Yale *Investments Office*

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Dear fellow members of the Yale community,

September 1st marked my two-year anniversary as Yale's Chief Investment Officer and the 20th anniversary of my arrival from St. Louis as a nervously excited new student on Old Campus. As was true on my very first day in Vanderbilt Hall, I am grateful to be part of such an outstanding community and, as has been true for the last 16 years, I relish the opportunity to serve such a singular institution. Over the past two years, I, alongside my colleagues at the Investments Office, have been laying the foundation for an evolution that we believe is necessary to extend our long-term record of success over the next several decades. While still early in this journey, reaching this two-year milestone has inspired me to share some early reflections in my new role as well as the road map ahead for the Investments Office.

To fulfill its mission, the Investments Office must generate excellent risk-adjusted returns to uphold the University's commitment to intergenerational equity within our community. But what does that really mean? Each year, Yale aims to spend approximately 5% of the value of its endowment. That number, while it may appear small on its face, has been carefully calibrated to ensure that students a century from now enjoy the same opportunities as students on campus today. The endowment grows in two main ways: endowed gifts from Yale's generous donors and investment returns on endowment assets. Given historical and expected future financial market rates of return, spending north of 5% per year from the endowment would slowly but steadily erode its real value after accounting for inflation, prioritizing today's Yalies over future generations of Elis.

Thankfully, looking back over the last nearly four decades, the endowment has well exceeded the average returns of the market. Under the innovative leadership of my former colleagues and mentors David Swensen '80 Ph.D. and Dean Takahashi '80, '83 MPPM, the Investments Office guided the endowment into alternative asset classes, such as private equity and venture capital, with less-efficient, less-liquid markets that naturally fit Yale's uniquely long time horizon. We pursued strategies that sought to generate returns by fundamental means, eschewing short-term or value-extractive approaches in favor of strategies that profit by sharing in the real value they create in the economy. We forged strong partnerships with some of the best investors in the world, helping many get their firms off the ground and offering our experience, expertise, patience, and support to all. Throughout, we acknowledged the obligations that come with managing an endowment like Yale's, maintaining high ethical standards in our day-to-day decision-making and carefully abiding by the University's rigorous but adaptive framework (governed by the Corporation Committee on Investor Responsibility with support from the Advisory Committee on Investor Responsibility composed of faculty, staff, alumni, and students) to satisfy those obligations.

This approach proved quite successful. From the start of David's tenure in 1985 through his passing in 2021, the endowment averaged a return of 13.7% per year, an incredible feat that grew Yale's pool of assets from $1 billion to over $40 billion. With this success came recognition and, eventually, competition. Not only did David openly and generously share the wisdom of Yale's investment philosophy (like any other Yale professor, David wrote a book!), but he also mentored fifteen eventual Chief Investment Officers at institutions such as Princeton, Stanford, MIT, Penn, and the Packard Foundation. After learning alongside David for nearly a decade and a half, I was honored to become the 16th (and I'm quite certain not the last).

As a result, the Investments Office today finds itself in a market crowded with institutional investors, many of them employing similar investment strategies. Furthermore, we find ourselves at an economic inflection point, as a 40-year trend of declining interest rates reverses. And so, I have spent much of my first two years thinking through how to adapt "The Yale Model" for a more competitive, more uncertain environment. One thing, though, is certain: success over the next four decades will look different than success over the last four.

Though challenging, adapting to the changing landscape plays into the key strengths of the Investments Office. In my view, the success of Yale's endowment has stemmed from three core principles: 1) focus on the long term; 2) think independently; and 3) people matter most. These principles, long at the core of our investment program, have inspired the early work I have undertaken as my colleagues and I seek to carry the torch forward.

1. Focus on the Long Term

As a 322-year-old institution, Yale benefits from the rare ability to invest with a truly long time horizon. Given this, we measure our success over decades, not days, months, or even years. The endowment's return of 10.9% per year during the ten years ending June 30, 2023 surpassed the mean endowment return by 3.0% per year. Such outperformance translates to an incremental $600 million to spend every year *in perpetuity* to, for example, increase access for the world's most talented students regardless of their background, hire excellent and diverse faculty to educate this next generation of future leaders, and ensure the free and open exchange of ideas and knowledge.

In this context, our ability to be patient with long-term, illiquid assets will continue to be one of Yale's key competitive advantages and central to our investment approach. That said, illiquidity does not, in and of itself, produce excess returns, and we must be careful to invest the endowment with an eye toward the stability of its critical support of the operating budget from year to year. Recently, in partnership with the senior leadership of the University, my colleagues and I reconsidered core questions about Yale's ability to tolerate investment risk. After extensive modeling and discussion, we affirmed our instinct that we could, and should, maintain a sizeable allocation to illiquid assets. While asset classes such as venture capital and private equity come with greater risk than traditional public markets, they also offer the opportunity for greater returns over the long term. The best investors in these asset classes have differential access to attractive opportunities and the ability to add value to their investments, offering a higher likelihood of sustainable outperformance.

