A Penton Media Publication
JUNE 2011
Trusts & Estates®
The Journal of Wealth Management for Estate-Planning Professionals—Since 1904

Committee Report: Investments

By Monica Issar

A Time of Change

Refining portfolio construction for endowments and foundations

A recent headline in *The Chronicle of Philanthropy* tells the story: "Recession's Hard Lessons Lead to Changes in Endowment Policies: The bulls may be back in control on Wall Street, but the painful lessons that endowment managers endured just a year ago are leading to a number of changes that affect how the funds are managed."[1]

The article goes on to cite the results of a recent survey, in which 23 organizations—roughly twice as many as a year ago—told the *Chronicle* their boards had adopted new policies regarding investments. Another 25 said they were considering new investment policies. This isn't a surprising development, given the huge losses suffered by endowments over the past few years: The top 10 university endowments lost a collective $36 billion for the fiscal year ending June 30, 2009.[2]

While (economic) pressures have eased a bit for some groups, the country's richest foundations expect their distributions to increase slightly in 2011.[3] Many more organizations, both large and small, continue to spend down, lay off staff, merge with other groups or close their doors forever.

Against this backdrop, finance committees and boards of directors continue to evaluate investment policies, weighing the need for rigorous portfolio risk management relative to their organization's ongoing financial and societal commitments. Along the way, there will be tough questions to answer—everything from "Who has investment discretion and accountability?" to "Are the right systems in place to measure total return and evaluate performance?"

Monica Issar is head of the J.P. Morgan Endowments & Foundations Group headquartered in New York

The Challenges

A 30-year-long bull market in credit, coupled with negative S&P 500 returns over the past decade, have long made it difficult for endowments and foundations to depend on normalized returns with traditional asset classes. In the current market environment—with low-for-long interest rates in the United States and lower-than-historical returns anticipated long-term for the S&P 500[4]—the 5 percent legally mandated payout ratio for private foundations and/or the comparable target distributions for other nonprofits become more aggressive hurdles. Factor in administrative costs, excise taxes and inflation, and it's clear that non-profit organizations more realistically need investment returns of at least 8 percent to 9 percent to meet their payout targets. (See "Key Investment Challenges," p. 56.)

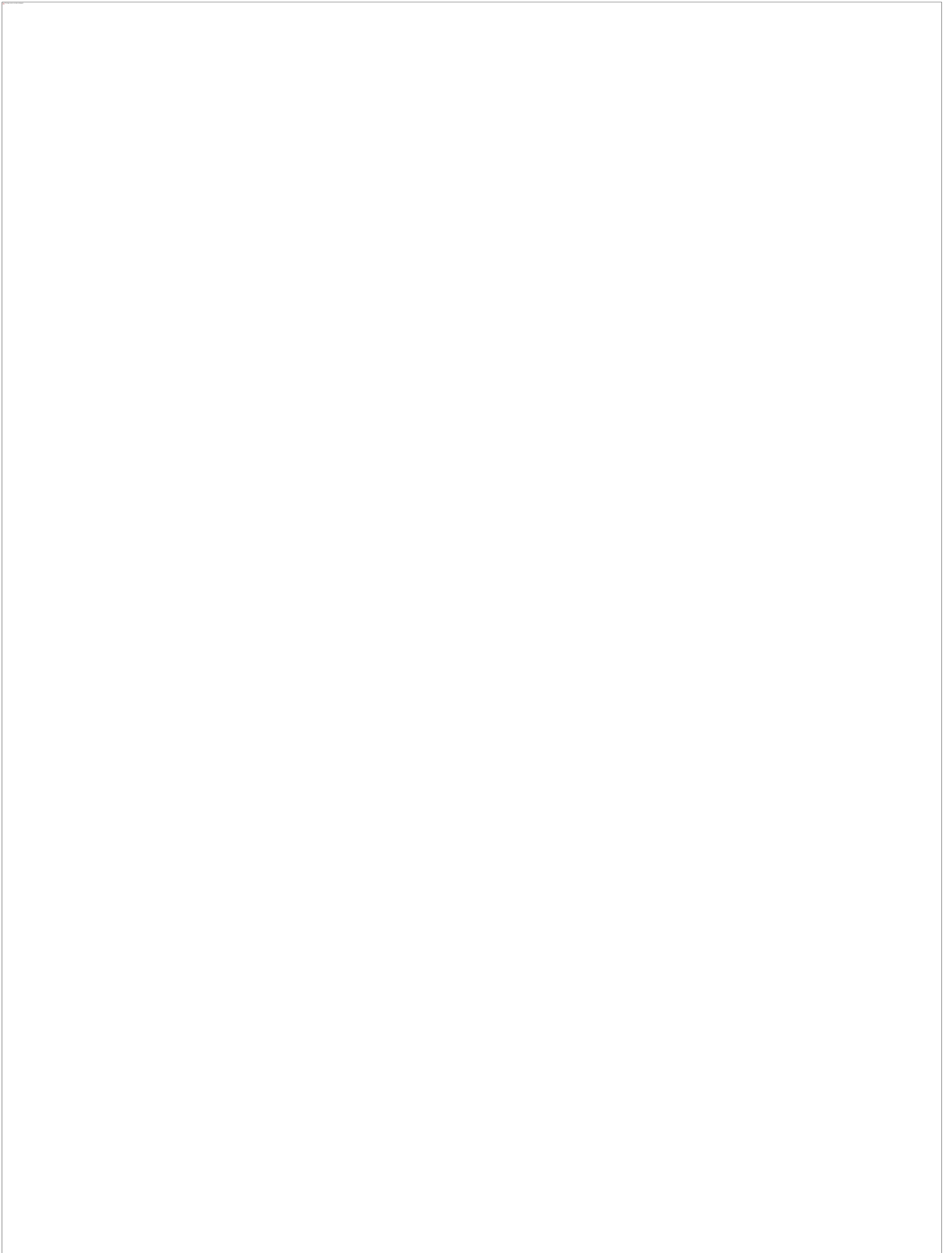
Generating consistent returns at requisite levels, therefore, requires unique portfolio construction considerations to meet the required distribution streams and administrative costs of non-profit entities.

