Ventura County Community Foundation

MARKET TURMOIL & CHARITABLE FUNDS AT VCCF
QUESTIONS & ANSWERS – OCTOBER 2008

Q What is your reaction to the recent market turmoil?
A These are historic times, with unprecedented responses from government, the markets and financial institutions – all happening within a short period of time. We are still digesting some of the turmoil, recognizing that the markets are responding to activities over the past couple of years – and discounting future expectations of economic activity.

Q How much have you lost?
A Our endowments are clearly impacted by the decline in financial markets around the world, as you would expect from a diversified portfolio invested across key asset classes. We are expecting September 30th results by the end of October, which we will share with our fund advisors in the Open Investment Committee in mid November and with statements, mailed also in mid-November. While we look at results quarter to quarter, we also look at the long term results since our portfolios are designed to generate positive returns over market cycles.

Q How safe is my fund at VCCF?
A Your fund is safe, although the endowments reflect the declines in the market values of all major asset classes.

Pass through funds are invested in money market funds, where there is little risk to principal.

Q Will this affect the amount my fund can distribute?
A Yes and no. Our endowment funds are invested long term, and to cushion the impact of sudden or significant shifts in the markets, we calculate the amount available for annual distribution based on a twelve quarter rolling average, based on June 30th numbers. Therefore, the amount available this year is based on the average value of your fund's portfolio from 2006-08; these distributions have already been approved by the VCCF board and, where eligible, are available October 1 for distribution.

Any sustained decline in markets will be included in future calculations, but the immediate impact will be mitigated. This works the opposite way too, as significant increases in the market work their way into the 3 year average as well. Ultimately, the performance of the portfolio has an impact on how much is available to be distributed.

Q Has this happened before?
A Yes, most recently in the 'dotcom bomb', when the markets declined dramatically in the years following 2000. VCCF portfolios, while diversified, suffered declines in subsequent years but, thanks to our diversified strategies and positive returns from the markets through 2007, ultimately recovered. As a long term investor, we plan for market cycles, some of which can last for several years.

Q	Have you changed your investment strategy?
A	No. Our core investment strategy is to invest in a diversified portfolio that – over market cycles, enhances the purchasing power of the funds contributed – after annual distributions, fees and inflation.

In the summer of 2006, as many equity based portfolios recovered to levels recently held in 2000, the investment committee engaged in a sustained review of our policies and reconfirmed the basic approach, with a recommendation to increase diversification by reducing exposure to the US equity markets, enhancing international exposure and expanding alternatives and private equity investments. These changes would be added over a four year time horizon, based on investment gains and new contributions to the portfolio. The recommendations, and a new set of target asset allocations, were approved by the VCCF board. As of September 2008, the managers for the core VCCF endowments had increased from 9 to 11, and we have 16 managers for alternative assets.

We still believe that picking good managers and holding them accountable is the most effective long term strategy to achieve our goals.

Q	How exposed are you to US markets?
A	Our endowment portfolios are invested in a diversified strategy that is designed to expand our exposure to asset classes that do not always move in the same manner, which reduces the risk of the overall portfolio. We have set targets for percentages invested in large cap US equities, small cap, mid cap, international large cap exposures, emerging markets debt, and alternatives – these are our asset allocation targets.

Q	Have you fired any of your managers?
A	Our committee consistently looks at our manager performance, tracked against both the right benchmark and our asset allocation targets. We control risk by managing exposure to specific asset classes and sometimes reallocate away from managers to ensure our compliance. Our investment committee also reviews managers for specific and relative performance, and we have terminated managers who have continued to underperform their benchmarks.

Q	Will my fees go down?
A	Investment fees are tied to the value of the endowment funds; a decline in the endowment values will reduce the actual dollar fees. Since all funds benefit from participation in the diversified endowment pool, each fund shares pro rata the costs; these fees currently are about 0.87% of the assets. The 1% management fee remains the same, with a discount to 0.65% for funds with limited activity and assets of $2.5 million. Management fees are assessed twice per year, based on September 30th and March 31st values.

Q.	How do you calculate annual grant distributions?
A	We use a 5% calculation, based on the fund value on June 30th, averaged over the prior twelve quarters. Based on historical analysis (and often referred to as the Yale plan after an analysis by Yale University in the 1980s), the 5% annual rate is applied on a total return basis. This rate has historically preserved through market cycles the core purchasing power of the funds contributed. This rate is reviewed annually by the VCCF board and has not changed in the last fifteen years.

