Stanford University Investment Report

2017
**INVESTMENT PERFORMANCE**

<table>
<thead>
<tr>
<th>TRAILING ANNUALIZED RETURNS</th>
<th>1 YEAR</th>
<th>10 YEAR</th>
<th>20 YEAR</th>
<th>SINCE INCEPTION**</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stanford’s Merged Pool</td>
<td>13.1%</td>
<td>5.8%</td>
<td>10.4%</td>
<td>11.7%</td>
</tr>
<tr>
<td>Cambridge Associates U.S. Colleges and Universities Median</td>
<td>13.2%</td>
<td>4.6%</td>
<td>7.0%</td>
<td>8.8%</td>
</tr>
<tr>
<td>70% Equities / 30% Bonds*</td>
<td>12.8%</td>
<td>4.3%</td>
<td>5.8%</td>
<td>7.0%</td>
</tr>
<tr>
<td>Higher Education Price Index (HEPI)</td>
<td>3.7%</td>
<td>2.4%</td>
<td>3.1%</td>
<td>3.1%</td>
</tr>
</tbody>
</table>

*Adjusted for lowest reasonable fee for equivalent passive vehicle.

**Inception date of July 1, 1991.
Dear Friends,

Stanford’s $24.8 billion Endowment provides critical financial support for the University’s mission, helping more than 16,400 Stanford students and 2,200 faculty members to pursue scholarship across a wide variety of disciplines, including the arts, humanities, social sciences, sciences, engineering, law, medicine, business, and education. The goal of this scholarship is to advance human knowledge and ultimately benefit our local, national, and global community.

The Endowment is the University’s largest financial asset, comprised of more than 7,000 individual funds that were established by the generosity of donors. Through careful investment management by Stanford Management Company, these funds are stewarded so that they benefit present and future generations alike.

Looking ahead, the University has initiated a Long-Range Plan to develop a bold and compelling vision for Stanford over the coming decade and beyond. This work will focus on four major areas: education, research, the Stanford community, and the University’s role beyond campus. Successful stewardship of the University’s investment portfolio will be a critical component of this Long-Range Plan and the execution of the University’s ongoing educational mission.

Sincerely,

Marc Tessier-Lavigne
President
Stanford University

Jeffrey S. Raikes
Chair, Board of Trustees
Stanford University
Dear Friends and Colleagues,

In this brochure, we report investment results through June 30, 2017. Stanford’s core long-term investment strategy, which relies on a portfolio diversified by asset class and geography, has remained relatively constant since SMC’s founding in 1991. However, SMC has continually refined and refocused the execution of its strategy to better serve the long-term mission of the University. Over the last two years, we have engaged in a significant effort to concentrate holdings within each asset class to take advantage of high conviction opportunities and ultimately generate additional value versus benchmarks. This effort, which will take a number of years to complete due to the size and liquidity characteristics of the portfolio, requires improvements to every asset class. We have been hard at work and are pleased by the early results of this effort.

During the year, very strong public equity markets supported the portfolio, continuing a pronounced bull market that began in early 2009. Such gains are very welcome, though thoughtful investors need to remain cognizant of the rising asset valuations that can result from such large and sustained moves. We intend to remain disciplined in our portfolio management and to continue to rebalance exposures to preserve desired overall risk and return characteristics.

Sincerely,

Robert F. Wallace
Chief Executive Officer
Stanford Management Company

Stanford Management Company manages Stanford University’s Merged Pool with the dual goals of preserving the purchasing power of the Endowment for future generations of students and scholars and enabling a robust annual disbursement to the current operating budget.
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INTRODUCTION
Stanford University established Stanford Management Company (SMC) in 1991 to manage the University’s endowment funds. Today, SMC remains a key part of the University community and is the fiduciary for the $26.9 billion Merged Pool, which comprises the substantial majority of Stanford’s investable assets.

SMC is overseen by a board of directors appointed by the University’s Trustees. The firm’s 19-person investment team and 50-person total staff are led by Robert Wallace.

MERGED POOL
As of June 30, 2017, the Merged Pool was valued at $26.9 billion, the majority of which represents endowment funds. The balance of the Merged Pool is other capital the University chooses to invest as long-term funds. The resources of the Endowment and Merged Pool support financial aid and a wide array of important academic programs. Stanford’s significant financial aid is enabled by the generosity of donors and the success of its investment program.

