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EP22 | Managing investments for foundations and not-for-profits

00:22	**Cam Webster**	On this episode we investigate the world of not-for-profit clients with Institutional Portfolio Manager, Andrew Johnson. Together, Andrew and I introduce you to Community Foundations of Canada, and cover a few key areas of concern for its membership.
01:08	**Cam Webster**	First of all, welcome Andrew Johnson.
01:09	**Andrew Johnson**	Thank you, Cam.
01:10	**Cam Webster**	So, we (Mawer) have a partnership with Community Foundations of Canada. We've had that partnership for five years now, Andrew?
01:19	**Andrew Johnson**	Yeah, a little over four years.
01:21	**Cam Webster**	Briefly, give us an introduction of what that partnership is, and why we do it.
01:25	**Andrew Johnson**	Sure! Well, I think if we step back a little bit ... we've been managing money for community foundations for quite a long time now. If we ... talk about foundations and not-for-profits in general, it's been about 30 years that we've been managing portfolios for them. Back in 2014, a really long-time community foundation client of ours introduced us to the leadership team at Community Foundations of Canada (the CFC).
01:52	**Andrew Johnson**	They're essentially a national organization for all of the 191 community foundations around Canada and...act as a network for this group, allow[ing] them to share information with each other. If you can put yourself in their shoes, they're dealing with a lot of similar issues, just in a very nuanced way in each case. And they also take a lot of these issues to the federal level. They're now working globally as well, so, leveraging all of the work that's being done outside of Canada as well as inside as a group and bringing that to the community foundations around the country.

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02:26 **Cam Webster**

That's a great setup and a good segue into: why are we sitting here, having a podcast about not-for-profits?
We actually went to the CFC and asked them: are there questions from your membership that you want answered from an investment manager point of view?

02:45 **Cam Webster**

Let's just kind of go to the question list—'cause that's why we're here! The first question involves, "how does a not-for-profit/community foundation go about selecting an investment manager?"
You and I have been through the process several times, so why don't you start? I'll pipe in where I see fit.

03:03 **Andrew Johnson**

I think this is one of the more common questions that we get from not only just our group of community foundation clients as well as the broader CFC group, but in general. A lot of volunteer boards and investment committees will come to us and ask us these similar questions. There are two buckets I would generally try to assess [for] how to select an investment manager. One is on the quantitative side of things and the other, a more qualitative aspect. This is my opinion, but I think it's relatively straightforward and simple to gain an understanding of the quantitative characteristics of an investment firm and how to assess that.

03:55 **Andrew Johnson**

Where we tend to see a lack of understanding—or probing—is on trying to get an assessment from the qualitative standard that you want in your investment manager. This is very much a long-term relationship that you're trying to strike. It's a marriage—not something that you would spend just five minutes superficially picking your partner out of a lineup. You would spend a lot of time thinking about it and thinking deeply about it. In general, I would bucket things into three main areas...the "who," the "what," and the "why."

04:32 **Andrew Johnson**

Starting with the "who:" It's really the board's, or an executive of a not-for-profit['s] (or community foundation in this case), fiduciary duty to themselves, their donors, as well as the stakeholders they have, to select an investment manager they trust to manage their assets in the best interest of their foundations.
Get a sense of the firm you're interviewing and the people being

interviewed from that firm. So, questions like: "how long have you been in the business?" is an obvious one. "How many employees do you have, and what's been the turnover?"
I think these are really good ice breakers to get a sense of their experience. In the case of personnel turnover, I think it's probably a really good sign if that's low. And it's probably a sign that the individuals that work at that firm are passionate about what they do, and likely the firm as a whole has a really good culture.

