TIFF

Enhancing the investment returns of non-profit organizations

COMMENTARY

A Quarterly Report of TIFF EDUCATION FOUNDATION

SEPTEMBER 30, 2004

Board Members

Highlights

- Their perpetual life status notwithstanding, some endowed charities would be well-served if their trustees focused less on the hereafter and more on the harms wrought here and now by their inattentiveness to a fundamental prerequisite for investment success: a concise and internally consistent investment policy statement (IPS).

- Like weak punting and persistently poor field position in football, prolixity and inconsistency tend to go hand in hand with respect to IPSs: the lengthier the list of return goals and risk parameters a trustee group stuffs into an IPS, the likelier it is that these goals and parameters will conflict.

- Investors can "take" only what markets "give," and they "give" or offer expected returns today that make it extraordinarily challenging to "solve" for 5+% real returns on well-diversified asset mixes without incurring what many trustee groups deem intolerably high risks.

- The illustrative IPS furnished at pages 3–8 is both leaner and meaner than the last such template that TIFF published five years ago. It's leaner because brevity's a virtue. And it's meaner because it reflects updated and generally lower guesstimates of the real returns that well-diversified endowments might earn over time horizons appropriate to investment policy formulation.

About TIFF

Origins. In 1991, a network of foundations founded an investment cooperative whose organizational structure and eligibility criteria have evolved over time but whose core mission has not. Known colloquially as TIFF, the cooperative seeks to improve the investment returns of endowed charities by making available to them a series of multi-manager investment vehicles plus resources aimed at enhancing fiduciaries' knowledge of investing. The cooperative comprises three regulated entities at present: a tax-exempt private operating foundation whose d/b/a (TIFF Education Foundation) is more descriptive of its focus on education and research than its formal legal name (The Investment Fund for Foundations); the TIFF Investment Program (TIP), a SEC-regulated mutual fund family; and TIFF Advisory Services (TAS), a taxable non-stock corporation and SEC-registered investment advisor that administers all investment vehicles bearing the TIFF name. As noted at left, there is substantial but not complete overlap among these three entities' boards, all of whose members except Richard Flannery and David Salem serve as unpaid volunteers.

Inquiries. For more information, please call TIFF at 434-817-8200 or visit www.tiff.org.

Vital Task. Honoring our pledge in last quarter's 10th anniversary issue of this commentary to kick the habit of larding these musings with references to The Game That Shall No Longer Be Named (henceforth TOG, short for "That Other Game"), we've borrowed the title for this report from a sport that's assumedly less appealing than TOG to all recipients of it — excepting perhaps any orthopedic surgeons who've found their way onto our mailing list. Football holds less appeal than TOG to this staff if not also to many of our readers not because it is less cerebral than TOG — pro quarterbacks can get quite a workout merely by lugging their monstrously thick playbooks around — but because football is dominated by the clock whereas TOG is devoid of temporal constraints. That untimed pursuits hold more appeal than timed ones for persons whose lives' work is stewarding capital for perpetual life charities should be unsurprising to our readers. Nor should they be surprised by our seemingly contradictory assertion that, all such charities' long life expectancies notwithstanding, some would be well-served if their trustees focused less on what the distant future might hold and more on the ongoing harm wrought by their inattentiveness to a fundamental prerequisite for investment success: a clear and concise written description of both the ends sought by their investment programs and the means to be employed in pursuit of these ends — in short, a **concise** and **internally consistent** investment policy statement (IPS). We emphasize concision and internal consistency because these have been the two attributes most lacking in the hundreds of IPSs that this staff has reviewed during the many years that it has labored in the endowment arena. Of course, like weak punting and persistently poor field position in football, prolixity and inconsistency tend to go hand in hand with respect to investment policy statements (to say nothing of political party platforms!): the lengthier the list of return goals and risk parameters a trustee group wants to stuff into its IPS, the likelier it is that these goals and parameters will conflict.

