Upcoming Events at the Council

Community Foundation Events

• Legal Matters for CFs Workshops.
  Milwaukee, WI — JUN 28
  Raleigh, NC — JUL 24,

• CFE Fundamentals (SOLD OUT) Baltimore, MD— JUL 18-19
  Jacksonville, FL— OUT 24-25

COF Cross-Sector Events

• Endowment & Finance Summit
  Washington, DC — SEPT 6-7

• HR Summit
  Denver, CO — SEPT 12-13

• Inclusive Economic Prosperity
  Midwest
  Minneapolis, MN — AUG 28-29

Upcoming Webinars

• Three Legged Stool: Evaluation, Monitoring, and Feedback
  JUNE 13

• Lunch with Legal Counsel: Issues for Private Philanthropy
  JUNE 20

Visit cof.org/events/webinar-upcoming to Register!

Leading Together 2019 – Call for Sessions!

To submit your session ideas on

• Bridging Divides
• Inclusive Economic Prosperity
• Climate Impacts and Vulnerability

by TODAY, visit
cof.org/leading-together-2019
Developing an Investment Strategy
David D. Center, CFA
Senior Vice President
• Investment professional since 2001
• FEG team member since 2014

Education:
• MSIA (MBA) in Finance & Strategy, Carnegie Mellon University
• BS in Electrical Engineering, Lehigh University

Experience:
• Cardinal Investment Advisors – Consultant
• New Leaf Capital Consulting – Managing Director
• Hammond Associates – Senior Consultant
• Entergy Services – Treasury Manager

Memberships:
• Krewe of the Rolling Elvi – Founder and Mission & Vision Committee Member
• CFA Society of Cincinnati – Member
• CFA Society of St. Louis – Former Board Member
• CFA Society of Louisiana – Former President
• Greater New Orleans Council of Campfire – Former President

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David has worked with Community Foundations since 2003 and is a champion of FEG’s annual Community Foundation Survey.
Introduction

Tim O’Donnell, CAIA
Senior Vice President

- Investment professional since 1995
- FEG team member since 1999

Education:
- BA in History and Political Science, Miami University

Experience:
- Robert W. Baird & Co. – Research Assistant

Memberships:
- Bikes Belong
- Hoosier Environmental Council
- Hoosier Mountain Bike Association
- US SIF – The Social Investment Forum
- The Sierra Club
- CAIA Association

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Tim has worked with Community Foundations since 1999 and is Chair of FEG’s Response Investing Committee.
1. Understanding Roles and Responsibilities
2. Developing an Investment Policy Statement (including hurdle rate and spending)
3. Asset Allocation
4. Selecting Investment Managers & Implementation
5. Ongoing Monitoring
6. Integrating Donor Designated Funds
1. Roles & Responsibilities
## Governance structure

<table>
<thead>
<tr>
<th>Operating Fiduciaries</th>
<th>2-TIER</th>
<th>3-TIER</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Governing Fiduciaries</strong></td>
<td>Board/Investment Committee, Staff, and Consultant (Supporting Fiduciary)</td>
<td>Board/Investment Committee</td>
</tr>
<tr>
<td><strong>Managing Fiduciaries</strong></td>
<td>CIO or Outsourced CIO (Consultant), and Staff</td>
<td></td>
</tr>
<tr>
<td><strong>Operating Fiduciaries</strong></td>
<td>Investment Managers, Custodian, Actuaries, Other Vendors</td>
<td>Investment Managers, Custodian, Actuaries, Other Vendors</td>
</tr>
</tbody>
</table>

Adapted from: *Pension Fund Excellence*, Keith P. Ambachtsheer and D. Don Ezra.
## Managing Fiduciaries

<table>
<thead>
<tr>
<th>RESPONSIBILITY</th>
<th>CONSULTING (Non-discretionary)</th>
<th>OCIO (Discretionary)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spending Policy</td>
<td>●</td>
<td>●</td>
</tr>
<tr>
<td>IPS Development</td>
<td>●</td>
<td>●</td>
</tr>
<tr>
<td>Asset Allocation</td>
<td>●</td>
<td>●</td>
</tr>
<tr>
<td>Portfolio Strategy</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>Manager Selection</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>Day-to-Day Supervision</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>Trading</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>Rebalancing</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>Risk Management</td>
<td>○</td>
<td>○</td>
</tr>
<tr>
<td>Performance Analysis</td>
<td>○</td>
<td>○</td>
</tr>
<tr>
<td>Reporting</td>
<td>○</td>
<td>○</td>
</tr>
</tbody>
</table>

- ● Service provider recommends and monitors; client approves and implements.
- ○ Service provider executes and monitors; client notified.