05:28	Andrew Johnson	Also, you want to ask: "what's your experience with other not-for-profits?" You want to find out how many clients, the dollar amount of those assets that they manage, as well as the years of experience that they have with not-for-profits and foundations. Find out if they volunteer with a not-for-profit. I think having a manager that is able to see things from your point of view and your side of the table, as it were, is a definite plus.
05:53	Andrew Johnson	Moving on from the "who," I think we want to gain an understanding of "what" the manager's investment philosophy is, and if it makes sense and lines up with what you're looking for in a manager. The obvious question there is, "What is your investment philosophy and process?"
06:08	Cam Webster	Right [laughs].
06:13	Andrew Johnson	A manager should be able to explain their investment philosophy and process—generally in layman's terms—and it should be easily understood.
06:20	Andrew Johnson	The next question they want to ask yourself is: "does it make sense?" If it comes across as complex and based on a lot of predictions and forecasting in order to be right—that's probably a red flag and you might want to take a step back and reassess what you're looking at. Similarly, if it's presented as being some sort of "new" way of investing and that they've discovered and there they're all about, I think that's also a red flag. I would actually say, step even further back. I think that most successful long-term investing principles come from investment philosophies that have really stood the test of time. We're generally talking about multi-decade here as opposed to multi-year.

07:02	Andrew Johnson	You also want to get an understanding of what that manager's thoughts are on risk. Find out if risk is top of mind and how they think about it. Do they classify risk as more short-term measures? Or is it volatility and standard deviation? Or do they view risk from a more absolute perspective? How we discuss it around the firm here is, “the permanent impairment of clients' capital.” In other words, an absolute dollar loss that can't be recovered. I think that helps you understand how they view the importance of downside protection.
07:35	Cam Webster	Let me recap. We're talking about quantitative, qualitative measures; understanding the investment manager's investment process and philosophy; also ... the focus is long-term.
07:55	Andrew Johnson	[Agrees]. In the context of long-term, I think the next logical step is to try to figure out how an investment manager has performed through various different market scenarios. You want to be able to look at examples of different market environments, periods of time, to see how they or their approach has performed.
08:14	Cam Webster	So we're in the quantitative bucket now ... what I'm hearing is, it's a combination.
08:22	Andrew Johnson	Absolutely.
08:22	Cam Webster	Is there any one that takes priority over the other? So when you're helping a foundation out, do you emphasize the qualitative more than the quantitative? Or is it kind of down the middle?
08:31	Andrew Johnson	That's a good question. I think how I would describe it is—the quantitative things will get you in the door, the qualitative things will get you the job.
08:41	Cam Webster	As an investment manager.
08:42	Andrew Johnson	Yes.
08:43	Andrew Johnson	So...that final piece of the “what,” which is finding out how an investment manager has performed over different market scenarios—especially bad

ones—they should be very open about sharing that information. If they're not, then I would be wary of that. And even though historical performance is not the greatest, if at all, indicator of future performance—

09:06	**Cam Webster**	Disclaimer! disclaimer!
09:08	**Andrew Johnson**	Exactly [laughs]—it does allow you to give a fuller judgment of the approach that a manager has, and how that has unfolded during real world scenarios.
09:20	**Cam Webster**	Joking aside, one of my recent meetings with a not-for-profit—we got to the performance page, and it's rolling returns...and it just really hit me how strange markets have been. Every number on the page—both asset class and benchmark—was positive. In my 25 odd years of investing, rarely do you see a performance page that isn't a mixture of numbers. These were all positive. I just want to pause there and emphasize the need now to look long-term in terms of evaluating what your needs are as a foundation and what type of investment manager you want to hire. Like you said, I think it's got to be multi decade, because otherwise you're going to annualize a 10-year period that looks like it's a bit of an aberration.
10:11	**Andrew Johnson**	Exactly. In my career, which spans just prior to the global financial crisis—
10:19	**Cam Webster**	Noo, don't date me!
10:19	**Andrew Johnson**	[laugh]—I at least got to experience that. But there are many people that are sitting on a volunteer board, or sitting in an investment committee—even working at investment management firms!—that have not faced that type of scenario unfolding. It is important not just to go back multi-decade, [which] probably captures, at least, most time periods that have a negative return environment...but I wouldn't classify it as such. I would just say, try to go back to whenever the last big blow-up in the markets was and see what happened with their portfolio. In this case, it would be 2008/2009. 2011 was a little hiccup. And so far, we've been running upwards from there. It's hard to judge when the tide's coming in all the time like that.