In contrast, focusing on the long term has led us away from oil and gas investments. We at the Investments Office believe that climate change represents the greatest challenge of our generation. In fact, Yale has long recognized the urgent reality of climate change, taking groundbreaking steps such as writing a letter to all of our partners in 2014 to urge them to build climate change into their investment underwriting. More recently, we have gone even further, eschewing new commitments to dedicated oil and gas investment firms for one simple reason: the world is rightly transitioning away from fossil fuels – a reality that makes new investment activity incompatible with our long-term approach to partnership. As such, we have not made a new commitment to an oil and gas investment firm since 2019. Looking ahead, my colleagues and I will continue to follow the Fossil Fuel Investment Principles established by the Corporation Committee on Investor Responsibility even as our focus turns away from oil and gas assets due to their long-term investment outlook.

Conversely, we are excited to support the energy transition, the scale of which is certain to provide attractive investment opportunities of which our entire community can be proud. In fact, our newly formed internal climate opportunities team has already made sizable commitments to climate transition strategies across our real assets, marketable alternatives, private equity, and venture capital portfolios. As with all of our investment activity, we will be selective, but such opportunities are perfectly in tune with our focus on long-term value creation.

2. Think Independently

The legacy of the Investments Office is one defined by innovation. Simply put, we have never been afraid to think differently or break new ground. Examples include our pioneering work in illiquid asset cash flow modeling, our early entry into multiple new asset categories and geographies, and the countless times we have backed new investors with no track record whatsoever. Such creative thinking has and always will be critical to our differentiation from other institutional investors.

We strive to foster a culture of continuous improvement at the Investments Office. That means an environment that welcomes new ideas of all types and from all team members. We have deliberately carved out time on our calendars to brainstorm, recognizing that the innovation process is just that – a process. Not even David knew what the thesis of *Pioneering Portfolio Management* would be when he started at Yale; it revealed itself over time as he and his team followed their instincts, rooted in strong first principles. And so we must continue to prioritize creative thinking and, just as importantly, be open to failing, even repeatedly, on our own path to success. Of course, we must be disciplined as we pursue new ideas, but we believe that the best investments often come from high-conviction, contrarian views.

While our evolution as an investment organization will take time to materialize, I am confident that new technologies will play a central role. In my previous position as the leader of Yale's venture capital portfolio, I saw firsthand how our partners modernized their investing activities using software, data analytics, and artificial intelligence to enhance their sourcing, decision-making, and ability to add value to their companies. Now, I'm excited to focus on our own use of such tools at the Investments Office. With a growing team and access to all of the phenomenal resources that Yale has to offer, we can and will build technology and data systems that most other institutions simply cannot.

3. People Matter Most

Once asked the real secret behind Yale's returns, David Swensen responded: "people, people, people." In our business, people matter most. Knowing David, I'd like to think that his ternary answer was purposeful, referring to the three sets of people critical to our mission: our external investment partners, my colleagues in the Investments Office, and the Yale community. These three groups are at the heart of the Investments Office's new mission statement:

> We strive to…
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> Be the partner of choice to the best investors in the world
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> Be the place where the most talented people want to work
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> Be engaged citizens of the University that we serve
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> …to generate excellent risk-adjusted returns to support Yale.

I believe that maintaining our edge in today's competitive landscape comes down to creating harmony between these three constituencies.

Collaborating with our Partners

Yale's investment partners have formed the backbone of the endowment's success, and I have no doubt that they will continue to both inspire me and produce excellent investment results for decades to come. This was, is, and will continue to be the foundation of our approach: to utilize a network of the world's best investment firms to invest the endowment on Yale's behalf. While the Investments Office itself has only 50 staff members, thousands of people work hard to deliver returns to Yale.

I could not be more grateful for these longstanding partnerships, most of which span over a decade, and some over four. Our partners have always been excellent stewards of Yale's capital, and many have been invaluable sounding boards to me as I have undertaken my new role. They also serve Yale in myriad ways beyond the profits they generate on our behalf. Many make routine guest appearances in the various courses that we teach on campus, others host residential college teas, and yet others serve as mentors for our summer interns. Without them, we could not do what we do.

Consequently, finding the next generation of talented investors and providing them with the staunchest long-term partnership possible remains one of our most critical priorities. In many ways, the job of Yale's investment team is remarkably akin to that of our venture capital partners. We both search for outstanding talent that we can partner with for decades, betting on outstanding people whether they lack traditional investment backgrounds or even an investment track record at all. To that end, during my short tenure we have hired 18 new firms. Many were raising institutional capital for the first time, and half of these firms feature a founder or managing partner from backgrounds historically underrepresented in finance.

