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Contents

About TIFF 1
Remembering Things Past ... 2
A Necessary Evil 6
Big Shoes, Well Filled 8
Real Opportunity 8
Membership Summary 8

COMMENTARY

A Quarterly Report of THE INVESTMENT FUND FOR FOUNDATIONS **DECEMBER 31, 2000**

Highlights

Page 2 **Financial markets were memorably unkind to most investors in 2000** — TIFF and its members generally excepted. Careful study of last year's market action reveals several important lessons for investors.

Page 3 **Genius has its limits**, a lesson revealed in the lamentable and unprofitable overreaching in 2000 of private equity firms that jumped too eagerly aboard the Internet bandwagon.

Page 3 **Patience has its rewards**, a lesson revealed in the unprecedented relative gains posted in 2000 by value-oriented managers.

Page 4 **Comfort has its costs**, a lesson revealed in the disappointing performance in 2000 of institutional portfolios weighted heavily toward asset classes and subclasses that performed especially well in the late 1990s.

Page 4 **Globalization has its drawbacks**, a lesson revealed in the distressingly high correlation in 2000 between returns on US and foreign stocks.

Page 8 **Michael McCaffery**, chief investment officer of Stanford University, joins TIFF's governing board.

About TIFF

The Investment Fund for Foundations (TIFF) is a not-for-profit cooperative founded in 1991 by a nationwide network of foundations. Its mission is to improve the investment returns of eligible organizations by making available to them (1) a series of multi-manager investment vehicles and (2) resources aimed at enhancing fiduciaries' knowledge of investing. Excepting TIFF's president, all TIFF trustees serve as unpaid volunteers.

Critical Mass. TIFF currently manages assets in excess of $1.7 billion for almost 300 not-for-profit organizations worldwide.

Carefully Researched. TIFF's investment programs are based on many years of extensive study into the investment needs of not-for-profit endowed organizations. The investment programs that TIFF administers enable member organizations to delegate selection and oversight of money managers and other essential vendors to experienced investment professionals whose personal and professional interests are highly congruent with the interests of TIFF's members.

Investment Vehicles. TIFF administers a variety of multi-manager investment vehicles that enable members to access a variety of asset classes and strategies, including US and non-US marketable securities, venture capital, buyouts, real estate, natural resources, and absolute-return oriented strategies. For more information, please refer to TIFF's separate quarterly reports entitled Marketable Investments and Alternative Investments.

Eligibility. The investment vehicles administered by TIFF are open to all 501(c)(3) organizations. Certain TIFF vehicles also employ SEC-imposed accreditation tests. For more information, please contact TIFF at 804-817-8200 or visit our Website at www.tiff.org. ■

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Remembering Things Past

Eternal Truths in a Changing World

Lessons Relearned. Folks who deem TIFF's reports frustratingly prolix will be unsurprised to learn that their chief scribe is a fan of Marcel Proust, the gifted writer (1871-1922) whose 16-volume autobiographical novel *Remembrance of Things Past* is rightly regarded as one of the best books ever written. Amazingly if not uniquely for a Frenchman, Proust has much wisdom to offer investors, although he seldom mentions money or markets. But Proust does discuss at length most of the root causes of big market movements, including one that manifested itself hugely in the year just ended: the irrationality of human behavior. At the risk of violating from the get-go this writer's New Year's resolution to make TIFF's reports less prolix, we've decided to catalog in this Commentary some of the lessons that investors learned in 2000. Alas, as Proust himself observed, life's most important lessons are seldom novel. Rather, they represent eternal truths that must periodically be relearned.

