

# THE RALPH M. PARSONS FOUNDATION

## INVESTMENT POLICY STATEMENT

Adopted by the Board of Trustees of the Foundation on December 7, 2011

### I. INTRODUCTION

- A. The Ralph M. Parsons Foundation (the “Foundation”) was incorporated October 27, 1961 as a non-profit corporation in the State of California as a private foundation dedicated to disbursing funds to a number of charities, educational institutions, and research and cultural organizations. Minimum distributions are required each year in accordance with a specified Internal Revenue Service formula.
- B. This statement is issued by the Board of Trustees (the “Board”) of the Ralph M. Parsons Foundation. It is anticipated that this statement will remain in effect until modified by the Board or as delegated to the Investment Committee (the “Committee”) as conditions warrant. The Board, the Investment Committee, and the investment managers are expected to propose revisions to these guidelines at any time they potentially impede the Foundation from meeting its investment objectives.
- C. The purpose of this statement is to foster a clear understanding of the Foundation’s investment objectives, policies and guidelines for the Investment Pool (the “Fund”) among the Board, the Foundation staff, the investment consultant, and the Foundation’s investment managers. This Investment Policy statement supersedes all previous versions.
- D. The Board will review this Foundation Investment Policy Statement periodically to ensure its continued appropriateness. It is the intent of this statement to be both sufficiently specific to be meaningful and yet flexible enough to be practical and enduring.
- E. The Board will delegate to the Investment Committee the duties of carrying out the policies contained in the Investment Policy Statement. Specifically, the Investment Committee will be in charge of selecting, monitoring, and when appropriate, terminating investment managers. Final approval of such action will rest with Board. The Investment Committee may hire a custody manager and/or an investment advisor to provide services necessary to perform its obligations as set forth in the Investment Policy Statement.

### II. FINANCIAL AND INVESTMENT OBJECTIVES

- A. The overall **financial objective** of the Fund is to preserve and enhance the real (inflation adjusted) purchasing power of the Foundation and to provide a relatively predictable, stable and constant return sufficient to meet the Foundation’s grantmaking and operating needs of approximately 5.0% of assets.
- B. The primary **investment objective** of the Fund is to attain an average annual real total return of at least 5.0% per year, net of management fees, over the long-term (rolling ten-year periods). It is recognized that in order to achieve the primary investment objective over extended periods, foundations have had to exceed the objective substantially during

some periods, such as the 1980's and 1990's, in order to compensate for shortfalls during other periods, such as the 1970's. Hence, evaluation of progress toward this objective should be made with a long-term perspective. It is recognized that this objective implies a high average allocation to equity securities and consequent market price volatility.

- C. In addition, the Fund will seek to outperform an appropriate blend of capital market benchmarks with reference to the Fund's "normal" policy targets for each asset class. The current performance benchmarks for the asset classes comprising the policy portfolio are attached as **Exhibit 1**.
- D. The fund will also seek to outperform the median return of a pool of foundation funds.
- E. It is recognized that the desire to maintain and increase the purchasing power of the corpus and to produce a stable, predictable, and large spending stream involves trade-offs that must be balanced in establishing the investment and spending policies.

### III. PORTFOLIO COMPOSITION AND ASSET ALLOCATION POLICY

- A. Over the long run, asset allocation will likely be the single most important determinant of the Fund's investment performance. The Board may change the asset allocation targets, and ranges. However, it is anticipated that such changes will be infrequent.
- B. The Fund will be diversified both by asset class (e.g., common stocks, marketable alternative assets, inflation-hedging assets, non-marketable alternative assets, bonds, and cash) and within asset classes (e.g., within common stocks by economic sector, industry, quality, and market capitalization). The purpose of diversification is to enhance prospective returns, lower the volatility of the overall pool of assets, and provide reasonable assurance that no single security or class of securities will have a disproportionate negative impact on the total Fund.
- C. To achieve its investment objective, the Fund shall be divided into five parts: a traditional equity allocation, a marketable alternative assets allocation, a non-marketable alternative assets allocation, an inflation-hedging assets allocation, and a fixed income allocation.
- D. The purpose of the traditional equity allocation is to produce long-term capital appreciation in order to facilitate the real growth of the corpus and the generation of a growing spending stream. It is recognized that the traditional equity allocation will have greater return variability than the fixed income investment. The Board shall ensure that the traditional equity investments are diversified across U.S., Non-U.S developed markets and emerging markets, as well as across market capitalization sectors that should generate return patterns that are expected to be imperfectly correlated (i.e., the returns of which do not always move in tandem).
- E. Within the traditional equity fund, portfolios of U.S. common stocks will comprise the largest long-term commitment. This commitment to U.S. common stocks will range from 10% to 25% of the total Fund, with a long-term target of 18% of the Fund. The

commitment to Non-U.S. stocks, which includes developed countries and emerging markets, will range from 15% to 25%, with a long-term target of 19% of the Fund.

