# 2019 Endowment Investment Annual Report

Hartford Foundation
FOR PUBLIC GIVING
Together for good.℠

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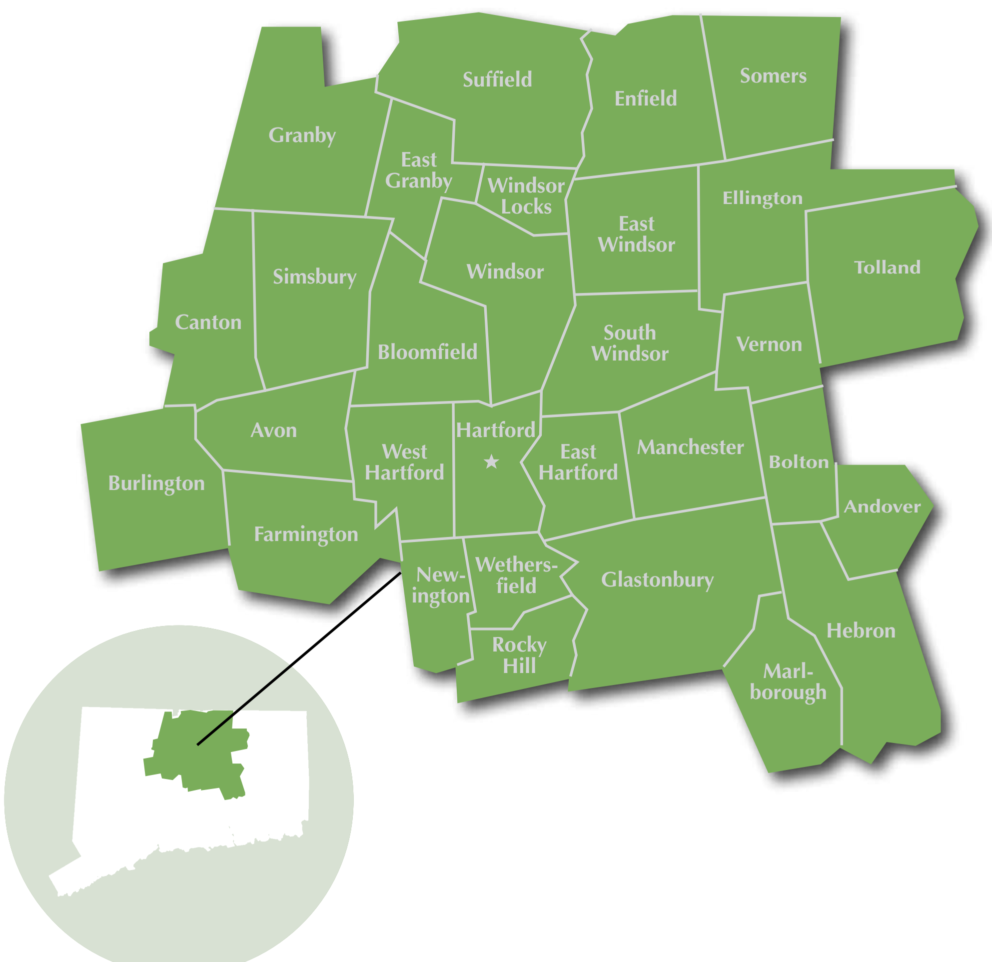


April 2020

David Roth

Alison Granger

Dear Friends,

It is our privilege to share the Hartford Foundation's 2019 endowment investment annual report. As a complement to the Foundation's annual report, this publication is intended to provide greater detail regarding the investment philosophy, process, and performance of the portfolios we steward on behalf of our generous donors and for the benefit of the Greater Hartford region.

The investment strategy of the Hartford Foundation aims to achieve long-term investment results that support the current spending needs of the Foundation while also preserving the future spending power of the endowment. The portfolios are also positioned to provide sufficient sources of cash to support current spending.

This report reviews investment results through December 31, 2019. In spite of investor concerns related to global trade wars, particularly between the US and China, the potential for a no-deal Brexit and other challenges in the political arena, it was a good year for investors. Stocks, bonds, gold, and oil all rebounded from their 2018 declines to deliver strong gains in 2019.