MERGED POOL COMPOSITION
(as of August 31, 2017)

- Hospitals 7%
- Non-Endowment* 18%
- Endowment 75%

*Non-Endowment primarily includes Expendable Funds, Donor Advised Funds, Life Income Gifts, and Pending Funds.
Note: The University’s Fiscal Year ends August 31.
In Fiscal Year 2017, the Endowment disbursed $1.2 billion in financial aid, support for academic programs, and other current operations. This amount represented 22% of the University’s Fiscal Year 2017 operating expenses. Annual spending from the Endowment has increased more than eleven-fold since SMC was established in 1991.
INVESTMENT STRATEGY
SMC’s investment strategy is designed to provide material support to annual University operations while preserving the purchasing power of the Endowment for future generations of students and scholars. These dual goals dictate an investment program that is equity-oriented to generate sufficiently high long-term real returns, and well-diversified to dampen annual volatility and mitigate the risk of principal loss.

The Merged Pool contains a variety of equity-oriented strategies, including domestic and foreign public equities, real estate, natural resources, and private equity. While the portfolio is primarily exposed to equity positions, absolute return strategies that have low correlation to broader markets significantly contribute to diversification. Acknowledging the University’s long time horizon, the investment program is designed to accept a responsible degree of illiquidity to drive incremental returns. A small portion of the Merged Pool is held in high-quality fixed income and cash for liquidity purposes. SMC’s Policy Asset Allocation codifies its strategy with exposure targets to each major asset class, shown below.

Based on mean-variance modeling, the current asset allocation is expected to generate a 7.4% real arithmetic annual return (after inflation and all costs) with annualized volatility of 13.5%. This translates to an expected compound real return of 6.5%. We believe these are reasonable risk-return assumptions when considering sufficiently long periods of time, but naturally expect material deviations over shorter time frames. We employ additional scenario analysis to forecast potential returns, volatility, and liquidity in stressful times.
In order to preserve desired risk-return characteristics as market conditions change, SMC exercises discipline in managing asset class exposures and frequently rebalances the portfolio back to its policy targets. Policy targets are revisited only once per year, though changes to exposures within asset classes occur more frequently as market opportunities evolve. By marrying disciplined portfolio management with an appreciation of the changing bottom-up opportunity set, we hope to generate attractive risk-adjusted returns.

SMC primarily relies on carefully chosen external partners to select individual securities, allowing Stanford to benefit from specialized knowledge in asset classes that reward superior active management. While our partners pursue a range of investment strategies, all share a common belief in fundamental investment that incorporates exhaustive quantitative and qualitative research on specific and analyzable opportunities. This discipline fosters a value-sensitive and often contrarian approach, which aligns well with Stanford’s long-term focus. Our partners appreciate the importance of Stanford’s mission, demonstrate a clear fiduciary mindset, and exercise consideration for human and environmental welfare.

Beginning in mid-2015, SMC initiated an effort to consolidate and upgrade its external partner roster to enhance performance relative to benchmark results. Our efforts include building fewer, more substantial positions with partners that demonstrate superior investment judgment, thorough processes, sound ethics, and a strong alignment of interests with the University. A concentrated set of investment partners brings the additional benefit of more frequent communication, leading to more fruitful and trustful partnerships. A better understanding of our partners’ work allows us to invest with conviction and contrarianism.

Early results from our efforts to concentrate the portfolio are encouraging, both in terms of the scope and pace of change. By Fiscal 2017 Year-end, approximately $10 billion of the Merged Pool had been reinvested—a significant achievement given the nature of the portfolio and its liquidity characteristics. Early performance associated with these changes has been strong, though it is too soon for such performance to be meaningful. Because of the liquidity profile of asset classes such as Private Equity, Natural Resources, and Real Estate, our efforts to concentrate the overall portfolio will inevitably slow from this point, requiring a number of further years to complete. Of course, such work is never actually complete; SMC will continually strive to refine and improve its portfolio.

