TIFF's Framework for Strategic Asset Allocation (SAA) and Benchmarking

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Introduction

At TIFF, we aim to add value to our clients in two distinct ways. First, we provide advice on Strategic Asset Allocation, or "SAA." We define SAA as the long-term portfolio weightings that, in light of an organization's unique financial circumstances, help it accomplish its long-term goals. Second, once we agree on an SAA and an associated benchmark, we seek to achieve net-of-fee alpha[1] above and beyond that benchmark. If we can deliver on these two value-adds, we are likely to have success in enhancing the missions of our nonprofit clients.

SAA and benchmarking are handled very differently across the outsourced chief investment officer (OCIO) industry, with firms taking a variety of approaches. The objective of this paper is to provide some detail around our framework for each. More specifically, we will address:

- Why we define SAA as the allocations to four major asset classes, rather than a more granular and detailed universe of asset classes
- Our rationale for using risk-equivalent public market composites as benchmarks, rather than other options that may not be investable or transparent in their construction

The structure of the SAA and benchmark may not seem quite as critical as other investment decisions. We would argue however, that the downstream effects of these structures can be quite impactful over the long-term.

Our SAA Approach: Four Major Asset Classes

At TIFF, we categorize investments into one of four areas: **public equity**, **private markets**, **diversifying strategies**, and **public fixed income**. While just four major asset classes may seem insufficient to capture the full universe of potential investments, it is rare that we consider opportunities that cannot be reasonably placed into one of these four broadly defined categories. Importantly, we believe strongly that our approach helps reinforce *two core aspects* of our investment philosophy.

First, we want to consider any investment, assuming it is consistent with a portfolio's guidelines, that we believe may have a chance to enhance the portfolio's long-term

[1] In an academic finance setting, the term "alpha" can be loosely defined as the investment returns that do not derive from exposure to a set of easily identified factors such as the global equity market. For the purposes of this paper, we will define it more practically, as the investment management industry has tended to, as simply the excess return relative to a well-defined benchmark.

risk and return profile. We do not want to limit ourselves to a more rigidly defined set of sub-asset classes. Indeed, the investments with the very best long-term returns are often those that do not neatly fit into a category, are not overly familiar to the institutional investment community, and can often be accordingly mispriced.

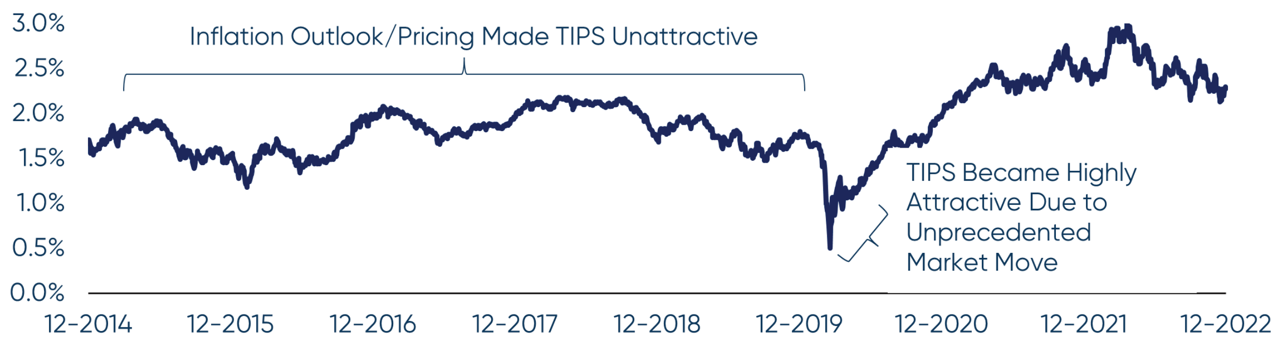
One recent example of this is our investment in carbon credits.[2] Despite the fact that carbon credits do not fit into any conventional asset class, we researched this space exhaustively and made our first investments within our diversifying strategies portfolios in late 2021. Our thesis on carbon credits has been borne out to date in the form of strong risk-adjusted returns. We would argue that investors with more granular SAA categories are less likely to evaluate, and ultimately invest in, these types of opportunities.

