ALBRIGHT COLLEGE 1856

**Endowment Fund**

# INVESTMENT POLICY STATEMENT

**May 10, 2007**

**Revised: January 27, 2022**

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# PURPOSE

The primary purpose of this Investment Policy Statement (Policy) is to guide the Albright College Board of Trustees, Finance Committee, Investment Subcommittee, staff, money managers, and consultants in effectively managing, monitoring, and evaluating the investing of Albright College's Endowment Fund. This document uses “endowment” or “portfolio” as a synonym for “Endowment Fund.” It is recognized that the Endowment Fund managed by the Subcommittee may contain non-endowment funds, and a portion of endowed funds are not included in the Endowment Fund.*

This Policy has been created and designed to:

- State in a written document the attitudes, expectations, objectives and guidelines for the investment of all endowment assets.

- Set forth a structure for managing endowment assets. This includes asset classes, target asset allocation, and allowable ranges that, together, are expected to produce sufficient diversification and acceptable returns over the long-term.

- Establish formal criteria to monitor, evaluate, and compare the performance results achieved by individual managers and the entire portfolio on a regular basis.

- Encourage effective communication among the Board of Trustees, Finance Committee, Investment Subcommittee, staff, consultants, money managers, and other stakeholders.

- Ensure compliance with fiduciary and prudent investor responsibilities.

- Affirm that all fiduciaries shall discharge their responsibilities under this Policy solely in the long-term interests of Albright College.

- Protect the endowment from market-driven departures from sound long-term policy.

- Educate new Trustees, staff, Finance Committee and Investment Subcommittee members, as well as consultants and investment managers, in order to maintain the consistency necessary to produce good long-term results.

* Non-endowed funds in the Endowment Fund include a clearing house account which accounts for less than 1%. Approximately 10% of total endowment represents donor-restricted funds (e.g. Hinnershots Trust) that cannot be placed into the Endowment Fund.

# OBJECTIVES

## Financial Objective

The overall financial goal of the endowment is to maintain or enhance its real (i.e. inflation-adjusted) market value while providing the College's operating budget with a relatively predictable and growing (in nominal terms) stream of revenue targeted at approximately 5% of the endowment. Therefore, the financial objective is to earn a total return (net of all fees and expenses) equal to or exceeding the spending rate plus the inflation rate—as measured by the Consumer Price Index.

## Investment Objectives

Investment objectives for the overall endowment include the following:

- Attain a total return matching or exceeding the portfolio's composite benchmark.
- Attain a total return matching or exceeding a relevant universe (e.g. endowments of a similar size or a smaller group of institutions with whom the College competes for students).
- Incur only a reasonable and prudent level of risk, which is codified in the target asset allocation and portfolio benchmark.

# DIVISION OF RESPONSIBILITIES

## Board of Trustees

According to the Board of Trustees Bylaws, "The Board of Trustees shall establish such…committees as it deems appropriate to the discharge of its responsibilities…The standing committees and subcommittees of the Board of Trustees" include a Finance Committee and an Investment Subcommittee.

## Finance Committee

According to the Statement of Role and Responsibilities of Committees, the Finance Committee "Oversees for the Board of Trustees the College's investment policy and practice." This is accomplished largely through the work of the Investment Subcommittee.

## Investment Subcommittee

According to the Statement of Role and Responsibilities of Committees, the Investment Subcommittee "shall develop, approve, and monitor the investment goals and objectives for the College. It is the responsibility of the Subcommittee to approve the employment of the investment manager(s) necessary to implement the investment goals and objectives of the College…There shall generally be at least four meetings per year…[All Board of Trustees' members will be informed of the Subcommittee's work and its results."

## Staff

The Chief Financial Officer (CFO) of Albright College will provide staff support to the Subcommittee and is charged with implementing Subcommittee decisions. The CFO serves as the primary contact with money managers, custodian, and consultants.

## Consultants

Consultants may be employed by the Subcommittee when their expertise can be expected to add value.