- F. The purpose of the marketable alternative assets allocation is to generate long-term returns similar to the traditional equity allocation at a lower level of volatility and with only modest correlations (e.g., 0.5 or lower) to public equity and bond markets. Over shorter time periods, this allocation would be expected to outperform hedge fund benchmarks. To achieve these goals, the Foundation may invest in various hedge fund strategies, including diversified arbitrage, event arbitrage, distressed securities and various long/short strategies. This allocation may be implemented either through direct investments in hedge funds or through investments in fund-of-funds that invest in funds following these strategies. The target allocation to marketable alternative assets is 18%, with a policy range of 10% to 25%.
- G. The purpose of the non-marketable assets allocation will be to earn longer term returns that are higher than would be expected from traditional equity investments. The long-term goal of this allocation is to outperform public equity markets, net of fees, by at least 3% per year. The shorter term return objective is to outperform a universe of funds with similar strategies inceptioned in the same vintage year. To achieve these goals, the Foundation may make investments in venture capital funds, buyout funds, private distressed funds, international private equity funds, mezzanine funds, secondary funds, and/or fund-of-funds that invest in the underlying strategies. The long-term target allocation to non-marketable investments is 10%, with a policy range of 0% to 15%.
- H. Equity assets held as a hedge against unanticipated inflation may include Treasury Inflation Protected Securities (TIPS), Real Estate Investment Trusts (REITs), equity real estate, and/or natural resource-related investments, (e.g., equity participation in oil and gas activities, or investment in marketable securities of energy companies, and commodities). Inflation-hedging assets may comprise 7%-20% of total Fund assets, with a long-term target of 15% of the Fund.
- I. It is recognized that it may take time for the Board to evaluate the various marketable alternative assets and to identify appropriate managers. Until such time, the Board may substitute an appropriate blend of traditional common stock and bonds for marketable alternative assets.
- J. The primary purpose of the **Fixed Income Fund** is to provide a hedge against deflation and, secondarily, to produce current income in support of spending needs and to help diversify the total Fund to reduce Fund volatility.
- K. The **Fixed Income Fund** should normally represent 20% of Fund assets at market value. Although the actual percentage of fixed income securities will vary due to market fluctuations and manager allocations, levels greater than 30% or below 10% should be closely monitored by the Board and additional funds should be transferred as needed to ensure that the ratio does not exceed those parameters for extended periods. For purposes of determining the Fund's compliance with this paragraph, fixed income instruments held as equity reserves (either directly or through equity managers) will be excluded.

L. Cash equivalents are maintained for short-term operating purposes and at the discretion of equity and bond managers.

M. In summary, the Foundation will have the following long-term policy target and ranges:

<u>Asset Class</u>	<u>Long-Term Policy Target</u>	<u>Long-Term Policy Range</u>
Equities		
Domestic	18%	10% to 25%
Non-U.S. Equities	19%	15% to 25%
Marketable Alternative Assets	18%	10% to 25%
Non-Marketable Alternative Assets	10%	0% to 15%
Inflation Hedging Assets	15%	7% to 20%
Fixed Income and Cash	20%	10% to 30%
<b>Total Assets</b>	<b>100%</b>	

N. In December, 2011, the Investment Committee adopted the following interim policy targets and ranges to allow more time for the Non-Marketable Alternative Asset allocation to reach the long-term policy target.

