MCV Foundation

VCU Health

FISCAL YEAR 2016 ENDOWMENT REPORT

(JULY 1, 2015 – JUNE 30, 2016)

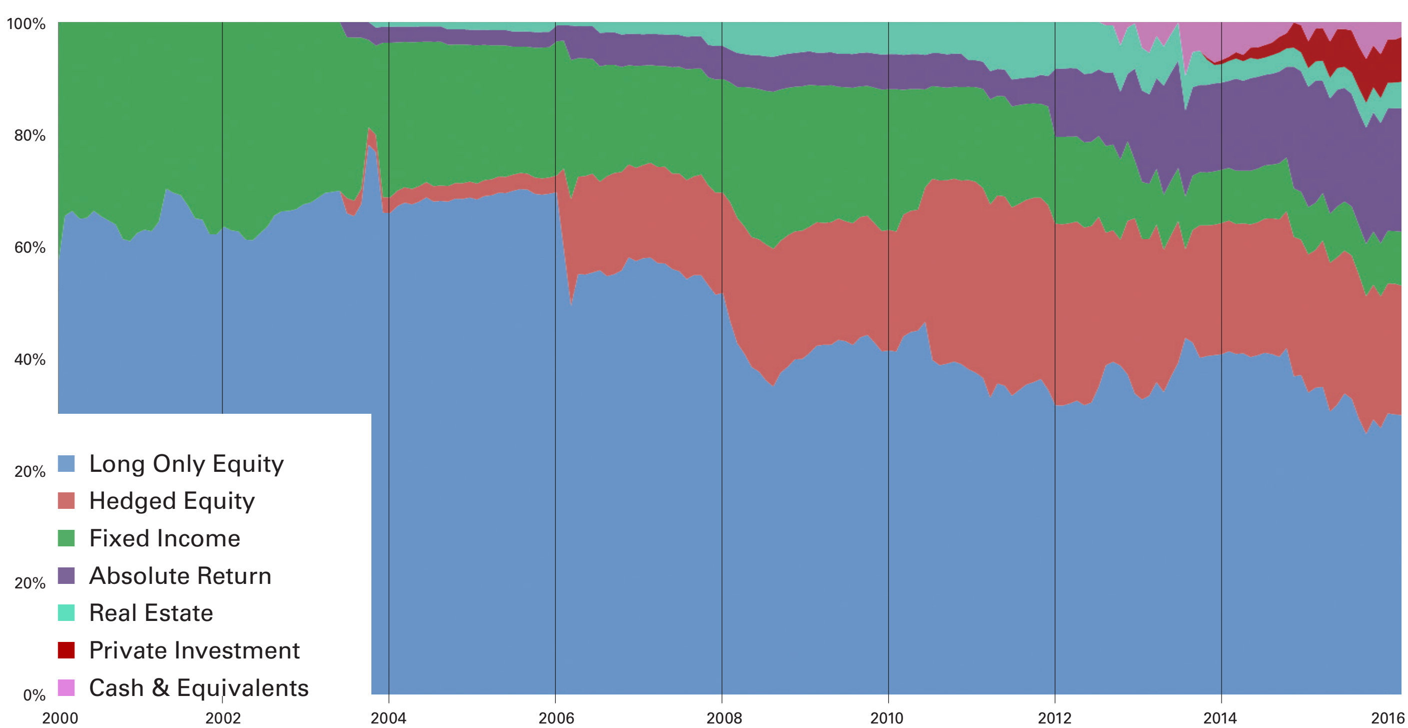
OVERVIEW

The MCV Foundation was established in 1949 to inspire and steward philanthropy that supports the MCV Campus, which has grown to include the VCU Schools of Allied Health Professions, Dentistry, Medicine, Nursing and Pharmacy, as well as VCU Massey Cancer Center and VCU Medical Center. This growth makes our mission at the Foundation more vital than ever — to ensure the MCV Campus remains at the forefront of excellence and innovation in patient care, education and research to support the life-saving work that occurs here every day.

INVESTMENT OBJECTIVE AND STRATEGY

The Foundation's endowment is invested in a long-term portfolio managed by Lowe, Brockenbrough & Company, Inc. The primary investment objectives for the MCV Foundation are to protect capital and grow the investment assets above the projected draw level and rate of inflation. This objective focuses simultaneously on: 1) preservation of capital and 2) earning an average real total return of at least 6% over the long term. The Foundation seeks to achieve these objectives by investing in a strategic mix of asset classes that produces the highest expected investment return given our established risk tolerance. Generally, risk can be reduced through diversification at the security, strategy and asset class level. The chart below shows how the portfolio's asset allocation has evolved since 2001.