Source: FEG.
## Operating fiduciaries

<table>
<thead>
<tr>
<th>POSITION</th>
<th>GENERAL RESPONSIBILITY</th>
<th>SPECIFIC TASKS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Investment Managers</strong></td>
<td>Executes investment guidelines for externally managed assets</td>
<td>▪ Complies with the Investment Policy, Investment Guidelines, and restrictions</td>
</tr>
<tr>
<td></td>
<td></td>
<td>▪ Produces desired return/level of risk</td>
</tr>
<tr>
<td></td>
<td></td>
<td>▪ Generates performance reports for their specific mandate</td>
</tr>
<tr>
<td></td>
<td></td>
<td>▪ Supports Investment Committee requests</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Note: These guidelines are different and rather limited for mutual funds, commingles funds, and ETFs.</td>
</tr>
<tr>
<td><strong>Custodian Bank(s)</strong></td>
<td>Safeguards specified financial assets</td>
<td>▪ Controls access to assets</td>
</tr>
<tr>
<td></td>
<td></td>
<td>▪ Settles trades efficiently</td>
</tr>
<tr>
<td></td>
<td></td>
<td>▪ Collects investment income and principal</td>
</tr>
<tr>
<td></td>
<td></td>
<td>▪ Collects and disseminates investment portfolio information</td>
</tr>
</tbody>
</table>

Source: FEG.
2. Developing an IPS
What’s in an IPS?

- Asset Class Rationales
- Asset Allocation Guidelines
- Risk Tolerances
- Portfolio Construction

- Benchmarks
- Performance and Manager Monitoring
- Risk Management

- Definition of Duties
- Enterprise / Mission
- Investment Goals / Spending
- Conflicts of Interest

- Dynamic Asset Allocation
- Manager Selection
Consider the market environment, investment considerations, and enterprise considerations when determining your objectives.

<table>
<thead>
<tr>
<th>ENTERPRISE CONSIDERATIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Agencies / Supporting Orgs</td>
</tr>
<tr>
<td>• Level of Operating Support</td>
</tr>
<tr>
<td>• Spending Policy</td>
</tr>
<tr>
<td>• Fundraising</td>
</tr>
<tr>
<td>• Impact Investing Goals (i.e. SRI, ESG)</td>
</tr>
<tr>
<td>• Donor Designated Funds Partnerships</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>INVESTMENT PROFILE</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Risk Tolerance / Appetite</td>
</tr>
<tr>
<td>• Liquidity</td>
</tr>
<tr>
<td>• Experience</td>
</tr>
<tr>
<td>• Other Restrictions</td>
</tr>
<tr>
<td>• Return Objective</td>
</tr>
</tbody>
</table>
What is your hurdle rate?

☐ A community foundation’s hurdle rate is the overall investment return objective for the portfolio

Hurdle Rate = Spending + Administrative Fees + Inflation

☐ It is important to carefully consider liquidity tolerances

☐ The degree to which a community foundation asset pool includes supporting organizations’ assets impacts tolerance for illiquidity
Comparing spending policy rates

SPENDING POLICY RATE (EXCLUDING ADMINISTRATIVE FEES)

Source: FEG 2017 Community Foundation Survey. Answers below 4% were grouped. To factor the average and median, numbers greater than 5% were figured as 6%. N=88.
While two community foundations’ objectives and asset allocations may vary, each foundation’s approach to portfolio construction should comply with two fundamental principles:

- Long-term focus
- Diversification
3. Asset Allocation
## Universe of options

### GLOBAL EQUITY
- U.S. & International
- Market Cap & Style
- Private & Public
- Equity Hedge Funds

### GLOBAL FIXED INCOME & CREDIT
- Investment Grade
- Structured Debt
- TIPS
- High Yield
- Bank Loans
- Private Debt
- Credit Hedge Funds

### REAL ASSETS
- Real Estate (Public & Private)
- Natural Resources
- Commodities
- Infrastructure

### DIVERSIFYING STRATEGIES
- Macro Hedge Funds
- Event Driven Hedge Funds
- Relative Value Hedge Fund
Framing your objectives

