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Investment Management

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SPENDING RESERVES, NOW OR NEVER?

Considering spending rates and reserves in light of economic conditions

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Newton Investment Management Limited

Charity Finance Group
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Please read the important information at the back of this material
PRE003117

DATA CLASSIFICATION: CONFIDENTIAL

Background

The triple threat faced by charities

Pre-pandemic equilibrium

Government Covid Support (furlough, grants, spending etc.)

As restrictions eased, so too did Gov support…

We now face a Cost-of-Living Crisis

Disruption to public services, (strikes, backlogs, staff shortages etc.)

We are now more reliant on Charities providing our social safety net

Until we get back to some sort of equilibrium... Hopefully!

Disruption; increased costs; increased demand

Agenda

- Reserves policy
- Newton survey observations
- Reserves, investment & sustainable withdrawal
- Economic outlook
- Case study
- Conclusions

Should charities be reviewing their reserves policies in light of current economic challenges?

Trustees and Reserves

A useful starting point

We experience uneven income from grants and contracts

There are unforeseen emergency or operational costs

Beneficiaries’ needs increase

Our ability to fundraise is severely curtailed

Business continuity plans activated

WHAT IF...

Our strategic plans include development or expansion

We experience a short-term deficit in a cash budget

Our ability to meet the needs of future beneficiaries is eroded

The charity is wound-up

Public perception of large reserves becomes unfavourable

Reserves policy
Best practice

- Set the tone of the financial approach of the organisation
- Clearly define the charity's reserves policy and why it is holding reserves
- Provide details on the measurement criteria
- Show the current level of reserves against targets and provides an explanation on variances. Furthermore, they provided details on indicative future reserves levels, based on the impact of the charity's own five-year strategy
- Make clear why the charity is holding the reserves at the level it is
- Provide details on the level of working capital that the charity determines sufficient to protect the continuity of work
- Show comparison of like-for-like data year on-year
- Link to both the liquidity policy as well as the investment policy

> Our reserves policy takes into consideration that we commit expenditure over the medium term, since our research commitments span many years, whilst recognising that, as we are a fundraising charity, we are subject to the effects of short-term volatility in income. We therefore hold funds in reserve to ensure that we can meet out research commitments in the face of such fluctuations. We use a rolling five-year plan to model how we will fund the delivery of our strategy, ensuring reserves remain at an appropriate level.
> The investment policy supports the reserves policy. The Charity seeks to adopt a cautious, prudent and well-diversified investment stance to balance potential returns with appropriate levels of risk.

Cancer Research UK

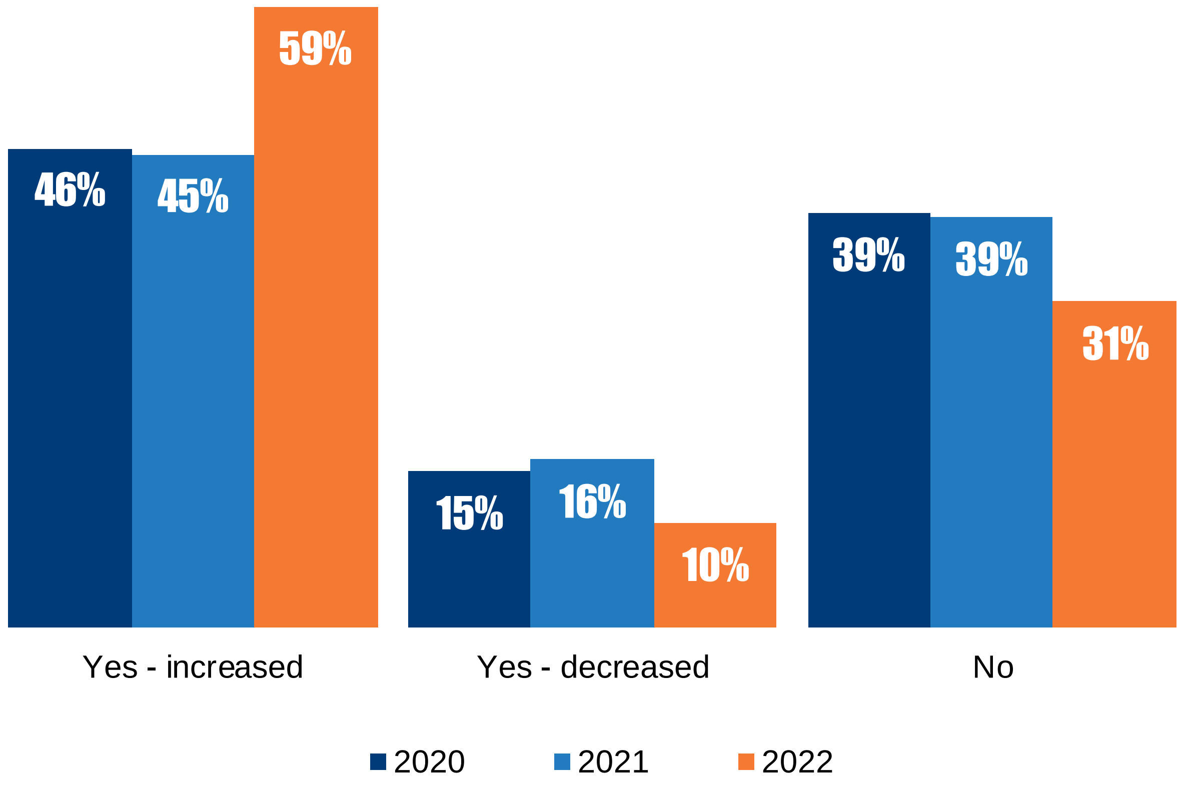
Sources: Cancer Research UK Annual Report & Accounts 2014/15.

