Embracing OCIO

Community foundation embraces key features of OCIO: Increased diversification and dynamic portfolio management

Client case study

The organization

A donor-funded community foundation located in the United States. The Foundation provides resources to non-profits through grant making, scholarships and impact funding for social issues in its local community such as homelessness, hunger and education. During the global financial crisis when its community needed more support than ever, the Foundation's pool of assets shrank by 30%. The net result was a renewed focus on improved management of its investment program as a critical component to sustaining the Foundation and the community.

The Foundation is managed by a president and small professional staff that oversee two main pools of capital totaling roughly $80 million. The majority of the assets are held in a long-term pool, which functions as an endowment supporting the financial needs of the overall organization.

Challenges

The Foundation originally consisted of a single asset pool, commingling dollars intended to be spent over the near to intermediate term, as well as dollars intended to support the endowment in perpetuity. These differing investment horizons created a conflict where assets earmarked for pending projects in the community ended up exposed to higher investment and illiquidity risk than necessary, whereas the true endowment assets couldn't undertake as much risk as desired to grow the corpus over time.

As with many non-profit organizations, the Foundation employed a consultant-based model to support its quarterly governance meetings. While this traditional approach delivered strategic advice, capital markets information, manager insights, and reporting to the Foundation each quarter, it also effectively limited its ability to:

- Implement decisions in a timely manner (e.g., efficiently hiring or firing managers)
- Make opportunistic investment shifts between quarterly meetings

Additionally, the Foundation's high spending policy was jeopardizing its ability to provide funding for the community over the long term. A highly aggressive rate of return on investments would have been needed to sustain the Foundation's assets in perpetuity, which would be in keeping with its stated mission. As the forecasted level of future market returns had declined in recent years, the Foundation felt at risk of eroding the endowment, and thus jeopardizing the fulfillment of its mission in the community for the next generation.

An OCIO solution

After an in-depth investment analysis and consideration of options, Russell Investments recommended a customized, multi-asset, outsourced chief investment officer (OCIO) solution for the Foundation, which was designed to help it best achieve its philanthropic goals.

Multiple objectives to manage

Return generation

Enable a more dynamic investment approach that allows the Foundation to capitalize on market opportunities while ensuring robust governance and oversight

Diversification

Explore a wider range of asset classes and alternative strategies for potential sources of return and diversification in the portfolio

Risk management

Ability to withstand short and intermediate term variability; maintain upside potential while limiting downside risk

Modify spending expectation

Improve the probability of meeting community funding needs now and into the future

The investment process and solution

The Russell Investments team met with the president, staff, board, and investment committee members to understand their objectives, governance preferences, and collective view of investment risk. After an in-depth investment analysis and consideration of options, Russell Investments recommended a customized, multi-asset, outsourced chief investment officer (OCIO) solution for the Foundation, which was designed to help it best achieve its philanthropic goals.

Aligning the portfolio with core objectives

Spending policy realignment

Russell Investments collaborated with the Foundation to examine its historical spending pattern and reasonable return expectations given its risk tolerance. Based on the results of that exercise, we determined that the Foundation's investment returns were insufficient to keep pace with its current spending rate. The Foundation was faced with a difficult decision as it became apparent that it could not sustain its current level of spending without eventually eroding its core endowment. Thus, the Foundation's fiduciaries elected to reduce the spending rate to help achieve one of their primary goals – to preserve their mission and continue to serve the community for many generations to come.

Portfolio realignment

With this new spending requirement in mind, Russell Investments recommended that the Foundation realign its investment strategy and improve the broad design of its investment pools. The recommendation included splitting the main asset pool into two different portfolios with different investment horizons: 30+ years for the long-term pool, and five to 10 years for the balanced pool. The balanced pool is 100% liquid and is designed to support the Foundation's intermediate term spending needs and to help its donors achieve their philanthropic goals, whereas the long-term pool is designed to maintain spending power and fund the endowed assets in perpetuity. The objective was to incorporate the right mix of assets to generate the required level of return (after inflation) while concurrently improving diversification and risk management of the underlying investments, and providing a long-term growth option for donors.

