

McGILL UNIVERSITY

REPORT ON ENDOWMENT PERFORMANCE 2008-09

The McGill endowment is comprised of (i) bequests and donations received by the University, for the most part with specific designations, and to be held in perpetuity (ii) those assets designated by the Board of Governors to be endowed and (iii) those assets of certain McGill units and affiliated entities which have been allocated to the McGill Investment Pool (“MIP”) as an investment vehicle. The endowment is managed by the McGill Office of Investments under the direction of the Investment Committee.

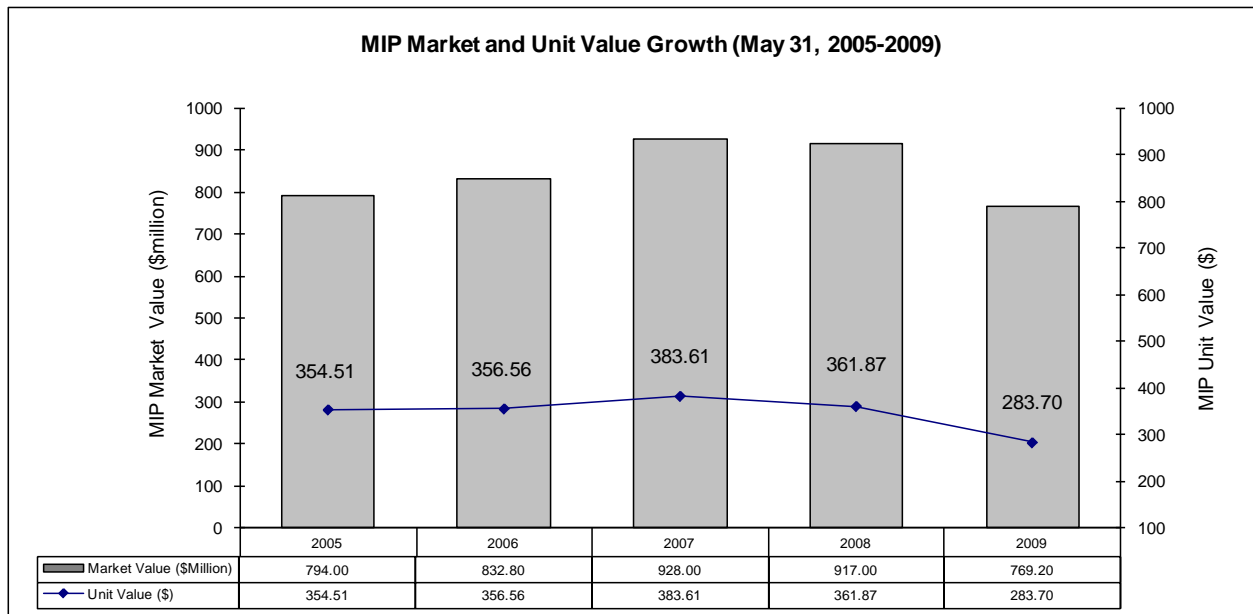
The overall objective of the endowment is to obtain a total return (yield plus capital appreciation) necessary to provide a dependable and optimal source of income for endowment beneficiaries, to cover the annual operating costs of the endowment and to preserve (in real dollar terms) the capital of the endowment within the social and ethical norms of the University.

The endowment fund is managed as the MIP which was formed in 1970. The use of a unitized pool allows for the investment of a critical mass of assets thus providing for broad diversification and economies of scale that have over the years resulted in positive performance, reduced volatility and low investment management fees.

At May 31, 2009, the end of the University’s fiscal year, the McGill Investment Pool (“MIP”), with a market value of \$769.2 million, consisted of investments for the McGill endowments and accounts managed on behalf of McGill units and affiliated entities.