Our survey says….

Insights from Newton's Charity Investment Survey

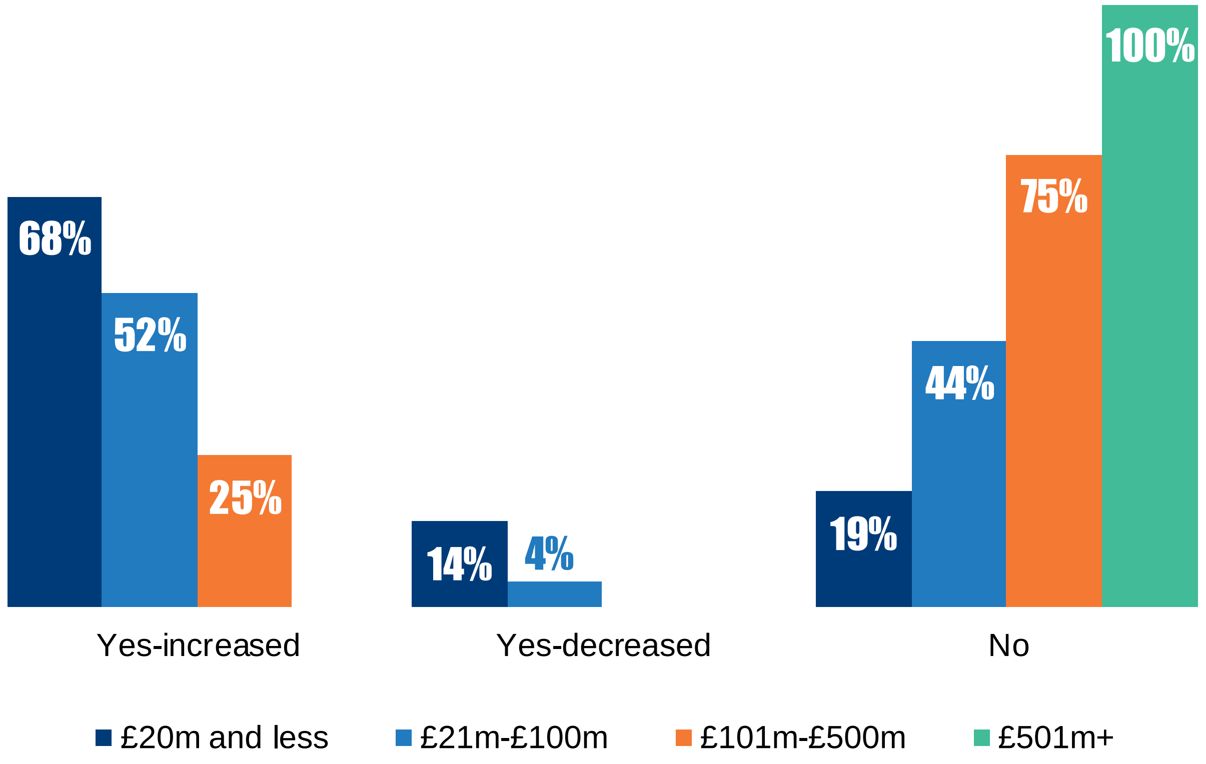
Most charities have experienced increased demand for their services in the survey period…

Have you seen a change in demand for your charity's services?



Most keenly experienced by smaller charities (£20m or less)… the larger the charity, the less likely they were to experience increase in demand…

Have you seen a change in demand for your charity's services?



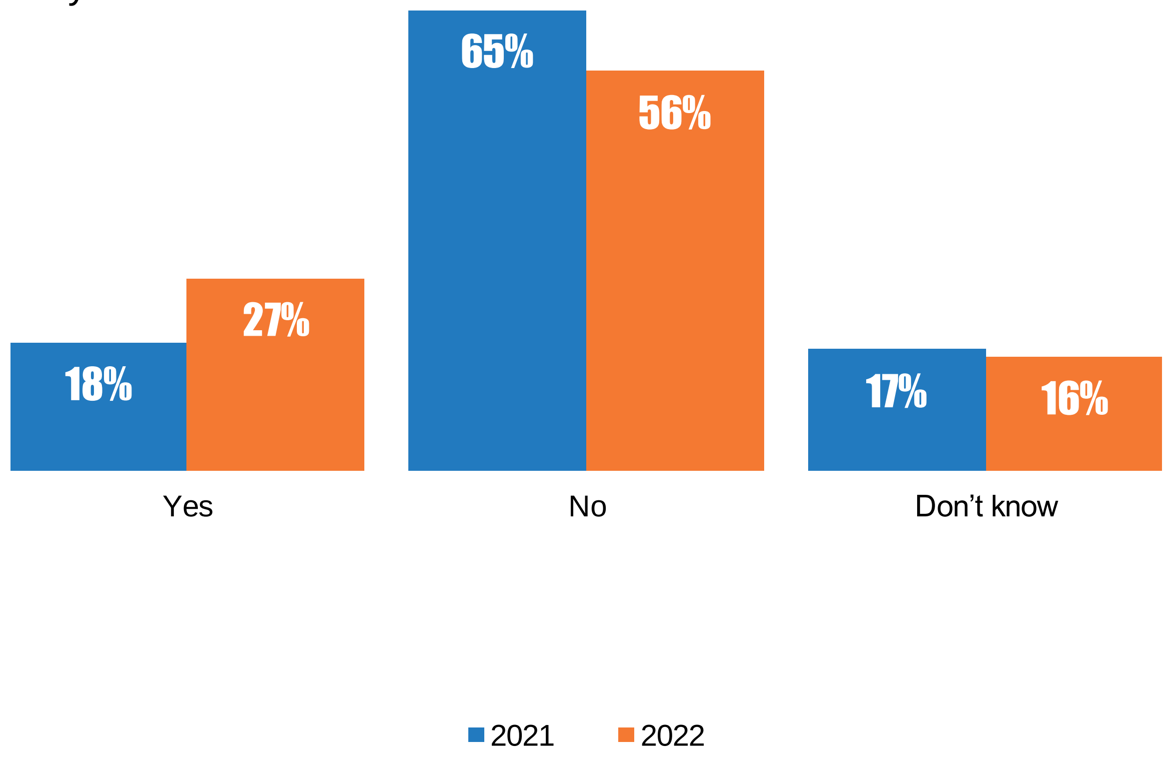
Source: 2022 Newton Charity Investment Survey, October 2022
No. of respondents: 2020: 114. 2021: 82. 2022: 91