As we produce this report in the early months of 2020, the impact of the coronavirus pandemic is weighing heavily on prices for most assets in the Foundation's portfolios. Our thoughts and prayers are with those afflicted and the treatment teams working tirelessly to combat the illness. We entered the current crisis with sufficient cash in the portfolio to sustain the Foundation's spending obligations for more than a year without having to sell securities that have declined in price. Working within the framework of our asset allocation discipline, we remain watchful for opportunities to redeploy capital as we seek to provide the investment growth and financial stability required to fulfill the Foundation's mission. We thank you for your interest and confidence in the Hartford Foundation and welcome your feedback on both this publication and our efforts.

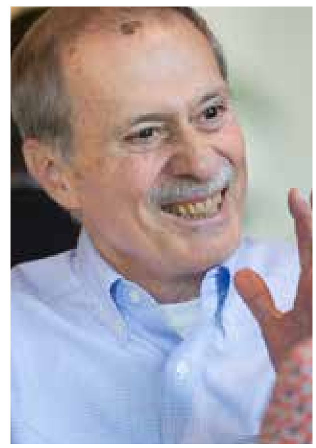
Sincerely,

David Roth
*Board Member and Chair*
*Hartford Foundation for Public Giving*
*Investment Committee*

Alison Granger, CFA
*Chief Investment Officer*

## Structure and Oversight of the Endowment Portfolios

Since the founding of the Hartford Foundation for Public Giving in 1925, more than 1200 funds have been established by donors to support non-profit organizations to improve the quality of life in Hartford and the 28 surrounding communities served by the Hartford Foundation. In accordance with donor wishes, these funds were either donated directly to the Hartford Foundation and overseen by our Board of Directors or given in trust form with oversight by the Trustee, as described below. For investment purposes, they are commingled with other donor funds established within the same legal entity (HFPG, Inc. or the Hartford Foundation Trust).



The Foundation's Board of Directors and Investment Committee oversee the management of the endowment. The Investment Committee is a standing committee of the Board of Directors that assists in fulfilling responsibilities related to the invested funds held by HFPG, Inc. Working closely with Foundation staff, the committee reviews and approves the investment policy and proxy voting policy statement and provides direction for the investment of the donor funds entrusted to the Hartford Foundation.

### *HFPG, Inc. (The Corporate Portfolio)*

Created in 1979 as a nonprofit corporation, HFPG, Inc. is the corporate affiliate of the Hartford Foundation. Northern Trust serves as the custodian of the donor funds that are contributed to HFPG, Inc. and held in the Corporate Portfolio. Colonial Consulting, LLC of New York, NY, serves as the investment consultant to the Investment Committee. Funds established in HFPG, Inc. are commingled for investment purposes and are invested in a diversified manner with external professional investment managers selected by the Foundation's Investment Committee at the recommendation of Foundation staff and Colonial Consulting. These managers are chosen based on their specialization in a given asset class after rigorous due diligence to measure key attributes of manager capability and firm stability. Manager performance is monitored regularly by Foundation investment staff and Colonial Consulting, and reviewed with the Investment Committee and the Foundation's Board of Directors on a quarterly basis. The vast majority of new donor funds created are received into HFPG, Inc.

### *Hartford Foundation Trust (The Trust Portfolio)*

The Trust Portfolio consists of numerous trusts established by many donors with trustee banks since 1925, each governed by a Declaration of Trust. Today, Bank of America, N.A. acts as the Trustee of these component trusts, which are held in a common fund. Bank of America also serves as the custodian of the trusts held in the Trust portfolio. The Trustee has sole authority to invest in a diversified portfolio with external professional investment managers (which may include Bank of America, N.A. or its investment management affiliates, if any) chosen on a competitive basis. The other authorized trustee bank is Key Bank. Mercer Investment Consulting, Inc. of Norwalk, Connecticut, served as investment consultant to the Trust in 2019. As of April 2020, NEPC will be the investment consultant to the Trust.

Investment manager selection for the Trust is reviewed with the Foundation's investment staff and Investment Committee prior to the retention or dismissal of an investment manager. Investment performance is monitored regularly by the Trustee and Foundation investment staff and the consultant and reviewed quarterly by the Foundation's Investment Committee and Board of Directors.