MIP Market and Unit Value

The MIP market and unit value changes over five years ended May 31, 2009 are shown below:

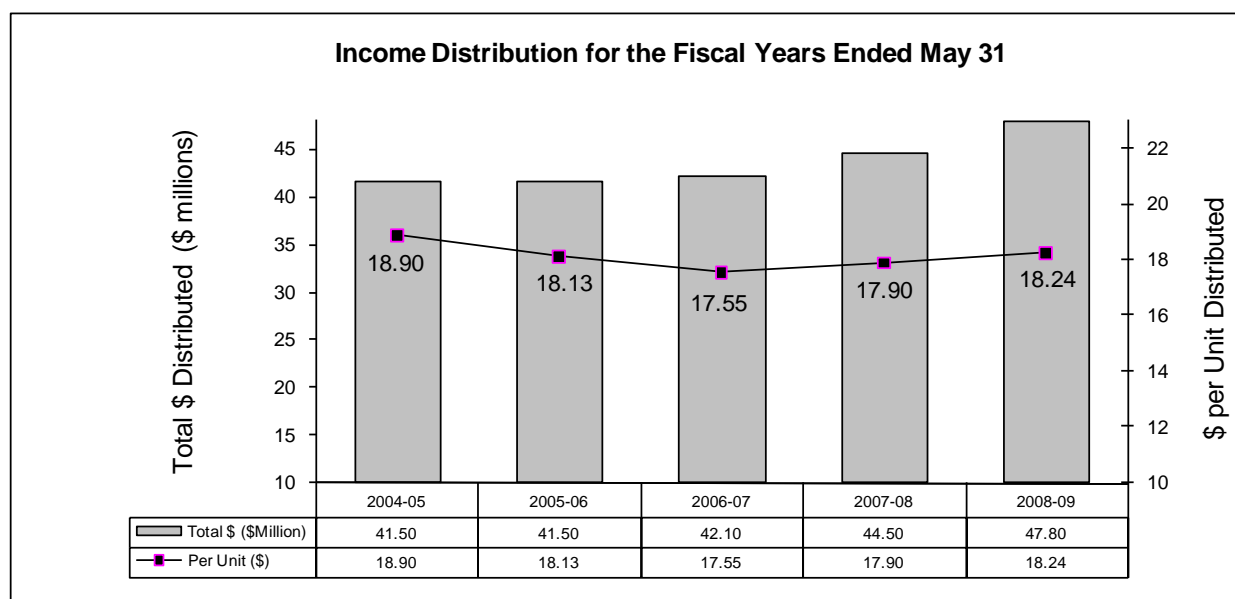


MIP Growth

Table 1: Change in market value for the year ended May 31, 2009

		(000's)
Market value of the MIP, beginning of the year		917,031
Market value of the MIP, end of the year		769,238
Unrealized market gain (loss)	(96,376)	
Gain (loss) on sale of investments	(21,273)	
Investment income	20,949	
Foreign exchange gain (loss)	<u>(50,005)</u>	
Total MIP earnings (loss)		(146,705)
Endowment income distribution and management fee		(55,516)
Gifts/bequests	46,669	
Net capitalization of income distributed	<u>7,759</u>	
Total net capital contributions		54,428
Net change in market value during the year		<u>(147,793)</u>

Income Distribution



For the year ended May 31, 2009, \$47.8 million in income was distributed to the University's endowment beneficiaries. Income is distributed monthly and adjusted quarterly for capital additions and withdrawals.

The 2008-09 distribution rate per unit was based on 5% of the average market value of the endowment of the previous three years calculated at May 31. This practice is used to minimize the impact of market fluctuations on the endowment fund and is consistent with practices adopted at other leading North American universities. It is based on the distribution of an appropriate and prudent level of income to all unit holders.

The income distribution rate for 2008-09 was \$18.24 per unit and will be \$14.60 for the 2009-10 fiscal year based on the unit value averages at the end of May 2009, 2008 and 2007.

Pursuant to the Board of Governors approval, the income distribution rate was reduced from 5% to 4.25% effective June 1, 2009 and the rate for the 2009-10 fiscal year will be applied to the three-year rolling average determined by including the May 31, 2009 MIP unit value in the calculation.

For 2008-09, the management fee was 0.9% of the average market value of the previous three years. The management fee covers the endowment fund's administrative costs, investment management fees and custodial fees as well as a contribution to the University's indirect costs. The management fee will be calculated in the same manner for the 2009-10 fiscal year with the exception that it will be based on the average market value for the three years ended May 31, 2009.

Governance and Investment Management

The Investment Committee, a committee of the Board of Governors ("Board"), oversees the investment of the MIP assets. The Office of Investments is responsible for implementing the Investment Committee's decisions.

