

- Dow Jones Reprints: This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers, use the Order Reprints tool at the bottom of any article or visit [www.djreprints.com](http://www.djreprints.com)
- **THE WALL STREET JOURNAL.**  
WSJ.com
- JANUARY 13, 2009, 6:04 A.M. ET

## Yale's Investor Keeps Playbook

### In Line for First Loss Since '88, Mr. Swensen Still Champions 'Alternatives'

By [CRAIG KARMIN](#)

He isn't a household name. But as the Yale University's endowment's chief investment officer for two decades, David Swensen has earned a reputation as one of the world's savviest and most successful investors.

He pioneered an approach that de-emphasized stocks and bonds while embracing less-traditional fare like hedge funds, private equity, and oil and gas. During his tenure, Yale has had an average annual return of 16% for the past 10 years through June, compared with a 2% average for the Standard & Poor's 500-stock index. Yale's assets more than tripled over that period to \$23 billion, trailing only Harvard University's in size.

[View Full Image](#)



*Joe Fornabaio/The Wall Street Journal*

David Swensen, investment chief for Yale University's endowment, says institutional investors should be built for growth, not to withstand stock-market downturns.





Yet even Yale hasn't escaped the financial crisis.

The university estimated late last month that the endowment had lost 25% of its value since the end of June. That is expected to lead to budget cuts and puts Mr. Swensen in line for his first negative fiscal year since 1988. Other endowments that have set out to follow the strategy he has advocated are also suffering.

Nonetheless, Mr. Swensen is sticking to the same investment approach that he's used in the past. He describes that process in detail in his book, "Pioneering Portfolio Management," which he revised and which was reissued this month.

He spoke to The Wall Street Journal about the financial crisis, hedge funds, scandal-scarred money manager Bernard Madoff, and ill-fated efforts to mimic Yale's investment strategy. Here are questions and his answers, edited for context and clarity.

**Wall Street Journal:** *As you revised your book, first published in 2000, did any sections strike you as dated?*

**David Swensen:** It was more in the other direction. The book talked about an approach to investing that has succeeded over the past decade. In the '90s, all you had to do was put your money in the S&P 500. In the ensuing decade, a diversified strategy just crushed the S&P. The book talks about a sensible approach that was also profitable."



**WSJ:** *Yet, other endowments have attempted a Yale-like approach, usually with less success. What goes wrong?*

**Mr. Swensen:** A lot of institutional investors think they are emulating Yale, but they are not. Most endowments use fund of funds and consultants, rather than making their own well-informed decisions. You can divide institutional investors into two camps: those who can hire high-quality, active-management investors and those who can't. If you are going to invest in alternatives, you should be all in, and do it the way Yale does it -- with 20 to 25 investment professionals who devote their careers to looking for investment opportunities. Or you belong at the other end, with a portfolio exclusively in index funds with low fees. If you're not going to put together a team that can make high-quality decisions, your best alternative is passive investing. With a casual attempt to beat the market, you're going to fail.

If someone looked at what we're doing superficially and made superficial attempts to copy us, then I have little sympathy for them. It's a much more complicated process than that, and I explain it in detail in the book. If someone read my book and failed, I'd have some sympathy.

**WSJ:** *What about fund of funds and consultants? Can they be a solution?*

**Mr. Swensen:** Fund of funds are a cancer on the institutional-investor world. They facilitate the flow of ignorant capital. If an investor can't make an intelligent decision about picking managers, how can he make an intelligent decision about picking a fund-of-funds manager who will be selecting hedge funds? There's also more fees on top of existing fees. And the best managers don't want fund-of-fund money because it is unreliable. You need to be in the top 10% of hedge funds to succeed. In a fund of funds, you will likely be excluded from the best managers. [Mr.] Madoff also relied enormously on these intermediaries. He wouldn't have had nearly as much resources were it not for fund of funds.

Consultants make money by giving advice to as many people as possible. But you outperform by finding inefficiencies most of the market has not yet uncovered. So consultants ultimately end up doing a disservice to investors.

**WSJ:** *Does the poor performance of most assets last year suggest you need to tinker with the endowment's portfolio to better withstand another year like 2008?*

**Mr. Swensen:** I don't think it makes sense for an institutional investor with as long an investment horizon as Yale's to structure a portfolio to perform well in a period of financial crisis. That would require moving away from equity-oriented investments that have served institutions with long time horizons well.

**WSJ:** *With hedge funds suffering their worst year on record, will institutional investors have more power to demand lower fees?*

**Mr. Swensen:** Put that in the category of wishful thinking. It would be nice if fees were not so onerous. But you still have investors who are happy to pay a high price in hopes of getting the holy grail of extraordinary returns.

**WSJ:** *Many hedge funds share little information with investors beyond their general strategy. Is that acceptable?*

**Mr. Swensen:** We require complete transparency. We either know every position, or we don't invest. I have access to every position in every hedge fund in which we're invested. If they won't trust us with that information, why should we trust them with our money?

**WSJ:** *Looking ahead, what investments do you like?*

**Mr. Swensen:** Distressed securities are one of the most interesting opportunities for institutional investors. But returns won't come right away because the credit markets are fundamentally broken. TIPS [Treasury-Inflation Protected Securities] are pretty attractively priced. They promise reasonable returns, and protection against inflation is really important. We may not see it in the next year or two, but the government's massive fiscal stimulus can't help but produce massive inflationary pressures. Stocks also look a lot more attractive than they have for a long time. We prefer higher-quality companies with low leverage.

**WSJ:** *Your compensation has been as much as \$2 million a year. Are you and other endowment managers are paid too much?*

**Mr. Swensen:** Compensation in the investment-management world, broadly defined, is excessive. Not-for-profits have not exhibited the same excesses as the private sector. But the amount that endowment and foundation investment managers get paid is extremely generous.

**WSJ:** *Amid the Bernard Madoff scandal, there has been criticism of a university for investing in a fund that was run by someone on its investment committee. The fund, it turns out, was invested with Mr. Madoff. What's your view on that issue?*

**Mr. Swensen:** Yale doesn't have a rule that we can't invest with someone on our investment committee. Such a rule would diminish the overall quality of our investment committee quite dramatically. But members don't participate in deliberations about whether to invest in their funds. For as many times as I have recommended an investment with a committee member, I have recommended against. You have to be tough about it and only recommend those things that make an enormous amount of sense for the institution.

**Write to** Craig Karmin at [craig.karmin@wsj.com](mailto:craig.karmin@wsj.com)

Copyright 2008 Dow Jones & Company, Inc. All Rights Reserved

This copy is for your personal, non-commercial use only. Distribution and use of this material are governed by our [Subscriber Agreement](#) and by copyright law. For non-personal use or to order multiple copies, please contact Dow Jones Reprints at 1-800-843-0008 or visit

[www.djreprints.com](http://www.djreprints.com)