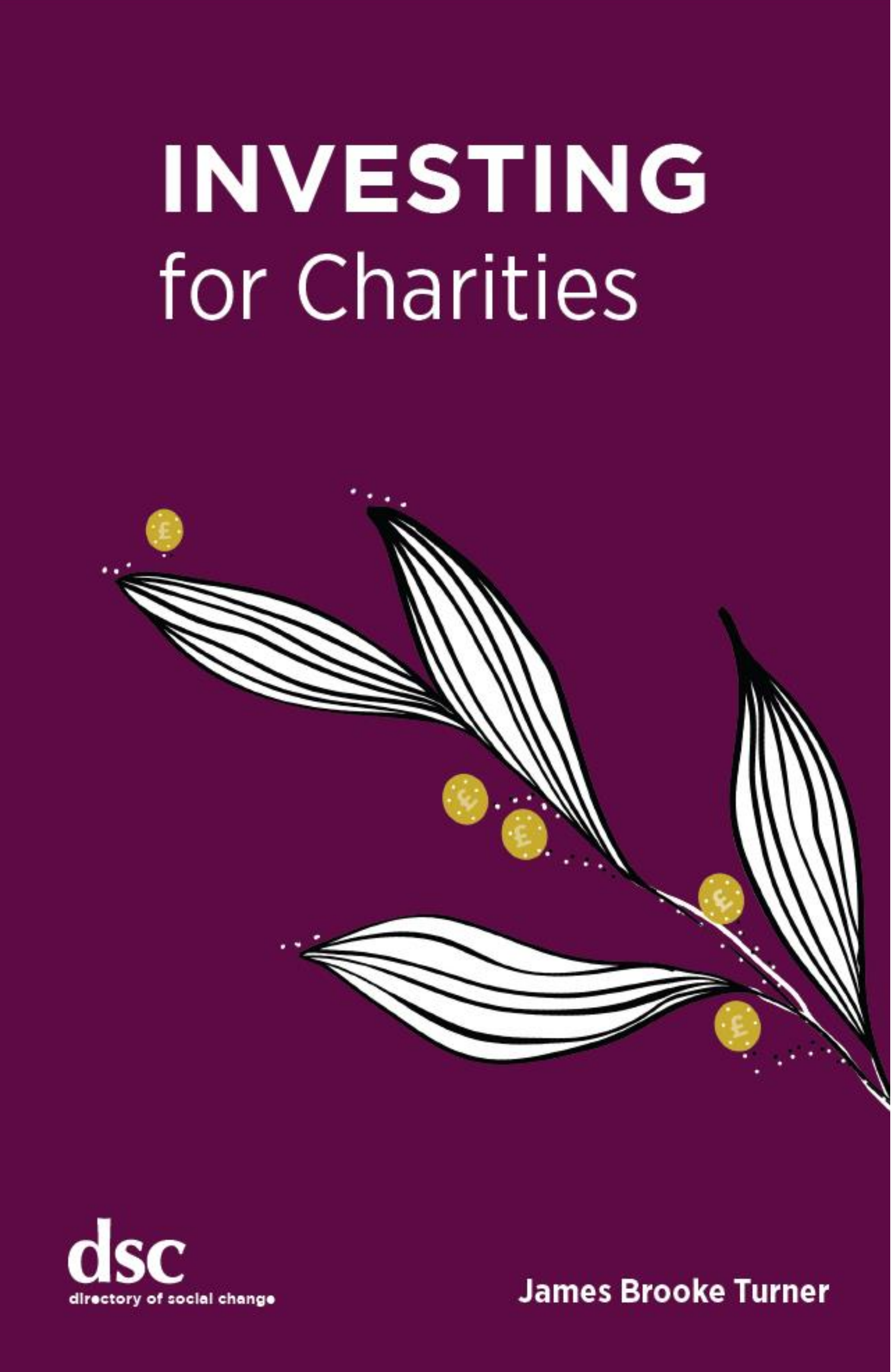


Investing for charities

a brief introduction

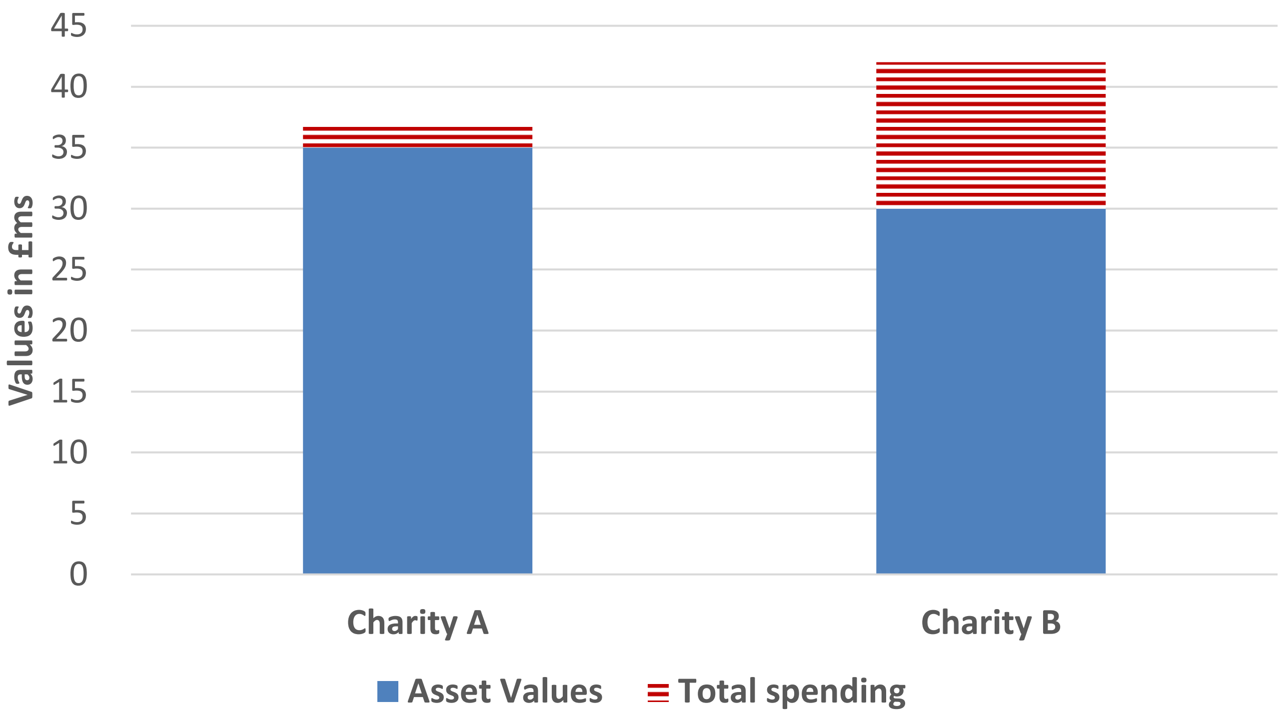
James Brooke Turner

www.dsc.org.uk/publication/investing-for-charities/

£35

What makes you charitable is what you spend, not what you save.

It’s not your money, it's for someone else
What’s best for them?



