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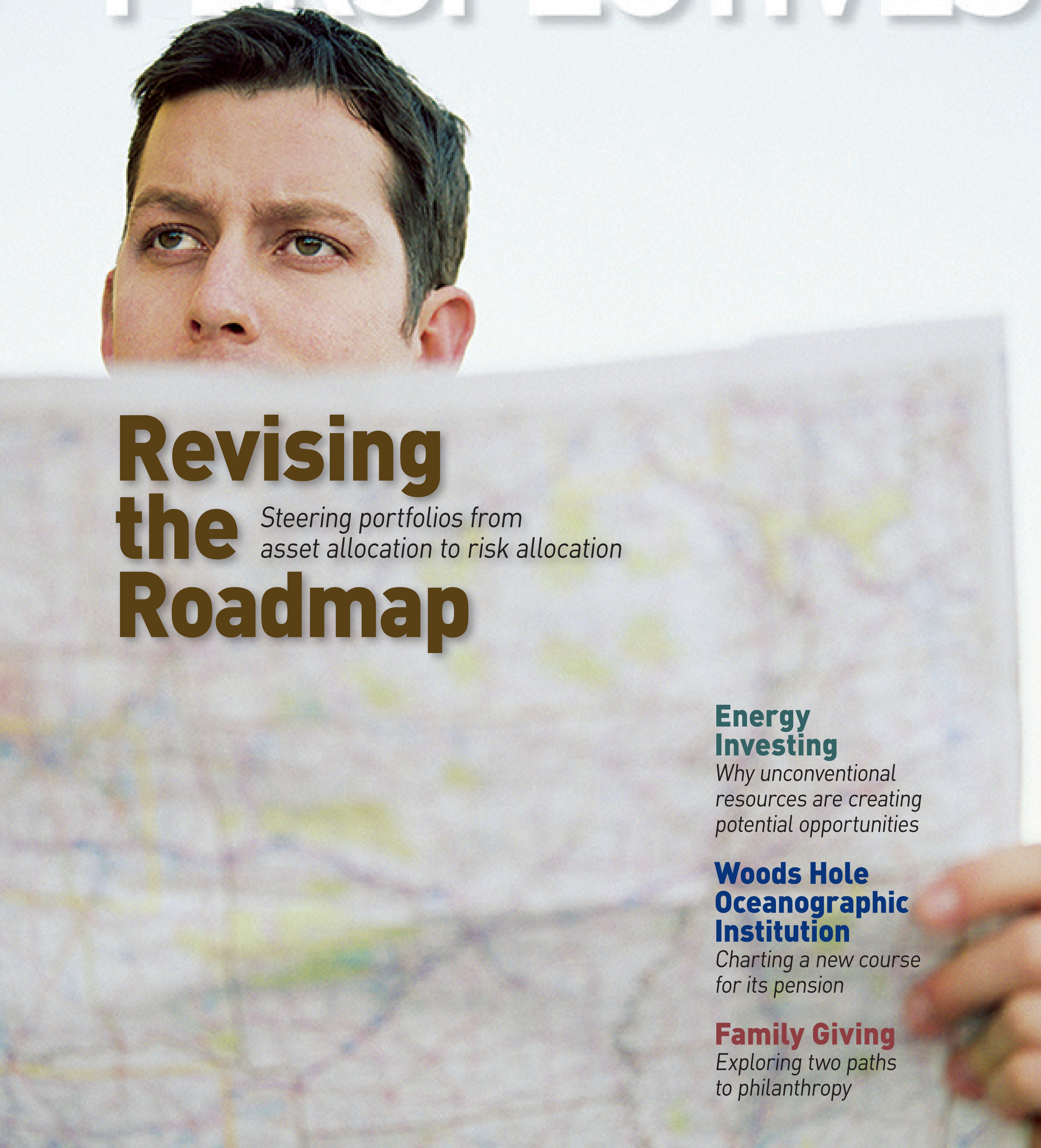
PERSPECTIVES



Revising the Roadmap

Steering portfolios from asset allocation to risk allocation

Energy Investing

Why unconventional resources are creating potential opportunities

Woods Hole Oceanographic Institution

Charting a new course for its pension

Family Giving

Exploring two paths to philanthropy

A Message from Sandy Urie

WHILE LIVING IN ASIA IN 2011, my husband Frank and I visited the Great Wall of China. This is a common tourist destination, but we decided to see it a bit differently. We embarked on a nine-mile hike along an extremely rugged part of the wall, an unrestored section of the so-called "wild wall." It was remote, and the hike was rigorous. Aside from our guides, we did not see any other hikers that day.