11:05	Cam Webster	One interesting way to get rid of all those positive numbers would be to go to calendar year returns and go back 20 years. You'll capture some of that.
11:12	Andrew Johnson	You'll capture more of it. Absolutely.
11:14	Cam Webster	That's the basis as a committee—if you're sitting trying to select a manager—to say, "what happened here?" Okay. We covered the "whats" and you mentioned the "hows."
11:23	Andrew Johnson	I was going to end with the "why," actually.
11:28	Cam Webster	What, how, why. Good! [laughs]
11:34	Andrew Johnson	[laughs] We just spoke about quantitative getting you in the door, qualitative getting you the job. I think that a lot of the time, what ends up happening, is that you're faced with a decision among very similar offerings ... you've narrowed it down, you've got three investment managers in front of you. Ultimately, you have to ask yourself: why would you choose one over the other? I think some of the factors that are important to foundations would be things like: do you give back to your community? If so, how do you go about doing that? What is the impact of that? How are the individuals compensated? And, do you invest alongside of your clients? What we're getting at here is trying to find out what kind of alignment we have between a foundation (in this case) and the investment manager. Obviously, you want to know what they charge for fees and what you can expect from client service These are all things I [find] are most important to foundations and community foundations in general. As I said, I think it's relatively easy to get to some sort of quantitative judgment, but I think it takes a lot of deep-thinking, time, and really good questions to get an understanding of the qualitative side.
13:02	Cam Webster	Here's another really good question, I think, that's been submitted: "how does an investment manager adjust to changing demographics?" I think we can answer this, Andrew, in the context of how foundations change with demographics and go from there.

13:21 **Andrew Johnson**

Absolutely. And I obviously want to hear your input on this too—I know that we've had a lot of conversations about it. Ultimately, for me, I think it all comes back to technology. When I think about an investment manager, two really important characteristics come to the top for me. One is just how good they are at investing. (Do they have a good philosophy and process and does that work over time.) One aspect of that is how they use technology—data, analytics, just sheer computing power—to complement that process.

14:04 **Andrew Johnson**

I think the other side of it is the client experience and the service delivery ... as clients raise the bar on what is expected from that client experience—how they interact, what type of information they're getting, how that's presented—we need to respond to that. How are we delivering on our promise of providing client service, or excellent client service in this case? The reality is that our clients have a lot of different definitions of that. And I think demographics are playing a huge role in determining those definitions.

14:40 **Andrew Johnson**

So, some of the things that we've been doing in response to those changes ... is our online portal for our clients. Essentially, what we're trying to do is work towards breaking down that barrier between the data that our clients want and need to see on a regular basis. We probably still have a-ways to go, but moving away from pushing information to our clients and allowing them the ability to pull information when they want it and how they want it.

So, rather than waiting for an email notification, or navigating to our website, for example—when they log into their portal, they are able to get all of the pertinent information that they want regarding their investments. Then there are also quick links and navigation that they can jump around to all of the other information pieces that we have on there to round out their understanding of what's going on in their portfolio and what our thoughts are on those items.

15:42 **Cam Webster**

From an investment manager point of view—obviously, this is a Mawer podcast, so we're going to give mostly Mawer kind of examples—but we recently hired a data scientist. If you overlay[ed] investment management and data scientists, like 10 years ago, maybe that was coming...a little bit.

You saw some PhDs being hired onto trading desks and whatnot. Combining computing power with a data scientist seems to be accelerating our ability to find new opportunities. Our data scientist came in and within a month, I think, he was able to more efficiently move the data so we could run 500 discounted cashflow models in two hours when it used to take 18 hours.

16:33 **Andrew Johnson** Just absolutely blows my mind.

16:34 **Cam Webster** Right? So that's one function of technology. And then, from a client point of view, I think the trends are pointing to—and it may be more as committees roll over at not-for-profits and this millennial influence comes in—I think millennials are highly engaged in their environment, including getting more involved in not-for-profits.

17:00 **Andrew Johnson** Absolutely.