Our survey says….

Insights from Newton's Charity Investment Survey

In 2022 we asked about the legacy of the pandemic. We noticed that the pandemic has impacted charity investment policies for some…

Do you think the pandemic will have a lasting impact on your investment policy?



… and where that is the case it was most likely to have impacted their reserves policy and/or their risk policy

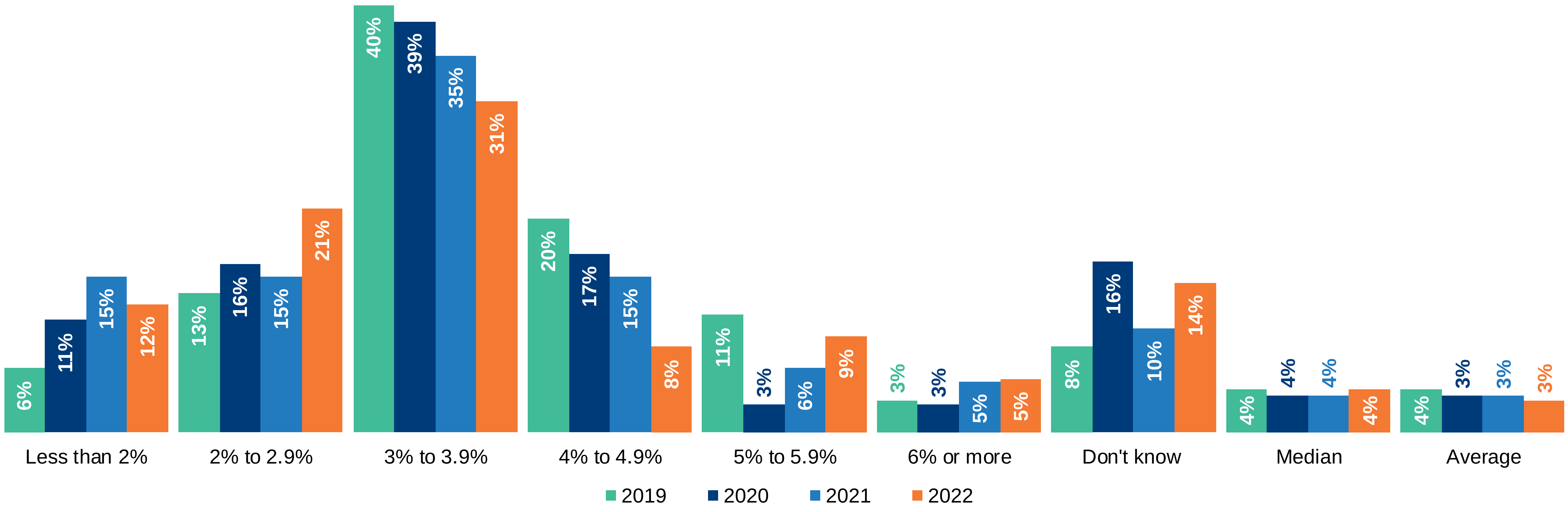
Which of the following statements apply?

Source: 2022 Newton Charity Investment Survey, October 2022
No. of respondents (LHS): 2021: 82. 2022: 91
No. of respondents (RHS): 2021: 15. 2022: 25

Our survey says….

Insights from Newton's Charity Investment Survey

What do you consider to be a sustainable withdrawal rate (comprising income and/or capital) from your portfolio over the long term to ensure that your portfolio does not reduce in value in real terms (i.e. after inflation is factored in)?



Source: 2022 Newton Charity Investment Survey, October 2022
No. of respondents: 2015: 94, 2016: 80, 2017: 93, 2018: 97, 2019: 102, 2020: 114, 2021: 82, 2022: 91.