Second, for any investment that we are considering for portfolios, we want to ensure that we are evaluating its expected impact on the portfolio's risk and return relative to all other options, not relative to a narrow universe of sub-asset classes. Accordingly, at TIFF every investment that we make must "compete" for a capital allocation. Importantly, this competition for capital is not amongst narrowly defined types of investments. Rather, it is wide-ranging, amongst ALL available opportunities. The reality is that market conditions evolve quickly, and not all sub-asset classes warrant an allocation at all times. In our view, an investor with a granular SAA that features, for instance, allocations to US high-yield fixed income or UK equities is not likely to properly evaluate those investments with a broad lens. In our experience, if there is an SAA target weight to granular sub-asset classes, these asset classes are likely to receive a perpetual allocation, even during times when the forward-looking returns are less strong.

[2] This website is a useful introductory resource on carbon credits. The Ultimate Guide to Understanding Carbon Credits • Carbon Credits.

One example of this from the recent past is the US Treasury Inflation Protected Securities (TIPS) market. Of course, our four-category framework does not have allocations to inflation-protected fixed income securities or a broader inflation hedging bucket. In the years leading up to the pandemic, we did not allocate any capital to TIPS. Very simply, in our view, the expected return on TIPS was quite modest given the pricing of these securities and the muted outlook for future inflation. This view was ultimately proven valid as the returns on TIPS during these years were not overly attractive. However, at the depths of the initial COVID lockdowns in March of 2020, when TIPS break-evens reached all-time lows (see Exhibit 1 below), we made an opportunistic investment in TIPS that delivered strong returns. If we had included an SAA target in inflation-hedging or inflation sensitive assets, it seems unlikely that we would have navigated this environment quite as deftly.

Exhibit 1 | 10-Year Break-Even Inflation, 2014-2022



In summary, while broad SAA categories are certainly not a panacea[3], we do feel that they help reinforce these two core investment principles: 1) Consider any and all investments that may enhance the risk and return profile of our portfolios, not simply those that fit into neatly defined categories; 2) Evaluate any investment relative to a broad set of alternatives, not relative to narrowly defined sub-asset classes. We would humbly argue that these two principles have been important contributors to our long-term investment success.

[3] We have highlighted two examples here of investments that have done well. However, any investment we make is subject to downside and although our long-term track record is strong, many positions we have held over the years have fared poorly.

Our Approach to Benchmarking: Investable, Transparent Primary Benchmark Supplemented by Various Analytics

Key Elements of Our Approach

For any portfolio that we manage, we seek to set up a primary benchmark and a set of customized analytics that will allow for our performance to be easily understood and evaluated. While we are not dogmatic in our approach and are always open to client requests on how portfolios are benchmarked, we do have strong views on what tends to work best. We will summarize a few of the key aspects of our approach.

1. ***Use a Risk-Equivalent Composite of Public Equity and Public Fixed Income Indices as the Primary Benchmark*** – We believe that a portfolio's primary benchmark should be the main lens through which the portfolio's performance and investment team are evaluated. In our view, any primary benchmark should be: i) investable; ii) transparent in its construction.

   If a manager is asked to outperform an index that is not investable (e.g., inflation plus 5%) or that is opaque in its construction (e.g., the Cambridge Private Market indices), it is difficult to see how a manager can be held fully accountable for delivering that outperformance.

   We use the MSCI All Country World Index (MSCI ACWI) and the Bloomberg US Aggregate Index as components in our composite benchmarks. These two indices are broadly accepted and well-known representations of the global equity and US high-quality fixed income markets. They are investable as they can each be accessed at minimal fees via a variety of mutual fund and Exchange Trade Fund (ETF) vehicles. Further, their index construction methodologies are well defined, simple, and widely available.

   We ultimately determine a portfolio's benchmark by matching its risk and return profile to the appropriate combination of these two indices. Our method for weighting the benchmark is simple. We refer to the sum of the public equity and private market weights as "return-generating assets" and assign MSCI ACWI to that portion of the portfolio. The remaining allocations, diversifying strategies and public fixed income, are then also combined. We refer to the sum of these weights as "risk-mitigating assets" and benchmark them to the Bloomberg US Aggregate Index. Exhibit 2 below shows an example of this.