## Investment Objective

In managing the endowment, we seek to preserve its future spending power to improve the quality of life for future generations of our region's residents, while also ensuring that cash is readily accessible from the portfolios to support current spending. To gauge our effectiveness toward this goal, we systematically compare the investment returns of the Corporate and Trust portfolios to an inflation-adjusted spending policy benchmark, the Consumer Price Index + 5%, and maintain some holdings in government money market funds and high quality fixed income to ensure ready access to liquidity. We further aim to control portfolio risk by limiting the potential for permanent capital loss in order to provide stability to the annual spending policy allocation and meet the Foundation's long-term investment return objective.
We invest current use funds which have been donated to the Foundation in government money market funds so as to preserve principal and insulate these contributions from short-term market declines.

## Spending Policy

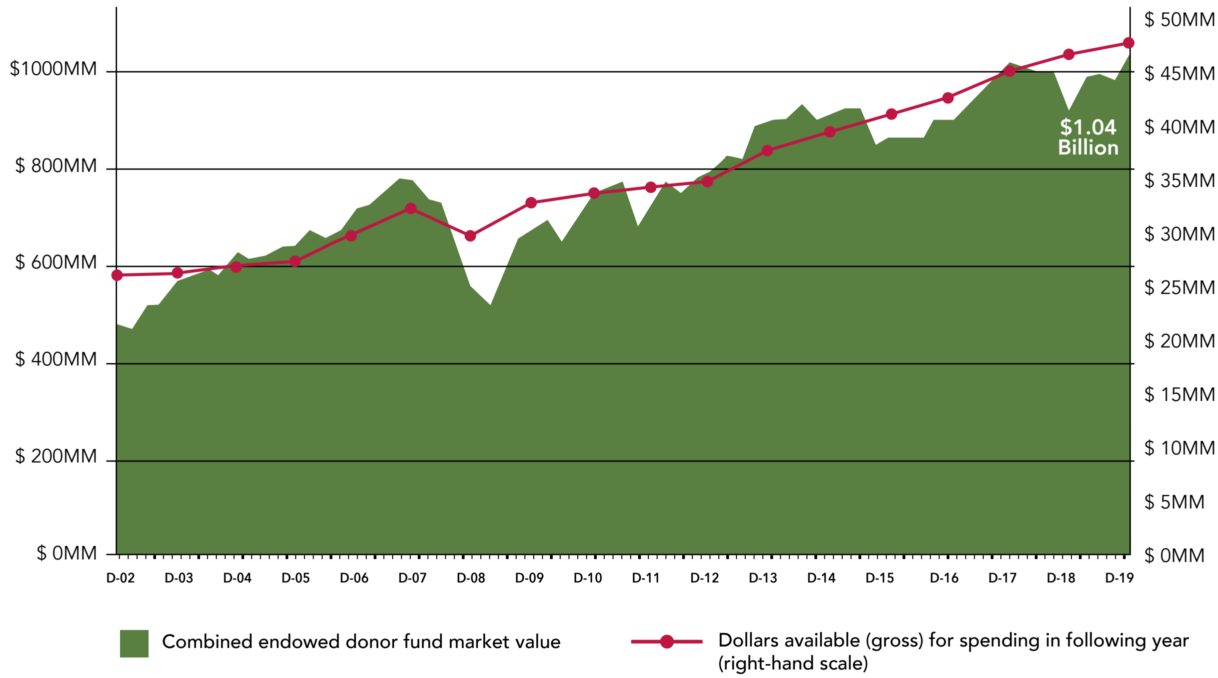
**Our grants support organizations and programs that contribute significant and persistent community benefit; our endowment ensures our region's continued progress for generations to come.**

The Foundation's spending policy and investment strategy are designed to work together to provide a predictable stream of dollars for annual grantmaking to the region's nonprofits while also prioritizing the preservation of the inflation-adjusted value of the funds in the endowment so that the impact of future grantmaking can be as effective as it is today.

