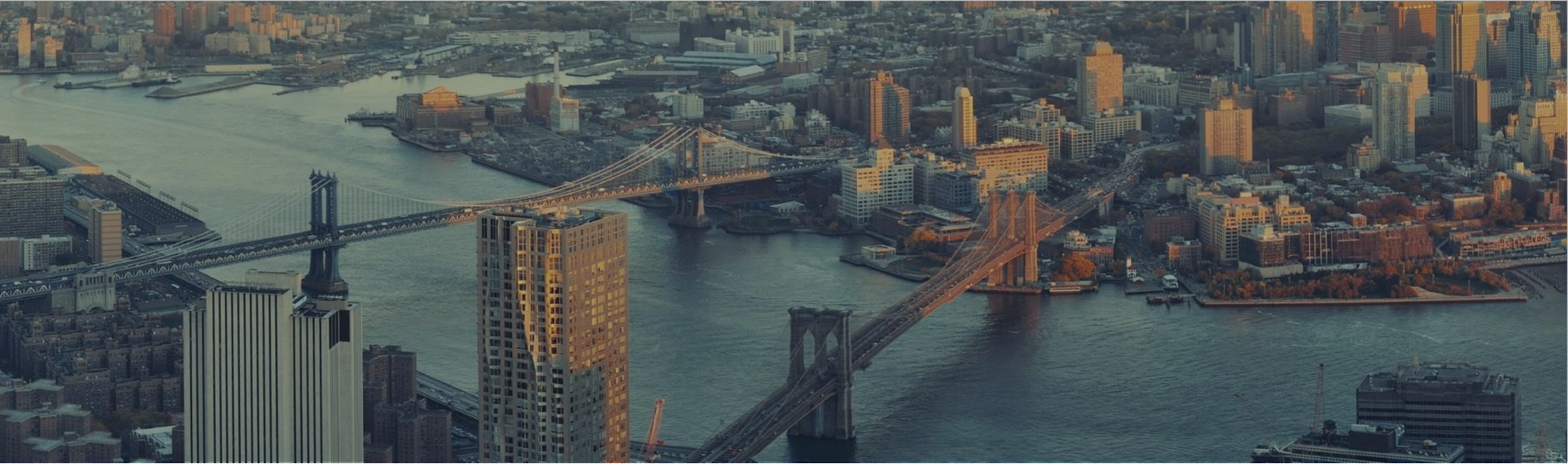

Q&A on Investment Management Strategies for Private Foundations

Peter J. Klein, CFA® is the President and Chief Investment Officer of the Claire Friedlander Family Foundation. Peter is also Chief Investment Officer and Founder of ALINE Wealth at Hightower Advisors.

Peter answers a series of questions about managing the investments in a private foundation, the current allocation in the foundation's portfolio and his outlook on private foundation investment management.

1) Can you share with us the foundation's current broad asset allocation?

Thank you very much for this opportunity to discuss the Friedlander Foundation's approach—the same approach we use at ALINE Wealth for the foundation portfolios under our stewardship.

As the CIO of the Friedlander Foundation my work is initially focused, broadly speaking, on the marriage between the Investment Policy Statement our board approved some time back, and has been periodically reviewed, and an asset allocation model, that meets those policy directives. Due to several macro-economic and market centric forces we have adopted a Tactical Allocation Policy in conjunction with our stated Strategic Asset Allocation Model. It is this Tactical policy model that we have used to navigate our asset exposures over the last 2 years.

The foundation currently has the following asset class exposures:

Cash and Equivalents:	16%
Fixed Income:	41%
Equities:	33%
Alternatives:	8%
Balanced:	2%

2) Is it safe to assume the Strategic Asset Allocation Model is a bit different?

Yes, to some degree. We would have less cash of course—closer to 5-7% and somewhat less exposure to fixed income and certainly a longer duration bias—we are now, and have been for the past 2 years, favoring a lower duration bias. Also, we would have a greater allocation to alternatives.

3) In speaking with other CIO's of private foundations we have heard that it has been difficult to glean the 5% return (needed to fulfill the qualified distributions to charities) given the typical 60/40 – fixed income to equity mix—that many CIOs have used for most of their careers. Is this time different and hence a new paradigm of thinking is needed?

Dangerous words— "this time is different"—as you know. Yes, it has been challenging given that fixed income returns have been so low and as such the 60/40 mix requires an equity return in the mid-teens to achieve the minimum 5%+ return that is requested by many foundation's boards. Remember boards of foundations are not focused on the market's return, they are not focused on the hottest sector or swinging for the fences—they are fiduciaries of a charitable entity and as such they are seeking solid risk-adjusted and consistent returns to permit the foundation's assets to do their charitable work. The objective is to provide the 5% distributions to charities and to hedge against inflationary forces and to be able to continue this work well into the future—and in some cases to perpetuity. So, it has been challenging, given the moderately conservative asset mix we have maintained, to achieve mid-single digit returns. We have managed to do so at the Friedlander Foundation utilizing the aforementioned tactical allocation policy—which allows us to add to risk

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investments when markets provide an opportunity (as they have recently but had not for most of 2017), a series of alternative investment strategies, a focus on the water sector (which also goes a long way to satisfy our sub-mandate of sustainable and ESG investing strategies) and through a process-driven selection of undervalued equity investments.

