

**School for Advanced Research**

# INVESTMENT POLICY STATEMENT

*Approved by the SAR Finance Committee*

*August 5, 2016*

*and*

*SAR Board of Directors*

*August 6, 2016*

## **I. Purpose of the Investment Policy Statement**

This Investment Policy Statement (the “Policy Statement”) outlines the priorities, scope and investment objectives of the School for Advanced Research (“SAR”) with respect to its endowment and other operating and investment funds (the “Investment Assets”). The Policy Statement is a framework for guidance of those who are responsible for implementation and monitoring of the portfolio and who bear a legal responsibility for prudently fulfilling these duties: the Finance Committee (the “Committee”) appointed by the Board of Directors (the “Board”) and any investment consultant or advisor that may be engaged by the Committee.

The Policy Statement has been adopted in order to:

- Establish objectives and risk tolerances for the Investment Assets;
- Specify target asset allocations;
- Establish guidelines for selecting consultants and investment managers or funds;
- Set constraints as to liquidity, spending requirements, permitted investments and asset concentration
- Specify criteria for evaluating consultants, individual managers and funds of the endowment and other funds as a whole;
- Define certain responsibilities of the Committee, the consultant, the managers, and other specified parties; and
- Ensure compliance with the provisions of the applicable statutes regarding the prudent management of institutional funds.

The Committee has designed this Policy Statement to reflect the current and anticipated future status of SAR, understanding that limits on its financial resources affect the ability of SAR fully to fulfill its mission. The Investment Assets are needed in the long term to support the Mission and Vision Statements adopted by the Board of Directors in February, 2016. In the short term SAR’s annual budget will continue to rely heavily upon annual distributions from the portfolio.

The Committee believes that the investment policies described herein should be dynamic, reflecting the current status of SAR and the Invested Assets and the Committee’s philosophy regarding investments. It intends to review the policies periodically for appropriateness, completeness and continued accuracy and revise them to reflect changes in the capital markets, the Committee’s charge from the Board, and in SAR’s strategic plans and operating needs as well as additional institutional priorities as may be defined by the Board.

## **II. Responsibilities of the Board, the Committee, the Consultant and the Custodian**

The Board is ultimately responsible for the financial condition of SAR. The Board appoints the chair and members of the Finance Committee to assist the Board in oversight. Through its charter, last adopted in February 2014, the Committee is charged by the board with endowment management, budget oversight, and short and long-range financial planning. Specifically, the Committee is responsible for managing SAR's endowment and other funds in keeping with its short and long term cash needs, and is authorized to delegate certain responsibilities to professional experts in various fields, including an investment management consultant, one or more investment managers, a custodian, and additional specialists such as attorneys and auditors to assist it in meeting prudently its responsibilities and obligations.

### **The Committee:**

The Committee understands its primary fiduciary responsibilities with respect to the oversight of the portfolio to be the following:

- Establish and approve an investment policy statement and periodically review it for continued accuracy and completeness;
- Prudently diversify, or oversee the diversification of, the portfolio assets to meet an agreed upon risk/return profile;
- Prudently select investment consultants, investment managers and custodians;
- Monitor the activities and performance of the Consultant, the investment managers and the accounts under management;
- Consider the information and recommendations provided by a consultant and other professional advisors and take prudent actions;
- Control and oversee all investment, record keeping and administrative expenses associated with the accounts;
- Review and deal prudently with conflicts of interest, and
- Report its decisions and the status of the Investment Assets to SAR's Board of Directors.

### **The Consultant**

The Committee may retain an advisor or consultant (the "Consultant").