Interlocking policies and ideas

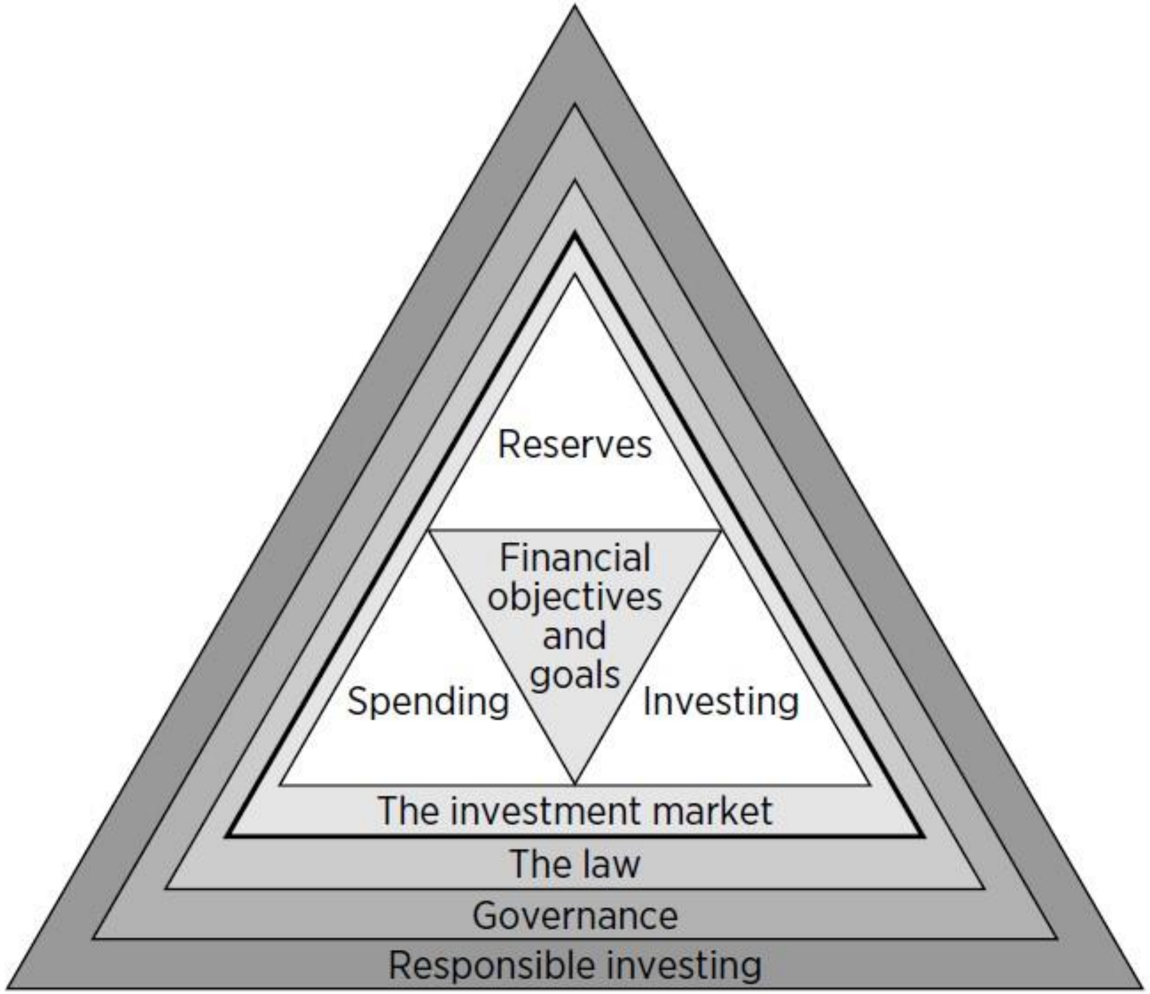
It’s about so much more than just investing…

Structure

Fundamentals
- Financial Objectives & goals
- The investment market
- Spending policies
- Investment strategy
- Reserves policies

Context
- The law
- Governance
- Responsible investing

In practice
- Appointing a manager
- Performance measurement
- Total return accounting

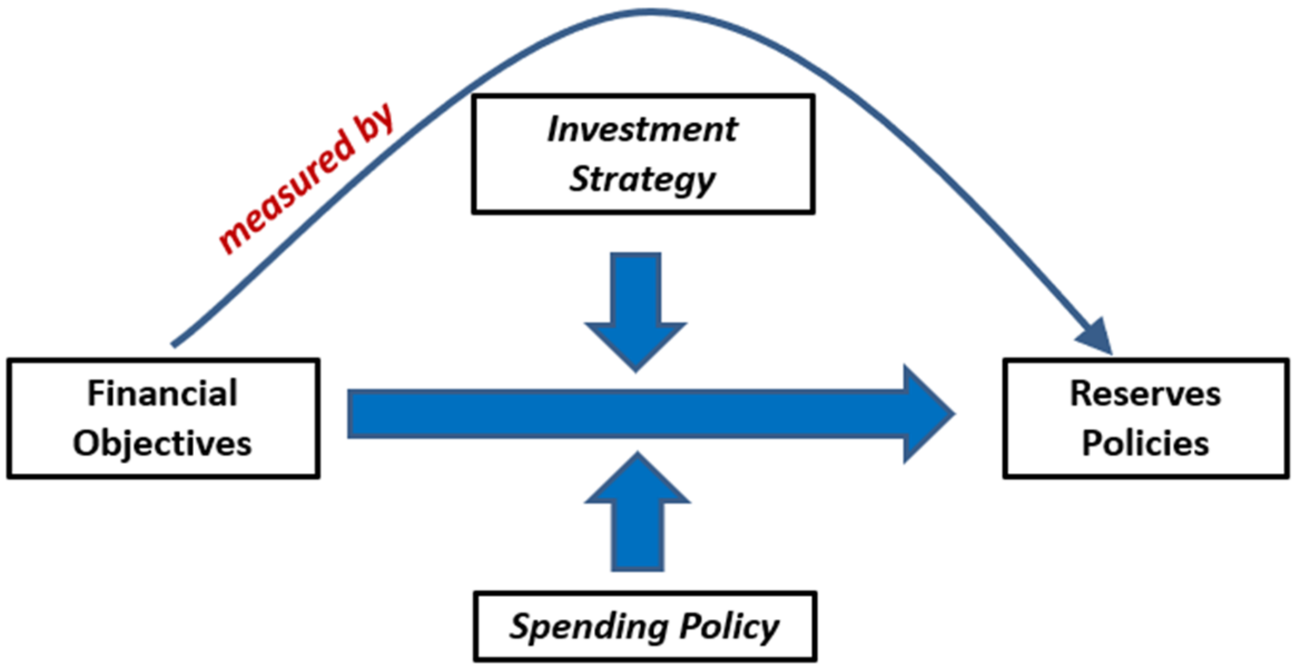


Financial objectives and goals

All charities have one of three financial objectives:

- To grow
- To stay the same size (after inflation)
- To spend out

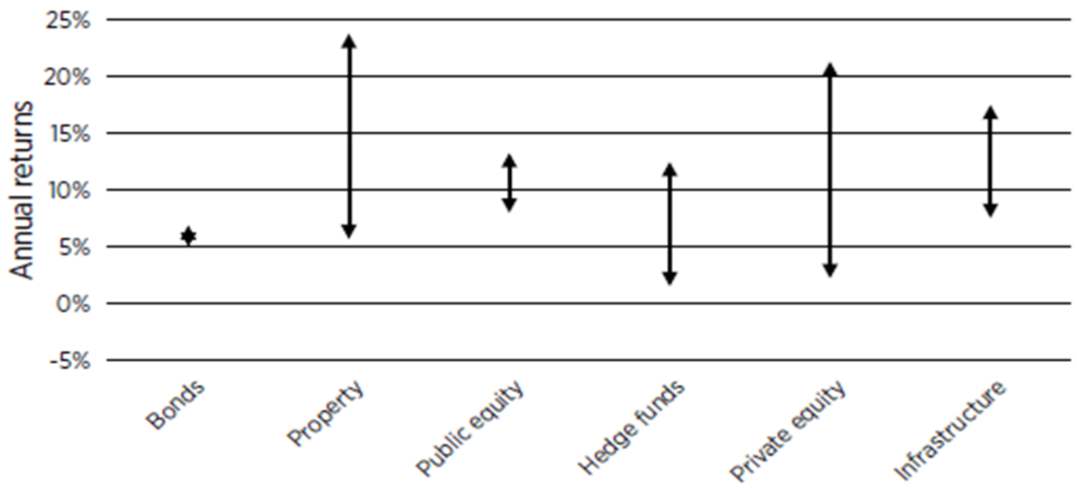
You must be able to answer this question in order to know what you can spend.

