A Message for the New Year: Priorities for 2016 and Beyond

Catherine Keating, President and Chief Executive Officer, Commonfund
January 4, 2016

As we begin 2016 and approach the one-year anniversary of my arrival at Commonfund, I want to share some thoughts on Commonfund, our views on the capital markets and our priorities for 2016 and beyond.

First, I thank our clients who have entrusted us to be stewards of their institutions' assets. This is a responsibility that we take seriously. "Client-centric" may be a vastly over-used term, but we exist solely to help our clients fulfill the missions of their institutions. As a nonprofit membership corporation, this focus has been our mandate from the beginning, and we remain committed to it every day.

Affirming our Mission

As we enter our 45th year, Commonfund celebrates being a truly multi-generational firm. We have a history of successful evolution and will continue to evolve and adapt to meet the needs of our clients and the marketplace. Our core mission remains unchanged: to enhance the financial resources of our clients by delivering exceptional performance, insight and service. Our focus on institutional investors, primarily non-profits and the public sector, remains steadfast. This single-minded focus is the key to unlocking higher value for you, our clients. We commit to delivering on this promise in three ways: first, by constructing investment solutions that extract the strengths of the endowment model of investing; second, by executing investment decisions using independent, institutional asset managers; and third, by providing distinctive insight and education through synthesizing proprietary and third party research.

Endowment Model

Commonfund was founded in 1971, supported by a $2.8 million grant from the Ford Foundation. The Ford Foundation was a major donor to higher education and was concerned that educational endowments' heavy reliance on fixed income investments at the time threatened the long term financial health of those institutions. Commonfund worked to develop and execute a better long term investment approach which, over time, became known as the endowment model.

At its core, the endowment model of investing is based on long-term outcomes, specifically the ability to maintain a real return net of all fees sufficient to cover distributions. In order to maintain this inter-generational equity, our clients today generally target nominal returns of CPI plus five percent or roughly seven percent annually. We are proud that Commonfund has a multidecade track record of successfully exceeding these targets as well as more traditional portfolio benchmarks. Today, given our medium term forecasts of returns, seven percent may be a tall order over the next few years. This isn't the first time we've seen challenging markets, though, and our experience managing assets through all types of investment environments will guide us. But more on that challenge later.

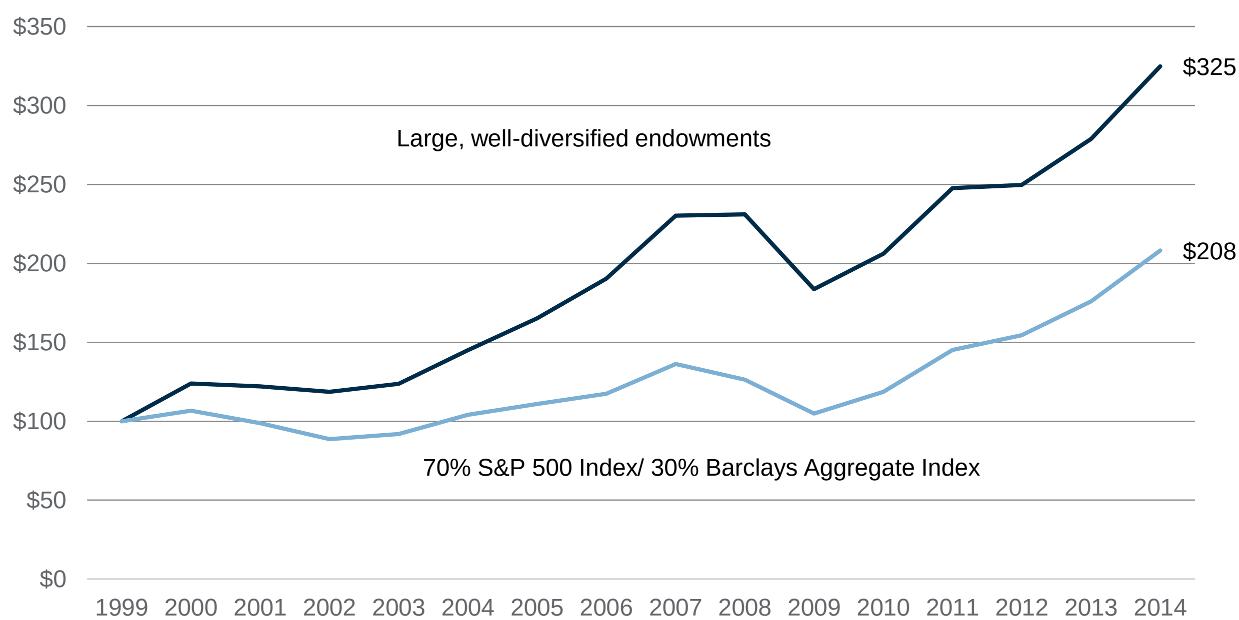
Importantly, we view the endowment model not as immutable but as dynamic and evolving. It demands understanding secular themes, cycles, opportunities and risks. But, at its core, it remains characterized by the three pillars of broad diversification, an equity bias, and prudent use of illiquid investments to capture the return premiums that they offer. This is the kind of thinking that has sustained institutions through time, and we continue to believe it is the best formula for long term success. The chart on page 3 from our proprietary NACUBO-Commonfund Study of Endowments®, demonstrates how this approach has delivered strong long-term results for large, well-diversified institutions that practice it. Our goal at Commonfund is to offer institutions of all sizes these three pillars, tailored to their unique needs.