Lean and Mean. Long-time readers of this series will recall that we sought to assist trustee groups engaged in the endowment arena's equivalent of blocking and tackling — i.e., investment policy (IP) formulation — by publishing a two-part IP handbook of sorts back in 1999. Part I, which focused on the premises or "first principles" underlying well-managed investment programs, appeared in the TIFF *Commentary* dated March 31, 1999. Part II, which comprised an illustrative IPS, appeared in the TIFF *Commentary* dated June 30, 1999. In our biased opinion, both documents remain choiceworthy reading for trustee groups struggling to formulate sensible IPSs *circa* 2004, despite having been published a half-decade ago. That said, Part II arguably merits revision — not because the passage of time has rendered it inapposite to fiduciaries' needs but because writers can always find ways to make even concise works briefer without undermining their practical utility. (A conspicuous exception to this rule was Ernest Hemingway, who met his self-imposed quota of 250 words of polished prose per day with writings as irreducibly lean as legendary punter Ray Guy.) Moreover, even if we remained as content with the illustrative IPS we published in 1999 as Mr. Guy was with the 93 (sic) yard punt he booted early in his storied career, we'd be publishing a "model" IPS of some sort here — as a cost-efficient means of responding to the multiple requests we receive each month for help with this fundamentally important but time-intensive task. (It's so time intensive that the cooperative must decline requests to devote large dollops of staff time to "customizing" statements of the sort proffered below.) By careful design the illustrative IPS furnished here is not just leaner than the one published in 1999, it's meaner also. It's meaner because it reflects updated guesstimates of the real or inflation-adjusted returns that well-diversified endowments are likely to earn over time horizons appropriate to investment policy formulation. With just one exception — foreign equities — these guesstimates are even more sobering today than they were five years ago, with expected returns on so-called hedging assets (i.e., high quality realty and bonds) having eroded the most due to large capital inflows into these asset classes.

Moving Targets. From whence have such inflows derived? Ultimately, they've come from the Fed, which has pumped more money into the global economy over the last five years than even extreme proponents of monetary ease counseled or expected it to do. The liquidity so created has made it easier than it would have been otherwise for endowed charities to preserve endowment purchasing power over the last half-decade without big and lasting cuts in annual withdrawals — gyrating stock markets notwithstanding — but has created a dilemma of sorts for some, especially for private foundations legally obliged to spend an average of 5% of their assets each year. Assuming as it does that future real returns will fall short of 5%, the IPS furnished here may seem unresponsive to the needs of endowed charities with spending rates of 5% or higher. We lament this fact but offer no apologies for it, as investors can only "take" what markets "give," and they "give" or offer expected returns today that make it extraordinarily difficult to "solve" for 5+% real returns on well-diversified asset mixes without incurring what many trustee groups deem intolerably high levels of reputational or peer group risk. (As an aside, some trustee groups or vendors retained by them have nudged expected real returns above the 5% threshold by engaging in "portable alpha" or dynamic asset allocation strategies to an extent that goes far beyond the policy framework outlined below. Your editor applauds such envelope-pushing, when it is done with extreme care, but extensive experience in eleemosynary fund management suggests that it entails excessive reputational risk for many trustee groups.) Of course, peer group risk, like essentially all forms of risk, is a moving target, and there's a non-zero chance that some fiduciaries will respond to the melancholy message we're consciously sending here by weighting non-US dollar-denominated assets in general and non-US equities in particular (private as well as public) even more heavily than does the IPS that follows. In our opinion, doing so would enhance the odds of achieving the objectives set forth in it. Why then haven't we stuck out our necks to a greater extent and proposed an even less US-centric approach to endowment management than the one proffered below? Because experience suggests that if we were to let sensible long-term risk and return forecasts for all asset classes be the **sole** determinant of the allocation targets and ranges outlined below, the resulting asset mix could cause some trustee groups to trash this document as readily as Ray Guy kicked the football when it was snapped to him. That said, we feel compelled to observe that the large upward revaluation in US financial assets since the early 1980s has lowered their expected returns to levels that arguably justify lower **policy** weights to such assets than those set forth below. The last sentence may seem to ascribe undue importance to current valuations in the policy formulation process but the current price tag on an asset or asset class always merits at least as much emphasis as past returns, even in the context of truly long-term planning. Our fervent hope is that, however US-centric their thinking is now or is destined to be, trustee groups lacking carefully considered IPSs of their own will spend materially more time with the illustrative IPS that follows than Ray Guy spent handling the ball when it was snapped to him. How quickly did Mr. Guy get his kicks airborne? Quick enough to execute 619 consecutive punts (out of a career total of 1,049) without a "block"— second on the NFL's all-time list.

