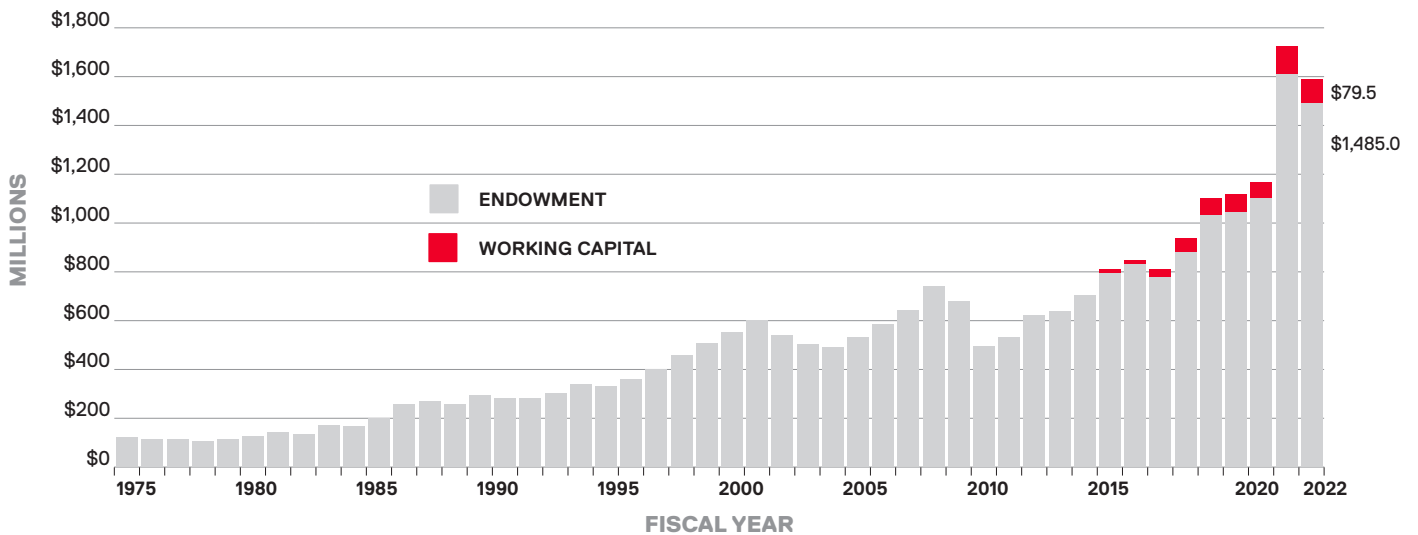


To the Wesleyan community:

After last year’s unprecedented gains, the endowment returned -4.6% for fiscal 2022, the first year of losses since fiscal 2016. During the latter part of the fiscal year, we witnessed a strong capitulation of valuations, particularly in sectors susceptible to rising interest rates or with clearly stretched valuations such as technology and biotech. With the Federal Reserve’s commitment to taming inflation, markets have continued to correct through the first part of the 2023 fiscal year. Importantly, our longer-term returns continue to meet our objectives of providing a strong financial foundation to the University.

The year-end Total Investment Pool<sup>1</sup> ended at \$1.56 billion versus last year’s \$1.67 billion. The chart below shows the path of asset growth since 1975. Roughly \$79.5 million (shown in red below) is working capital invested alongside the endowment and managed by the investments staff as part of the long-term pool.



Two observations should be apparent in the graph above. The first is that returns are susceptible to economic and market cycles, with periods of losses that may last several years before returning to expected long-term returns. The second is the significant growth of the endowment over the last decade during one of the most benign and stimulative interest rate environments in history. Fed fund rates, persisting at close to zero for 14 years, lowered the cost of capital, enhanced liquidity across the

<sup>1</sup> The Total Investment Pool includes endowment assets as well as long-term reserves (“Working Capital”) of the University that are invested alongside them.

globe and encouraged investors to increase their exposure to risk assets. We are now in a period of correction, the length and amplitude of which, despite economists’ certainty, is unknowable.