Independent Asset Managers

Key to Commonfund's ability to serve clients is our flexibility to independently source investment managers, without broader organizational constraints. Our long history and desirable client base often enable us to access otherwise unavailable managers and opportunities. The alignment and independence offered by this method of investing are central to our value proposition. These features are even more important today than they were when we were founded, given the massive growth and consolidation of the asset management industry over the last four decades.

WELL-DIVERSIFIED ENDOWMENTS HAVE OUTPERFORMED

1999-2014



Large, well-diversified endowments represent the cohort of institutions with over $1 billion.
Source: Commonfund Institute and NACUBO, reports data back to 2000.

Unique Insight

We remain committed to providing research and education that advance the financial resources and understanding of our clients and all institutional investors. The Commonfund Institute, in particular, stands out as one of the industry's most trusted sources for useful and proprietary data, analysis and best practices. It makes our clients more successful and it makes us more successful as well. The Institute will continue to address a range of investment topics, while maintaining its position as the industry leader on governance practices. The long term success of any institutional investor is as dependent on strong governance as it is on strong investments, neither of which is sufficient on its own.

Evolving to Serve You Better

Commonfund is committed to evolving to continue to deliver strong investment outcomes for our clients. Over the next year, we will be focused on three priorities: first, strengthening investment execution; second, providing more custom portfolios; and third, managing investment costs.

Investment Execution

Later this month we will welcome Mark Anson as our new Chief Investment Officer. Among Mark's early charges will be to work with our investment teams to strike the appropriate balance between diversification and conviction in the portfolios that we construct and manage. This may mean that you could see fewer managers in some of our strategies, along with emerging and smaller managers, as we take advantage of the alpha opportunities that they often represent. We will continue to refine our sourcing of beta and alpha, recognizing that there is a role for passive strategies as a complement to active management. And we will also continue to identify market themes and gaps that we think offer compelling opportunities to the long-term institutional investor. Large-scale, secular themes such as the tremendous growth in the emerging market middle class and the profound structural changes taking place in credit markets are just two examples of opportunities on which we are focused.

Custom Portfolios

Through our years of experience, we understand the financial ecosystems in which our clients operate and are in a position to address factors unique to them when we design and build investment solutions. We know that while the size of an organization's investment portfolio is important, the bigger consideration is often the extent of funding obligations from the portfolio: whether it is supporting a large (or small) percentage of an organization's operating budget or a significant population of current (or future) retirees.

This means that our work as an investor needs to incorporate factors beyond the portfolio itself. We must consider the sources of funds, the resiliency of the budget, cash flows, liabilities, debt service and more. The ultimate goal is to sustain our clients' organizations over the long term but also to enable them to maintain their operations and obligations over a business cycle. We are committing more resources to enhancing our toolset to optimize the intersection of finance and investments for our clients.

We will also be expanding our responsible investing capabilities in response to growing requests from our clients in this area. Since 2013, we have been signatories of the PRI (Principles of Responsible Investment) and have long offered the ability to customize portfolios to align with clients' particular preferences or missions. You can expect to see more research and investment programs that incorporate ESG (Environmental, Social and Governance) factors. This past year, we delved deeply into the investment and fiduciary implications of fossil fuel exposure in portfolios and reached some conclusions that challenged our own preconceptions – and may challenge yours too.

Fees and Costs

Investment fees and costs are among the least understood factors of the asset management business. Our studies suggest that few institutions know the total costs of portfolio management. Many are surprised when they learn that the true fully-loaded cost of a well-diversified, actively-managed portfolio crossing public and private markets is between 100 and 200 basis points annually. For any investor, achieving intergenerational equity depends on a variety of factors. Some factors are not controllable (markets, interest rates, inflation) but costs are controllable and can also have a significant impact on portfolio value over time. Our goal is to continuously measure and manage the expenses of our managers, service providers and our own firm.

