Fiducient Advisors, Nonprofit Investment Stewards Podcast
Episode 30, October 27, 2021

One Year Anniversary Special

[00:00:00] Welcome to Non-profit Investment Stewards with Bob DiMeo and Devon Francis from Fiducient Advisors. Bob and Devon are passionate about helping nonprofit organizations prosper. Whether you oversee endowment, foundation or retirement plan investments, this podcast exists to help stewards improve performance, reduce costs and discover strategies that enable your charitable organization to prosper and advance its mission.

[00:00:26] Now onto the show. Hello and welcome back to the Nonprofit Investment Stewards podcast. I'm Bob DiMeo, always great to be joined by co-host Devon Francis. Now Devon and I started this show about a year ago. So, this is actually our anniversary special episode, where we're not only going to highlight some of the best content and really some of the most downloaded shows over the past year or so.

[00:00:51] But we're also going to conclude today with tips for investment committee members and even other nonprofit stakeholders on [00:01:00] five things we believe you ought to be thinking about if you oversee an endowment or a foundation portfolio. Before all of that, I simply want to take a moment to thank Devon for being an absolutely terrific business partner and extremely talented investment advisor and just a terrific person.

[00:01:17] So Devon, thanks for all you do. And for somehow saying yes to me and finding the time to squeeze in being co-host of the show, it's just been great working with you. Of course, happy to do it. And I'm honored to have been asked and it's been a thrilling experience for me. So, thank you, Bob. Absolutely. Well, what we're going to do.

[00:01:39] And as I think about it, you shouldn't pick favorite children, you know, maybe we should call these highlight episodes, Devon, because we really did, if you think about it, have so many terrific guests. Some of the episodes were a little bit more targeted and specific and some really had sort of a general broad interest, but we'll touch on a half dozen [00:02:00] different episodes and really try to bring out what you or I thought were really interesting points and very helpful for the non-profit investment stewards that listened to this show.

[00:02:09] So, why don't we kick things off with one of your favorite highlights? Sure. The first thing that spring to mind as I was trying to think about the most meaningful episodes is actually a pretty recent episode we had with Brad Long, our director of public markets.

[00:02:26] So this episode took place in August of 2021. And it was titled Endowment Investment Considerations for Today's Market. And one of the things that I thought was so great about this episode is it just provided a lot of fundamental analysis of how non-profit investment stewards should go about constructing their portfolio.

[00:02:47] Thinking about the markets, thinking about the opportunity set. One of the things that I think is so great about Brad is that he constructs these really interesting analogies. [00:03:00] And when we were talking about diversification and the importance of diversification in a portfolio, he gave us the analogy of if before you were born, you were going to come into this world, you could roll the dice and you'd have the chance of perhaps becoming a billionaire or perhaps languishing and squalor, or ending up somewhere in between.

[00:03:24] So really all the broad spectrum of options is open to you. Or if you could have a guarantee to end up somewhere in the middle. So, give up the billionaire scenario, but you'd also eliminate the possibility of ending up in poverty. And he was saying that most folks would certainly choose the, uh, the more guaranteed approach of, you know, you'd have a reasonably comfortable lifestyle.

[00:03:51] And I thought that was such an important analogy when it comes to diversification, because as fiduciaries, as [00:04:00] stewards of these investment assets, it's really necessary for investment committees to take that prudent path. They can't gamble with a nonprofit organization's assets. And there may be points in time where diversification doesn't add much value.

[00:04:17] We recently went through a period of time where that was the case where if you had just been invested in a couple of core asset classes, you would have done better than having a broadly diversified portfolio, but in the long run, the importance of diversification cannot be overstated.

[00:04:35] So that was one of the interesting takeaways from Brad's episode I thought. Another thing that we talked about with Brad was active versus passive. And we actually started by saying that it's not either/or. It shouldn't really be framed as active versus passive. It should be "and." Active and passive. And we talked a little bit about the Fiducient approach and how we believe in [00:05:00] active management in some areas of the market.

[00:05:02] And we prefer passive in other areas of the market. One of the things that I thought was really interesting statistic that Brad quoted was that about 85% of active managers spend at least one three-year-period in the bottom half of the peer group. And what he said was if you're going to be an active investor and have active management in your portfolio, you need to be patient.