Each year the Foundation's Board of Directors, in accordance with the Connecticut Uniform Prudent Management Institutional Funds Act, reviews the seven prudency factors that must be considered when appropriating funds from an endowment prior to establishing spending policy for the year. The current spending policy formula has been in effect since 2003 and is calculated as follows: 5% of a trailing twenty-quarter average of the market value of each fund, provided that the resulting value falls between 4.25%

(the floor) and 5.75% (the cap) of the respective fund value as of the most recent calendar year-end. If the value is higher than the cap, the annual spending policy allocation from the fund during the year will be limited to 5.75% of the most recent calendar year-end fund value. If it is lower than the floor, the annual spending policy allocation from the fund will be raised to 4.25% of the most recent calendar year-end fund value. Fees charged by the Foundation to administer donor funds are deducted from this amount prior to making funds available for grants. The graph which follows illustrates the historical interaction between the value of all funds held in the Corporate and Trust portfolios combined and the spending policy allocation made available each year for grantmaking and administrative expenses. As you can see, the spending policy formula has resulted in relatively stable and growing financial support to the Hartford region's nonprofit organizations. This period encompassed the Great Financial Crisis during which a minor reduction in support occurred, but quickly recovered and advanced to new heights.

**Annual Spending Policy Allocation relative to Total Market Value of Donor Funds held in the Endowment Portfolios**




In calendar year 2019, the Hartford Foundation allocated more than $47 million to grants and operations. More than $38 million comprised grant awards and funding to program-related activities.

## Investment Policy, Strategy and Asset Allocation

### Investment Policy

Each November, the Hartford Foundation Investment Committee meets to conduct a strategic review of the Corporate and Trust portfolios in order to assure that they are properly positioned to achieve the Foundation's long-term goals. As part of that process, we collectively review the investment policies and proxy voting policy statements which govern the Foundation's investment process. The Hartford Foundation investment policies address the portfolios' objectives and constraints, and outline the roles and responsibilities of those engaged in the oversight, management, and safekeeping of the investments which support the Foundation's programs.

### Investment Strategy

The Hartford Foundation for Public Giving investment strategy is equity-oriented to seek substantial long-term real returns, broadly diversified to control volatility amid short-term market fluctuations, and designed to provide cash flow in any market environment to support current year spending needs. Target asset allocations guide the investment process and are discussed below. Portfolio risk is controlled to minimize the risk of permanent capital loss, as such losses are particularly damaging to an investor's ability to achieve their long-term objective. Our process includes an annual review of the expected long-term returns available in the various segments of the capital markets and an assessment of the risks associated with those expected returns. Subject to the approval of the Investment Committee, the portfolio strategic targets may be adjusted to maintain the appropriate return and risk balance within the portfolios. In order to pursue opportunities to better manage risk, the portfolios can tactically deviate from this strategic direction within a predetermined range.

The philosophy employed to achieve the Foundation's investment objectives has consistently emphasized active management, a value orientation, patience, and emphasis on expense control and liquidity management. This often entails a contrarian approach to investing. As we seek to outperform our benchmarks on a net of fees basis, we must not only deviate from consensus opinions, but also be correct (more often than not) over time in our assessment of situations where our managers' current estimate of intrinsic value differs from market price. In managing the risk of being wrong, our value orientation provides a margin of safety to help cushion the potential downside risk of our investments, in contrast to a more speculative approach. Mark Twain, a one-time resident of Hartford, had this to say about thinking differently:

