Board Policy 4010: Investment Policy Statement

I. INTRODUCTION

A. This Investment Policy Statement ("IPS") is issued by the Investment Committee[1] (the "Committee") of The Claremont Colleges, Inc. ("TCC"), and is approved by its Board of Directors (the "Board").

B. The Board has delegated to the Committee the fiduciary responsibility for the investment of TCC's *Investment* Pool ("Pool"), including the allocation of funds to various asset classes within Board-approved policy ranges, and the engagement of professional investment advisors and managers.

C. The purpose of this IPS is to foster a clear understanding of TCC's investment objectives, policies and guidelines among the Board, the Committee, the Staff, the investment consultant, and the Pool's investment managers. This investment policy statement supersedes all previous versions.

D. The committee shall take into account the requirements of the Uniform Prudent Management of Institutional Funds Act (UPMIFA) and shall invest the Pool's assets in good faith, in a manner the Committee reasonably believes to be in the best interests of TCC and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances

E. The Committee will review this investment policy statement no less often than every three (3) years to ensure its continued appropriateness and will recommend any proposed changes to the Board. The Committee may change this investment policy statement at any time, subject to Board approval. It is the intent of this statement to be both sufficiently specific to be meaningful and yet flexible enough to be practical and enduring.

F. The Committee may choose a custodian bank and/or investment consultants to provide services necessary to perform its obligations as set forth in the policy statement.

II. FINANCIAL AND INVESTMENT OBJECTIVES

A. The primary long-term financial objective for the Investment Pool is to preserve the real value (purchasing power) of the Pool's principal (net of new gifts) and of its spending distributions, while providing a relatively stable and growing source of funding for grants and operating expenses.

B. The primary long-term investment objective of the Investment Pool is to earn an average annual *real* (e.g., after adjusting for inflation) total return of 5.5%, or at least equal to the Pool's total spending rate (as outlined in section III), net of consultant and management fees, over long time periods (e.g., rolling twenty- to thirty-year periods). Over shorter time periods (e.g., rolling five- and seven-year periods), the Pool will seek to outperform an appropriate composite of market indices reflecting the Pool's asset allocation policies and to outperform other institutional funds with broadly similar investment objectives and policies.

C. It is recognized that in order to achieve the primary investment objective over extended periods, endowments have had to exceed the objective substantially during some periods, such as the 1980s and 1990s, in order to compensate for shortfalls during other periods, such as the 1970s. Hence, evaluation of progress toward this objective should be made with a long-term perspective. It is recognized that this objective implies a high average allocation to equity securities and consequent market price volatility. The Committee's policy regarding investment risk is that it cannot be eliminated, but can be managed consistent with

[1] As of January 2018, the "Investment Committee" is a committee of the entirety of the Board of Directors.

modern portfolio theory.

D. It is recognized that the desire to maintain the purchasing power of the Investment Pool's principal and to produce a relatively stable, growing, and predictable spending stream involves trade-offs that must be balanced in establishing the investment and spending policies.

III. SPENDING POLICY

A. The purpose of the Investment Pool is to provide a permanent stream of income to support TCC's operational expenses. The spending policy objective is interlinked with the financial and investment objectives and has been formulated in the context of the overarching goal for prudent management of endowments: to optimize the balance between preserving the real (after inflation) long-term purchasing power of the endowment principal with the need to make annual distributions. TCC has approved the spending policy for the Investment Pool to balance these oft-times competing considerations.

B. The general spending policy for the Investment Pool is to pay out annually 4.5% of the trailing twenty-quarter moving average market value of the Pool, determined on September 30 for the fiscal year which begins July 1 of the following year. However, the Board may, at its discretion, modify this spending percentage as clarified below.

C. The Investment Committee shall be responsible for reviewing the spending policy formula on an annual basis. The Committee shall review the resultant payout dollar distribution, based on the existing formula, giving due and prudent consideration to other factors such as:

- Need to ensure stability of funding from one year to the next for planning purposes;
- Prevailing market conditions and their potential impact;
- Realized gains reserve; and
- The impact on the operating budget of any recommended changes to the spending policy.

The Investment Committee may, at its discretion, recommend for approval by the Board an alternate payout rate or rule.