# GUIDELINES AND INVESTMENT POLICY

## Time Horizon

The investment guidelines are based upon an investment horizon of greater than ten years, in accordance with the College's status as a perpetual entity. The endowment's target (or strategic) asset allocation is based on this long-term perspective. Interim fluctuations should be viewed with appropriate perspective. Except for the annual borrowing of several million dollars at fiscal year-end, there are no special short-term cash flow or liquidity considerations.

## Relevant Risks

Two of the greatest risks facing any long-term portfolio are deflation and inflation. Accordingly, both inflation and deflation hedges have been incorporated into the asset allocation.

Another risk that any portfolio faces is that of volatility, usually due to market risk, or the risk from broad-based declines in securities markets. The College will mitigate this risk by being well-diversified across many markets and strategies.

The Subcommittee recognizes that short-term volatility in the value of the endowment must be tolerated to achieve the endowment's long term objectives. In fact, the Subcommittee believes that the greatest risk facing the endowment is not short-term volatility, but rather a reduction or insufficient increase in the endowment's inflation-adjusted contribution to the operating budget that is likely to result from an overly conservative investment posture.

The constant changing of policy or strategy based on recent market conditions is another important risk. This risk will be managed by establishing and adhering to the Policy's asset allocation ranges.

An additional risk that should be monitored is that of underperforming Albright's peer institutions, which would harm the College's competitive position.

The Subcommittee recognizes the impossibility of achieving the endowment's investment and financial objectives in every period due to the uncertainties of securities markets.

## Performance Expectations

As stated previously, the desired financial objective is to earn a long-term rate of return equal to or exceeding the spending rate plus the inflation rate. Based upon the assumption that future returns will approximate the historical long-term rates of return experienced for each asset class in the Policy, this target should be achievable. The College recognizes that market performance varies widely in the short-term and that any specified rate of return will not be obtained during all periods.

Relative performance benchmarks for each asset class are set forth below. The entire portfolio's composite benchmark will equal the sum of each asset class benchmark weighted by its target allocation. Performance comparisons will be made over various time periods, but particular attention will be focused on rolling three- or five-year periods. However, managers cannot be hired or terminated based solely (or even largely) on such performance. The Investment Subcommittee will also monitor performance compared to relevant universes (e.g. endowments of similar size and/or those of Albright's close and/or aspirational peer groups).

**Diversification**

The endowment will be diversified by investing in several different asset classes—including U.S. and international public equities, private equity, and fixed income—and a variety of strategies, including inflation hedges strategies. In addition, the endowment will be diversified within each asset class if appropriate. No single firm will manage more than 40% of the portfolio's assets in active strategies. The purpose of all these forms of diversification is to reduce risk by providing reasonable assurance that no single asset class or manager will have a disproportionate impact on the total endowment. Diversification is also expected to enhance risk-adjusted returns over the long-term.

**Asset Allocation**

The Subcommittee believes, as numerous studies have shown, that the endowment's risk and return experience will largely be a function of asset class mix. Therefore, it has reviewed the long-term performance characteristics of various asset classes, focusing on balancing the risks and rewards of market behavior. Different asset classes and strategies are expected to play different roles, but they must work in concert to achieve the portfolio's overall financial and investment objectives. The Investment Subcommittee has selected six major asset classes and strategies (with performance benchmarks in parentheses below) for investment:

## Total Return Assets/Strategies

U.S. Equity (Russell 3000): U.S. Equity has a long-term expected real return above the College's spending rate, represents a large portion of the world's investable assets, offers good liquidity, and avoids currency risk. As a result, U.S. Equity is one of the portfolio's primary asset classes. Since the College will have exposure to large-, mid-, and small-cap stocks, a broad market measure such as the Russell 3000 is most appropriate as a benchmark.

International Equity (MSCI All-Country World ex-USA): International Equity—comprising both developed and emerging markets—has a long-term expected real return above the College's spending rate, represents a large portion of the world's investable assets, offers decent liquidity, and provides access to growth opportunities outside the U.S. Since International Equity is not perfectly correlated with U.S. Equity, this asset class also provides some diversification benefits. Although not without its problems, the MSCI All Country World ex-USA benchmark is well representative of foreign markets. This allocation was not divided into separate emerging and developed components because of its modest size.