Changing Desires. Markets were memorably unkind to most investors in 2000 (TIFF and its members generally excepted). To be sure, investment grade bonds generally performed well, but most lesser-rated bonds did not, and many produced large losses. In the equity arena, the broad US stock market slumped (Wilshire 5000 down 11%), most foreign bourses fell even more sharply in US dollar terms (due in part to currency losses), and portfolios laden with technology stocks (including index funds tracking many widely followed benchmarks, foreign as well as domestic) moved downward at a rate eclipsed only by the rate at which they had moved upward during technology shares' earlier manic phase. Indeed, one cannot understand why 2000 proved so painful for so many investors without understanding the months if not years of market action that preceded it. As per usual, Proust fingered the root cause of the phenomena to which we allude: "We do not succeed in changing things according to our desires," he wrote, "but gradually our desires change." As the 1990s drew to an end, many investors made the mistake of abandoning settled policies respecting risk and hoped-for returns. They did so because they could not stand to see other investors' portfolios appreciate at a far swifter rate than their own. To its enduring credit, TIFF's board displayed a different mindset altogether, reaffirming investment policies that contributed to some TIFF-administered vehicles underperforming their benchmarks during the market's manic phase. Indeed, the board went even further in the case of TIFF's US Equity Fund, endorsing staff's recommendation to let the Fund's "active risk" (i.e., potential deviation from its benchmark) rise in order to avoid putting fresh money into high-flying "TMT stocks" (technology, media, and telecom issues) at what were then nosebleed prices. The TIFF mutual funds' generally strong relative performance during 2000, coupled with the pleasing results produced by other TIFF initiatives that securities laws prohibit us from even mentioning in these pages, made the year just ended the most gratifying in TIFF's history.

Standing Fast. The preceding sentence notwithstanding, this essay is no advertisement for TIFF. To be sure, TIFF's mutual funds remain open to new money and members, and their generally superb relative performance in 2000 has stimulated fresh interest in them among eligible charities. Good performance aside, however, the recent feat of which TIFF is most proud is its adherence to that part of its mission which makes the pursuit of "best practices" a far more important objective than asset growth per se. Consistent with this aim and as noted in this quarter's report on TIFF's alternative investment (AI) programs, TIFF is resisting calls to relax the self-imposed asset caps on certain AI vehicles that it offers. We've adopted these caps — which are most unwelcome in some eligible charities' eyes — in response to behavior that Proust would find quite familiar: frustrated by the apparent inability of more traditional assets to produce the lofty returns to which holders of same became accustomed during the great bull market, many governing boards today evince heightened if not excessive ardor for so-called alternative investments. For reasons adduced below, we're confident that TIFF's alternative investment vehicles will continue to perform satisfactorily moving forward, but we're even more certain in stating that their capacity to do so would be undermined rather than enhanced if we succumbed to pressures to accommodate all of the eligible charities seeking to invest in them.

Revealed Truths

Novel Act. Engaged as we are in the novel act (for TIFF) of praising things French, we'll doff our cap to another Frenchman, political scientist Alexis de Tocqueville (1805–1859). In addition to predicting generally but not specifically most of what transpired during the unlovely US presidential election of 2000, Tocqueville's brilliant *Democracy in America* (1835) explored profitably the concept of "self interest rightly understood," by which Tocqueville meant not the inherently futile pursuit of infinite material and political gains but the more restrained quest of incremental and thus more enduring improvements in living standards and political clout.

Best Practices Rightly Understood. We fancy the phrase "rightly understood" because it applies aptly to TIFF's pursuit of "best practices" in endowment management, an endeavor in which — as has always been true in politics — the perfect is the enemy of the good. Indeed, as is underscored

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by the following catalog of some of the past year's revealed truths for investors, the self-correcting character of financial markets makes it perilous indeed for fiduciaries to assume that what has worked well in the past will continue doing so. To be sure, some practices work well in **all** market environments — e.g., vesting investment decisionmaking in small committees or subcommittees comprising seasoned investors only — while other practices work well only if other investors shun them. By the way, the catalog that follows deliberately excludes some of the past year's most conspicuous "lessons" for investors, on grounds that these have been well-vetted by mass media.

Genius Has Its Limits

Overreaching. Paradoxically, perhaps the most important lesson about investing that fiduciaries must master is one that they most readily forget, due in part to their presumed failure to recognize its true universality. In 1998, many wealthy persons and organizations got burned (directly or indirectly) by the flagrant overreaching of Long-Term Capital Management, the ill-fated hedge fund whose investors (and creditors!) made the mistake of assuming that the genius of LTCM's principals had no limits. In 2000, the dynamic duo of greed and naiveté combined once again to produce very sorry results, not primarily in the hedge fund arena (although several famed hedge fund managers were burned badly by gyrating markets) but in private equity broadly defined. Of course, the peculiar reporting protocols of the buyout and venture capital industries have postponed the dissemination of much bad news occasioned by the tech stock implosion over the last nine months. But any careful observer of the private equity scene knows intuitively what reported results have not yet revealed: that many private equity firms made some very foolish investments last year.