The Investment Committee is comprised of 10 members who, as of the current date, are Ian Soutar (Montreal), Chair; Dr. Heather Munroe-Blum (Montreal), Principal and Vice-Chancellor, ex-officio; Marc Weinstein (Montreal), Vice-Principal (Development and Alumni Relations), ex-officio; Anthony Campbell (New York), Gerry Manolovici (New York), Brenda Norris (Montreal), Jeremy Reitman (Montreal), Gerald Sheff (Toronto), Arnold Steinberg (Montreal) and Danny Ritter (Montreal) (appointed in June 2008). There were no departures from the Committee during the year. Members are appointed on the basis of their expertise and interest in investment, business and economics.

Pursuant to its Terms of Reference, the Committee is responsible for overseeing the management of the University's investments in accordance with the Statement of Investment Policy. Included in the Committee's functions are (i) providing advice to the Board in establishing policies related to investments and making recommendations thereon to the Board for approval, (ii) reviewing annually the appropriateness of the Statement of Investment Policy and making recommendations on proposed modifications to the Board (iii) recommending to the Board policies on the annual distribution rate for the income from the university's endowment (iv) reviewing and approving the appointment and termination of investment managers and service providers, investment manager mandates and the performance of each fund manager and (v) monitoring compliance with the Statement of Investment Policy.

The Committee met six times during the fiscal year ended May 31, 2009 either in person or by conference call. Overall attendance averaged 72%.

The Investment Committee's annual review of the Statement of Investment Policy resulted in a recommendation to the Board to increase the target and maximum weights allocated to equity investments and to reduce the target and maximum weights allocated to fixed income investments which was approved in September 2008. The current target asset allocation of 80% equity/20% fixed income is being implemented.

In June 2008, the Investment Committee approved the delegation of proxy voting for North American equity segregated mandates to the investment managers responsible for managing such portfolios.

The Committee's Statement of Investment Beliefs, a document that provides guidance to the Committee in formulating investment decisions, was reviewed and revisions were made during the year.

Recommendations to reduce the income distribution rate to 4.25%, effective June 1, 2009 and that such rate be applied to the three-year rolling average determined by including the May 31, 2009 McGill Investment Pool unit value in such average were made to and approved by the Board in April.

Decisions related to manager and service provider changes are noted below:

During the year, new investment mandates were awarded to Formula Growth Ltd. ("Formula Growth") and Comgest Asset Management International Limited ("Comgest"). Formula Growth will manage an investment in the Formula Growth Hedge Fund, a U.S. long/short equity fund with a focus on small and mid-cap stocks. Comgest will manage an investment in the Comgest Growth Emerging Markets Fund, an emerging market equity pool fund.

Commitments were also made to alternative strategies: one commodity fund of funds and two real estate funds. The commodity commitment was to a U.S. natural resources fund of funds (US \$15 million). The real estate commitments were to two Canadian real estate limited partnerships investing in a diversified portfolio of Canadian real estate (CAD \$10 million each).

During the year, two investment mandates were terminated. The Formula Growth U.S. equity mandate was transferred to the Formula Growth Hedge Fund and the holdings in the ABN AMRO (Fortis) Global Real Estate Fund were sold.

As a result of the decision to consolidate safe-keeping and custodial services under one service provider (there were two separate providers for each of the endowment and pension funds), CIBC Mellon Trust Company was hired on October 1, 2008.

The Treasury/Pension Investments unit was re-designated in late 2008 to Treasury/Office of Investments and staffing changes have been and are being made to reflect the renewed emphasis and focus on the investment process for both the McGill Investment Pool and McGill Pension Fund assets. Subsequent to the fiscal year-end, Dave Brochet was hired as Director, Investments and the engagement of a Senior Investment Analyst is expected by the end of the year.