4) Can you share with us the Foundation's returns over the last few years?

The portfolio has appreciated, on a total return, net of fees, basis 5.7% a year over the last 2 years. However, those figures do not tell the complete story—with less than 40% of the assets allocated over that time to equities (as of January 2018) the Foundation's portfolio has maintained a decidedly "risk-off" posture. In fact, looking at just the equity sleeve our returns are greater than 16% annually over the last 2 years.

5) The passive school of investment management has been getting a great deal of interest in the last few years —where do you stand on the use of index funds and index-based ETFs?

We subscribe to the Core-Satellite methodology whereby a portion—for us, between 30-50%, of the portfolio is invested in a host of index funds and ETFs covering the investment landscape ("core")—from fixed income and global real estate to domestic and international equities. The balance of the portfolio embraces an active strategy of thematic posturing, screening for free cash flow generating securities and a sustainable, socially-responsible bias ("satellite").

We have, and continue to, eschew the thinking that a fiduciary-managed portfolio needs to be "all-in, all the time" by favoring a more thoughtful, targeted-return bias. Passive investing is just that –all-in, all the time. With an index fund there isn't an effort to consider the risks of an investment or the current state of valuation of the markets—it is a one-decision investment—BUY. Furthermore, many index-based products, be it funds or ETFs, are cap-weighted (mimicking the underlying index) and in some cases less diversified than we would typically prefer. As fiduciaries we cannot subscribe to the passive strategy for the majority of our assets for we firmly believe that thinking and studying investments and markets is important work that provides strong risk-adjusted—that is a key item to remember—RISK—returns over time. However, the passive strategy does have a place given its effectiveness and simplicity, in most cases, and as such we have adopted it as a part to our overall portfolio.

6) What type of strategies do you deploy on the satellite or active side of the portfolio?

We have and continually research and deploy a series of thematic portfolios—themes such as, bio-pharmaceutical/genetics companies, cyber-security companies, an Internet of Things portfolio, a market-neutral portfolio, a SRI/ESG portfolio and our long-standing work in the water and infrastructure sectors. These portfolios are initiated with deep industry research and substantive fundamental security analysis. We also conduct proprietary screens where we search for securities that have a significant, above market, free cash flow yield—we have found that this valuation measurement yields under-valued opportunities that we can then dig into and conduct more complete fundamental analysis. Finally, the foundation's portfolio has adopted a strategy of using a covered call writing program to enhance cash flow generation of the portfolio. In this conservative strategy we utilize call options to generate income on a portfolio of equities that the foundation owns—if the shares of these stocks appreciate above the option's strike place we receive the proceeds from that sale plus the option premium—if it doesn't we maintain the owned position but receive the cash from the sale of the option nonetheless. This is a lower risk/income generation strategy that Klein Wealth Management also advocates for their foundation clients.

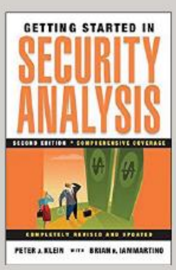
7) You mentioned ESG/SRI investing and your portfolio focused on the water sector—can you expand on that please?

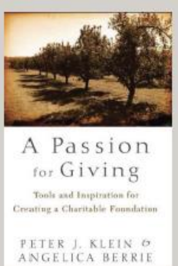
We have found, more frequently in the last couple of years, a greater interest in Socially Responsible Investing, especially in our target market of private foundations and endowments. We maintain two portfolios in this regard—a SRI/ESG portfolio comprised of equities and funds and a water sector portfolio that is focused on this scarce resource on the companies up and down the global channel that provide support to the delivery and protection of water. We own pump manufacturers, water utilities, testing companies, metering companies and a host of infrastructure companies focused on the water sector. It has been a sector we have worked on for several years and have achieved considerable results—it also plays well in a SRI framework.

8) Finally, what do you believe is the most important place for a private foundation to start when they are focused on their portfolio management?

We start with the Investment Policy Statement (IPS)—insuring that our foundation clients are fully on the same page as we are with respect to their long-term investment policies. In the IPS we develop a defined asset allocation model—a strategic asset allocation model as well as a tactical allocation model. We also pay a lot of attention to the mission of the foundation to ensure that our holdings and approach are consistent with the "spirit" of the foundation's mission. It all comes down, like in asset management, to doing the work—taking no short cuts.

**This interview took place in February 2019*





PETER KLEIN IS THE AUTHOR OF TWO WELL-REGARDED BOOKS:

Getting Started in Security Analysis (Wiley, 1998, 2009)

A Passion for Giving: Tools and Inspiration for Creating a Charitable Foundation (with Angelica Berrie, Wiley, 2012

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