Failed Promises. In virtually all such cases, the investments in question had two things in common. First, they were Internet-related (a pejorative broad enough to encompass the large-scale and now-failing "broadband" ventures that certain prominent "buyout" firms conspicuously elected to back). Second, they were inconsistent with the managers' espoused approaches, meaning the strategies that induced their limited partners to entrust capital to them in the first place. Having discussed this phenomenon at length in our Alternative Investments report for 3Q 2000, we'll say no more about it here, except to note that (a) we're pleased but unsurprised at how little overreaching the private equity managers employed by TIFF have exhibited and (b) we're redoubling our efforts to ensure that all managers to whom TIFF entrusts its members' capital have strong incentives (primarily financial but also psychological) to refrain from such odious behavior.

Patience Has Its Rewards

Welcome Relief. The triumph of value- over growth-oriented strategies in 2000 came as no surprise to serious students of stock market history: manias of the sort that caused "growth" (read: momentum) stocks to rocket skyward in 1999 and the first 10 weeks of 2000 (Nasdaq Composite up 130%) have **always** ended in tears. That said, no serious student of "the market" can claim **not** to have been shocked by the rapidity with which growth stocks fell out of favor from mid-March onward (Nasdaq Composite down 51% through year-end, producing the worst year for a major US stock index since — gulp — 1931). Indeed, the spreads between calendar year returns on value- and growth-oriented portfolios in 2000 were the largest in recorded stock market history (25%-45%, depending on capitalization sector), enabling some value-oriented managers to erase the seemingly insurmountable performance deficits that their adherence to time-tested valuation disciplines had produced during the latter half of the 1990s.

Only Too Human. As with the many private equity managers whose stars faded materially in 2000, the growth stock specialists whose foresight seemed superhuman in prior years have proven themselves all too human of late. This is acutely true of the once-revered but now-ridiculed sell-side analysts whose self-interest wrongly understood caused them to trumpet too loudly the vacant virtues of e-commerce ventures. Why wrongly? Because a more restrained approach to valuations could have enabled such analysts to maintain at least some credibility with their buy-side clients. As things now stand, such analysts' best hope for future riches lies in a high rate of turnover among the money managers to whom sell-siders purportedly cater. (Can you keep a secret? Sell-side analysts cater primarily to their employers' investment banking clients.) For better or worse, such turnover seems reasonably assured, since even the best-financed mutual fund family will have trouble stemming staff defections in the face of massive shrinkage in assets under management and shareholder populations.

Crossing the Rubicon. To be sure, outflows from growth stock mutual funds are not remotely close to the dollar levels that inflows reached when the Nasdaq was shooting the moon — **yet** — but year-end statements have only recently arrived in the mail, and it takes the average investor (as well as certain politicians) considerable time to concede defeat. Unfortunately, once disaffected mutual fund investors cross this mental Rubicon, there are no perceived barriers to their doing to underperforming mutual fund

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managers what Caesar sought to do to the Pompeian regime when the future dictator crossed the real river Rubicon in 49 BC. After all, most stock mutual funds permit their holders to come and go for "free." As noted in the discussion of trading costs at pages 6-7 of this report, TIFF thinks this is madness and is clinging stubbornly to its policy of asking its members to pay their fair share of the trading costs that their comings and goings generate. Regrettably, this makes some TIFF members hopping mad. We hope that members who have berated TIFF about its mutual fund transaction charges will take the time to read pages 6-7.