Just Ask. Endowed charities seeking to lay hands on a manipulable (Word-based) version of the illustrative IPS below should zap an email to info@tiff.org.

INVESTMENT POLICY STATEMENT (IPS) FOR XYZ CHARITY

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Preface. The board of XYZ [sic] believes that investment committees function best when they are kept small in size and when participation in committee deliberations is confined to persons who are closely familiar with an organization's investment policies and practices. To the extent that members of the XYZ board or staff who do not serve on its investment committee ("IC") attend IC meetings, it is expected that they will have read this document, recently and in its entirety, before playing an active role in IC discussions. The IC shall review this document on an ongoing basis and make changes as needed. Material changes shall be communicated to all board members.

I. Key Boundary Conditions

A. Cash Flow Requirements. As a publicly supported organization, XYZ is not legally obliged to spend a stated percentage of its endowment assets in any given year. However, in order to achieve both reasonable stability in budgeting and a reasonable balance between near-term and distant programmatic priorities, the board has adopted the following spending rule: spending in any given fiscal year shall equal 70% of spending for the prior fiscal year, adjusted for cumulative changes in inflation (as measured by CPI), plus 30% of XYZ's long-term spending rate applied to the endowment's market value at the beginning of the fiscal year. As of the date of the adoption of this statement, XYZ's long-term spending rate is 4%.

B. Return Objective. XYZ's return objective is to preserve and if possible enhance the purchasing power of its endowment assets, net of costs and board-approved withdrawals, over rolling five-year periods. This goal is synonymous with the pursuit of a time-weighted net return on endowment assets that equals and if possible exceeds inflation (as measured by CPI) plus XYZ's long-term spending rate measured over rolling five-year periods.

C. Risk Parameters. XYZ stands prepared to incur risks consistent with its pursuit of the return objectives set forth above, subject to two overarching limits: its endowment should be deployed in a manner that reduces to tolerable levels (defined as 25% or below) the probabilities that it will suffer (1) peak-to-trough declines in endowment purchasing power exceeding 30% or (2) a shortfall exceeding 3% in XYZ's annualized endowment returns relative to those of a board-approved peer group measured over rolling five-year periods. These two overarching risk parameters are deemed choiceworthy as a means of reducing the probability that the IC or full board will undermine XYZ's capacity to achieve its return objectives by modifying its investment policies or practices at inopportune times. The endowment's ongoing adherence to these parameters shall be monitored using the statistical techniques illustrated in Exhibit 2.

D. Measurement Periods. The adoption of rolling five-year periods for assessment of results reflects a balancing of the return objectives set forth above with the board's perceived tolerance for unexpectedly poor results. The five-year period for assessing results is intended as a floor but not a ceiling: its adoption indicates that the board ascribes little importance to declines in endowment purchasing power that have persisted for less than five years, unless they entail peak-to-trough declines exceeding 30%. The 30% limit serves as a proxy for XYZ's tolerance for changes in its financial condition that, however transitory when viewed in hindsight, would likely trigger fundamental changes in the scope and character of its programs.

II. Policy Portfolio

A. Purposes. XYZ's Policy Portfolio (furnished in Exhibit 1) represents the highest expected return asset mix that, in the investment committee's opinion, is likely to satisfy the objectives and risk parameters set forth above. Because the Policy Portfolio entails benchmarks for each of its segments, and hence also for the endowment as a whole, it constitutes an appropriate standard by which to measure progress toward achievement of the objectives set forth above.

Use and Potential Abuse of Policy Portfolio. The board recognizes that XYZ's actual returns could lag the Policy Portfolio's returns over any interim measurement period, for two reasons. First, the IC has discretion to shift funds across segment boundaries (within prescribed limits) to enhance returns or reduce risks. When exercising such discretion, the IC recognizes the difficulty of making timely shifts across segment boundaries. Accordingly, the IC and its delegates refrain from making frequent shifts other than for rebalancing purposes. Second, the IC has discretion to deploy the capital allocated to each segment into holdings other than those whose evolving returns mimic precisely each segment's benchmark. When exercising such discretion, the IC's decisions shall employ the criteria for asset substitution set forth in section D below.

