



PERSPECTIVES

Are you afraid
of missing out?

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A Message from Sandy Urie

THE INTERNET IS FILLED with thousands of websites. If you are like me, you have a select few that you visit regularly. The sites I most often find myself clicking on are ones that provide useful, interesting information that is both thought provoking and relevant. Some of my favorites include WBUR, Foreign Affairs, Bloomberg, and the Financial Times, among others.

We recently redesigned our public website with this in mind. We want cambridgeassociates.com to be one of the “go-to” destinations for the industry, providing timely, interesting, and thought-provoking content on a regular basis. As leaders in the investment world for more than 40 years, we have a unique perspective on what’s new and evolving as we work together with our clients on their portfolios. With a focus on uncovering and researching new ideas that would best benefit our clients, we have always shared our views and welcomed the opportunity for discussion and debate. Our new website gives us an improved distribution mechanism for getting our ideas and opinions to our clients and to the broader marketplace.

Our new online presence will include regularly changing, timely content that focuses on what’s happening in the investment world right now. The homepage “slider” provides easily accessible highlights on a variety of topics that impact investors. And you will hear from different voices, both in our reports and in videos designed to share our perspective. We hope you visit frequently to see what is new and that you will make our new website one of your “go to” sites for innovative, ground-breaking insights from best-in-class investors.

In this issue of *C|A Perspectives*, we explore a variety of topics that people are currently talking about in the market. To start, in “Just Another FOMO Market” (page 3), two seasoned Managing Directors, David Thurston and Andy Martin, review some of the common behavioral traps that long-term investors with diversified portfolios fall into during market rallies like the

one we have experienced in recent years. In “New Ways to Make an Impact” (page 7), Kyle Johnson, a leader in our Mission-Related Investing practice, explores how some clients have integrated impact investing into their portfolios and shares perspectives on how to think about impact investing within your overall portfolio strategy. Meyer Memorial Trust, a leading foundation in mission-related investing, is the focus of our client profile (page 10). We speak with CFO and CIO Wayne Pierson as he nears his

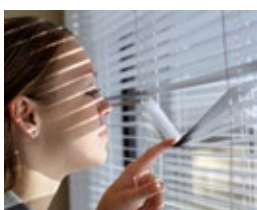
retirement after more than 30 years at MMT. In this profile, we discuss his time with the Trust and what he believes have been its keys to success. Finally, in “Clearing a Higher Hurdle,” Chris Houston, Director of Tax Strategy at C|A, examines different considerations that private wealth investors might weigh when developing a holistic tax-strategy approach to portfolio management (page 14).

We hope you find our new public website informative, fresh, and thought provoking. Visit it often to stay at the forefront of the ever-evolving global investment world with us.



Sandra A. Urie
Chairman and CEO

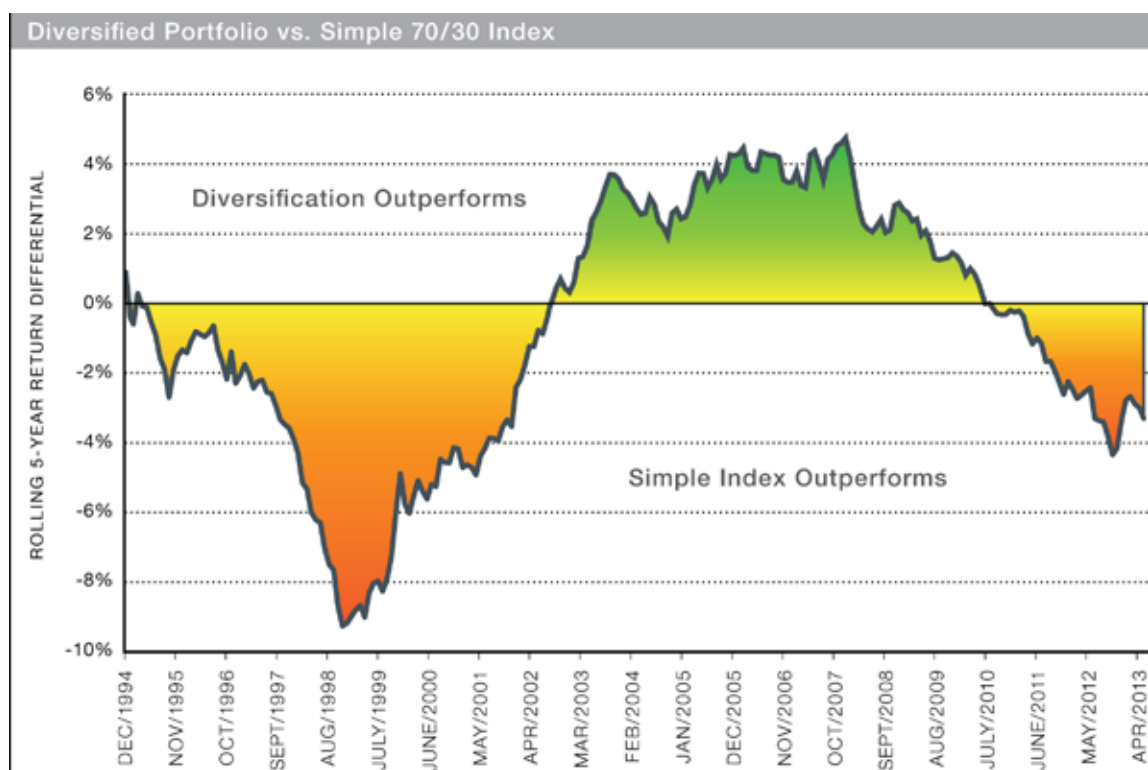
Just Another “FOMO” Market: Avoiding Behavioral Pitfalls