**Whenever you find yourself on the side of the majority, it is time to pause and reflect.**

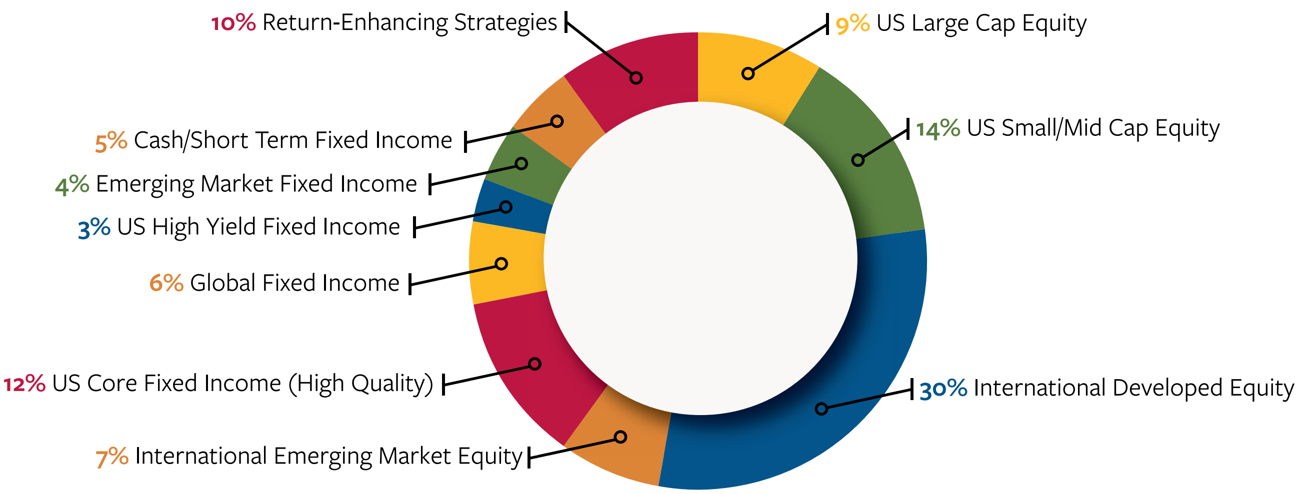
The Foundation relies on the external investment management firms hired to manage Corporate and Trust portfolio assets to select the individual securities held in the portfolios. With the assistance of our investment consultants, we seek to retain firms that have specialized expertise in the particular asset class or sector for which they were hired. We place a high priority on retention of investment managers who are experienced, disciplined, research-driven, and follow a low-turnover, long-term investment approach. We expect that they will approach investment management with the mindset of a fiduciary, and have a sophisticated process for engaging with corporate management on the environmental, social, and governance aspects of concern to shareholders. It is important to the Foundation that there be strong manager-client alignment and as such, the investment management firms we retain tend to be majority-owned by one or more of their investment professionals and disciplined in managing firm assets under management to a target capacity. We strongly prefer that these professionals have a significant portion of their personal net worth invested in the same strategy. As of the end of 2019, a total 47 investment management firms were retained to manage the Hartford Foundation endowment. These assets were invested in 54 investment strategies. Because of our careful selection process, the Foundation's turnover of these external investment management firms tends to be low. Our intention when each firm is hired is to begin a long relationship with the organization. When we do perceive the need to terminate our relationship with a firm, it is more often related to turnover among investment professionals rather than short-to-medium term underperformance of their benchmark.

The discipline of portfolio rebalancing occurs as relative market valuations shift or when cash is contributed to or withdrawn from the portfolios. We do so in order to align the portfolio weightings with the policy targets in accordance with the investment policy. We also continuously look for opportunities to enhance portfolio returns, whether it be through changes in asset allocation or identification of talented investment managers who are compatible with the Foundation's investment philosophy and approach.