B. Process. The Policy Portfolio was established initially and gets revised periodically based on research and discussion involving IC members, other XYZ trustees, staff, and outside experts. Such discussion focuses on XYZ's liquidity needs and perceived risk tolerance, as well as the projected behavior of asset classes and strategies deemed worthy of consideration for XYZ's potential use. The return objectives and benchmarks for each segment are based on an analysis of capital market history, adjusted for valuations and economic conditions at the time this statement of policies was last revised. The Policy Portfolio is reviewed regularly by the IC and modified as needed in light of experience and changing circumstances.

C. Return Expectations. The Policy Portfolio set forth in Exhibit 1 includes real return expectations for each segment that are themselves the sum of two independent variables: (a) an expected real return for the assets comprising the segment's benchmark if held on a passive or indexed basis over time horizons appropriate to perpetual life charities and (b) an assumed premium from active management (net of fees and trading costs). These premia or "alphas" are necessarily "best guesses," and are necessarily expressed in the form of point estimates rather than ranges. In practice, the higher the expected return on an asset class or subclass, the larger the range of expected alphas, i.e., the greater the dispersion between the long-term returns produced by the best-performing managers and those produced by the worst-performing managers.

Portable Alpha. The Policy Portfolio reflects two related and important assumptions with respect to the deliberate overweighting of any of the Portfolio's segments: first, the types of securities normally represented in a segment will be overweighted (relative to the segment's normal weight) only when the IC concludes that the excess return opportunities presented by such securities are truly compelling; second, the economic impact of funding decisions that would otherwise cause segment weights to fall outside the ranges specified in the accompanying guidelines shall be neutralized through the use of derivatives and similar securities.

D. Asset Substitution. The Policy Portfolio is founded on the assumption that the IC will exercise judiciously its discretion to allocate assets within segments in a manner that will cause each segment's actual returns to diverge favorably from the returns of its specified benchmark.

Selection Criteria. IC decisions to employ assets other than those comprising each segment's benchmark shall be based on a careful assessment of the following variables: expected returns, net of fees, expenses, and, with respect to leveraged investments, financing costs; a substitute investment's capacity to reduce overall fund downward volatility; and the ease with which such assets can be accounted for and traded. The weight accorded each of these variables shall differ depending on the segment in which an asset would be held. As a general rule, substitute assets held within segments whose primary purpose is to enhance overall fund returns are not expected to contribute to the reduction of overall fund downward volatility, whereas substitute assets held within segments whose primary purpose is to control overall fund downward volatility must have the potential to both achieve that purpose and to outperform a "naive hedge" over a rolling five-year time period (or longer periods in the case of investments entailing longer-term lock-ups). "Naive hedge" as used here means the benchmark for the hedging segment in which a substitute asset being considered for purchase would be held.

Alpha Estimates. When adding substitute assets to each segment, staff shall propose and the IC shall approve or modify estimates of each prospective investment's expected annualized real return over its expected holding period defined three ways: (1) worst case, (2) best case, and (3) best point estimate. The purpose of specifying expected returns in this manner is to ensure that substitute assets embody an acceptable trade-off between risk and expected return, with risk defined broadly to include (*inter alia*) illiquidity and potential declines in capital values or current income yields. In the case of actively managed holdings and excepting those cases where active excess returns ("alphas") are indistinguishable from indexed or passive returns (e.g., private equity), staff shall specify each of these two sources of total return under scenario (3) [i.e., best point estimate], as well as the expected volatility of such "alphas."

E. Subsegment Benchmarks. As a means of promoting regular and rigorous consideration of (1) the endowment's progress toward achievement of its longer-term objectives and (2) investment opportunities and perils confronting XYZ, staff shall propose and the IC shall approve the specification of a relevant benchmark for assessing the performance of each endowment subsegment. (Subsegment as used here means any combination of securities, including investments consummated via separate accounts or commingled funds, held within a given segment that the IC has grouped for monitoring and measurement purposes based on such assets' fundamental characteristics.) In some cases (e.g., with respect to an internally managed TIPS subportfolio held in the All-Purpose Hedge segment), the most relevant benchmark for a subsegment will be identical to the benchmark for the segment to which the holding has been assigned. In other cases (e.g., an externally managed account of foreign stocks held within the marketable stocks segment), the chosen index or benchmark will differ materially from the benchmark for the segment in question. The more material the difference between the index deemed most relevant to a specific subsegment and the benchmark for the segment in which it is held, the more conviction the IC must have that the asset or strategy in question can achieve the segment's overall return objective.