From the heights of the Wall, we did see people in the valleys, farming and tending to their crops. The Wall continued into the horizon, snaking over the hilltops and terrain. It took our breath away. As we reflected on the vastness and diversity of the country, we recognized that we would not have gotten this perspective from the restored part of the Wall. It reminded me that some of the best discoveries can come from exploring things in a new way.

As CEO, I've incorporated that urge to explore beyond the conventional part of my regular activities. I spend much of my time with clients, learning about their needs and how Cambridge can assist them. Our firm's core strategic goals evolve in large part from these insightful discussions.

I also enjoy exploring through what we refer to as our "CEO-in-Residence" program. This program sent me first to Singapore for four months in 2011. In 2012, I focused on traveling to our U.S. offices to meet with clients we serve from these locations. And now, as you read this, I am working from our London office, in the midst of a six-week stay.

Working in our offices around the world is a unique opportunity. I more fully appreciate what it means to serve a truly global group of investors and invest from a truly global perspective. The lessons I learn from these visits inform how we invest our resources. We opened a second office in Singapore last year to provide back- and middle-office support to our clients.

My time there convinced me that the talent and resources in the region would make it a worthwhile commitment.

While in London, I have traveled throughout Europe and the Middle East. It has given me deeper insight into how investors balance a desire to allocate globally with the considerations—and the very real challenges—of the economic and geopolitical issues present in many regions right now.

Equally as important, my time in our global offices allows me to build enduring relationships with clients and colleagues alike. On a recent visit back to Singapore, as we gathered for a client dinner reception, it felt like a meal shared among friends. London has afforded me similar opportunities, and I anticipate more frequent visits back to this region—starting with another extended visit this coming fall.

The articles in this issue of C|A *Perspectives* also focus on looking at things from a new perspective. A Question & Answer with Celia Dallas, Director of Investment Strategy Research, discusses some of the portfolio insights investors can gain from our Risk Allocation Framework (page 3). Two of our energy experts, Marc Cardillo and Meagan Nichols, discuss how new resources in the sector are creating potential investment opportunities (page 7). Our client profile on Woods Hole Oceanographic Institution (page 10) shares why the institution decided to take a new approach to investing its pension plan. For private clients with an interest in philanthropy, we outline two common avenues for meeting their goals (page 14).

I look forward to continuing to meet with—and to learn from—you.

Sandy Urie

Sandra A. Urie
Chairman and CEO

Revising the Roadmap

Steering Portfolios from Asset Allocation to Risk Allocation

By Krista Anderson

C|A *PERSPECTIVES* recently caught up with Celia Dallas, Director of Investment Strategy Research and one of the lead architects of our new report *From Asset Allocation to Risk Allocation: The Risk Allocation Framework* to discuss this evolution in portfolio construction.

What was the impetus for creating the new Risk Allocation Framework?

Dallas: There really wasn't a specific impetus for us to revisit portfolio construction. We've continuously developed tools and techniques for analyzing risk as our thoughts on portfolio construction evolved.

We've always recognized that risk is far more than standard deviation, and we've published a series of papers about that over the years. In the mid-1990s, we began looking more deeply into various measures of shortfall risk, or the fundamental risk of failing to meet your liabilities. By the late 1990s, as investors had increased allocations to a wide range of alternative assets, we started to recognize that asset allocation had become a construct that didn't tell you a lot about the portfolio. So we started working on other ways to characterize portfolio risks.

We published a report in early 2000 called *Diversification: A Warning Note*. We encouraged investors to recheck their policy allocations in terms of risk exposures. We warned that they should not assume their portfolios are diversified simply because they are invested across multiple asset classes and strategies. Throughout the 2000s, we worked on ways to better describe the portfolio, particularly from a risk perspective.

With the Risk Allocation Framework, we really just enhanced and integrated our risk analytics. In many ways, our goal was to get back to basics—explore the decision-making process and make direct connections to why various investment practices exist. We wanted to break down the notion of merely following standard rules of thumb.

How is this framework different than the traditional "Endowment Model" approach?

Dallas: It's not a different approach in the sense that it would necessarily get you to a different place. In fact, for investors who use the Endowment Model approach, we recommend that they evaluate their portfolio through the lens of the Risk Allocation Framework. This can lead to a deeper understanding of how much and what kinds of risk they can take to earn the returns they need to meet their long-term liabilities.

This is similar to the shortfall risk we were focused on 20 years ago. Today, though, we are more explicit about telling investors to choose which risks they are willing to take. How much downside risk, illiquidity risk, equity risk, and so on, are you willing to accept to meet long-term returns?

The framework also helps investors analyze manager selection skill, which is a big piece of the Endowment Model strategy.

So the framework not only allows investors to evaluate the Endowment Model approach, it also gives them the ability to look at how well they are implementing it and improve their process if they need to do so.