[00:05:29] You need to understand a manager's investment process. You need to understand that they will likely have periods of underperformance, but if you are able to stick it out in the long run, you should experience alpha above the benchmark. And what Brad said was, if you can't be patient, be passive. And I think that was really great, very straightforward advice.

[00:05:53] That a lot of clients probably need to hear. You know, you have that [00:06:00] reactionary behavior where folks want to sell the weak performer and choose a new strategy that has strong recent performance, but we all know about the cyclicality of investing and taking that reactionary approach.

[00:06:14] In the long run, we'll really have detrimental effects on the portfolio. So yeah, I thought that Brad's episode had a lot of really meaningful content, some good fundamental advice for our listeners. I completely agree. And for our listeners, that episode was episode 26 with Brad Long, and you're welcome to access that and everything we talk about today at Fiducientadvisors.com or Fiducient.com. Either one.

[00:06:39] So I'll jump in. And one of my favorites, Devon, was actually when you were not the host, but the guest on the show, and you talked about effective spending policies for nonprofit organizations. And I liked so many of your relevant points. You talked, I guess I almost thought of it as sleeves if you will, of, of [00:07:00] circumstances.

[00:07:00] And the first was a bit about pandemic impacted institutions, such as a museum where maybe attendance is off. And what might that mean in terms of either reviewing or potentially even modifying the spending policy, given the different inflows and such that an organization might be experiencing. You then talked about, I'm going to call it evolving or transitioning institutions.

[00:07:28] Like a religious order that might have a declining number of members. And how do you think about spending in today's environment? How might you look at that on a go forward basis, particularly as demographics and such shift? And then you certainly spend time on core, or maybe what we'll call traditional circumstances.

[00:07:48] And, we think of these as the in-perpetuity organizations that are really trying to advance their mission and do more good. And then just how can, and, and should [00:08:00] those organizations think about their spending. And frankly, this will dovetail nicely into what we talk about a little bit later, lower return expectations, but I really liked what you laid out there in terms of considerations.

[00:08:13] And then, you also provided very good, very practical guidance and talked about attempting to guard against the perfect storm. And maybe before jumping to the perfect storm, it is worth noting for our listeners that despite the pandemic, many non-profits have actually seen contributions grow. And quite frankly, their endowments and foundations grow quite a bit. But history really has provided many, many examples of double or I dunno, maybe even a triple whammy.

[00:08:45] And that's when sometimes you see the markets go down and yes, that still happens or will happen. And perhaps contributions and donations go down at the same time. And sometimes, even expenses go up at the same time. [00:09:00] And I just really liked the way you laid that out. And I know you also wrote a terrific blog post that appears on our website, really drilling down with more insights on the spending and how investment committee members and stewards might think about it.

[00:09:15] So I liked that a lot. Devon, I'm wondering if there's anything you'd add as long as I have you here. Well, thank you for choosing that episode, Bob. I am a very flattered, um, you know, spending is really one of the most important topics that a nonprofit organization needs to tackle. It's one of the three levers, inflows outflows, and then the target return.

[00:09:35] And it's really important to have that balance between, balance between those three things so that you know the organization can achieve that intergenerational equity, which really is the ultimate goal, preserving the purchasing power over time. So, yeah, I thought that that was probably a worthwhile episode for organizations that kind of [00:10:00] want to get the lay of the land and learn the fundamentals with regard to spending policy.

[00:10:04] I also talked about my two daughters' spending habits in that episode. And I said that my older daughter was a spender. She just, you know, a dollar bill crosses her palm and it's gone the next minute and I'm happy to report.

[00:10:19] She has adjusted those practices and she now requests that her $10 allowance be given to her in two $5 bills and she saves one and she spends one. So, she's going for that intergenerational equity now as well. I love it. Maybe it was the power of the podcast. That's terrific. So that, for our listeners, that was episode number 14. And up next, Devon, what's on your list?