COMFORT HAS ITS COSTS

Stating the Obvious. It embarrasses us to state the obvious, but if we couldn't tolerate embarrassment from time to time we'd take up work that does not seek to produce readily measurable results (e.g., teaching in certain public school systems). If 2000 taught nothing else to well-intentioned fiduciaries, it reminded them that comfort and returns tend to be inversely related. Precisely because certain asset classes and subclasses had provided such comforting recent returns as 2000 commenced, they were priced in a manner that made their continued rapid ascent very unlikely. Through the innumerable relationships developed by TIFF's staff and trustees, TIFF is in the privileged (but not necessarily enviable) position of being able to monitor the investment decisions of many governing boards. Alas, the picture that we're uniquely privileged to view is not uniformly pretty: most boards are commendably contrarian in their investment decisionmaking, but some are depressingly short-sighted, a mindset that manifests itself in excessively frequent and for that very reason generally unprofitable changes in investment strategies and tactics.

Unwitting Changes. Actually, the changes in question constitute unwitting changes in investment **policy**, even if written policy statements remain unchanged. Policy as used here is defined as the articulation of (a) long-term return goals and (b) the types and levels of risk that governing boards are willing to incur in pursuit of such goals. By rotating endowment funds on a depressingly frequent basis among available asset classes and subclasses — typically in a manner that favors comfort over value — some trustee groups unwittingly reduce long-term expected returns while simultaneously increasing expected volatility. This is especially true with respect to trustees of organizations whose asset bases and governance norms make a "turnkey" approach to portfolio management such as that provided by the TIFF Multi-Asset Fund (MAF) advisable if not essential. Sadly, some organizations that can be characterized as such shifted funds out of the MAF or similar funds and into US-centric stock portfolios (including S&P 500 index funds) as the latter were cresting. In doing so, they essentially lightened up on high quality bonds (which were the best-performing major asset class in 2000), reduced their exposure to absolute return-oriented strategies (which also performed well in 2000), and augmented already-heavy bets on the continued rise of large capitalization US growth stocks.

Least-Worst Choice. We hope but would never expect endowed organizations to display sounder judgment in 2001, especially respecting MAF and vehicles like it. Although it outperformed virtually all domestic stock portfolios (including index funds) in 2000, the MAF's unswerving commitment to equities in general (55% normal allocation) and to non-US equities in particular (25% normal allocation, equaling 45% of the 55% overall stock allocation) caused it to produce a modest 2.5% return in 2000. The fact that the Fund added substantial value relative to the markets in which it invests (approximately 400 basis points in 2000, on top of 530 basis points the prior year) may not be enough to induce some governing boards to view it as the least-worst solution to their long-term marketable securities needs. But the MAF is arguably exactly that (i.e., the least-worst choice) for some governing boards, including all those now inclined to shift material sums on the margin out of stocks (especially foreign ones) and into high-grade bonds, i.e., out of instruments that proved uncomfortably volatile in 2000 and into those whose returns were pleasingly positive during this very memorable year.

GLOBALIZATION HAS ITS DRAWBACKS

Cardinal Fact. Speaking of the real and perceived risks of global diversification, we feel compelled to highlight another important lesson that investors should draw from market action in 2000. Without question, capital markets are becoming increasingly globalized (a trend for whose continuance all citizens of the largest debtor-nation in world history should devoutly pray). What's more, the accelerating convergence of accounting and disclosure standards is making it easier for competent investment professionals to make informed judgments respecting the relative valuation of securities traded in different countries. These salutary trends are highly consistent with TIFF's long-held view that there are fewer truly distinct "asset classes" available to investors than most asset allocation models assume. (A quick aside: "hedge funds" are anything but a distinct or homogeneous "asset class," the marketing claims of some funds-of-funds notwithstanding.) The flip side of this argument is that governing boards that have finally persuaded themselves to reduce their "home country biases" (a trait shared by virtually all investors, regardless of domicile) may discover that the benefits of global diversification have been greatly oversold. That was indeed

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the case for many US-based investors in 2000, for reasons anticipated by warnings that TIFF issued at pages 6-7 of its Commentary for 4Q 1999. Our concern was that foreign stock markets had become almost as skewed toward TMT shares (technology, media, and telecommunications) as had the US market. We didn't hazard a guess as to when the TMT party would end, nor did we forecast that dollar strength would add insult to injury to US holders of tech-centric foreign stock portfolios in 2000. Happily for TIFF members, all TIFF vehicles that invest routinely in foreign stocks were underweighted in TMT shares throughout 2000, which is the chief reason that all such vehicles beat their benchmarks by wide margins on the year. Unhappily, even the best pilots fail to provide smooth flights when atmospheric conditions are turbulent, and TIFF's foreign stock mutual funds as well as the foreign stock segment of its Multi-Asset Fund produced negative absolute returns in 2000. So too did virtually all diversified foreign stock portfolios held by US-based investors, thus underscoring a cardinal fact about investing: just when you think you've gotten everything figured out — e.g., you've diversified your equity bets among multiple countries in an effort to reduce risk — markets behave in unexpected ways.