How do you expect the framework to change the way investors approach portfolio construction?

Dallas: The framework is meant to encourage an explicit dialogue about the trade-offs that investors need to make when constructing portfolios to meet long-term objectives. In many cases, it may simply reinforce the strategy already in place. But, in all cases, it provides investors with a clearer understanding of which risks they are taking. It helps identify what the potential impact of each risk might be under different scenarios, and it implements a more rigorous approach to dynamic monitoring of key risk exposures and performance.

Over time, the framework could also result in modifications to the ways investors take risk. For example, investors may determine that they are better at adding value through manager selection than through asset allocation shifts. So they may choose to focus more heavily on the former. Other investors may discover there's really more equity risk in their inflation-sensitive allocations than they are willing to take. This could lead them to consider defensive strategies that have real opportunity costs. They will need to weigh the trade-offs and decide which approach they are most comfortable with based on their long-term objectives.

How does this framework differ from those used by other investors?

Dallas: Many investors use "role-in-portfolio" allocations to reflect fundamental investment decisions. We share the perspective that asset allocation classifications don't give enough information on risk factors across asset classes and can limit investment flexibility. But our framework offers a number of pieces that may not be fully reflected in other frameworks.

First, our approach begins with a comprehensive review of the role a portfolio plays in the enterprise. We analyze the institution's or family's circumstances to fully understand the objectives of the portfolio and any constraints it may face from an investment perspective. These insights help to create appropriate policy allocations—these role-in-portfolio allocations—in addition to other top-down portfolio objectives and constraints. This ties the investor's risk and return objectives more closely to long-term goals and shorter-term risk tolerances.

These top-down considerations also play a role when thinking about different risks. So, we look not only at return and volatility expectations, but also at equity beta objectives, maximum illiquidity constraints, foreign currency exposure, and value-added objectives relative to policy benchmarks.

We also understand that portfolio characteristics are not static. So, we look at the portfolio's risk characteristics dynamically. This helps us to better understand what risks are embedded in the portfolio today and how these change over time to provide a better real-time way of managing those risks.

You mentioned the "Enterprise Review" as a key distinction in this framework. Why is this a vital first step in the portfolio construction approach?

Dallas: The Enterprise Review is a powerful way of identifying and crystallizing the fundamental risk capacity and attitudes of the institution or the family as it relates to the way that the assets are invested. It helps ensure that various stakeholders are on the same page about the ability and willingness to take risks. It gives investors a baseline understanding of how to best invest the portfolio without jeopardizing the ability to use the pool of assets as the stakeholders intend. It really is vital for setting policies to meet long-term goals.

Speaking of policy, the framework separates policy and implementation decisions in a more clear-cut way than previous strategies. What is the importance of this distinction?

Dallas: The main reason we do this is to elevate the importance of policy relative to implementation. This makes it clear that policy setting is the more evergreen part of the strategy. It relates to the fundamental exposures, constraints, and objectives within the long-term investing strategy. Implementation deals with the here-and-now, shorter time horizons.

In the framework, policy is expressed as a simple, fully investible benchmark. So, if you have this broad, top-down policy, you can then evaluate how implementation decisions performed relative to policy in a way that was not possible with more complex or dynamic benchmarks.

Let's talk more about benchmarks. Which do you think are most critical for monitoring a portfolio from a risk management perspective?

Dallas: The most fundamental benchmark is, *how am I doing overall?* This can only be answered in relative terms over a reasonable time horizon. With the framework, we look at a volatility-equivalent simple benchmark of stocks and bonds. So, if investors look at a portfolio with an equivalent amount of risk to what they seek to take (and by risk, I mean volatility in this case),

Celia Dallas
Director of Investment Strategy Research

"The framework is meant to encourage an explicit dialogue about the trade-offs that investors need to make when constructing portfolios to meet long-term objectives."

Policy should serve as the guideline for the investing strategy and the baseline for evaluating implementation. Investors measure how they have done relative to policy. Many investors change their policy allocations and benchmarks as they make new decisions. That really eliminates a way to evaluate implementation decisions over time.

they can easily evaluate how they performed in the capital market environment adjusted for the level of risk they took. This value added can be broken down further in many ways. They can look at the value added from policy, from implementation as a whole, and from a host of individual portfolio positions.

So the volatility-equivalent simple benchmark is fundamentally most important. But investors should really spend the most time evaluating decisions based on where they are taking the most risks. If an investor's philosophy is to take a high degree of active manager risk, the most important evaluation is the success of those active management decisions. If the most risk comes from tactical bets, the investor should measure how much value these tactical decisions added. It really amounts to identifying where the investor is taking the greatest amount of risk and then measuring how those risks have played out.

What about portfolio monitoring? How does the framework impact it?