IV. INVESTMENT POOL COMPOSITION AND ASSET ALLOCATION

A. The Investment Pool will be diversified both by asset class (e.g., common stocks, bonds, and cash) and within asset classes (e.g., within common stocks by economic sector, industry, investment style, and market capitalization). The purpose of diversification is to enhance prospective returns, lower the volatility of the overall pool of assets, and provide reasonable assurance that no single security or class of securities will have a disproportionate impact on the total portfolio.

B. For purposes of investment policy, the Pool shall be considered as two parts: the **Equity Fund** and the **Fixed Income Fund**. The Committee will establish long-term policy target allocations and ranges for the Equity and Fixed Income Funds, as well as long-term target allocations and ranges for the primary asset classes within the Equity Fund. See **Exhibit 1** for detailed asset allocation policy targets with corresponding ranges.

C. The primary purpose of the **Equity Fund** is to provide long-term capital appreciation in order to facilitate the real growth of the corpus and support a growing spending stream. Over the long term, the total return of the **Equity Fund** should exceed the rate of inflation by at least 6%

D. It is recognized that equity investments will have greater return variability than fixed income investments. To help mitigate this variability, the Committee shall ensure that the equity investments are diversified across different types of assets with return patterns that are expected to be imperfectly correlated (e.g., the returns of which do not always move in tandem).

E. The **Equity Fund** should normally represent 85% of total Pool assets at market value. Although the actual percentage of equities and equity reserves will fluctuate with market conditions, levels above 90% or below 80% should be closely monitored by the Committee and funds should be transferred as needed to ensure that the ratio does not fall outside of these parameters for extended periods.

F. The primary purpose of the **Fixed Income Fund** is to serve as a deflation hedge. Other important, but secondary purposes are to generate income and to diversify the Investment Pool. Over the long term, the total return of the **Fixed Income Fund** should exceed the rate of inflation by at least 2%.

G. The **Fixed Income Fund** should normally represent 15% of Pool assets at market value. Although the actual percentage of fixed income securities will vary with market conditions, levels greater than 30% or below 10% should be closely monitored by the Committee and funds transferred as needed to ensure that the ratio does not fall outside of these parameters for extended periods.

H. Within the approved policy ranges, the Committee may, at its discretion, change the proportions of the Equity Fund, the Equity Fund components, and the Fixed Income Fund**,** but it is anticipated that such changes will be infrequent and within the allocation ranges set forth in **Exhibit 1**. However, given that it will take time to become fully invested in certain non-marketable asset classes (e.g., private equity/venture capital) it is recognized by the Board that the allocation to such asset classes may fall below the lower allocation range for extended periods.

V. GUIDELINES FOR THE EQUITY FUND

A. The Equity Fund will generally be diversified among U.S. stocks, non-U.S. stocks, inflation hedge assets (e.g., real estate, REITs, oil and gas, energy stocks, timber, commodities), marketable alternative assets (e.g., hedge funds, absolute return strategies such as distressed securities and arbitrage), venture capital/private equity, and potentially other "opportunistic" investments (e.g., individual allocations to high-yield bonds, emerging markets debt, and other areas that can be expected to generate equity-like returns).

B. The overall long-term investment objective for the Equity Fund is to outperform, net of investment fees, an appropriate market benchmark or blended benchmark reflecting the Equity Fund's asset allocation policies over five- to seven-years. See **Exhibit 2** for detailed investment performance benchmarks.

C. Passive (or index) managers will be expected to perform consistently with their corresponding index benchmarks, less management fees.

D. Active common stock managers will be measured against market indices, net of all fees, and will be expected to outperform these benchmarks by varying degrees depending on the asset class and specific investment style employed by the manager. Managers may also be compared against peer benchmarks (e.g., manager medians), but it is recognized that such benchmarks typically contain significant "survivor" or "add-in" bias, and thus are less reliable than market benchmarks in assessing performance.

E. Performance will be monitored quarterly, and marketable equity managers will be evaluated over a complete market cycle (five- to seven-years). It is recognized that active managers will periodically underperform their benchmarks, but should outperform over a complete market cycle. The Committee acknowledges that the pursuit of long-term outperformance may increase the volatility of returns, and will increase the risk that the manager will underperform the benchmark.

F. Equity Fund common stock managers of separate accounts generally may not buy securities on margin, borrow money or pledge assets, or buy or sell uncovered options or commodities, or currencies without the advance approval of the Committee. A more detailed statement on the use of derivatives by investment managers is set forth in section VII.