AS DIVERSIFIED PORTFOLIOS underperform against a rising equity market, investors often want to act. But behavioral traps like “FOMO” or “fear of missing out” can pose a larger threat to long-term portfolio returns than systematic risk does. | **By Ben Buttrick**

Many investors have become increasingly frustrated with each passing quarter as they see their returns lagging a 70/30 benchmark of US stocks and bonds. While absolute performance for diversified portfolios since the market low of 2009 has been almost universally strong and positive, the magnitude of the difference between a diversified portfolio and simple benchmark has been a source of concern and second-guessing.

Recent underperformance of institutional portfolios is not nearly of the same magnitude as the late 1990s tech bubble market. But with most of the 2000s seeing diversification pay off handsomely, the reversal to a market where good process doesn't seem to matter has been particularly tough to swallow. It doesn't help that many investors are still striving to recoup the decimating losses they suffered during the 2008–09 financial crisis.



Sources: Barclays, Hedge Fund Research, Inc., MSCI Inc., and Standard & Poor's. MSCI data provided "as is" without any express or implied warranties.

Another key difference between the S&P's out-performance today and 1999 is portfolios' starting positioning. In 1999, endowments allocated an average of 45% to US equities. Many institutions had as much as two-thirds in the asset class. Today the average allocation to long-only US equities is just 20%, magnifying the pain of missing out on the steep rise of the S&P.

"All of this portfolio pain can cause investors to fall into some common behavioral traps," says David Thurston, a Managing Director who has been with the firm for more than 35 years. "But falling into these traps to ease short-term frustrations can have negative consequences that linger for years and cause more damage to the long-term portfolio than a short-term period of underperformance."

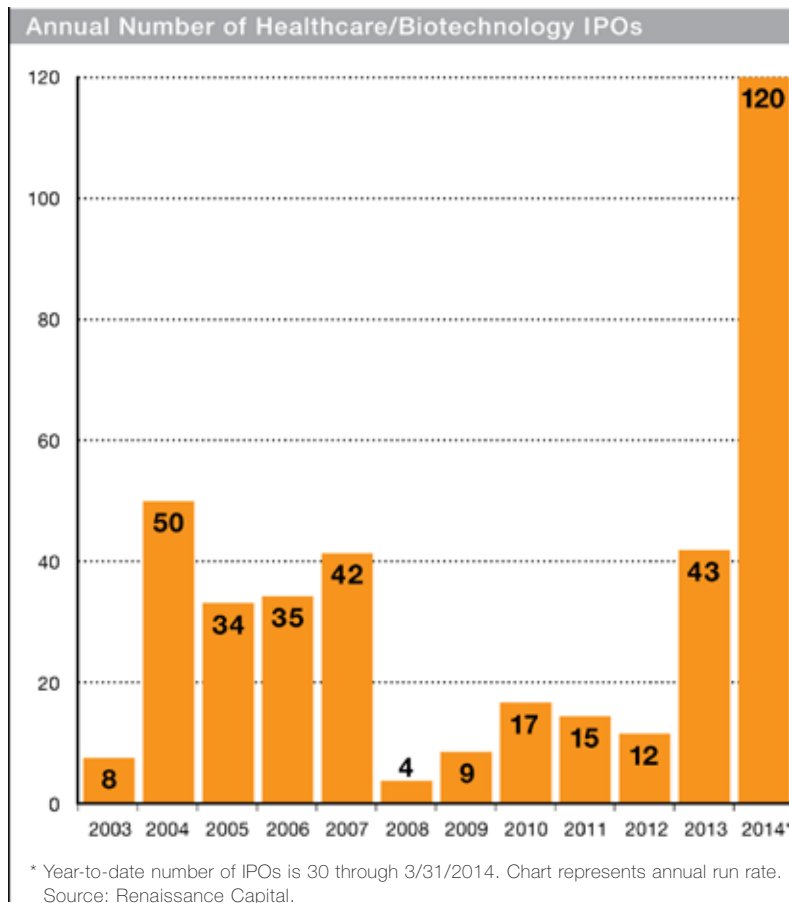
While there are a number of traps that investors can fall into, Thurston warns about two in particular: favoring the recent best-performing asset class and dismissing underperforming, undervalued assets.