In last year’s letter, we noted our worries about high valuations, inflation, rising interest rates, de-globalization, COVID-19, and politics, while recognizing that we could do little to predict the consequences or onset of any of them. Twelve months later, we are now navigating through all of these concerns (plus war in Ukraine). In today’s turbulent and volatile environment, it is difficult to understand what is priced into the market on any given day. Instead, we continue to steer the portfolio towards its long-term strategic asset allocation, rebalance when practical, and re-underwrite our manager roster. We draw comfort in knowing that our managers often find attractive long-term investment opportunities during the worst periods of “gloom and doom,” setting us up for future returns.

## FISCAL 2022 PERFORMANCE

The endowment’s -4.6% return underperformed both its policy benchmark (a composite of benchmarks weighted in proportion to a policy asset allocation) and the Higher Education Price Index (HEPI) inflation plus our spending payout. The return slightly lagged the top quartile of preliminary returns from peer institutions. However, our three-, five-, and 10-year results remain strong versus all benchmarks. The endowment has performed particularly well compared to peer colleges and universities, generating roughly \$430 million in incremental value versus the median peer return over the past 12 years. Below, a summary of annualized returns and benchmarks highlights the University’s long-term track record:

WESLEYAN UNIVERSITY ANNUALIZED PERFORMANCE (%)					
ENDING JUNE 30, 2022					
	1-Year	3-Year	5-Year	10-Year	20-Year
Wesleyan Managed Pool <sup>2</sup>	(4.6%)	17.0%	13.7%	11.2%	9.2%
Wesleyan Policy Benchmark <sup>3</sup>	(0.7%)	12.2%	10.6%	8.9%	n/a
70% Stocks/30% Bonds <sup>4</sup>	(14.0%)	4.3%	5.4%	6.7%	6.5%
HEPI + 4.5% (Absolute Return Hurdle)	9.7%	7.8%	7.6%	7.1%	7.5%
Median: College & University <sup>5</sup>	(6.7%)	9.3%	8.5%	8.3%	7.5%
Top Quartile: College & University <sup>5</sup>	(3.1%)	11.3%	9.8%	9.2%	8.4%

Most risk asset classes represented by publicly traded securities were highly correlated over the year and generated negative returns. Illiquid asset classes such as private real estate and private equity

<sup>2</sup> Assets under the direction of the Investments Office

<sup>3</sup> A policy benchmark replicates a portfolio using policy allocation targets and relative benchmarks

<sup>4</sup> 70% MSCI All Country World Index and 30% Bloomberg Barclays U.S. Aggregate Bond Index

<sup>5</sup> Results reported as of October 2022 to Cambridge Associates

performed well, but valuation marks typically lag the public markets by a few quarters, and we expect significant corrections to this part of our portfolio during fiscal 2023.

We also note that Wesleyan’s historical returns overall are high versus our forecasted model that reflects long-term returns; the laws of mean reversion are likely to bring these returns down to more normalized levels over time.

Our one-year asset class returns versus comparable benchmarks are shown in the chart below.

ONE-YEAR PERFORMANCE ENDING JUNE 30, 2022				
ASSET CLASS	ENDOWMENT RETURN (%)	BENCHMARK RETURN (%)	VALUE ADDED (%)	BENCHMARK
Developed Equity	(26.0)	(14.3)	(11.7)	MSCI World
Emerging Markets Equity	(21.8)	(25.3)	3.5	MSCI Emerging Markets
Absolute Return	(11.9)	1.9	(13.8)	CSFB/Tremont Hedge Fund
Real Estate	23.8	25.2	(1.4)	C.A. U.S. Real Estate
Natural Resources	37.5	30.5	7.0	C.A. U.S. Upstream and Royalties
Private Equity	6.9	7.1	(0.2)	Cambridge Associates Composite
Fixed Income	(10.3)	(6.4)	(3.9)	Barclays Intermediate U.S. Treasury
<b>Managed Pool<sup>2</sup></b>	<b>(4.6)</b>	<b>(14.0)</b>	<b>9.4</b>	<b>Passive Benchmark<sup>4</sup></b>
<b>Managed Pool<sup>2</sup></b>	<b>(4.6)</b>	<b>(0.7)</b>	<b>(3.9)</b>	<b>Policy Benchmark<sup>3</sup></b>
<b>Managed Pool<sup>2</sup></b>	<b>(4.6)</b>	<b>9.7</b>	<b>(14.3)</b>	<b>HEPI + 4.5%</b>