During Fiscal Year 2017, public equity markets continued their multi-year recovery from the 2008 financial crisis. Strong domestic and international market gains led to increased valuations that, at least in some cases, were already notably elevated. Strong public market performance also masked some of the benefits of a diversified portfolio like Stanford’s, which has less than 30% invested in traditional public equity. Despite this relatively modest public equity exposure, the Merged Pool’s 13.1% performance exceeded a traditional “70/30” portfolio of equities and bonds and provided a handsome absolute gain for the University. Importantly, we continue to manage the portfolio with discipline, rebalancing asset class exposures to policy targets and rotating capital within asset classes to the most attractively valued opportunities.
ASSET CLASS

DOMESTIC EQUITY  Domestic Equity gives Stanford exposure to corporate activity in the United States through publicly-traded companies. The asset class has a long-term expected return of 7.0% after accounting for the impact of the Higher Education Price Index (“HEPI”) and expected annual volatility of 20.0%. These long-term expectations assume equilibrium starting valuations, a condition which only periodically holds, and returns over shorter periods can deviate substantially from these baseline assumptions.

SMC invests in domestic equity both through active and passive strategies. Active approaches are implemented through external partners who employ comprehensive, fundamental research to identify holdings that are attractively priced over a medium-term horizon. Passive investments reflect broad parts of the U.S. equity market and are generally implemented using low-cost index instruments.

Domestic Equity has been largely rebuilt over the last two years in an effort to upgrade and concentrate its active management capabilities after a decade of sub-par performance. Domestic Equity is targeted to be 7.0% of the Merged Pool.

INTERNATIONAL EQUITY  Comprising publicly-traded companies outside the U.S., International Equity provides exposure to foreign economic activity across both developed and emerging markets. Developed foreign equities have a long-term expected return of 6.5% net of HEPI, with expected annual volatility of 20.0%. Emerging market equities have an expected real return of 9.0%, with expected annual volatility of 27.0%.

The asset class primarily includes active management strategies implemented by external partners. The inefficiency of many international equity markets provides talented stock pickers with a fruitful hunting ground to pursue their work. The University’s international equity partners perform rigorous, fundamental analysis to identify attractive public holdings over a medium-term horizon. Because a holistic understanding of a country’s legal, social, and cultural norms underpins accurate assessment of corporate activity within the country, our partners tend to be based in the region or country in which they invest. We hold passive international equity exposure when we have no suitable active management solution.
Over the last two years, large parts of International Equity have been rebuilt in an effort to concentrate the asset class and upgrade our active management capability, with a particular emphasis on our Asian holdings. The asset class comprises 21.0% of the Merged Pool at its policy target.

**Absolute Return** Absolute Return is a collection of value-driven and event-driven strategies meant to provide attractive returns with low correlation to traditional equity and fixed income markets. Core strategies in the asset class include long/short equity, relative-value fixed income arbitrage, distressed investment, and special situation investment. The diversifying characteristics of the asset class can provide significant benefit to the Merged Pool as a whole. Absolute Return is expected to generate a 4.75% annual return net of HEPI over the long term, with expected annual volatility of 11.0%.

The University’s approach to absolute return is based on security-specific microeconomic analysis. Our partners perform exhaustive quantitative and qualitative research on equity and fixed income instruments to identify undervalued and overvalued assets that can be owned long or sold short. When coupled with disciplined portfolio management, long and short positions can drive returns that are independent from broader market movements. This diversification is critically important. We expect the trailing monthly “beta” of the asset class to equity markets to be at or below 0.3 over most trailing five-year periods, levels far less than what would result from a simple cross-section of the hedge fund industry.

Stanford’s focus on rigorous, bottom-up security selection with disciplined portfolio management precludes investments in the portions of the hedge fund complex that rely on top-down, speculative, or technical analysis. We view strategies requiring material amounts of leverage, or that possess significant market exposure, with great caution. This current focus has led to changes in the asset class over the last two years. Absolute Return is targeted to be 22.0% of the Merged Pool.

**Fixed Income** Fixed Income is a relatively low return asset class meant to provide stable, liquid exposure to assets likely to hold their value in stressful or deflationary periods. For this reason, the asset class is comprised of U.S. Treasuries, which enjoy the full faith and credit of the U.S. Government. Assuming equilibrium starting valuations, we expect these high-quality fixed income assets to generate a 2.5% annual return net of HEPI, with annualized volatility of 10.0%. Fixed Income has a policy target of 6.0% of the Merged Pool.