[00:10:44] Okay. I really enjoyed our episode with Dennis Morrone, who is the non-for-profit and higher-ed practice leader with Grant Thornton. That episode was titled How Nonprofit Leaders Can Overcome Today's Challenges. And I thought it was [00:11:00] really interesting. We talked about the COVID landscape.

[00:11:02] We talked about the, the tone of the nonprofit community and how different types of organizations have been impacted differently by the COVID pandemic. But one of the things that I thought was most interesting in his episode was his focus on governance and his advice that nonprofits should flex and evolve their policies.

[00:11:27] They need to keep pace with the changing landscape. They need to be able to morph to change with the time, make sure that their boards are reflective of the constituents of their mission and really be introspective and think about the required skill sets for future board members. So, to really acknowledge that some of the things that they've looked for, or some of the things that they've focused on in the past may not be what is most critical going forward.

[00:11:56] So I thought that was very helpful. Another thing that Dennis spent a lot of [00:12:00] time talking about was enterprise risk management and thinking about risk from a variety of different perspectives. So, financial risk, operational, strategic risk, compliance risk, reputational risk, investment risk, all of those different things need to be taken into account.

[00:12:18] And he spent a fair amount of time talking about scenario planning. And not just standard financial budgeting or general risk assessment, but kind of an if-then approach. If this happens, how are we going to tackle it? If that happens, or this, uh, if this particular thing comes to fruition, how will we pivot and be able to overcome that challenge?

[00:12:45] So I thought that was very practical and useful guidance for nonprofit organizations. I completely agree. That was great. And that was episode number 18. And I'll jump in with one here that sounds [00:13:00] like it might be meant for a more narrow audience, but really our guest was terrific. And I think really his, his input and wisdom had brought application.

[00:13:11] And that was Russ Gronewold, who talked about effective strategies for health care systems. And again, it seems narrow, but so many of our listeners really appreciate it. Russ touched on managing both short and long-term portfolios, which hospitals need to do, but so do many others. And he touched on endowment management.

[00:13:31] Pension fund management, including liability-driven investing, defined contribution plan investing, and really there was something for everyone in the episode. And then it's interesting, he also talked about incorporating enterprise risk into the investment strategy and how that just isn't done often enough.

[00:13:53] And I also liked the way, well, we'll talk about this a little bit later, and we'll talk about again that lower, likely [00:14:00] lower future return expectations. Russ talked about alternative investments and how they've grown in their portfolio as it's increased in size. And as the committee has grown more comfortable, and then he made some terrific points about assembling a good investment committee and best practices.

[00:14:19] So, really enjoyed that. And that was episode number 13. Yes. I thought Russ's episode was excellent as well. The last episode that I wanted to talk about was Bob, you and I spoke about 10 habits of effective investment committees. This was in April of 2021. It's episode number 17. And we provided several examples of things that investment committees should do, tend to be exact.

[00:14:47] But we also talked a little bit about points along the way where perhaps we have made mistakes or we haven't followed these directives. And some of the repercussions of that. So, I thought [00:15:00] that was a helpful perspective. Obviously, I won't take the time to go through all 10 habits, but a few of them stand out as being really good advice.

[00:15:06] One is to have a pre-call with the nonprofit organization staff and the advisor, and perhaps the chair of the investment committee. Having a pre meeting discussion, whether it is a phone call or an email or whatever, to really set the table to lay out the goals and objectives of the meeting, I think makes for a much more efficient meeting.

[00:15:35] So I think that's great advice. Another good piece of advice was to use smart logistics. So, of course, all the regular things that you think about, having a regular meeting cadence, planning in advance, having a solid agenda. One of the most important takeaways from that piece of advice was making sure that your meetings are long enough to achieve the goals that you have set for the meeting.

[00:15:59] If you're talking [00:16:00] about revamping your investment policy statement, and you only set 20 minutes on the agenda for that discussion, chances are you're not likely to be able to accomplish that goal. And then, one of the other things that I think is really important is to remember the time horizon.

[00:16:15] So for non-profits, if we're talking about endowment portfolios, the time horizon is perpetual. And Bob, you gave the example of the dangers of extrapolation by giving the, uh, the Elvis impersonators analogy. And I thought that was a really funny example, but also very useful to help put things in perspective.