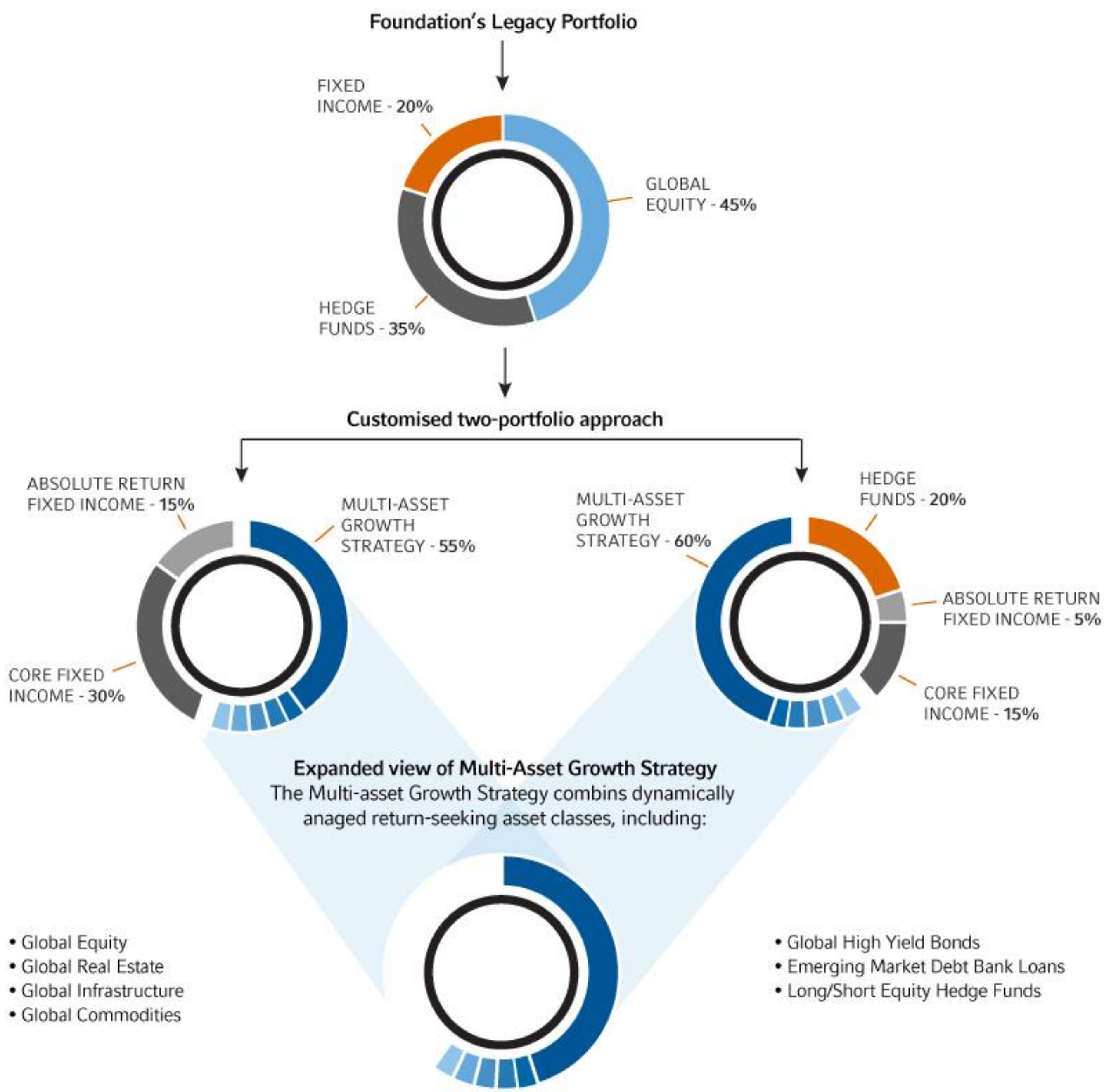
The existing asset pool consisted of stocks and bonds plus a sizable allocation to alternatives. Russell Investments determined that the portfolio could be better optimized by:

- Shrinking the overall allocation to less liquid strategies
- Increasing the breadth of liquid strategies
- Incorporating a more dynamic, multi-asset strategy to improve diversification and risk profile

Reallocating the assets in this manner helped bring the investment strategy in line with the investment committee's risk tolerance while positioning the portfolio to support the Foundation's spending requirements.

The charts in Figure 1 compare the Foundation's legacy portfolio (as it existed under its previous consultant) with the new, customized two-portfolio approach implemented as part of Russell Investments' OCIO implementation.