Chasing Returns

"Even within a diversified portfolio and disciplined decision-making structure, the temptation to overweight the recent winners can be high," says Thurston. This can occur either by actively adding to the better-performing (and often higher-valued) asset class or by consciously deciding against rebalancing out of the stronger performer.

According to Thurston, chasing returns has been most evident in venture capital. Since 2002, annual capital invested into venture capital funds has ranged from \$20 billion to \$32 billion annually. However, 1999, 2000, and 2001 were outlier years when \$55 billion, \$105 billion, and \$41 billion, respectively, flowed into venture capital. These outsized flows into venture capital followed a period when seasoned funds from earlier in the 1990s were generating thousands of basis points of outperformance versus the Russell 2000® Index. Not surprisingly, the median returns for venture capital on funds that came to market over 1999–2001 have lagged the Russell 2000® by over 700 bps through September 30, 2013.¹ Those disappointing returns caused many to question the viability of the asset class.

But Thurston suggests a different response. "Thoughtful diversifiers added to venture capital in the 2004 to 2008 time period in both new venture funds as well as household names. The truly contrarian invested in much maligned early-stage technology and biotech investing," says Thurston. "Many of these difficult, contrarian investments are being well rewarded in the current market environment as a very strong equity market for biotechs has created nice exit opportunities for VC funds. The current year is at a record-setting pace for biotech IPOs."



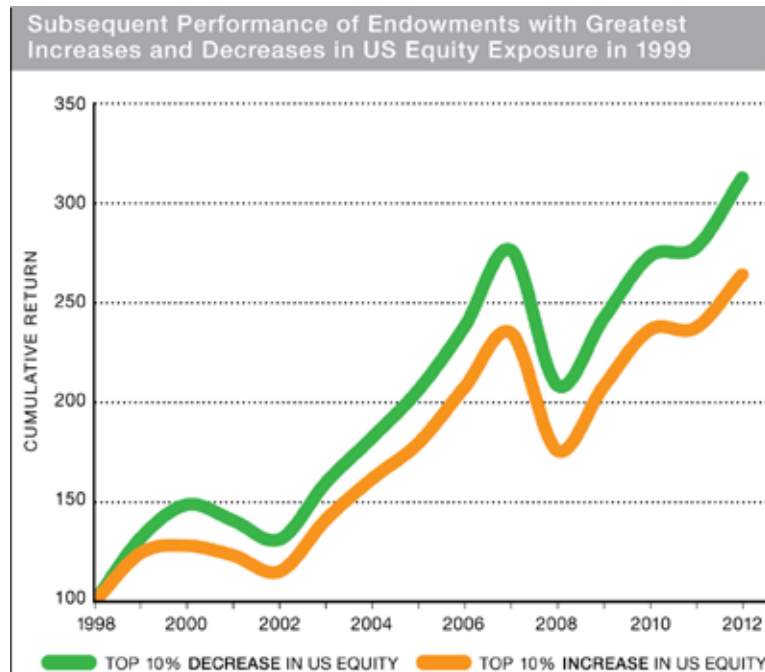
¹ Source: Cambridge Associates LLC. Based on data compiled from 321 US venture capital funds, including fully liquidated partnerships, formed between 1999 and 2001. Internal rates of return are net of fees, expenses, and carried interest. Returns of VC funds based on IRRs and matched up against Russell 2000® returns from 12/31 of vintage year through 9/30/2013.

Since broad diversification has only become ubiquitous in the past ten years, there is simply not enough long-term contiguous asset allocation data to make any definitive conclusions about the long range outcome of chasing returns, or what behavioral investment scholars refer to as recency bias. But the current US equity market presents renewed “whipsaw” risk. There is no question that the current advantage of a simple US-focused 60/40 portfolio will end, Thurston says. It is simply a question of timing, particularly with bonds overvalued and US equities now at valuation levels seen only a handful of times before.