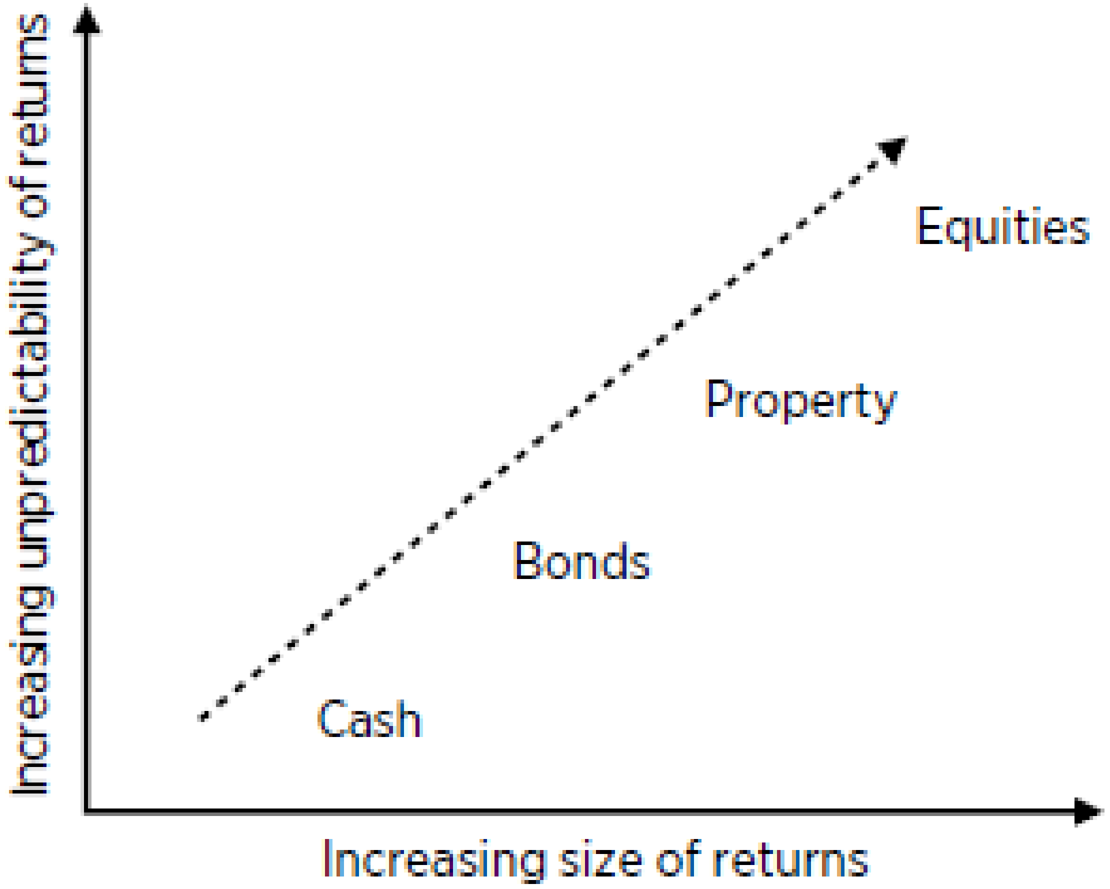


Investment market

What's the money for?

Principal asset classes	Expected return above inflation
Cash	+0.5% - 1%
Fixed income/Bonds	+ 2% - 3%
Property	+ 3% - 4%
Public equities	+ 4% - 6%





Spending policies

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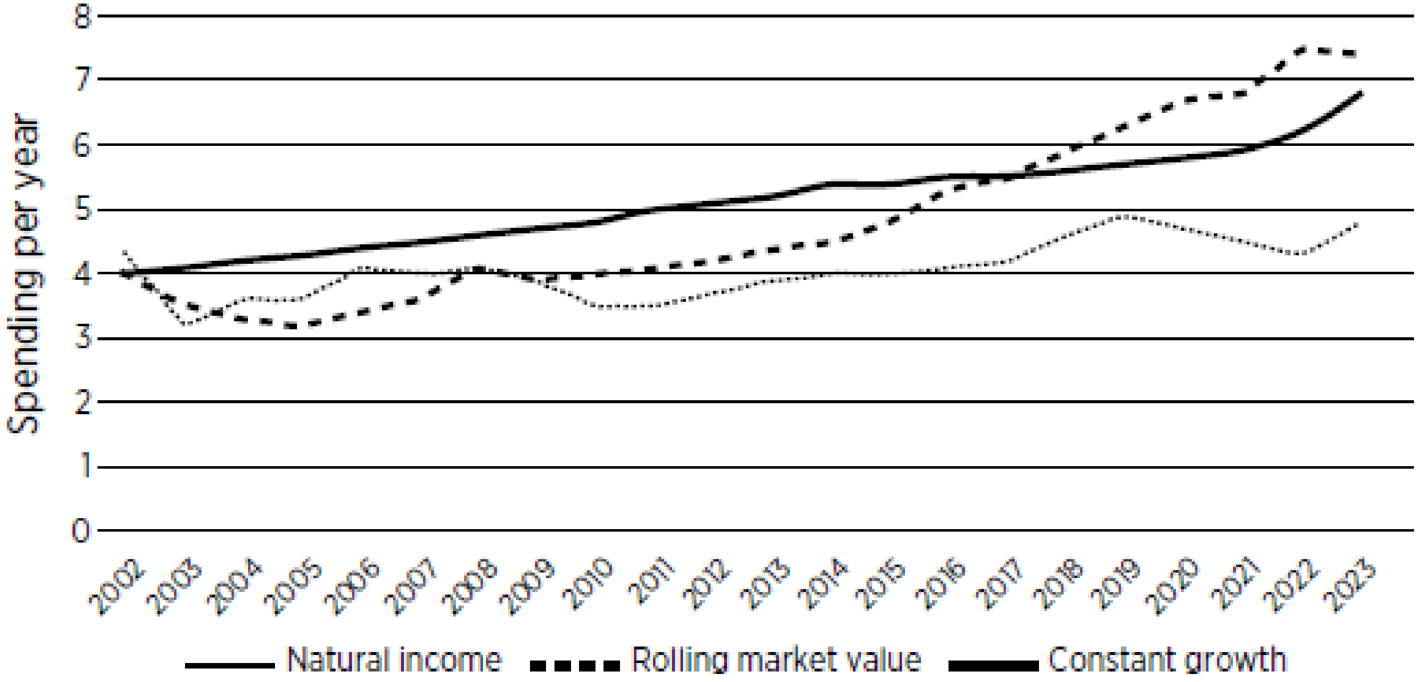
	Most appropriate spending policy for			
Spending rule	**Stable spending**	**Capital maintenance**	**Simple cash flow**	**Charity accounting**
Natural income	✓	✗	✓	✓
Rolling market value	✗	✓	✗	✗
Constant growth	✓	✗	✗	✗

Three basic rules, two of which use total return

Total return
Income + Capital = Total Return

More complex but good if you have:

- More than 70% investment income, or
- A large investment portfolio, or
- A permanent endowment which has grown much faster than inflation which you want to spend.