Familiar Tune. In the case at hand, efforts to shed risk by diversifying equity bets on a global basis proved fruitless, with most foreign markets falling (tech-starved but oil-rich Russia being the unsurprising exception) as tech stocks worldwide morphed from must-haves to have-nots. Devotees of TIFF's preferred approach to asset allocation (discussed in mind-numbing detail in our Commentaries for 1Q and 2Q 1999) hopefully avoided the mistake of assuming that foreign stocks would provide meaningful protection during truly rough times for US stocks: our two-part monograph on asset allocation warned explicitly that they would not. Of course, now that investors have awakened to the fact that capital markets are becoming increasingly globalized and have arrayed their assets accordingly, US and foreign stock markets will probably … decouple. They can't diverge forever, of course, nor too materially, else arbitrageurs will step in and make money exploiting unjustified valuation discrepancies. But US and foreign markets could diverge over time periods that exceed the actual as distinct from theoretical time horizons of many investment committees, especially if the US dollar gives back some of its recent gains. In short, now would be a bad time to jettison foreign holdings in favor of overly US-centric approaches to asset allocation. The fact that TIFF has sung the same tune on past occasions, in advance of relative gains for US stocks, does not render such warnings misguided, even in hindsight. On all matters relating to endowment management, if not life itself, TIFF takes the long view. Broadening one's investment universe to include the very large set of opportunities available outside the US is unarguably sound policy — long term — for return enhancement more than diversification reasons. (We'd make this argument even if foreign stocks weren't as attractively priced relative to US stocks as they appear today, on grounds that foreign markets remain compellingly fertile ground for active stock-picking.)

REAL ASSETS HAVE REAL APPEAL

Inefficiencies Abound. Contemptuous as we are of corner-cutting, but committed as ever to helping endowed charities invest wisely, we're logically drawn to asset classes that provide true as distinct from apparent diversification within portfolios properly biased toward common stocks. Which assets fit the bill? Inflation-linked bonds (ILBs) come immediately to mind, for reasons discussed in the two table-pounding (i.e., bullish) pieces on ILBs that TIFF published in 2000. (Copies available upon request, as are materials describing TIFF's proposed Inflation-Linked Bond Fund.) We're also powerfully impressed by the diversifying power and — dare we say it? — return potential of two other forms of investment that remain relatively out of favor as the new century begins to unfold: real estate and resource-related assets (including but not limited to oil and gas and mineral producing properties). We see large inefficiencies in the realty and resource-related sectors, but even absent such inefficiencies, we might nonetheless recommend such holdings for diversification reasons alone. Given the pricing anomalies to which we're alluding, we think that realty and resource-related investments could also help some endowed organizations earn enhanced long-term returns. Alas, the securities laws to which the cooperative is subject prohibit us from discussing here the initiatives we are considering. But you know how to reach us (see back cover). ■

Iacocca Was Wrong. "When the product is right," Lee Iacocca once observed, "you don't have to be a great marketer." With due respect, Iacocca was wrong. While we'd never claim that the mutual funds that TIFF administers are perfect in design and management, we do believe that at least one initial design choice made long ago remains unarguably sound. Ironically, the policy in question has proven as unhelpful in a marketing sense as it has helpful in vouchsafing our members' interests. The policy to which we're alluding is the levying of transactions charges on cash flows into or out of TIFF's equity-oriented mutual funds. The discussion of such charges that follows seeks to help trustees better understand why TIFF insists on safeguarding its members' interests in this manner.[1]