FEG 7- TO 10-YEAR CAPITAL MARKET ASSUMPTIONS

Expected Return vs. Expected Standard Deviation

- U.S. Inflation
- Core (Investmen…
- Diversifying Strategies
- Public Real Estate
- Int’l Large Cap Developed
- High Yield Global & Hedged Equity
- U.S. Equity
- Commodities
- Private Debt
- Private Real Estate
- MLPs
- Private Energy
- Private Equity
- Emerging Markets

7% Hurdle (2% CPI + 4.5% Spend + 0.5% Admin)

Source: FEG. As of December 31, 2017. FEG Capital Market Assumptions are hypothetical based on asset category. Please refer to the Disclosures for full disclosures.
Comparing asset allocations

### Community Foundation Asset Allocation

<table>
<thead>
<tr>
<th></th>
<th>Domestic Equities</th>
<th>Int’l Dev. Equities</th>
<th>Emerging Markets</th>
<th>Core Fixed Income (FI)</th>
<th>Credit Sensitive FI</th>
<th>Public Real Assets</th>
<th>Private Investments</th>
<th>Hedge Funds / Low Volatility</th>
<th>Short-Term Securities</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Overall Median</strong></td>
<td>37</td>
<td>17</td>
<td>6</td>
<td>18</td>
<td>2</td>
<td>4</td>
<td>5</td>
<td>11</td>
<td>3</td>
</tr>
<tr>
<td>(&lt;) $25 million</td>
<td>44</td>
<td>16</td>
<td>4</td>
<td>19</td>
<td>0</td>
<td>4</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>$25 - $50 million</td>
<td>42</td>
<td>18</td>
<td>7</td>
<td>20</td>
<td>1</td>
<td>6</td>
<td>3</td>
<td>8</td>
<td>3</td>
</tr>
<tr>
<td>$51 - $100 million</td>
<td>39</td>
<td>15</td>
<td>4</td>
<td>18</td>
<td>1</td>
<td>5</td>
<td>4</td>
<td>15</td>
<td>2</td>
</tr>
<tr>
<td>$101 - $250 million</td>
<td>33</td>
<td>18</td>
<td>6</td>
<td>17</td>
<td>4</td>
<td>4</td>
<td>6</td>
<td>12</td>
<td>2</td>
</tr>
<tr>
<td>(&gt; ) $251 million</td>
<td>31</td>
<td>17</td>
<td>7</td>
<td>12</td>
<td>3</td>
<td>2</td>
<td>6</td>
<td>12</td>
<td>1</td>
</tr>
<tr>
<td>N=87</td>
<td>N=82</td>
<td>N=71</td>
<td>N=86</td>
<td>N=60</td>
<td>N=60</td>
<td>N=71</td>
<td>N=70</td>
<td>N=75</td>
<td></td>
</tr>
</tbody>
</table>

1 Cash / Other. Source: FEG 2017 Community Foundation Survey. Asset Allocation shown as median of survey responses, thus may not add up to 100. Answers that were more than 20% off a total of 100 were removed. See disclosures for equal-weighted averages.
4. Selecting Investment Managers
Active and passive

DETERMINANTS OF RETURN

PASSIVE

Market Return

Pure Indexing

ACTIVE

Manager Skill

Smart Beta

Pure Active

Source: FEG.
### Average Community Foundation Perception

**Sentiment: active and passive**

<table>
<thead>
<tr>
<th>ACTIVE (1)</th>
<th>NEUTRAL (3)</th>
<th>PASSIVE (5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall</td>
<td>2.7</td>
<td></td>
</tr>
<tr>
<td>(&lt;) 25MM</td>
<td></td>
<td></td>
</tr>
<tr>
<td>$25 - $50MM</td>
<td>2.5</td>
<td></td>
</tr>
<tr>
<td>$51 - 100MM</td>
<td>2.5</td>
<td></td>
</tr>
<tr>
<td>$101 - $250MM</td>
<td>2.9</td>
<td></td>
</tr>
<tr>
<td>(&gt; $250MM)</td>
<td>2.2</td>
<td></td>
</tr>
</tbody>
</table>

