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FOUNDATION ENDOWMENT FUNDS LOSE MONEY
PROPER MANAGEMENT PREVENTS LOSSES

In New Mexico, there are many non-profits and private foundations managing millions of dollars of endowment money. The top 25 Foundation Endowment Funds in New Mexico manage well over $1 Billion. The losses to some of the most visible endowment funds nationally have made headlines during this past year, reporting losses ranging from 15% to 30%. The New Mexico scene is no different! Investment losses to endowment funds have severely handcuffed their resource distributions. From the very large to the very small, almost all endowment funds have suffered significant losses.

It is time, once, and for all time, to understand the realities of investment risk. Even the most knowledgeable investment managers have fallen prey to a hubris that presumes that investment models provide protection from such losses as have been experienced over the past 18 months. Underlying all of these management models is the premise that “markets are efficient”. That premise is pinned on the ideal that a marketplace will allow pricing of assets to seek their real value through the bid and offer process. As we have experienced since 1998, this presumption is untenable. Illiquid assets - those assets that cannot be valued at a price related to their purchase cost - have frozen our markets, stopped national and international commerce, and caused great losses to endowment investment portfolios.

These are the problems facing endowment fund managers. As a member of the Endowment Board - and, perhaps, a participant on the Investment Management Committee - each Endowment Director has a higher responsibility than the one that says “we must grow these assets”. That highest responsibility is first to protect your capital; next, it is charged with making those assets produce a steady stream of income; lastly, is the charge to grow those assets.

In fact, this is not such a difficult task. There are simple rules to follow: For Charitable Foundation investment portfolios, there is a need for both income and for growth. It is important to structure investments such that both these needs - dependable cash flow; and growth – can be accommodated. To this end, two independent portfolios are established, one for reliable cash flow and one for growth. Future Endowment Contributions are allocated similarly.

The Reliable Cash Flow Portfolio invests in fixed income assets including bonds - corporate and treasury, mortgage backed securities including government guaranteed assets and whole loan product, government agency notes, preferred stock, other investments that generate cash flows that are stable and of high quality. Typical investments should be investment grade assets. In today’s market, it is possible to create a portfolio that generates a net investment yield between 5 ½% and 6%. That yield will vary over time. The portfolio is constructed with a ladder of maturities such that a significant part of the portfolio – 10% to 15% - pays off each year and is reinvested. This strategy requires knowledgeable investment managers who are experienced in the “over-the-counter” fixed income market and who have access to this market.
This portfolio would normally distribute for charitable purposes, all of the interest and dividend income received. Growth in the Foundation Endowment is generated only through new contributions to the Foundation and/or by distributions from the Growth Portfolio.

For The Growth Portfolio, in order to grow the total portfolio, a certain part of the portfolio can be set aside to be invested as a growth instrument. During years when this portfolio grows, a certain portion of this growth can be converted to cash for distribution by the Foundation and a portion can be moved into the Reliable Cash Flow portfolio. When there is no growth, the portfolio must be preserved for the future. Risk is defined as volatility. Foundation managers must determine the amount of risk that is acceptable.

A typical annual distribution from the Growth portfolio: From the appreciated value, 50% is moved to the Reliable Income Portfolio, and 50% is paid out to special allocations as determined by the Foundation managers. (The growth investment strategy is left for a later article.)
There is no substitute for “hard headed” risk management that measures risk to the total portfolio by the risk of its individual assets.

In Summary, a successfully managed endowment portfolio creates a guaranteed income, protects its capital, provides for growth, and is designed to patiently grow its assets over the years to come.
New Mexico foundations, like foundations around the country, must let go of their current assumptions and consider a more prudent way of managing assets. Their current and future beneficiaries (or constituents) depend on that.

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