**The Consultant shall be deemed a fiduciary with respect to SAR and its Investment Assets and shall so acknowledge in writing. The consultant shall also acknowledge in writing the receipt of this investment policy and any subsequent revisions.**

The responsibilities of the Consultant shall include the following:

- Assist the committee in establishing investment policy, objectives, and guidelines;
- Advise the committee continually regarding spending policy, risk management and liquidity;
- Assist in developing an asset allocation strategy and portfolio structure and monitoring their effectiveness;
- Propose investment managers that can help achieve the policy objectives;
- Perform due diligence on proposed managers, and on active managers on an ongoing basis;
- Assist the committee in developing selection criteria and evaluating proposed managers;
- Report and interpret investment performance reports on managers and the portfolio as a whole as well as the cost of the investment program;
- Initiate discussions as to changes in strategy, managers, and policy;
- Monitor and report on the costs of investing (i.e. fees);
- Meet with the committee in person at least annually.

### **The Custodian**

The Committee shall obtain the services of a custodian, which may be related to the Consultant, to maintain possession of securities owned by SAR and effect receipt and delivery following purchases and sales. The specific duties and responsibilities of the custodian include:

- Maintain separate accounts by legal registration;
- Value the holdings;
- Settle all transactions;
- Collect all income and dividends owed to the Investment Assets in its custody;
- Perform regular accounting of all investment assets owned, purchased, or sold and the original basis for each position, as well as movement of assets into and out of investment accounts, and
- Provide monthly reports that detail transactions, cash flows, securities held and their current value as well as the change in the value of each security and the overall portfolio since the previous report and since accession.

## **III. Objectives**

### Investment Objective

The principal investment objective of SAR is to preserve, in perpetuity, the purchasing power of its Investment Assets and to provide a stream of income to cover budgeted expenses of SAR, which are expected to increase with inflation and modest growth in programs.

SAR is indifferent as to whether this objective is met through current income or appreciation in value of assets. The focus of the objective is on total return. SAR expects, over time, to achieve an annualized total return which exceeds budgeted spending plus an amount equal to inflation (defined as the

increase in the Consumer Price Index). This objective is based on historical returns of the asset classes included in the target allocation. Market returns are the long objective for each asset class and the portfolio in total. Over a market cycle this objective is intended to insure that the investment strategies, budgeted spending and inflation expectations are coordinated sufficiently to preserve the purchasing power of the Investment Assets.

For SAR's fiscal year ended June 30, 2016 the budget requirement to be distributed from the Invested Assets is approximately \$1.27 million. For the following several years, the requirement is expected to be of comparable magnitude.

#### Spending Objective

The annual spending objective for SAR's operating budget is *a maximum of 6% and a minimum of 3.5% of the five-year moving average of the market value* of the funds designated (either donors and the Board) as endowment as of the December 31 prior to the end of the fiscal year. The actual spending for the year ended June 30, 2016 is equal to 5.5%. The Committee considers this percentage too high to meet its long-term objectives and intends to reduce it gradually to 4% to 4.5%. However, it recognizes that in the short term, while public support is still in a building phase, the actual spending percentage may well be higher than 5.5%.

## **IV. Risk Management**

There are no defined, finite liabilities secured by the endowment assets. Portions of the Invested Assets are restricted to particular future activities. However, in order for SAR to function effectively in the next several years, the portfolio must be able to provide adequate cash flows. Since SAR is set up to fulfill its mission in perpetuity, the portfolio will need to grow in order to maintain longer-term spending needs of the longer term. This necessarily means exposing it to risk. In order meet both short and long-term needs, the portfolio will be segmented as follows.

Protective assets: A portion of the Invested Assets sufficient to meet cash needs for up to three years, together with a reserve designated as the "Rainy Day Fund" and restricted, pre-paid grants will be allocated to liquid, lower risk securities. The Invested Assets portion may represent as much as 20% of the total portfolio and is included in the fixed income allocation. The investment goal for this segment of the portfolio is to provide safety and ensure that operating cash needs can be met without being impacted by declines in the markets, while earning a return consistent with a low risk profile. The amount required for this segment will be re-determined near the end of each fiscal year, after analyzing the budget proposed for the upcoming year and conferring with the Development Committee about SAR's progress in building public support. The time horizon for the Protective Assets is from six months to three years.