Investment strategy

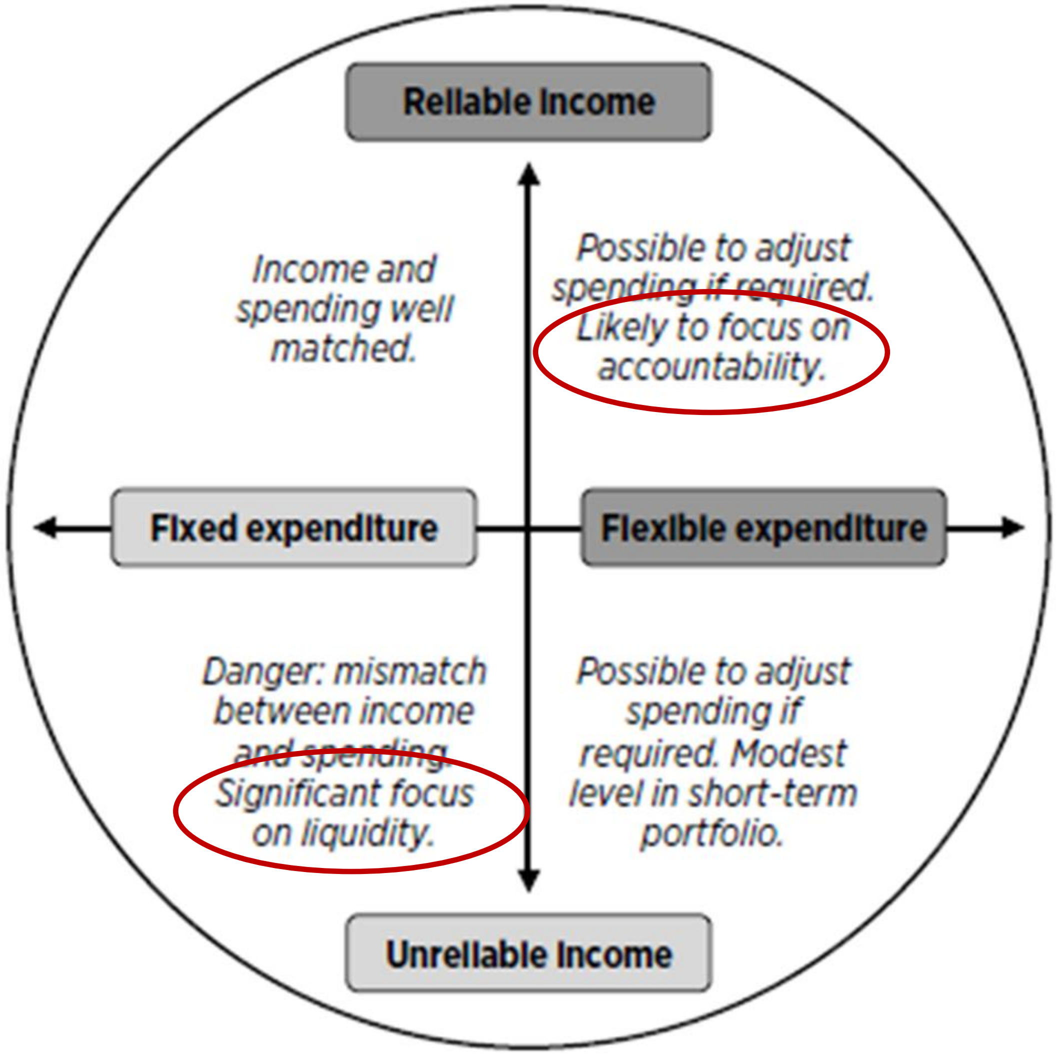
It's all about risk and liquidity

'Proper' risks
- Fraud
- Counter-party failure
- Lack of diversification
- Poor investment management

Mitigation
- Due diligence

'Investment' risk
- Unpredictability of future value
- Uncertainty about annual return
- Being different to a benchmark index

Mitigation
- Time horizon



Time is of the essence

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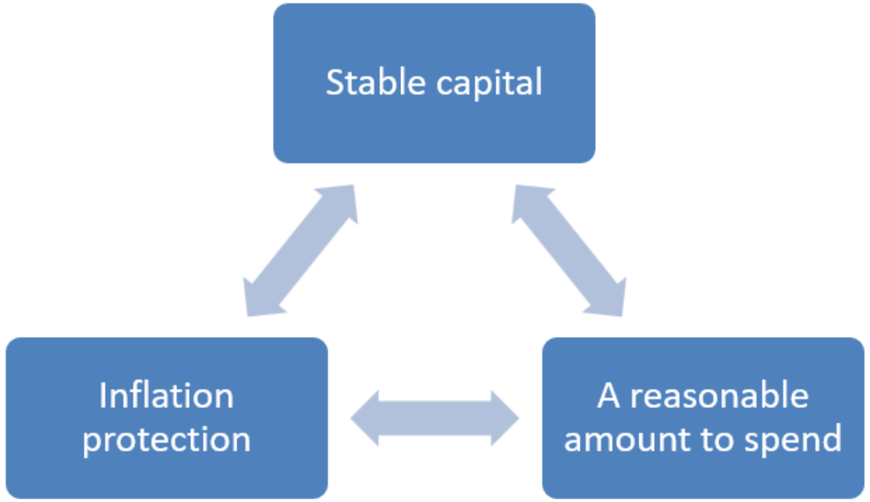
Most charities have two time horizons, short and long. Tolerance for investment risk and unpredictability is a function of your time horizon.

	Short-term portfolio	**Long-term portfolio**
Safe assets	Cash and bonds	Equities and property
Unsafe assets	Equities and property	Cash and bonds

Liquidity belongs in your investment policy, not your Reserves policy. It is forward looking.

Investors can only have two of these three desirable characteristics



Which one would you drop?

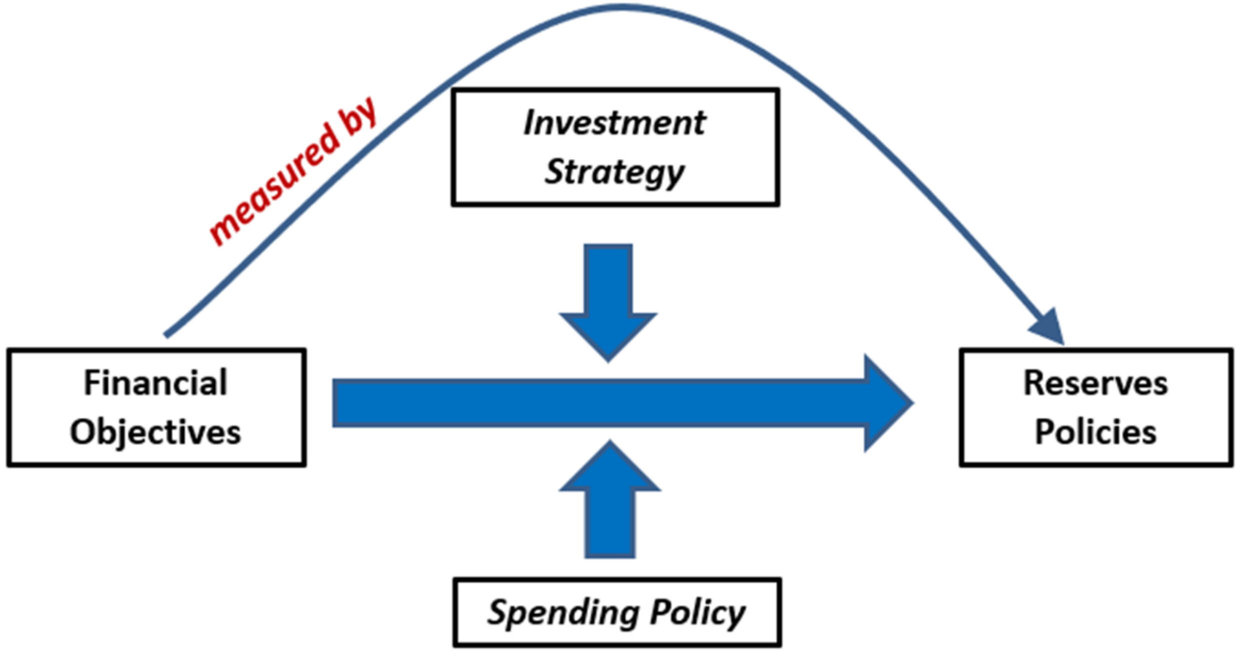
Reserves

Reserves are what you hold back for a reason and can measure against your Financial objectives

Trustees are like a dam.....

What you keep in your reserves is an accountability question so is backward looking.

But trustees need to be able to explain clearly what they are retaining and why.