Figure 1: Legacy and customized two portfolio approach comparison



Source: For the specific asset allocation of the Multi-asset Growth Strategy at the time of the analysis, please refer to endnote 1.

Dynamically managed: Multi-asset approach

This new multi-asset approach is designed to allow the Foundation to capture return opportunities through a dynamically managed, diverse mix of equities, fixed income, and alternative strategies. Importantly, this strategy also incorporated inexpensive passive strategies to keep costs down. This new approach also positioned the Foundation for improved risk management as compared to its previous approach of reviewing and picking individual managers on a quarterly basis. Having Russell Investments manage the real-time implementation decisions allowed the board and investment committee to focus their efforts on higher level, strategic decisions.

By moving the portfolio from a combination of multiple asset classes (legacy portfolio) to a dynamically managed multi-asset portfolio (long-term and balanced pools), Russell Investments created several key benefits for the Foundation:

	**Return generation strategies**	**Dynamic asset allocation**	Moving away from a static asset allocation that primarily seeks to outperform a benchmark to a dynamic asset allocation that allows the Foundation to take advantage of market opportunities
		Wider array of asset strategies	Highly targeted approach of combining active and passive strategies to achieve higher diversification and access to different asset classes across a broader opportunity set
	**Risk management strategies**	**Total portfolio risk management**	Real-time risk management implemented in the portfolio can be particularly valuable in volatile and increasingly complex markets
		Shorter time to implementation	Allowing Russell Investments the discretion to implement tactical shifts within and across asset classes allowed the Foundation to capitalize on short-term shifts in the market

A key value-add for the Foundation was Russell Investments' ability to monitor and evaluate discrete portfolio positions in real time and adjust specific strategies as warranted by changing market dynamics.

A different approach

By working with Russell Investments, the Foundation gained a true co-fiduciary partner that understood its goals and built a durable and robust investment solution. This approach enabled the board and investment committee to focus their time on long-term strategic decisions and monitor the investment decisions that Russell Investments makes on their behalf.

Operating as an extension of the Foundation's team, Russell Investments aligned the investment design of the balanced pool with the intentions of donors seeking returns to fund their important work over the next five to 10 years, and also positioned the long-term pool to maintain the endowment in perpetuity.

Conclusions and client experience

Working together with the staff, board and investment committee, Russell Investments served as a strategic provider enabling the Foundation to benefit from:

- Greater diversification and breadth of investment strategies in the long-term pool, which helped improve its annualized return assumptions to 8.4% with volatility assumptions of 10.5%, versus 8.0% return assumptions and volatility assumptions of 10.0%; the newly created balanced pool, which was designed to be less risky and more liquid, had a return assumption of 9.1%.[1]
- A revised spending rate that, when combined with the new return assumptions, is structured to allow the Foundation to maintain its corpus into perpetuity.
- A dynamic portfolio management structure positioned to take advantage of short-term market shifts for both improved return potential and better management of downside risk between quarterly investment committee meetings.

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 **866-739-7979** or visit **russellinvestments.com/nonprofit**

Important information

[1] Please note that the analysis shown is based upon the Russell Investments 20-Year Capital Market Assumptions as of 12/31/2014 and the asset sector allocations reflected in the previous page 3. Forecasting represents predictions of market prices and/or volume patterns utilizing varying analytical data. There is no guarantee that the stated results will occur. More information about the Capital Market Assumptions and sector allocations used for the multi-asset growth strategy are available upon request.

Nothing contained in this material is intended to constitute legal, tax, securities or investment advice, nor an opinion regarding the appropriateness of any investment, nor a solicitation of any type. The general information contained in this publication should not be acted on without obtaining specific legal, tax and investment advice from a licensed professional.

Case study provided for discussion purposes only. Individual client results will vary based on individual circumstances and market events. There is no guarantee that all clients will experience the same positive results. The information expressed herein represents the current, good faith views of the author(s) at the time of original publication, and has not been updated. Any predictions, opinions, and other information contained in this material are subject to change continually, without notice.

Please remember that all investments carry some level of risk, including the potential loss of principal invested. Although steps can be taken to help reduce risk, it cannot be completely removed. Investments typically do not 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 does not ensure a profit and does not protect against loss in declining markets.

Russell Investments' ownership is composed of a majority stake held by funds managed by TA Associates with minority stakes held by funds managed by Reverence Capital Partners and Russell Investments' management.

First used: May 2017. Revised: July 2020 AI-28336-07-23