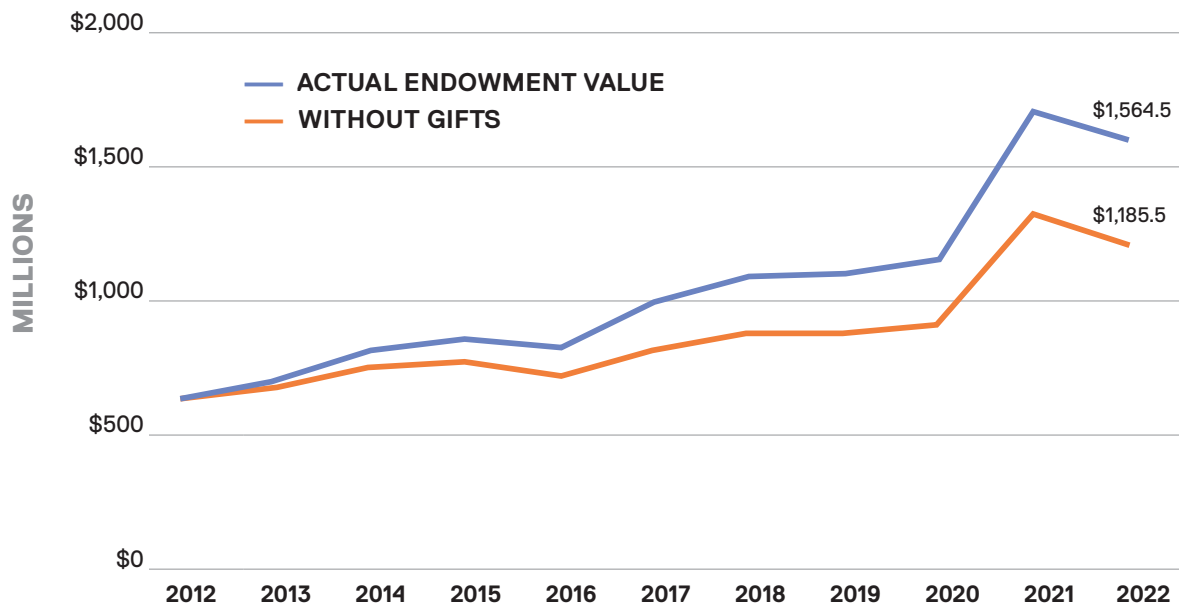
Developed markets equity managers were hit particularly hard in the second half of the year, especially those that held technology-related positions. High growth stocks, in general, saw a significant downturn in the second half of the year, offsetting the very strong gains of the prior year. Returns in the absolute return portfolio were well below benchmark, mostly reflecting biotech exposure, which also experienced a negative re-rating during the year. Our natural resources and real estate portfolios, two areas that provide some inflation protection, performed well.

## THE LONGER TERM

The past 10 years have provided a Goldilocks period for investors, with even passive portfolios turning in unusually strong returns. Our investments added value relative to benchmarks from every asset class. During this period, Wesleyan achieved an investment gain of over \$1.1 billion, which more than offset \$377.3 million of cumulative spending payouts and contributed to the restoration of endowment purchasing power lost during the global financial crisis.

