THE INVESTMENT FUND FOR FOUNDATIONS

pursuing investment excellence on behalf of endowed non-profits

From the office of Laurence H. Lebowitz, President and Chief Investment Officer

July 2013

Dear TIFF Members and Friends,

My job is much easier when the TIFF team that surrounds me works in unison to plan well and then to execute those plans crisply. This letter, I am pleased to say, results from many individual parts at TIFF – including our underlying managers – working smoothly to produce what I believe was a notably strong first half of the year for our organization. However, we continue to challenge ourselves on ways to improve our investment process. Along those lines: further additions to our investment team are in the pipeline; modest adjustments to our vehicles' manager rosters and risk profiles are being implemented; and we remain focused on new avenues of research aimed at finding additional value and stronger defenses against inevitable market slumps.

PERFORMANCE HIGHLIGHTS

As always, members can find specific investment performance of TIFF's various vehicles in their respective quarterly reports.

Core Endowment Strategies

From the data we have as I write this midyear message, the investments comprising TIFF's Core Endowment Strategies (our so-called "Outsourced CIO" or "OCIO" solutions) appear to have generated quite good returns in the first half of 2013, building on solid performance in calendar year 2012. Many large university endowments operate on a June 30 fiscal year and will therefore be reporting their full-year results over the coming months. We look forward to seeing how our OCIO program stacks up against our big brothers and sisters.

Our current data suggest that returns for our core strategies for the 1H 2013 and FY June 2013 periods will compare favorably to a 65/35 mix of stocks and bonds (consisting of 65% MSCI All Country World Index and 35% Barclays US Aggregate Bond Index) and very favorably to the Constructed Index (CI), the policy portfolio for our core program. The CI is described in detail in our quarterly reports (and on TIFF's website). We retained double-digit allocations to cash in the first half, representing both a defensive pillar and dry powder as we search for attractively priced opportunities.

The magnitude of the first half's outperformance versus the CI raises an interesting question: is our performance inherently strong or are our CI allocations inherently weak? Put another way, did we exhibit some form of skill in this admittedly brief period or were we merely chasing a slow rabbit – or a bit of both? We have looked carefully at attribution for our core program and the CI. What we see so far indicates that, in the first half of 2013, external manager selection (and, by extension, our external managers' general skill at security selection) was a significant contributor to our performance . Our skill at allocating capital was also a positive contributor but on a smaller scale. In short, we believe we are allocating capital reasonably well, for now, and that our underlying managers, on the whole, are demonstrating skill in the realm of security selection. The challenge is to keep up this short-term record across a majority of market cycles. As for the "slow rabbit" question, the CI's allocations to commodities and inflation-linked bonds detracted meaningfully from performance in the first half of 2013. We tilted away from those segments during the period.

Members will recall that we adjusted the CI in April, primarily adding a TIPS Breakeven Inflation segment (essentially a hedged position in inflation-linked bonds). So far, that position has been modestly helpful, but we won't know the hedge's ultimate effectiveness for quite a while. We continue to evaluate the CI and will implement further adjustments as changes in markets and investing strategies dictate. In the meantime, we have the freedom to alter our tactical tilts and won't hesitate to do so. Indeed, we lowered risk modestly in our core program as equity markets rallied in the first half of 2013 – prior to the May-June equity sell-off.

Finally, as you know, an important investment theory – sometimes referred to as the "Illiquidity Premium" – posits that over the long term, strategies with larger allocations to less liquid strategies (like hedge funds and private equity) ought to outperform strategies that are highly liquid. At TIFF, we believe that the theory of Illiquidity Premium is real and therefore ought to be taken advantage of when possible. It is one of the factors we weigh carefully as we shape our strategies.

Hedge Fund Program

After a significant reconfiguration of the portfolio at year-end 2012, our hedge fund program recorded what I view as very solid returns for the first half of 2013. To date, the changes we made have been additive to performance. We remain optimistic about the opportunity set for hedge fund strategies, and we are examining ways to extend our program's diversification. New share classes were rolled out July 1; we believe they offer greater flexibility to members and will allow us to manage the portfolio more effectively. We've been pleased with a pickup in interest in the program and in subscriptions, although we expect some outflows at year-end.

