

Aligning Investment Strategy with Philanthropic Mission

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Three topics for discussion

- Getting more from your investment portfolio
- Trade-offs
- How we solve the problem

Can you increase your grants?

Translating social objectives to financial objectives

- Social objectives
 - ranking priorities can be hard
- Money helps
 - either income or donations
- Balancing act
 - demands / objectives can be greater than income

Our expertise is getting the most from your investment portfolio

What are your circumstances?

- How much income do you need?
 - this year and future years
- Where do you get income from?
 - portfolio returns, donations
- What happens if your income is lower than expected?
 - how much flexibility do you have?

Vital to understand your circumstances

How much income do you need?

- Investment objectives generally expressed as real returns
 - Real = after inflation
- Say 4% real return objective
 - 3% real grants
 - 1% real growth
- What is easiest way to meet objective?

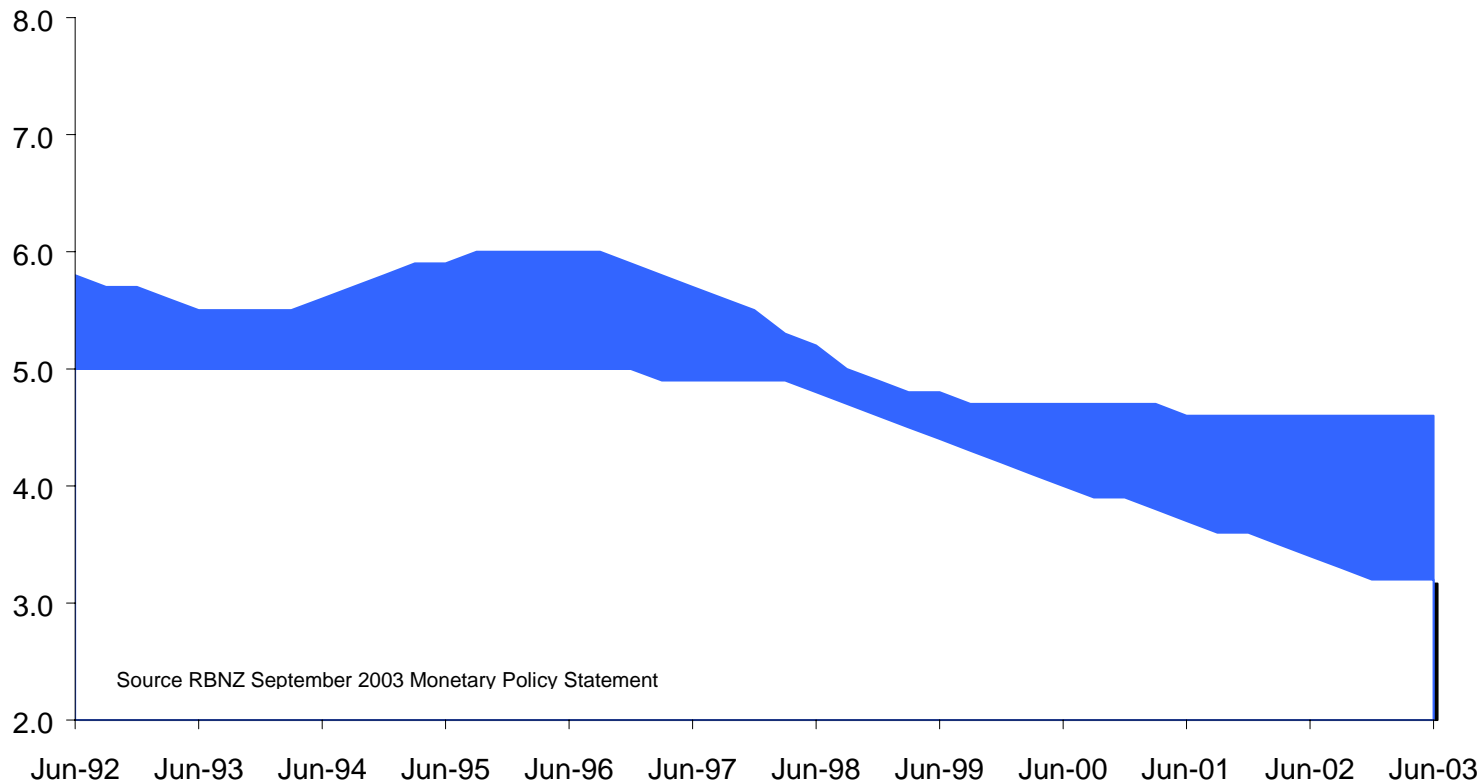
How much income do you need?

- Answer = put it in the bank
- Cash offers real return
- RBNZ estimates neutral cash rate to be 3.75% +/-1%