The law

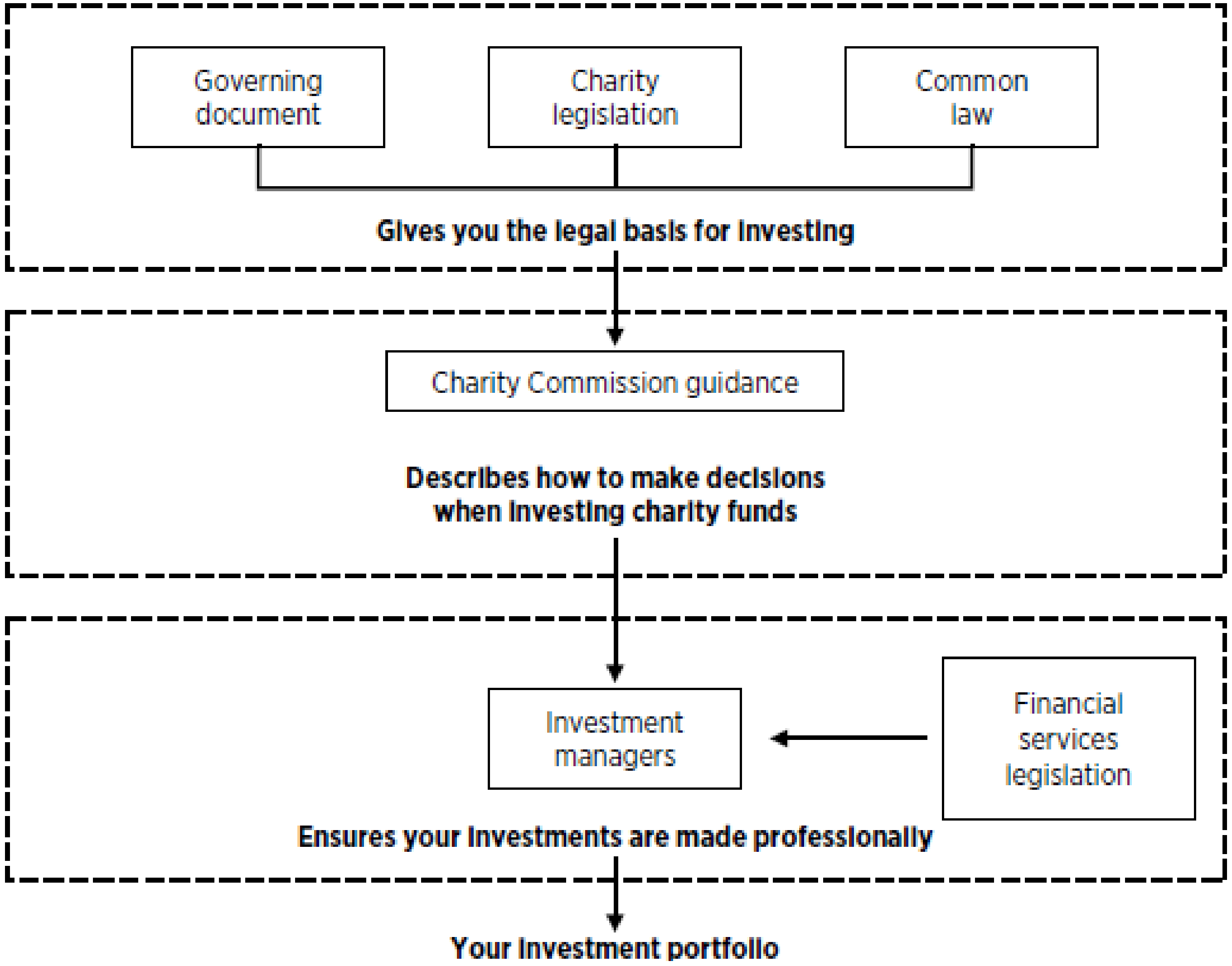
Standard duties

Trustees are required to consider the need to:

- Diversify
- Suitability of their investments
- Take advice

The chief investment sin is not losing money through disappointing performance, but acting outside your powers and duties.

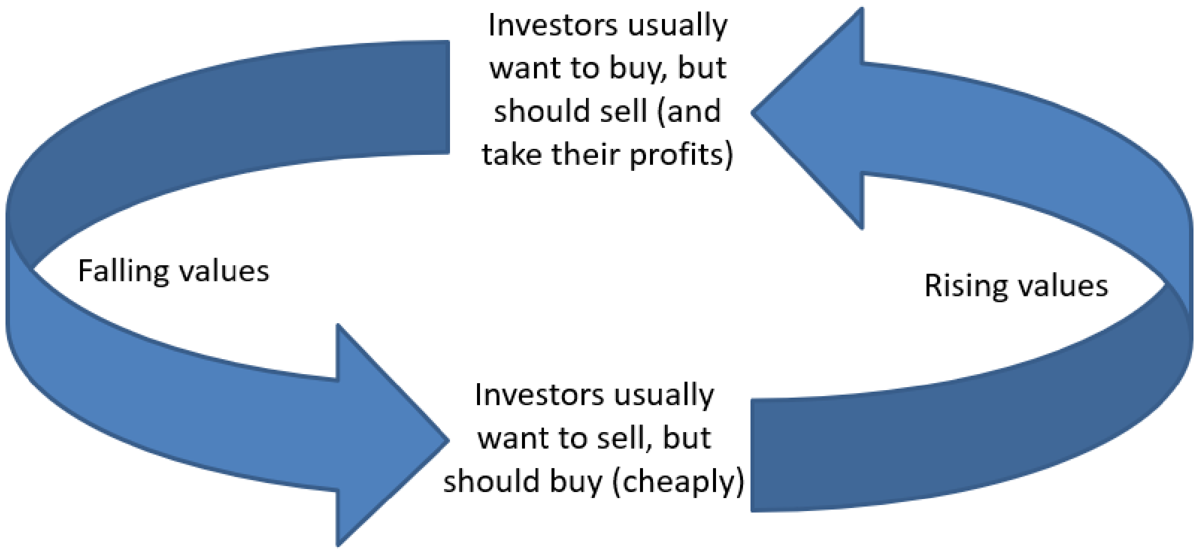
Be prudent, not (recklessly) cautious



Governance

Only trustees can destroy an endowment

Good investing demands steadfast decision making because investing can be scary.



Training your Finance Committee is essential preparation for inevitable shocks

The value of good governance

	Contribution to return	Cost
Steadfast governance	3	1
Choice of asset classes	2	2
Choice of manager	1	3

