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Rethinking Liquidity: Fixed Income's Role in University Endowments

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Universities face multiple headwinds that may include the threat of rising tax rates on investment income, reduced federal support, declining enrollment, and rapidly rising costs. Moreover, some illiquid investments like private equity and real estate have been providing on average lower than were historically the case.[1] While Harvard, Yale, and Princeton can access liquidity by issuing taxable bonds and borrowing from banks, other adherents of the Yale model that favors illiquid but higher return-generating private investment may have fewer options for meeting their liquidity needs.[2]

One possible area for universities to consider is an asset class that had taken a backseat in many endowment portfolios for the past two decades – fixed income. According to the most recent National Association of College and University Business Officers (NACUBO) study, the average university total fixed income allocation was just over 16% when public fixed income, private credit, and cash were added together (see Figure 1).

Between the Global Financial Crisis and the onset of the global pandemic, fixed income markets offered much lower yields as global central banks held policy rates near zero. But that dynamic has changed since 2022, when inflation helped drive both short-term policy rates and longer-term yields higher. In this environment, university

[1] Source: Meketa. https://meketa.com/leadership/cash-flow-gridlock-understanding-the-private-equity-distribution-challenge/

[2] Source: Financial Times, R. Wiggelsworth, "The Death of the Yale Model?" March 31, 2025.

endowments and foundations may look to optimize their fixed income allocations, which now offer more favorable yields and deliver regular cash distributions.

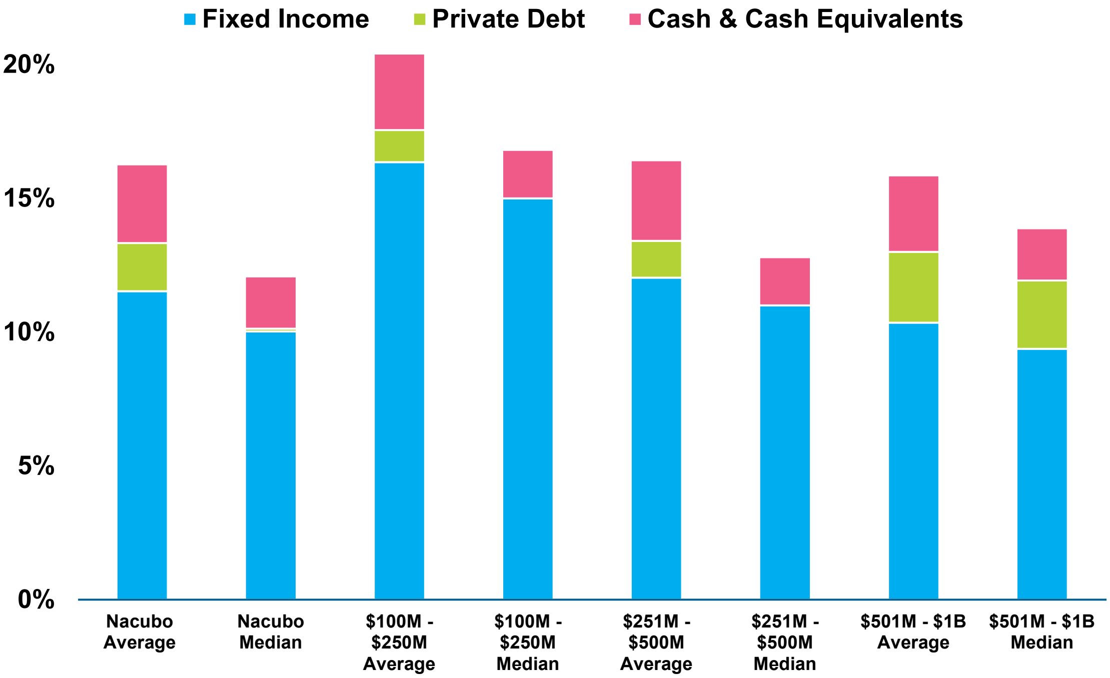

FIGURE 1
NACUBO University Survey Fixed Income, Private Credit, and Cash Allocations (Median & Average %)

Source: NACUBO – Commonfund Study data as of February 15, 2025.

Over the long-run, larger endowments have outperformed smaller endowments largely due to their higher level of private investments, which have experienced an estimated average premium over US stocks of 3.5% per annum.[3] But in fiscal year 2024, endowments under $50 million dollars had an average return of 13%, while those with over $5 billion dollars in assets returned 9.1%.[4] This reversal was likely driven by smaller endowments' higher average exposure to public equities, as the extended period of US exceptionalism and the epoch of the Magnificent Seven helped boost US equity returns. But now, these smaller funds that tend to rely less on illiquid private equity investments also enjoy better liquidity.

A recent survey of the attendees of the Commonfund Conference 2025 found that endowments and foundations are now paying more attention to liquidity, given higher spending needs and tax and funding uncertainty.[5] As recent scholarship from the Central Bank of the Netherlands states, pursuit of the "illiquidity risk premia can lead to unintended overallocation during extended period of asset lockups, increasing the vulnerability of portfolio consumption and investor welfare."[6]

While there is no silver bullet to fix the pressing needs of university endowments, the current higher-for- longer interest rate environment could offer some opportunities in private and public fixed income markets. Traditional public fixed income may become

[3] Source: Commonfund, "Key Takeaways for Forum 2025," March 21, 2025.

[4] Source: NACUBO – Commonfund Study data as of February 15, 2024.

[5] Source: Commonfund, "Key Takeaways for Forum 2025," March 21, 2025.

[6] Source: SSRN and Eurosysteem [sic], D. Dimitrov, "Untangling Illiquidity: Optimal Asset Allocation with Private Asset Classes," January 30, 2025.

a more important building block to help meet return objectives while also providing a source of ready liquidity. While private credit markets are slightly more liquid than private equity with their average hold-period about half of that of a private equity fund, they could offer investors a much higher rate of return than public market fixed income markets. With higher yields as well as the introduction of new fixed income products like multi-asset strategies, private bank loans, and collateralized private debt, there could be new tools that allow endowments to use fixed income allocations to help meet their overall return objectives while providing enhanced liquidity.

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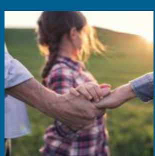

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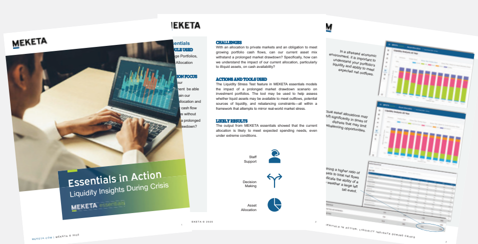

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