Being tax exempt helps

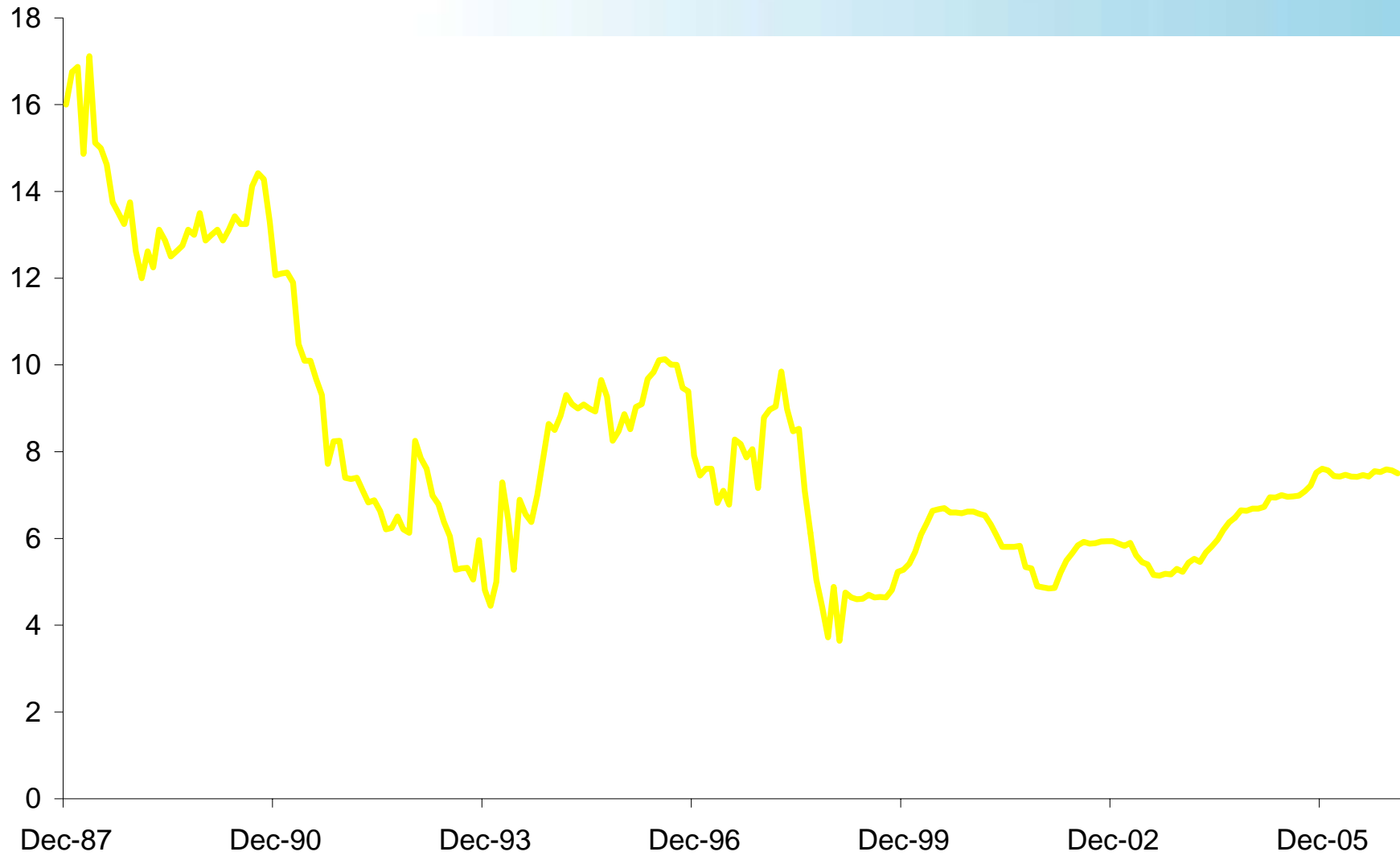
RBNZ estimate of neutral cash rate

Envelope of 14 empirical estimates of the neutral real short term interest rate



RBNZ estimates neutral real cash rate to be 3.75% +/- 1%

NZ 1 month wholesale rates



Getting the most from your assets

- All cash/fixed interest is not a starter for most
 - returns not high enough
 - recession risk, when cash rates would be lower
- What about the risks?
 - sharemarkets could fall 5% in a week
 - 6 similar events in last 3 years
 - risk aversion rising....

Wealth is created outside fixed interest

Growth encouraged by risk taking

- “Despite all the gloom and doom you often hear, world economic growth since the Second World War has been at the highest pace ever recorded. “
- “No work ethic can compensate for a misallocation of capital and the resulting failure to invest in the most profitable ventures.”
 - Federal Reserve Governor Frederic Mishkin – Globalisation: A Force for Good October 2006

If the backdrop was better, prices would be higher

What keeps you awake at night?

- What does a zebra stress about?
 - being eaten by a lion
- We stress over non-physical issues
 - same chemical response
- Investment stress is usually over losing money
 - we like to avoid losses

We rarely worry whether our money is working hard enough – we should

Allocating capital – pulling it together into a portfolio

- Extract premiums above cash rate
 - diversify sources of premium
- Capture additional returns from active management
 - possible to consistently outperform the market
 - boost grants
- Portfolios with efficient trade-off between **return and risk**
 - take risks you are paid for