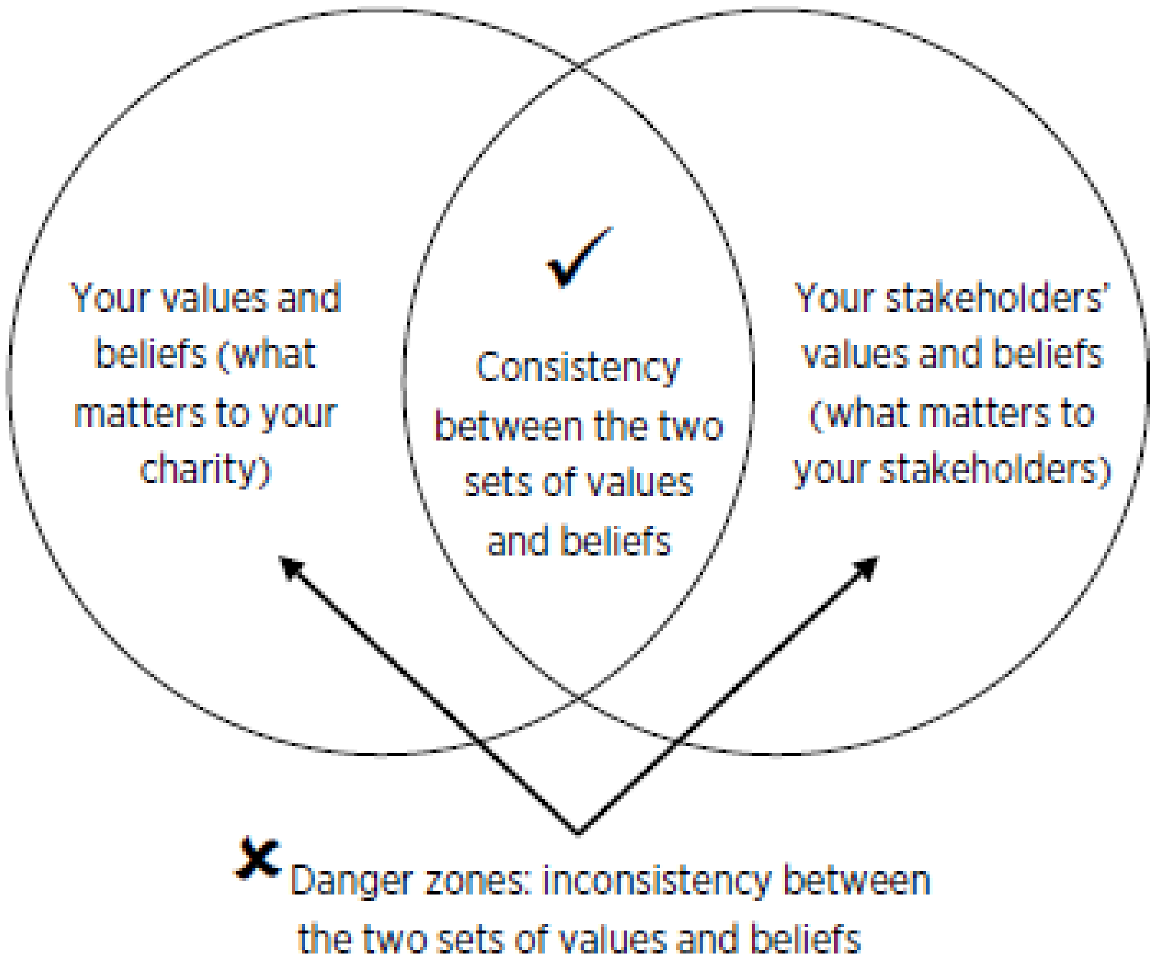
The value of good trustees

Return if 100% of the portfolio were in bonds at 1%	£100,000
Return if 100% of the portfolio were in equities at 4%	£400,000
Benefit of holding equities	£300,000
Number of trustees	6
Value of each trustee	£50,000

Responsible investing

Another tool in the toolbox for delivering benefit

The ABC of Impact: i) Avoid harm ii) Benefit society iii) Contribute to solutions



Delegated moral decisions, or not?

Level	Exclusion	Engagement	Key features
6	Not necessary (unlikely to own those companies)	Yes, fully run in-house	Full impact investing in such a way as to directly advance the charity's purpose while, if possible, seeking good financial outcomes
5	Potentially still needed	Yes, usually led in-house with some external support	Assets largely chosen for financial outcomes but with good internal engagement on ESG issues; exclusions may be unnecessary at this level
4	Yes, required	Yes, handled partly in-house and partly outsourced	Common exclusions with assets largely chosen for financial outcomes but with internal commitment to ESG engagement
3	Yes, required	Yes, fully outsourced	Common exclusions with engagement focused mainly on financial outcomes with ESG interest delegated elsewhere
2	Yes, required	None, or little	Common exclusions but with little commitment to ESG engagement
1	No interest in exclusion	No engagement at all	Unconcerned about any impact other than financial returns

Implementation

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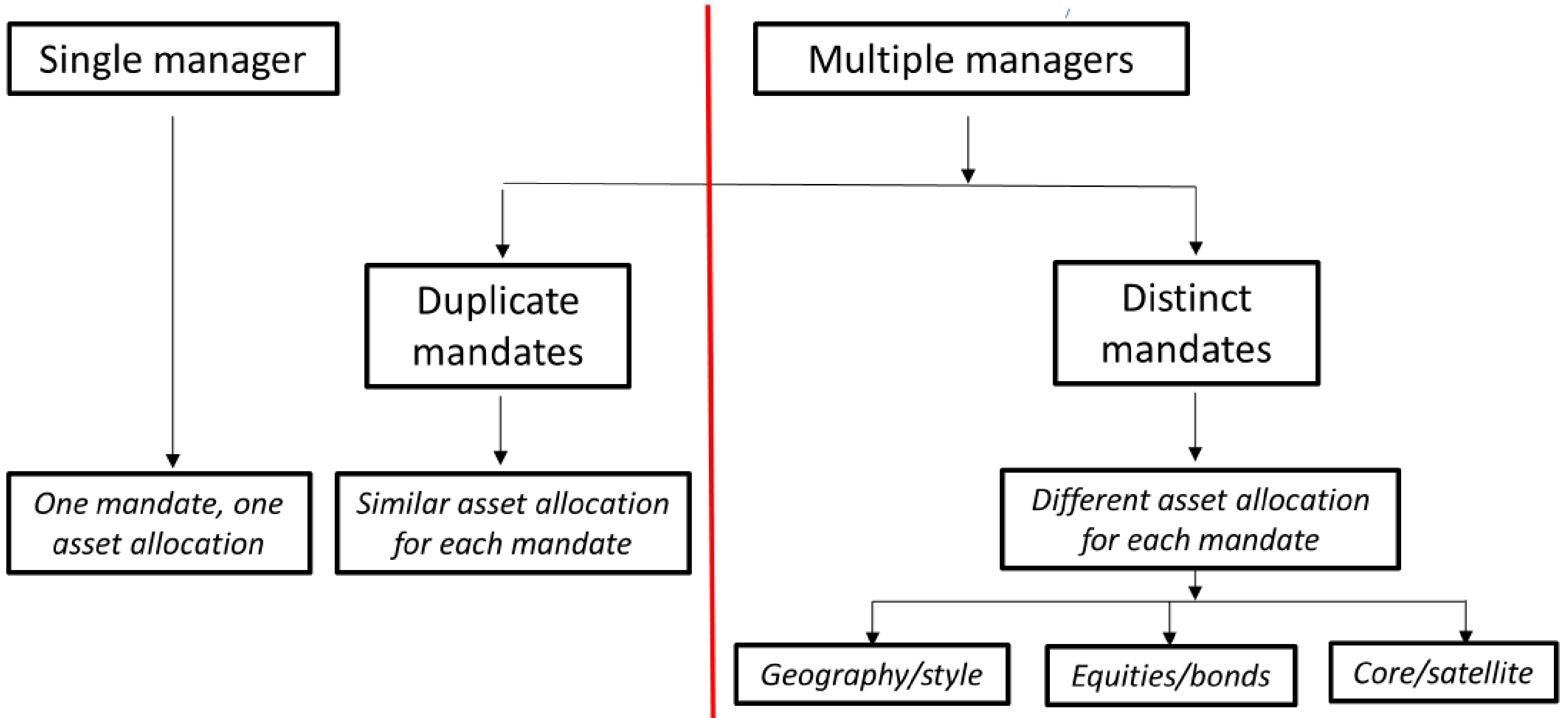


The manager controls the asset allocation to get the best results from the investment strategy