As at June 30, 2009, approximately 93% of the University's endowment investments were managed by external investment managers. These managers and their respective mandates were:

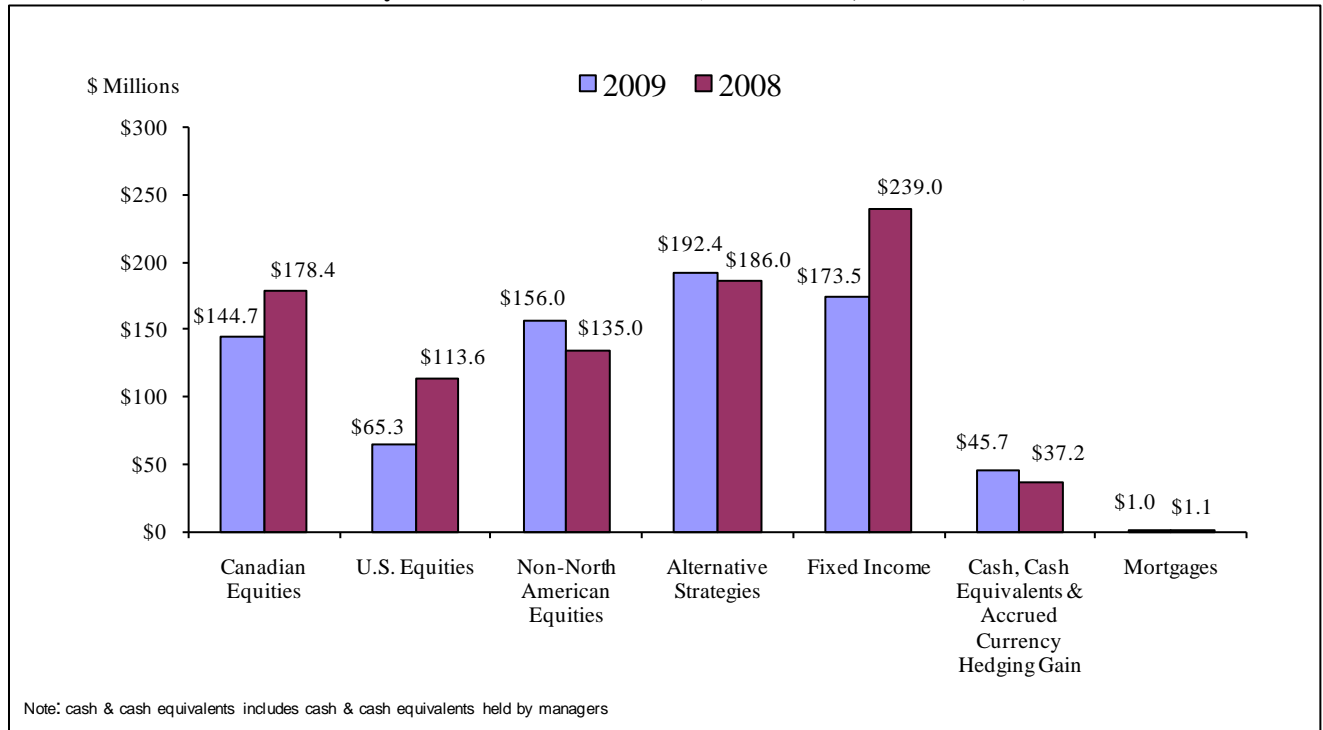
- **Phillips, Hager & North** (Canadian equity and fixed income)
- **Jarislowsky, Fraser** (Canadian and U.S. equity)
- **Acuity and MFC Global** (Canadian income trusts)
- **State Street** (U.S. mid-cap index equity)
- **LSV Asset Management** (U.S. small/mid-cap equity)
- **Brandes and William Blair & Company** (non-North American equity for both developed and emerging markets)
- **Capital International and Comgest** (emerging markets equity)
- **TD Asset Management** (Canadian bond index and a passive currency hedging program)
- **Commonfund** (two hedge funds of funds)
- **Formula Growth** (U.S. long/short equity)
- **Private equity** (eight private equity funds of funds, investing on a combined basis in North American and European buyout, venture capital and global secondary funds and two Canadian venture capital limited partnerships)
- **Commodities** (two North American natural resources funds)
- **Real estate** (four limited partnerships investing in Canadian real estate and one U.S. open-ended real estate fund)

The Office of Investments manages 7% of the MIP internally. It holds securities in an account pending liquidation or allocation to an external investment manager, in addition to managing cash and cash equivalents and a currency hedging reserve.