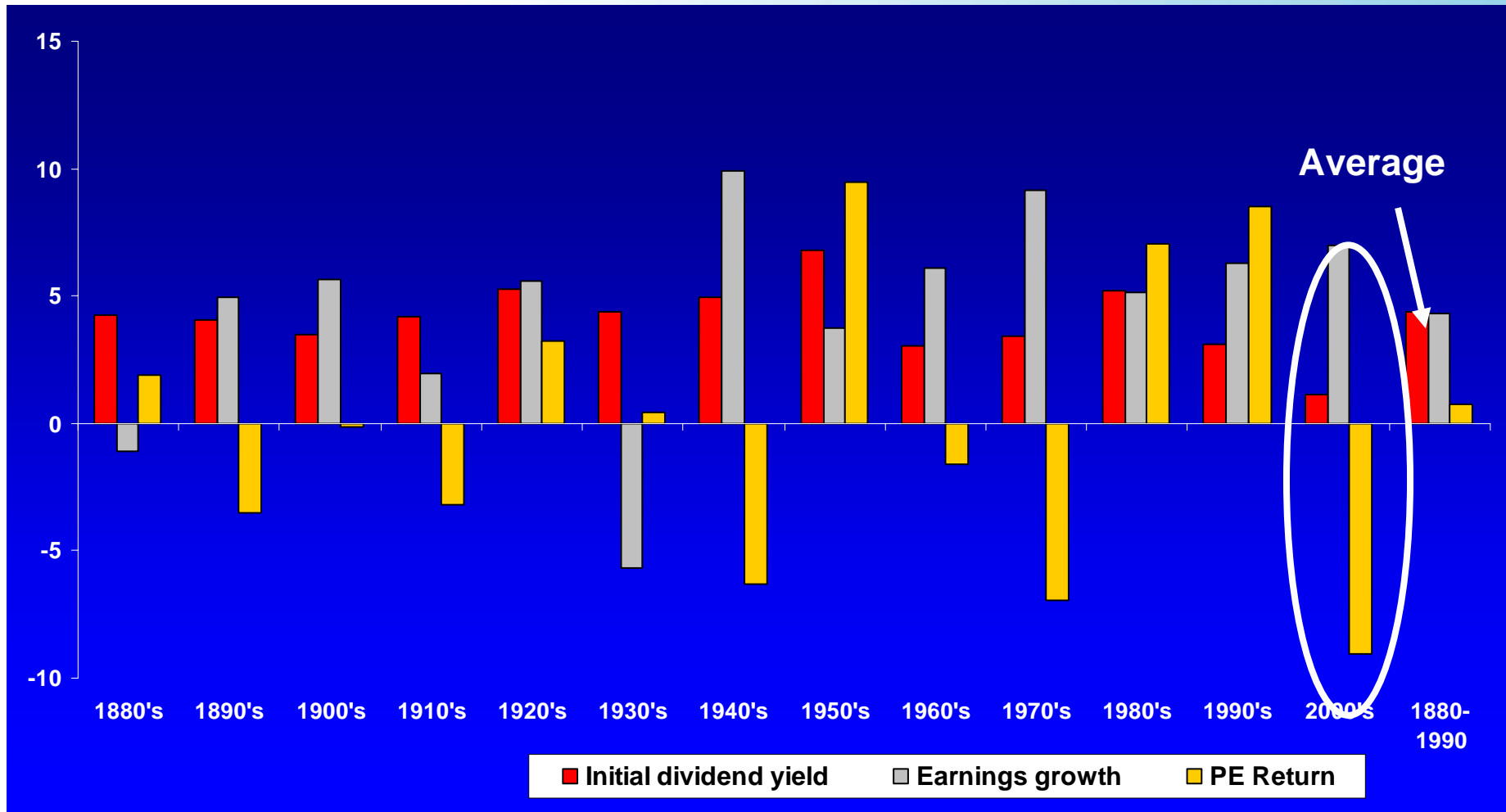
Be fairly paid for the risks you take

Extracting premium

- Stocks have historically returned more than cash
 - best to bank on less outperformance
- Let's say half stocks half fixed interest
- Expected return around 6.25% real
 - potentially higher through active management