Our research on sustainable withdrawal

The headline conclusions in 2013 were:

The average asset allocation produced an income yield of c. 3%

That was lower than many rates of withdrawal used by long-term endowments

Long-term market returns suggested that 3.5%-4% per annum would have been a reasonable level of sustainable withdrawal (protecting the remaining endowment against the effects of inflation)

Holding more equities (and real assets) increased the probability of maintaining the purchasing power of capital (albeit with higher volatility), but for prolonged periods, even at 2% withdrawal rates, there was a significant chance that the real value of an endowment would not be maintained

The market returns (after the effects of inflation) are based on work by Elroy Dimson, Paul Marsh, and Mike Staunton of the London Business School, which looks at returns for equities, bonds, and cash from 1900 to 2012. The property return is taken from analysis by P Scott in 'The Property Masters' (1996), and additional analysis by Chambers, Dimson, and Foo (forthcoming), from 1921 to 1970; and the IPD UK Annual Index thereafter. Over the 113-year period, inflation (as measured by Dimson, Marsh, and Staunton) has averaged 4.0% per annum, so on a nominal (i.e. not adjusted for inflation) basis, the total return for our average portfolio would be 8.4%, which is enough to support a 4% withdrawal per annum.

That was then, but what about now?

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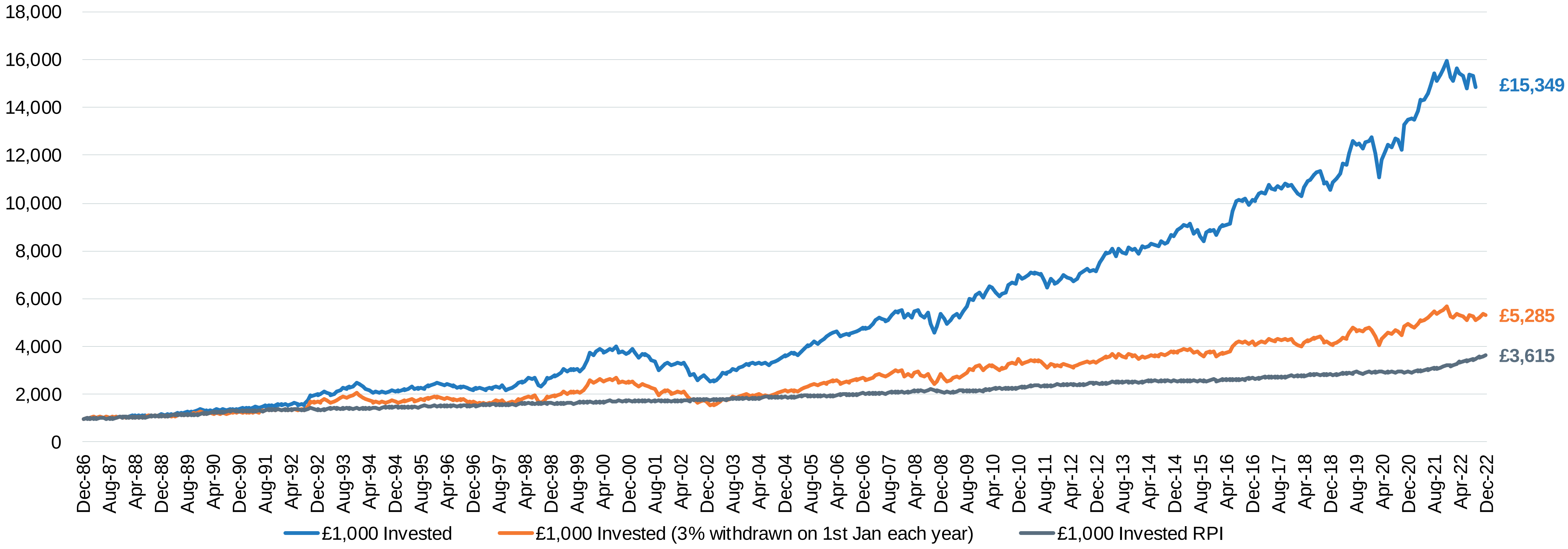
Withdrawal rate analysis

Illustrative multi-asset representative portfolio

Illustrative multi-asset representative portfolio (£1,000 Invested vs. RPI)



Your capital may be at risk. The value of investments and the income from them can fall as well as rise and investors may not get back the original amount invested. Past performance is not a guide to future performance. Please refer to slide 21 for full performance history.

Notes: Periods to 31 December 2022; Inception date is 31 December 1986.
Source: Newton, close of business prices, total return, income reinvested, gross of fees, in GBP, 31 December 2022
Performance is stated gross of management fees. The impact of management fees can be material. A fee schedule providing further detail is available on request.

Our research on sustainable withdrawal

Methodology for updated study

FOR EQUITIES

A 'first principles' actuarial approach for real returns over the long term is:

Equity real (inflation-adjusted) return

=

initial dividend yield + real (inflation-adjusted) dividend growth rate

FOR BONDS

The long-term real (inflation-adjusted) return assumption would be:

Bond real return

=

gross redemption yield – inflation expectation

FOR PROPERTY

The real return expectation would be the net initial property yield.

FOR CORPORATE BONDS

We assume a 1% higher return than for gilts.

FOR CASH

We assume a return of the Bank of England base rate minus inflation.