F. Illiquid Assets. XYZ may invest without limitation in illiquid assets, defined for these purposes as assets that cannot be liquidated for cash within 53 weeks, except that new agreements to purchase such assets shall not be executed if the aggregate market value of all such illiquid assets exceeds 50% of the aggregate market value of XYZ's investable assets. The purpose of this cap is to ensure that the sufficient amounts of cash can be withdrawn from the endowment without triggering the sale of holdings at depressed prices.

G. Leverage. Under normal circumstances XYZ will not engage in borrowing for purposes of enhancing returns. However, the IC has discretion to purchase assets using borrowed money, provided that such debt financing does not exceed 5% of the total endowment's market value when any such purchases are consummated nor 10% of total endowment assets at any subsequent valuation date. As defined here, leverage shall not include derivatives or similar securities held for purposes of equitizing cash or short positions.

H. Transporting Alpha Using Derivatives. To facilitate XYZ's aggressive exploitation of active management opportunities, segment weights that would otherwise fall outside the ranges set forth in Exhibit 1 without regard to any derivative securities holdings may be perpetuated so long as segment weights fall within specified ranges after the notional values of such holdings are taken into account.

III. Implementation

A. Staff Responsibilities. The chief investment officer (CIO) and her staff are responsible for day-to-day management of the endowment, for promoting the IC's discussion of investment opportunities and perils, for implementing decisions made by the IC, and for rebalancing the endowment as needed to ensure compliance with the asset allocation ranges set forth in Exhibit 1.

Manager Selection. The CIO has discretion to hire external managers provided that she provides to each member of the IC a due diligence memo respecting each prospective manager at least 15 business days in advance of the manager's initial funding. This 15-day notice requirement is intended as a floor rather than a ceiling, the assumption being that staff and the IC will conduct an ongoing discussion of promising managers, with the IC approving informally the hiring of designated managers prior to the commencement of highly time-intensive due diligence tasks (e.g., the preparation of formal memos or the performing of detailed tax and legal analyses). The CIO also has discretion to terminate external managers provided that she provides to each member of the IC written notice of the planned termination at least five business days in advance of the termination. When hiring and terminating external managers, staff shall be guided by the selection criteria set forth in Exhibit 3.

Staff Compensation Plan. The IC believes that XYZ's long-term interests would be well-served by adoption of compensation arrangements for the CIO and other senior investment professionals comprising at least three parts: (1) base salary, (2) a qualitatively determined bonus awarded and paid annually, (3) a quantitatively determined bonus awarded annually but paid out in accordance with "clawback" provisions designed to inhibit undue risk-taking (e.g., year-end "gaming"). These arrangements are described in a separate document.

B. Investment Committee Responsibilities. The IC shall oversee staff's fulfillment of its responsibilities as specified above and shall also be responsible for reviewing on an ongoing basis the performance of the overall endowment and its constituent parts. Aided by staff, it shall also be responsible for monitoring and exploiting opportunities to enhance returns through asset substitution as that task is defined above.

Committee Composition. To avoid "lowest common-denominator" decisionmaking as well as excessive diffusion of responsibility for portfolio results, XYZ's IC is small in comparison to peer group norms. At present, it comprises four voting members: XYZ's president; its chief investment officer; and two outside trustees of XYZ, each of whom has demonstrated competence supervising institutional funds.

Future Additions. The board is committed to keeping the IC's membership at five individuals or fewer under all circumstances, including any non-trustees serving as voting members of the committee.

Decisionmaking Process. Given the IC's relatively small size and the extensive investment experience of its members, the committee deems it wise to operate on a consensus basis with each member enjoying a *de facto* veto over non-delegable decisions (i.e., policy decisions that the IC rather than staff is authorized to make).

