

MCGILL UNIVERSITY

REPORT ON ENDOWMENT PERFORMANCE 2009-10

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.

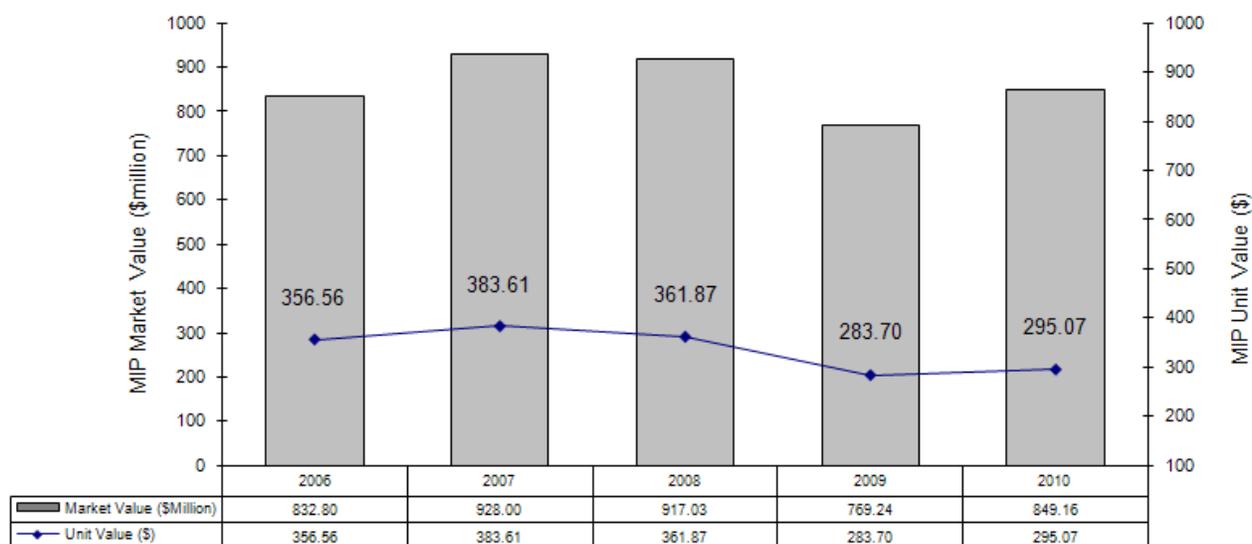
The endowment fund is managed as the MIP which was formed in 1970. The use of a unitized pool allows for the investment of a critical mass of assets thus providing for broad diversification and economies of scale that have over the years resulted in positive performance, reduced volatility and low investment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

At May 31, 2010, the end of the University’s fiscal year, the McGill Investment Pool (“MIP”), with a market value of \$849.2 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, 2010 are shown below:

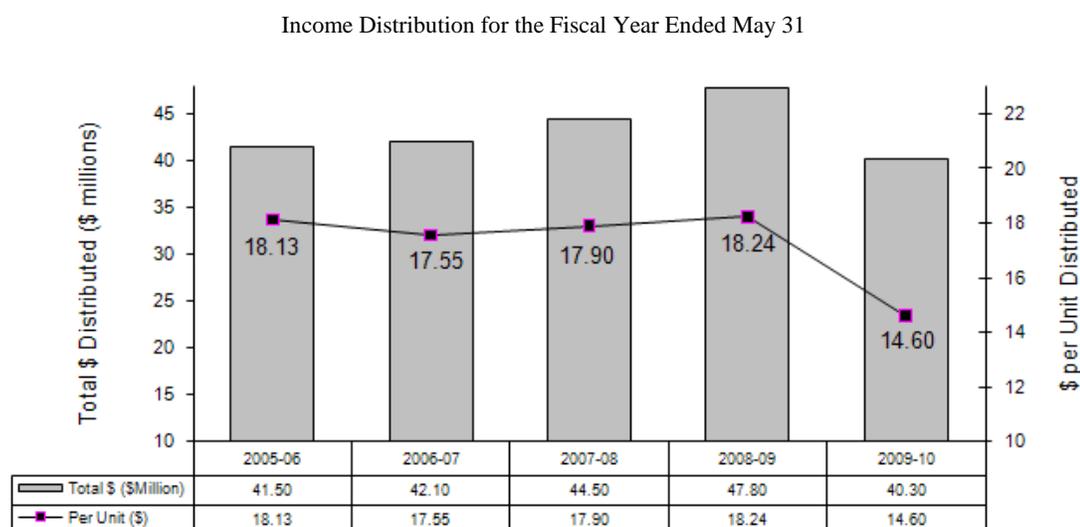
MIP Market Value and Unit Value Change (May 31, 2006-2010)



