TIFF Roundtable Discussion

The Ongoing Search for Alpha in a Low Return World

Detroit – Summer 2018

After nine years of double-digit returns in most equity markets around the globe, can non-profit organizations achieve their investment goals in a low return environment? How might rising interest rates and inflation concerns be incorporated into portfolio positioning? Where are the most interesting investment opportunities? What are the most concerning risks in global capital markets today? Laura Kirkpatrick, Outreach Director at TIFF, moderated a panel exploring these and other topics during a regional roundtable at the Detroit Athletic Club on June 20th.

- Erik Lundberg (panelist): CIO, University of Michigan
- Robert Manilla (panelist): VP and CIO, The Kresge Foundation
- Dick Flannery (panelist): CEO, TIFF
- Laura Kirkpatrick, CFA (moderator): Outreach Director, TIFF

Highlights from the Roundtable Discussion

Spending

The panel agreed that approximately 5% is still the prevailing spending rate among most non-profit organizations. Private foundations must spend 5% each year for charitable purposes to avoid paying excise taxes, while endowments and other charities often have more flexibility. Assuming inflation of 2%, most non-profits seek an annual after-fees return of 7%. Many, however, were not able to achieve a real rate of return of 5% over the last decade, primarily as a result of the Global Financial Crisis (GFC) and actions taken by central banks to mitigate the damaging effects of the GFC and to provide support for weakening economies. Looking forward, our panel doubts that non-profits will be able to rely on above-average public equity market returns to achieve their return objectives.

Given this view, our panelists had several comments and suggestions on portfolio construction. First, non-profits should embrace the advantage of a permanent life capital structure, i.e., maintain a long-term investment horizon and incorporate active management for downturn protection. Second, certain non-profits might consider reducing spending and/or being more disciplined in spending. Next, our panelists suggested that non-profits utilize an investment opportunity set that extends across traditional asset classes and includes alternatives. They did not recommend adding leverage to portfolios. Finally, noting that sourcing and evaluating managers requires expertise and is resource-intensive, our panelists believe that there are still talented active managers in the marketplace consistently delivering solid returns in excess of their benchmarks, and exposure to this type of manager enhances their ability to meet their real return objectives over the longer term.

Portfolio Risk

Our panel considered several aspects of portfolio risk: how to define risk, how to manage risk and what risk(s) were capturing their attention in the current environment.

As mission-driven organizations, the risk of not being able to offer grants/ to contribute to operating budgets is top-of-mind for our panelists and their trustees. If portfolio results are substandard, is the organization still effective? It is with an eye (not only toward preservation of capital but) to faithful execution of organizational mission that our panelists consider investment and portfolio risks.

Their investment policy statements provide structure for analyzing and accepting portfolio risk. Our panelists try not to be distracted by upsetting headlines or what they referred to as “noise” in the markets, but to remain focused on long-term fundamentals. Portfolios must accept a degree of risk to meet return goals, but it is critical to determine if the organization will be adequately compensated for any given risk. As well-resourced, experienced investors, our panelists are willing to accept liquidity, volatility, asset class, country/currency and other risks when they find the trade-off beneficial.

When asked what factor(s), e.g., economic growth, Fed policy, inflation, global trade tensions, terrorism, etc., were of most concern at present, our panelists agreed that inflation was what they worried most about as it erodes purchasing power. To minimize inflation risk, one of our panelists maintains a 65/35% balanced portfolio and implements inflation hedges through absolute return strategies, cash and Treasuries. Another panelist relies on real estate, commodities, and natural resources exposures to protect in periods of higher inflation.

Investment Opportunities

China was discussed at some length. Our panelists have significant portfolio exposure to China via public and private investments and, while differing somewhat on how to best access opportunities in China, they agreed that there are compelling opportunities. India was also described as an area of current research focus.

While certain segments of the global capital markets are richly priced, private equity including venture capital remains a key component to achieving real return targets over the next decade. Other opportunity sets discussed included: healthcare, co-investing, private finance and impact investing.

Part of TIFF’s mission is to promote within the non-profit community an understanding of investment management. Our events are offered with this goal in mind and in this spirit. Our Investment and Outreach teams are always available to speak with our members about TIFF’s approach to capturing alpha. We are grateful to Erik Lundberg and Robert Manilla for sharing their own views at this roundtable.

About TIFF

TIFF is a mission-driven, not-for-profit organization dedicated to delivering comprehensive investment solutions to foundations, endowments, and other charitable institutions. Since its inception in 1991, TIFF has exclusively served the non-profit community by providing experienced manager selection and access, risk-sensitive asset allocation, and integrated member service to institutions with long-term investment horizons.
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