Offputting but Essential. The generally strong relative performance of the TIFF funds in recent years has spawned heightened interest in them among eligible charities. This is a welcome development in TIFF's eyes, because in contrast to TIFF's private equity and absolute return-oriented offerings its mutual funds could readily and immediately accommodate new members and assets without sacrificing return potential. That said, the current wave of interest in TIFF's mutual funds does pose a problem for staff, albeit one of its own making. Since their inception, those TIFF-sponsored mutual funds that invest routinely in equities have levied transaction charges aimed at making participating non-profits pay their fair share of trading costs generated by their comings and goings. When staff proposed to TIFF's founding board that it approve the levying of such charges, it knew full well that they would prove offputting to some eligible charities. It knew also that some folks would confuse such fees with "loads" — the loathsome tolls that some mutual fund sponsors stuff into their own pockets when money flows into (and in some cases out of) the funds that they administer. Because they get paid to the TIFF funds themselves, rather than to TIFF or persons associated with it, the transaction charges levied by TIFF's equity-oriented mutual funds have nothing in common with "loads" (except a tendency to repel certain investors). Indeed, their *raison d'être* is wholly different from the aims underlying "loads," which exist solely to generate profits for fund sponsors. TIFF's entry and exit charges exist solely to compensate non-transacting members for the costs that they would otherwise be forced to bear when cash flows into or out of such funds.

[1] This essay focuses on TIFF's equity-oriented mutual funds (of which there are four at present; see table on following page) because the dominance of highly liquid government debt in bond markets makes trading costs almost immaterial with respect to investment grade debt portfolios of the sort administered by TIFF. This explains why the TIFF Bond and Short-Term Funds do not assess entry and exit fees, whereas our other funds (which invest primarily or exclusively in stocks) do levy such charges.

Frictional Costs. Regardless of whether an endowed organization invests via commingled vehicles or separate accounts, it incurs costs when converting cash into portfolio securities or vice versa. These costs fall into four distinct categories, three of which are susceptible of precise measurement and one of which is not. The measurable costs are (1) brokerage commissions, (2) custodial bank charges, and (3) applicable government fees. Though not insignificant, these costs of doing business tend to pale in comparison to the other, generally unmeasurable cost that investors incur when buying and selling securities: "market impact." Market impact means the incremental wealth that one party to a trade must transfer to the contra party to bring the trade to fruition; it is generally unmeasurable because security prices tend to fluctuate throughout each trading day in response to multiple factors, most of them unrelated to the needs or motives of the two parties involved in a given trade. For example, if my broker tells me that a stock I seek to buy is "$49.75 bid, $50.25 offered" at 10 a.m. on a given day, and I ultimately end up buying the stock at $50 at 10:15 a.m., I cannot simply infer that "market impact" cost me $0.25 per share (i.e., my purchase price of $50 less the pre-existing "bid" of $49.75). After all, between the time I place my order and the time it gets filled, exogenous events could cause other investors to place their own orders to trade the stock in question, causing its price to change for reasons unrelated to my own activity. This is true even if the lag between my placement of an order and its execution is very brief.

Unknowable but Not Immaterial. Of course, with respect to isolated trades (especially those involving very thinly traded stocks), I can probably estimate my "market impact" with reasonable accuracy. But with respect to a series of trades involving many different securities, there is no way of measuring precisely what we've referred to here as "market impact." But we do know from analysis and experience that, at least with respect to stock trades, "market impact" is anything but immaterial. Of course, materiality like beauty lies in the eyes of the beholder. But as TIFF beholds its members' investable wealth, the $0.25 per share of "market impact" cited in the above example is hardly immaterial, equating as it does to 0.50% of the recorded purchase price of $50 per share. To be sure, the estimated "market impact" of the typical US stock trade is less than 0.50%, but as noted in the table at page 7 the **total** costs of the average trade (including commissions and other frictional costs) are not much below 0.50%, and "market impact" alone can be far higher with respect to some trades.