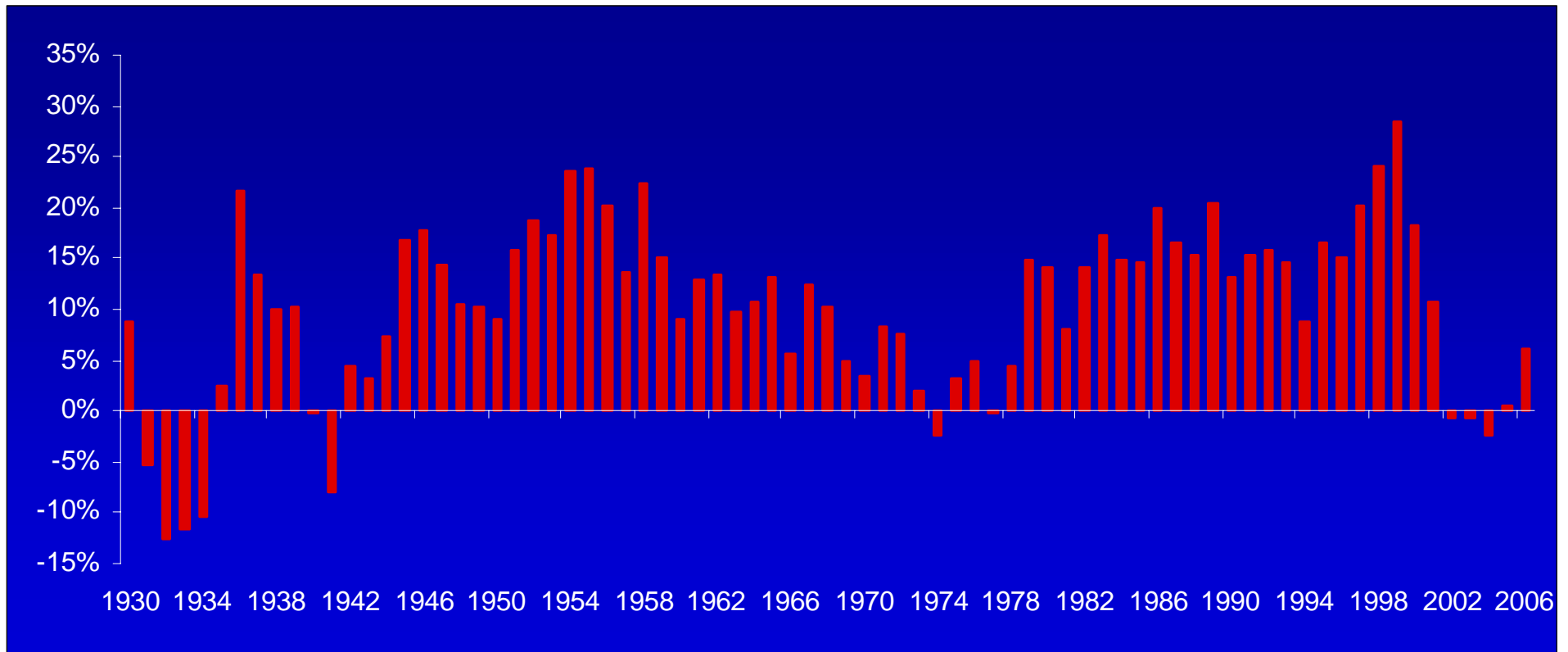
Gifts could be 100% higher than cash

S&P500 - sources of return



P/E's expanded in 80's and 90's, contracted in 2000's

S&P500 Annual Returns : Rolling 5 year



Negative returns around a third of the time, much better over 5 years

US equity return profile

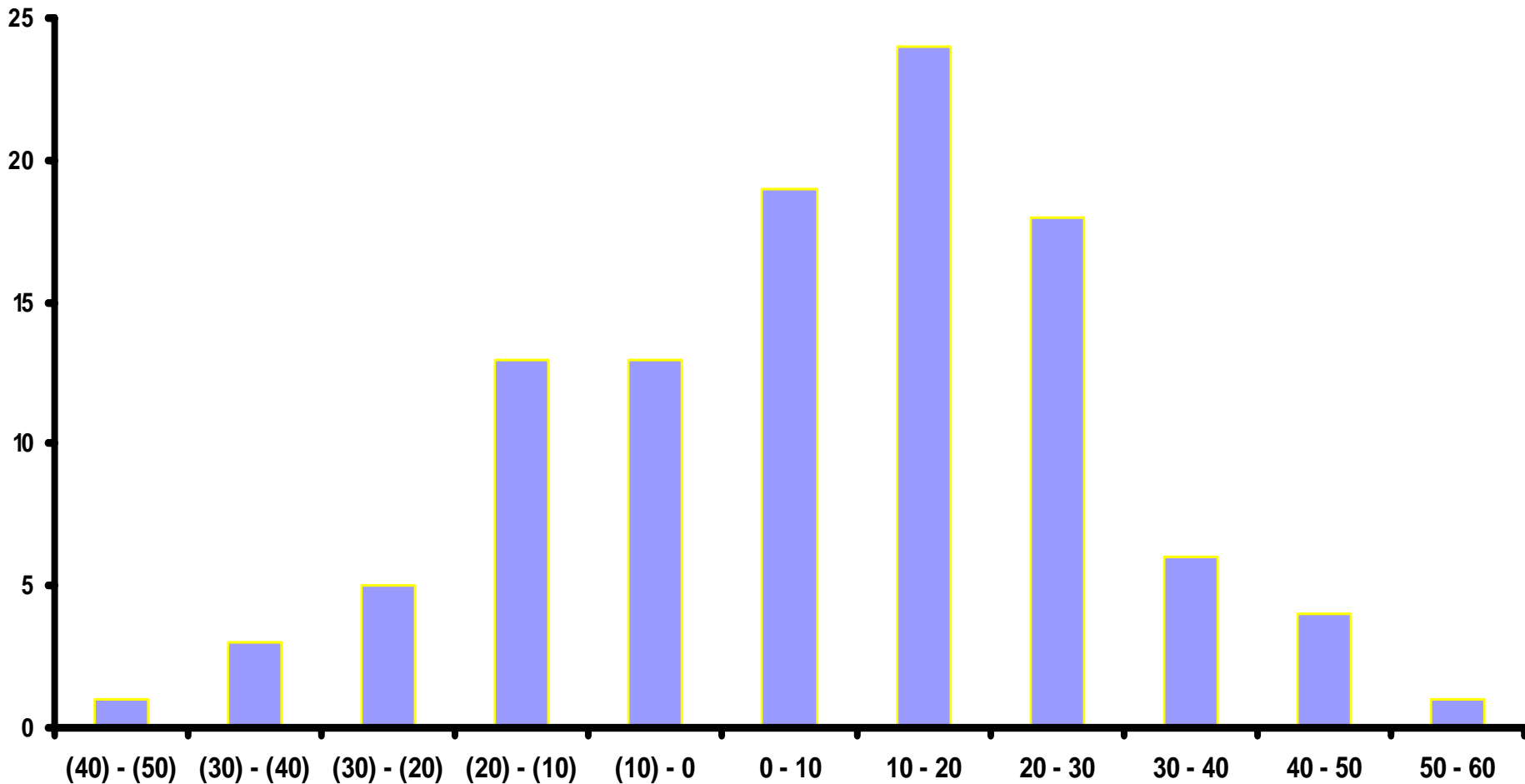
- US equities
 - expected return often thought of as cash +5%
- How often has the annual US equity return been cash +/- 5%
- Answer = 18% in last 107 years
 - 19 times in past 107 years
 - Around 1 year in 5 or 6

US equity return profile

- US equities
 - in last 107 years what is most common return?
- 0-10% worse than money in the bank?
 - 0-10% better money in the bank?
 - 10-20% better money in the bank?
 - 20-30% better money in the bank?
- Answer = 10 - 20% better than money in bank
 - 20-30% nearly as common as 0-10%