Dallas: The biggest impact is the ability to use real-time information to make more informed decisions. Monitoring how different positions contribute to performance relative to the policy portfolio gives the investor an understanding of how assets relate to one another and how different decisions may offset each other. This is often called active risk—it measures the potential to outperform or underperform a benchmark. So, for example, if an investor sees a meaningful decrease in the active risk of a manager relative to its benchmark, the investor would first want to understand if the manager typically exhibits that sort of change during whatever the current environment is. If not, it allows him or her to ask more informed questions of the manager as part of monitoring, or even during upfront due diligence — *Why are you sticking so close to the benchmark right now? Is this permanent or because of the current environment?* It just provides more information to use in evaluating managers, taking current conditions more fully into account.

Another example might involve a change in the relationship between two asset classes. For example, the correlation between equities and sovereign bonds has been very negative in recent years. So, any underweight in bonds would have a greater impact on increasing total portfolio equity risk today than would be the case on average. Understanding these relationships on a dynamic basis improves investors' insight into portfolio exposures as they make changes to portfolio allocations. ■

"Policy should serve as the guideline for the investing strategy and the baseline for evaluating implementation."

From Asset Allocation to Risk Allocation: The Risk Allocation Framework *is available in its entirety on C|A's website, www.cambridgeassociates.com.*

Unconventional Resources Heat Up Energy Investing

By Harriett Magee

WITH PRIVATE EQUITY ENERGY INVESTMENTS providing robust returns to LPs—18.4% annualized capital-weighted returns for the ten years ending June 30, 2012, according to C|A data—and some protection for portfolios against inflation, many investors are actively increasing their exposure to this sector, clearly expecting strong returns to continue. Weighing in on the merits of such expectations in the current investment environment are C|A energy experts Marc Cardillo and Meagan Nichols, who together have performed due diligence on more than 75 private equity energy funds competing for institutional investors' capital.

The two research consultants have witnessed a revolution in the American energy industry over the past decade. As recently as the mid-2000s, the United States was resigned to an inevitable decline in natural gas and oil production, the slippery slope to greater reliance on natural gas and oil imports. Yet, behind the scenes, geologists were developing techniques to recover long-known but previously untapped natural gas resources of immense scale. These "unconventional resources," explains Cardillo, are hydrocarbon reservoirs with low porosity and permeability, making it difficult to extract oil & gas.

Fracturing the rock to release the oil or gas offers a solution to this geological difficulty. Hydraulic fracturing, or "fracking," involves pumping liquid, mostly a mix of water and sand, at high pressure into a well to release the gas. When combined with advances in horizontal drilling technology that allow access to more of the shale than a traditional vertical well, fracking enabled these industry pioneers to "crack the code" within various U.S. and Canadian shale formations. According to the U.S. Energy Information Administration (EIA), shale gas resources have helped to increase total U.S. natural gas reserves by almost 50% over the past decade, and shale gas is projected to rise to 47% of U.S. natural gas production in 2035. Some industry experts predict the United States could become a net exporter of natural gas by the middle of the next decade.

Cardillo notes that the gas industry has become so proficient at extracting gas from shale rock that it has become, to some degree, a victim of its own success. New supply has been so robust that natural gas prices, as measured by the benchmark Henry Hub price, have declined from an average

price of $8.84 per MMBtu in 2008 to an average price of $2.76 MMBtu in 2012. Producers have continued to drill wells despite low gas prices for a couple of reasons. In many cases, Cardillo says, producers have hedged a significant portion of their production at price levels meaningfully higher than the current strip prices. In some situations, operators are even drilling wells to maintain leases so they can drill additional wells when gas prices go up.

Nichols adds that while fracking began with the extraction of shale gas, the technology was eventually enhanced such that oil reserves, too, could be extracted using these methods, producing what the industry calls "tight oil." The EIA estimates that 51% of total onshore oil production in the lower 48 states in 2040 will come from tight oil, up from 33% in 2011. Nichols adds that the majority of rigs active in the United States today drill tight oil as opposed to shale gas, again in response to the current high oil prices and low natural gas prices.

Much of the strong returns generated by private equity energy funds over the past decade can be attributed to their participation as early movers in many of the most prolific unconventional natural gas and oil plays. While many of these early plays, like the Barnett, Hayneville, and Marcellus shales, are now dominated by global oil companies, private equity–backed firms continue to identify emerging unconventional plays. Cardillo and Nichols expect investments in unconventional resources to continue to attract significant private equity capital.

"Energy is a hugely capital-intensive business," Cardillo notes. KKR, the multinational publicly held private equity firm, estimates that approximately $2 trillion in upstream investment is required between 2011 and 2035 to effectively produce U.S. gas reserves, which equates to $80 billion per year. KKR is one of a growing number of generalist private equity firms now investing in energy.