<u>Asset Class</u>	<u>Interim Policy Target</u>	<u>Interim Policy Range</u>
Equities		
Domestic	19%	12% to 35%
Non-U.S. Equities	21%	15% to 30%
Marketable Alternative Assets	18%	5% to 15%
Non-Marketable Alternative Assets	7%	0% to 15%
Inflation Hedging Assets	15%	7% to 20%
Fixed Income and Cash	20%	10% to 30%
<b>Total Assets</b>	<b>100%</b>	

#### **IV. INVESTMENT MANAGER STRUCTURE**

- A. Specific investment decisions, both in the equity and fixed-income funds, will be developed and implemented by active and passive external investment managers. To provide diversified exposure, a multiple manager structure will be employed. The purpose of diversification through multiple managers is to provide reasonable assurance that no single security or class of securities will have a disproportionate impact on the Fund's aggregate results. In addition, the expectation is that exposure to multiple investment philosophies will smooth the path of returns through different market cycles.
- B. Within the equity fund, it is expected that the multiple manager structure may include a variety of disparate investment styles, including value-oriented, growth-oriented, opportunistic, etc.

#### **V. GUIDELINES FOR THE TRADITIONAL EQUITY INVESTMENTS**

- A. The traditional equity fund will generally be diversified among U.S. equities and non-U.S. equities.
- B. The performance objective for the equity fund is to achieve a real return (i.e., above inflation), net of manager fees, of at least 5.0%. In addition, the return should be superior to that of appropriate blended market benchmarks.
- C. Passive (or index) managers will be expected to perform consistently with their corresponding index benchmarks less management fees.
- D. Active managers will be measured against both market indexes and peer benchmarks, net of all fees, and will be expected to outperform these benchmarks by varying degrees depending on the asset class and specific investment style employed by the manager.
- E. Performance will be monitored quarterly, and common stock managers will be evaluated over rolling three- to five-year periods. It is recognized that active managers may underperform their benchmarks under certain conditions, but should outperform over a complete market cycle (3-10 years). The Board acknowledges that the pursuit of long-term outperformance is likely to increase the volatility of returns, and will increase the risk that the manager will underperform the benchmark.
- F. Decisions as to security selection, security size and quality, number of industries and holdings, current income levels, turnover and the other tools employed by active managers are left to broad manager discretion, subject to the usual standards of fiduciary prudence.
- G. Equity managers may at their discretion hold investment reserves of either cash equivalents or bonds with the understanding that the performance of their total account will be measured against the appropriate stock indices and peer managers.

**VI. GUIDELINES FOR THE INFLATION HEDGING ASSETS**

- A. The objectives of inflation hedging assets are: (1) to protect the portfolio against the economic risk of inflation; and (2) to improve the diversification of the Equity Fund.
- B. Inflation hedging assets, which include REITs, private real estate, natural resource stocks, private energy funds, commodities, timber funds, and Treasury Inflation Protection Securities (TIPS) shall not exceed 20% of the total fund.

**VII. GUIDELINES FOR THE MARKETABLE ALTERNATIVE ASSETS**

- A. The performance objectives for most marketable alternative assets are: (1) to earn U.S. common stock type returns over long-term periods with less volatility; and (2) to improve the diversification of the Equity Fund. The investment and trading approaches of such funds should have explicit strategies in place through which risk is monitored and moderated.
- B. Marketable alternative assets, such as risk arbitrage, distressed security, and long/short managers shall not exceed 15% of the total fund.

**VIII. GUIDELINES FOR THE NON-MARKETABLE ASSETS**

- A. The performance objective for the non-marketable assets is to: 1) earn a return higher than traditional common stocks by 3% per year; and 2) to outperform funds with a similar strategy incepted in the same vintage years
- B. Non-marketable assets shall not exceed 15% of the total fund.

**IX. GUIDELINES FOR THE FIXED INCOME INVESTMENTS**

- A. The performance objective for the fixed income fund is to outperform the Lehman Brothers Aggregate Bond Index by 0.5%, net of fees, over rolling three- to five-year periods. The performance of each fixed income manager will be measured against this index and against an appropriate bond manager universe (e.g., the Cambridge Associates Intermediate/Long-Term Fixed Income Manager Universe), and evaluated over rolling three- to five-year periods.
- B. Money market instruments as well as bonds may be used in the Fixed Income Fund, but equities are excluded. The managers are expected to employ active management techniques, but changes in weighted average duration should usually be moderate and incremental.

- C. To provide a hedge against extended deflation, the Fixed Income Fund should maintain a high credit quality (i.e., a weighted average credit rating of “A” or better) and an intermediate- to long-term duration (i.e., 3 to 8 years).
- D. In general, the fixed income investments should be prudently diversified with respect to economic sector, financial sector, and issuer in order to minimize risk exposure. A maximum of 5% of the Fixed Income Fund may be invested in the securities of any single issuer, except that issues of the U.S. Government or agencies of the U.S. Government may be held without limitation.

