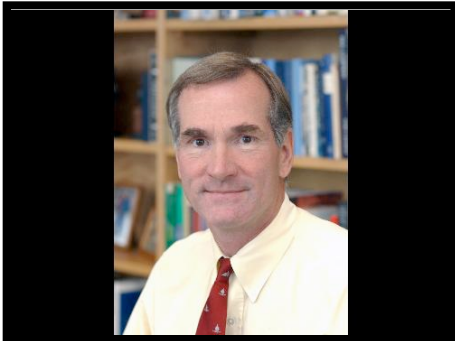


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## Yale's Swensen Sees 'Extraordinary' Opportunity to Snap Up Debt

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By Oliver Staley



Jan. 2 (Bloomberg) -- **Yale University**, whose endowment dropped \$5.9 billion in six months because of the recession, is pursuing a recovery by acquiring distressed debt.

"There are some really extraordinary opportunities in the credit world," said **David Swensen**, the school's investment chief, in a phone interview from his office at the New Haven, Connecticut, university. "Everything, from bank loans to investment-grade bonds to less-than-investment grade bonds, is priced at really extraordinarily cheap levels."

Swensen, 54, increased Yale's endowment to \$22.9 billion on June 30, from \$1 billion in 1985 when he assumed the job, making it the second-wealthiest university in the U.S. The school estimated on Dec. 16 that the fund had fallen 25 percent, to \$17 billion, because of the global financial crisis. Swensen, who has updated his 2000 book on investing for re-release Jan. 6, said periodic losses are inevitable in a portfolio

tilted toward stocks and built to grow over many years.

"There isn't an investment strategy that can produce the kind of long-term results we've generated at Yale that isn't going to post the occasional negative return," Swensen said in the Dec. 30 interview. "I don't think people should disregard the book because of the market trauma of the last few months. We're not even done with the current fiscal year. Judging a long-term investment strategy based on the results of a five- to six-month period is foolish beyond words."

'Flight To Quality'

Among Swensen's core principles identified in "**Pioneering Portfolio Management: An Unconventional Approach to Institutional Investment**" (Free Press, 408 pages, \$35) is the importance of diversifying holdings while focusing on equities. In a recession, the advantages of diversification get overwhelmed by investors' selling equities in favor of U.S. Treasury bonds in a "flight to quality," he said.

"When you have a market in which any type of equity exposure is being punished, it's going to hurt long-term investors," he said.

In the current environment, distressed corporate securities can produce "equity-like" returns, Swensen said.

"You want to make sure you're with companies that have the ability to survive in a really tough economic environment" he said, declining to

name any of the companies.

Yale, one of eight schools in the elite Ivy League in the northeastern U.S., dates from 1701. The school, which has about 13,100 students, trails only **Harvard University** in wealth. Harvard, in Cambridge, Massachusetts, had an endowment valued at \$36.9 billion on June 30 before reporting losses of about \$8 billion, or 22 percent.

Ph.D. in Economics

Swensen earned a Ph.D. in economics at Yale before working for **Lehman Brothers Holdings Inc.** and Salomon Brothers, now a unit of Citigroup Inc. When he took over Yale's endowment, the fund contributed \$45 million, or 10 percent, to the school's annual budget. In the current fiscal year, which will end on June 30, the endowment is expected to contribute \$1.15 billion, or 45 percent of Yale's revenues, he said in the book.

The distribution from the endowment is based on an average of five years of returns, so the consequences of any loss this fiscal year will be blunted by the gains of previous years, Swensen said.

"We're projecting no decline in endowment support for the operating budget," he said.

Since the budget is due to grow in coming years, Yale President **Richard Levin** has said the school is projecting an operating shortfall of \$100 million for fiscal 2010, increasing to more than \$300 million four years later. The school estimates no growth in the endowment in fiscal 2010, with increases resuming in 2011.

Slashing Spending

To begin closing the budget gap, the school will slow increases in salaries, and cut budgets for non-faculty staff pay by 5 percent through attrition. Yale said it will reduce other expenses 10 percent over two years by **slashing spending** on consultants, travel and energy while delaying construction.

Until financial institutions resume lending, the economy will remain stagnant, Swensen said.

"I don't think the Fed or the administration has figured out how to fix credit markets," he said. "We are going to experience economic and financial stress as long as the credit markets are broken and it's not until we start seeing the credit markets functioning properly will we be able to see a path to economic recovery."

Swensen advocates federal guarantees for deposits in money- market funds as a way to encourage investment in the vehicles that buy corporate debt.

Swensen's book is updated to stress the importance of organization and governance for investment firms.

Bernard Madoff

Concerns over governance helped Yale stay clear of **Bernard Madoff**, the financier accused of a \$50 billion fraud. One reason was an inability to see where investors' money was going, Swensen said.

"If we can't sit down with the people making the decisions, and understand what it is they're doing and how they're doing it, we're not going to invest," he said. "We're not going to have anything to do with it."

If Madoff's victims had read his book, Swensen said, Madoff, who relied on money from so-called funds of funds to feed his operation, "never

would have been funded.”

“The reason I don’t like funds of funds is that they facilitate the flow of ignorant capital,” Swensen said.

In general, most investors should stick to passive investments such as index funds that track the market, since attempts to outperform it are often unsuccessful. For every winner there is a loser, and even the winners pay for much of their gains in fees and commissions, he writes in his book.

#### Contrarian Investing

“Casual attempts to beat the market provide fodder for organizations willing to devote the resources necessary to win,” he wrote.

Building Yale’s endowment required sticking to a contrarian investing philosophy, a high-performing research team, and the ability to coax “uninstitutional behavior from institutions,” Swensen said.

“Nobody said this was easy,” he said. “You’ve go to do an enormous amount of work to get it right.”

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*Last Updated: January 2, 2009 00:00 EST*