17:01 **Cam Webster** So, with that, comes a demand for different client service models—maybe deeper questioning. How does [a not-for-profit organization] demonstrate results?

17:13 **Andrew Johnson** I think it's absolutely driven mainly by younger individuals that are joining and working either directly at the foundation, or they're working as volunteers on the investment committee. And they're having all of these incredible experiences out there, from, I guess, a customer experience standpoint. Think about dealing with an Amazon, or how easy it is to Google around things...and you know, they're expecting that, and they're accustomed to that experience. I think it's only natural to expect it from your investment manager as well. So, I think those are areas that investment management firms (I know we are) are focusing on putting a lot of resources behind and thinking more deeply about as we move forward.

17:57 **Andrew Johnson** I think it's important to highlight the fact that a lot of the times when we talk about technology entering some industry and “disrupting” as it were, we're usually talking about the robot overlords taking over and doing everything, right? When often what is unfolding out there is that we've got this human + machine combination going on.

That's more of what we've embraced and what we've seen have more positive outcomes. Your example about running those DCF models is incredible because, think about the time that it opens up—the screening that that helps us with. It allows us to allocate our resources in a much more effective way, which ultimately should, and we would expect to end with better outcomes for our clients.

18:50	**Cam Webster**	The CFC certainly would have a focus on helping foundations in Canada adapt to technology, or give them access to technology...perhaps how to more efficiently generate donations.
19:02	**Andrew Johnson**	Right.
19:02	**Cam Webster**	There are plenty of, I think, shared models out there—whether it's Givology (or something else), that generates a tax receipt for the donor. It's seamless, and you can direct your donation now online. It's a fantastic innovation that's being applied globally.
19:21	**Andrew Johnson**	It's all about reducing friction between two parties, essentially.
19:26	**Cam Webster**	Another question, Andrew, is maybe more specific to how foundations/not-for-profits are trying to establish ways to invest in the community. There are lots of labels out there...I think the most well-known label is “impact investing.” You have a not-for-profit that wants to target a specific program, and they will generate donations specifically for that. Let's talk a little bit about impact investing. The question was, “does Mawer do this type of thing?” The quick answer is: no we don't, but we can offer some perspective on that.
20:07	**Andrew Johnson**	I think you touched on it really briefly there, but for those who don't know, impact investing would be, in a very simple way, investments that are made with the intention to generate some sort of measurable impact alongside of financial return. Normally that's within the social realm or the environmental realm. The example that I would give—and I'll keep it local here to Calgary—is the Calgary Foundation. They have a formal impact investing approach that is

all centred around providing financing. So, debt to other charitable organizations within the Calgary community and surrounding area.

20:48	Andrew Johnson	They would do things like bridge financing—that would be short-term credit available to other smaller organizations. If they find themselves in a period of time where they're in between funding cycles, but they've still got all this granting that they've committed to, that's something that could come in really handy for them, and a larger organization like the Calgary Foundation can provide that. Similarly, I think they can provide debt to scale up an enterprise at a faster rate than normally they would have otherwise. And they can also work alongside more traditional financing methods. So, a combination of bank financing as well as financing from a community foundation can allow an organization to go further and faster than maybe they could have otherwise. That's a really good example of that unfolding from a community foundation standpoint.
21:35	Andrew Johnson	I would argue that community foundations ... are kind of the true embodiment of impact investing. If you use that definition I used at the beginning—which was to have some sort of impact alongside of financial return—that's exactly what community foundations are doing with their portfolio and their granting together.
21:56	Cam Webster	Let's talk a little bit about planned giving and donations. That was one of the subject areas that was submitted, so changing gears a little bit. But, what does planned giving mean? How can it set up a not-for-profit for long-term stability?
22:09	Andrew Johnson	I think in this sense the question was centered around, what are some more tax effective ways to give money after you've passed away, for lack of a better way to put that.
22:22	Cam Webster	Right.
22:23	Andrew Johnson	A lot of people call this “gifting from the grave.” It's setting yourself up where you can donate money after the fact. You don't need it anymore, essentially. There are a number of different ways to do this ... There's a lady by the name of Kathy Hawkesworth, who works with the Edmonton

Community Foundation, who has given a lot of good information to us on this. You can essentially do it one of three ways that I'm best aware of, at least. You can write it simply in your will that you want to donate a portion of your estate to a foundation. Simple enough. You can designate a piece of your life insurance policy to go to a foundation or a charitable organization. And lastly, you can do the similar thing with, for example, your RRSP, RRIF, or tax-free savings account. You can designate a beneficiary, and that can be a charitable organization within here in Canada. So, in general, we call all of these "estate gifts" and they come with the ability to receive a tax receipt and have some sort of relief on the donation (on the amount that's going).