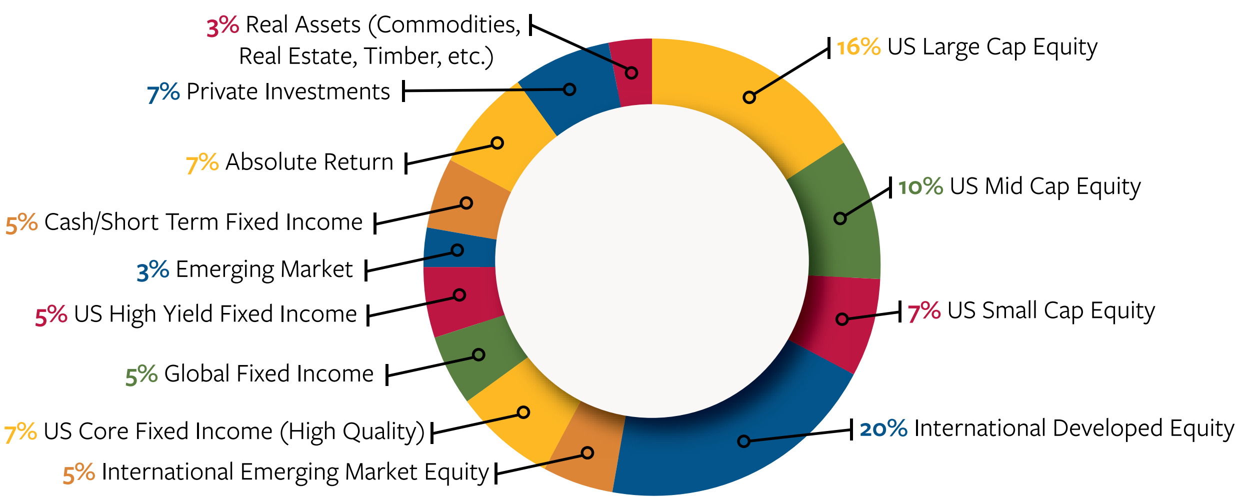
### Asset Allocation

The target asset allocations for the Corporate and Trust portfolios are shown in the graphs on the next page. The Trustee is responsible for the asset allocation of the Trust portfolio. The majority of the assets held in the Corporate and Trust portfolios are invested in a variety of equity-oriented strategies, including domestic and foreign public equities, real assets, private equity, and venture capital. Fixed income strategies that have a low correlation to our equity and credit investments provide diversification to the Foundation's portfolios. A small portion of each portfolio is held in government money market funds for liquidity purposes. Each of these asset classes is described on the following page.

## Corporate Portfolio Target Allocation
## (% of Portfolio)




## Trust Portfolio Target Allocation
## (% of Portfolio)



### Asset Classes

**Equities** broadly provide the Hartford Foundation portfolios with the potential for high long-term real returns and a modest stream of income from dividends. Equity investments also carry the potential for greater loss.

**Domestic Equity** provides the Hartford Foundation with returns from publicly-traded companies domiciled in the United States. We invest in domestic equity through active and passive management approaches, with significantly greater emphasis on active management. Passive investments are managed in low-cost index funds.

The target allocation to domestic equity in the Corporate portfolio totals 23% with 9% in US large capitalization equities and 14% in small to mid-capitalization equities. In the Trust portfolio, the target allocation is 33% with a breakdown of 16% in US large capitalization equities, 10% in mid-capitalization equities, and 7% in small-capitalization equities.

**International equity** provides the Hartford Foundation with returns from publicly-traded companies domiciled outside the US in developed and emerging markets. The Foundation's international equity investments are primarily managed in active strategies, as many international equity markets are less efficient that those in the US. In order to capitalize on this inefficiency, professional investment managers are retained to perform rigorous fundamental research to identify and invest in foreign companies which have the potential for significant outperformance.

The target allocation to international equity in the Corporate portfolio totals 37% and is further allocated to 30% in international developed market equities and 7% in emerging market equities. The target allocation to international equity in the Trust portfolio totals 25% and is further allocated to 20% in international developed market equities and 5% in emerging market equities.

**Private equity and venture capital** investments provide the Foundation with the opportunity to earn investment returns from early-stage venture capital investments and later-stage venture capital, growth equity and leveraged buyouts, predominately in the US. While offering the potential for the highest expected return over long time periods among the investments available to the Hartford Foundation, these investments also possess the highest potential for loss, entail the payment of significant fees, and are illiquid. As such, they represent a relatively small allocation within the portfolios. Corporate portfolio holdings in private equity and venture capital are included in the Return-Enhancing Strategies allocation discussed below. Overall portfolio liquidity is managed to account for the fact that these investments require the contribution of capital when called and are not readily redeemable.

**Fixed Income** serves a number of roles within the portfolios. First and foremost, high quality bonds are an integral part of a balanced investment strategy as they tend to react to economic and market events in a manner that differs from equities. The diversification provided by our fixed income allocation is important as it serves to mitigate total portfolio volatility which in conjunction with the structure of

The target allocation to fixed income in the Corporate portfolio totals 30% and is further allocated to 12% in US core fixed income, 6% in global fixed income, 4% in emerging market debt, 3% in high yield, and 5% in a government money market fund. In the Trust portfolio, the target allocation is 25% and is further allocated to 5% in global fixed income, 3% in emerging market debt, 7% in US core fixed income, 5% in high yield, and 5% in money market and short-term fixed income.

**Absolute Return** investing describes a category of strategies employed in the Trust portfolio whose objective is to earn a positive return over time regardless of whether markets rise, fall, or remain unchanged and to do so with lower volatility. Core strategies in the asset class include overweighting assets that are trading at attractive valuations and avoiding those which, in the analysis of the investment managers, are overvalued. The strategy is also intended to provide significant diversification benefits to the Trust portfolio. The Absolute Return target allocation in the Trust portfolio is 7%.

**Real Assets** are investments held in the Trust portfolio which provide high current income, inflation protection, capital appreciation, and/or low correlation to equity markets. Real assets have an inherent physical worth and include real estate, natural resources and infrastructure investments.