C. Rebalancing. Mindful that XYZ's actual portfolio comprises in part illiquid assets, its choice of an appropriate rebalancing rule is essentially a choice between two simple alternatives: (1) rebalancing to norms, i.e., as soon as practicable following the valuation of all endowment holdings, segment weights are restored to the targets specified in the accompanying exhibit; or (2) rebalancing to allowed ranges, i.e., as soon as practicable following the valuation of all endowment holdings, segment weights are adjusted, but only to the extent needed to move each weight back within its specified range. Which rule will work best in any given investment environment depends on a host of inherently unforecastable variables, including the correlation of returns among the assets susceptible to rebalancing, estimated trading costs, liquidity needs, and qualitative variables such as XYZ's image in the eyes of valued external managers.

Rebalancing Under Normal Conditions. As a general rule, the first approach is potentially the most profitable provided that trading costs are controlled effectively, and this is the approach favored by the IC when rebalancing capital across segments. Actual segment weights will be reviewed regularly and adjusted as needed, with adjustments required when actual weights fall outside the indicated allocation ranges, taking into account the likely range of values for private assets as well as the illiquid nature of such vehicles. Intra-segment rebalancing is dictated less by either of the rebalancing rules outlined above than by the asset substitution criteria set forth above.

Rebalancing in Extreme Market Environments. The rebalancing rules employed by XYZ under normal market conditions must necessarily be modified in extreme market environments, which are defined as environments in which one of the three segments described in the accompanying exhibit outperforms materially the other segments. In such environments, XYZ will rely heavily on the sale of appreciating assets to meet grantmaking needs, thereby reducing if not eliminating the need to liquidate other assets at depressed prices.

■

Exhibit 1 — Policy Portfolio for XYZ

- Return objective = preserve and enhance purchasing power net of spending over rolling five-year periods.
- Primary risk parameter = avoid peak-to-trough declines in endowment values exceeding 30%.
- Secondary risk paramater = avoid shortfall exceeding 3% in annualized endowment returns relative to peer group over rolling five-year periods.

	Long-Term Allocation			Expected Gross Return				
Segment/Eligible Assets [a]	Min	Norm	Max	Real Return	Value Added [b]	Real Total Return	**Benchmark**	**Reason for Holding**
Total Return Assets	50%	**70%**	75%					
US Stocks	10%	15%	30%	3.0%	1.5%	4.5%	Dow Jones Wilshire 5000	preserve and enhance purchasing power in non-extreme market environments
Foreign Stocks	10%	15%	25%	4.0%	2.0%	6.0%	MSCI All Country World ex US	
US Private Equity	0%	10%	20%	10.0%	subsumed	10.0%	Dow Jones Wilshire 5000+5% per annum	
Foreign Private Equity	0%	10%	20%	11.0%	subsumed	11.0%	MSCI All Country World ex US+5% per annum	
Absolute Return	0%	15%	25%	3.0%	subsumed	3.0%	Treasury Bills + 5% per annum	
High Yield Bonds	0%	5%	10%	1.5%	2.0%	3.5%	Merrill Lynch US HY Master II Constrained	
Inflation Hedges	10%	**15%**	25%					
Resource-Related Assets [c]	0%	6%	15%	6.0%	subsumed	6.0%	Global Index of Resource-Related Stocks	protect capital values during periods of high inflation
Private Real Estate	0%	6%	15%	5.0%	subsumed	5.0%	Treasury Bills + 4% per annum	
Mktable Real Estate (REITs)	0%	3%	10%	1.0%	3.0%	4.0%	Morgan Stanley REIT Index	
All-Purpose Hedges	7%	**10%**	20%					
Inflation-Linked Treasuries	5%	10%	20%	2.0%	0.0%	2.0%	10-year Treasury Inflation-Protected Security	avoid forced sale of other assets to meet cash flow needs
Cash Equivalents	–5%	0%	15%	1.0%	0.0%	1.0%		
Deflation Hedges	0%	**5%**	15%					
Conventional Treasuries	0%	5%	15%	2.5%	0.0%	2.5%	10-year US Treasury Bond	protect capital values during deflations
Total		**100%**					Weighted average of segment benchmarks	