Losing Valuation Discipline

In today’s market, which Thurston dubs a “FOMO (fear of missing out)” market, investors can find it difficult to adhere to a strict valuation discipline. The pressure to “do something” can be especially intense as stakeholders compare institutional portfolio returns to retail and personal portfolios, which are often more strongly weighted to US stocks, and are bombarded with information by the 24-hour financial news cycle. But continued discipline is vital. “A central tenet of our approach is thoughtful diversification and a keen focus on value. Portfolio positioning among asset classes requires careful consideration of price. US equities are simply too richly valued and at the wrong phase of the earnings cycle to justify overweighting to policy,” says Thurston.

Indeed, the negative impact of abandoning a systematic rebalancing strategy and valuation discipline can linger for years. A review of endowments for which CJA has continuous asset allocation and returns data reveals that those institutions that had the contrarian sensibility and discipline to most boldly reduce US equity exposure in 1999 had dramatically higher returns over the long term, with portfolios growing by nearly 20% more since 1999 than the portfolios that increased their exposure to equities. “It is ironic,” says Andy Martin, a Managing Director, “that so soon after many investors were



Source: Cambridge Associates LLC. Exhibit represents the top and bottom deciles of endowment clients for which we have contiguous asset allocation and performance data. The top 10% decrease includes 13 clients and top 10% increase includes 14 clients.

hurt by overriding policy targets and bailing out of US equities during the crisis that they are now inclined to the same thing, just in the opposite direction.”

Arguably the asset class that is currently most undervalued is emerging markets equities. Since the low of most markets in spring 2009, emerging markets equities have only captured about 61% of the upside of the S&P 500 and have posted negative returns in 2013 versus 30% returns for US stocks. “Despite the long-term valuation case and presence of interesting ideas within emerging markets, many clients are choosing not to rebalance back to target,” says Martin. “It’s easy to rationalize avoidance of emerging markets on the grounds of near-term risks, a slowing China, conflict in the Ukraine, or that undervaluation comes from very specific segments. These issues are real, but there is considerable relative value.” Martin points out that emerging markets are diverse and shouldn’t be viewed through just a single lens. “Certain segments within emerging markets equities are more interesting than others and this dynamic makes a strong case for active management with the asset class. It can take some fortitude, but for clients that can look past the next few years, odds are that rebalancing back to target or even overweighting will eventually pay off.”



David Thurston (left)
and Andy Martin

Performance Attribution

Before investors can make portfolio decisions, they have to have a clear understanding of performance drivers. To that end, there are two key benchmarks beyond the simple “70/30” point of reference. The first, and arguably most important, is the policy benchmark. This benchmark should reflect the long-term diversified strategic or “policy” allocation of the institution. Today, the policy benchmarks of many endowments are lagging simple US-centric benchmarks over three and five years.

The second most helpful benchmark is a “custom” or “dynamic” benchmark. This measure is adjusted to mirror the actual asset allocation weightings on either a monthly or quarterly basis. When the dynamic benchmark outperforms the policy benchmark, it suggests that on balance tactical over- and underweights are adding value.

When actual performance exceeds the dynamic benchmark, active managers are, on balance, adding value. A top-down view of CJA's client universe shows that many investors are outperforming their policy benchmark. This suggests that value is being added through some combination of tactical positioning or manager

selection. The current market has been challenging for tactical bets because overvalued assets such as US equity continue to perform well and undervalued assets such as emerging markets have been lagging.

Staying the Course

In periods of underperformance, the tempting course of action is some combination of revisiting asset allocation policies or reconsidering active management. But overall, the question of active management is really just limited to the efficient global equities portion of the portfolio. Indeed, some degree of indexing can make sense for many investors—particularly those with low tolerance for straying from benchmark targets. But a real risk lies in choosing to shift strategies in a way that results in buying or selling at the wrong time. The temptation to abandon a valuation-based discipline or re-evaluate diversified investment policies can be most alluring in markets like today's, but history suggests that such a move would end badly.

Thurston points out that he has seen these cycles play out many times during the three-plus decades he has spent at CJA. “The biggest hazard to building wealth is abandoning long-term valuation-based investing to chase short-term performance. Timing is never perfect, but a consistent discipline of making uncomfortable contrarian moves and avoiding chasing the latest trend should result in higher returns and lower risk for the truly long-term investor.” ■



Read more about the long-term success of diversified investing in our research reports *The Endowment Model 2.0: A Success Story That Endures and Why Did I Diversify?*, available on our website.

“The biggest hazard to building wealth is abandoning long-term valuation-based investing to chase short-term performance.”



In Addition to Traditional Methods of Grantmaking, Investors Consider Impact Investing as Another Tool to Achieve Mission Objectives | By Jessica Matthews

MEYER MEMORIAL TRUST invests in Oregon. The Esmée Fairbairn Foundation aims to lead other investors by example. And many other investors are exploring ways to maximize their social objectives in addition to their financial ones.