**Return-Enhancing Strategies** provide the Corporate portfolio with the flexibility to retain investment management firms that possess a unique competence and significant potential to outperform investments which can otherwise be accessed via our traditional approach. We expect the investments in the Return-Enhancing Strategy allocation to have two or more of the following characteristics: Illiquidity, alternative investment fee structure, reduced transparency, and/or a narrow investment focus. Examples may include private equity, venture capital, single-country equity funds, industry-specific funds, hedge funds and various types of private debt funds. The Corporate portfolio target allocation to return-enhancing strategies is 10%. As of the end of the year, the strategies represented in this allocation included a venture capital fund of funds, a Japan-only equity fund, a highly concentrated long-only equity limited partnership, a private equity fund-of-funds specializing in small company investments, and two private equity fund-of-funds which are approaching full distribution.

## 2019 Investment Environment and Portfolio Performance

In spite of investor concerns related to global trade wars, particularly between the US and China, the potential for a no-deal Brexit and other challenges in the political arena, it was a good year for investors. Stocks, bonds, gold, and oil all rebounded from their 2018 declines to deliver strong gains in 2019.

The Federal Open Market Committee reversed its 2018 tightening stance and cut the Federal Funds Target Rate three times, resulting in an overall decline of .75% in the policy rate range which ended 2019 at 1.5% to 1.75%. Other major central banks also were more accommodative. In response, interest rates declined so much that by late summer, negative-yielding debt outstanding reached $17 trillion worldwide, most of which represented debt issued by European and Japanese governments.

The S&P 500 Index rose 31.5% in 2019. Most of this gain was attributable to multiple expansion, rather than earnings growth, leaving the valuation of the index firmly in the most expensive quartile relative to its history. Mid- and small-capitalization stocks also delivered impressive returns. The Russell Mid Cap index rose 30.5%, while the Russell 2000 (smaller capitalization) index advanced 25.5%. Overseas, the MSCI EAFE Index rose 22% while the MSCI Emerging Market index advanced 18.4%. The Bloomberg Barclays US Aggregate Bond Index, a broad measure of the US bond market, advanced 8.7%, as yields on fixed income securities declined. The FTSE World Government Bond index, a proxy for the global bond market, rose 5.9%. Among global currencies, the Canadian dollar strengthened 5.3% versus the US dollar. The British pound outperformed our currency by 4% for the year as fears of a no-deal Brexit declined when the Conservatives won a strong majority in the United Kingdom general election in December. The Swedish Krona was one of the worst performers during the year, depreciating by 5.3% versus the US dollar.

Against this backdrop, during 2019, the Foundation's broadly-diversified Corporate portfolio posted a net-of-fee investment gain of 17.3% while the Trust portfolio returned 19.4%. The Foundation's inflation-adjusted spending policy target, as measured by CPI + 5% and reported to us by Colonial Consulting, was 7.7% in 2019. The performance of each portfolio is compared to a customized target asset allocation benchmark. This comparison enables us to judge the effectiveness of each of the Foundation's investment managers relative to the market benchmark which best reflects the asset class and investment style in which they specialize. During 2019, the Corporate portfolio underperformed its customized target benchmark by 1.9%, while the Trust underperformed its customized target benchmark by 1.2%. The significant exposure in the Corporate portfolio to value-oriented equity strategies and to international equity investments held back performance relative to the target benchmark in 2019 up until the fourth quarter when these factors and our investment managers who specialize in these areas generally outperformed. Evidence of this can be seen in the fact that during the final three months of the year the portfolio returned 6.8%, outperforming the target benchmark by .7%. The underperformance of the Trust portfolio relative to its benchmark was attributed to Private Equity underperformance relative to the targets set for the allocation.

Since its inception in September of 1996, the Corporate portfolio has returned an average 7.5% per year, net of investment management fees, outperforming its customized target benchmark by an average of

.2% per year. Over the same period, the average net-of-fee return for the Trust portfolio was 7.2% per year. The return of the Corporate portfolio has met the CPI+5% target of 7.5% per year since inception, while the Trust has lagged by .3%. The future direction of equity markets continues to be the significant determinant of progress toward this goal. This result placed it near the top of the second quartile of a broad universe of endowments and foundations as measured by Investment Metrics. Over the same time period, the average net-of-fee return for the Trust portfolio was 7.2% per year, matching its custom target benchmark. The Trust placed in the middle of the second quartile of the Investment Metrics universe over this timeframe.