Private Equity—Buyouts & Venture Capital (Russell 3000)
Private Equity is expected to generate higher returns than public equities reflecting the lack of liquidity and market inefficiency of these investments which allow good managers the opportunity to add sizable value. Private equity returns are more volatile than public equity returns and are not perfectly correlated with other equity returns. Therefore, the role of this asset class is to enhance returns and provide diversification. Because of the added risks, the Investment Subcommittee believes that Private Equity should earn a premium to public markets. However, until the actual Private Equity allocation equals 5% or more, the benchmark will be the Russell 3000 index, recognizing that it takes time to build a mature Private Equity program.

## Hedging Assets/Strategies

Inflation Hedges (Consumer Price Index + 5% / Higher Education Price Index + 5%):
Inflation Hedges have been incorporated into the Policy to guard against unexpected inflation and sustained periods of general price increases when financial assets tend to do poorly. This strategy may include inflation-linked bonds, energy, real estate, timber, natural resource funds, and other investments which can be expected to produce solid returns in inflationary times. Results will be measured against inflation as reported by CPI to determine whether the Policy objective is being met. During periods of average inflation (3% or so), the benchmark of CPI + 5% requires that these investments earn a nominal return of about 8%—roughly midway between the historical returns of equity and fixed income. This asset class will also serve to diversify the portfolio and reduce its overall volatility.

The Higher Education Price Index ("HEPI") is an inflation index designed specifically to track the main cost drivers in higher education, which is issued annually by the Common*f*und Institute. While HEPI is a more accurate indicator of changes in costs for colleges and universities than CPI, the infrequency with which it is updated prevent it from serving as a meaningful benchmark for time periods of less than one year. As such, results of one year and longer will also be measured against inflation as reported by HEPI for Private Baccalaureate Institutions for informational purposes.

U.S. Bonds (Index TBD): The primary purpose of U.S. bonds is to serve as a hedge against deflation (a decline in general price levels), severe market disruptions, and/or depression. Therefore, the appropriate benchmark is one of relatively long duration and heavily weighted towards U.S. treasury bonds. In early 2007, the duration—a measure of sensitivity to interest rates—of intermediate (long-term) treasuries was 5.1 (10.4) years, roughly 11% (2.3x) greater than the duration—4.6 years—of the widely-used Lehman Aggregate Index. One could utilize a longer duration benchmark in conjunction with a lower allocation to this asset class to obtain the same protection from deflation, but with much greater volatility. This would lead to greater divergence from peer results, and a lesser likelihood of adhering to the Policy during adverse times of rising interest rates. An allocation to bonds also generates cash flow and reduces the volatility of the overall endowment.

Cash: No Policy allocation is made to cash, although individual managers may hold some cash.

Both an efficient frontier analysis and a Monte Carlo simulation were reviewed by the Subcommittee. Both analyses concluded that a portfolio reflecting the long-range target asset allocation below should earn greater returns with less volatility than a traditional portfolio invested solely in stocks (70%) and bonds (30%). Recognizing all the inherent limitations of such analyses, the Investment Subcommittee believes that such an outcome can reasonably be expected over the long term.

| Asset Class/Strategy | Target Allocation and Range | Benchmark |
|---|---|---|
| Total Return | | |
| Private Equity (VC/Buyouts) | 10 - **15** - 20 % | Russell 3000 |
| U.S. Equity | 32 - **37** - 42 % | Russell 3000 |
| International Equity | 14 - **17** - 21 % | MSCI All Country World ex-USA |
| Hedges | | |
| Inflation Hedges | 10 - **13** - 16 % | CPI + 5% (and HEPI + 5%) |
| U.S. Bonds | 14 - **18** - 22 % | Barclays 3-7 yr Treasury |

Asset allocation ranges are established at ± 20% of the target (not 20 percentage points) rounded up to the nearest whole percentage point, with a minimum of plus or minus two percentage points and a maximum of plus or minus five percentage points. These ranges have been created to minimize the temptation to engage in market timing and to maximize the likelihood that investment objectives will be met. Due to the nature of private equity investing and only periodic rebalancing, actual holdings will at times fall outside of these target ranges. In the absence of unusual circumstances, however, the goal should always be to move towards compliance with the stated asset allocation target ranges—unless the Investment Subcommittee makes a specific decision to do otherwise.