Historical Asset Allocation (12/31/2000 – 6/30/2016)



The only significant asset allocation change during the fiscal year was a reduction in long only equities to continue funding the build-out of the private investment program. The reduction in long only equities was primarily in domestic oriented managers, as valuations in domestic equities remain less attractive than valuations across most international equity markets. The increase in private equity is part of the long-term plan approved to build exposure to private investments over several years. Private investments provide the opportunity for higher returns and further diversification of the portfolio through exposure to less correlated streams of investment returns.

The following table illustrates the Foundation's current asset allocation.

Current Asset Allocation

	Allocation as of June 30, 2016
Long Only Equity	41.6%
Hedged Equity	19.2%
Fixed Income	8.0%
Absolute Strategies	18.4%
Private Investments	10.6%
Real Estate	3.9%
Private Equity	6.7%
Real Assets	0.0%
Cash	2.2%

PERFORMANCE OF ENDOWMENT

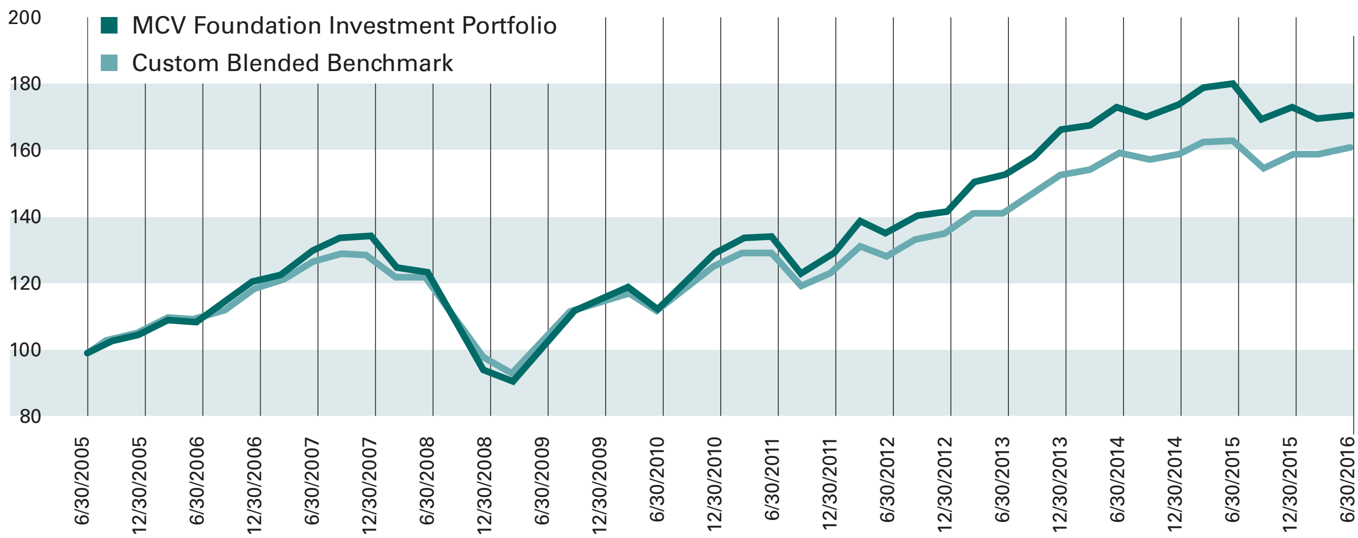
The past year was extremely challenging, with most endowments, including the Foundation's, reporting negative returns. The endowment portfolio fell by 5.9% and underperformed the custom blended benchmark's return of -1.6% over the past fiscal year, primarily due to the poor performance of the long only domestic equity and hedged equity funds. Despite the underperformance in fiscal 2016, the portfolio's annualized return is 6.3% since manager inception in January 2012, which is above the custom blended benchmark annualized return of 6.0%.

