

AGB

FUTURE PROOF

2020 NATIONAL CONFERENCE ON TRUSTEESHIP

Endowment Management 2020: Guidance for the Forward- Looking Investment Committee

Nicole Wellmann Kraus

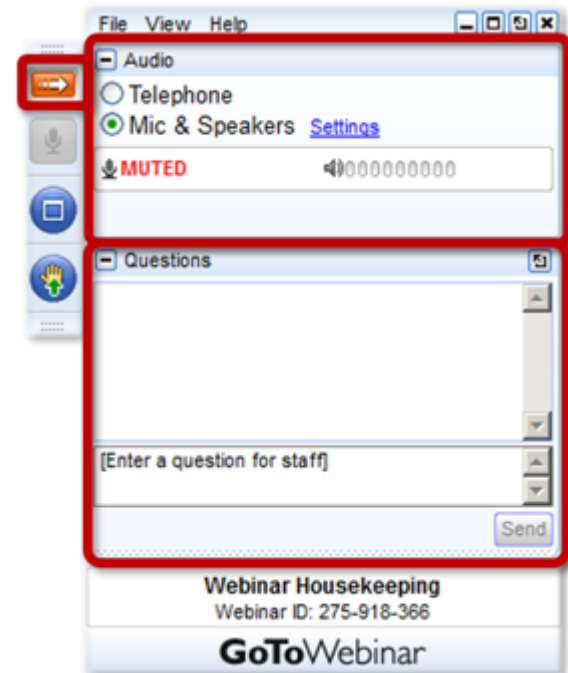
managing director and global head of client development, Strategic
Investment Group

INTERACT WITH US

You will receive a link to the webinar recording

You can listen via phone, tablet, or computer

We want you to ask questions during and after the webinar!



THANK YOU TO OUR EVENT PARTNERS



THANK YOU TO OUR YEAR-ROUND PARTNERS



commonfund



BANK OF AMERICA



CYBERNANCE
First In Cybergovernance



AGB
SEARCH



SEI New ways.
New answers.®



Agility / PWP



EducationDynamics®
Find. Enroll. Retain.



FARRELL DAY

KaufmanHall



AGB Webinar

Endowment Management 2020: Guidance for the Forward-Looking Investment Committee

April 21, 2020

Legal Disclosures

Strategic Investment Group is a registered service mark of Strategic Investment Management, LLC.

Copyright 2020. Strategic Investment Management, LLC. No portion of this publication may be reproduced or distributed without prior permission.

This material is for educational purposes only and should not be construed as investment advice or an offer to sell, or solicitation of an offer to subscribe for or purchase any security. Opinions expressed herein are current as of the date appearing in this material and are subject to change at the sole discretion of Strategic Investment Group®. This document is not intended as a source of any specific investment recommendations and does not constitute investment advice or the promise of future performance.

Nikki Kraus, CFA

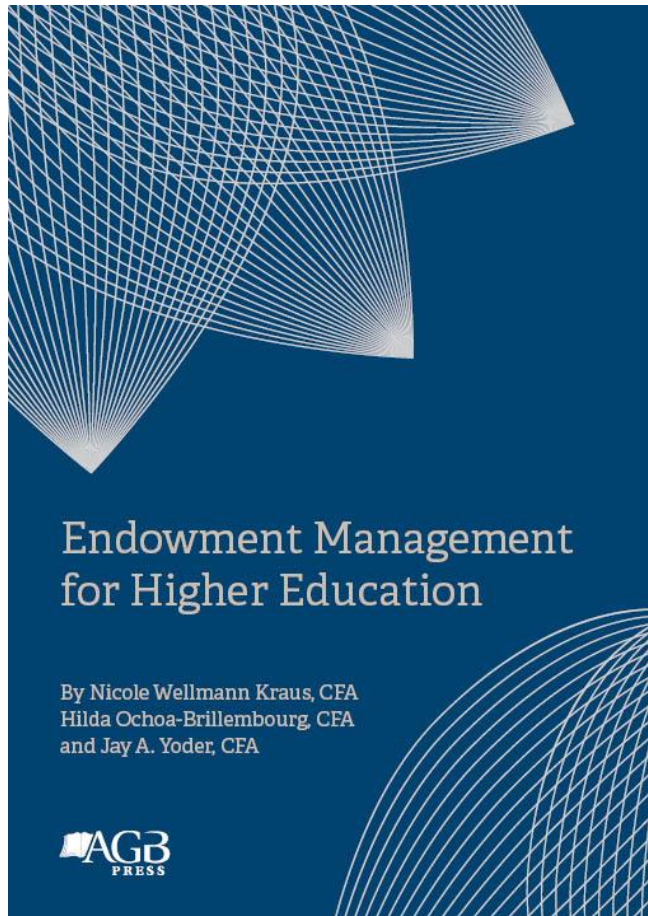
Managing Director and Global Head of Client Development