10-YEAR PERFORMANCE ENDING JUNE 30, 2022				
ASSET CLASS	ENDOWMENT RETURN (%)	BENCHMARK RETURN (%)	VALUE ADDED (%)	BENCHMARK
Developed Equity	9.9	9.5	0.4	MSCI World
Emerging Markets Equity	5.6	3.1	2.5	MSCI Emerging Markets
Absolute Return	6.7	4.7	2.0	CSFB/Tremont Hedge Fund
Real Estate	14.8	13.0	1.8	C.A. U.S. Real Estate
Natural Resources	(1.3)	(2.7)	1.4	C.A. U.S. Upstream and Royalties
Private Equity	22.0	18.1	3.9	Cambridge Associates Composite
Fixed Income	1.2	1.0	0.2	Barclays Intermediate U.S. Treasury
<b>Wesleyan Managed Pool<sup>2</sup></b>	<b>11.2</b>	<b>6.7</b>	<b>4.5</b>	<b>Passive Benchmark<sup>4</sup></b>
<b>Wesleyan Managed Pool<sup>2</sup></b>	<b>11.2</b>	<b>8.9</b>	<b>2.3</b>	<b>Policy Benchmark<sup>3</sup></b>
<b>Wesleyan Managed Pool<sup>2</sup></b>	<b>11.2</b>	<b>7.1</b>	<b>4.1</b>	<b>HEPI + 4.5%</b>

It is difficult to overstate how critical gifts were in building the endowment over this timeframe. The \$221.2 million of donations received by the endowment over the trailing 10-year period grew in value well above the aggregate initial gifts. The combination of these gifts and investment growth has to date generated an additional \$57.5 of payout to the operating budget when compared to receiving zero gifts and added an additional \$379 million to the endowment balance. The path of endowment returns with and without gifts since 2012 is shown below:



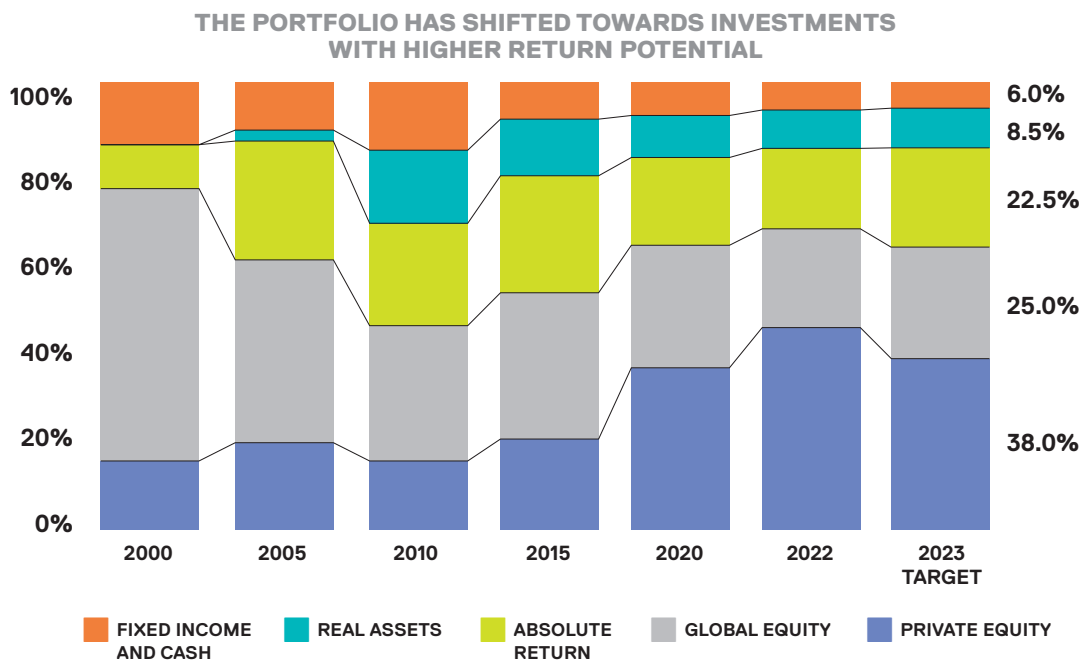
## ASSET ALLOCATION

The Investment Committee and staff principally control risk through two types of decisions. The first is asset allocation, where selecting a mix of diversified and uncorrelated assets should provide the returns necessary to achieve Wesleyan’s long-term financial goals. The second is manager selection, which requires staff to identify talented managers who can add value within each asset class.

Asset class targets are approved each year by the Investment Committee and reflect a blend of long-term expected risk and returns and an assessment of our ability to identify and access talented managers. Each asset class has a strategic long-term target, a realistic target for the upcoming year, and an acceptable range around those targets. Ranges allow the investment team to select the best opportunities based on a bottom-up assessment of opportunities rather than “filling a bucket.”