**Real Estate** The Merged Pool’s Real Estate asset class is an important diversifying asset class that can help protect the University in inflationary environments. The asset class is expected to return 5.5% per year net of HEPI in the long-term, with annualized volatility of 15.0%.

While we invest in some international real estate, the asset class is primarily focused on office, retail, residential, industrial, and leisure assets in the United States. Through external partners, we pursue value-added strategies in private real estate that attempt to drive incremental returns through superior deal sourcing and asset management. We will hold publicly-traded real estate when valuations are attractive. We endeavor to maintain a quality bias and to ensure an adequate degree of cash flow from our real estate holdings.
The asset class, a notably poor long-term performer for the University, is being transitioned from numerous legacy holdings to a focused group of disciplined partners. The overall risk profile of the asset class is being reduced in the process, shifting toward higher quality assets with less financial leverage. Real Estate is targeted to be 8.0% of the Merged Pool. The University also has significant real estate holdings outside of the Merged Pool.

**NATURAL RESOURCES** Like Real Estate, Natural Resources provides important diversifying benefits to the Merged Pool, particularly in inflationary environments. The University’s resource holdings span timber, metals, conventional and renewable energy, and agriculture. The asset class is expected to generate a 6.0% annual return net of HEPI in the long run, with annual volatility of 18.0%. Stanford’s natural resource holdings focus primarily on private producers of resources, rather than outright holdings of commodities themselves. In this way, we hope to earn an incremental return through superior selection and asset management above and beyond the commodity price movement. From time-to-time, we hold publicly-traded resource companies in the asset class. The natural resource portfolio principally focuses on the U.S. and other jurisdictions where the rule of law and property rights are respected.

We invest in resources with an awareness of climate change and the impact of carbon on the risk profile of specific investments. The University’s Trustees elected to divest from direct thermal coal holdings in 2014. Natural Resources is targeted to be 10.0% of the Merged Pool.

**PRIVATE EQUITY** Private Equity provides illiquid exposure to corporate activity in the U.S. and abroad. Both early-stage investments, in the form of venture capital, and later stage investments, in the form of growth equity and leveraged buyouts, are included in the asset class. In the long run, expected annualized returns net of HEPI range from 11.5% for leveraged buyouts to 14.0% for venture capital. Annualized volatility is expected to range from 25.0% for leveraged buyouts to 30.0% for venture capital.

Simultaneously offering the highest return and highest risk of any asset class in the Merged Pool, Private Equity demands superior execution. Implemented through carefully selected external partners, we strive to drive incremental value through careful asset selection, price discipline, and strategic and operational initiatives. While leverage is employed in parts of the asset class, we strive to work with partners that make the businesses they own more valuable from a fundamental perspective, rather than by relying on financial engineering. Liquidity is monitored closely to ensure the University can meet its liabilities in stressful periods.

We are in the early stages of upgrading and concentrating the Private Equity asset class, which had become overly diversified, to drive higher levels of return above its benchmark. This work will take several years due to the illiquidity of the asset class. Private Equity is targeted to be 25.0% of the Merged Pool.
“Today, more than ever, fundamental research needs vocal and ardent champions — all of us.”

PRESIDENT MARC TESSIER-LAVIGNE
In 1891, the year of Stanford’s founding, President David Starr Jordan appointed the University’s first faculty members. Just 15 professors comprised this inaugural group. Today, Stanford has 2,219 total faculty, 611 of whom hold endowed professorships. The Endowment’s support of faculty is one of its most important uses, and a key reason why Stanford has long made significant contributions to research and scholarship in a wide variety of fields.

The University currently has 19 living Nobel Laureates, and a total of 31 faculty members have won the Nobel Prize since the University’s founding. Stanford professors have also been recognized for their scholarship in other ways. The faculty currently includes 31 MacArthur Fellows, 4 Pulitzer Prize winners, 16 National Medal of Science recipients, 4 National Humanities Medal recipients, and 2 Presidential Medal of Freedom recipients, among numerous other awards. Below are profiles of a few of these award-winning Stanford scholars and their research.

Over the past five years, the endowment has contributed nearly $850 million in aggregate support to their departments.