Over the last decade, attention to impact investing, through which investors allocate capital to market-based (i.e., profit-oriented) solutions to social and environmental challenges, has grown. The increasing availability of investment opportunities that could be considered impact investments, combined with the proliferation of impact investing organizations like the Mission Investors Exchange, the Global Impact Investing Network, and the UN Principles for Responsible Investing, has contributed to a growing awareness and adoption of impact investing among investors worldwide.

Why the growing interest in this area? Kyle Johnson, a Managing Director at CJA and a leader in the firm's Mission-Related Investment practice, explains that impact investments can achieve an investor's social return objective directly through portfolio investments, while also generating a financial return that aids spending. This is an attractive way for investors to further their mission in more than a financial capacity, Johnson says.

So what does impact investing actually look like? How are investors allocating capital to these investments? Not surprisingly, specific investments vary greatly, given the wide range of organizational types, social and environmental return objectives, asset classes, and monetary return expectations, Johnson says. But, a common thread among impact investors is the desire to focus on specific



Kyle Johnson

issues of interest to the organization such as supporting local communities or addressing climate change concerns.

In the United States, the Meyer Memorial Trust has been a pioneer in impact and mission-related investing (MRI). Initially, the Trust's primary MRI focus was on adding market-rate mission-related investments to its existing portfolio, with some, but not always perfect, mission alignment. At one point, the Trust invested in a mortgage-focused community bond fund, which allocates a portion of its fund to communities in the Pacific Northwest. More recently, the Trust carved out a portion of its portfolio dedicated to mission-aligned, Oregon-focused investments that take appropriate risk commensurate with both investment and programmatic returns in mind. With a much tighter mission focus, the social returns from the Oregon-focused investments compensate, at least partly, for any possible reduction in return potential. This gives the Trust more flexibility to allocate capital to these targeted place-based investments. "This dual approach has served us well," explains Doug Stamm, chief executive officer of the Trust. "We have integrated market-rate, mission-related investments throughout our entire portfolio for years, and we continue to add these types of investments when we find attractive opportunities. But supplementing these investments with more targeted, local investments allows us to further the alignment between our endowment and the core mission of the Trust."

The Esmée Fairbairn Foundation (EFF), based in the United Kingdom, is also recognized as an important first mover in impact investing. In 2008, EFF launched a dedicated impact investing sleeve of its endowment to make mission-focused investments that align with its grantmaking to

maximize its impact in the communities in which it operates. As part of this initiative, EFF provides capital to organizations that it hopes can use those investments to attract other investor interest. For example, EFF provided support to UK-based Bridges' Social Entrepreneurs Fund, which invests in social enterprises delivering high social impacts and operating sustainable business

models. EFF invested equity in the form of a partnership share, with the hope that it will catalyze additional investors and therefore grow and scale Bridges' impact. "We have been keen to explore options that involve breaking down the silo between investments and grants to make our money work harder," says Claire Brown, finance and investment director at the Foundation. "In this case, by investing capital in a new fund, EFF helped grow the opportunity set of social enterprises with investible business models that may also then attract larger scale investment from more mainstream capital sources."

While impact investing offers great promise, the challenges are formidable, Johnson cautions. The impact investment opportunity set for any given social return objective is often narrow, and the actual investments are frequently unproven, illiquid, and require interdisciplinary talent to monitor. Ensuring that the pursuit of impact investing actually helps an investor maximize its social mission is hardly straightforward, Johnson explains.

So what is an investor to do?

"What investors must always keep front and center is that the impact investing opportunity set is a tremendous variable—completely a function of the investor's social return objective," Johnson advises. "There are several key questions that impact investors need to resolve throughout the entire investment management process. That's why we offer investors a framework for thinking about whether it makes sense to engage in impact investing and, if so, how to go about doing so."

As a first step, investors must understand the nature of impact investments—what they are,

why they might be attractive, and what their common challenges are. The key is the investor's intent, says Johnson. Impact investments do not adhere to any particular asset class, and they are not constrained by any particular social return objective. "An impact investment is one chosen by an investor precisely because of its ability to generate the particular social and/or environmental returns of interest *to that investor*," explains Johnson.

For this reason, impact investors should strive to be as specific as possible in articulating their impact investment social return objectives, while at the same time taking a more opportunistic, bottom-up approach to impact investment selection and allocation.

While there is no one "right" answer, Johnson argues that investors should be wary of setting hard, predetermined target allocations to impact investments given the frequently narrow, small, and continually evolving nature of one's impact investment opportunity set. "Investors must make sure that any impact investments are truly additive to the organization's ability to maximize the overall social returns it hopes to achieve," Johnson says. "Attempting to set hard, top-down impact investment allocation targets as a matter of policy could cause investors to sacrifice impact investment quality for the sake of quantity." ■



To read more about CJA's impact investing framework, read our research report Impact Investing: A Framework for Decision Making, available on our website.