[00:16:39] Are there any tips from that 10 habits episode, Bob, that you particularly liked? Yeah, that was a fun episode. There were really a lot of good points, but I think one that I'll mention here is having investment committees focus on what really matters. And we talked a little bit about [00:17:00] not just the past 90 days of results, but really looking more broadly about things like asset allocation and getting back to the three levers.

[00:17:09] And how does the portfolio construction ultimately tie into advancing the charitable organization's mission. But we can go on and on and I'm sure we'll revisit that episode at some point. So again, that was episode number 17. And then the final episode I'll touch on today is we did with Frank Kelly of Deutsche bank.

[00:17:32] And it was how elections could impact nonprofit investors. And to be candid, the content now is a bit dated in that Frank mostly addressed the presidential and congressional elections in late 2020, but his thought process was just so constructive. And I really enjoyed when he touched on the risks and the considerations for nonprofits, he provided some still applicable, great insights on the markets and the economy and a [00:18:00] divided Congress and, and, and, and so on.

[00:18:02] And he was just very informative, very user-friendly, and we will absolutely have him on the show again. I don't know if there's anything you would mention from that particular episode, Devon. I thought Frank's energy was just so great. You're right that he gave very good and practical advice. It was so interesting to revisit the, you know, November 2020, and I had forgotten how uncertain the outcome of the election was.

[00:18:31] We booked Frank for a couple of days after the election, and we thought for sure that the results would be, you know, tallied up. And there was a lot more uncertainty than I think we were prepared for. And I had forgotten all about that. So, it was fun to revisit that. So those are a half dozen episodes that sort of stand out.

[00:18:48] We've had so many terrific guests and so many great topics on the show. And we're looking forward to obviously bringing some of the guests back and really just continuing to expand on the topics and such. What we'll transition [00:19:00] to now are five tips for investment committee members and other stakeholders who oversee endowments and foundations. And I'll tackle the first one.

[00:19:09] And that is portfolio diversification. Or let's call it preparing for a downturn. There is absolutely no denying that the markets, particularly US stocks, have performed amazingly well. As we're doing this recording, we're near record levels on US stocks. There have been well over 50 new highs for the S and P 500 this year.

[00:19:34] And even with the volatility that arrived in September, returns still look really good. But there are negatives definitely that folks want to consider. We've got the Delta variant and what will its ultimate impact be? We've got earnings growing at a slower pace now. Supply chain challenges continue. Rising interest rates. Inflation, especially in wages.

[00:19:58] Debt ceiling considerations. [00:20:00] And I could go on and on, but I will just say that it's human nature for investors to become complacent. And I think we might look back at this time, fourth quarter of 2021, and say there was rarely a time in history when diversification mattered more. So, I'm not saying, and certainly Fiducient is not saying that stocks are going to crash.

[00:20:25] But we are saying that if your portfolio is big, good for you, that that's absolutely terrific. But use this opportunity to ensure that you're properly diversified. We touched a little bit earlier on three levers. What are the inflows? What are the outflows. And what are the required returns for your organization?

[00:20:43] It's a great time to examine that and it shouldn't start with, boy, I like this investment, looks attractive. Or I sit on another committee that's doing. It should begin with what is your organization attempting to do? Hospital, add a wing. University, supplement more [00:21:00] scholarships, so on and so forth. What are you attempting to accomplish in terms of your mission?

[00:21:05] And then working backwards, looking at inflows, outflows and required return to establish a risk and return budget. And then, construct a portfolio that can give you a fighting chance, hopefully, of doing well in any sort of environment. Rising rates, slowing economy, growing economy, and so on. That's great.

[00:21:25] Bob, one of the things that I wanted to talk about in terms of tips for committees looking to the future is to be mindful of the structure of your investment committee. This is something that we've talked about. We talked about it in our top 10 habits of effective investment committees. I know Dennis Morrone talked about it in his episode.

[00:21:46] We've really touched upon this many times throughout the history of the podcast, but investment committee structure is so important. It's important to have diversity of thought and perspective to make sure that you [00:22:00] have folks that serve on the investment committee, that don't all look, act, and think the same. It's important to have the right kind of expertise.