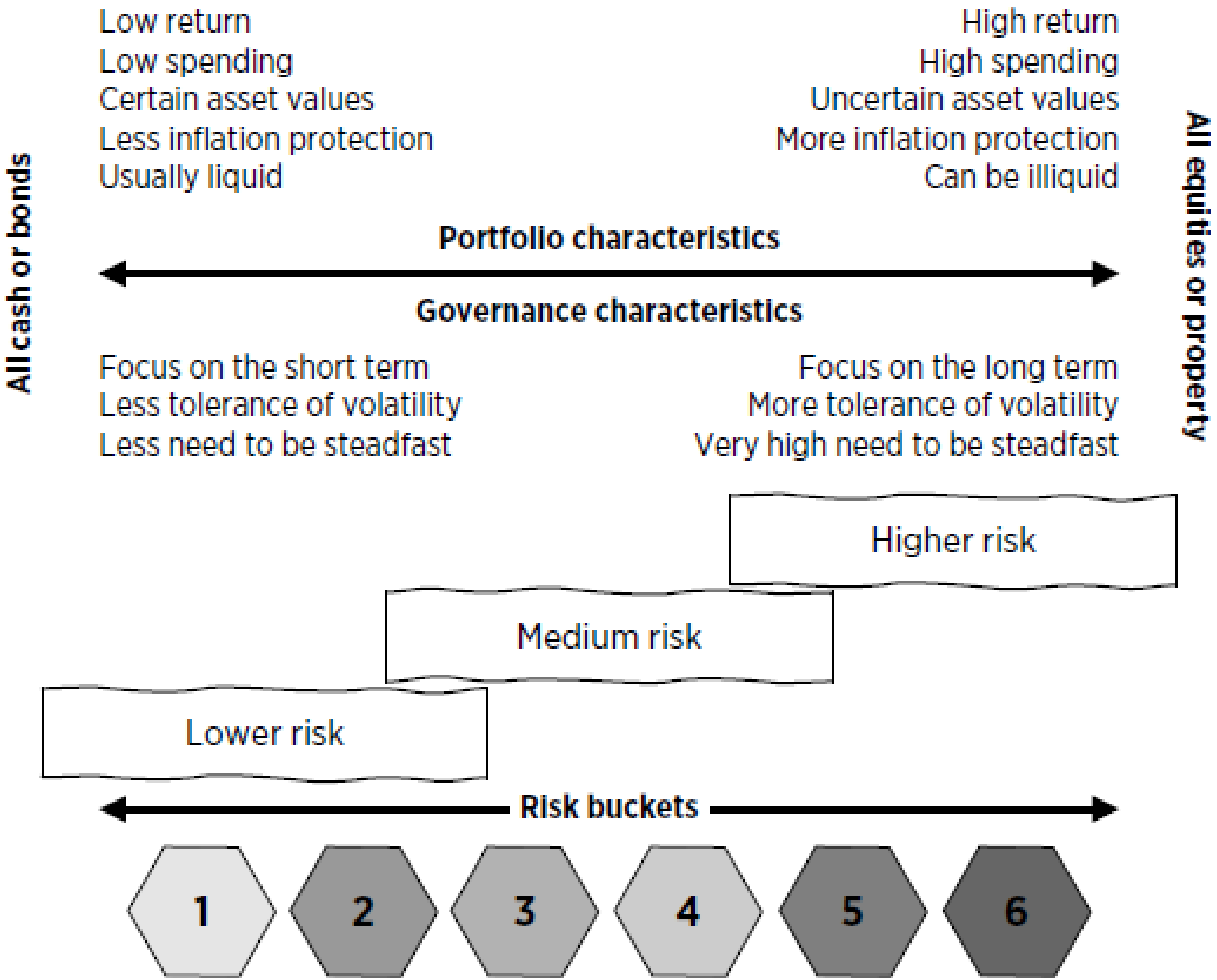
Trustees must control the asset allocation themselves to get the best results from the investment strategy

Always be wary of firms that encourage you to have a complicated portfolio.

Over-engineering is expensive and adds little

Bringing it all together

(for each time horizon)



Measuring success

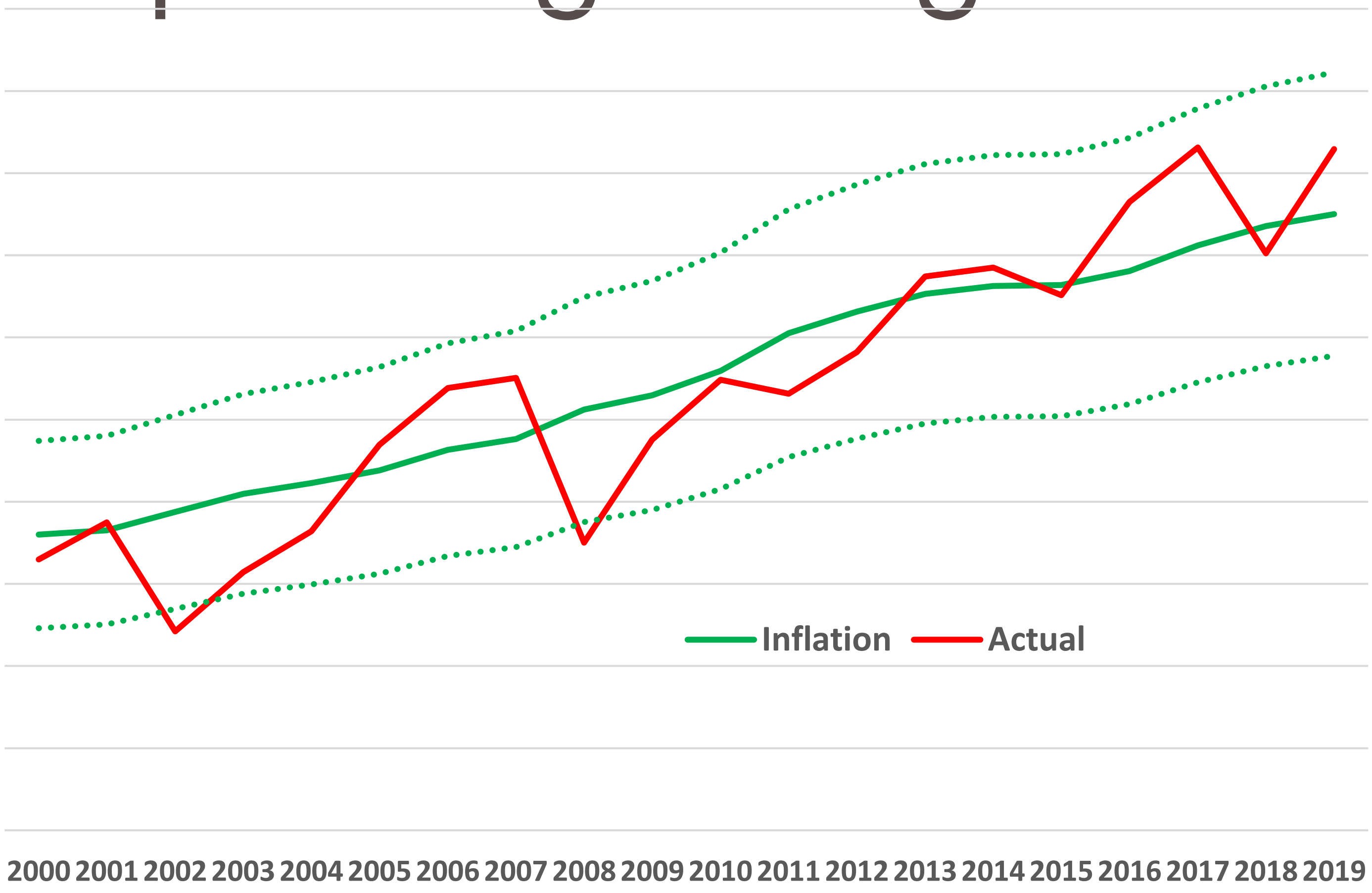
What questions should you ask?

1. Are you delivering on your financial objectives and goals (as a saver, spender or spend-outer)?
2. Are you spending enough?
3. Is your investment strategy delivering what you intended?
4. Are you investing as responsibly as you expected?

Who should answer them?

Only the charity can answer these questions, but it will usually require information from others to help produce the answers.

Are you meeting our financial objectives and goals, and spending enough?