While unconventional resources get most of the headlines, conventional oil & gas assets remain a significant part of the industry and will continue to attract private equity capital. Several high–quality private equity firms, Nichols notes, focus on conventional assets. In fact, many public energy exploration and production companies sell their conventional assets to fund drilling programs for their unconventional resources. This has created potentially attractive opportunities for private equity firms to acquire good properties that, in some cases, have been starved for capital over the past few years. Conventional properties can also benefit from technical advancements in drilling techniques to enhance production.

The explosive growth in the production of crude oil, natural gas, and natural gas liquids like ethane and propane has created a massive need for new infrastructure to process, store, and transport these hydrocarbons. *Barron's*, in a recent article, estimated that $250 billion of capital would be needed over the next 25 years to build out this infrastructure.

Nichols says that private equity will also participate in this build out; she recently conducted due diligence on a new energy fund focused in this midstream space. Similar to the upstream strategies, the midstream companies that the new fund would invest in seek to be early movers in

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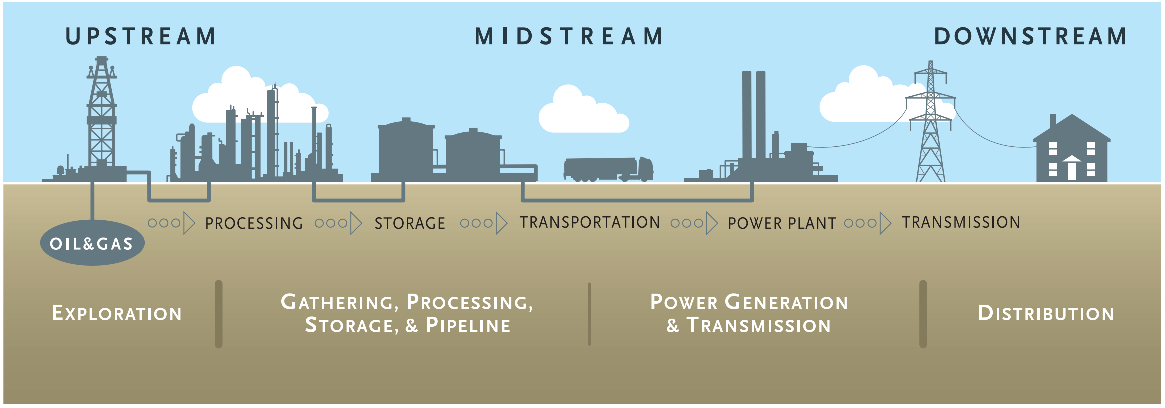

emerging resource plays. “That’s not to say that these companies are engaging in speculative development,” says Nichols. Before breaking ground on an infrastructure project, a company will typically structure a contract with an upstream producer to secure a minimum volume of hydrocarbons, requiring the producer to pay a fixed fee whether the volumes materialize or not. The upstream company has an incentive to structure such a deal to ensure it has adequate takeaway capacity.

The midstream sector offers the potential for attractive returns, Cardillo agrees, but the returns are typically correlated more to volumes than the direction of hydrocarbon prices. As a result, “a midstream investment can complement most clients’ energy portfolios, which are typically weighted toward upstream investments,” he notes. However, the midstream sector’s lower correlation to oil & gas prices limits its usefulness as a hedge against unanticipated inflation.

When asked what keeps them up at night, Cardillo and Nichols both point to the enormous amount of capital raised by private equity funds targeting energy investments. “A long period of consistent, high returns, combined with the sector’s attractive inflation-hedging characteristics, has attracted the attention of a growing number of institutional investors. This demand has allowed established energy investment firms to raise larger funds, significantly larger, five or ten times in some cases,” Cardillo explains. It has also encouraged new entrants, including a number of well-known private equity firms, to raise new dedicated energy funds. One online database lists some 400 firms currently investing in energy, roughly one-fifth of the online database’s 2,000 listings.


Marc Cardillo
C/A Energy Expert

“Historically,” Nichols points out, “when asset classes experience a significant influx of capital, future returns inevitably fail to match the past performance.” Both researchers say they haven’t yet seen evidence that increased competition among private equity firms is pressuring valuation multiples or fees or the percentage of profit paid to portfolio company management teams. However, as Nichols says, “we continue to look for any red flags.”

Environmental concerns pose another risk to such investments. Hydraulic fracturing, in particular, has received much coverage for its potential role in contaminating ground water. Should opposition from citizens, the scientific community, or both convince state and national elected officials that natural shale gas production needs strong regulation to protect the environment and public health, investment returns could suffer. And for certain clients, the “headline risk” associated with any strategy that extracts resources from the earth needs to be considered before investing.