MIP Growth

Table 1: Change in market value for the year ended May 31, 2010

	(000's)
Market value of the MIP, beginning of the year	769,238
Market value of the MIP, end of the year	849,163
Unrealized market gain	3,296
Gain on sale of investments	15,364
Investment income	17,671
Foreign exchange gain	<u>42,546</u>
Total MIP earnings	78,877
Endowment income distribution and management fee	(48,185)
Gifts/bequests	38,676
Net capitalization of income distributed	<u>10,557</u>
Total net capital contributions	<u>49,233</u>
Net change in market value during the year	<u>79,925</u>

Income Distribution

For the year ended May 31, 2010, \$40.3 million in income was distributed to the University's endowment beneficiaries. Income is distributed monthly and adjusted quarterly for capital additions and withdrawals.

The 2009-10 distribution rate per unit was based on 4.25% 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 2009-10 was \$14.60 per unit. While the decision was made to maintain the distribution rate for the fiscal year 2010-11 at the same level as 2009-10 (\$14.60 per unit), the Quebec

government announced in February 2010 that all universities in the province will be required to change their fiscal year end from May 31 to April 30, commencing April 30, 2011. As a result, income distribution in the 2010-11 fiscal year will be based on 11 months to April 30, 2011.

For 2009-10, the management fee was .90% 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 2010-11 fiscal year, in 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 11 members who, as of May 31, 2010, are Ian Soutar (Montreal), Chair; 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), Danny Ritter (Montreal) and Stuart Cobbett (Montreal), Chair of the Board, ex-officio who joined the Investment Committee during the year. 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 seven times during the fiscal year ended May 31, 2010 either in person or by conference call. Overall attendance averaged 66%.

The Investment Committee's annual review of the Statement of Investment Policy resulted in a recommendation to the Board to change the real rate of return objective to 5.15% or a nominal return of 5.15% plus CPI from the previous year's 5.9% plus CPI to reflect the change in the income distribution rate. This is effective as of June 1, 2010.

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 maintain the income distribution rate at 4.25% for the 2010-11 fiscal year and that such rate be applied to the three-year rolling average determined by including the three fiscal years ending May 31, 2009 were approved by the Board in May 2010.

Decisions related to manager changes for the year ended May 31, 2010 are noted below:

During the year, new investment agreements were entered into with two hedge fund managers, one of which invests in global long/short credit and event driven strategies. The other invests in a long-biased portfolio of value-based, event driven positions in equity and debt instruments.

In addition to the above, two new investment management mandates were granted to Desautels Capital Management Inc. for (i) global equity and (ii) global fixed income. These mandates are managed by students in McGill University's Desautels Faculty of Management.

Commitments were also made to one commodity fund and one private equity fund. The commodity commitment was to a Canadian early stage oil & gas fund (\$10 million). The private equity commitment was to a Canadian fund investing in securities of distressed and under-valued Canadian companies (US\$ 15 million).

During the year, the Brandes Investment Partners' non-North American equity value mandate was terminated and the assets under its management were transferred to State Street Global Markets on a temporary basis. Subsequent to year-end, Hexavest Inc. was engaged for a non-North American equity value mandate. Also, subsequent to year-end, the Canadian equity and income trust mandates managed by Phillips, Hager & North, Acuity Investment Management and MFC Global Investment Management were terminated and their respective holdings, as well as Canadian iShares holdings in RIAL-Holding, were allocated to Jarislowsky Fraser, an existing manager, and to Fidelity Investments Canada (Pyramis Global Advisors), a new manager, for Canadian equity mandates.

As at June 30, 2010, approximately 95% of the University's endowment investments were managed by external investment managers. These managers and their respective mandates were:

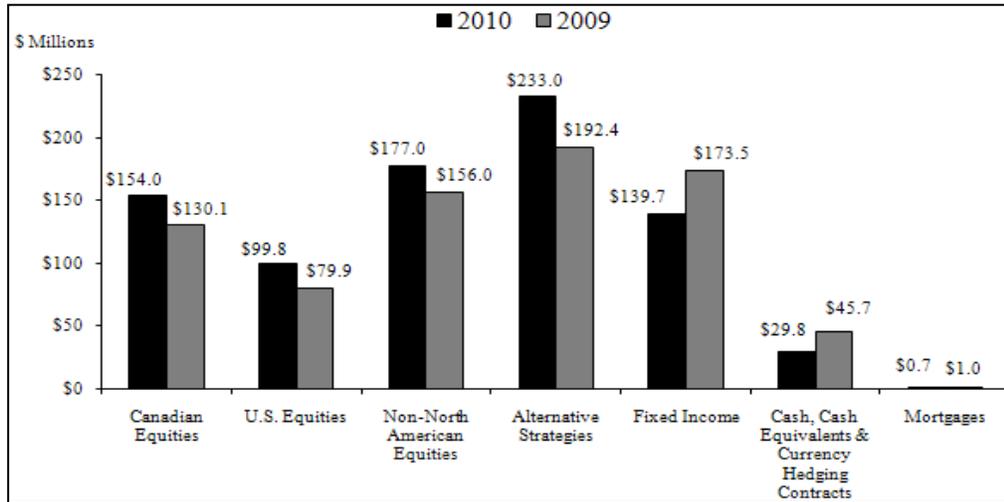
- **Jarislowsky Fraser** (Canadian and U.S. equity)
- **State Street Global Markets** (non-North American equity, developed markets, Canadian Equity)
- **State Street Global Advisors** (U.S. mid-cap index equity)
- **LSV Asset Management** (U.S. small/mid-cap equity)
- **William Blair & Company** (non-North 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)
- **Phillips, Hager & North** (fixed income)
- **Hedge Funds** (two funds of funds, primarily invested in long/short equity; a U.S. long/short equity fund and two event driven funds)
- **Private equity** (six private equity funds of funds, investing on a combined basis in North American and European buyout, venture capital and global secondary funds, a Canadian fund investing in securities of distressed and under-valued Canadian companies and two Canadian venture capital limited partnerships)
- **Commodities** (two North American natural resources funds of funds, one Canadian oil and gas fund)
- **Real estate** (four limited partnerships investing in Canadian real estate and one U.S. open-ended real estate fund)

The Office of Investments manages approximately 5% 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.

Asset Distribution

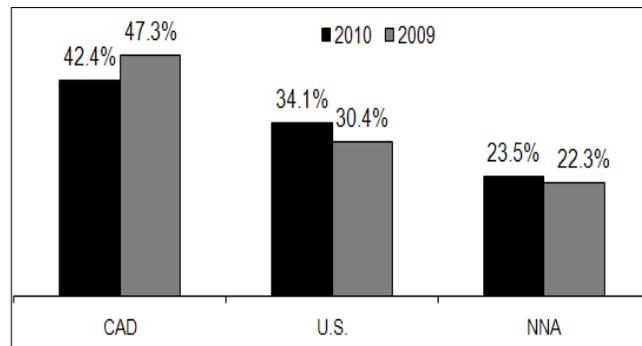
The asset allocation of the MIP portfolio by asset class at June 30, 2010 and at June 30, 2009 is shown below:

MIP Asset Distribution by Asset Class as at June 30 (2010 - \$834.0M; 2009 - \$778.6M)



Changes to the MIP's asset distribution from June 30, 2009 resulted in increases to Canadian Equities, U.S. equities, non-North American equities and alternative strategies. These were offset by decreases in fixed income and cash and cash equivalents. The changes reflect market movements during the year as well as ongoing rebalancing. The current target asset allocation is 80% equity/20% fixed income. The actual asset allocation at June 30, 2010 was in line with the approved target allocation.

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 4.9 percentage point decrease in Canadian exposure and the corresponding increase in U.S. and non-North American exposure reflect market movements during the year as well as rebalancing activities.

Performance Measurement – 2009-2010

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 MIP and all external managers (excluding RIAL-Holding, staff mortgages and the currency hedging program) over a range of time periods ended June 30, 2010 as well as the median return of the BNY Mellon Canadian Master Trust Universe (comprised of 86 pension funds), the BNY Mellon Endowments and Foundations Universe (comprised of 21 participants), the absolute return objective, a composite of the returns of four selected Canadian university endowment funds 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 Endowment (MIP)	7.1%	-3.4%	1.6%	2.4%
Total External Managers (ex RIAL-Holding, staff mortgages, currency hedging program)	4.2%	-2.5%	2.2%	2.8%
Composite of the returns of four selected Canadian university endowment funds	7.8%	-5.7%	1.2%	3.5%
Median – BNY Mellon Canadian Master Trust Universe	7.9%	-1.8%	3.3%	4.3%
Median – BNY Mellon Foundations & Endowments Universe	7.8%	-2.3%	2.3%	3.1%
Absolute Return Objective	6.9%	7.2%	7.6%	7.8%
Composite benchmark (policy weights times related index returns)	5.9%	-2.9%	1.8%	1.0%

Prepared by: McGill University Office of Investments

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