US equities better than cash – last 107 years

Source: ABN-AMRO Global Investment Returns Yearbook 2006



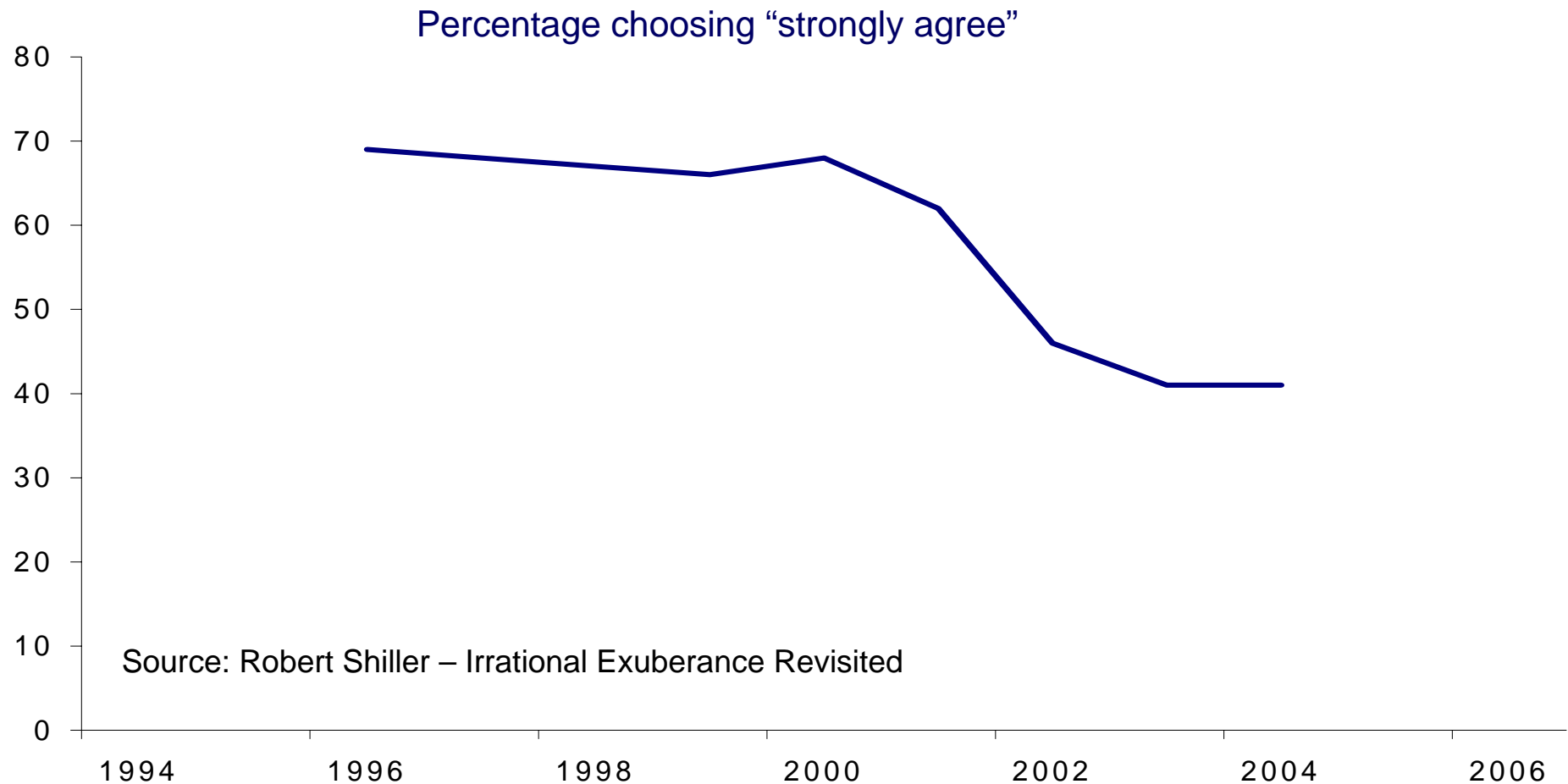
All in shares?

- Works for some people, institutions
- But stocks can fall
 - around 1 year in 3 better to be in bank
 - 35 of past 107 years
- Human nature
 - we trend follow
 - pain of losing \$1 is greater than enjoyment from making \$1

