The Colony Group

PERSPECTIVES
Institutional Series

PART I: STRATEGY AND TACTICS FOR ENDOWMENTS' AND FOUNDATIONS' ANNUAL DRAW

In what way(s) do endowments and foundations think about their annual draw differently?

Pier Friend: Endowments and foundations will have different approaches to how they think about their annual draw. Private foundations ((501(c)(3) organizations), are required by the IRS to spend 5% of their average net investment assets each year. Endowments do not have the same restriction.

Why is liquidity important for institutions?

PF: Every institution should have a liquid reserve equivalent to 12-24 months of operational expenses that can be accessed at any time without concern for market volatility. One consideration is the regularity of an organization's cash needs. Is it monthly in equal amounts or irregular in timing and size? This can impact short-term tactics in an investment portfolio but does not negate the imperative strategy to have assets available in safe and liquid investments such as cash and U.S. Treasuries. Additionally, the available yield can help immunize immediate cash needs without the risk of timing, access, or safety.

How do institutions calculate and plan for their annual draw?

PF: The IRS 5% rule states a foundation must draw an average of 5% of its net investment assets per year. Unfortunately, calculating a 5% draw using a one-year parameter subjects an institution to the volatility of financial markets. This can result in a poor outcome for grant making and expense control during difficult markets. To alleviate this issue, an institution can choose how to measure the 5% threshold. Two common methods are 1) calculating the net investment assets over a trailing 3-year (12 quarters) period or 2) over a 5-year (20 quarters) period. The benefit of the 5-year calculation is that the longer time horizon will smooth out extreme financial market volatility and allow for a more predictable budgeting and grant-making process.

What processes should institutions and their committees/boards have in place to ensure their investments can support the institution's long-term mission?

PF: A regular review of the institution's investment portfolio is critical to prudent planning. A committee should be appointed to review annually (at a minimum), and up to quarterly depending on the size and nature of the underlying investments. Several basic guidelines to follow include:

- The portfolio should generate, over a full market cycle, a net return that meets or exceeds the annual draw over that same period.
- The portfolio should have sufficient liquidity so that the annual draw is available from securities that are liquid and safe, and that long-term investments will not be sold in market weakness.
- An understanding of the primary risks in the portfolio, especially as it relates to leverage, concentration, and the permanent loss of capital.

For more on this important topic, stay tuned for Part II of *Strategy and Tactics for Endowments' and Foundations' Annual Draw.*

PIER FRIEND

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As the Chief Investment Officer of Colony's Institutional Advisory Practices, Pier is responsible for all aspects of the investment process — from manager research to portfolio construction, asset allocation, and client communication. He also supports the needs of our institutional and ultra-high net worth clients.

Pier served as Chief Investment Officer at New Providence Asset Management prior to their merger with The Colony Group in 2021. Previously, Pier spent ten years at Goldman Sachs Asset Management where his responsibilities included Head of the U.S. Core Equity business. He began his career in Japan teaching English as a second language, then returned to NYC where he worked for Nihon Keizai Shimbun before joining Gabriel Capital Group as a research analyst responsible for risk arbitrage and long-short investments for a $1 billion hedge fund. Pier has served on the Advisory Council for the Headmaster of St. Andrew's School.

Pier earned his Master in Business Administration from the New York University Leonard N. Stern School of Business, and his Bachelor of Science from Williams College.

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