Wired World. The ease with which investors in today's wired world can trade securities causes some folks to conclude that stocks can be bought and sold essentially for "free." This mistaken impression is reinforced by today's

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staggeringly high trading volumes, which seduce some folks into believing that their relatively small trades can't possibly "move the market." Obviously, viewed in isolation, one individual investor's decision to sell a small block of shares of a liquid stock such as Cisco cannot be said to "move the market." But viewing in isolation anything having to do with investments is perilous indeed, and it would be unwise for trustee groups to assume that they can buy and sell stocks at will without incurring frictional costs. This admonition applies to separate accounts as well as commingled vehicles, including the many mutual funds that prefer to submerge rather than highlight (as does TIFF) the costs of facilitating shareholders' ins and outs. Returning to our Cisco example, it should be obvious that a decision by a mutual fund behemoth like Fidelity to sell even part of its gigantic block of Cisco shares will indeed "move the market." And to the extent that Fidelity's sell decision is motivated not by its perception that Cisco shares are overvalued but rather by the need to raise cash to finance mutual fund redemptions, the non-redeeming shareholders will suffer as a result of the downward price pressures created by the exiting holders' decision to bail. The deleterious effect of mutual fund **inflows** is perhaps a bit harder to discern because "buys" put upward price pressures on portfolio holdings that assumedly redound to the benefit of a fund's pre-existing investors. But, sticking with our example, if mutual fund inflows rather than changed fundamentals are the sole reason Fidelity is buying a big slug of Cisco on any given day, the safe assumption is that it will be forced to "pay up" to get other Cisco holders to part with their shares. Unless Fidelity charges entering mutual fund investors an entry fee — which it and most of its competitors do on shockingly few funds — the pre-existing holders of the fund buying Cisco will get socked with costs that they should not properly bear.

Timing Is Everything. The inherent unfairness of **not** levying explicit charges on mutual fund purchases and redemptions is exacerbated by the peculiar way in which shareholder ins and outs are reflected on a mutual fund's books. As many readers are aware, most equity trades "settle" one day after the trades themselves have been executed. In other words, if a manager employed by the TIFF US Equity Fund sells 10,000 shares of Company XYZ at $50 per share on a given Monday afternoon in order to raise cash to meet a foundation's urgent redemption request received by TIFF that morning, the shares will remain in the Fund's possession until Tuesday. Sometime on Tuesday, ownership of the shares will transfer to the buyer (through the medium of an automated clearing house), with the Fund receiving about $500,000 in "cash." We say "about $500,000" because the ultimate proceeds will be reduced by the three measurable forms of expense identified above (commissions, custodial bank fees, and relevant governmental levies). Moreover, the $50 per share proceeds assumedly reflect real but unknowable "market impact" as defined above. Now consider this question: when does the redeeming foundation in our example get priced out of the Fund? The answer is, "At the Fund's close of business on **Monday**." As can be seen, if the redeeming member gets priced out on Monday night but the securities sales triggered by its redemption aren't booked until Tuesday (for reasons lying totally beyond TIFF's control), the redeeming member is essentially shifting some of the costs of converting securities into cash to the Fund's other holders. Strike that: the redeeming member **would** be shifting such costs to other holders if the TIFF fund in question did not levy an exit charge aimed at mitigating this harm. Needless to say, a similar problem arises with respect to purchases of Fund shares, which trigger trading whose costs (measurable or otherwise) often do not get reflected in the stated net asset value of a Fund's shares until days after the member's purchase has been recorded in the Fund's capital accounts. Why? Because in an effort to mitigate "market impact" TIFF's outside managers do not always put incoming cash to work immediately.

Believe It or Not. It may surprise TIFF members who've complained about the transactions charges we've been discussing to learn that such charges don't cover staff's best guesses respecting the true costs of trading incurred by the TIFF funds in question:

TIFF Fund*	Estimated One-Way Trading Costs	Entry/ Exit Fee**
Multi-Asset Fund	0.60%	0.50%***
International Equity Fund	0.95%	0.75%
Emerging Markets Fund	2.10%	1.00%
US Equity Fund	0.45%	0.25%

* As noted in footnote 1 at page 6, the TIFF Bond Fund and TIFF Short-Term Fund do not charge entry or exit fees.

** The fees in question apply only to transactions that trigger trading within each fund. Accordingly, such fees are waived on dividend and capital gains distributions (as well as the reinvestment of same) and on in-kind contributions and redemptions. The latter are permitted by the prospectus but are exceedingly rare.

