PART II: STRATEGY AND TACTICS FOR ENDOWMENTS' AND FOUNDATIONS' ANNUAL DRAW

In Part I of *Strategy and Tactics for Endowments' and Foundations' Annual Draw*, Institutional Advisory Practice, Chief Investment Officer, Pier Friend introduces considerations and practices that institutional boards and committees should have in place when planning their annual draw. In Part II, Pier continues the conversation with regard to draw optimization and organizational long-term financial wellness.

What factors should an institution consider when aiming to optimize their annual draw?

Pier Friend: Some key questions include:

- Does an institution receive regular financial gifts or contributions? Private schools, for example, will receive annual contributions from alumni and parents. While there often is cyclicality to gifts that correspond to a benefactor's own feeling of wealth, these annual contributions can mitigate some financial market volatility in investment assets.
- What is the breakdown between fixed and discretionary expenses? The higher amount of fixed expenses the more susceptible an institution becomes to investment asset price volatility, often finding itself in the uncomfortable position of cutting programs or staff due to financial market volatility.
- What is your institution's inflation rate, and does it tend to trend higher or lower than the broader definition of inflation? Some studies suggest that private school inflation has averaged higher than the broad consumer price index ('CPI') due to factors such as rising labor costs to attract faculty, technology upgrades, facilities maintenance and expansion, healthcare costs, etc. Recognizing these trends while also modeling and estimating their future is an important step to optimizing an institution's purchasing power.

Does an annual spending rate impact an institution's long-term financial prospects?

PF: Most tax-exempt organizations have endowments that were formed to exist in perpetuity rather than the minority that are set up as "limited life" or "spend-down" entities. In the case of perpetual organizations that are not subject to the IRS 5% rule, it is important to keep in mind the power of compounding within the investment portfolio and its relation to the annual draw.

Take the example of two institutions with $100 million in investment assets. Both institutions target an average net return of 7% per annum but one has a 5% annual draw and the other has a 4% annual draw. After 20 years the 4% draw institution will have an endowment worth $32 million more, and in the subsequent decade will be worth $61 million more. The faster rate of net compounding within the investment portfolio also means that by year 23 the institution with the 4% operational draw is drawing more actual dollars each year for its programs, grants, and expenses than the 5% draw institution even though its drawing 1% less on a percentage basis.

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As the Chief Investment Officer of Colony's Institutional Advisory Practices, Pier is responsible for all aspects of the investment process — from manager research to portfolio construction, asset allocation, and client communication. He also supports the needs of our institutional and ultra-high net worth clients.

Pier served as Chief Investment Officer at New Providence Asset Management prior to their merger with The Colony Group in 2021. Previously, Pier spent ten years at Goldman Sachs Asset Management where his responsibilities included Head of the U.S. Core Equity business. He began his career in Japan teaching English as a second language, then returned to NYC where he worked for Nihon Keizai Shimbun before joining Gabriel Capital Group as a research analyst responsible for risk arbitrage and long-short investments for a $1 billion hedge fund. Pier has served on the Advisory Council for the Headmaster of St. Andrew's School.

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