EVERGREEN®
INSTITUTIONAL

“Once you know the way broadly, you will see it in all things.”
-Miyamoto Musashi

Investing can be both easy and exceedingly difficult, joyous and immensely frustrating, gregarious and isolating, rewarding and dangerous; we welcome it all. We have a passion for learning, not just about the world and its endless and everchanging opportunities, but for learning about ourselves and our continuous improvement as stewards of the capital entrusted to us by the institutions we serve.

We seek a deep understanding of our investments and their impact on stakeholders beyond just shareholders. This deep understanding allows us the conviction to stand by our approach during the inevitable periods when it will be out of favor and the investment landscape becomes divorced from traditional fundamental rules of value. We intentionally seek the humility and integrity to admit our mistakes and continuously improve our process.

We are firm believers in opportunity through innovation and the long-term potential for the human race to produce amazing things that we have not yet imagined, just as we progressed from our first manned flight to landing on the moon in roughly 50 years, we expect the innovation of our lifetimes to be similarly breathtaking. Long-term investing in such a dynamic environment requires the right philosophy, mindset, process, team, clients and culture as well as a wealth of patience and humility. We are guided by the principle that investing is ownership. Ownership brings with it the responsibility to understand the mission, purpose, risks, opportunities, and societal impacts of our investments.

We are Intentionally Invested.

Investing Principles & Philosophy

Too often institutional investors are given an investment plan that is homogeneous and not tailored to the needs and mission of the organization itself. We recommend that institutions avoid overly-diversified crowd-following portfolios, but instead they should clearly identify their investment objectives in order to ensure that they are closely aligned to the mission of the institution. When objectives are clearly defined, it is easier to track progress toward meeting those objectives and avoid distractions of short-term relative performance to market benchmarks. We prescribe a core philosophy focused on five primary investment principles:

Communication:
Having a clearly-defined mission and portfolio objectives allows an often diverse group of professionals and volunteers to have a shared vision and road map through inevitable periods of volatility. Clearly defined roles, responsibilities, and objectives are critical to success when multiple fiduciaries are at the table. Codifying a long-term plan for your institution is key to maintaining course as fiduciaries come and go during the life of your perpetual institution. Of course, the plan should be reevaluated periodically but should be changed infrequently.

Alignment:
As much as possible, investment managers and fiduciaries should be compensated based on the success of your institution's results. In investing, costs are often the greatest hurdle to success, so judiciously (but not blindly) minimizing expenses will likely lead to greater long-term success, particularly if any expense paid are tied to the long-term success of your organization.

Conviction:
Concentrate in best ideas as

as opposed to overly-diversified benchmark-hugging portfolios often prescribed by investment large firms; seek out market inefficiency and pockets of capital scarcity as we believe these will provide the best long-term opportunities.

Value:
Investments should be made when they are expected to provide a compelling return that is commensurate (or better) with the level of expected risk taken. This does not mean blindly buying “cheap” stocks and avoiding “expensive” ones based on traditional measures like price-to-earnings ratio. Instead, it means dig in and do the work to find opportunities and new forms of growth not yet appreciated by the market at large.

Emotional Intelligence:
It is important to remember that most institutional investors have very long-term investment horizons, so patience through volatility is paramount. Even the most seasoned investment professionals can be influenced by the emotions that come with the market’s ebbs and flows. Fiduciaries should be willing to ask tough questions of themselves and all parties involved in the institutional investment process and remain collaborative, humble and open-minded. In investing, there will inevitably be periods of market euphoria and despair, where even the most experienced investors will question their judgement in stewarding wealth entrusted to them. In these times it is particularly important to have a long-term plan and roadmap in place, to avoid the siren call of short-term emotionally-driven decision making.