Right exposure depends on circumstances

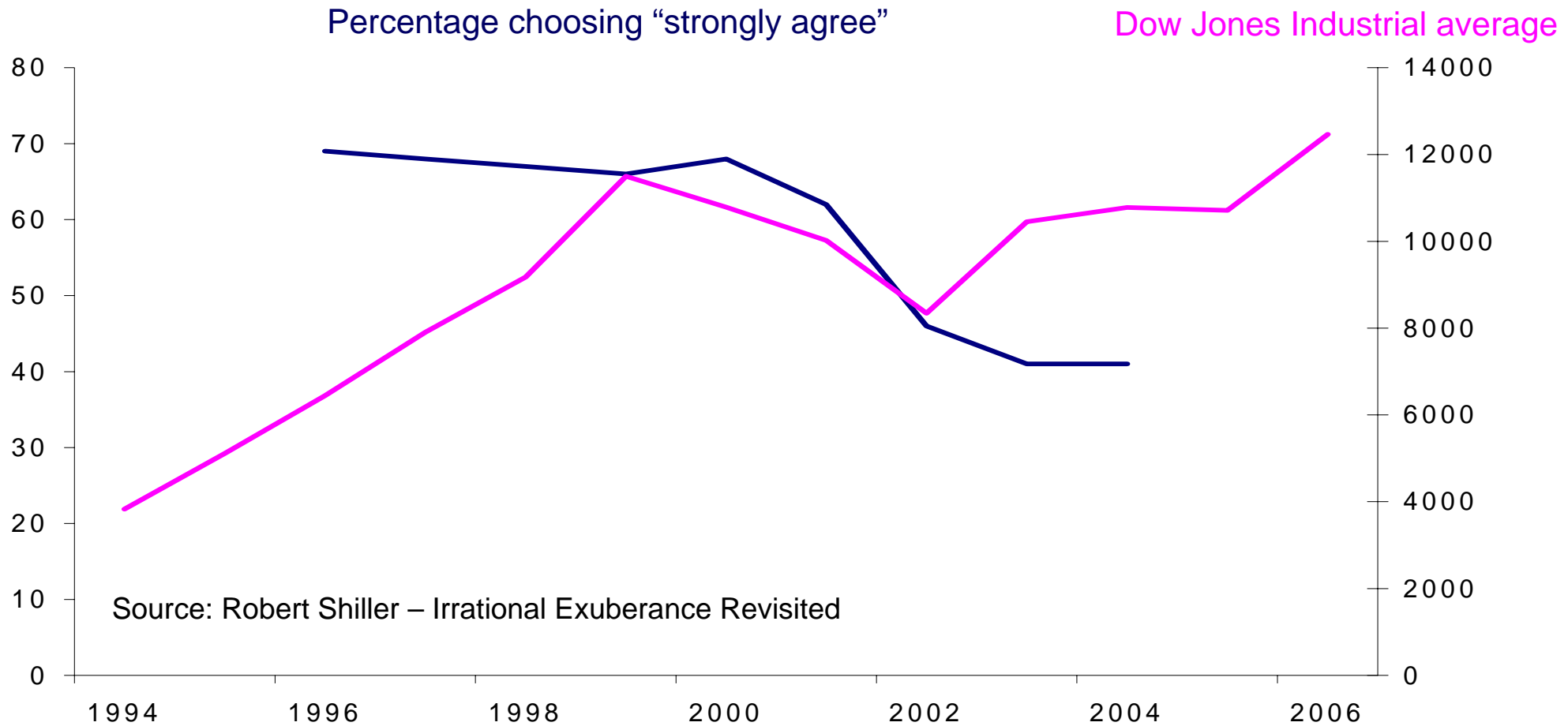
Opinions change

- “The stock market is the best investment for long-term holders who can just buy and hold through the ups and downs of the market”



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Does your risk tolerance match your risk taking capacity?

- Aligning portfolio characteristics with your performance horizon
- Avoid extreme outcomes
 - tail risk
- Fall back on sound process
 - value in being assisted through the process

Ideally reviews result in tweaks instead of wholesale changes

The valuation backdrop

- Hard to find “cheap” assets
 - not an excuse for not trying
 - liquidity provides some comfort but look out if it turns
- Bonds provide low yields
 - low cash rates
- Equities OK if earnings sustainable
 - labour share of profits a potential issue