## Total Portfolio Benchmark

The benchmark for the total portfolio is a composite that weights each asset class benchmark by its policy target. Comparing actual performance to this benchmark will enable the College to determine value added (or lost) from both asset allocation and manager selection decisions.

## Rebalancing

Periodic rebalancing is necessary to keep the asset allocation from shifting too far from Policy guidelines. According to an Ibbotson study of historical returns from 1970 to 1996, investors experience lower returns and higher risk when they do not regularly rebalance their portfolios back to their strategic mix. An asset allocation allowed to drift with market returns automatically ensures that the portfolio will be overweighted in an asset class at market peaks and underweighted at market lows. A rebalancing policy forces the sale of those investments that have recently performed very well (and thus have become a larger percentage of the portfolio than policy would dictate) and the purchase of those assets which may have recently performed poorly. It is often difficult to voluntarily execute such a policy in the absence of an explicit policy requirement.

Whenever the allocation to any asset class falls outside its permissible range, the staff and Subcommittee Chair will agree upon a rebalancing back within the permissible range as soon as practical. The Subcommittee will be informed of all rebalancing activity no later than the next meeting. Rebalancing one-half of the way back to the Policy target—which some research has demonstrated is the optimal strategy—is the preferred action. All rebalancing actions will, however, take into account cash flow needs, trading costs, and the status of other asset classes. When cash is needed to fund capital calls or to meet spending requirements, the Chair and staff will jointly determine the sources of that cash.

## Indexing

It is generally accepted that the U.S. equity market, especially the large-cap sector, is very efficient, allowing an indexed approach to investing to produce greater returns at less cost than active managers as a group. However, individual active managers can produce value-added over an indexed approach, and as a group, active managers can outperform for certain periods, especially when the market has moved to extremes. To avoid the danger of jumping back and forth between active and passive strategies at the wrong point in the cycle, a policy on indexing is appropriate. Based on the above factors, the Investment Subcommittee believes that it is prudent to maintain at least 25% of total U.S. equity holdings in an index product or fund at all times.

There is also a compelling case for indexing U.S. bonds, an extremely efficient market. Since the chief function of Albright's U.S. bond holdings is to serve as a hedge against deflation, close adherence to the benchmark is critical. Therefore, an indexed or quasi-indexed approach will be utilized. The manager will be required to maintain the duration of the U.S. bond portfolio within one-half (½) year of the duration of the assigned index.

Although international equity markets are generally considered less efficient, the decision has been made to fully index this asset class for the following reasons: 1) the modest size of the allocation; 2) the desire to gain exposure to both developed and emerging markets in one fund; and 3) the difficulty of selecting outperforming managers in advance.

# Investment Managers

## General

It is the responsibility of the Investment Subcommittee to oversee the endowment, to determine whether assets should be managed internally or externally, and to hire and fire all external managers. While the Investment Subcommittee reserves the right to alter these policies when it deems appropriate, the following policies describe the general operating procedures used to select and monitor the investment managers.

It is the general policy of Albright College to utilize professional institutional money managers to invest endowment assets, although some assets may be managed internally. No single manager or fund utilizing an active strategy will be allocated more than 40% of total endowment assets. Face-to-face meetings with active managers investing 20% or more of the portfolio shall be conducted one or more times each calendar year by the Subcommittee, staff, or consultant.

## Manager Selection

The manager selection process should incorporate review and analysis of the following factors:

- Ability of the firm to meet endowment objectives.
- Length and quality of experience of key investment professionals.
- Long-term track record evaluated on both a risk and return basis.
- Consistency of investment strategy and results.
- Historical growth of, and future plans for, assets under management.
- Confidence that past track record can be repeated in the future.
- Risk management efforts.
- Sufficient organizational depth and continuity of personnel.

When hiring a manager, very little weight shall be placed on recent performance, as numerous studies have shown that it is not a good predictor of strong future performance.

