





# Contents

---

<b>CHAPTER 1</b>	<b>Introduction</b>	<b>1</b>
	A Crying Need	1
	Shocks to the System	2
	Finances	3
	Contributors	4
	The Pension Problem	4
	Environment of Mistrust	4
	The Good News	5
	The Fund-Raising Challenge	6
	Gifting Strategies	6
	Investment Strategies	6
	Expect to Find	7
	How to Use this Book	8
	Who Should Use this Book?	9
<b>CHAPTER 2</b>	<b>Special Issues</b>	<b>11</b>
	Hospitals—The Retirement Plan Mess	11
	Underfunded Pensions	11
	403(B) versus 401(K)	12
	Annuities	13
	Mutual Funds	15
	Education and Communication	16
	Endowment and Operating Funds	18
	Contributions	18
	Considerations for Religious Institutions	19
	Summary	20
<b>CHAPTER 3</b>	<b>The Total Return Approach</b>	<b>21</b>
	Early History	21
	The Modern Era	22
	The Legal Challenge	23
	The Barker Report	23
	UMIFA, ERISA, UPIA, and the Prudent Investor Standard	24
	The Case for the Total Return Approach	25
	Potential Negatives	26
	Summary	26

<b>CHAPTER 4</b>	<b>The Prudent Steward</b>	<b>29</b>
	Build a House . . . Build an Investment Program	29
	Set Goals: The Blueprint	29
	Allocate Assets	30
	Manager Selection: Hire the Subcontractors	30
	Rebalance	30
	Monitor Performance	31
<b>CHAPTER 5</b>	<b>Set Goals</b>	<b>33</b>
	Introduction	33
	Define the Mission	34
	Determine a Spending Policy	34
	Establish the Required Return	40
	Understand Your Risk Tolerance	41
	Designate the Time Horizon	42
	Summary	44
<b>CHAPTER 6</b>	<b>Investment Policy</b>	<b>45</b>
	Overview	45
	Why Is It Important?	45
	Content	46
	Sample Investment Policy Statement	46
	Implementation and Maintenance	48
	Specific Investment Guidelines	48
	Investment Benchmarks	49
	Summary	49
<b>CHAPTER 7</b>	<b>Asset Allocation</b>	<b>51</b>
	The Efficient Frontier	51
	Capital Market Assumptions: The Building Blocks of Portfolio Construction	53
	Developing Expected Return Assumptions	54
	Modern Portfolio Theory	60
	Shortcoming of Traditional Mean Variance Optimization	62
	The Long Run	64
	Probabilistic Optimization Models	65
	Summary	67
<b>CHAPTER 8</b>	<b>New Asset Classes</b>	<b>69</b>
	Real Estate Investment Trusts	69
	The Statistical Properties of Historical REIT Returns	71
	High-Yield Bonds	73
	International Bonds	78
	Mutual Fund or Separate Account?	86
	Experience Counts!	87
	Summary	87
	Inflation Indexed Bonds	87
	Risk Factors	92
	Conclusion	92

<b>CHAPTER 9</b>	<b>Investment Style</b>	<b>93</b>
	Academic Research	93
	Ancillary Uses	97
	The Current State	98
	Summary	98
<b>CHAPTER 10</b>	<b>Manager Selection</b>	<b>99</b>
	Overview	100
	Herd Mentality	100
	Avoiding the Star System	101
	Where to Begin	102
	Manager Selection	104
	Passive versus Active Management	111
	Databases	112
	Administrative Compatibility	113
	Trade Execution	113
	Social Investing	113
	The Commonfund	114
	Proxy Voting	115
	Account Types	115
	Negotiate Fees	116
<b>CHAPTER 11</b>	<b>Alternative Investments</b>	<b>119</b>
	Hedge Funds (Absolute Return Strategies)	120
	Funds of Funds	121
	Risks	122
	Benefits	124
	Fund-of-Funds Search	125
	Real Estate	126
	Timberland	127
	Private Equity	131
	Structured Equity	134
	Managed Futures	136
	An Investment Strategy	136
	Benefits of Diversification	137
	Risks	137
	Conclusion	139
<b>CHAPTER 12</b>	<b>Portfolio Rebalancing</b>	<b>141</b>
	Traditional Rebalancing Methods	141
	A New Approach	143
	Building Your Own Model	147
	Conclusion	150
<b>CHAPTER 13</b>	<b>Performance Measurement and Evaluation</b>	<b>151</b>
	Performance Calculations	152
	Benchmarks	153
	Market Indexes	155
	Style	155