23:37	Andrew Johnson	There are some considerations. The receipt is actually issued—or the value of the receipt is issued to the charitable organization at the time that they receive it. So, it's not at the time of the death of the individual. That's just something to be aware of—that there could be a gap in time from when a person passes away, to when that money actually arrives at the charitable organization.
24:04	Cam Webster	So that would be probate period?
24:05	Andrew Johnson	That would be a part of it, yes.
24:06	Cam Webster	Okay.
24:07	Andrew Johnson	On that note, gifts made from an insurance policy, or through a designated beneficiary, tend to move a lot quicker because they're just going from an organization to another organization. Whereas when you write something into a will, not only does it have to go through the entire estate process, it also has a lot of eyes on that estate process.
24:29	Andrew Johnson	So, you could be opening yourself up to someone that you didn't want to have eyes on your estate. That said, there could be some privacy issues there. In an extreme case, a charitable organization could even have some sort of administration over that, because they are involved and they are named in the will.

24:46	**Andrew Johnson**	It is more often that we see things written in a will and donated to a charitable organization—but it does move a lot slower.
24:57	**Cam Webster**	Last subject here on the question list is ... there are several questions around, "what's the appropriate asset mix?" "how do I deal with volatility?" Markets are so-called skittish, or acting up right now ... Let's give people a sense of, well, there's volatility out there, but how do we manage through it?
25:26	**Andrew Johnson**	I think it's always important to speak on this topic with full context. I think you start with—as somebody working for a foundation/we're sitting on the investment committee—you want to gain a really good understanding of what the purpose of the portfolio is. The first part of that is figuring out what we call, the "spending requirement" for a portfolio.
25:55	**Andrew Johnson**	So you've got this pool of capital and you've got a mandate to grant into the community. What is that percentage that you're going to do it? What's the dollar amount that you're going to do that on an average annual basis? There's where we start. Let's start with that number. You're starting to build what we call a "required rate of return," or "return objective" if it's written into an investment policy.
26:17	**Andrew Johnson**	Then you want to layer on top of this, obviously, all of the other administration costs that your organization has including investment management fees. That would get you an even higher percentage number. Then, I think it's also prudent to include some sort of measure of inflation, because that is a true cost to a portfolio over time. It's a time cost of money that's going to take place, so you want to account for that. You end with this estimated return that would be essentially required to break even in the portfolio. In other words, all else being equal, if you met that target and you didn't have any more money coming in to the portfolio, it should stay the same through time, in real terms. That's where we start.
27:08	**Cam Webster**	My experience has been, at least recently, that writing an investment policy statement has been part of the, "get-to-know you (investment manager)" process, right? Somebody kind of knows what their organization looks like, they have multiple pools of capital—maybe. Again,

there's going be nuances with every individual organization. But your message of knowing what your financial need is year in, year out and scoring that against, "what's our access capital?"
Lots of committees will restrict capital, and that's usually the pool of capital we get to manage. The challenge in that is , if you have a short-term pool of capital and a long-term pool of capital, you have to be clear in designating those and then approaching the long-term bucket with an investment policy statement that matches that timeframe.

28:03 **Andrew Johnson** That would naturally be the next step—to figure out what the time horizon is as well. Again, most foundations do have both a short and a long-term mandate in front of them. They've got to grant money on a year-to-year basis, but they also have this pool of money that they have to have available to them essentially in perpetuity. Those things together—spending requirement, estimated rate of return ... time horizon—that gets you to an understanding for you and I as institutional portfolio managers to figure out what their ability to take risk is.