- Nikki Kraus, CFA, is the Managing Director, Global Head of Client Development of Strategic Investment Group.
- Member of 8 person Strategic Management Committee which runs the firm.
- Oversees the building of client relationships, drives the firm's marketing strategy, and is a member of Strategic's Board of Managers.
- Nearly 26 years of OCIO and investment committee experience, including nearly a decade at Hirtle, Callaghan & Co. where she worked with the firm's largest clients and ultimately led the institutional practice and nearly 12 years at SEI Investments working with endowments, pension funds, healthcare organizations and foundations.
- Serves on the Investment Advisory Subcommittee of the John Templeton Foundation.
- Co-author of *Endowment Management for Higher Education*, a publication released by the Association of Governing Boards of Universities and Colleges (AGB) in June 2017 and publisher of numerous blog posts on subjects like Investment Committee succession planning and how to build the most effective investment committee.
- Extensive experience working with college and university endowments. Active collaboration with National Association of College and University Business Officers (NACUBO) for nearly a decade and has presented or spoken at NACUBO events multiple times (NACUBO EMF in 2020, 2019, 2018, 2017 and 2013 and on Endowment Study Webcast in 2013 for 2012 study). Speaker at many AGB events (2016, 2017, 2018 twice, 2019 and 2020). Often asked to provide insights on best practices for college and university Investment Committees.
- B.A. in English and Computer Applications from the University of Notre Dame.
- CFA charterholder and a member of the CFA Society of Philadelphia.
- Years in Industry: 25.

Published by the Association of Governing Boards (AGB)

Endowment Management for Higher Education ~ co-written by Nikki Kraus



Research Done Over Years to Complete the Book:

- Front row seat at Investment Committee meetings for 25+ years in Outsourced CIO Industry.
 - Saw excellent, good, and bad practices.
 - Witnessed some “\$100MM mistakes” due to governance problems and started paying closer attention.
 - Attended as many as 50 Investment Committee meetings a year.
 - Engaged with industry experts.
-
- ***Great Financial Crisis was seared into my memory when working on this book. Every recommendation was developed to avoid mistakes made during a period like this.***

Written for those who serve on investment committees and shoulder the important responsibility of a fiduciary.

Objectives for Our Time Together

- Educate the group re: ways to avoid expensive mistakes often made during crisis periods.
- Provide some best practices for endowment management that will be especially important in 2020.
- Agree to some next steps to memorialize the above and the actions you will take to get there.

Caveat: We understand that COVID-19's impact on all of us is impossible to predict. We also recognize that institutions are in different situations relative to their financial strength, which will affect their required actions at this time. We will focus on preserving endowment value in this session.

**Don't hesitate to reach out to me at nkraus@strategicgroup.com as a follow up to this session.
You can also find me at www.ocio.com.**

Key Principles

STOP
BREATHE
THINK

- Take a step back. If you didn't have a crisis committee, assess where you have risk in your committee or with your institution. These are the times when any cracks in your foundation are exposed. Huddle with the key, trusted leaders to think about where the risks are. Candor is critical.
- There isn't "just one thing" to be thinking about today. There are many threads that must be woven together to create a strong fabric of good governance.
- Always remember: **no committee member can make a gift large enough for the potential damage he or she might do to the endowment value.**
- AGB's: *An Anatomy of Good Board Governance in Higher Education*: Get the Right People. Focus on the Right Things. Engage in the Right Way.

Right People: Optimizing the Selection of Investment Committee Members – Risk Areas in Yellow

Personality Attributes / Skills	Required	Great to Have	Not Needed	Never Allow
Love of Institution	All			
Asks big picture questions	At least one			
Reluctant to speak up even when they disagree				X
Speaks over others and demands their proposed action be taken				X
Willingness to listen to others' opinions, especially when different from theirs	All			
Commitment to do required work of committee	All			
Tenure on Committee >10 years to provide institutional memory	At least one			
Tenure on Committee <3 years to promote new ideas	At least one			
CIO experience		At least one		
Attorney		At least one		
CEO / Senior Business Leader		At least one		
General Money Management Executive			X	
Alternative Investment Experience		At least one		
Diversity by gender, ethnicity, full scholarship kids / full pay kids		At least one of each		

Source: AGB Blog "Optimizing the Selection of Investment Committee Members," by Nikki Kraus and Ken Grossfield. October 23, 2018.

