THE WHITE PAPER

Your Retirement Planning Newsletter

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Tori Patrick
President
Progressive Strategies Financial Group
27201 Puerta Real Suite 300
Mission Viejo, CA 92691
949.204.3800 702.893.1500
Fax: 702.549.1900
Tori@psfgwealth.com
www.psfgwealth.com
CA Insurance Lic#

Family Foundations: Keep Fundamentals in Mind When Investing Assets

When managing family foundation assets your goals are generally twofold: strive to generate current income while also preserving principal to help the family continue to meet its long-term charitable objectives. Often families will find that many of the investment principles used in managing individual portfolios also apply to foundations.

Following are some "evergreen" investment strategies that can help lead to effective foundation asset management.

- Keep a long-term perspective. While it is all too easy to get caught up in the stock market's daily roller-coaster ride, doing so can easily lead to bad investment decisions. Although past performance is no guarantee of future results, history informs us that the longer you hold a stock investment, the less likely you'll be to experience high variability of returns.[1] As an example, for all the one-year periods since 1926, domestic stock returns have varied from as low as -67% to as high as 160%. Yet, for all 10-year periods, returns have not been below -4% or higher than 21%. And for all periods of 15 years or longer, returns have all been positive.[2] The lesson: Don't get caught up in day-to-day or even week-to-week variations -- in either direction. Instead, focus on whether your long-term investment returns are meeting the goals you have established for your foundation assets.
- Keep inflation in mind. Inflation is a constant economic reality, and it can have a dramatic impact on purchasing power over the long term. For foundations that are designed to exist indefinitely into the future, even an inflation rate of just 2% to 3% - which we have been experiencing for the past several decades - can have a marked impact on the value of grants over time. Therefore, when calculating portfolio return requirements, be sure to account for inflation.
- Craft an appropriate asset allocation.[3] In order to outpace inflation *and* fulfill the federally mandated "5% payout rule," which requires private foundations to distribute an amount equal to 5% of the foundation's net asset value each year to charities, foundations should strive to maintain an asset allocation (i.e., a predetermined mix of asset classes such as stocks, bonds, and cash) that is appropriate for their specific time frame and return expectations.[4]Because different asset classes carry different levels of risk and return potential, by allocating your investments strategically among them, you potentially can help smooth out the short term ups and downs.For instance, during volatile times, more risky asset classes such as stocks have the potential to fluctuate more, while lower-risk assets such as bonds or cash tend to be more stable.[5]
- Diversify, diversify,diversify.In addition to dividing your foundation assets by asset class, you should also diversify among different segments of each asset class -- for instance small-cap and large-cap stocks, domestic and international stocks, and growth and value stocks.[6] Why? Because different categories of investments take turns outperforming one another. Similarly, foundation managers may want to choose to work with a variety of asset management firms. Different firms may have unique strategies and investment styles to bring to the table -- all of which could potentially help to mitigate risk and enhance foundation returns over time.[5]
- First things last. Last but not least, prudent foundation asset management should start with a comprehensive investment policy statement. Working with the appropriate legal and investment professionals, families can design a document that can serve as a master blueprint throughout the foundation's lifetime, indicating long-term investment objectives, return expectations, time horizon, risk tolerance, and asset allocation guidelines.

Given the proper planning and maintenance, your family foundation can support a charitable legacy that spans generations.

[1]*Investing in stocks involves risks, including loss of principal.*

[2]*Source: Wealth Management Systems Inc. For all indicated holding periods between January 1, 1926, and December 31, 2013. Domestic stocks are represented by the total returns of Standard & Poor's Composite Index of 500 Stocks, an unmanaged index that is generally considered representative of the U.S. stock market. Past performance is not a guarantee of future results.*

[3] *Asset allocation does not assure a profit or protect against a loss.*

[4] *Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and are subject to availability and change in price.*

[5] *Past performance is not a guarantee of future results.*

[6] *Securities of smaller companies may be more volatile than those of larger companies. The illiquidity of the small-cap market may adversely affect the value of these investments. Foreign investments involve greater risks than U.S. investments, including political and economic risks and the risk of currency fluctuations, and may not be suitable for all investors. Past performance is not a guarantee of future results.*

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