{PMFA} Special commentary

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EXECUTIVE SUMMARY

- *Investment committee members must understand each and every underlying investment, not only on a stand-alone basis, but also the role each investment plays within the context of the total portfolio in shaping overall investment strategy.*
- *There is more than one way to construct an investment portfolio – most decisions come down to a matter of preference rather than "right" or "wrong." Committees can easily go wrong by abandoning their chosen long-term investment strategy or philosophy at the first sign of trouble.*
- *Committees that attempt to engage in market timing, predicting the next recession or expansion, or chasing performance are certain to struggle and are more than likely wasting their valuable time. Instead, investment committees should focus their efforts on aspects they can control.*
- *Committees are responsible for establishing broad guidelines and providing oversight. To work efficiently, committees need to streamline and delegate decision-making about manager implementation and ongoing portfolio maintenance to a few key members and/or staff.*
- *One underrated challenge of maintaining a successful investment program is the ability to withstand turnover among committee members. While there are plenty of valid reasons for a reasonable level of turnover, excessive changes can lead to inconsistencies in investment approach.*

DISCLOSURES

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A strategic view to maximize returns: Five best practices for investment committees

Maintaining an institutional investment program, including the oversight and responsibilities of acting as fiduciary, can be daunting to even the most seasoned investment committees. With so much involved in managing an investment portfolio – establishing an investment strategy, documenting the investment process, evaluating and hiring managers, ongoing monitoring, and due diligence – it's easy for committees to get lost in the details and lose sight of the big picture.

The most successful investment committees support their organizations by using these five best practices.

1) **Make education and understanding a top priority**

   No portfolio or investment strategy is fool-proof. Every investor must learn to cope with some level of short-term discomfort to attain long-term success. The keys to withstanding the discomfort ultimately come down to the time and effort spent on investment education, a committee's level of understanding of the portfolio, and the expectations set ahead of time. Committee members must understand each and every underlying investment, not only on a stand-alone basis, but also the role each plays within the context of the total portfolio to shape the overall investment strategy. Identifying a realistic range of expectations is inherent in understanding your investment strategy – thinking through what could happen if economic growth declines or interest rates rise, for example – and evaluating future results relative to those expectations. Investment outcomes that are disappointing, but within the realm of expectations discussed beforehand, are easier to manage than the unexpected.

2) **Consistency, consistency, consistency**

   When it comes to capital markets, cyclical relationships are everywhere. Active vs. passive, growth vs. value, domestic vs. international – investment styles and strategies go in and out of favor over time. Since these dynamics are often driven by investor behavior, which can be irrational, attempting to time the inflection points is exceptionally difficult. As outlined in a piece we released last year, there's more than one way to construct an investment portfolio. Most decisions come down to a matter of preference rather than "right" or "wrong." Committee decisions, such as choosing a strategic ("set it and forget it") or tactical asset allocation philosophy, whether or not the portfolio should include alternative investments, or whether investments should be actively or passively managed, should be discussed thoroughly at the start of the investment process and remain long-standing tenets of the overall program. More risky than making a "wrong" decision is abandoning a chosen long-term investment strategy at the first sign of trouble.

3) **Focus on what you can control**

   Let's begin with what cannot be controlled or predicted – the future. Committees that attempt to engage in market timing, predict the next recession or expansion, or chase performance of an asset class/sector/fund/stock are destined to struggle and are likely wasting valuable time. Instead, investment committees should focus efforts on aspects they can control, such as monitoring portfolio costs, identifying and minimizing potential conflicts of interest, and planning for upcoming liquidity needs. In addition, committees should evaluate the portfolio based on progress toward the organization's overall financial goals, whether those goals include achieving a targeted rate of return, providing sufficient income to support operations, or some other objective. While comparisons against an index or peers are certainly helpful in measuring relative performance results, investment success in the long run is most often determined by, quite simply, sticking to the plan rather than constantly searching for ways to beat a benchmark.

4) Identify key decision-makers and opportunities for delegation

The fundamental purpose of an investment committee is to assess the financial goals of the organization, develop a broad investment framework to achieve those objectives, monitor results, and make necessary adjustments along the way. Committees are ideal for establishing broad guidelines and providing oversight – but, if you've ever worked in a team environment, you likely know how difficult and time consuming it can be for a large group to make decisions. To maintain efficiency, committees need to streamline and delegate decision-making about manager implementation and ongoing portfolio maintenance to a few key members and/or staff. Ideally these individuals would be knowledgeable about investments, making them well-suited to handle decisions quickly and effectively.

5) Strive for stability, but prepare for turnover

One underrated challenge of maintaining a successful investment program is the ability to withstand turnover among committee members. There are plenty of valid reasons for some turnover, but excessive change can lead to detrimental inconsistencies in investment approach (see #2 above). As members relinquish their duties, committees lose valuable institutional knowledge. Most organizations establish staggered terms for committee members, with term renewals for critical decision-makers, to mitigate the potential for dramatic membership changes. Strong documentation, in the form of a well-constructed investment policy statement and consistent memos and meeting minutes, can also help with continuity by informing new committee members of the portfolio's history and past decisions. Finally, making investment decisions with future committee members in mind can go a long way toward building a portfolio that can stand the test of time.

While most of our comments focus on investment committees specifically, the over-arching concepts can be applied in most group decision-making efforts.

Just as there's no one way to run an investment portfolio to achieve a desired rate of return, there's no one way to structure an investment committee. Still, the most successful committees do have one thing in common – they use these five best practices to optimize their efforts and support the long-term financial health of their organizations.

PMFA is a member of the Independent Advisor Group (IAG) of Callan Associates, Inc. Callan recently wrote a similar article titled "10 Tips From Successful Investment Committees". We have drawn upon our own experiences, as well as Callan's article, in the thoughts expressed above.