At year-end 2019, approximately $1.04 billion were invested in the Corporate and Trust portfolios. The investment performance of the Foundation's broadly-diversified endowment portfolios for periods ended December 31, 2019 is shown in the table below. For more recent performance data, please visit hfpg.org/investmentperformance. When reviewing this information, please keep in mind that past investment performance is not a guarantee of future results and market values shown have not, as of the production of this report, yet been audited:

### *Annualized* Investment Returns as of December 31, 2019 (*net* of investment management fees)

| Portfolio | Value* | 1-Year | 3-Year | 5-Year | 10-Year | 20-Year | Since Inception* |
|---|---|---|---|---|---|---|---|
| Corporate | $437MM | 17.3% | 8.0% | 6.0% | 7.7% | 6.2% | 7.5% |
| Trust | $603MM | 19.4% | 9.3% | 6.3% | 7.9% | 6.1% | 7.2% |

**Rounded to nearest $1 million*
***September 30, 1996 inception date*

As we produce this report in the early months of 2020, the impact of the coronavirus pandemic is weighing heavily on prices for most assets in the Foundation's portfolios. Our thoughts and prayers are with those afflicted and the treatment teams working tirelessly to combat the illness. We entered the current crisis with sufficient cash in the portfolio to sustain the Foundation's spending obligations for more than a year without having to sell securities that have declined in price. Working within the framework of our asset allocation discipline, we remain watchful for opportunities to redeploy capital as we seek to provide the investment growth and financial stability required to fulfill the Foundation's mission.

## Investment-Related Fees

As indicated in the performance chart, investment returns are reported after fees charged by the Foundation's investment managers have been deducted. Nonetheless, as part of the Foundation's ongoing oversight of the endowment, fees paid to these managers, as well as to the custodians and consultants, are closely monitored.

Over the past decade, total annual investment management fees, including estimated incentive fees on the small allocations to private equity and venture capital and similar alternative investments, have approximated .75% to .85% of portfolio market value. Investment management fees on traditional equities and fixed income have been quite steady. The incentive fees on alternative investments have the potential to rise and fall significantly depending on the level of recent returns. Given that the Corporate and Trust portfolios have had low exposures to these higher-fee alternative investments, the overall variability in the fees paid has been relatively low.

We are often asked why we do not hold a higher percentage of the portfolio in lower-fee index funds. Our answer is simple: over the long term and after taking investment management fees into account, our managers have, in aggregate, outperformed the respective asset class benchmarks against which we measure them. When we consider hiring a new manager, the analysis of their fees relative to their potential for outperformance is thorough and monitored on an ongoing basis if they are hired.

In addition to the aforementioned investment management fees, custody, consulting and in the case of donor funds held in the Trust portfolio, trust and administration fees, are monitored. Custody and consulting fees combined have approximated .1% in the Corporate portfolio. Trust, administration, custody and consulting fees in the Trust portfolio have approximated .2% over the past decade.


## INVESTMENT COMMITTEE

*David M. Roth, Chair**
Robert B. Goldfarb
David Marks
Carl Peterson^
Theodore S. Sergi*●
Cynthia Steer
John Wright

## FINANCE AND INVESTMENT STAFF

Jay Williams, President
Alison Granger, Chief Investment Officer
Bonnie Malley, Vice President for Finance & Administration
LouAnn Campanello, Director of Finance
Josephine Morrison, Accounting Manager
Mark Niland, Investment Professional Volunteer

## TRUSTEE

Gillian Howell, Relationship Manager, Bank of America
Mark Hathaway, Trust Portfolio Manager, Bank of America

## CONSULTANTS

To HFPG, Inc.: Michael Miller, Chief Investment Officer, Colonial Consulting, LLC
To Hartford Foundation Trust: Elizabeth Warren, Principal, Mercer*
Wyatt Crumpler, Principal, Senior Consultant, NEPC**

*Through March 31, 2020
**As of April 1, 2020

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* Member of Board of Directors
● Ex-officio
^Pending approval of Hartford Foundation Board of Directors

Hartford Foundation
FOR PUBLIC GIVING
Together for good.℠

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