## **X. USE OF DERIVATIVES**

- A. Derivatives may be used by the Foundation’s investment managers to hedge existing portfolio investments (e.g., to hedge the currency risk of a foreign stock or bond position) or to create un-leveraged investment positions as a more efficient and cheaper alternative to investments that would otherwise be made in the cash market. Derivatives may not be used by marketable securities managers to leverage a portfolio or significantly increase its risk above that of an account with similar objectives that is managed without derivatives. Use of derivatives by a manager other than as described in this paragraph is permitted only if such use is authorized by the Board.
- B. The Board expects that its investment managers utilizing derivatives will have in place processes and procedures to control and measure risk.
- C. For separate accounts, manager-specific guidelines shall include covenants with respect to use of derivatives and shall require the managers to give written notice to the Board immediately upon discovering that any of the guidelines have been violated. The Board shall periodically review the derivatives policy of each manager of a commingled vehicle to ensure that such policy is within this Investment Policy statement or that it has made an exception in appropriate cases.

## **XI. GUIDELINES FOR TRANSACTIONS**

- A. Except under unusual circumstances, all transactions should be entered into on the basis of best execution, which means best realized net price.

## **XII. FUND OVERSIGHT AND REBALANCING**

- A. The Investment Committee will monitor the Fund on a continual basis for consistency of investment philosophy, return relative to objectives, and investment risk. Risk will be evaluated as a function of asset concentration, exposure to extreme economic conditions, and performance volatility. The Board will normally review the Fund’s asset allocation, manager team and performance quarterly in order to evaluate diversification and progress toward long-term objectives. The Board will evaluate each manager’s total return without regard to whether the return was in the form of income or capital

appreciation. Each manager's performance will be evaluated against an appropriate passive index and the median return of an appropriate universe of institutional quality managers or funds as determined by the Board. While short-term results will be monitored, it is understood that the objectives for the Fund are long-term in nature and that progress toward these objectives will be evaluated from a long-term perspective.

- B. Although managers' investment performance will normally be evaluated over rolling three- to five-year periods, the Board will evaluate each manager periodically in order to establish that the factors that led to initial performance expectations remain in place and that each manager's philosophy is appropriate for the Fund's overall objectives.
- C. Each investment manager will report to the Board the following information quarterly: total return (on a time-weighted basis) net of all commissions and fees, additions and withdrawals from the account, current holdings at cost and market value, and purchases and sales for the quarter. Regular communication concerning investment strategy and outlook is expected. Additionally, managers are required to inform the Board of any material change in fundamental investment philosophy, firm ownership, organizational structure, professional personnel, or account structure (e.g., number, asset size, account minimum).
- D. For separate accounts, the Investment Committee will provide the manager with a set of mutually agreed-upon guidelines. In the case of investments made in commingled funds, the Board will summarize the investment strategy and performance objectives for each commingled fund in which the Fund is invested. Subject to such guidelines and the usual standards of fiduciary prudence, the managers will then have complete discretion over the funds.
- E. If at any time any manager of a separate account believes that any policy guideline inhibits his or her investment performance, it is his or her responsibility to communicate this view in writing to the Investment Committee.
- F. The Investment Committee acknowledges that, if it elects to invest in a commingled fund (e.g., mutual fund); the policies established for the commingled fund will govern and may not comply fully with policies established for the Fund. The Board will periodically review the policies (i.e., investment parameters) of any commingled fund investment to determine if they remain appropriate for the Fund.
- G. At its sole discretion, the Investment Committee may recommend the termination of any manager at any time if it determines, for whatever reason, that the manager is no longer appropriate for the Fund.
- H. Rebalancing asset allocations to strategic targets is essential for maintaining the risk profile adopted by the Board. The Fund's actual asset allocation will be monitored regularly relative to established strategic targets. The Board recognizes adjustments may be constrained by practical limits with respect to liquidity and transaction costs, but will make efforts to rebalance as appropriate. Cash flow in or out of the Fund should be viewed as an opportunity to adjust the allocation, close to targets.

- I. The Investment Committee will periodically review the related services provided to the Foundation, including custodial services, performance evaluation and consulting.