"There are several key questions that investors should resolve as they set their financial and social objectives for their portfolio", Johnson says. A few questions to explore include:

- ☐ Are the social returns generated by impact investments interchangeable with those that are generated through spending?
- ☐ What is the optimal blend of spending and impact investing that will help you maximize social returns?
- ☐ Is your investment oversight team structured appropriately to select and monitor impact investments?
- ☐ Do you hope to provide "concessionary capital" (capital that is willing to accept below-market rates of return) to spur "non-concessionary capital" interest?
- ☐ To what degree do the characteristics of the available impact investments overlap with the types of risk exposures your portfolio would otherwise have if supporting spending were its sole purpose?
- ☐ Will the impact investing portion of the portfolio be carved out from the "non-impact" portion, or will impact investments be integrated into the portfolio's target risk exposures?
- ☐ Will the focus be on direct investments or investments in commingled funds or funds-of-funds?

CLIENT PROFILE: *Meyer Memorial Trust*

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AS CFO AND CIO of Meyer Memorial Trust for more than 30 years, Wayne Pierson has witnessed countless changes at his job. The last of the Trust's original staff members, he recalls overseeing the conversion from a manual general ledger to a computer system and debating over whether to invest in a fax machine.



But through the changes in the investment world, Wayne has steered a steady ship. Since its formation in 1982, the Trust has achieved top decile performance while aligning its portfolio with its mission: to work with and invest in organizations, communities, ideas, and efforts that contribute to a flourishing and equitable Oregon.

As Wayne gets ready to retire from the Trust in June to join his son-in-law's investment management business, *CJA Perspectives* recently spoke to him to learn more about his time with the Trust and its primary keys to success.

Tell us about the Meyer Memorial Trust.

The Meyer Memorial Trust was created in 1982 at the request of Fred Meyer, who was a retailer in the Pacific Northwest. Our mission, simply stated, is to serve the state of Oregon and southwest Washington. We are a general

purpose foundation: we fund education, human services, health, arts, culture, conservation, and environmental efforts. Some of our initiatives include improving the quality of K-12 public education, providing more access to affordable housing, and restoring the Willamette River Basin, which is home to two thirds of the state's population and 75% of its economic output.

How do you divide responsibilities among staff, yourself, and Trustees?

We view investment work as a partnership between the Trust, our advisors, and our investment managers. As the CIO, I report to the CEO and to the Trustees. In our particular case, the Trustees ultimately make the investment decisions. Our Trustees are very dedicated and they spend a lot of time on Trust business.

We also hold an investment roundtable conference every 12 to 18 months. We invite all of our managers, advisors, Trustees, and financial staff.



WELCOME
TO
OREGON



During the investment roundtable conference, we talk about investment opportunities and concerns, asset allocation, and macro issues. We don't talk about performance or individual managers' portfolios, other than to use portfolio names to illustrate a point. We are holding our next one in September, which will be our 27th. It's a lot of work and I think that is why many organizations don't do it. However, it really has paid dividends for us over the years.

How have the challenges you have faced at the Trust changed since its formation?

In 1982, most US foundations invested primarily in US stocks and bonds. We started with five managers. We had one dedicated fixed income manager, three dedicated equity managers, and one balanced manager. One of my personal challenges was trying to convince the Trustees to invest in international equities, which we did in 1985.

In more recent years, my biggest challenge was the market crash and dealing with liquidity. I can remember waking up at night, going through the portfolio and trying to figure out, "What are we doing? What can we do differently?"

“The environment is always changing, but you need to know your strengths and how you can play upon your strengths.”

How has the investment environment changed the most during your tenure?

As time has gone on, the investment world has become more complex, and the speed at which things are done has changed. The proliferation of products and managers has transformed the environment. There's more travel than there used

to be because there are more managers to see. Our policy is to attend our investment managers' investor meetings. With more managers and more in alternatives, it takes a great deal of time.

When you look back to 1982, it just seemed like people had more time. It was a slower pace. We don't have the same opportunity to get to know people as well today because everyone's in a hurry.

The Trust has experienced impressive long-term performance. What do you think has been the biggest driver of that?

We've been very fortunate to have top decile performance. Part of our success has been our long-tenured Trustees. The last of our original five trustees just retired last March. One of the advantages of having that lengthy tenure is that you look at things more long term.

The other part of the story is the relationships that we've had with our managers. Some of our manager relationships go back to the 1980s and 1990s. Every manager goes through a rough patch. Our key has been not to buy high and sell low, but to understand who they are and what has changed.

