Foundation

Aligned investment program with mission and reduced costs through ESG beta completion portfolio

Client case study

The organization

A donor-funded foundation managing over $4 billion in assets. Its mission is to find a cure for a life-threatening disease and to improve the quality of life for individuals with the disease. As a proponent of venture philanthropy, the foundation partners with leading biotechnology and pharmaceutical companies, as well as academic medical centers, to fund groundbreaking research, clinical trials, and drug development in pursuit of its mission. Its investment program is managed by the chief investment officer (CIO), investment staff, and investment committee.

The foundation teamed up with Russell Investments to help better meet its investment objectives through a three-pronged solution, which consisted of the following phases:

1. Setting strategic direction
2. Implementing a total equity restructure and managing a custom environmental, social and governance (ESG) beta completion portfolio
3. Maintaining ongoing risk management and utilizing overlay and other bespoke strategies

This three-pronged approach helped the foundation address the multiple challenges it was facing.

The challenges

Misalignment of risk budget with market opportunities

To support a growth in assets and to help shoulder the greater fiduciary burden, the CIO had set out to expand the foundation's investment staff. The newly minted staff soon found themselves grappling with a legacy global equity portfolio, which consisted of over $2 billion in active and passive listed equity investments that had been recommended by prior consultants, but no longer fully aligned with the foundation's investment priorities. The staff understood that these investments contained concentrated risks that were unintended and hard to manage. The staff therefore committed themselves to restructuring the listed global equity portfolio in order to better align their active risk budget with market opportunities.

Restrictive asset allocations

Additionally, given increased market volatility, economic malaise, and the emergence of attractive, increasingly complex investment strategies, the CIO and staff became convinced that asset-class restrictions within their investment policy statement prevented the foundation from capitalizing on certain return-enhancing and risk-reducing opportunities. For example, the policy benchmark had a significant allocation to passive fixed income, while the foundation preferred to own larger allocations to hedge fund and absolute return strategies, which could potentially yield greater incremental returns.

Total portfolio risk management

In addition to asset-class restrictions, the foundation was concerned with drawdown risk. The staff did not have access to an effective risk-management platform and sought to better understand what risks they owned in the legacy portfolio, which risks they would likely be compensated for, and which risks would not yield any reward—at a total portfolio, and not just individual asset class, level.

Misalignment with mission

Direct ownership of companies in the tobacco industry within the foundation's portfolio presented another challenge, contradicting the foundation's health-driven mission. The foundation wanted to ensure that its investments were more aligned with its mission.

The foundation approached Russell Investments with these challenges, sparking a lively, thoughtful discussion that led to a dynamic collaboration and strategic partnership.

Phase I: Strategy

The first phase of collaboration centered on strategic direction. This was a consultative period that spanned several months and focused on defining the foundation's unique objectives and drawdown risks. After discussing many different options to restructure the global equity portfolio, we settled on a customized solution that aimed to realign the foundation's investment program with its mission as well as better measure and manage drawdown risks in its portfolio. We then moved to execute this solution in the two latter phases.

Phase II: Implementation

Custom beta completion portfolio with ESG screen

In the second phase, our dedicated, well-resourced implementation team of over 26 portfolio managers and traders helped the foundation transition over $2 billion in assets across 30 investment managers from its legacy global equity portfolio into a **custom ESG beta completion portfolio**. This portfolio intended to achieve the foundation's beta needs, or target return, while also screening out tobacco companies.

Transitioning the foundation's existing equity exposures into a custom Russell Investments-managed separate account was a carefully orchestrated process that was planned for over four months, and traded over the course of one month, requiring steady control over risk exposures and total costs throughout. We successfully transitioned the foundation's legacy assets, minimizing total trading and saving them nearly $3 million in transaction costs, compared to having the foundation's managers conduct the trading activity in isolation.