Market volatility was driven by fears over a Chinese economic slowdown, Brexit and the unprecedented monetary policies of global central banks. The performance of the long only domestic equity and hedged equity funds was impacted by two primary factors: 1) underperformance in the specialty pharmaceutical sector of the healthcare industry and 2) the unexpected flight to lower volatility, higher dividend paying stocks by investors searching for higher returns in an environment of historically low interest rates. Those stocks were underweighted in most portfolios due to their lower growth potential and very high valuation premiums. First, the portfolio was impacted as fundamentals deteriorated across the specialty pharmaceutical sector due, in part, to negative sentiment on drug pricing. The sector was also coming off a surge last year due to a high-growth product pipeline and hefty restructuring activity. A significant number of specialty pharmaceutical positions have since been sold by the underlying funds. Second, interest rates continued to decline around the world and almost $12 billion of global sovereign debt had negative yields at the end of the fiscal year. Investors around the world have sought out other sources of yield and have crowded into equities that pay higher dividend yields. Most of these companies generate very little growth in earnings or free cash flow; however, at fiscal year end, they traded at one of the largest valuation premiums relative to other equities in history.

The best performing asset class in the portfolio was real estate, which delivered a 16.1% return to outperform the 11.8% return of the real estate benchmark (NCREIF Property Index). The real estate portfolio benefitted from significant exposure to multifamily properties that have continued to enjoy impressive operating performance due to the demand for apartments. Both international and U.S. equities outperformed, with the U.S. market leading the way.

The following exhibits compare the Foundation's return with that of its custom blended benchmark return over the long term, as well as the past fiscal year ending June 30, 2016.

MCV Foundation Cumulative Performance (July 1, 2005 – June 30, 2016)



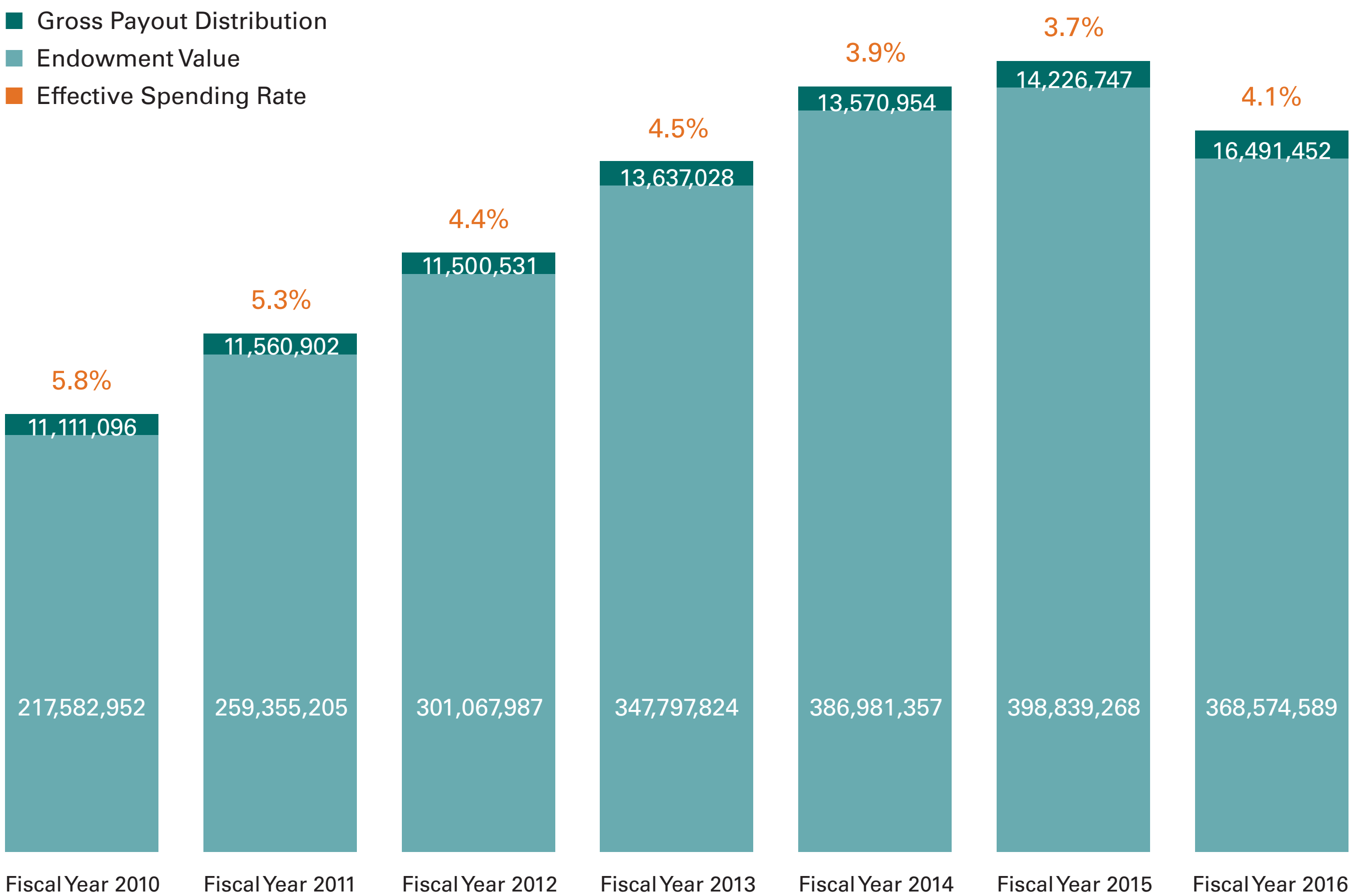
MCV Foundation Trailing Performance as of June 30, 2016