The first year of bad performance, most people end up saying, "We'll hang in there." The second year, they're saying, "Well, I don't know..." By the third year, there are a lot of terminations. And that's usually the time when their style has come back into favor and their returns come back up. We've been very patient with many of our managers, which has paid handsomely in the long run.

How does the portfolio reflect the Trust's mission?

When we started mission-related investing (MRI), one of the first things we did was to expand and formalize our program-related investments (PRIs). We made our first PRIs in 1984 and

1985, and today PRIs represent about 2 to 3% of the portfolio. As we moved to more market rate MRIs, we realized that we already had some investments that were MRIs but we had never labeled it that way. We wanted to make sure that we had success with our MRIs, which we have, so we were very deliberate and took it step-by-step in a natural progression.

We also recently started a program called the Invest Oregon Program. We're trying to find opportunities where we can invest to help the economic growth of the state.

What type of advice would you give a similar organization?

I believe that relationships are very important. No one has all the knowledge or all of the best ideas. It's also important to know what works for you. The environment is always changing, but you need to know your strengths and how you can play upon your strengths. And you also need to know your weaknesses.

What are you most proud of?

I'm proud of our performance and the round-table conferences that we've already discussed. I also created the Foundation Financial Officers Group annual investment survey and conducted the survey for more than twenty years. The willingness that foundations have in sharing information to help each other is amazing. And it's because we're not competitors in the sense of fighting for market share. We're trying to improve the world. And when we can help each other to either improve returns or reduce expenses, that's a win-win for everybody.

I've been honored to have been at the Trust all these years and to watch it grow. To be able to help people achieve their dreams and to make a difference in the world is a wonderful feeling. ■



Doug Stamm

Reflections on Wayne Pierson's impact on MMT

As Wayne Pierson approaches his retirement after more than 30 years with Meyer Memorial Trust, CEO Doug Stamm reflects on Wayne's long tenure and many contributions to the Trust.

"Wayne has been a very steady guide for the Trust and our investments. He has always taken a long-term perspective, not overreacting to changes in the markets or struggles that managers may have. Historically, there has been a firewall between the investment side of foundations and the programmatic side. And with the encouragement of our trustees and me, Wayne has been on the forefront of trying to break down those walls through impact and mission-related investing.

Wayne has been a master of building relationships. There's no question that the investment manager relationships he forged early on and nurtured over the life of the Trust have been critical to our success.

The combination of Wayne's perseverance, his relationship building, his integrity, and his ingenuity leave a legacy that is going to be pretty challenging to fill. We are grateful for his commitment to the Trust and wish him the very best in what's ahead."



Private Wealth

Clearing a Higher Hurdle

For families, taxes effectively raise the bar when it comes to maximizing investment returns. So what, if anything, should they do differently? | By Lauren Higgins

IF LONG-TERM INVESTORS generally set the bar high, taxable investors often push it even higher—and with good reason. Taxes add a variable to the investing equation that can erode investment returns for many families. The myriad events triggering taxes often leave many families wondering how to incorporate tax strategy into the portfolio.

For better or worse, there's no single right answer. "The approach to tax strategy differs for every investor," says Christopher Houston, Director of Tax Strategy at Cambridge Associates. "All families present different sets of circumstances, needs, and priorities with regard to taxes, estate planning, and cross-border issues, just to name a few considerations. Plus, the tax consequences of investments can vary significantly depending on the income generated and the countries where the income is generated and taxed."

Investors shouldn't get too swept up in tax considerations though. Instead, taxes should inform the portfolio construction process, from policy setting through implementation, but not at the expense of risk and return objectives and other priorities.

"That's where it becomes important to connect not just with the family but with their other key advisors," Houston explains. Families often work with their own attorneys, accountants, family offices, and other specialists in taxes, trust and estate planning, and other areas—all familiar territory to Houston. Previously an attorney with an international Boston-based law firm, Houston advised private clients for 15 years on a range of matters including taxes, trusts and estates, charitable giving, and securities law in the United States and overseas, while taking a lead role in the management of trust portfolios worth an aggregate \$3 billion.

Houston brings this experience to C|A as portfolios and tax matters become increasingly complex, which in his view calls for even more

collaboration with other advisors. "Families should have their advisors working together. Having all the key advisors sitting at the table draws all of the different perspectives and expertise into the conversation. It tends to be more productive and leads to better outcomes, both for the portfolio and for the family's overall circumstances."

Putting Theory into Practice

In the oversight of a portfolio, investment decisions often run into tax issues without simple solutions. Take Derik Reiner* for example. Founder of a publicly traded manufacturing company, Reiner held a sizable position in the company but wanted to liquidate a portion of his holdings at or above a specific price. But, this could involve significant tax consequences depending on the liquidation strategy used.