28:34 **Andrew Johnson** Then we need to figure out what their willingness to take risk is, and that, (what I think you were just alluding to), is getting to know the client. So, finding out just how much volatility a committee member, or committee as a whole, can stomach on a year-to-year basis. How much can your donor base stomach on a year-to-year basis?

28:56 **Andrew Johnson** How much sleep are they getting? How much sleep are you getting, knowing that your portfolio is maybe taking wild swings in the market? Or maybe it's not. That's why we're trying to get an understanding of both—two sides of the coin. The ability and the willingness to take risk.

29:10 **Cam Webster** And sometimes perception is reality. The perception is, "well yeah, we've got a time horizon that's beyond ten years, it's twenty years."

29:21 **Andrew Johnson** It's next week.

29:22 **Cam Webster** Yeah.

29:23 **Andrew Johnson** Yeah.

29:25	Cam Webster	We run into that all the time where, you add the human factor at the committee level and there's a real difference.
29:41	Cam Webster	What we found worked for clients over long term is the 60/40 type asset mix, where you've got equities, fixed income, a long-term objective, and over time that seems to allow people to manage through the year-to-year volatility.
29:57	Andrew Johnson	Exactly. The asset mix becomes a reflection of that willingness and that ability to take risks. We've joked about this before, but if you've got a traditional balanced portfolio of 60% equities and 40% mix between cash and bonds, those cash and bonds are your goalie and your defence if you're a hockey team, for example.
30:20	Andrew Johnson	We want them to be able to lock down the fort when things get a little hairy in the markets, like we've seen obviously in October and November this year. We've got the forward—so that's the equity part of the portfolio—we don't just want them to be snipers. We don't want them to just be all: guys going to the net. We want them to be two-way players. We want them to have a defensive mindset, so I think the next step within equities is to always make sure that you're broadly diversified across geographies, industries, sectors, whatever. That's important because those different countries and regions and sectors and different company sizes—they're going to go through different cycles at different times, to different degrees.
31:05	Andrew Johnson	So that's going to smooth things out. If we've got a really broadly diversified equity portfolio to also be in conjunction with that cash and bond element.
31:15	Cam Webster	I love the way you closed it out, but I do want to ask you the challenge question of the podcast. It's your own fault to Andrew, because you made the analogies! So, if you had to pick five players to build your 60/40 portfolio out of, give me the five best players, in your opinion, that would build that 60/40 model.
31:40	Andrew Johnson	I'm a Boston Bruins fan.
31:42	Cam Webster	I know that [laughs].

31:44	**Andrew Johnson**	So the five players, you're actually missing one, there's six on the ice at most times—
31:49	**Cam Webster**	Good God, you don't need a goaltender do you?
31:50	**Andrew Johnson**	Unless you're down by four goals [laughs], and you've pulled the goalie.
31:54	**Cam Webster**	The defence is just so good, you don't need a goalie.
31:57	**Andrew Johnson**	I'm going go with Tim Thomas, because he won us the Stanley Cup. I'm going go with Ray Bourque, because I grew up watching him, as well as Paul Coffey, on the defence side of things.
32:06	**Cam Webster**	Okay, good skater.
32:07	**Andrew Johnson**	And then, I have to go with Cam Neely as my first forward. I've always been a big fan of Glen Wesley, I don't know if that's even going land with a lot of people.
32:17	**Cam Webster**	I don't even remember Glen Wesley! You probably know his number.
32:20	**Andrew Johnson**	Don't off the top of my head.
32:22	**Cam Webster**	Ohh, thought we'd get that one.
32:23	**Andrew Johnson**	And then finally, Glen Murray, who was actually a Nova Scotia native. He's been great goal scorer for the Bruins for a few years.
32:31	**Cam Webster**	Okay, I love that because we closed on personal interest and we built it back into a 60/40 portfolio, so thanks Andrew. I think we had a good, informative, conversation for not-for-profits and we'll have you on again soon.
32:43	**Andrew Johnson**	Awesome, thanks Cam.