Asset class ranges and manager selection are investment judgments made in the context of a long-term time frame. The endowment’s portfolio construction is not designed to take advantage of short-term dislocations (although we do expect our managers to do so). Instead, we seek to maximize the probability of meeting long-term performance goals through a variety of market conditions. For this approach to succeed, the portfolio must be diversified with investments that behave in an uncorrelated manner. At times of true stress, however, we recognize that correlations will increase between and within all asset classes. We do not manage the portfolio for those types of crises, since such an approach would guarantee that we would not take enough risk to generate the returns needed to maintain the real purchasing power of the endowment. While economic cycles and downturns are painful, we accept that they are inevitable and something we must manage through.

In the chart below, we show our actual asset allocation at fiscal year ends since 2000 and our targets for fiscal 2023. Real assets reflect real estate and legacy oil and gas investments, however Wesleyan no longer directly invests in fossil fuels strategies. We wholly anticipate current oil and gas positions to run off by 2031, coinciding with the University’s 200th anniversary. Until then, the value of our oil and gas assets will fluctuate with commodity prices.



## HISTORY LESSONS

Over the years, our annual endowment update has briefed readers about themes including socially responsible investing, managing an endowment through COVID, and our criteria for hiring managers. Those subjects reflect our research and thinking over the prior year. This year, with inflation stubbornly refusing to fall into the “transitory” bucket and with technology valuations at all-time highs, we decided to look back at economic periods that shared similar characteristics.

Wesleyan’s endowment benefitted significantly from strong, post-World War II market conditions and the sale of the *Weekly Reader* in 1965 (a publication owned by the school and sold to Xerox). During the 1970s, Wesleyan’s endowment was larger than many of its peers. By 2005, however, Wesleyan had lost significant ground to most peers. As we looked further into what had happened, we realized we needed to examine both the 1970s as well as the tech bubble of the late 1990s. For many weeks, our conference room table was piled high with decades worth of investment reports dating from the 1960s. Focusing on Wesleyan’s experience through the 1970s and 1990s, we walked away from this experience with several findings to share with the broader Wesleyan community.

### The 1970s and 80s

Triggering our look back to the 1970s era was the observation that today’s economic environment shares some similar characteristics with that era of stagflation (high inflation with poor economic growth). We sought to understand Wesleyan’s responses to events during that period and whether there were any lessons we could apply to our work today. In the 20-year period between 1965 and 1984, Wesleyan’s endowment lost a little more than two-thirds of its purchasing power, due in part to challenging economic conditions, stock market crashes, and high inflation.

Notably, while Wesleyan lost much of its purchasing power, so did its peers. High inflation during the 1970s and early 1980s decimated the purchasing power of most endowments. By the time 1984 rolled around, US citizens needed \$268 to buy the same basket of goods they purchased in 1970 for only \$100. Today, we see similar factors causing inflation, notably a sharp rise of commodity prices from an imbalance of supply and demand. In addition, there are a few new drivers today, such as China lockdowns, supply chain reshoring, tight labor markets with rising wages, and massive injections of stimulus money to provide COVID relief.

While the loss of purchasing power from 1970 to 1984 was devastating, some of the pain could have been mitigated through asset allocation and spending policy decisions. For example, after two devastating years of stock market declines (-14.7% in 1973 and -26.3% in 1974), Wesleyan shifted its investments predominantly to cash. Further, this cash overweight persisted for several years, which reduced equity exposure and prevented Wesleyan from participating fully in the subsequent market recovery.

Another contributor to the decrease in purchasing power in the 1970s was Wesleyan’s spending. Following strong endowment growth in the 1960s, Wesleyan’s reliance on the endowment to fund operating and capital expenditures increased. Effective spending (spending divided by beginning

endowment balance) peaked at 11.6% in 1971 (versus our current target of 4.5%). Through the early 1970s, operating expenses and capital expenditures continued to increase while the endowment dwindled. Financial models show that had we adhered to our current spending formula during that timeframe, we would have reduced the long-term impact to the endowment significantly.