[00:22:09] So, perhaps a blend of sophisticated investors and folks who are a little more green in the investment landscape and might bring a fresh set of eyes to the portfolio. It's important to have the right size, probably somewhere in the neighborhood of five to eight investment committee members is ideal.

[00:22:28] Anything less than that and you don't have that diversity of thought and anything more, it just gets unwieldy and you generally have one or two voices that make themselves heard. And then the rest of the folks just sit back. And it's very important to have appropriate governance policies.

[00:22:48] And that includes right-sized term limits. So, term limits that are not too short, so as to eliminate the opportunity for institutional memory, [00:23:00] but also not too long, that you never get that benefit of a fresh perspective.

[00:23:09] Great points, Devon. And I will jump to something we mentioned a little bit ago, and that is preparing for a likely lower return environment going forward. So, our ten-year outlook, and we've got some great white papers and other content on our website, but our outlook for stocks is about five and a half percent per year over the next 10 years.

[00:23:32] And if you think about spending and how many organizations are spending 5%, or even if you're spending 4%, well, if you say stocks, and we know how risky a portfolio that's entirely dedicated to stocks would be, but if stocks are going to earn around five and a half percent, and then you subtract inflation, and then you subtract your five or 4% spending.

[00:23:56] You're really leaving nothing there for growing the corpus [00:24:00] and really trying to advance the mission in that manner. So, we think it makes a lot of sense for folks overseeing endowments and foundations to think about the likelihood of lower returns on a going forward basis, to re-examine the three levers, what are the inflows, outflows and required return?

[00:24:19] And sometimes you'll find that boy, to have a fighting chance of that higher return, you need to become so aggressive in the portfolio that you're just not comfortable with what might happen in a downturn. And we obviously model all of this for our clients. And when that happens, when folks start to say, gosh, I couldn't really tolerate, or we couldn't tolerate a loss of this level.

[00:24:44] 30%, 40%, or whatever the case may be. Well, that means one of the other levers has to shift. We either increase the inflows through charitable efforts donations and so on and development efforts. Or we try to modify the [00:25:00] outflows, but now again, with markets where they are, at or near record levels, is a great time to be thinking about that and thinking about what you do in a lower return environment.

[00:25:11] You may also look to other opportunities or other asset classes. So, for example, it doesn't appear that anything is cheap. I mean, show me an asset class and I can show you an asset class that is not cheap. But if you look, for example, at foreign developed stocks or emerging market stocks, relative to US stocks, you can say they're not cheap, but their valuations are lower.

[00:25:33] We also have many clients who invest in alternative investments, private equity, and otherwise, and there are others who are considering alternative investments. And it's a great time for investment committees to have an eyes wide open approach about either entering and considering alternatives or potentially increasing allocations to alternatives.

[00:25:55] But again, the size wide open fashion. So, Bob, one of the pieces of advice that I [00:26:00] wanted to give is with regard to ESG investing, environmental, social, governance investing. This is something also we've talked about many times throughout the history of the podcast. And my piece of advice would be to approach the concept of ESG investing in a responsible manner, not in a reactionary manner.

[00:26:18] And what do I mean by that? Well, there has been so much traction in the market and ESG inflows are just going through the roof. According to one survey, it says that there has been a 42% increase in US sustainable assets since 2018. So just over the past two and a half years or so. A 42% increase and already the 2018 numbers were much higher than what they were a few years previous.

[00:26:49] So, this is certainly much more than just a trend in the marketplace. It's an entire movement. But my advice would be to approach it from a very [00:27:00] practical perspective. Don't simply take an ESG approach because you're seeing and hearing a lot about it in the news. Think about whether it is vital to your mission, if it's important for your nonprofit organization to have your mission and your ethics and your values reflected in the portfolio.

[00:27:21] And the truth is that many active managers are already incorporating ESG criteria into their investment process. And I'm talking about strategies that are not marketed as ESG strategies. So, we actually went out to all of our recommended managers and we asked them some broad ESG questions and it came back with 85% of our active managers incorporate ESG criteria into their investment process in one way or another.