ALTERNATIVES AND 'OTHER'

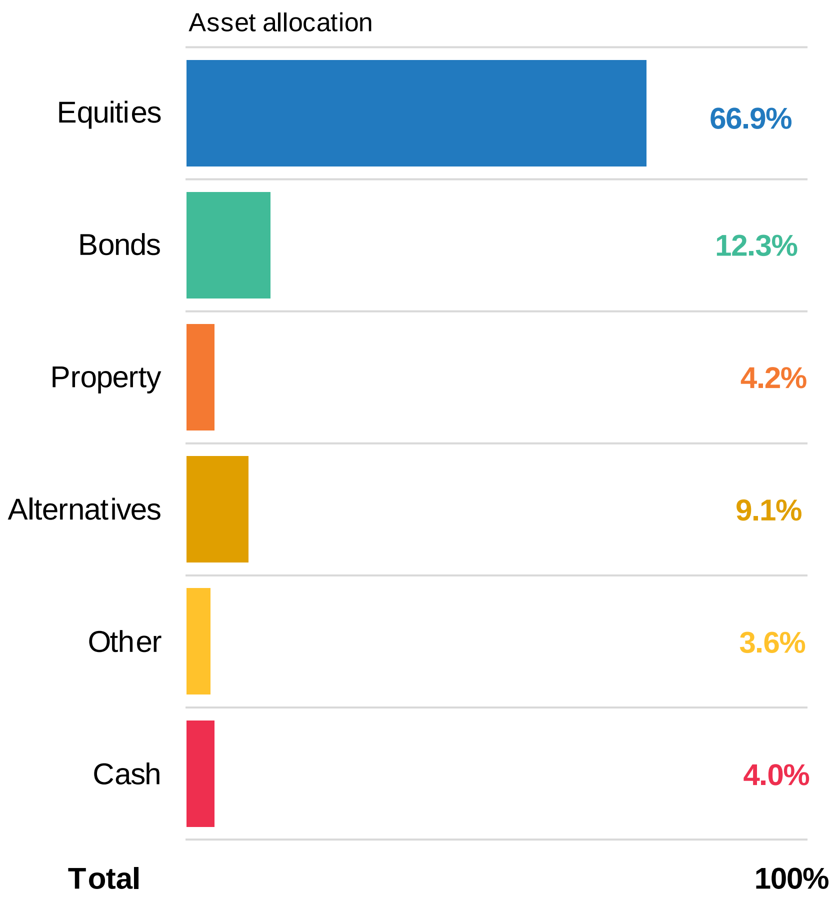
We assume a return of cash plus 4% per annum nominal, subtracting our assumed inflation rate for the real return.