In summary, our financial analysis showed that remaining invested in the equity markets, rebalancing the portfolio over time, and adhering to our current spending rule would have reduced the loss of purchasing power from nearly 70% to just under 40%. While still an extremely painful result, limiting purchasing power losses by this magnitude would have had a positive long-term impact, as the salvaged value would have compounded over the next several decades.

Unfortunately, investment offices dedicated to making asset allocation and rebalancing decisions simply did not exist during the challenging period of the 1970s. It was not until the 1980s and 1990s that universities began to hire specialized talent pools with expertise to focus on portfolio construction, implementation, and reporting.

## The 1990s and Venture Capital

The technology correction underway in 2022 impelled us to review the 1990s for additional history lessons. In 1990, Wesleyan’s endowment value was still on par with that of many of our peers. Several factors contributed to the school falling substantially behind by 2005. Not only was our effective spending higher than our peers through the 1990s and early 2000s, but we also vastly underperformed those peers in fundraising. In addition, Wesleyan’s fundraising during that period was directed toward our annual operating expenses rather than building long-term financial strength through the endowment.

From an investment strategy and returns standpoint, however, that period stands out for Wesleyan’s lack of exposure to venture capital, which created an almost insurmountable gap between Wesleyan and its peers who had entered this asset class in the 1970s and 1980s. Peers with venture capital portfolios had returns in the 40% to 50% range in 2000, while Wesleyan saw returns of 12.4%. While those peers suffered in the subsequent “bust” of the 2000s, the gains made in the decade leading up to the correction more than offset those losses. With no exposure to venture, Wesleyan missed the extraordinary returns of 1999 and 2000, but still experienced painful losses as both public and private markets corrected in the early 2000s.

Although we recognize that innovation cycles appear infrequently, maintaining exposure to venture capital appears to pay off over the very long term. The returns of a single vintage year have the potential to drive returns for an entire decade. Our takeaway is that it is important to remain invested in “risky” asset classes, as they are the strong drivers of returns over very long time horizons.

The last decade in venture has mirrored the late 1990s in terms of massive innovation and strong returns. Unlike the late 1990s, Wesleyan participated in the recent cycle of strong venture returns through a portfolio it began building in 2011. However, we are also likely to experience a meaningful correction over the next few years as valuations fall back to Earth and nascent start-ups fail. The

current market reflects similarities to the 2000 to 2003 bear market, characterized by technology company valuations plummeting. Multiples for high growth companies—both public and private—have taken a strong beating since January 2022.

## MOVING FORWARD

In drafting this letter, we re-read our closing words from 2021:

**“With an extraordinary fiscal 2021 in the rearview mirror, it’s likely that future returns were brought forward, and the road ahead for generating performance will be difficult.”**

While fiscal 2022 was a year of losses for the endowment, we do not believe we are out of the woods yet. After decades of easing monetary policy, it is impossible to predict all of the cascading effects of tighter capital markets and more expensive costs of financing. We know there will be ramifications for our portfolio, but armed with some of our lessons from the 1970s and 1990s, we are intent on avoiding the mistakes of the past. Our retrospective on the University’s experience in the hyperinflationary days of the 1970s and the strong venture cycle of the late 1990s has taught us to remain disciplined in our approach to investing, rebalancing, and spending, in both good times and bad.

As we enter a period of non-zero interest rates, an about-face from the declining interest rate environment of the last 30 years, there are bound to be unanticipated challenges along the way. Our top priority is ensuring the endowment has the liquidity to meet its obligations to the University and our investment partners, while continuing to stay invested and taking advantage of opportunities that present themselves amidst the volatility. Despite the inevitable challenges that the capital markets are presenting and may continue to present in the next few years, we feel well prepared to weather the storms ahead given the hard work of the staff, Investment Committee, and Board of Trustees to create a clear roadmap for governance, asset allocation, manager selection, liquidity management, and endowment payout.

We are grateful to support the work of this extraordinary university.

Anne Martin  
Chief Investment Officer

Susannah Gray ’82  
Investment Committee Chair



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