Portfolio Construction

Institutional Return Objective
In defining the investment objective for an institution, it is important to distinguish between the **required return** and the **desired return**. The required return can be calculated by identifying the building blocks of the institution's needs. At first blush, the required return for an endowment or foundation may be defined as the institution's annual spending rate, or the amount withdrawn from the portfolio eachyear in furtherance of the organization's mission. However, this does not take into account that providing the same level of support next year, and the year after that, and so on, will require expectations for inflation. For example, consider a donor who provides a gift to a college or university endowment and establishes an annual scholarship with that gift. It's fairly likely that tuition will cost more ten years after the gift was made, so ideally the annual withdrawal from the portfolio will grow to provide the same level of inflation-adjusted support to the 10th student receiving the scholarship as the first. This is a central concept in institutional investment management called **intergenerational equity**; the principle that institutional fiduciaries should seek to provide for both present and future beneficiaries in a balanced manner.

"The trustees of an endowed institution are the guardians of the future against the claims of the present. Their primary responsibility is to preserve equity among generations."
-James Tobin, Nobel Prize winning economist

Through the concept of intergenerational equity, we can

derive our institution's required return. The institution must identify an appropriate inflation expectation, such as the expected cost of tuition increases for a scholarship endowment. So, if managing an endowment in support of a scholarship that provides 5% of the endowment value annually in support of the recipient's education and tuition is expected to rise 3% next year, then the required return to maintain intergenerational equity would be approximately the sum of these two components (8%). A desired return may include the addition of a growth component above the required return in order to allow the investment pool to appreciate in excess of spending and inflation. However, the added return target will come with additional risk, and the institution's fiduciaries should have an open discussion regarding whether this additional risk is appropriate and prudent.

The excellent quote above from James Tobin ends with, "[...] Their primary responsibility is to preserve equity among generations." So, it may be perceived that targeting a risk level above the required return effectively saddles the current portfolio and generation of beneficiaries with extra risk in pursuit of greater returns for future generations.

Institutional Risk Assessment

The starting point for portfolio construction for every institution should be a thorough evaluation of their tolerance for risk. The two primary sources of risk that will impact an institution negatively are **drawdown risk** and **liquidity risk**. Drawdown risk refers to the potential for losses in an institutional portfolio. For example, typically fixed income securities have more stable values through time, while the value of equity securities may

experience large losses over a short period of time. Liquidity risk refers to the difficulty or outright inability to sell an investment at different periods of time, potentially when an institution is in need of liquidity leading to the forced sale of assets at disadvantageous prices. The duration of investment assets should be closely matched to an institution's liabilities. For example, a university endowment with a perpetual time horizon but an annual obligation to provide current support to the institution in the form percentage-based distributions from the portfolio must balance the desire for long-term growth from higher risk and less liquid investments against the need to provide stability and current income with a portion of the portfolio.

Institutions should evaluate both their **ability** and **willingness** to accept risk across a handful of metrics. The evaluation should not be conducted with a narrow view of the investment portfolio in isolation, but instead should encompass a review of the whole institution in aggregate. For example, in the midst of a recession the investment portfolio values may be negatively impacted alongside an increase in need from the institution for additional support to meet its core mission. In this environment, a hypothetical institution such as college or university might

simultaneously be witnessing lower revenue from gifts, tuition, and endowment income balanced against little ability to reduce costs in the short-run. The institution may need to take a special distribution from the endowment at a point when endowment assets may be trading below fair value and investment opportunities are prevalent.

An institution's ability to accept investment risk is driven by the mission and financial conditions of the institution, and thus each is unique and individual to that institution. However, while every institution is unique, we have been able to cut through the noise and complexity to systematically identify the five key risk metrics that should be evaluated in order to assess the risk tolerance of an institution. Three of these metrics are associated with the institution's income statement while two are associated with the institution's balance sheet.

Operating budget support rate: Percentage of the institution's operating budget that is supported by the investment pool

Spending Rate: Spending rate refers to size of the annual transfers from the investment pool in support of the organization

Contribution rate: Annual percentage rate of new transfers into the investment pool

Asset-to-liabilities ratio: Other liabilities (e.g. – long-term debt) that are on an institution's balance sheet restrict flexibility

Unrestricted asset ratio: Percentage of the investment pool that legally could be liquidated at any time

Note: the time horizon of the investment pool is a key consideration of an institution's ability to accept investment risk. We have not explicitly listed this consideration above as the majority of institutional portfolios a very long or perpetual time horizons. An institution with a shorter or highly uncertain time horizon should carefully consider this constraint when considering its ability to accept investment risk.