"This is where it's helpful to present our clients with practical, investment-driven alternatives that are consistent with the relevant tax rules," notes Philip Walton, head of C|A's Private Wealth practice. In coordination with the client team and others at C|A, Houston analyzed several derivative and other strategies for achieving the client's objectives for the concentrated stock holding. This included projecting potential tax consequences, after-tax returns, and breakeven points for options and other aspects of the proposals. His approach took into account varying tax treatments and complex rules (such as straddle and constructive sale rules) that could otherwise reduce returns or create tax risks.

Reiner's family wealth also included numerous irrevocable trusts that independently were unable to meet investment minimums for certain managers. Together with Reiner's outside counsel, Chris and the client team provided guidance for establishing a series of investment vehicles to pool assets and meet manager minimums, while complying with relevant tax and SEC rules.

* Name changed in the interest of the client's privacy.

"It's very much to our advantage having such a broad perspective on the portfolio," explains Walton. "We can see how all the pieces fit together—especially the interaction between the investment strategy and the tax considerations—to coordinate the portfolio more effectively for the client."

What's Ahead

Having addressed the uncertainty over the 2013 tax changes, investors are now ready to move ahead. "We know the landscape better, and we need to look where opportunities remain," says Houston. "In addition to tax-efficient managers and tax-loss harvesting, it's also worthwhile to look for strategies in estate planning, charitable giving, and non-US tax jurisdictions."

The 2013 increase in US estate tax rates brought renewed attention to ways of passing assets to the next generation, especially since many clients advisably used most of their gift and estate tax exemption (just over \$5 million per person) before the end of 2012. In the United States, "zeroed-out" grantor-retained annuity trusts, or GRATs, provide one such option—at least for now. GRATs make specified payments to the grantor that establishes the trust during the GRAT term. At the end of the GRAT term, any remaining property can pass tax-free to the intended beneficiaries, assuming the trust's total return exceeds the rate of return assumed by the IRS (based on interest rates) at the trust's inception. With the currently low hurdle rates, brief GRAT terms, and the grantor's ability to establish unlimited single-asset GRATs and recycle payments into new GRATs, GRATs offer an attractive way to pass property to the next generation, with great upside and optionality and little downside.

Houston warns of potential risks in delaying GRATs, though, as Congress or the IRS may look to impose meaningful restrictions on the technique. For example, some proposals would reduce the upside potential and optionality of GRATs, while



Christopher Houston

others would ensure a GRAT includes at least some taxable gift component, such as 10% of initial value—regardless of how much (or how little) property remains for beneficiaries after the GRAT term.

For now, zeroed-out GRATs remain a strong option, as do charitable lead annuity trusts, or CLATs, for the charitably inclined. Like GRATs, CLATs make payments during an initial term, with property remaining at the end of the term passing to other beneficiaries. But the term payments are to charity instead of the grantor. "As with GRATs," Houston reminds, "CLATs are especially favorable in the current low interest rate environment."

While US citizens are subject to US tax on worldwide income, regardless of residence or domicile, it's especially worthwhile for non-US families to look for managers offering funds in entities and jurisdictions that won't create unnecessary adverse tax consequences. Managers will often offer parallel investments under different entities and/or jurisdictions so that investors can choose the most favorable tax regimes. Of course, it's crucial to understand any anti-tax haven restrictions, transparency requirements, and tax consequences in an investor's residence and domicile before selecting investment vehicles, Houston says.

All these considerations are just a starting point. "These conversations will likely become more and more complicated," Houston concludes. "Understanding and recognizing the tax implications of investment decisions—in conjunction with our clients' other advisors—will make us better prepared to advise our clients and their portfolios." ■



See Us at Institutional Investors' E&F Roundtable

Three leaders at the firm will present at the Endowment and Foundation Roundtable organized by *Institutional Investor*. David Shukis, Head of Global Investment Services, and Q Belk, Director of Diversifying Investments, will share their views on the present and future of hedge funds. Celia Dallas, Chief Investment Strategist, will lead a discussion on portfolio construction. The event will take place June 2–4 at the Four Seasons Hotel in Boston. For information on how to register for the event, visit www.institutionalinvestor.com.



See Us at SuperReturn

Two private investment experts will be featured speakers at this year's SuperReturn US conference. Marc Cardillo, a Managing Director in Real Assets Research, will moderate a panel on real assets and Sheila Ryan, a Managing Director in Private Investments, will add her perspective to a discussion on investment manager fees and terms. The event will take place June 9–12 at the Renaissance Boston Waterfront Hotel. For more information, visit www.icbi-superreturn.com.



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