Our research on sustainable withdrawal

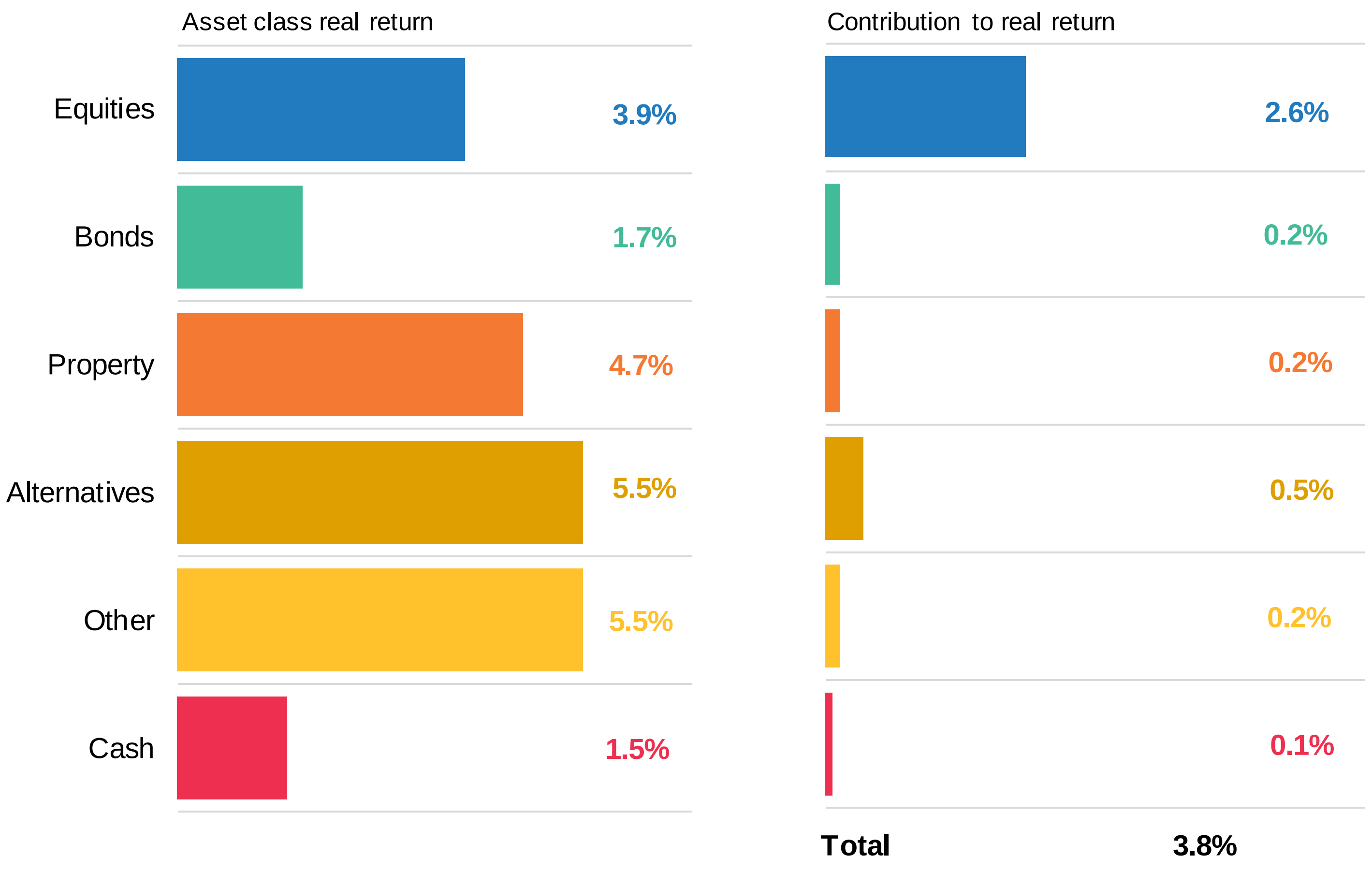
Asset allocation and return assumptions

3.8% The likely sustainable return rate based on today's values

Current 'average' asset allocation for investing charities



So, if we apply the above forward-looking return assumptions to the average charity asset allocation described, we get:

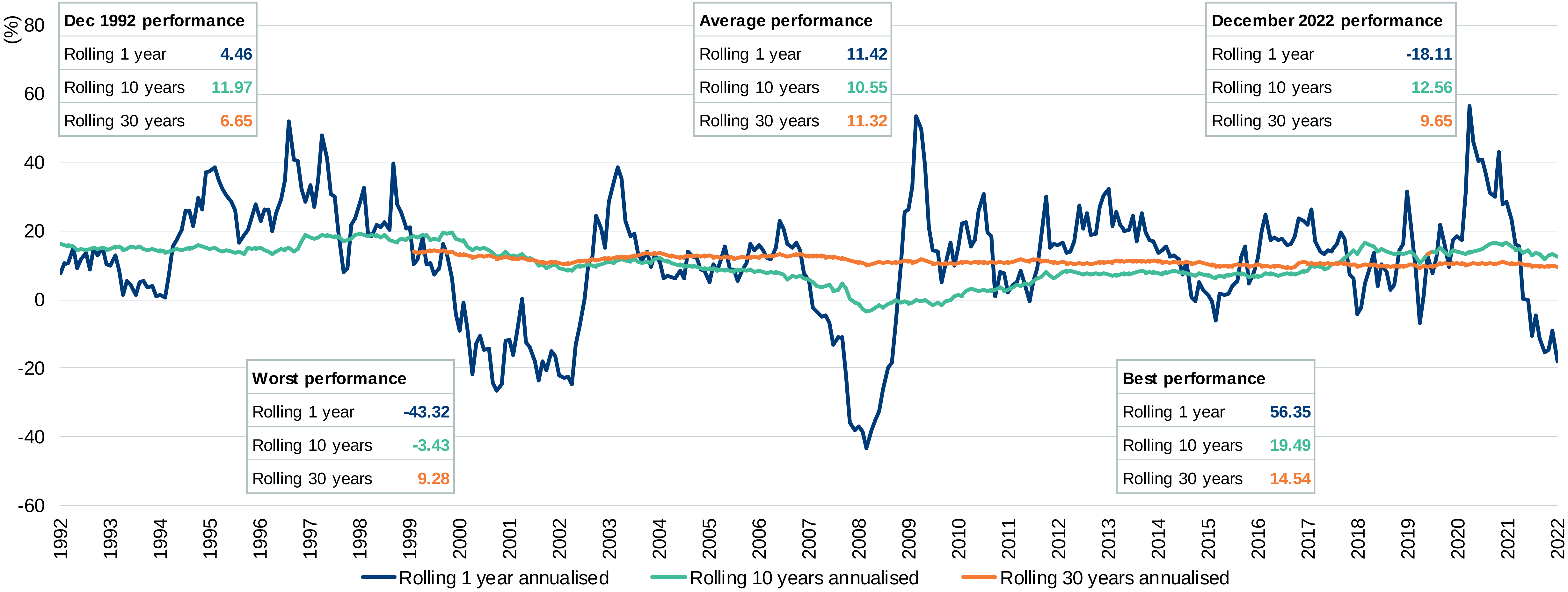


Source: Teknometry CIG Charity Fund Universe. Data as at 31 December 2022.

Reserves and Investment Policy

Time horizon is important

S&P 500 price index



Dec 1992 performance	
Rolling 1 year	4.46
Rolling 10 years	11.97
Rolling 30 years	6.65

Average performance	
Rolling 1 year	11.42
Rolling 10 years	10.55
Rolling 30 years	11.32