While the construction of a portfolio is primarily driven by an institution's ability to accept risk, an institution's willingness to accept risk is also very important and must be evaluated as part of the portfolio construction process. Every asset allocation review should include a short risk tolerance survey that is distributed to the institution's Board members and key senior employees. The objective of the survey is twofold: to illicit a discussion of the potential variability of personal risk tolerance across the leaders of the institution as well the behavioral biases to which all investors and institutions are vulnerable. For example, investors' responses to questions regarding their willingness to accept investment risk can vary drastically across two dimensions: time and asset ownership. In other words, investors often tend to be willing to accept more investment risk after long periods of market gains and relative stability and less risk following recessions and market corrections (variability across time), and investors may have a greater tolerance for investment risk when managing a portfolio that is not comprised of their own personal wealth (variability across asset ownership).

When once asked of a University President what was an intolerable level of portfolio decline in his opinion. His answer was surprising. Like any astute leader of a large complex organization, he had multiple considerations and datapoints that were important to him, but his most important criterion was that his University did not decline alone. In other words, he was worried about the reputational damage and decline in competitive

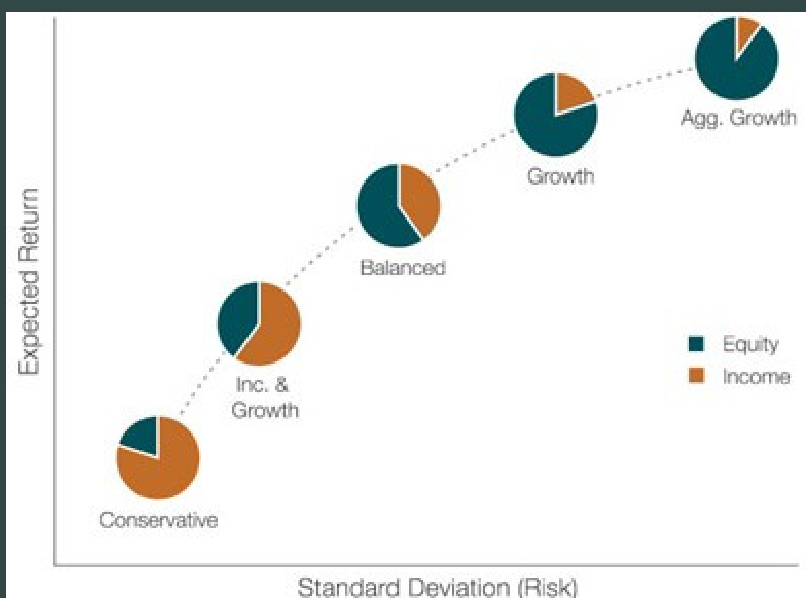
position relative to other schools more than the actual potential damage to the portfolio and University budget. This is not to say his response was inappropriate or misguided. Instead, it underscores that risk means something different to everyone, so it's imperative that the perspectives of all fiduciaries of an institutional investment portfolio are gathered through an institutional risk questionnaire.

Capital Market Expectations
Capital market expectations (CME) refer to a set of assumptions about future developments in the market. These can pertain to interest rates, equity returns, volatility, and other key financial variables. Establishing solid capital market expectations is a foundational step in the portfolio management process, as it influences asset allocation, risk management, and strategic decision-making. The ability to have reasonable expectations for long-term expected returns on asset classes provides institutional portfolio managers and fiduciaries with the ability to set basic strategic allocation targets that are expected to meet the institution's long-term return goals .