**Responsibilities of Managers**

The College does not seek to micromanage its money managers or interfere with their efforts to attain investment objectives. However, managers employed by Albright must recognize their role as fiduciaries and agree to:

- Comply with all guidelines and instructions contained in this section of the Investment Policy, unless a specific exception is requested and granted.
- Assume broad discretion in the selection of individual securities or investments, subject to fiduciary standards.
- Notify staff immediately of any changes in the ownership of the firm, changes in responsibilities of key investment professionals, departures of investment professionals, or other significant matters.
- Make no material departures from the strategy for which they were hired.
- Keep cash balances at 5% or less of the account's total market value.
- Utilize no derivatives in the College's account without prior approval.
- Attend meetings with representatives of the College as requested.
- Act solely in the best interests of Albright College.
- Establish and maintain an effective relationship with the College's custodian, including vigorous efforts to reconcile any performance discrepancies.
- Make all trades on a best-execution basis.
- Fulfill the reporting requirements listed in the next section.

Any exceptions to the above guidelines must be approved in advance by the College. College staff—specifically, the CFO or his/her designate—is charged with ensuring that managers comply with these responsibilities and the reporting requirements which appear on the next page.

Commingled funds and private partnerships cannot be held to client-specific guidelines and are therefore exempt from the above responsibilities.

**Manager Reporting**

All investment managers must report their performance in writing at least every calendar quarter. Performance calculations should be in compliance with AIMR standards. Managers must also provide written reports on a quarterly or monthly basis that contain the following:

- Commentary on investment results.
- Key decisions of the period and the underlying rationale.
- General outlook and specific actions, which may result.
- Expected changes in strategy
- Portfolio holdings (hedge funds are exempt from this requirement).

**Manager Benchmarks**

Benchmarks will be established for individual managers that most closely reflect the strategy pursued, or securities purchased, by that manager. The appropriateness of the assigned benchmark should be agreed to by both Subcommittee Chair and manager in advance of hiring and, where possible, explicitly included in the written agreement. The performance of managers may also be compared to peer managers following similar strategies.

**Protocol for Reviewing "Underperforming Active Money Managers"**

| Timeframes | Actions |
|---|---|
| Qtr | Each quarter, an inquiry will be completed for any turnover of the portfolio management team or any changes in the ownership structure of the firm. This will be done regardless of poor performance. |
| 1 yr | A review will take place regarding any changes in the asset management "style." This will be measured in terms of value/growth and small vs. large drifts from the stated objectives upon hiring. Additional inquiries will be conducted regarding the cash flow into the particular fund or management product, and overall firm. |
| 3 yrs | A manager will be placed on a "watch list" to be reviewed each quarter, versus peer groups and appropriate indicies. |
| 5 yrs | A portfolio manager will be required to make a presentation discussing the recent underperformance and why the prospects for future performance improvement are imminent. |
| 5+ yrs | The Investment Committee will be required to discuss potential alternatives. This review will occur each quarter until a consensus is arrived by a majority of Committee members to terminate or continue the relationship. |

# MISCELLANEOUS

## Spending Policy

Responsibility for the spending policy resides with the Finance Committee of the Board of Trustees. A formal spending policy has been adopted to fairly apportion endowment income between current and future generations of Albright students. An additional goal of this formal policy is to minimize the temptation to relieve all budgetary pressures by simply taking additional monies from the endowment. The approved spending rate formula is designed to provide a relatively predictable and growing stream of revenues to the operating budget.

## Proxy Voting Policy

The College recognizes its rights and responsibilities as a shareholder of many corporations in which it has invested funds, including the voting of proxies.

Direct responsibility for and administration of proxy voting for securities held by investment managers will be delegated to those managers if possible. They are in the best position to ascertain the stakes involved in each issue and to vote accordingly, based on the following criterion:

> **Investment managers are expected to vote all proxies with the sole purpose of maximizing shareholder value, thereby enhancing Albright's financial interests.**

The College fully intends for managers to vote against corporate management recommendations where the interests of shareholders diverge from that of management. For example, in the absence of unusual circumstances, Albright expects managers to vote FOR anti-greenmail proposals and AGAINST "poison pill" provisions.

Proxies for mutual funds, limited partnerships, and other directly held investments will be voted by staff, according to the criterion established above.

## Exceptions

All exceptions to this Investment Policy Statement must be approved in advance by a majority of all voting members of the Investment Subcommittee.