Private Investments

As we've noted in the past, TIFF's PI vehicles are hard to measure over short time periods. Members invested in our PI program will soon receive our hefty PI annual review (the most comprehensive of our quarterly reports), which details performance and other metrics for each of our PI private partnerships and provides commentary on the state of each fund. Cash distributions for all TIFF PI funds during the first half of 2013 totaled $100 million, right on pace with 2012, when $200 million was distributed for the full year (the largest annual amount since 2006). In our view, having a stable of skillful and disciplined private equity managers who focus on adding value to mid-sized and smaller companies remains a very reasonable approach to our goal of outperforming public equities over long time periods. While we believe a large majority of TIFF's manager relationships in the private investing arena remain appealingly strong, we are working hard to research new teams and probe for potential value in the secondary marketplace. For the time being, secondaries feel generally overpriced to us, although we source potential offerings on an ongoing basis.

About Our Investment Team

We continue to build out our investment team. Two additional analysts have just joined us, and we recently reconfigured our now-bustling Cambridge office to accommodate more people. In my last note, I mentioned the possibility of further investment team hiring. While that process is on track and may result in an addition or two, we are close to reaching an optimal staffing complement for the tasks we face in the immediate future. Fully integrating the team and supplying it with the tools necessary for an efficient investment process remains a high priority.

Market Environment

My permanent list of "issues that keep me awake at night" – now a fixture in these letters – has not really gotten shorter, unfortunately. While some items that had been flashing red may now be only flashing yellow, two issues may rise above the rest, and each has the potential for significant market disruption. The first is the bond market and the second is China. The reasons are obvious, so rather than dwell on them, I will simply convey how we frame the critical questions. As we have been anticipating for some time, the Fed is more explicitly telegraphing its intention to cut its quantitative easing program and allow rates to rise gradually. Long rates already have reacted to a somewhat meandering set of Fed statements. The larger question is: as interest rate shifts play out, what will the impact be on equity markets? We can only guess at the answer, so we remain keen observers of bond market movements and the attendant impact on stocks. Some markets merit particular attention. For example, Prime Minister Abe's extensive reflation program in Japan also bears careful attention, particularly given our allocations to Japanese equities.

The story in China has changed since my last message. The world's second-largest economy now seems more fragile. The country's leadership is attempting to manage multiple pressure points and pursue reforms in a fast-evolving situation. How that leadership handles China's major challenges will have a serious impact on the economies of its trading partners and neighbors, many of them emerging economies. Indeed, emerging markets generally have already suffered meaningful losses amid Chinese credit and banking worries, and EM valuations are approaching levels that might make EM equities attractive. We are playing close attention.

Closing Thoughts

By now, I hope members are becoming accustomed to more frequent and clear communications from TIFF's investment team: the semiannual conference calls we've scheduled for each of our major investment programs and vehicles, our regional roundtables, the refreshed Quarterly Reports we launched earlier this year, and the reconfigured annual TIFF Investment Forum, during which we offer opportunities to better understand TIFF's strategies and our approach to investing. I am keenly aware that, from a performance standpoint, the first half of 2013 will be a tough act to follow. Our strategies will experience periods of stress and, despite our best efforts, underperformance. However, I remain optimistic. In my view, TIFF's ability to manage capital with the care and intelligence our member organizations deserve – already excellent when I arrived nearly three years ago – has grown steadily stronger since. We are dedicated to continuing to find ways to improve.

I know important work lies ahead, and all of us at TIFF remain grateful for your continuing trust. I look forward to commenting on our latest efforts at the October 23 TIFF Investment Forum in Boston and hope to reconnect there with many of you in person.

Yours sincerely,

Laurence H. Lebowitz
President and Chief Investment Officer