Nichols cautions, “It’s relatively easy to make the case for investing in energy today. It is a dynamic sector in the midst of an incredible transformation, which has potential to reduce energy import dependence and spur manufacturing and job growth. Private equity firms raising energy funds boast strong track records and their funds offer the potential to hedge against unanticipated inflation. But the investment and regulatory issues are real. As always, thorough due diligence and a clear understanding of the potential risks are critical.” ■

Woods Hole Charts a New Course for Its Pension

By Andi Pollinger

THOUGH ITS INVOLVEMENT with the 1985 discovery of the RMS *Titanic* certainly put Woods Hole Oceanographic Institution on the world stage, this global leader in oceanography and marine biology has been studying, exploring, and providing education on the ocean and our global environment for nearly 100 years.

Founded in 1930 with a grant from the Rockefeller Foundation, Woods Hole is the world's largest private nonprofit institution focused exclusively on the ocean. A team of approximately 1,000 scientists, engineers, researchers, technicians, and administrators strives to understand all facets of the ocean and its connections to the earth as a whole.

Woods Hole's desire to have a lasting impact isn't exclusive to the environment. The Institution implemented a defined benefit pension plan decades ago to support its employees. In 2011, the Board decided to freeze the pension plan and introduce a defined contribution plan for employees. The process also led to the decision to outsource the oversight and discretion of the retirement portfolio.

C|A Perspectives recently spoke with Board of Trustees Chair Newt Merrill and Retirement Trust Committee Chair Bob Ducommun about the Institution and their management of the retirement trust.

Tell us about your employees and their various roles at the Institution.

Merrill: The Institution employs roughly a thousand people, making it a major employer on Cape Cod. Many of the employees have worked for Woods Hole for a long time, some for more than 30 years. Others have come more recently but are also participants in the retirement trust.

We have scientists and engineers, as well as technicians, who help build and run the machines that our scientists depend on. We have mariners who operate the ships and submersibles, as well as administrators and researchers. There are also a number of oceanography graduate students working here through a joint degree program with MIT.

What factors have helped make Woods Hole so successful in oceanographic exploration?

Merrill: The synergy between science and engineering is what I believe makes Woods Hole an extraordinary place. A scientist will say, "You know, if I could just have a piece of equipment that would do this," and the engineers will say, "We can do that."

Or the engineers will say, "You know, we could develop this particular piece of equipment. We could expand its capabilities, and it could do XYZ. Would that be helpful?" And the scientists will say, "Yes, but, wait a minute, let's take it in this direction." So there's a real partnership that takes place between them that helps us do incredible things.

What kind of innovation has the partnership between the engineers and scientists allowed the Institution to advance?

Merrill: We were asked by NOAA [the National Oceanographic and Atmospheric Administration] and the Coast Guard for help in responding to the Deepwater Horizon oil spill. A team of scientists and engineers spent hundreds of hours trying to assess very quickly what the water was like before the oil reached it.

Another example was locating the Air France 447 wreckage and black box. It was unprecedented to locate items the size of a desktop computer in the most rugged terrain on the planet—the ocean floor in the middle of the Atlantic. None of this had been explored or charted before us, so we had no guidance on what terrain we were going to find down there.

As a board member, do you have the opportunity to engage with Woods Hole scientists?

Merrill: Yes, we do. It's one of the most rewarding parts of the job. Board members can choose to be assigned a scientist and have the opportunity to visit a science lab. It gives board members a chance to find out what's going on and hopefully broadens their understanding of the type of work that's being done by the Institution.

Woods Hole had a defined benefit pension plan for many of these employees but it was recently frozen. Can you talk about the decision to shift to the defined contribution plan you have now?

Merrill: The defined benefit plan was becoming increasingly costly to the Institution and had no portability for the many scientists who would move from time to time. We have scientists who join us from other institutions, and our scientists sometimes leave for other institutions. So, we capped it, froze it, and introduced a new defined contribution plan. This is what any new employee now goes into, and what all of our existing employees transitioned into at the time that we started the plan.

What factors led Woods Hole to freeze the defined benefit plan?

Ducommun: The retirement trust had been managed by a subset of the Investment Committee as an independent pool of investments for many years. The portfolio resembled that of our endowment. A number of years ago we recognized that we probably should reset the asset allocation to better reflect the funding requirements of the employee retirement pool.

How did you come to the conclusion that mirroring the endowment perhaps wasn't the best approach any longer?

Ducommun: The market provisions of the Pension Protection Act of 2006 as well as the increased volatility of the markets revealed that we had a risk of not being able to fund the liability with the portfolio as it was constructed without drawing on the endowment. The magnitude of the unfunded liability and the extent to which it was moving around due to market volatility gave the trustees great concern. So we decided that we needed to immunize the portfolio and reduce its volatility as much as we prudently could without compromising the portfolio's earning capacity.