G. The objectives for Marketable Alternative Assets (e.g., absolute return/hedge fund) are to improve the diversification of the Equity Fund, reduce Equity Fund volatility, and outperform, net of fees, a T-Bills + 5% benchmark over full market cycles, or rolling five- to seven-year periods.

H. The objective for Venture Capital / Private Equity is to enhance the total return of the Equity Fund, earning superior returns, net of fees, over marketable securities (e.g. the *C|A Private Equity/Venture Capital*) and/or over appropriate peer benchmarks over rolling five- to seven-year periods.

I. The objectives for Inflation Hedging assets (e.g. real assets) are: (1) to help protect the Investment Pool against unanticipated inflation, which can dramatically decrease the Pool's purchasing power and its ability to sustain spending; (2) to improve the diversification of the Equity Fund; and (3) to exceed the return, net of fees, of appropriate benchmarks over full market cycles, or rolling five- to seven-year periods. Assets in this category may include private real estate, public real estate (e.g., REITs), natural resources (e.g., oil & gas, timber partnerships, or marketable securities of energy or other natural resource stocks), commodities, and/or TIPS.[2]

J. Equity managers may at their discretion hold investment reserves of either cash equivalents or bonds with the understanding that the performance of their total account will be measured against the appropriate equity indices.

VI. GUIDELINES FOR THE FIXED INCOME FUND

A. The performance objective for the Fixed Income Fund is to outperform an appropriate bond market index or blend of indices, net of fees, over rolling five- to seven-year periods. Individual active fixed income managers may be expected to outperform other indices, or blended indices, which more closely parallel the manager's investment style. In addition, active fixed income managers may also be compared against peer benchmarks (e.g., manager medians), but it is recognized that such benchmarks typically contain significant "survivor" or "add-in" bias, and thus are less reliable than market benchmarks in assessing performance. Index fund managers will be expected to match the return of the appropriate index, less fees.

B. Money market instruments as well as bonds may be used in the Fixed Income Fund, but equities are excluded. Active managers are expected to employ active management techniques, but changes in weighted average duration should usually be moderate and incremental.

C. To provide a hedge against extended deflation, the overall Fixed Income Fund should ordinarily maintain a high credit quality (e.g., a weighted average credit rating of "AA/Aa" or better) and an intermediate- to long-term duration (e.g., 3- to 9-years). An allocation may be made to below investment grade (e.g., high-yield) bonds so long as the weighted average

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[2] TIPS and other inflation-linked bonds, though fixed income, may be included in the inflation hedge category because of their inflation-hedging characteristics.

credit rating for the total fixed income portfolio meets the above credit quality standards. Non-dollar denominated securities are permitted up to 30% of the Fixed Income Fund.

D. In general, fixed income investments should be prudently diversified with respect to economic sector, financial sector, and issuer in order to minimize risk exposure. A maximum of 5% of the Fixed Income Fund may be invested in the securities of any single issuer, except issues of the U.S. Government or agencies of the U.S. Government, which may be held without limitation.

VII. USE OF DERIVATIVES

A. The Committee recognizes that investment managers have come to use various derivative instruments and that the prudent use of such instruments can be advantageous for controlling portfolio risk, increasing returns, implementing strategies quickly and reducing costs. Accordingly, the Committee permits the use of derivative securities only in a manner consistent with the spirit and specifics of the investment objectives and policies described herein.

B. Derivatives may be used by the Investment Pool's investment managers to hedge existing portfolio investments (e.g., to hedge the currency risk of a foreign stock or bond position), or to create unleveraged investment positions as a more efficient and cheaper alternative to investments that would otherwise be made in the cash market (e.g., purchasing Treasury bond futures contracts). Derivatives may not be used by managers to leverage a portfolio or significantly increase its risk above that of an account with similar objectives that is managed without derivatives. Use of derivatives by a manager other than as described in this paragraph is permitted only if such use is authorized by the Committee. This provision does not apply to investments with Marketable Alternative (e.g., absolute return/hedge fund) managers.

C. The Committee expects that its investment managers utilizing derivatives will have in place processes and procedures to control and measure risk.

VIII. CONFLICT OF INTEREST POLICY

Refer to The Claremont Colleges, Inc. Board of Directors Conflict of Interest Policy.

IX. MONITORING THE PORTFOLIO

A. The Committee will normally review the Pool's asset allocation, manager structure, and performance quarterly in order to evaluate diversification, adherence to policies, and progress toward long-term objectives. While short-term results will be monitored, it is understood that the objectives for the Investment Pool are long-term in nature and that progress toward these objectives will be evaluated from a long-term perspective.