Moreover, by screening out tobacco investments, the new portfolio helped realign the foundation's investment strategy with its mission. The new platform is unique thanks to its flexibility and openness to further portfolio enhancement. The foundation can potentially increase the level of ESG integration in the portfolio through additional negative screens and positive ESG factor optimization. The foundation can also include more sophisticated physical and synthetic strategies, such as factors and derivative overlays.

The resulting custom ESG beta completion portfolio is purpose built for the foundation's mission, and well positioned to evolve as the investment staff and committee continue to realign the investment strategy with the foundation's mission and investment needs. This evolution will come as a result of Phase III work with the client.

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Phase III: Total portfolio risk management

In the final stage, we worked with the foundation to establish views of risk and exposure management at the total portfolio level, considering overall positioning from both top-down and bottom-up perspectives. These views include scenario analysis, modeling out return/risk impacts in various market conditions, and advice on how to address major exposure mismatches versus the policy benchmark. Additionally, by providing access to risk and exposure systems, Russell Investments is able to help the foundation's staff understand risk biases that its active managers have on an ongoing basis, and provide the investment tools to address these unwanted risks.

By partnering with us, the foundation was able to access our proprietary holistic risk management systems. The foundation benefited from:

- A multi-dimensional approach to total portfolio risk management, centered on aggregate outcomes
- Risk management modeling and advice as an ongoing deliverable
- Tactical decisions that are informed by risk modeling and advice, and that are available to implement with a broader set of tools and strategies coming at higher complexity and often higher fees

Ultimately, the beta completion portfolio provided the foundation with the ability to tailor a physical solution that can mitigate and manage risks more precisely than trading blunt instruments such as futures, index funds, ETFs, or even allocations between active managers. Additionally, the cost of managing a physical portfolio ended up being lower than the cost of moving capital between ETFs or index strategies.

The results

By partnering with Russell Investments, the foundation gained:

- A strategic partner that serves as a seamless extension of the foundation’s staff, aligned on the same investment objectives and overall desired outcomes
- A holistic investment policy that incorporates custom exclusions aligned with the foundation’s mission; preferred factor and risk positioning; and regular portfolio adjustments to maintain the integrity of the overall portfolio
- Input from Russell Investments on return-enhancement opportunities for the foundation
- A formal risk management partnership that affords the foundation access to proprietary risk management systems, CIO dashboards, and actionable advice
- Real-time views into what the foundation owns in its portfolio, and insights on how to intentionally position risks to increase the probabilities of meeting objectives
- An implementation platform that is purpose built to meet the foundation’s ESG mission, at lower fees than those offered by traditional asset managers

Our innovative, customized solution directly met the foundation’s objectives by aligning its global equities portfolio with its wider mission. This allowed the foundation to spend more time on the activities and programs driving its core mission.

About Russell Investments

Russell Investments is a global asset manager with a unique set of capabilities that we believe is essential to managing your total portfolio and to meeting your desired outcome. At Russell Investments, we stand with you, whether you're an institutional investor, a financial adviser, or an individual guided by an advisor's personalized advice. We believe the best way to reach your desired outcomes is with a multi-asset approach that combines: asset allocation, capital markets insights, factor exposures, manager research and portfolio implementation.

For more information

Call Russell Investments at **800-426-8506** or

visit **russellinvestments.com/nonprofit**

Important information

This case study represents a unique situation faced by a donor-funded foundation seeking to help better meet its investment objectives and address multiple challenges it faced. Case studies are problem-solving stories. We select a situation that is indicative of problems clients in this category are facing. The recommendations described do not represent a standard strategy or set of recommendations made for all advisory clients with similar issues. Each client has unique requirements, challenges, and constraints, and our advisory solutions are tailored to each client's specific needs. Every client's situation, experience and needs are different, and Russell Investments does not imply that the solution herein is appropriate for any other client.

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Please remember that all investments carry some level of risk, including the potential loss of principal invested. They do not typically grow at an even rate of return and may experience negative growth. As with any type of portfolio structuring, attempting to reduce risk and increase return could, at certain times, unintentionally reduce returns.

Diversification and strategic asset allocation do not assure profit or protect against loss in declining markets.

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