

## Foundations Post Solid Returns for Second Year

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Foundations posted an average 12.5% return for fiscal year 2010, their second consecutive year of double-digit returns since the 2008 market crash, according to the latest Commonfund Benchmark Study of Foundations.

Although the returns represented a significant drop from the 20.9% posted in fiscal year 2009, the back-to-back showing of solid fiscal-year returns helps foundations offset the 26% loss they suffered in 2008. Their three-year return also got a bump to -0.3% from -1.1% last year, while their five-year return jumped to 4.2% from 3.6% in 2009. Foundations' fiscal years typically end on Dec. 31 of each year, unlike most endowments, whose fiscal years end on June 30.

Foundations made only modest changes to their asset allocation between 2009 and 2010, but nonetheless they continue to follow endowments toward larger allocations to alternatives. There is also an indication that foundations are more willing to give managers increased flexibility to search out returns.

But even as foundations continue to climb out of the economic downturn, the struggle for a full recovery continues. They also face challenges ahead as they struggle to maintain their long-term purchasing power.

"What we saw in [2010] was the continuation of the strong recovery that began in '09," says William Jarvis, managing director of the Commonfund Institute. "I think the bounce-back that was essentially completed in 2010 presents us with the question of whether we really are back where we started. And the answer is, not really."

Jarvis says that he's "not trying to be negative," because the returns over the past couple of years have been strong for foundations. But as with Commonfund's annual study of endowments – the latest one released in January showed an average 11.9% return for the year ending June 30 – the fiscal year 2010 benchmark report on foundations shows them to be in a transitional period in which they are benefiting from a strong run-up in the public markets.

**John Paul Cavaliere, senior analyst for nonprofit advice in SEI's Institutional Group, says that foundations are increasingly looking for other sources of returns outside of the public markets. They have especially shown interest in hedge funds of funds, private equity and, most recently, direct real estate.**

“These have been strong recovery years, and that’s good,” Jarvis says. “But on average, these institutions are not back to where they were before the downturn, and it’s unclear whether investment returns alone will be enough after spending to put them back to that place of purchasing power.”

Besides an uptick in investment returns, foundations are likely going to have to increase their fundraising to help them make a full recovery. But, as Jarvis notes, “there isn’t a single study that says the giving environment is robust.”

John Griswold, executive director of the Commonfund Institute, notes in a statement that, in the nine years since Commonfund began publishing its benchmark study, the average foundation is still below its original nominal dollar value. In other words, they have less today in real terms than what they had nearly a decade ago.

Commonfund’s benchmark report is actually comprised of two corresponding studies of foundations and operating charities. The former comprises 175 independent/private foundations and community foundations, while the latter is made up of 69 cultural, religious and social service institutions.

The numbers for operating charities were similar to what foundations saw last year, as they posted an average net return of 11.6%, compared with 21.5% the year before. Meanwhile, average losses in 2008 totaled 25.8%.

For foundations, the average asset allocation was 38% to alternatives, 26% to domestic equities, 16% to international equities, 13% to fixed income and 7% to short-term securities, cash or other. Their asset mix stayed mostly unchanged between 2009 and 2010, with only fixed income dropping by 1% and alternatives getting a 3% boost.

“If there’s anything that the downturn taught us, it’s that real diversification matters,” Jarvis says. “People talk about how hedge funds and alternatives went down [during the crisis], but they only went down 12% as opposed 36% in domestic equities. So I look that as a hedge.”

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Cavaliere says that foundations face fewer liquidity concerns than endowments, as long as they are not experiencing changes within their cash flows. That makes them more willing to look at more illiquid assets, like private equity or direct real estate, in order to improve their risk-adjusted returns and the overall efficiency of their portfolio.

“There is definitely an appetite for private real estate, because a lot of them know that when you invest at a time when it’s at distressed levels, you can get decent returns and better yields,” Cavaliere says. “It can also act as an inflation buffer.”

He adds that, even if foundations have not yet moved into these more illiquid assets, he's "seen more chatter about it than I did even six months ago." The move into alternatives is often coming through reallocations out of equities and fixed income, Cavaliere adds.

Cavaliere also says that foundations are becoming more interested in giving asset managers more flexibility with their target allocations so that managers can "work around the fringes" in order to make adjustments and capture returns. While this doesn't mean that managers are being given unlimited range to move in and out of investments, there is more interest in having proactive managers that can be more tactical and less strategic.

"We have seen new clients implement a tactical manager that takes a shorter-term focus where value between stocks and bonds is changing," Cavaliere says.

