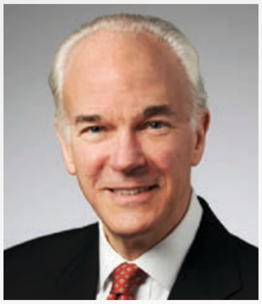
Investment governance in times of market volatility

by William F. Jarvis, Managing Director, Bank of America

About the author

William F. Jarvis is a managing director at Bank of America, based in New York. Experienced with investment policy and governance for endowed nonprofit organizations, he is responsible for strategic thought leadership with institutional and private philanthropic clients.



Human experience, supported by behavioral finance research, teaches us that at times of market volatility the emotional side of investing can sometimes threaten to override the intellectual side. At times like the present, it is more important than ever to avoid making decisions driven by emotion that can, in the cold light of hindsight, seem ill-advised.

As your board or investment committee meets to consider possible responses to the current market volatility, here for your meeting agenda are five recommendations that we hope will guide you to better decisions:

Recommendation Number 1: Don't panic.

The great majority of nonprofits are perpetual, long-term investors. This is a tremendous advantage when compared to individuals, who often let short-term market fluctuations and human emotions govern their investment decisions. At your meeting, think in terms of decades, not days or weeks, and resist calls that urge "this time is different." Especially, don't bolt for the "safety" of cash. Going to cash in a market downturn has two disadvantages. First, it crystallizes your loss, and second—and more importantly—it requires that you have perfect foresight in determining when to get back into the market. Most organizations fail that second test, with the result that the crystallized loss can remain on their books long after a recovery has begun.

Recommendation Number 2:
Use your Investment Policy Statement (IPS).

Your IPS exists for moments like this. If it was properly crafted, it represents the distillation of your team's best thought, arrived at in moments of calm. Its policies should be re-examined, but not discarded: If it truly reflects what you intended to do with the portfolio, now is the time to refresh your collective memories and recommit to the considered judgment that you used in creating it.

Recommendation Number 3: Rebalance.

Your IPS should contain a target, or policy, portfolio for your organization, and ranges within which the various allocations are permitted to move. If market volatility has caused them to exceed these ranges, you should consider rebalancing the portfolio so it is again in compliance with the IPS. This may mean selling investments that have performed better, in relative terms, in order to purchase investments that have performed less well. If that seems counterintuitive, think of your policy portfolio as your list of desired investments. Rebalancing presents an opportunity to purchase assets that you know you want for the portfolio at a discount. When items that they want go "on sale," most people are not opposed to making the purchase.

Recommendation Number 4: Check your liquidity.

Your organization's operating or grantmaking budget may already be largely set. Where will the money come from? If your portfolio has commitments to less liquid or illiquid alternative investment strategies that may be difficult or impossible to sell at a reasonable valuation, you may be faced with the unpleasant task of having to decide which of the portfolio's liquid assets to sell to raise the cash. This is a decision to be taken in close consultation with your investment counselor, who should be able to supply some professional advice about the relative position of the markets and the likelihood of future fluctuations. In the meantime, your board or investment committee should meet with your organization's financial and (if appropriate) fundraising staff to determine where additional sources of liquidity might be found. For example, do you have an available line of credit that can give the organization access to funds for the near term? What are the prospects for fundraising, and how will this year's annual campaign moneys be used? Is it possible to "pull forward" a prospective gift from a potential donor? In a perfect world, these questions might already have been answered—but if not, now is a good time to reach out and start.

Recommendation Number 5: Schedule an IPS review session for a future meeting.

With everything else that is happening, now is not the time to try to revise your IPS. But it may be that the current market is exposing issues that merit attention and that may call for a revision to the existing document. Appoint a committee to review the IPS, in concert with your investment counselor and staff, and report back to the board at a meeting later in the year—perhaps at the midsummer session. Experience is a great teacher, and now is the time to distill and profit from its lessons.

Periods of market turbulence are seldom enjoyable. We offer these five recommendations in the hope that they will enable you to navigate the current volatility with greater confidence and a clearer sense of how your organization could emerge stronger from this challenging time.

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