Right People: Optimizing the Selection of Investment Committee Members

- Many experienced investment committee leaders believe there is a correlation between average tenure of committee members and the committee's time horizon.
- The most well functioning committees we saw during the Great Financial Crisis (GFC) had very long serving members. Today, as many as 50% of committees we have met with don't have one member who was serving during the GFC. This is concerning.
- If you don't have long-serving members, consider asking someone to come out of retirement. Nearly every institution has a beloved, respected committee member who would be delighted to serve as a ballast during this time and provide an important voice of reason.
- If you have some misbehaving members on the committee, be ready to be a strong leader. Members who haven't attended will likely all attend now, and many aren't shy in speaking up.

Right People: Optimizing the Selection of Investment Committee Members

- A great Chair of the IC is critical to investment success. If the Chair of the IC isn't an excellent leader, your most respected leader should participate in meetings to provide additional leadership.
- Consider making exceptions for term limits during this time. If your most experienced leader is about to term off the committee, please consider asking them to stay until things quiet down.

Experience Provides a Steady Hand and a Long View;
Especially Valuable During Turbulent Times

Focus on the Right Things – Roles

- Go back to the IPS to review who is accountable for what.
- Keep in mind this is when any gaps in coverage may be found or when a difference between what is done and what is documented will be exposed.
- In *Endowment Management for Higher Education*, there is a list of things that need to be done for every investment program. This would be a good time to review the list and make sure everything is covered.
- Don't leave any asset pool orphaned. Every asset pool must have oversight and monitoring. Have you identified who is doing this for each, including operating pools, 403(b) plans, pensions, planned giving, etc.?
 - Have seen situation where IC assumed an operating pool was there to provide liquidity to support a higher equity allocation in the endowment, and during GFC, the President admitted to the IC that he had spent the excess operating fund.

List can be found in *Endowment Management for Higher Education*, Chapter 2, page 14.

What Should Be in an IPS

Governance

- **Roles and responsibilities of each party involved (must not contradict Charter)**
- Date of last review and how frequently IPS will be reviewed
- Description of asset pools the policy covers

Investment Return and Risk Objectives

- Objectives – prioritization
- Constraints to be considered
- Mission-aligned investment strategy (if you do it)
- Any other context to frame ability to take risk in portfolios
- **Target asset allocation (allowable asset classes and ranges)**
- **Asset class rationales (and why they are included) – newer item**
- Specific benchmarks for the portfolio and how performance will be measured – benchmarks should never be changed by outside firm without express consent of Committee.

Risk Management

- **Risk management considerations, including liquidity**
- **Risk management process**
- **Rebalancing procedures**

If your IPS doesn't include all areas above, consider finding documentation around the other areas to have a full picture of your investment program.

Focus on the Right Things – Liquidity

- **Review the institution's dollar values and liquidity** across multiple operating pools and within the endowment. This is critical. Then, confirm that the endowment will not need to be used for any additional liquidity to support operational needs. The endowment portfolio should be tapped as a last resort. It is the most expensive time to use extra funds from the endowment – in any form (loan, additional spending, etc.). 12-25% premium to a normal cost given the decline in portfolio value.
- **Understand where the endowment fits with the overall institution's finances.** This is always essential (but especially in times like these), in order to take the appropriate level of risk across the institution.
- **Spend time on your illiquids portfolio and get a sense of your expected capital calls.** Many endowments just added a great deal to these investments and now that the rest of the portfolio value has fallen considerably, you will want to get a sense of how this impacts your liquidity.

Focus on the Right Things – Communication

Communication is critical – and necessary on many levels.



You should communicate for planning purposes, but also to build confidence in the investment program and the approach you are taking.

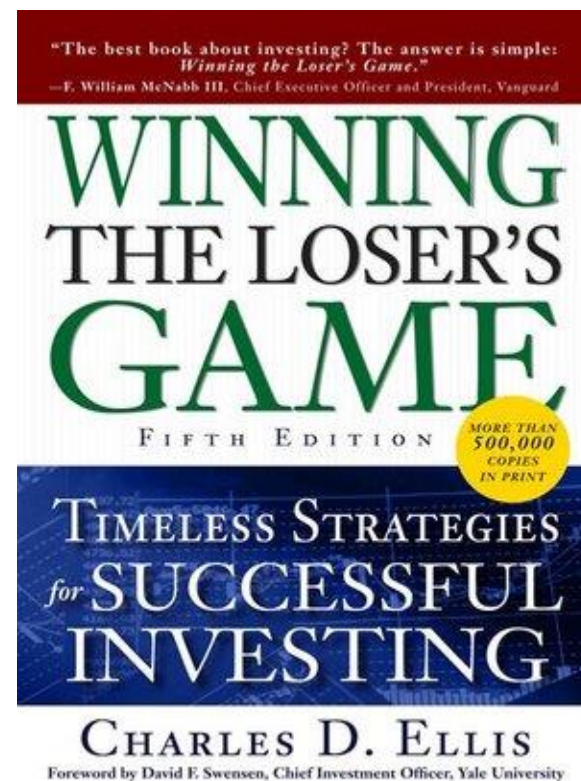
How many deposits have you made in the “confidence bank”?