The committee had a fairly involved role in running the pension up to that point. What made you decide to outsource the oversight of the portfolio?

Ducommun: We had increasingly been feeling the pressure of fulfilling our fiduciary responsibility in a much more volatile, 24-hour-a-day world. We also considered the succession of the IC members and concluded we were unlikely to replace the sophistication and, perhaps, the level of the commitment of the current committee members.

In August 2011, we formed a task force that included Newt and me, as well as the head of our Endowment Investment Committee, the head of the Investment Committee, and the Institution's Treasurer.

Merrill: It had become increasingly difficult for us as volunteers meeting quarterly to be in the primary position for managing the funds.

We definitely discussed giving up discretion. It's probably why it took us more than six months to reach a conclusion. It wasn't one person's decision. It had to be the consensus of our committee. It's like letting go of your children.

It sounds like those discussions laid the groundwork for repositioning the portfolio.

Ducommun: Yes. Our outsourced CIO and his investment team began making portfolio shifts in September. By January, once the new allocation and managers were in place, it made sense to begin monitoring performance of the newly positioned portfolio.

How has the role of the pension committee changed now that you've outsourced the management of the pension pool?

Ducommun: We don't expect to be as actively involved in the decision making and review of specific investments as we once were. We'll monitor performance and meet with our outsourced CIO and his team at least quarterly, expecting to have conversations with them between formal reviews given our desire to stay informed about their responses to macroeconomic events and directional changes in the markets.

We also have a lesser role in the coordination aspects of managing the retirement trust. For example, we have a very capable team at Woods Hole that helps us with many of the technical aspects of the plan, like monitoring our lump sum provisions and payout needs. This team communicates directly with the outsourced investment team so they can ensure that the portfolio maintains appropriate liquidity to meet the payout needs. It's a real team effort from all sides. ■

Read more about C|A's approach to pension investing on our website. Available reports include: Pension Risk Management *and* Pension De-Risking in a Low-Rate Environment–A Better Solution.

Meet Alvin, *the submersible.*

Scientists and engineers worked together to build *Alvin*, one of Woods Hole's most famous submersibles. First commissioned in 1964 as one of the world's first deep-ocean subs, *Alvin* gets its name from Allyn Vine, the Woods Hole scientist who was the prime mover and creative inspiration for the sub. A typical eight-hour dive takes two scientists and a pilot as deep as 4,500 meters (nearly three miles).

While *Alvin* is old, it isn't outdated. With a number of reconstructions under its belt, *Alvin*'s technology remains state-of-the-art. To keep it running smoothly, the sub is disassembled every few years for a complete inspection of all its working parts, all of which have been replaced at least once in the sub's lifetime. Currently, *Alvin* is undergoing a complete reconstruction and enhancement that will allow it to increase its dive capacity to 6,500 meters—about a mile deeper than it can currently go.

Although *Alvin* has made more than 4,400 dives, the sub is most known for two dives in particular: locating a hydrogen bomb accidentally dropped into the Mediterranean Sea in 1966 and surveying the sunken ocean liner RMS *Titanic* in 1986.

Pathways to Philanthropy

Private Foundations and Community Trusts Create Opportunities for Family Giving

By Krista Anderson

FOR FAMILIES WITH TEENAGE CHILDREN, the holidays often revolve around wish lists and gift wrap. A few years ago, Roger Devin* had a different idea.

"Through our family foundation, we had built a clinic for AIDS orphans in South Africa," he explains. "So my wife and I decided to take our kids there for Christmas and see what we'd done."

His four children, at the time ranging from early teens to early 20s, spent several days at the clinic, meeting with patients and doctors alike. "It was such an eye-opening experience for them," Devin says. "It really helped them understand what a difference you can make."

According to The Foundation Center, approximately 40,000 family foundations contribute roughly $20 billion annually to needy causes. The last decade saw a significant uptick in the creation of private foundations, with more than one-third of today's private foundations created during the 2000s.

A major reason for this is control. "Families with private foundations oversee all aspects of their philanthropy, from where the money goes to how it is invested," says Doug Macauley, a managing director at Cambridge Associates and leader of the firm's private wealth practice area. Through private foundations, families can decide exactly where the donations go and in what amounts. From an investing perspective, the foundation's board may elect to oversee the investments itself or hire an outside advisor to manage the day-to-day oversight of the portfolio, explains Macauley.

But for many families, the reason to create a private foundation is a personal one. "We wanted to use the foundation to instill in our children a way to think about wealth and the responsibility that comes with it," explains Devin. "It was our way to say to them, 'Make wise choices and make the world a better place.'"

