Report Highlights

This report looks at the evolving allocation trends, and international market exposures those trends create, within the Foundations & Endowments (F&E) investor group. The report drills down into a segment of recent strong demand, emerging markets fixed income, and illustrates what specific characteristics and markets exposures within this universe F&E have generated for themselves as a result of their global reach for income.

• On a consistent basis, persisting for nearly ten years, Foundations & Endowments have been moving away from long-only US equity market exposure and repositioning into US, global and emerging markets fixed income in a way which clearly illustrates a preference for income and global diversification from their traditional portfolios.

• Among their smaller universe holdings, those accounting for less than USD 10 billion in F&E assets reported to eVestment, F&E’s have allocated more to emerging markets fixed income strategies than any other since 2011.

• F&E’s exposure to emerging markets fixed income reported to eVestment accounts for nearly USD 8 billion in assets across 23 firms and 38 strategies. The two leading firms in this niche manage over 45% of these assets between them. The five most prominent firms managing F&E’s EM fixed income exposure account for 70% of assets.

• The seven countries of Mexico, Brazil, Indonesia, Turkey, Colombia, Russia and South Africa make up 61% of all foundation & endowment emerging market fixed income exposure, further indicating the diverse set of nations and unique risks facing F&E’s in their global reach for income.
Introduction
The investor summary report uses eVestment’s suite of intelligence to provide an overview of the recent allocation preferences of a particular investor type. Trends within large allocator segments take time to develop and tend to persist for long periods. Using the information reported to the eVestment global database on more than USD 500 billion of foundation and endowment (F&E) assets under management, we can show how F&E’s have repositioned their traditional portfolios over the years to what appears to be a concerted effort to rely more heavily on income producing assets and what exposures they have created and risks assumed going forward.

Shifting Asset Allocations
Figures 1 and 2 show the dominant allocation trends among foundations and endowment funds since 2005, separated into two segments based on the size of each group. The first group accounts for just more than 90% of all reported F&E assets managed by traditional strategies, made up of universes with greater than USD 10 billion of F&E assets, and the second illustrates emerging trends at the margins. On a consistent basis, persisting for nearly ten years, F&E’s have been repositioning away from long only US equity market exposure. These assets have been landing in multiple places, many of which support the notion of increased demand for income and global diversification from their traditional portfolios.

Much of these assets appear to be landing in US fixed income strategies, but beyond this natural domestic repositioning for income over capital gains (equities for fixed income), we see that global equity allocations have been consistently expanding, along with the emergence of global fixed income strategies. Among smaller holdings, the desire for global flexibility and income continues to be evident; however, trends tend to shift more quickly.
**Exposure Preferences**

Since 2009, F&E’s have been moving away from US-focused, balanced/TAA strategies and rapidly increasing their exposures to emerging markets fixed income. The rapid increase of higher yielding emerging markets in F&E portfolios matches the goal of searching for income. While there has been a slight reduction of relative portfolio weighting toward EM fixed income in recent quarters, this is more likely due to relative performance as F&E’s continued to allocate to emerging market fixed income strategies throughout 2014. (See Figure 3)

Given the tendency of asset shifts to be long-term, it is important to illustrate the portfolio characteristics these trends are increasingly providing F&E’s. To do this we will look more closely into the portfolio compositions of F&E’s fastest growing traditional segment, emerging market fixed income, to see where their greatest risks and exposures lie. F&E’s exposure to emerging markets fixed income reported to eVestment accounts for nearly USD 8 billion in assets across 23 firms and 38 strategies. The two leaders in this niche manage over 45% of these assets between them. The five most prominent firms managing F&E’s EM fixed income exposure account for 70% of assets.

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**Figure 3:** Cumulative F&E funds flows by universe of smaller holdings, 2012 - 1Q 2015
Emerging Market Fixed Income Exposures
Foundations & Endowments’ exposures are primarily in sovereign debt (85%) and BBB/Baa-rated securities (45%) with only just over 30% rated below investment grade, see Figure 5. Latin America has been the region of choice with equal splits to the Far East ex-China and Africa/Middle East. Latin America exposure is dominated by Brazil and Mexico, accounting for 50% of the region, following by Colombian debt at 16%. Indonesia dominates Asia exposure (39%), Russia emerging Europe (38%) and Turkey Middle East/Africa (46%). (See appendix for composition of country exposure by region)

Country Specific Exposure
The seven countries of Mexico, Brazil, Indonesia, Turkey, Colombia, Russia and South Africa make up 61% of all foundation & endowment emerging market fixed income exposures. Since we know there is a dominant theme of rising exposure and allocations to emerging market fixed income, which countries dominate this exposure, and that major changes in country specific exposure tend to take time, then by illustrating how the prominent F&E EM fixed income asset managers have been shifting their country exposures, we can understand what specific countries are driving F&E’s search for yield.

Figure 4: Distribution of F&E’s EM fixed income AUM by credit quality, 1Q 2015

Figure 5: Distribution of F&E’s EM fixed income AUM by region, 1Q 2015

Figure 6: Distribution of F&E’s EM fixed income AUM by region, 1Q 2015
Country Specific Exposures (cont.)
Of the seven emerging market countries with the largest FE exposure, only two have seen a decline in recent quarters, Russia and, to a lesser extent, Mexico. South African debt began to attract interest from F&E’s in 2010, but has since remained relatively steady, while F&E’s have seen their exposure to Indonesia and Colombia consistently increase. Lastly, exposures to Turkey and Brazil have also been increasing in recent quarters; however their paths have been less smooth. It is likely the reduced exposure to Russia is due to portfolio losses and near term exposure to the country will be dominated by these performance swings. By combining county exposures by perennial EM debt staples (Brazil, Mexico, Russia) and the remainders of the seven (Turkey, South Africa, Indonesia, Colombia), there has been a long-term shift of exposure for F&E to the latter group.

Summary
Foundations and endowments have actively been searching the globe for yield as part of their effort to rely more heavily on income producing investments. This process has brought with it significant increases in exposure to the sovereign debts of a diverse set of nations that each increasingly carry with them unique risks. While the bulk of F&E assets remain in US-domicile markets, often what happens at the margin is a great source of opportunity for asset managers marketing to this investor segment.
COMPANY DESCRIPTION

eVestment provides a flexible suite of easy-to-use, cloud-based solutions to help global investors and their consultants select investment managers, enable asset managers to successfully market their funds worldwide and assist clients to identify and capitalize on global investment trends.

With the largest, most comprehensive global database of traditional and alternative strategies, delivered through leading-edge technology and backed by fantastic client service, eVestment helps its clients be more strategic, efficient and informed.

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Appendix
Representations of country specific exposures within primary emerging market regions, 1Q 2015

Africa/ Middle East
- Egypt
- Ivory Coast
- Jordan
- Lebanon
- Morocco
- Nigeria
- Pakistan
- South Africa
- Sri Lanka
- Tunisia
- Turkey

Central & South America
- Argentina
- Brazil
- Chile
- Colombia
- Dominican Republic
- Ecuador
- El Salvador
- Mexico
- Panama
- Peru
- Uruguay
- Venezuela

Far East, including China
- China
- India
- Indonesia
- Korea
- Malaysia
- Philippines
- Taiwan
- Thailand
- Vietnam

Emerging Europe
- Czech Republic
- Greece
- Hungary
- Poland
- Russia
- Serbia & Montenegro
- Ukraine