Exhibit 2 | Sample SAA and Associated Benchmark[4]

Asset Allocation	SAA Target
Public Equity	60.0%
Private Markets	15.0%
Total Return-Generating Assets	**75.0%**
Diversifying Strategies	15.0%
Fixed Income + Cash	10.0%
Total Risk-Mitigating Assets	**25.0%**
Total	**100.0%**

→ *Portfolio is benchmarked to 75% MSCI ACWI/ 25% Bloomberg Aggregate Bond Index*

2. ***Use Uninvestable Asset Class Indices to Help Explain Performance Outcomes*** – The Cambridge Private Market indices and Hedge Fund Research indices are neither investable nor transparent in their construction, so we do not use them as primary benchmarks. However, they do provide useful representations of how broad swathes of the investment universe have fared. Accordingly, we tend to employ them in our standard reporting packages, as well as on a more ad hoc basis, to give perspective on our performance within these key asset classes.

3. ***Periodically Feature Peer Comparisons*** – Clients will often wonder how their overall portfolios have fared relative to broad peer universes, such as the NACUBO-Commonfund Study of Endowments. With the caveat that such indices are also not investable and may contain meaningful reporting biases,[5] they can provide useful context for performance. We do therefore report on them from time to time.

[4] We opt for a global index, MSCI ACWI, for the return-generating portion of the portfolio. This is because we believe that a wide net should be cast to capture the full breadth of attractive return opportunities. However, we do use a US-focused index, the Bloomberg US Aggregate, for the risk-mitigating portion of the portfolio. High-quality US fixed income assets, and US Treasuries more specifically, are still viewed as safe-haven assets and have exhibited the strongest diversification properties of any fixed income market.
[5] Similar to some alternative asset class indices, peer indices also rely on self-reporting. This is in stark contrast to an equity or fixed income index, in which an index provider simply observes a publicly available closing price and calculates an index level. This self-reporting introduces a variety of biases, as organizations may opt to start or stop reporting for a number of reasons.

4 ***Check In on Long-Term Results Versus Return Objective*** – Many nonprofits have a simple overall portfolio return objective of inflation (often measured by the Consumer Price Index or "CPI"), plus 4%-6%. In our reporting, we periodically show overall portfolio returns relative to an organization's target return objective. While this measure is often quite useful, it is also important to keep in mind that investment teams can only have so much influence over a portfolio's long-term returns. Very simply, if markets do extremely well or extremely poorly over a multiyear period, that is likely to be the key driver in a portfolio meeting its return objective. While an investment team's alpha is critical, it is rare that it will be so significant to counteract a strong or weak market environment.

We Believe That Our Approach Promotes Clarity and Accountability

In our view, among the prerequisites for strong long-term investment results are a clearly stated investment objective and a team that is fully accountable for meeting that objective. With this in mind, the attractiveness of our simple, investable, and transparent benchmark approach becomes evident. Under our approach, investment teams and nonprofit stakeholders can easily and quickly reach full alignment in terms of what is expected. This allows for the type of clear and straightforward evaluation of investment performance that we believe to be optimal.

Impactful Alpha Decisions are Embedded in the SAA

In our framework, the benchmark is composed of public market indices. But in most of our portfolios, we invest "off benchmark" in alternative asset classes, namely private markets and diversifying strategies. Alternative investments are well known to provide greater return dispersion[6] than public market strategies. This greater dispersion, coupled with the fact that these investments represent off-benchmark holdings, implies that these holdings represent a significant amount of active risk in our portfolios. This is all to say that the decision to use alternative investments, and the myriad decisions on how exactly to implement alternatives, represent sources of potential significant outperformance or significant underperformance.

That said, we believe strongly in the virtues of alternative investments, and we have been using alternatives in our portfolios for our entire 30-plus year history. While each market cycle and portfolio is unique, we can say with conviction that these alternative investments have been a key part in our long-term performance relative to benchmarks.