Risk/Return Attributes

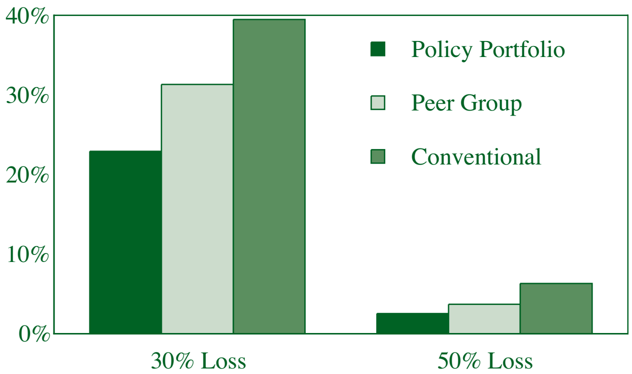
■ Expected Real Total Return	4.6
■ Standard Deviation [d]	9.3

[a] Ranges for each segment and subsegment (i.e., absolute differences between minima and maxima) as well as permissible movements between minima and norms or norms and maxima are asymmetric by design and reflective of the specific role that each segment or subsegment plays in the overall fund.
[b] Expected value added from the use of assets or strategies that could cause a subsegment's returns to deviate from the returns of its parent segment's benchmark.
[c] Publicly traded securities and private investment vehicles providing exposure to a potentially broad variety of "hard assets," including but not limited to timber and oil and gas.
[d] Portfolio standard deviation is based on assumed variances and covariances for individual asset segments, such statistics embodying the joint distribution of the asset class and active management.

Exhibit 2 — Absolute and Relative Loss Probabilities

- Policy Portfolio is defined in Exhibit 1.
- Conventional mix comprises 60% US stocks, 10% foreign stocks, and 30% US bonds.
- Peer Group represents the weighted average allocation of tax-exempt endowments with assets of $100 million to $500 million as reported by a non-profit consortium to which XYZ belongs.

Probability of Absolute Loss during 20-Year Period



Probability of Annualized Underperformance of Peer Group during 5-Year Period

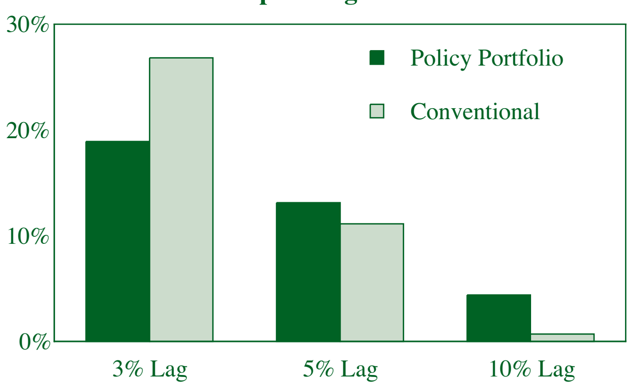


Exhibit 3 — Manager Selection Criteria

Important Attributes

- Well-defined investment philosophy that gives the manager a discernible competitive advantage in the gathering or processing of investment data
- Verifiable record that the firm has faithfully executed its philosophy over time
- Stable and cohesive management team with strong personal incentives (financial and psychological)
- Reasonable amount of assets under management for the philosophy
- Proven capacity to deliver reasonably uniform results to all clients' assets to which the philosophy is applied
- Satisfactory returns versus a relevant benchmark
- Proven capacity to adapt to changes in financial markets
- Proven willingness to invest adequately in its own business (including technological resources)

Helpful Attributes

- Investment management is sole (preferably) or primary business
- Decisionmakers are seasoned professionals or firm's evolving investment philosophy is innovative (preferably both)
- Willing to use performance-based fee arrangements
- Fee structure links manager's compensation directly and primarily to returns (versus assets)

Undesirable Attributes

- Insufficiently trained administrative personnel
- Insufficiently robust investment accounting systems
- Investment decisionmakers unduly burdened with administrative tasks
- Unwillingness to specify product size limits

Disqualifying Attributes

- High degree of personnel turnover
- Investment decisionmakers (as distinct from portfolio management) engaged primarily in brokerage or financial planning
- Inability to meet performance reporting deadlines
- Criminal convictions or sanctions

MEMBERSHIP SUMMARY

	Number of Members
TIFF Membership	**461**
▪ Private Foundations	183
▪ Community Foundations	38
▪ Educational Institutions	46
▪ Other Endowed Charities	194

THE INVESTMENT FUND FOR FOUNDATIONS
Enhancing the investment returns of non-profit organizations

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