Focus on the Right Things – Asset Allocation

Do not market time.

Charley Ellis *Winning the Loser's Game* chapter on “Why Policy Matters” is a good read during a time like this.

“The principal reason you should articulate your long-term investment policies explicitly and in writing is to protect your portfolio from yourself – helping you adhere to long-term policy when Mr. Market makes current markets most distressing and your long-term investment policy suddenly seems most seriously in doubt.”



Focus on the Right Things – Asset Allocation

- Review your asset allocation. Why did you choose the asset allocation you did? Did you document the rationale for your decisions? If so, go back to that documentation and provide it to all committee members to remind them.
- Review what has changed. Do all you can to stay the course regarding level of equity today. **This is not the moment to market time and to reduce equities.**
- Many committees were discussing taking on more equity risk late last year. It is a good time to review that discussion again now, when equities are cheaper. If there is no longer the appetite to add to equities, recognize that some of that desire to add equities was likely driven by market timing impulses.
- If there are no members who were around when the asset allocation was set, keep in mind that there is a higher risk that they won't defend this action.
- If you conducted stress tests to simulate negative periods for the endowment, pull them out. It tends to be helpful to remind people that this is in line with what would have been expected in a negative environment, that we all agreed we were comfortable with this when we set the investment policy, and that we would stay the course.

Other Important Considerations

Risk Tolerance and Manager Line-up

- Recognize that people overestimate their tolerance for risk when things are good. This will be a good test of what people have said over time. You may need to remind them of their words as you implemented your asset allocation. You need to have earned the right to do this.
- This is not a time to make drastic changes to your manager line-up, unless managers have made major changes to process or failed to stick to their discipline.
- Rely on your investment team to communicate what results are in line with expectations. You may have selected some managers with highly volatile strategies that were masked during the low volatility environment.

Other Important Considerations

Discuss and Resolve Investment Philosophy Differences within the Committee

- This is a time when you will expose investment philosophy differences that may not have been fleshed out before. It is critical to have everyone on the same page or try to get them there to provide direction to an outside firm.
- Consider:
 - Active versus passive
 - The allocation to alternatives
 - Liquidity needs
 - Art versus science
 - Concentration versus more diversified in manager names and in approach
- These are unfortunately the times when people say, “I never understood why we had an allocation to ABC manager, or were overweight emerging markets or didn’t have more money in index funds.” These backward looking criticisms cannot be tolerated.

Other Important Considerations

Document. Document. Document.

- Do it right after key meetings while things are fresh. Refer to old documents around key decisions.

Mission-Related Investing

- Prior to this period, there was tremendous focus on mission-related investing at many institutions.
- Our only message is this: Make sure that a balanced approach is taken in evaluating any trade-offs associated with mission-related investing.
- We would caution to say that there are more and less thoughtful approaches and the less thoughtful ones could erode returns.

Other Important Considerations

Freedom of Information Act (FOIA) Considerations

- Every state is different, yet in general, things are moving to a “sunnier” state of affairs.
- This is a time when actions could be on the front page of a newspaper, so please consider this.
- Bad press could do tremendous damage to your efforts during this critical time.

Questions?

Important Disclosures

The information in this webinar should not be considered an individualized recommendation or personalized investment advice.

The investment strategies mentioned here may not be suitable for everyone. Each investor needs to review an investment strategy for his or her own particular situation before making any investment decision.

The views, opinions and estimates herein are as of the date of the material and are subject to change without notice at any time in reaction to shifting market conditions.

Past performance is no guarantee of future results and the opinions presented cannot be viewed as an indicator of future performance.

Examples provided are for illustrative purposes only and not intended to be reflective of results you should expect to attain.



STRATEGIC THINKING ■ INSPIRED INVESTING

Empowering investors through experience, innovation, and excellence.

1001 Nineteenth Street North
16th Floor
Arlington, VA 22209 USA

+1 703.243.4433 TEL
+1 703.243.2266 FAX

strategicgroup.com

THANK YOU

We greatly value your attendance and participation. Within 48 hours of this webinar you will receive a recording of this webinar, as well as a brief online evaluation. We kindly request that you share any and all feedback, and please do not hesitate to AGB or to the speakers should you have follow-up questions.

programs@agb.org

APRIL 9–11, 2021
MANCHESTER GRAND HYATT, SAN DIEGO, CA
WORKSHOP FOR BOARD PROFESSIONALS 2021

AGB 100th Anniversary

**SAVE
THE
DATE**



APRIL 10–13, 2021
MANCHESTER GRAND HYATT, SAN DIEGO, CA
NATIONAL CONFERENCE ON TRUSTEESHIP 2021