[6] The following two papers show clearly that private equity and hedge fund investments feature significant dispersion and downside risks: "The Performance of Private Equity Funds" by Ang, Chen, and Goetzmann, and "Downside Risk of Hedge Funds" by Agarwal and Naik.

However, we want to be emphatic: Outperformance stemming from alternatives is not a sure thing. Many academic studies[7] have pointed out that alternatives can provide significant benefits, but also face meaningful downsides if not implemented thoughtfully. Our experience certainly corroborates the conclusions of these rigorous, industry-wide studies.

The decisions that nonprofit investment managers make regarding alternative investments are extremely impactful on the long-term absolute and relative performance of portfolios. We firmly believe that these decisions should be a key part of any alpha calculation. And while we certainly think that alternatives can be a great benefit to nonprofit portfolios, we would urge organizations to partner with investors that have significant experience evaluating and structuring alternative investments.

Potential Criticisms of Our Approach

Broadly Defined SAAs Give Insufficient Detail on Portfolio Positioning

While we have rarely heard objections to our view that an SAA with broad buckets encourages virtuous behavior, we have periodically heard concerns that our approach is not overly conducive to an investment committee knowing how the portfolio is positioned at any given time. We acknowledge that our four-category approach does not give a great deal of clarity on how a portfolio is positioned within the major asset classes over the long term. However, we do believe that this concern can be mitigated via clear, detailed, and timely reporting. Our typical quarterly reporting package, customized to the needs of each investment committee, delivers this. For any committee that is interested, we will show exposures within each of the asset classes (e.g., sectors and countries for public equity, investment type/strategy within private markets and diversifiers) as well as exposure to managers. The rationale for any positioning can, of course, be discussed at each investment committee meeting. In short, a more granular understanding of positioning is something that we think we readily deliver to any client that has the appetite for it.

[7] "Private Equity Performance: What Do We Know?" by Harris, Jenkinson, and Kaplan shows that the overall private equity industry has in fact added small amounts of risk-adjusted alpha, but that outcomes can vary significantly based on a number of variables. Conversely, "The Performance of Hedge Funds: Risk, Return, and Incentives" by Ang, Chen, and Xing argues that the industry has not added value in aggregate, though many hedge fund strategies and managers have done so.

Public Market Benchmarks Are Not Sufficiently High Hurdles

While we tend to get positive feedback on the simplicity and clarity of our benchmarking approach, we will periodically hear that public market indices can be beaten easily, especially if alternatives are employed.

As we note above, however, while alternatives can be incredibly valuable tools in delivering outperformance, they also have meaningful downsides. In fact, we are frequently told by OCIO search consultants that our ability to outperform public markets within our overall portfolios, has been fairly unique in our space. Further, anecdotally, given the broad cross section of nonprofit portfolios that we see, it is evident to us that many nonprofit portfolios do in fact underperform public markets. Last, while aggregate studies of nonprofit portfolios are challenging for a number of reasons that are beyond the scope of this discussion, there is certainly some evidence[8] that broad swathes of the nonprofit universe have materially underperformed. In summary, if public market benchmarks are easy to outperform, in our opinion, nonprofit portfolios broadly have not been able to take advantage.

Conclusion

Our framework for Strategic Asset Allocation (SAA) and associated benchmarks is fairly straightforward:

- Establish the SAA as the long-term weightings to four broadly defined asset classes: public equity, private markets, diversifying strategies, and public fixed income.
- Define the benchmark as the approximate risk-equivalent combination of well-known, investable, and transparent representations of the global equity and US fixed income markets (i.e., the MSCI ACWI and the Bloomberg US Aggregate Index). Provide a series of analytics on asset class indices, peer indices, and total portfolio return objectives to complement the benchmark.

While no SAA and benchmarking system is perfect, we do feel that ours works quite well. It encourages behavior that we believe to be conducive to strong long-term investment results and promotes clarity and accountability for those responsible for investment decisions.

[8] For instance: Failure of the Standard Model of Institutional Investment - Richard M. Ennis (richardmennis.com).

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