	Picking the Right Index	156
	Multiple Benchmarks	157
	Presenting the Data	157
	Universe Comparisons	157
	Portfolio Analysis	160
	Style Analysis	160
	Risk Analysis	162
	Recent Developments	164
	Performance Reporting	166
	Terminating a Manager	166
<b>CHAPTER 14</b>	<b>Socially Responsible Investing</b>	<b>169</b>
	History	169
	Socially Responsible Investing Strategies	170
	Separate Accounts versus Mutual Funds	175
	Performance Impact of Socially Responsible Investing	176
	Incorporating Socially Responsible Investing into Investment Policy	178
<b>CHAPTER 15</b>	<b>Selecting Other Vendors</b>	<b>179</b>
	Step One	179
	Step Two	180
	Step Three	182
	Step Four	184
	Record Keepers	186
	Narrow the Field	188
	Final Steps	190
	Defined Benefit Plans	190
	Gift Annuities	191
	Brokers	194
<b>CHAPTER 16</b>	<b>Hiring an Investment Management Consultant</b>	<b>195</b>
	Identifying the Need: A Tale of the Typical Nonprofit Organization	195
	The General Contractor—A.K.A. The Investment Consultant	196
	Effective Use of a Consultant	204
	Summary	205
<b>CHAPTER 17</b>	<b>Behavioral Finance</b>	<b>207</b>
	Trying to Break Even	208
	Snake Bitten	208
	Biased Expectations and Overconfidence	208
	Herd Mentality	209
	Asset Segregation or Mental Accounting	209
	Cognitive Dissonance	210
	Anchors	210
	Fear of Regret and Seeking Pride	211
	Representatives	211
	Familiarity	211
	Investor Personality Types	211

	Risk-Seeking Behavior	212
	Naturally Occurring Ponzi Schemes and Market Bubbles	212
	Conclusion	213
<b>CHAPTER 18</b>	<b>Legal Aspects of Investing Charitable Endowment, Restricted, and Other Donor Funds</b>	<b>215</b>
	Overview	215
	The Nature of Endowment or Restricted Funds	216
	Endowments Created by the Board	216
	Donor-Created Endowment Funds	217
	Donor-Created Restricted Gifts or Funds	217
	General Statement About Investing Endowment and Other Funds	217
	The Prudent Man Rule	218
	The Prudent Investor Act	218
	Uniform Management of Institutional Funds Act	220
	Private Foundation Rules	222
	Summary	223
<b>CHAPTER 19</b>	<b>Fiduciary Issues—Retirement Funds</b>	<b>225</b>
	ERISA	225
	Who Is a Fiduciary?	227
	Fiduciary Requirements	229
	Penalties for Fiduciary Breaches	231
	Prudent Procedures to Limit Fiduciary Liability	233
	Department of Labor Tips to Help Fiduciaries Understand Their Responsibilities	236
<b>CHAPTER 20</b>	<b>Final Thoughts</b>	<b>239</b>
	Summary	239
	The Prudent Steward	240
	Take Aways	240
	Conclusion	241
<b>APPENDIX A</b>	<b>Sample Investment Policy Statement</b>	<b>243</b>
	Introduction	243
	Purpose	243
	Spending Policy	244
	Investment Policy	244
	Investment Objectives	244
	Asset Allocation	245
	Cash Flows/Rebalancing	245
	Transaction Guidelines	246
	Selection of Investment Funds/Managers	246
	Performance Monitoring	246
	Termination of Managers	247
	Proxy Voting Policy	247
	Responsibilities of the Investment Consultant	247
	Meeting Schedule	248
	ABC Hospital Fund	248

	General Guidelines for All Managers	248
	Specific Guidelines	249
	Investment Manager Objectives: Evaluation	
	Benchmarks of Selected Managers	249
<b>APPENDIX B</b>	<b>Investment Manager Questionnaire</b>	<b>251</b>
<b>APPENDIX C</b>	<b>Sample Search: Investment Analysis</b>	<b>259</b>
	Definition of Key Statistics	259
	Large Company Value Search: The Screening Process	261
	Large Company Value Investment Analysis	262
	Large-Cap Value Equity Analysis	264
<b>APPENDIX D</b>	<b>zzz eVestment Alliance, L.L.C.:</b>	
	<b>eA U.S. Equity Sample Product</b>	<b>271</b>
<b>APPENDIX E</b>	<b>Request for Proposal for Hedge</b>	
	<b>Fund-of-Funds Management</b>	<b>293</b>
<b>APPENDIX F</b>	<b>Request for Proposal: Record-Keeping Services</b>	
	<b>Firm Background</b>	<b>305</b>
	Plan Sponsor Services	307
	Administration/Record Keeping	308
	Participant Services	309
	Communication and Education Services	311
	Investments	312
	Trustee Services	313
	Mutual Fund Trading Practices	313
	Fees	314
	Conversions	316
<b>APPENDIX G</b>	<b>Resources</b>	<b>319</b>
	Data	319
	Analytical Software	320
	Other Resources	323
	<b>Glossary</b>	<b>325</b>
	<b>Index</b>	<b>333</b>