Strategic Asset Allocation
Utilizing our understanding of an institution's objectives and risk tolerance in concert with our long-term capital market expectations allows for the formation of the investment portfolio's long-term strategic asset allocation. The strategic allocation can be thought of as the portfolio's skeleton; it is the frame onto which all additional portfolio management decisions are incorporated. It represents a mix of core and complementary assets designed to achieve the institution's long-term objectives with as little risk as possible (note: this allocation may also be utilized as a benchmark to determine if implementation decisions such as tactical allocation and investment selection are actually adding value relative to the portfolio's

basic framework).

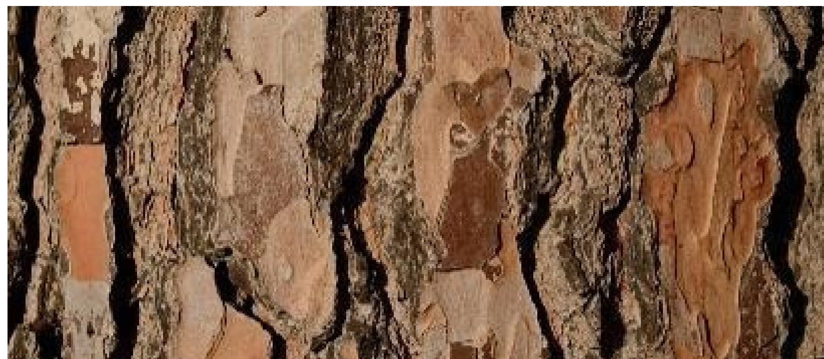
Since the strategic asset allocation is driven by very long-term capital market expectations and the overall risk tolerance of the institution, it should be reviewed periodically but changed infrequently. We would expect a change to the strategic asset allocation only when there has been a significant change to either the core mission or the overall financial conditions of the institution.



Tactical Asset Allocation
Here we appraise the overall environment for investing. This includes an assessment of the economic and market cycle, overall financial conditions, and the opportunity provided by broad asset classes such as stocks, bonds, real estate, natural resources and private investments. Based on our expected point in the business & market cycle, an institutional portfolio manager may "tactically" chose to vary from the strategic allocation target. For example, by going overweight equities during periods of market stress and attractive prices. The amount of latitude afforded for deviations relative to the strategic allocation by portfolio managers should be clearly defined in the institution's investment policy statement.

Within broad asset classes such as stocks, we seek to allocate to the most compelling parts of the market. For example, absent any

particular research or opinion, it might be most appropriate for an investor to simply purchase a broad market index like the MSCI All-Country World Index which owns roughly 2,000 of the largest stocks globally in order of size (often referred to as “passive investing”). Investors may also choose to express a specific view by tilting toward specific themes, geographies, industries and companies within this global opportunity set (“active investing”). or example, certain asset classes like small cap stocks may appear compelling or long-term themes like the transition to electric vehicles may be expressed through the companies and industries that are owned in your portfolio.



Tactical allocation involves making adjustments to the asset allocation in a portfolio in order to take advantage of market opportunities. One can make sense of the interplay between strategic and tactical asset allocation using the analogy of a ship at sea. Upon departure, a clear course is charted to the ultimate destination (the course being the strategic allocation). But if the course could be tactically modified so as to encounter favorable winds or to avoid a storm, the ship would follow a slightly different path. In this way, we establish a fixed allocation with a destination in mind, but we may build into this plan enough flexibility to seize opportunities and avoid rough seas along the way.

Establish Objectives
Thorough evaluation of your risk tolerance, return goals, income needs, and other considerations such as values-oriented investing
Strategic Allocation
Construct a framework portfolio comprised of a broad mix of assets expected to meet long-term objectives with minimal required risk
Tactical Allocation
Forecasting the economic cycle and evaluation of the intermediate-term opportunities for various asset classes to select sub-asset classes within the strategic allocation framework
Implementation
Evaluating individual securities, investment managers, and private investments, if applicable, using fundamental & technical analysis
Monitoring & Rebalancing
Ongoing evaluation of the investment landscape, portfolio construction, and risk level. Periodic rebalancing of assets to capture opportunities and remain within risk targets

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