Building Our Team

The end of the nine-year battle that David – our friend, colleague, and mentor – waged against cancer hit our team particularly hard. Furthermore, culture and cohesion were already stressed due to the pandemic, which kept us apart for well over a year and a half. Despite both of these challenges, our mutual commitment to each other, the institution, and the continued pursuit of excellence inspired us to regroup and recommit to carrying the torch forward together. Our senior team holds a collective 235 years of experience at the Investments Office. I am proud to work alongside such a dedicated, brilliant group of mission-oriented people. The Investments Office has always had a strong, close-knit culture, and one of my favorite moments of the last two years came when we sat down together to codify our values: excellence, integrity, camaraderie, curiosity, passion, and partnership. We have used this inflection point to retain the best elements of our past but also to be honest with ourselves about how we can be better teammates, investors, and stewards of the University's resources that have been entrusted to us.

At the same time, I felt the need to bring in more talent to manage a larger pool of assets and a more complicated operation. We have made several key senior-level hires – a chief operating officer, a chief technology officer, a director of private equity, a director of capital markets, and a principal to lead our real estate effort – and I am humbled by their decision to share in our collective journey. These new colleagues joined from outstanding firms, and we have already benefitted enormously from their fresh perspectives. We have hired more broadly throughout the organization, as well. Since I started as Chief Investment Officer, we have added 22 new team members, in total. Still, the team will continue to grow, and I am particularly excited to strengthen the critical functions that support our investment team in an operational and technological capacity.

In all that we are doing with our team, I am focused on the importance of diversity, equity, and inclusion. We strive to build a diverse team because we have seen time and again that the best investment results come from robust conversations that reflect many perspectives. Thus, we have more than doubled the number of women on our investment team since I took over, from four to ten. Racial and ethnic minorities have increased from five investment team members to twelve. As a result, 70% of our investment team are women, racial or ethnic minorities, or both. I am also proud of our track record of supporting underrepresented talent within the investment management community, and we have only stepped up these efforts in recent years. For example, this year we launched the Yale Endowment Expanding Representation in Investing Workshop, a program designed to provide a practical introduction to investing for students, including those who are underrepresented along economic, racial, and ethnic lines. I intend to continue efforts like this to improve diversity in investment management, both at the Investments Office and more broadly.

Engaging with the Yale Community

The staff of the Investments Office have dedicated their working lives to the institution that our community holds dear because we, like you, believe in its mission. Each member of the team has a different answer for what Yale means to them. For some, Yale is the place where they shared formative years with close friends. For others, Yale is an institution that enables access to education for those otherwise unable to afford it (as was true for me two decades ago). For many, Yale is an instrument of humanity's commitment to the pursuit of knowledge, a commitment that forms the crux of what makes us human and the engine that has driven our civilization forward for millennia. For my part, I simply believe in the power of Yale to change the world for the better. Like any institution of its magnitude, and like the world in which it resides, Yale is imperfect. That said, the University's contribution to humanity in the form of scientific discoveries, medical advancements, the education of future leaders across all facets of society, and the creation, preservation, and transmission of knowledge across generations far outweighs its flaws and has never been more critical than it is today, in a world of disinformation, distrust, pandemics, and geopolitical turmoil.

David Swensen's dedication to all things Yale – from its people to its values – was infectious. I consider the close connection he forged between the Investments Office and the rest of the University to be one of our irreplaceable and distinct advantages. I aim to ensure that we continue to be good citizens of the broader Yale community. Members of our team enjoy attending Yale sporting events, art gallery exhibitions, musical performances, scholarly lectures, and much, much more. But we know it is important to give back to the Yale community and not just take from it. And so, we, collectively, are guest speakers in class seminars, advise first-year students, oversee senior projects, and teach courses in Yale College and at Yale Law School (and, in the past, at Yale SOM). We have welcomed faculty into our office for collaborative discussions, supported Yale Ventures, helped the Development Office raise funds from alumni, played the carillon in Harkness Tower, and given campus tours to prospective students. One of our team's favorite recent gatherings was a trip to the Yale Farm, where we learned more about Yale's Sustainable Food program and pitched in with a little weeding. Not only do these connections with Yale enliven the mission of our work at the Investments Office, they present us with opportunities – unparalleled elsewhere – to engage directly with the people, resources, and discoveries that will someday change the world and to contribute to the very lifeblood of the University itself.

In closing, I would like to thank my team at the Investments Office, President Salovey, the rest of Yale's administration, the Investment Committee and its chair Mike Cavanagh, and all of our investment partners for the universal support I have received since stepping into my new role. It is truly the privilege of my life to serve Yale alongside you, and I could not be more excited about the opportunities we have ahead of us.

With gratitude,

Matt Mendelsohn '07