Looking to the Investment Environment in 2016 and Beyond

As we look to 2016 and the balance of this decade, we anticipate an environment of lower global growth, accompanied by lower investment returns and higher volatility. Our own medium term outlook for broadly diversified portfolios that cross public and private markets suggests returns in the six percent range (including forecasted alpha) versus the seven percent targeted by most of our clients.

FORECASTED RETURNS AND ALLOCATION FOR A SAMPLE CLIENT POLICY PORTFOLIO

Numbers in percent

Investment Strategy	Allocation*	Return (with α)
Equity	57.0	6.8
Fixed Income	10.0	2.4
Hedge	20.0	5.6
Real Assets	13.0	6.4
Total	**100.0**	**6.0**
Total Beta**		4.6
Total Alpha		1.4

* The sample client policy portfolio is provided for illustration and discussion purposes only. See Important Notes | Eligible Investors

**Includes median forecasted alpha for hedge funds and private capital. See Important Notes | Forecasts

Our investment teams are working hard to close the gap. At the same time, we recognize that current market cycle and structure need to inform us.

Cycles Matter

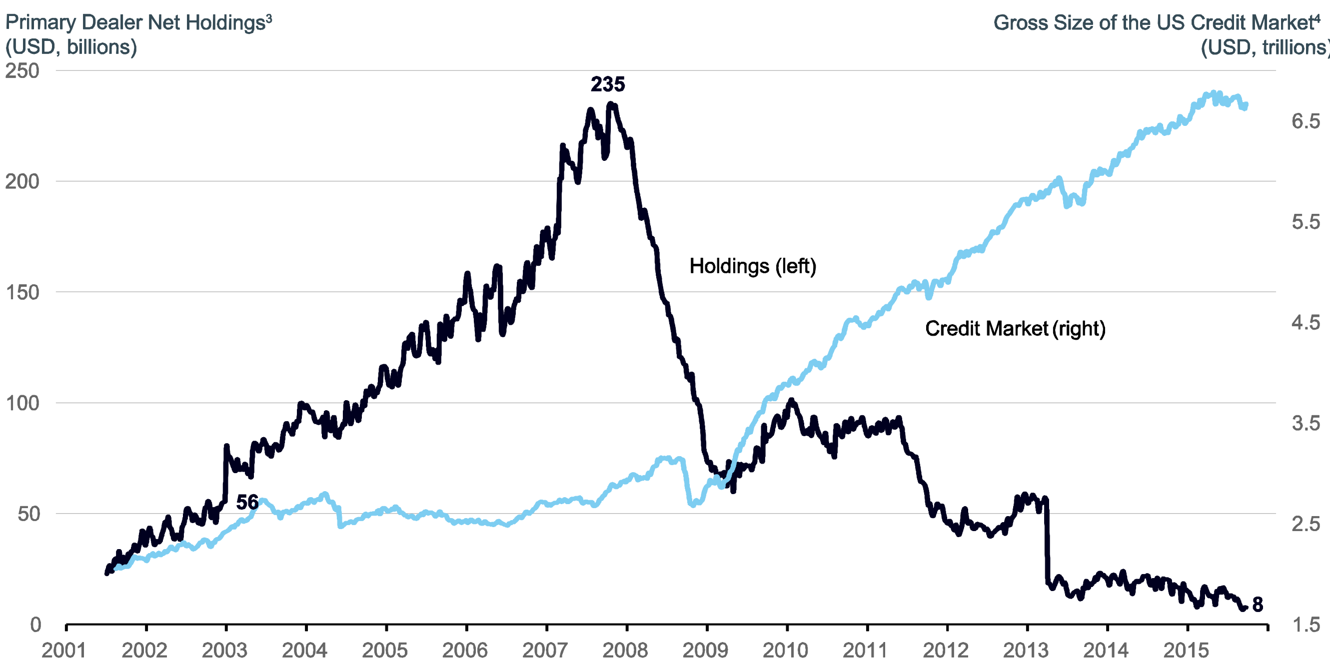
We are now late in one of the longest recovery/expansion cycles since the Civil War. We believe that this market cycle has room to run for another year or more, but we are increasingly alert to signs of the cycle changing. Among the most important indicators we track and watch are: (1) corporate profits - when profits decline, recessions tend to follow within two years; (2) the yield curve, and in particular any sign of inversion, which often signals a recession in the upcoming year; (3) Federal Reserve actions and the extent to which they fuel a tightening in global financial conditions; and (4) inflation, including signs of price pressure in wages and energy. In this environment, we are focused on some broad late-cycle themes in our portfolios and with our managers, including higher quality, lower leverage, increased liquidity and overall active management (which is also risk management). Our accompanying 2016 Global Economic and Investment Outlook provides a more detailed look at our expectations and portfolio positioning going forward.