Annualized Returns	1 years	3 years	5 years	10 years	Since Manager Inception 1/1/2012*
MCV Foundation Investment Portfolio	-5.92	3.55	4.73	4.56	6.28
Custom Blended Benchmark	-1.62	4.45	4.42	3.90	6.01

* LB&C was formally engaged to manage the portfolio on January 1, 2012. Prior to that it was managed by an ad hoc investment committee appointed by the Foundation board of trustees.

DISTRIBUTION OF FUNDS

The chart below shows the value of the endowment fund and the distributions made over the past six years to support the mission of the MCV Campus based on our approved spending policy. The long-term objective of the spending policy is to generate returns over an economic cycle sufficient to provide a predictable and sustainable level of income to support the important teaching, patient care and research taking place on the MCV Campus, as well as to grow the endowment. Our policy is structured to reflect best industry practices among endowment institutions and incorporates an inflation factor measured by the Higher Education Price Index (HEPI), in addition to a long-term spending target on the value of the endowment in each of the previous three years. As a result, we are able to maintain a more consistent spending policy that is beneficial to the budgeting needs of our campus partners. This year, we were not only able to maintain, but increase our distribution in support of MCV Campus scholarships, professorships, research and programs.



CONTACT

The MCV Foundation thanks you for supporting the educational, research and clinical care mission on the MCV Campus. If you have any questions or comments about the endowment or our investment reports, please contact Alison Smith, Interim Chief Financial Officer, at 804-828-2393 or alison.b.smith@vcuhealth.org.

NOTES ON THE 2016 ENDOWMENT REPORT

About the Enclosed Report(s)

The enclosed reports provide financial information for Fiscal Year 2016 (July 1, 2015 - June 30, 2016). If you made gifts to a fund after June 30, 2016, that information will be provided in next year's reports to allow time for measurable growth. If you contributed to a fund during this fiscal year, the amount of your gift(s) is included in the market value figures.

Definitions

Market value is a measure of a fund's value in the Foundation's endowment. It's based on the value of that fund's units on a particular date.

A **unit** is similar to a share in investment terms.

Endowment distribution is the earnings that can be spent on a stated fund purpose during a fiscal year. An endowment distribution is not made if a professorship is vacant, a scholarship or fellowship is not awarded, or a fund's criteria are not met. In these cases, the endowment distribution may be reinvested in the university's long term pool endowment for future growth.

Effective spending rate is a percentage of the endowment distribution for a given fiscal year divided by the market value of the endowment as of June 30 of the previous fiscal year.

Lifetime giving to a fund represents the total cash contributions to the fund received by June 30, 2016. Gifts made after June 30, 2016, are included in next year's report.

Date of last gift is the date of your most recent cash contribution.

Policy for Spending the Endowment

Spending for a given year equals the sum of two factors: (1) 70% of spending in the previous year, adjusted for inflation as measured by the Higher Education Price Index (HEPI) for the 12 months prior to the start of the fiscal year; and (2) 30% of the trailing three-year average market value of the endowment investment pool multiplied by the long-term spending rate (currently 4.5%). Spending on gifts received in the previous fiscal year will be prorated based on the number of whole months each gift was included in the fund. For example, Year 2 payout from a gift received December 15 would be based on 6/12 of the spending target calculated under the formula above because the endowment held the gift for six full months (January through June) in Year 1.

This spending policy has two implications. First, by incorporating the previous year's spending, the policy eliminates large fluctuations, enabling us to plan efficiently for operating budget needs. Second, by adjusting spending toward a long-term rate (currently 4.5%), the policy ensures that spending levels will be sensitive to the portfolio's fluctuating market value, thereby stabilizing long-term purchasing power.

www.mcvfoundation.org/about/spending_policy.html