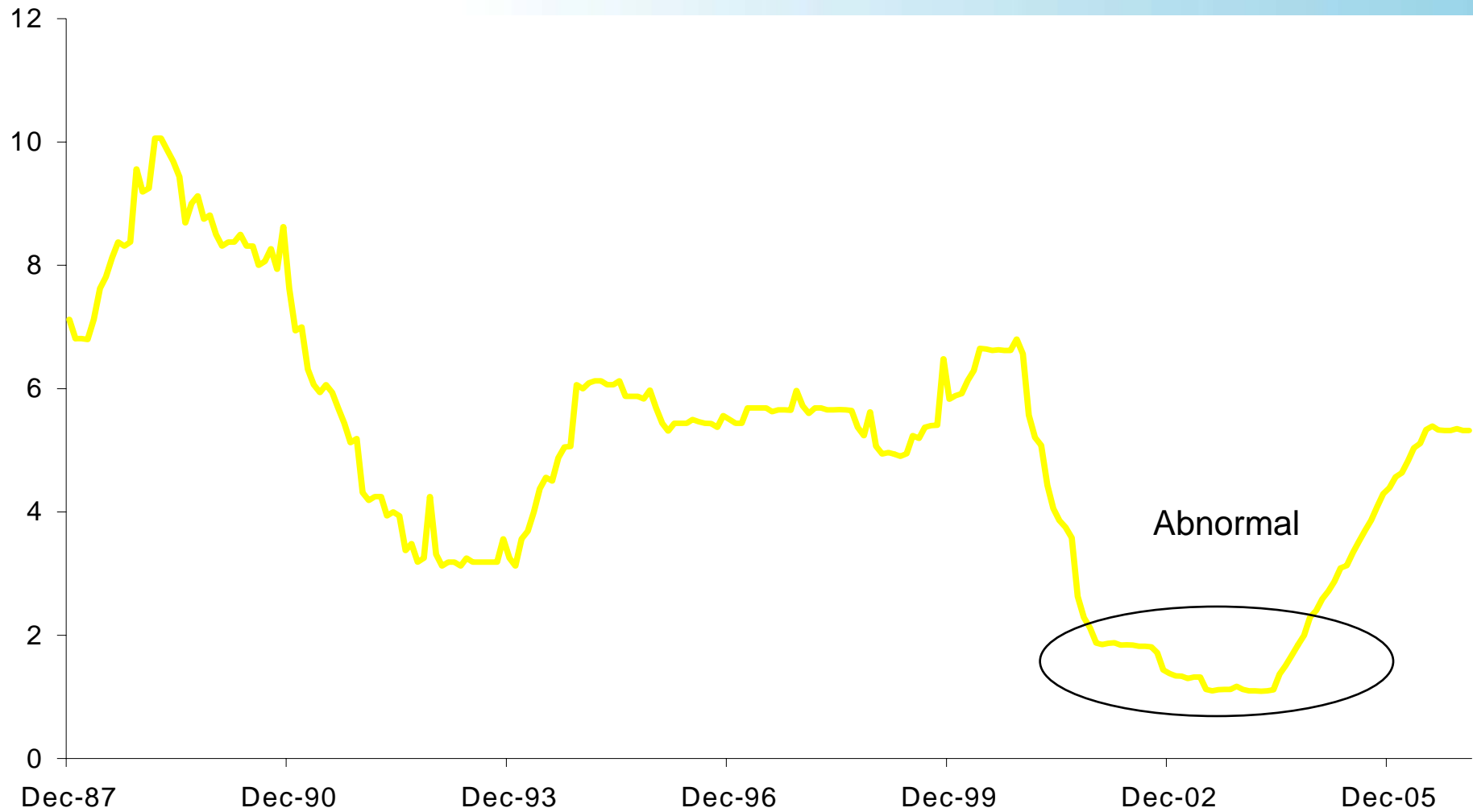
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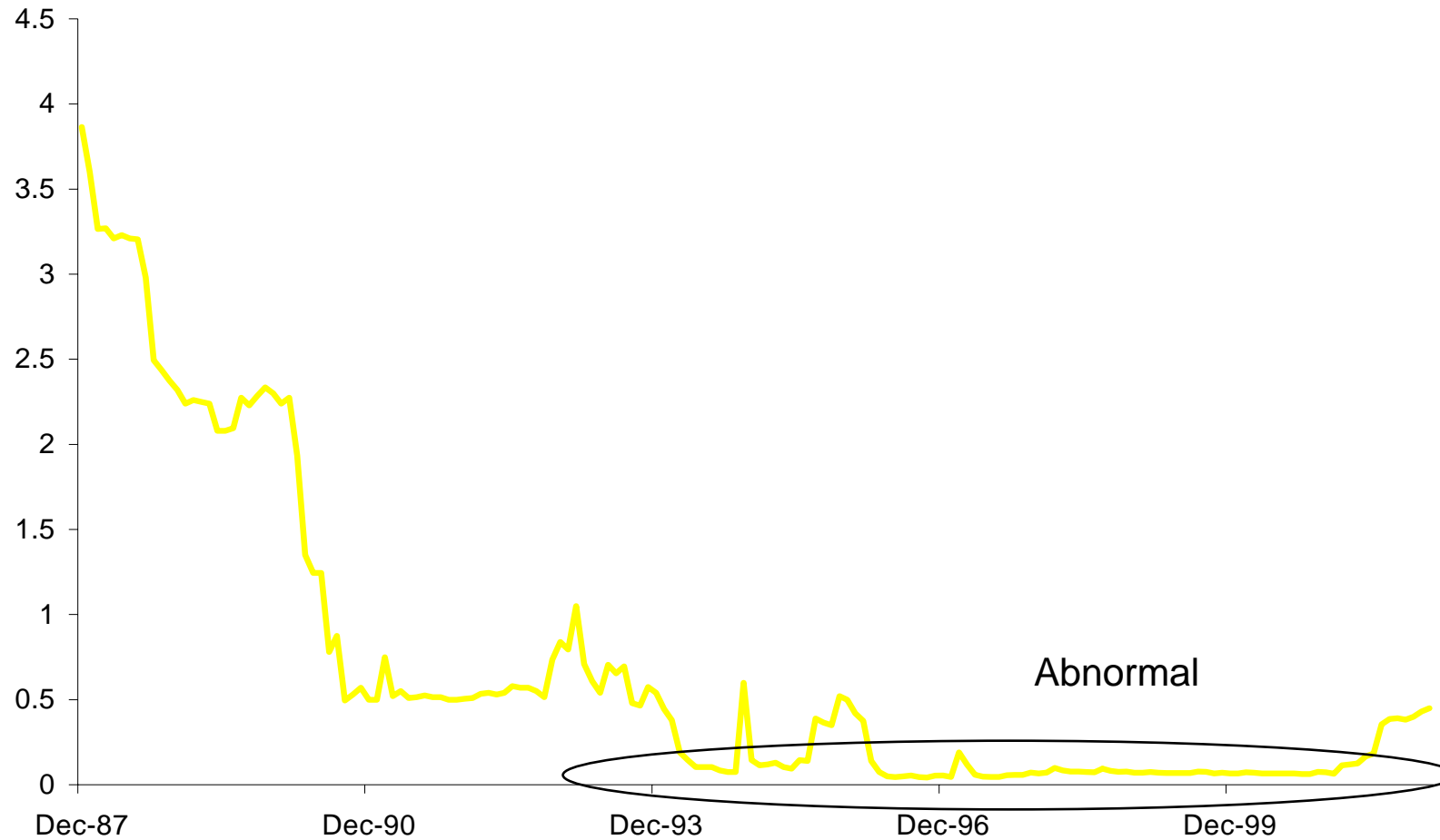
- Investors are looking for yield
 - global phenomenon, carry trade – borrow in yen, invest in higher yield
- We live in a low return world
 - investors need “equity” returns
- Excess and irrationality
 - hedge funds, absolute return funds, private equity,
 - hard assets e.g. commodities and property

Being overly defensive won't work

US 1 month interest rates



Japanese 1 month wholesale rates



Virtually zero interest rates for a decade!!

Mis-estimating risk taking capacity

- Too little in growth assets
 - can meet current grants, forego potential grants
- Too much in growth assets
 - risk that poor short-term performance negatively impacts on future grants
- Average retail investor bias is risk averse
 - pain of losing \$1 versus joy of making \$1