Roger Kornberg, the Mrs. George A. Winzer Professor in Medicine and Professor of Structural Biology in the School of Medicine, received the 2006 Nobel Prize in Chemistry for his research on transcription, the process of converting DNA into RNA. By studying RNA polymerase, the central enzyme in transcription, he developed groundbreaking insight into its molecular structure. Professor Kornberg earned his Ph.D. in Chemical Physics at Stanford in 1972, and joined the faculty in 1978. His father, Arthur Kornberg, was a Professor of Biochemistry at Stanford, and was awarded the Nobel Prize in Medicine in 1959. They are one of only seven parent-child pairs to win Nobel Prizes.
Jennifer Eberhardt is the Morris M. Doyle Centennial Professor in Public Policy and Professor of Psychology at Stanford, where she arrived in 1998. Professor Eberhardt received the MacArthur Foundation “genius” fellowship in 2014 for her work on the influence of ingrained racial biases in society. Using statistical analysis in conjunction with a variety of research methods ranging from laboratory studies to field experiments, Professor Eberhardt seeks to use psychological insights to improve outcomes in the criminal justice system and elsewhere. In addition to her research, Professor Eberhardt currently teaches courses on race and crime and serves as a doctoral advisor for several graduate students.

David Kennedy, the Donald J. McLachlan Professor of History, Emeritus, received the 2000 Pulitzer Prize for his book *Freedom from Fear: The American People in Depression and War, 1929-1945*. In *Freedom from Fear*, Professor Kennedy profiles the experience of Americans during the Great Depression and World War II. He argues that, while the economic collapse of the 1930s generated a set of catastrophic consequences, it also created an opportunity to reimagine the economic fabric of the country via Franklin Roosevelt’s New Deal. Meanwhile, German and Japanese imperial ambitions forced the same generation of Americans who lived through the Depression to confront global military conflict as the United States waded into World War II. Professor Kennedy comprehensively recounts these two pivotal episodes in American history while reexaming their role in forging a modern American identity. Professor Kennedy completed his undergraduate degree in history at Stanford in 1963. He joined the faculty in 1968 and became Professor Emeritus in 2008.
Lucy Shapiro is the Virginia and D.K. Ludwig Professor of Developmental Biology in the School of Medicine. She was the founding chair of the department, initiated at Stanford in 1989. She was awarded the National Medal of Science in 2012 for her study of the dangers of emerging infectious diseases, antibiotic resistance, and climate change. Her current research focuses on the bacterial cell cycle and the mechanisms that generate three-dimensional structures from a one-dimensional genetic code. Professor Shapiro's goal is to use genome sequencing and microarray technology to identify the genetic circuitry that controls the bacterial cell cycle.

Robert Sapolsky is the John A. and Cynthia Fry Gunn Professor in the School of Humanities and Sciences. He is a Professor of Biology, Neurology & Neurological Sciences, and Neurosurgery at Stanford, where he has worked since 1987. He was awarded the MacArthur Foundation “genius” fellowship for his work on the mechanisms that cause stress damage to the brain. His most recent work has touched upon the relationship between free will, human biology, and human psychology. In addition to his research, Professor Sapolsky teaches courses on human behavioral biology, mechanisms of neuron death, and physiology.
For the 12 months ending June 30, 2017, the Merged Pool generated a 13.1% net return, slightly trailing the 13.2% median return for U.S. colleges and universities\(^1\) and outperforming the 12.8% return for a traditional “70/30” portfolio of equities and bonds.

Since Stanford Management Company’s inception in 1991, the Merged Pool has generated impressive results relative to a number of benchmarks. Over the 26-year period, the Merged Pool has earned an annualized net return of 11.7%, exceeding the median of a broad group of colleges and universities by 2.9% annually and a passive portfolio of public equities and bonds by 4.7% annually.

\(^1\) As reported by Cambridge Associates.
SMC’s long-term performance has generated substantial resources for the University and added billions of dollars to its Endowment versus the results of peers and the traditional passive portfolio of equities and bonds, as shown in the dollar-value-added analysis below.

### DOLLAR-VALUE-ADDED SINCE INCEPTION* ($ in billions)

<table>
<thead>
<tr>
<th>Stanford’s Merged Pool</th>
<th>vs. Cambridge Associates U.S. Colleges and Universities Median</th>
<th>$16.6</th>
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</thead>
<tbody>
<tr>
<td>vs. 70% Equities / 30% Bonds</td>
<td></td>
<td>$22.4</td>
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</table>

*Inception date of July 1991. Note: Analysis does not account for gifts and payout.