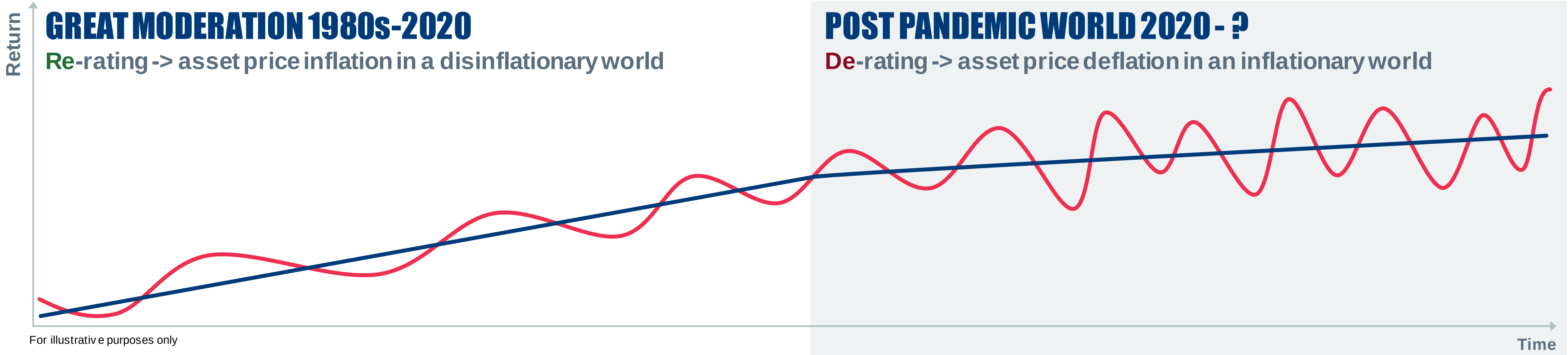
December 2022 performance	
Rolling 1 year	-18.11
Rolling 10 years	12.56
Rolling 30 years	9.65

Worst performance	
Rolling 1 year	-43.32
Rolling 10 years	-3.43
Rolling 30 years	9.28

Best performance	
Rolling 1 year	56.35
Rolling 10 years	19.49
Rolling 30 years	14.54

Source: FactSet, 31 December 2022.

Perspective on business cycles and investment returns



- Lower inflation
- Low volatility longer cycles
- State intervention: prolong the cycle if inflation not prohibitive
- Increasing corporate profit share of GDP

- Inflation is a bigger risk than deflation
- High volatility & short boom-bust cycles
- State intervention: limited scope to stimulate as inflation elevated
- Increasing labour share of GDP, expensive labour and commodities

INVESTMENT IMPLICATIONS

- Traditional asset diversification less beneficial
- Greater need for flexibility
- Modest equity market returns; focus on alpha rather than beta

Active, flexible strategies best suited

Source: Newton, 2022.

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Case study 1

Going beyond sustainable withdrawal

Background:

- A benevolent charity that supports key workers with welfare grants
- c.£14m investment portfolio
- Triple impact: Increased demand, CoL Crisis, Pandemic legacy
- Economic factors disproportionally impacting their beneficiaries

Outcomes:

- Worked closely with investment manager to ensure trustees have the critical information to navigate difficult financial decisions
- Trustees explored sustainable withdrawal rates, and have made the decision to temporarily increase the withdrawal rate from their portfolio to meet the needs of members impacted by the CoL Crisis

Takeaways:

- Exploring the sustainable rate of withdrawal/spending was an essential starting point
- Trustees were able to set clear timeframes/conditions around increased spending
- Risk to reputation is mitigated by clear and transparent communication

Case study 2

Going beyond sustainable withdrawal

Background:

- A University endowment
- c.£55m investment portfolio
- Triple impact: Increased demand, CoL Crisis, Pandemic legacy
- Economic factors disproportionally impacting their beneficiaries

Outcomes:

- Worked closely with investment manager to ensure trustees have the critical information to navigate difficult financial decisions
- Trustees explored sustainable withdrawal rates, and have made the decision to permanently increase the withdrawal rate from their portfolio

Takeaways:

- Exploring the sustainable rate of withdrawal was an essential starting point – as was understanding the risks of increasing it
- Major donors are another significant source of income, they are more likely to give, and so the endowment is more likely to grow and support the University, if the withdrawal rate compares favourably with peers

Case study 3

Identifying and spending 'excess return'

Background:

- Charitable Trust - award life-changing scholarships that unlock individual potential and broaden horizons through study and travel overseas
- Triple impact: Increased demand, CoL Crisis, Pandemic legacy
- Economic factors disproportionally impacting their beneficiaries

Outcomes:

- Specifically helping them understand income they had spent and 'real' capital return they had not
- Worked closely with investment manager to ensure trustees have the critical information to navigate difficult financial decisions

Takeaways:

- Identified 'excess returns' – those above inflation that have not been spent
- Identifying this has given the Trust confidence to spend beyond their means, in the short term, to support beneficiaries when they are most in need

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Conclusions

Working with your investment manager

Working with your investment manager:

- Make use of all the available meetings and updates, set ad hoc meeting if required
- Leverage your manager's insights into the economic outlook
- Interrogate your manager's investment philosophy and practice… is it optimal for the current economic environment?
- Make use of your managers value-add services… trustee training, research and thought leadership, roundtables, and discussions
- Maintain an open dialogue about how your spending priorities, costs, or demand for services may be changing
- Keep them up-to-date on your thoughts relating to risk… do your investments still align?

Check out our Charity Investment Survey and our Sustainable Withdrawal Paper…

QUESTIONS & DISCUSSION

Newton team

Rorie Evans, CFA
Head of charity clients

Rorie is a member of Newton's Charity Team and is responsible for managing relationships with a number of Newton's charity clients. Prior to joining Newton he served for seven years as an Officer in the Royal Gurkha Rifles. During this time he served in various places around the world including Afghanistan, Nepal and Belize.

Outside of work Rorie is kept busy by his young family but when time permits he enjoys playing the bagpipes and a range of sports including tennis, golf and cricket.

Rorie holds a Financial Economics degree from St Andrews University, the IMC and is a CFA charterholder[1]. He is also a Trustee and Finance Committee member of a military mental health charity.