[00:27:57] So that may be [00:28:00] analyzing risks associated with environmental, social, or governance issue. It may be voting proxies. It may be engaging with company management and these are strategies that are not marketed as ESG strategies. So, my advice would be to, you know, by all means we think that ESG investing can be you know, you can certainly build a very strong portfolio with ESG guidelines, but also be aware that.

[00:28:29] Kind of when you peel back the layers of the onion, a lot of the active managers in your portfolio may already be doing this work behind the scenes. So perhaps the guidelines don't need to be put in place within your investment policy statement, or, you know, you may not need those hard and fast parameters.

[00:28:50] When it comes to portfolio construction and, and taking that more practical approach may offer some flexibility. Now I don't want this to come across as we [00:29:00] don't like ESG. I think ESG is great. I happen to be the co-chair of our internal mission-aligned investing committee. So, I'm certainly not trying to spin it from that perspective.

[00:29:12] But what I'm saying is that don't put ESG policies into place simply because it's the hot trend in the marketplace. It needs to come from a more meaningful place than that. Very well put, Devon. And that leads to our fifth and final tip here. And that is fees. So, what can you control as a steward overseeing endowment or foundation portfolios?

[00:29:34] Actually not a lot. You cannot control volatility or where the market goes and so on, but one thing you can control or at least have a lot of influence over is the fee structure in your portfolios. And actually, as a steward, we would suggest you have an obligation to do that.

[00:29:54] So, we always try to help our clients negotiate fees in terms of the asset management and invest in the right share classes and so on. [00:30:00] But it's a great time to be thinking about not just your investment fees, but your advisor's fees, custodian costs, auditors, and so on. And again, these markets are at or near all-time highs. It's a wonderful time to examine the fee structure and make sure that you are in a competitive and from a good stewardship perspective in a really good place.

[00:30:23] So Devon, it would be great as we wrap things up. If you could share in our anniversary episode, a highlight, or maybe a benefit that you personally gained from doing the show. Oh, that's easy. It's speaking with our guests. We've had so many really bright, articulate, experienced guests from a diverse set of backgrounds and perspectives, and really talking with all these different folks who covered different, who are in different professional areas.

[00:30:51] Has taught me to approach things with a kind of a fresh perspective and to perhaps look at [00:31:00] the world through a different lens. So having those conversations has just been so meaningful to me. What about you, Bob? I'll throw the question right back at you.

[00:31:08] What's been, uh, most significant for you? Well, I 1000% agree with your point about the guests and so on and another real benefit for me, I'm a continuous learner. I know you're a continuous learner. I think it's just been absolutely wonderful. And sometimes they say the teacher sometimes learns more and sometimes we're teachers in this role and sometimes we're learners in this role.

[00:31:34] And so I think just overall, you, you have a guest on the show, you later on write an article or a blog post or a research paper or something, and it all interrelates. And I think just makes us better prepared to help clients and frankly, colleagues as well. So, Devon, we've talked many times on the show about silver linings and a lot of our guests have shared there. There are still plenty of weirdness with [00:32:00] this pandemic and without being able to do our typical client conferences. The podcast has just been a great way to knowledge share.

[00:32:08] And I know I've really, and you've really appreciated having many of our colleagues on their show. They're just true experts. And of course, we owe great gratitude to our listeners and obviously with them tuning in and spreading the word and really helping make the show a success. So happy anniversary to you, Devon. Happy anniversary to you.

[00:32:28] Thanks for bringing me along for the ride and thank you to all of our wonderful listeners out there. Uh, ditto that. So, if any of these topics prompted a thought or perhaps a to-do comes to mind, please feel free to reach out to me or Devon via LinkedIn or the email address in the show notes.

[00:32:48] And to all you good stewards, thanks for investing time to help your nonprofits prosper. We'll connect with you soon on the next episode. Thank you for listening to the Nonprofit Investment Stewards podcast. Click the subscribe button [00:33:00] below to be notified of new episodes and visit Fiducientadvisors.com for more information. The information covered and posted represents the views and opinions of the guest and does not necessarily represent the views or opinions of Fiducient Advisors.

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