Several asset classes have generated outperformance relative to benchmarks over the last 10 years, with notable outperformance in International Equity. More muted relative results in other asset classes suggest room for improvement, our approach to which we outline elsewhere in this report.
Graduate Student Financial Support and the Endowment

Stanford’s Endowment provides a significant source of financial support for graduate students, whose education is core to the University’s mission. The University’s graduate students pursue doctoral, master’s, and professional degrees across Stanford’s seven schools: Business; Education; Engineering; Humanities and Sciences; Law; Medicine; and Earth, Energy and Environmental Sciences. Graduate students also play a critical role in making the University one of the world’s leading research and teaching institutions, supporting faculty in cutting-edge research and teaching.

In Stanford’s first year, 1891, 39 men and 12 women from 19 states enrolled as graduate students, pursuing one of the first opportunities for graduate study on the West Coast. In the Autumn Quarter of 2017, there were 9,368 graduate students, making up more than half of Stanford’s enrollment.

One of Stanford’s highest priorities is to remain affordable and accessible for graduate students. The University provides financial assistance to graduate students in the form of fellowships, as well as teaching and research assistantships. Approximately 78% of graduate students received more than $140 million of combined financial support from the Endowment in Fiscal Year 2017.

For example, the Stanford Graduate Fellowships (SGF) in Science and Engineering program helps the University recruit outstanding graduate science and engineering students from around the world. By providing tuition and stipend support, SGF funds allow the students to participate in groundbreaking research at Stanford without being constrained by the agendas of sponsored research grants. The SGF Program has supported over 1,600 fellows since its inception in 1997.

Another distinctive University-wide fellowship is the Stanford Interdisciplinary Graduate Fellowship (SIGF) program, which awards three-year fellowships to outstanding doctoral students engaged in interdisciplinary research, which is essential to fulfilling Stanford’s mission to solve increasingly complex global challenges. Since 2008, SIGFs have been awarded to over 200 students and span all seven of Stanford’s graduate schools and more than 40 academic departments.

The generosity of donors and the strong investment results of the Endowment play a critical role in supporting graduate students. If federal support continues to be uncertain, these funding sources will remain even more vital for the University’s excellence in graduate education. Through prudent investment execution, Stanford Management Company is dedicated to supporting the University’s commitment to graduate financial support.
## Investment Team

Robert Wallace  
*_Chief Executive Officer_*

Greg Milani  
*Stanford degrees shown.*  
*M.B.A. 1996, M.A. 1996*  
*_Senior Managing Director_*

Jay Kang  
*_Managing Director_*

Yidi Lu  
*Yidi Lu is a Managing Director of the Stanford (Beijing) Consulting Co., Ltd.*  
*_Managing Director_*

Thomas Lurquin  
*_Managing Director_*

Charles Moore  
*J.D. 1995*  
*_Managing Director_*

Mark Shoberg  
*M.B.A. 2003*  
*_Managing Director_*

Michael Lee  
*_Director_*

Mary Mei  
*_Director_*

David Captain  
*_Associate Director_*

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Blair Critchlow  
*B.A. 2008*  
*_Associate Director_*

Rick Devlin  
*_Associate Director_*

Austin Lawrence  
*_Associate Director_*

Becca Levin  
*B.A. 2007, M.B.A. 2012, M.S. 2012*  
*_Associate Director_*

Steven Wright  
*B.A. 2008*  
*_Associate Director_*

Daniel Truong  
*B.A. 2009*  
*_Associate_*

Natalie Ferguson  
*_Senior Analyst_*

Andrew Elott  
*B.A. 2017*  
*_Analyst_*

Julian Skotheim  
*_Analyst_*

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Eric Wright  
*A.B. 1985*  
*_Senior Legal Counsel_*

Kristal Dehnad  
*_Chief Operating Officer_*

Eunice Kim  
*_Legal Counsel_*

Mark Tannahill  
*_Legal Counsel_*

20 /
“Always be gentle in manner, resolute in purpose, and you will develop characters on which others can depend.” JANE STANFORD