Indeed, families frequently use the foundation as a stepping stone for the younger generation. "Being a trustee of the family foundation can often serve as an introduction to both philanthropy *and* investing," Macauley says.

For some philanthropists, their foundation ultimately serves as their legacy. "For many people, running their foundation becomes what they *do*. They invest their money, their time, and their ideas into a foundation that is their own," says Marc Bloostein, a legal advisor to Devin.

Still, running a private foundation requires a degree of administration and a significant time commitment. Families who go this route must be prepared to handle the administrative burden associated with setting up and running a foundation or be able to hire people who can, explains Bloostein. While creating a foundation is a relatively straightforward process, it can take several months to receive approval from the Internal Revenue Service and begin operating. During that time, the family can incur a number of expenses related to the setup, including attorney and staff fees.

For families considering this option, the decision should focus more on the resources involved rather than the size of the donations being made. "There is no magic number when it comes to asset size," says Bloostein. "It's more about making sure families understand what's involved in running the foundation and knowing they are prepared to take that on."

Still, some families want to support philanthropies without creating one. Whether gifting directly to an organization they wish to support or creating tax-efficient vehicles through which to donate, a variety of alternative avenues exist to help families meet their charitable goals.

One avenue increasing in popularity is community foundations. With more than $4 billion granted by 700 community foundations in the United States in 2011, according to The Foundation Center, community foundations currently represent nearly 10% of all U.S. foundation giving. They also report the fastest-growing cumulative growth in the U.S. foundation space over the last two decades.

The New Hampshire Charitable Foundation is one such institution. Many of the Foundation's donors have elected to donate there because of the simplicity of the option, explains Michael Wilson, chief financial officer and vice president of finance. Community foundations allow families to support worthwhile causes of their choice while freeing them from the administrative burden of foundation governance.

Although families do not retain precise control over grant making, many community foundations, like the New Hampshire Charitable Foundation, allow supporters to create donor-advised funds or contribute to a "field of interest fund." These options allow families to ensure their money supports particular areas of importance to them. According to Wilson, the New Hampshire Charitable Foundation's aggregate portfolio includes more than 1,300 of these kinds of "component funds."

Along with the administrative ease, community foundations allow families to maintain complete privacy in their philanthropic endeavors if they choose. "For donors who wish to remain anonymous, contributing to a community foundation can provide a sort of 'buffer' between them and the public," offers Wilson.

So why has community foundation growth continued to trail private foundation growth? One such reason, Wilson surmises, is simply an issue of familiarity. "Individuals typically rely on their advisors to help with all of their planning needs," he explains. "And most advisors are just more familiar with the notion of creating private foundations. So that's what they suggest."

Still, a number of the funds overseen by the New Hampshire Charitable Foundation are actually former private foundations. Many families have elected to turn assets over to the Foundation once they fully realize the level of administrative burden it takes to keep the private foundation running, Wilson explains.

As philanthropists make more high-profile donations to community foundations, Wilson anticipates that the idea will continue to gain traction with individuals and their advisors alike. One such example is Mark Zuckerberg's announcement of a nearly $500 million donation to the Silicon Valley Community Foundation at the end of 2012.

With so many options to choose from, everyone agrees that there is no one right answer. Families must weigh the options and settle on the right decision for them. "Our job is to help our clients think about how their philanthropic giving might impact their personal assets," Macauley states. "How much to give and which vehicles to use are entirely personal decisions."

Please Join Us In June

To learn more about approaching philanthropy, join us at our first "Next Generation" conference in June. This conference serves as an introduction to philanthropy and investing for the younger generation. In addition to various investment-related topics, the agenda includes sessions focused on options for charitable estate planning as well as mission-related investing through family foundations.

* *To protect our client's identity, this name has been changed.*

IN THE QUEUE

Interested in SRI for Your Religious Institution?

C|A is hosting an inaugural SRI conference on September 17th in our Boston office. The event aims to educate religious institutions about options available beyond traditional stocks and bond screening. It will also provide a forum for institutions to hear directly from others who have implemented meaningful SRI programs. Discussion topics may include negative and positive screening, SRI in direct hedge fund programs, and impact investing. Contact Jessica Matthews (*jmatthews@cambridgeassociates.com*) to learn more about this event.

New Clean Tech Statistics Available

C|A now offers a series of clean technology company performance statistics. Despite tens of billions of dollars in clean tech investment from venture capital and private equity funds since 2000, there has been a conspicuous absence of robust, widely available performance data for this sector. The new statistics are compiled from the performance of over 1,200 clean tech private investments in our proprietary database. The clean tech statistics report will be updated quarterly and is available by logging in to the C|A website.

NEWSLETTER PUBLICATION

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