Market assets: The balance of the portfolio, with the exception of funds identified as strategic assets, will be invested to seek higher returns with moderate risk, in order to provide for future liabilities and

intermediate to longer-term spending needs, taking into account inflation. This segment will thus be exposed to systematic risks such as international economic forces, government policy or acts of nature. Investments will be well diversified and provide exposure to equities, fixed income, and possibly alternative investments if these can be carefully diversified and monitored. Market Investments may include traditional passive, enhanced-index and alternatively weighted strategies as well as reasonably diversified long-only asset managers who run concentrated portfolios. The time horizon for the Market Assets and Strategic Assets is infinite.

Strategic Assets: Funds allocated to this category would be those earmarked for organizational growth, beyond the need for annual spending in support of the SAR mission as currently defined. Such investments may also entail losses from time to time. This category can only be funded if Protective and Market Assets are deemed sufficient to meet SAR's needs for at least five years.

## **V. Asset Allocation Strategy**

The primary method to reduce risk for the Invested Assets is diversification through asset allocation. In line with the Committee's return objectives and risk parameters, an asset allocation policy has been established and is included herein as Appendix A. The Asset Allocation Policy lists the categories of allowable assets and the target percentages of market value that reflect the Consultant's consideration of expected returns, volatility and correlations among the categories.

### Rebalancing Procedures

The Consultant/Committee will review the asset allocation at least quarterly and reallocate assets from one class to another to adjust over- and under-funding. The Consultant/Committee will have authority to reallocate the portfolio when any single asset class is over or underweighted by more than 20% of that specific asset class target. Rebalancing can also be accomplished through distribution spending design. All rebalancing should consider current and known future cash receipts and requirements.

New gifts directed to endowment that come in the form of marketable securities shall be liquidated as soon as practicable. Cash generated by the sale of securities shall either be invested in an underfunded asset class, or used as a portion of the next spending distribution.

## VI. Investment Manager Selection and Responsibility

Any contract or engagement letter with a consultant shall include the following points:

### Selection and Evaluation Criteria for Investment Managers

The Committee expects the Consultant to conduct the initial and ongoing due diligence processes for those managers they recommend. However, the Committee intends to review the Consultant's due diligence reports prior to investment approval and on an ongoing basis. At the annual face-to-face meeting with the Consultant, the Committee will review the status of the documentation related to each manager and discuss any changes to the Consultant's due diligence process.

The Committee will consider an investment manager recommended by the Consultant using the following criteria:

- The investment style and discipline of the manager;
- The degree to which the manager's style or strategy complements other managers in the portfolio;
- Consistency of management according to the investment style/asset class as described in its relevant documentation;
- Maintenance of diversification in the portfolio subject to the constraints outlined in this Investment Policy;
- Reasonableness of expense ratios and fees
- Past and present performance compared to relevant benchmarks for the investment asset class.
- Level of risk taken to achieve results
- Level of experience, financial resources, and staffing levels of the manager
- Stability of the organization and of the individual or team managing SAR's assets.

### Fiduciary Responsibilities of Investment Managers

Investment managers can include regulated banks or insurance companies; mutual funds registered under the Investment Company Act of 1940 (where applicable), or registered investment advisors. With respect to the assets of any mutual or other commingled funds that have been purchased, it is understood that the prospectus or documents of the fund will govern its investment policies, not a separate agreement with SAR.

If an investment advisor is engaged to manage a separate account, a client agreement will formalize the investment policies, roles and responsibilities. **Investment managers who manage separate accounts for SAR shall acknowledge in writing that they are fiduciaries to SAR with respect to the Investment Assets under their management.** Each such investment manager shall demonstrate that it has adequate fiduciary liability insurance and bonding for the management of the account. An investment

manager is expected to manage its portion of the Invested Assets in a manner consistent with the investment objectives, guidelines, and constraints outlined in this Policy Statement. This obligation includes responsibilities to SAR consistent with “Prudent Investor” standards, and all other applicable fiduciary regulations and requirements.

