HOW ARE COMMUNITY FOUNDATIONS NAVIGATING 2023?

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Community Foundations (CFs) take on many challenges: raising funds, meeting the desires of donors, and supporting the critical needs of their communities. It's a tough job, recently made more challenging by difficult economic and market conditions.

Over the last 18 months, as interest rates have soared and the economy has wobbled, NEPC consultants have been working with their CF clients to develop strategies to address their concerns. As community needs rise and donor funds become harder to find, there are three key portfolio strategies that we believe can add stability and durability to CF missions.

FOCUS ON COSTS

Portfolio cost control is a win-win for all the stakeholders in the CF universe: Lower expenses mean that the CF and its donors can maximize the resources for their community. However, low-cost investment options are not always an ideal fit for either the mission or the performance needs of CFs.

Passive portfolios are inexpensive, but they have limitations. Active strategies have more tools to manage risk and potentially limit losses if markets remain choppy. Higher-cost private equity options may be needed to suit the CF's return targets. And many CFs want to invest in alignment with their mission, which will require more research.

NEPC consultants have been working with our CF clients to balance their objectives and portfolio costs in creative ways. For example, having access to NEPC's research resources allows us to present CFs with a focused slate of high-conviction ideas, rather than spending time and resources on a wide range of options. It simplifies decision making and makes costs easier to predict.

REVISIT THE ROLE OF ALTERNATIVES/PRIVATE EQUITY

Alternatives (primarily private equity) have been a useful way for CFs to enhance diversification and returns during a time of low interest rates. These investments tend to be illiquid, but if they are complemented by more liquid instruments, they can create a diversified source of returns.

Unfortunately, 2022 and early 2023 have posed challenges for both higher-liquidity investments and private markets. In many cases, private equity became a larger percentage of CF portfolios as the liquid portion of their portfolios drew down (creating what is known as the denominator effect). Consequently, insufficient liquidity has become a risk at a time when liquidity is greatly needed.

NEPC consultants continually monitor liquidity levels to ensure there is ample liquidity to meet the needs of the CF, as well as donor grant-making. Understanding the balance of endowed funds and donor advised funds is a critical component of this ongoing exercise.

RECONSIDER FIXED INCOME

During the recent super cycle in bonds, which featured very low interest rates, yields on fixed income instruments were unappealing. Often, including them in a CF portfolio weighed on its ability to meet its return goals. That is one reason that many CFs reduced fixed income allocations over the past decade in favor of higher-returning options in risk assets. Recently, fixed income has also suffered losses as interest rates spiked, a consequence of the Federal Reserve's historic tightening.

However, now may be a good time to reconsider the role of fixed income. With the bulk of rate hikes likely behind us, fixed income instruments are offering better yields and a more attractive risk/return profile.

Fixed income still represents a net drag compared to most CF return objectives, and further rate hikes are still a possibility. However, fixed income can improve a portfolio's defensiveness and risk-adjusted returns as the economy faces a potential recession. Particularly for portfolios that have ample liquidity needs, fixed income may provide a risk-reducing store of value.

WORK WITH NEPC'S ENDOWMENTS AND FOUNDATIONS TEAM

NEPC's Endowments and Foundations Team has extensive experience advising Community Foundations through all phases of market cycles. We understand the challenges of juggling complex requirements and ensuring that portfolio needs are met at a reasonable cost.

We're also happy to work with you on sharing information and education about investment strategies that fit the CF model. Reach out to your NEPC consultant to discuss your CF portfolio and for any questions you may have.

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