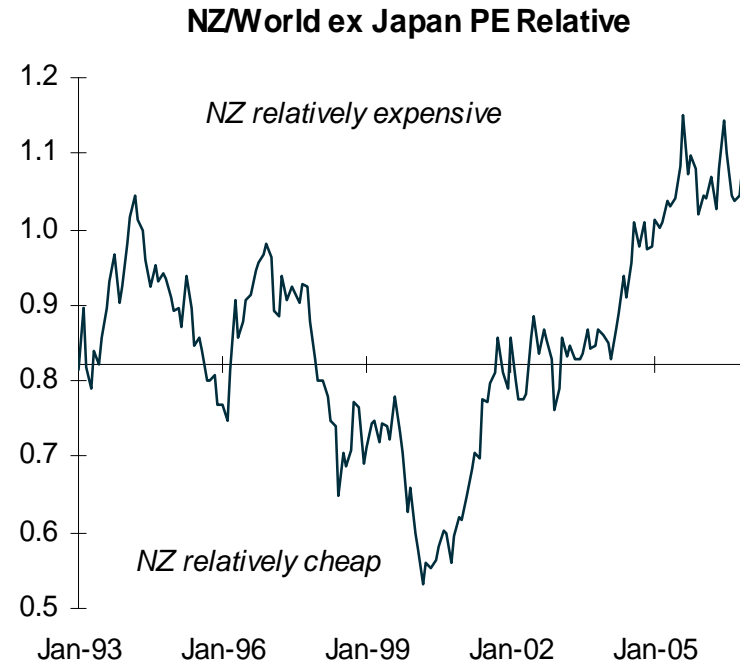
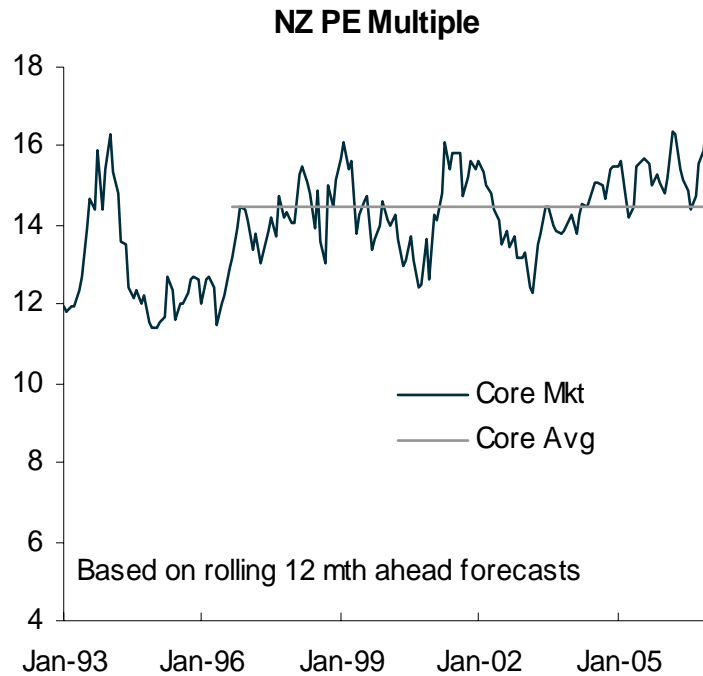
NZ'ers are under invested in stocks

Our approach

- Sensible asset mix
 - exploit diversification benefits
 - being mindful of current valuations
- Quality active managers
 - ability to boost grants
- Tax and cost effective

Ensure value for money

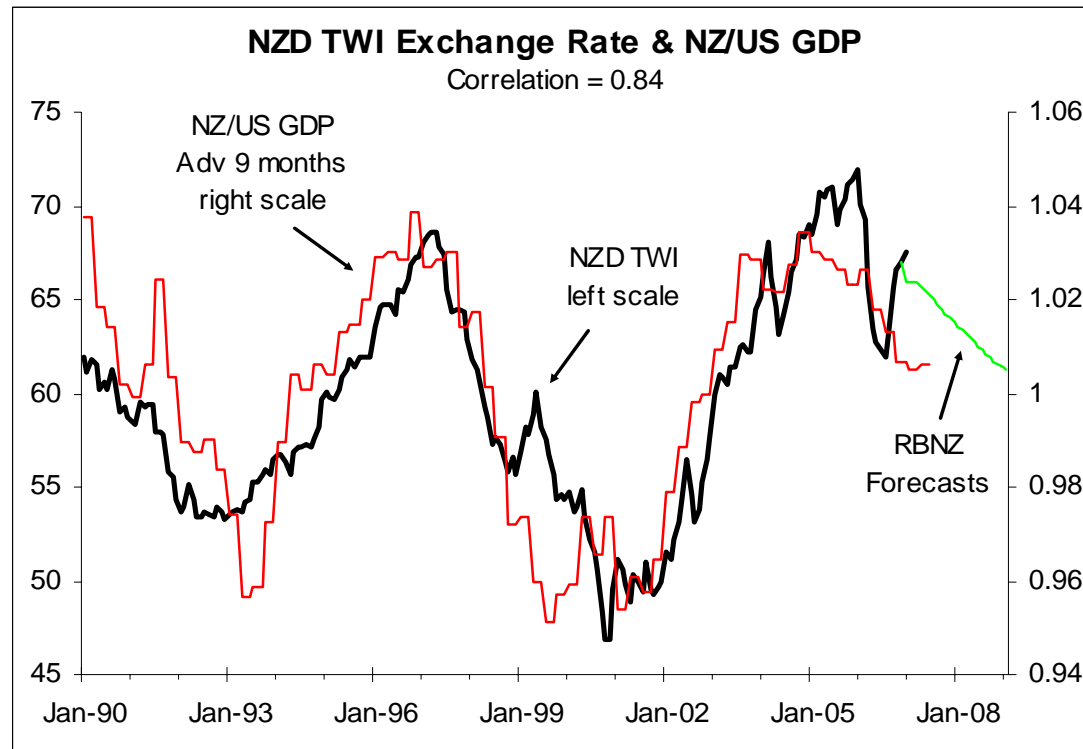
Valuation signals for NZ vs. global equities



Strong signal

What about the NZD?

Source: Strategic Risk Analysis Ltd



Relative growth is more important than the yield as high interest rates tend to slow the economy

Relative growth has been slowing while the NZ\$ has risen

Tax changes: do they matter if you don't pay tax?

- Most charities are tax exempt
 - need to invest in tax effective vehicles
- Changes will allow appropriate marginal tax rate to be paid
 - if tax exempt answer = nil
 - Should review your holding of Listed Property Trusts
- Will widen choice to vehicles that were previously unavailable
 - local relationship management

Expanding investment choice is positive as long as it doesn't cloud issues

Summary

- Growth is fostered by risk taking
- Ensure your risk tolerance and risk taking capacity match
- Sensible asset mix, quality active managers, cost and tax efficiency

A well structured portfolio can help you increase grants

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