#### Proxy Voting

Absent delegation to another service provider, each investment manager is responsible and empowered to exercise all rights, including voting rights, as are acquired through the purchase of securities, where practical. An investment manager shall vote proxies according to their established Proxy Voting Guidelines. A copy of those guidelines, and/or a summary of proxy votes shall be provided to the Committee upon request.

It shall be every investment manager’s responsibility to seek to obtain the best price and execution of trades for the Invested Assets.

#### Manager Communications:

As a matter of course, each separate account investment manager shall communicate to the Consultant and the Committee any material change in outlook, investment policy, and tactics and any material event affecting firm ownership, brokerage affiliation, and key investment or management personnel.

## **VII. Constraints**

#### Concentration Limits

The Committee prefers to avoid concentration as well as reduce risk by using different strategies and asset classes that have low correlations to each other.

No individual holding, whether purchased or received by gift, may exceed 5% of the portfolio, measured at market. No more than 5% of the securities of any one issuer, measured at market, may be held, excluding issues of the U.S. Government or its agencies. If the Committee determines that a portfolio of individually managed securities is appropriate, it will provide to the selected investment portfolio manager a set of guidelines addressing portfolio diversification and concentration of risk.

#### Unrelated Business Taxable Income (UBTI)

SAR is a 501(c) (3) non-profit corporation and not subject to Federal or New Mexico income tax, but SAR is taxable on any Unrelated Business Taxable Income. SAR wishes to avoid being subject to tax on UBTI. If the Consultant or a Manager intends to recommend or make an investment which would generate



unrelated business income, the rationale for such an investment must be presented to and approved by the Committee and the Vice President of Finance and Administration in advance.

#### Derivatives and Structured Products

The Committee understands that derivatives and structured products, including hedge funds, can be used efficiently to reduce portfolio risk and enhance return. Because they can also increase the risk and diminish the liquidity of the portfolio, before derivatives are purchased, the Consultant must present to the Committee an explanation of the structure and a rationale for the risk entailed, and obtain Committee approval before permitting a manager to proceed.

Derivatives are allowed for the purpose of hedging an underlying position and may be used to take a long position in anticipation of a cash inflow, but once the cash is used to open a position in the underlying security, the derivative position should be closed out. Any derivative or structured product that will increase the potential for loss greater than that of a long position in the underlying security is not allowed.

#### Cash and Cash Equivalents

The cash reserve portion of the Invested Assets (mainly in the Protective Assets segment) should be held in the custodian's money market fund and should short-term Treasury securities and insured savings instruments of commercial banks and savings and loans. Because the cash allocation will be managed at the portfolio level, investment managers are expected to be fully invested in securities. New managers or those receiving a large infusion of cash will have up to three months to allow for an orderly investment of funds.

## **VIII. Performance Evaluation**

#### Portfolio Performance

As noted above, the Consultant is charged with providing quarterly performance measurements sufficient to allow the Committee to monitor the portfolio as well as its individual components and managers. The Committee will evaluate success in achieving the investment objectives over a three- to ten-year time horizon and a full market cycle.

The performance of the Protective Assets, the Market Assets, the Strategic Assets and the Invested Assets as a whole should be reported in terms of a dollar-weighted rate of return as well as changes in dollar value. Returns should be reported net of fees, including the fee of the Consultant. The Committee, the Consultant and the Managers will agree to appropriate benchmarks at the time services

are retained. Benchmarks should measure the effectiveness of the individual classes as well as the asset allocation as a whole.

#### Consultant Performance

The Committee shall evaluate its relationship with the Consultant periodically, but at least annually, to determine the extent to which the consultant adds value to the Committee's work. Factors will include:

- Clarity, accuracy and timeliness of reporting;
- Accessibility;
- Effectiveness in interpreting investment reports;
- Quantity and Quality of manager recommendations in all asset classes;
- Level of due diligence;
- Attention to managing cost of investment management services;
- Fairness of fees relative to service provided, and
- Transparency with respect to fees or other benefits received as a result of its work on behalf of SAR; (See Conflicts of Interest, below)
- Degree to which the Consultant's actions contribute positively to returns.

