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# Investment Returns: Time to Lower Expectations

*By Ben Gose*

The typical private foundation anticipates long-term returns from its endowment that average more than 8 percent a year. But why should foundations expect in the future what they haven't been able to achieve in the recent past?

The bull market of the past six years may dull the memory of the financial crisis, but a look at the trailing 10-year returns for foundations offers a case study in how challenging it is to recover from a nasty decline. The latest study by the Council on Foundations and Commonfund found that private and community foundations posted average annual returns of 6.3 percent for the 10 years ending December 2014.

The same study found that the most frequently cited long-term return objective for private foundations ranged from 8 to 9 percent.

Prognosticators say the future may look like the recent past. With bond yields at record lows, many suggest that annual returns of 6.5 to 7.5 percent on a diversified portfolio are likely. Those returns may prove satisfactory for operating charities, which can raise additional money and also decide how much they want to spend from their endowments.

**Endowments Show Strong Gains — and Provoke Controversy**

A survey and analysis by *The Chronicle* shows big asset gains that are being used to launch new projects and better prepare balance sheets for the future. But impact investing and divestment are growing points of contention.

But for private foundations, many of which are set up to operate in perpetuity, such returns may be a disappointment. Foundations often have no new donations coming in, and they are required by federal law to spend 5 percent of existing assets each year. Inflation and investment expenses also eat away at an endowment's value over time.

**Walking a 'Tightrope'**

The Commonfund report sums up the challenge foundations are facing. "If, as many economists believe, the world has entered a period of lower economic growth that will lead to correspondingly lower average investment returns, this mismatch between investment objectives and investment performance will need to be addressed," the report says.

Robert Manilla, chief investment officer at the Kresge Foundation, figures his annual bogey is 7.5 percent — the 5 percent spending requirement, another half percent in other expenses, and 2 percent for inflation.

Mr. Manilla, reached during a break in a meeting with 20 other foundation chief investment officers, says that every one of them walks the "tightrope" of producing a high enough return to preserve the purchasing power of their endowment without adding too much risk and jeopardizing the corpus. That's one reason that Kresge and most other foundations are only cautiously wading into impact investments — which, if implemented carelessly, could sacrifice financial return in a bid to accomplish social goals. (See the sidebar on impact investments).

"It's hard to generate a 7.5-percent return when your cash is earning zero," Mr. Manilla says. "We don't have the capacity to take below-market returns in an environment where we think it's going to be difficult enough to meet our base hurdle."

William Jarvis, executive director at the Commonfund Institute, the research arm of Commonfund, which manages institutional investments, says one option for foundations that fret about earning enough on their investments is to simply abandon the desire to keep making grants forever.

"But we don't see much of a tendency toward that," Mr. Jarvis says. "The overwhelming number of foundations tell us that they're trying to exist in perpetuity."