Asset Distribution

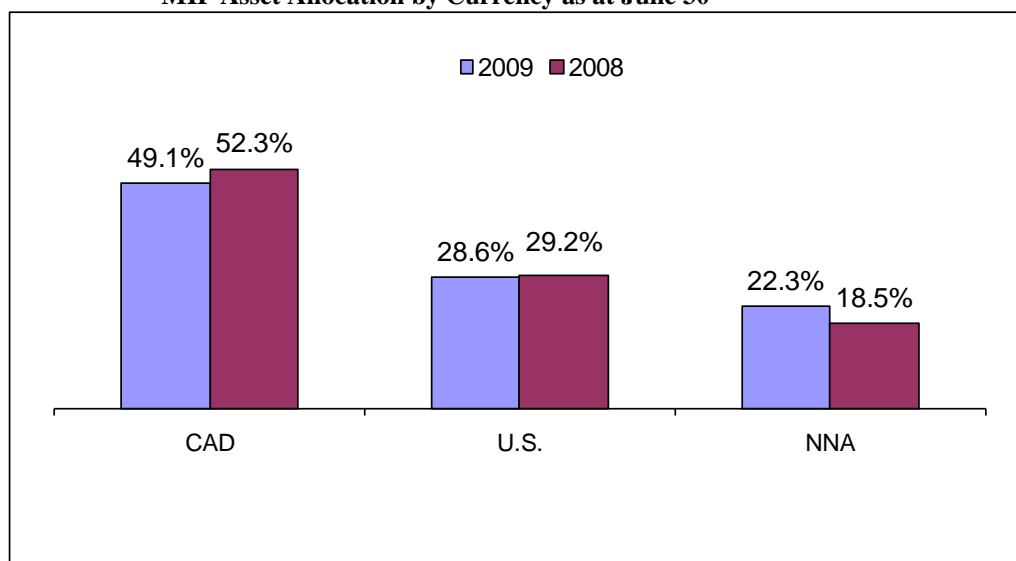
The asset allocation of the MIP portfolio by asset class at June 30, 2009 and at June 30, 2008 is shown below:

MIP Asset Distribution by Asset Class as at June 30 (2009 - \$778.6; 2008 - \$890.3)



Changes to the MIP's asset distribution from June 30, 2008 resulted in decreases to Canadian equities, U.S. equities and fixed income. These were offset by increases in non-North American equities, alternative assets and cash and cash equivalents. The changes reflect market movements during the year as well as ongoing rebalancing. In 2008, the Investment Committee approved the revised target asset allocation of 80% equity/20% fixed income which is being implemented.

MIP Asset Allocation by Currency as at June 30



The currency allocation for total investments at June 30 is shown in the accompanying chart. The 3.8 percentage point increase in non-North American exposure and the corresponding decrease in Canadian and U.S. exposure reflect market movements during the year as well as ongoing rebalancing activities.

Performance Measurement – 2008-2009

Performance measurement of the MIP is carried out quarterly on a calendar year basis by an independent performance measurement service. Investment rates of return are stated on a total return basis which is capital appreciation, both realized and unrealized, plus income received and accrued. The following table indicates the performance of the total fund and all external managers (excluding RIAL-Holding, staff mortgages and the currency hedging program) over a range of time periods ended June 30, 2009 as well as a composite of the returns of four selected Canadian university endowment funds, the median return of the Universe (composed of pension funds, foundations and endowments, and public funds), the BNY Mellon Endowments and Foundations Universe (comprised of 22 participants), the absolute return objective, and the MIP's composite benchmark:

	Annualized Returns			
	<u>1 year</u>	<u>3 years</u>	<u>5 years</u>	<u>10 years</u>
Total Fund (MIP)	-14.3%	-1.5%	1.1%	2.9%
Total External Managers (ex RIAL-Holding, staff mortgages, currency hedging program)	-8.2%	0.2%	2.4%	3.6%
Composite of the returns of four selected Canadian university endowment funds	-18.2%	-2.8%	1.4%	3.8%
Median – BNY Mellon Canadian Master Trust Universe	-10.5%	0.5%	3.9%	5.0%
Median – BNY Mellon Foundations & Endowments Universe	-9.4%	-0.4%	2.4%	3.4%
Absolute Return Objective (5.9% + CPI)	5.6%	7.6%	7.7%	8.1%
Composite benchmark (policy weights times related index returns)	-10.5%	-0.3%	1.8%	1.6%

Prepared by: McGill University Office of Investments

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