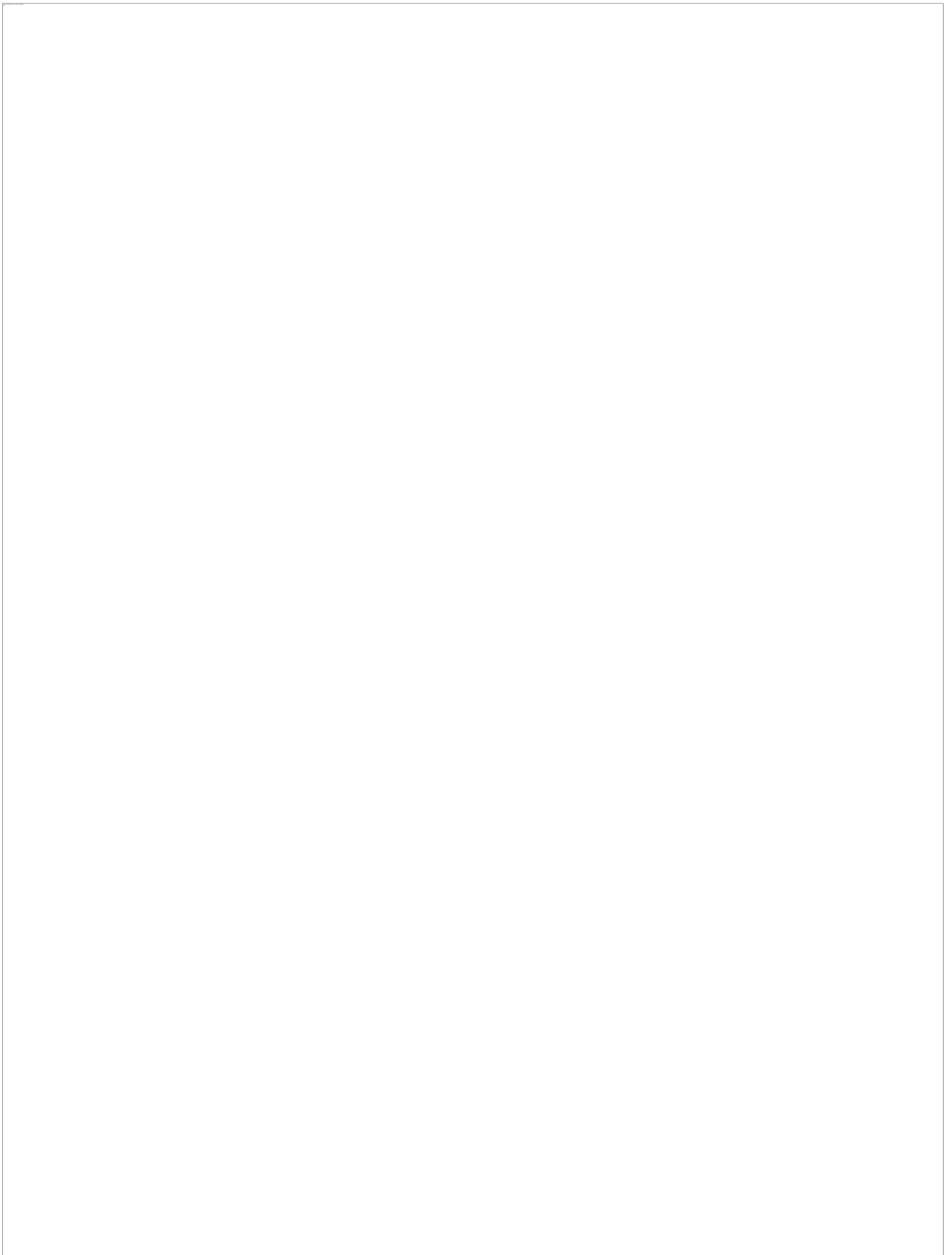
Managing Risk and Reward

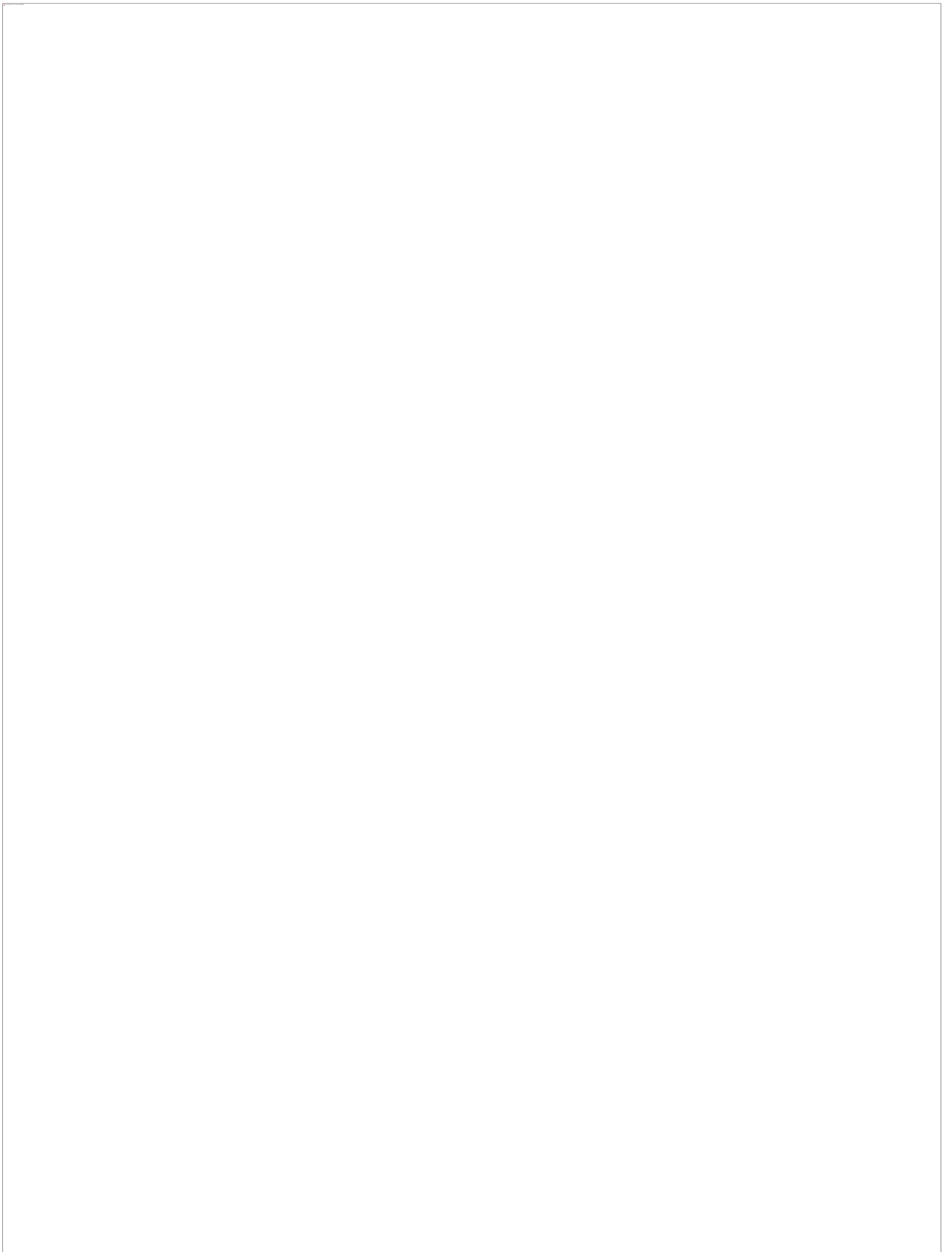
At any given moment, there's risk and opportunity in the market.

Today, we see strong corporate earnings, averaging about 10 percent this year and a relatively inexpensive stock market. Emerging markets are driving global growth, accounting for roughly half of global gross domestic product and eclipsing the growth rate of most developed nations. Meanwhile, the U.S. economy has moved from recession to recovery and, very recently and very slowly, into expansion.

At the same time, we don't know what we don't know. We didn't anticipate recent events in Pakistan or North Africa, although we could have expected higher oil prices. We had no idea Japan would experience disaster on a grand scale. As if those events weren't enough, the


This image cannot currently be displayed.




This image cannot currently be displayed.

This image cannot currently be displayed.