*** At their December 2000 meeting, TIFF's mutual fund directors approved staff's recommendation to reduce MAF entry and exit fees from 0.75% to 0.50%, effective December 15, 2000.

Why doesn't TIFF **raise** the transactions charges shown above to cover the true costs of trading? Because we'd rather undershoot than overshoot, mindful that trading costs continue to decline. Also, strange as it may seem, we don't really enjoy being harangued about such charges, and we're certain that complaints about them would become more numerous and strident if we boosted them to levels consistent with each fund's true trading costs. ■

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Big Shoes, Well Filled

Smooth Baton Pass. At its most recent meeting, the TIFF board paid tribute to departing trustee Robert Kasdin and approved unanimously the nomination of a worthy successor, Michael McCaffery.

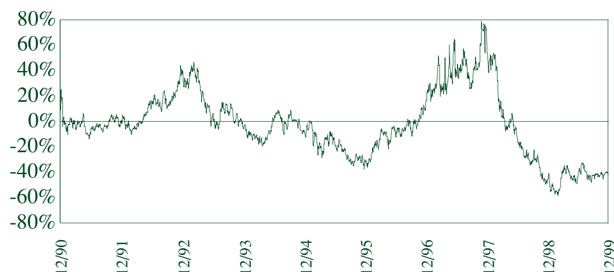
Hail, Hail. A multi-talented and conscientious executive, Mr. Kasdin was treasurer of the famed Metropolitan Museum of Art in New York City when he joined TIFF's board. For the past few years, he has performed with distinction the wide variety of tasks falling on the shoulders of the University of Michigan's chief financial officer. As noted in a memorable adaptation of Michigan's stirring fight song ("The Victors") that TIFF's board belted out in his honor, Mr. Kasdin contributed materially to the board's conversations and happy karma during his multiple years of board service. TIFF is very grateful for the wise counsel that Mr. Kasdin provided.

No Recount Needed. Mr. McCaffery's landslide election reflects his superb qualifications for TIFF board service. As president of Stanford Management Company, Mr. McCaffery serves as Stanford University's chief investment officer. Prior to his return to Stanford, from which he received his MBA, Mr. McCaffery enjoyed great success in investment banking, including a successful tenure as CEO of San Francisco-based Robertson Stephens & Co. Of course, Mr. McCaffery's professional success is unsurprising to those who knew him when he was literally wet behind the ears: a star student and swimmer at Princeton, Mr. McCaffery also earned academic and athletic laurels as a Rhodes Scholar at Oxford. TIFF's board and staff are pleased and gratified that Mr. McCaffery has agreed to serve and look forward to working with this able gentleman and his SMC colleagues in coming years. ■

Real Opportunity

Interestingly Inefficient. TIFF's staff furnished the exhibit below to TIFF's trustees in support of the board's ongoing (and very interesting) conversation about the means TIFF might employ to help eligible charities exploit investment opportunities in the resources sector, including energy broadly defined. Before explaining how the exhibit was compiled, we'll summarize what it tells us: it tells us that there's potentially good money to be made exploiting the market's tendency to misgauge future commodity price movements. The graph plots the divergence between the price of 12-month crude oil futures contracts on a given date and crude's actual spot price 12 months later. With respect to 41% of the data points that the graph comprises, spot prices deviated from forward prices (as reflected in futures trading) by **20%** or more. Trim the study so that it comprises only rolling 12-month periods starting after December 1996, and the errors exceed 30% more than two-thirds of the time. How can endowed institutions exploit such confusion? We're not quite prepared to tip our hand, but large and persistent divergences of the sort pictured here theoretically create interesting opportunities for long-term investors to buy certain "inflation hedging" assets, lay off price risk (via derivatives), and thereby lock in attractive real returns, while perhaps also retaining at least a share of future price increases.

Crude Oil Forecasting Errors



Membership Summary

	Number of Members	Assets
TIFF Membership	**285**	**$1,727 mm**
▪ Private Foundations	159	$1,002 mm
▪ Community Foundations	27	$257 mm
▪ Other 501(c)(3) Organizations	99	$468 mm

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