Market Structure Matters

The asset management industry today is vastly different than it was when Commonfund was founded or even prior to the financial crisis. Today, we invest in a market that is evolving by client segment, by market liquidity and by manager scale. For example, the U.S. retail client segment is now larger than the institutional segment. Bond and equity market liquidity continue to evolve due to factors including post-crisis regulations reducing bond market liquidity and the growth of index funds and ETFs, which account for a significant and growing share of U.S. equity holdings. Investment managers today also operate at un-precedented scale: today in the United States there are 10 asset managers with over $1 trillion in assets under management while 15 years ago there were none. Scale is even impacting alternative asset managers, with just two percent of hedge fund firms and 10 percent of private equity firms responsible for close to half of hedge fund assets managed and private equity funds raised over the last five years. Collectively these and other developments lead to increasingly concentrated markets, trading strategies and asset flows.

UNDERSTANDING LIQUIDITY

Taking corporate bonds as an example, as inventories have declined, market size has grown, increasing relative illiquidity.



See footnotes at end of document.
Source: Federal Reserve Bank of New York. As of September 23, 2015.

We are focused on the implications of these changes in market structure for our clients. Historically, markets have been viewed as either public (and liquid) or private (and illiquid). The accumulation of these structural changes suggests to us that we need to be even more alert to market structure, liquidity and performance implications across all markets. Today long term investors need to be prepared for liquidity shocks as well as market shocks, and we will be devoting more attention to both in the future.

Happy New Year

In closing, I want to thank you again for the confidence you have placed in Commonfund. My colleagues and I are committed to continuing to earn it. We wish you a happy and prosperous new year and look forward to seeing you and discussing these topics and more over the course of 2016.

With thanks and warm regards from all of us at Commonfund,

1. Commonfund Portfolio: 70% Commonfund Multi-Strategy Equity Fund, 30% Commonfund Multi-Strategy Bond Fund (Net) with calendar year end rebalancing. The respective inception dates for the Multi-Strategy Equity and Bond Funds are July 1971 and August 1976, respectively. Therefore, this composite performance is 38 years. The Commonfund Portfolio funds are available only to educational institutions. We also offer parallel programs for qualified investors. The stated return is the net total return for a hypothetical investment in each of the indicated funds for the stated period, allocated between the funds at the indicated ratio and calculated assuming an annual rebalancing at year-end to the indicated ratio. While the stated blended return is based on historical performance, it is provided for illustrative purposes only, and does not necessarily represent the actual performance of any investor, or a recommendation on the part of The Common Fund for Nonprofit Organizations or its affiliates, Commonfund Asset Management Company, Inc., Commonfund Capital, Inc., Commonfund Realty, Inc. or Commonfund Securities, Inc. to any particular investor. The goals, risk tolerance and circumstances of each investing institution should be taken into account in determining whether any such blended investment might be appropriate for it.
   In addition, the reader should be aware that the assumption underlying this return - namely, that the investor maintained a steady allocation among the funds and rebalanced annually - is artificial in that it does not take into account changes that might be made in response to significant market events, etc.

2. Traditional Benchmark: 70% S&P 500 Index; 30% Barclays Capital US Aggregate Bond Index with calendar year end rebalancing. The stated return is the net total return for a hypothetical investment in each of the indicated indices for the stated period, allocated between the indices at the indicated ratio and calculated assuming an annual rebalancing at year-end to the indicated ratio. While the stated blended return is based on historical performance, it is provided for illustrative purposes only, and does not necessarily represent the actual performance of any investor, or a recommendation on the part of The Common Fund for Nonprofit Organizations or its affiliates, Commonfund Asset Management Company, Inc., Commonfund Capital, Inc., Commonfund Realty, Inc. or Commonfund Securities, Inc. to any particular investor. The goals, risk tolerance and circumstances of each investing institution should be taken into account in determining whether any such blended investment might be appropriate for it.
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3. On April 1, 2013, the Federal Reserve Bank of New York adjusted the way corporate securities are calculated by excluding non-agency residential mortgage-backed securities.

4. Credit market = Barclays U.S. Investment-Grade Index + Barclays U.S. High-Yield Index

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Forecasts are based on data as of December 30, 2015.

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