## Manager due diligence

### FEG’S SIX TENETS FOR MANAGER REVIEW

<table>
<thead>
<tr>
<th>Tenet</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CONVICTION</strong></td>
<td>Strong belief in the investment philosophy; willing to put investment decisions ahead of business decisions; invests alongside of clients, aligning interests.</td>
</tr>
<tr>
<td><strong>CONSISTENCY</strong></td>
<td>Stability of organizational structure, composition of the investment professionals, and the investment philosophy and process.</td>
</tr>
<tr>
<td><strong>PRAGMATISM</strong></td>
<td>Understand core strengths and have the ability to capitalize and sustain their competitive edge.</td>
</tr>
<tr>
<td><strong>INVESTMENT CULTURE</strong></td>
<td>Strong ethical foundation, passionate about investing; proper organizational and compensation structure; culture pervades across organization.</td>
</tr>
<tr>
<td><strong>RISK CONTROL</strong></td>
<td>Not blind risk takers, but risk conscious; acknowledge mistakes; robust and effective risk mitigation.</td>
</tr>
<tr>
<td><strong>ACTIVE RETURN</strong></td>
<td>Ability to identify and profit from investment opportunities; successful track record.</td>
</tr>
</tbody>
</table>
Expect periods of underperformance

☐ Investors in active management should expect periods of underperformance and need to have patience to weather the storm.

**PERCENTAGE OF MANAGERS WITH AT LEAST A SINGLE PERIOD OF 1-YEAR OUT-/UNDER-PERFORMANCE OF 10%, 2007 – 2016**

- Large Cap Value
- Large Cap Growth
- Small Cap Value
- Small Cap Growth

Source: Lipper as of December 31, 2016.
Consideration beyond stocks and bonds

EXPECTED RETURN OF A TRADITIONAL “70/30” PORTFOLIO

Data source: Robert Shiller and Standard & Poor’s, adapted from AQR. U.S. stocks expected real return calculated from 50% of the earnings yield*1.0107 plus 50% dividend yield + 1.5% to account for real earnings growth. U.S. bond yield is the government rate - FEG's 10-year inflation forecast. Please see Disclosures for full disclosure.
### Sentiment: Alternative Investments

#### Average Community Foundation Perception

<table>
<thead>
<tr>
<th>Alternatives (1)</th>
<th>Neutral (3)</th>
<th>Non-Alternatives (5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall</td>
<td>3.3</td>
<td></td>
</tr>
<tr>
<td>(&lt;) 25MM</td>
<td></td>
<td>3.7</td>
</tr>
<tr>
<td>$25 - $50MM</td>
<td></td>
<td>3.8</td>
</tr>
<tr>
<td>$51 - $100MM</td>
<td></td>
<td>3.2</td>
</tr>
<tr>
<td>$101 - $250MM</td>
<td></td>
<td>3.0</td>
</tr>
<tr>
<td>(&gt; $250MM</td>
<td></td>
<td>2.6</td>
</tr>
</tbody>
</table>

5. Ongoing Monitoring
Benchmarking is measuring the performance of a portfolio relative to an index or a stated return target.

It is important to keep a long-term perspective in mind; often, committees expect an investment manager to exceed its benchmark over a full-market cycle (typically quoted as a 5-7 year period).

Best practice to maintain performance reporting and analysis at the individual manager, asset class, and total portfolio levels.
It is also important to **holistically and individually** monitor:

- Style and correlation analysis
- Attribution
- Risk (beta, standard deviation, tracking error, etc.)
- Fees
- Liquidity

Don’t forget about your donor designated funds!
6. Integrating Donor Designated Funds
Donor designated funds – outside advisors

ALLOW DONOR DESIGNATED FUNDS MANAGED BY OUTSIDE ADVISOR

- No donor directed funds: 14%
- No: 31%
- Yes: 55%

ANTICIPATED DONOR DESIGNATED FUNDS AMOUNT IN FUTURE

- Decrease: 3%
- Stay the Same: 41%
- Increase: 56%

ALLOW DONOR DESIGNATED FUNDS MANAGED BY OUTSIDE ADVISORS

RESTRICTIONS PLACED ON DONOR DESIGNATED FUNDS

* Specific to external advisor.
Questions?
Conclusion
☐ Building a holistic investment program is important
☐ Alignment with the foundation’s long-term goals is critical
☐ Well-defined roles and responsibilities documented in a thorough investment policy statement is a key first step
☐ Various asset classes and types of investment managers provide investment opportunities
☐ Foundations can extend their investment philosophy to donor managed accounts
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The data is obtained from the proprietary FEG 2017 Community Foundation Survey. The study includes a survey of 90 U.S. Community Foundations as of April 7, 2017. The data from this survey was divided into five categories based on assets of the community foundation with assets ranging from less than $25 million to greater than $250 million. The information in this study is based on the responses provided by the participants and is meant for illustration and educational purposes only.