#### Corrective Action

The Committee recognizes that a long-term focus is best when evaluating relationships with consultants and investment managers. Performance over short-term periods may deviate significantly from benchmarks and representative market indexes. The Committee will not, as a rule, terminate a consultant or investment manager based on short-term performance. It will however reserve the flexibility to terminate their relationships at any time for any reason

## **IX. Exceptions and Investment Policy Review**

This policy statement summarizes an investment philosophy and supporting practices to guide the Committee, the Consultant and other parties responsible for management of the Investment Assets. It is understood that there can be no guarantees about the attainment of the goals or investment objectives outlined here. The Committee shall review the policy at least annually to update its assumptions about the financial condition of SAR and the financial markets, and propose such changes in objectives, strategy and asset allocation as it deems necessary. Between meetings of the Board of Directors, at the request of the Finance Committee, the Executive Committee may approve modifications in the policy and report them to the full Board at its subsequent meeting.

Exceptions to the policy guidelines may be made at any time with the approval of the Committee and shall be reported immediately to the Executive Committee and included in the Committees report to the next meeting of the Board of Directors.

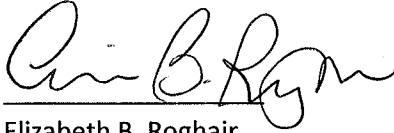
## **X. Conflicts of Interest**

All members of the Committee, staff or consultants responsible for investment decisions, investment management, investment consulting, or any investment advice whatsoever, shall disclose at the beginning of any discussion or consideration by the Committee, any relationships, material ownership, or other material interest(s) that the person has with respect to any investment issue under consideration. The Committee will require such persons to remove themselves from the discussions or final decision.

Any members of the Committee, staff or consultants responsible for investment decisions or who are involved in the management of the Investment Assets shall refuse any remuneration, commission, gift, favor, service or benefit that might influence them in the discharge of their duties, except as disclosed in writing, agreed upon by the Committee and documented in Committee minutes. Failure to disclose any material benefit may be grounds for immediate removal from involvement with the Committee.

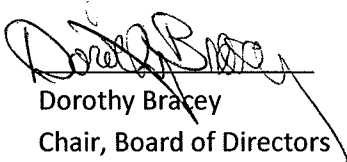
## XI. Approval and Acknowledgement

This Policy Statement is adopted by the Finance Committee on August 5, 2016



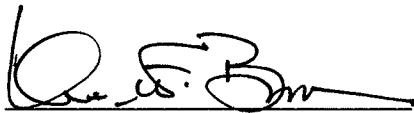
Elizabeth B. Roghair  
Interim Chair, Finance Committee

Approved by the SAR Board of Directors at its meeting on August 6, 2016



Dorothy Bracey  
Chair, Board of Directors

Acknowledged by SAR Management on: \_\_\_\_\_



Michael F. Brown  
SAR President and CEO

Acknowledged by the Consultant on \_\_\_\_\_

\_\_\_\_\_  
Virginia M.K. Stanley  
Principal-in-Charge  
REDW Stanley Financial Advisors, LLC.

**Appendix A**  
**ASSET ALLOCATION POLICY**

<i>Asset Class</i>	Target Percentage of Market Value (%)
Cash and Equivalents	
Fixed Income	
Domestic Equities	
Foreign Equities	
Real Estate	
Alternatives	
<b>Total</b>	<b>100</b>

Adopted on: \_\_\_\_\_

By: \_\_\_\_\_  
Chair, Finance Committee

By: \_\_\_\_\_  
Chair, Board of Directors

Acknowledged for the Consultant by: \_\_\_\_\_  
REDW Stanley Financial Advisors, LLC