Given the volatile market changes, we remind donors they can take <u>up to 5%</u> in any given year, preserving some capital growth for future years. We also recognize that in tougher economic times, donors often want to increase their support for local nonprofits.

Q What does total return mean?

A Total return reflects the amount the entire portfolio has grown – including income, dividends and unrealized capital gains. By using a flat percentage (5% in our case) of the portfolio, this smoothes out the annual distributions to nonprofits so that contributions to their budget do not adjust to accommodate significant changes year/year based on the portfolio returns. VCCF manages all of its endowments on a total return basis

Q What are alternatives?

A With a long term investment strategy, our efforts to diversify risk include expanding alternatives to stocks and bonds. These include hedge funds which invest in funds of other investments ('fund of funds'), absolute return managers (who manage month to month returns based on various long/short strategies), and in private equity investments in sectors and companies, some here in the US and some abroad. We believe these 'alternatives' provide not only diversification of risk but also higher levels of return over time. Many are not as liquid as stocks and bonds, but provide better long term results, which enhances the long term returns of the entire portfolio.

Q Why didn't you liquidate your stock portfolio when things began to go south?

A As investors, our focus remains long term. Market timing is a strategy that is very risky, both because it is very difficult to pick the exact time when a market has peaked (when you need to sell) or when it has hit the bottom (when you want to buy). If you miss one of the turns, the impact on your portfolio returns can be significant – losses if you miss the high, missed gains if you miss the bottom. We are not market timers.

History has demonstrated that a combination of stocks, bonds and alternatives is the best way to generate long term growth of portfolios. We believe that remaining fully invested in each of our market segments will allow us to capture the best returns over time, and that the best way to manage the shifts in market sentiment and shifts in value/growth sectors is to monitor the asset allocation targets and keep to approved targets.

Q Does VCCF buy stocks directly

A No. We follow a "manage the manager" approach. Our investment committee works with a consultant who helps us pick, monitor, evaluate managers from a wide universe of potential sources; this consultant has been helping VCCF for over fifteen years?

Q Can I get my endowment back?

A Endowment funds are not reserve funds, and should not be seen as accessible for short term cash flow needs. If a nonprofit wants to preserve reserve funds for access, it should not invest them in long term endowment investments.

Unless there are specific provisions in the fund agreement, the fund at VCCF is the result of a completed gift and the funds are now the property of VCCF, and under the fiduciary oversight and control of the VCCF board. Even if it were possible, returning the gift might call into question the original charitable deduction. VCCF oversight is directed to ensure that the purpose for which the fund was established is protected and that all distributions are in alignment with that purpose.

With funds established by local nonprofits ('agency endowments'), there are times when such funds can be returned – with the approval of the board of the organization and the VCCF board. These provisions must be clearly outlined in the original fund agreement and do not apply to any funds donated to VCCF directly by donors. Such provisions should be disclosed to donors, so that they are aware that the board of the nonprofit has the option of requesting endowment funds to be returned in future years.

In most cases, these provisions provide for a distribution over a number of years (in many cases, restricted to 25% of the fund's value in any given year); this is to ensure that the endowment fund's long term investment strategy is not countermanded by making short term decisions.

Q What is VCCF's strategy for the future?
A VCCF is committed to managing prudently the funds entrusted to its care, focusing on generating long term growth after annual distribution, fees and inflation. We are watching the financial markets carefully, both regarding the impact on the endowment funds and the impact this will have on our programs, initiatives and own operating budget in the coming years.

Q What if I have other questions?
A We provide an annual open meeting of our investment committee, scheduled this year for November 18th at 12.00 noon at the Community Foundation's offices in Camarillo. The chair of our investment committee and our investment consultant will be there to answer questions. Please call to make sure we know you are coming. Last year's presentation on our investment strategy is available on the VCCF website at www.vccf.org, under investment philosophy.

If you have other questions about your VCCF fund or the funds VCCF manages, please email or call VCCF staff with any questions – either Clare Brown, VP Controller at ext.129 or Hugh Ralston, VCCF President & CEO at ext. 116, or send queries via email at cbrown@vccf.org or hralston@vccf.org.