Using target values will help identify whether you are achieving your financial objectives and goals

Level	Trigger	Action
1	More than 115% of target	Above upper range – consider increasing spending
2	100% to 115%	Between upper range and target – spend with confidence
3	85% to 100%	Below target – spend at current rate with caution
4	Less than 85% of target	Floor – reduce spending

Manager performance

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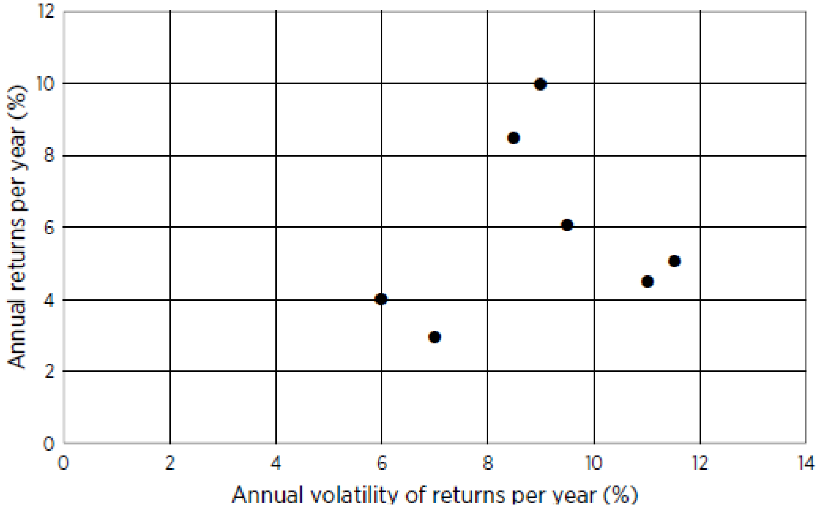
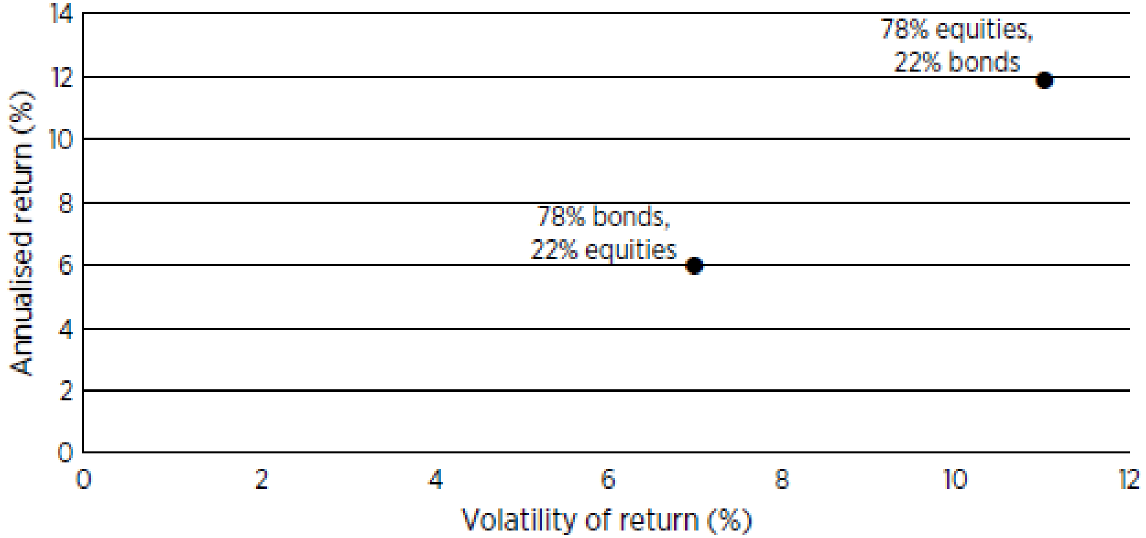
In pictures





Key questions: how much money are you making (with how much volatility) compared to:

- Inflation
- The market
- Your peers?

In numbers

Manager	Return (%)	Volatility (%)	Sharpe ratio (return ÷ volatility)
Manager 1	10.8	14.6	0.7
Manager 2	10.1	9.7	1.0
Manager 3	4.3	4.7	0.9
Manager 4	5.0	8.7	0.6
Manager 5	5.4	11.6	0.5
Manager 6	3.9	9.4	0.4
Manager 7	1.3	10.0	0.1
Manager 8	–1.5	13.0	–0.1

Monitoring responsibility

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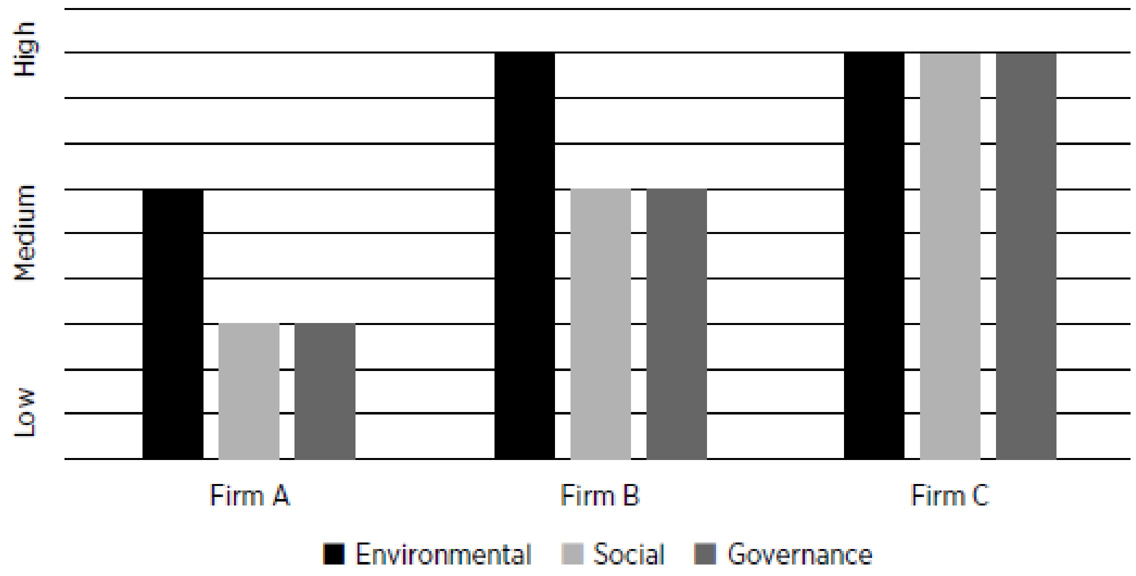
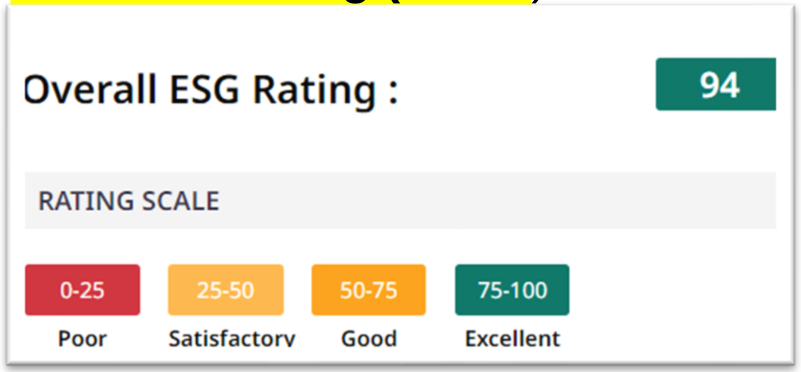
The same companies can have different ratings from different providers



Key questions:

- Do managers vote all the time?
- Do they ever disagree with their proxy advisers?
- How do they vote for Shareholder proposals?
- Examples of engagement

BAT ESG rating (LSEG)



Carbon measurement

Science Based Target Initiative (SBTI)	Tonnes $\mathrm{CO}^2/\$\mathrm{m}$ sales
Mainstream MSCI index	165
Climate change fund	205
Ex fossil fuel fund	32

Note: If I had more time I would have written you a shorter letter. (Blaise Pascal)

Six key takeaways from this

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1. Are you saving for a particular target, spending out, or maintaining (against inflation)?
2. Are you thinking about liquidity (investment policy) or accountability (reserves policy)?
3. Separate your risk appetite into the long and short term
4. Accept some things cannot be planned for (‘game over’ scenarios)
5. For all reserves set both a target level to aim for as well as a floor to use as a trigger
6. Be prudent, not cautious.

Guy Davies
Director
07866 314400
guy@yokeandco.com

James Brooke Turner
Director
07939 643420
james@yokeandco.com

yokeandco.com