Joined Newton: 2016
Joined industry: 2016

Sarah Dickson
Head of Charity Business Development

Sarah is a member of Newton's Charity Team and is responsible for developing relationships and opportunities in the UK Charity Sector. She builds on experience supporting non-profits with their mission as part of the wider BNY Mellon global citizenship team. Prior to joining the financial services industry Sarah served for nine years as an Officer in the Royal Air Force.

Sarah holds an undergraduate degree in Geography from the University of Oxford and a Master's in Human Resource Management from Cornell University. She regularly volunteers with organisations working to combat social isolation and loneliness, and those committed to building diverse and inclusive workforces.

Outside of work, Sarah maintains her passion for geography and the environment with regular trips out of London exploring the UK with her young family in tow. She is a SCUBA instructor with dives logged in Skye, Orkney, the Isles of Scilly, St. Kilda and Ascension Island.

Joined Newton: 2022
Joined industry: 2012

Note: [1] CFA® and Chartered Financial Analyst® are registered trademarks owned by CFA Institute.

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Key risks

Illustrative multi-asset representative portfolio

Investment objective

- To achieve a balance between income and capital growth over the long term (5 years or more).

Benchmark

- The representative portfolio will measure its performance against the UK Investment Association Mixed Investment 40-85% Shares NR Sector average as a comparator benchmark (the 'Benchmark'). The representative portfolio will use the Benchmark as an appropriate comparator because it includes a broad representation of funds with levels of equity and bond exposure similar to those of the representative portfolio.
- The representative portfolio is actively managed, which means the Investment Manager has discretion over the selection of investments, subject to the investment objective and policies as disclosed in the Prospectus.

Investment performance

12-month returns, %	**Mar-22 to Mar-23**	**Mar-21 to Mar-22**	**Mar-20 to Mar-21**	**Mar-19 to Mar-20**	**Mar-18 to Mar-19**
Representative portfolio	0.67	11.31	23.88	-2.68	8.42
Benchmark	-4.22	5.88	27.26	-7.86	4.55

Calendar year returns, %	**2022**	**2021**	**2020**	**2019**	**2018**
Representative portfolio	-3.71	18.01	7.06	19.40	-1.82
Benchmark	-8.66	12.91	6.67	17.74	-4.84

Performance is stated gross of management fees. The impact of management fees can be material. A fee schedule providing further detail is available on request.

Source: Lipper, midday prices, total return, income reinvested, gross of fees, in GBP, 31 March 2023.

Key investment risks

- **Past performance is not a guide to future performance. Your capital may be at risk. The value of investments and the income from them can fall as well as rise and investors may not get back the original amount invested.**

- **Objective/Performance Risk:** There is no guarantee that the representative portfolio will achieve its objectives.
- **Currency Risk:** This representative portfolio invests in international markets which means it is exposed to changes in currency rates which could affect the value of the representative portfolio.
- **Derivatives Risk:** Derivatives are highly sensitive to changes in the value of the asset from which their value is derived. A small movement in the value of the underlying asset can cause a large movement in the value of the derivative. This can increase the sizes of losses and gains, causing the value of your investment to fluctuate. When using derivatives, the representative portfolio can lose significantly more than the amount it has invested in derivatives.
- **Changes in Interest Rates & Inflation Risk:** Investments in bonds/money market securities are affected by interest rates and inflation trends which may negatively affect the value of the representative portfolio.
- **Credit Ratings and Unrated Securities Risk:** Bonds with a low credit rating or unrated bonds have a greater risk of default. These investments may negatively affect the value of the representative portfolio.
- **Credit Risk:** The issuer of a security held by the representative portfolio may not pay income or repay capital to the representative portfolio when due.
- **Emerging Markets Risk:** Emerging Markets have additional risks due to less-developed market practices.
- **Charges to Capital:** The representative portfolio takes its charges from the capital of the representative portfolio. Investors should be aware that this has the effect of lowering the capital value of your investment and limiting the potential for future capital growth. On redemption, you may not receive back the full amount you initially invested.
- **Shanghai-Hong Kong Stock Connect and/or the Shenzhen-Hong Kong Stock Connect ('Stock Connect') risk:** The representative portfolio may invest in China A shares through Stock Connect programmes. These may be subject to regulatory changes and quota limitations. An operational constraint such as a suspension in trading could negatively affect the representative portfolio's ability to achieve its investment objective.
- **CoCos Risk:** Contingent Convertible Securities (CoCos) convert from debt to equity when the issuer's capital drops below a pre-defined level. This may result in the security converting into equities at a discounted share price, the value of the security being written down, temporarily or permanently, and/or coupon payments ceasing or being deferred.
- **Counterparty Risk:** The insolvency of any institutions providing services such as custody of assets or acting as a counterparty to derivatives or other contractual arrangements, may expose the representative portfolio to financial loss.
- A complete description of risk factors is set out in the Prospectus in the section entitled 'Risk Factors'.

Important information

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Newton's assets under management are as of the most recent quarter end, unless noted otherwise. Newton's assets under management include assets collectively managed by NIM, NIMNA and NIMJ. In addition, AUM for Newton includes assets of bank-maintained collective investment funds for which Newton has been appointed sub-advisor, where Newton personnel act as dual officers of affiliated companies and assets of wrap fee account(s) for which Newton provides sub-advisory services to the primary manager of the wrap program.

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