B. Although marketable manager investment performance will generally be evaluated over rolling five- to seven-year periods, the Committee will periodically evaluate each manager, as appropriate, to establish that the factors that led to initial performance expectations remain in place and that each manager's philosophy is appropriate for the Pool's overall objectives. The Committee will evaluate each manager's total return without regard to whether the return is in the form of income or capital appreciation.

C. It is expected that the Committee will provide each manager of a separate account outside the Investment Pool with a set of mutually agreed-upon guidelines. Subject to such guidelines and the usual standards of fiduciary prudence, the managers will then have complete discretion over the funds.

D. The Committee acknowledges that, if it elects to invest in a commingled fund[3], the policies established for the commingled fund will govern and may not comply fully with policies established for the Investment Pool. As appropriate, the Committee will periodically review the policies (e.g., investment parameters) of any commingled fund investment to determine if they remain appropriate for the Investment Pool.

E. At its sole discretion, the Committee may terminate any manager at any time if it determines, for whatever reason, that the manager is no longer appropriate for the Investment Pool.

F. The Committee will periodically review the related services provided to the Investment Pool, including custody services and investment consulting.

X. REBALANCING

A. The Committee shall consider, at least once each year, whether the amounts invested with managers should be rebalanced toward the policy allocation targets, but such amounts must be rebalanced if outside approved target ranges.

B. As a general rule, new cash inflows and withdrawals should be used to rebalance the Investment Pool in the direction of policy targets, subject to any tactical or opportunistic shifts within policy ranges that have been previously approved by the Committee.

XI. COMMUNICATION

A. Regular investment manager communication concerning investment strategy and outlook is expected. All reports will be sent to TCC and to its investment consultant, including at the minimum:

- Monthly written reports with market values, income received, and transactions of the investment portfolio;
- Quarterly written reports showing securities held, cost, and current market value as well as performance measurements and portfolio commentary;
- The availability to meet with the Committee, at least, annually subject to the needs and schedule as determined by the Committee.

B. The Manager is required to promptly inform TCC of any material change in ownership or organizational structure, professional personnel, assets and accounts under management, fundamental investment philosophy and strategy, and of any regulatory investigation or action or litigation of any kind involving the firm or its personnel acting in an official capacity for the firm.

Policy History: Approved by CUC Board, February 12, 2008
Revision last approved by CUC Board, May 11, 2016
Approved for name change revision by TCC Board of Directors April 3, 2018
Revision approved by TCC Board, August 23, 2018

[3] Commingled funds include institutional commingled trusts, mutual funds, limited partnerships and other similar investment vehicles.

Exhibit 1

THE CLAREMONT COLLEGES, INC.

ASSET ALLOCATION POLICY TARGETS

AND RANGES

Asset Class	**Long-Term Policy Targets**	**Policy Range**
U.S. Equity	18.0%	15 - 25%
Global ex-U.S. Developed Equity	14.0%	10 - 20%
Emerging Markets Equity	8.0%	3 - 10%
Marketable Alternative Assets (e.g. Absolute Return / Hedge Funds)	20.0%	15 - 25%
Non-Marketable Alternative Assets (e.g. Private Equity / Venture Capital)	10.0%	5 - 15%
Inflation Hedging / Real Assets (e.g. Real Estate, Energy, Commodities)	15.0%	10 - 20%
Total Equity	**85.0%**	**80 - 90%**
Fixed Income	13.0%	10 - 30%
Cash	2.0	
Total Fixed Income and Cash	**15.0%**	**10 - 30%**

Exhibit 2

THE CLAREMONT COLLEGES, INC.

PORTFOLIO PERFORMANCE BENCHMARKS

ASSET CLASSES	PERFORMANCE BENCHMARKS
Large Cap Equity	S&P 500 Index *CA U.S. Equity (ex Small Cap) Manager Median*
Small Cap Equity	Russell 2500® Index *CA U.S. Small Company Manager Median*
Total U.S. Equity	**Russell 3000® Index** *CA U.S. Equity Manager Median*
Global ex U.S. Developed Markets	MSCI EAFE Index *CA Global ex U.S. Equity Manager Median*
Emerging Markets	MSCI Emerging Markets Index *CA Emerging Markets Equity Manager Median*
Total Global ex U.S. Equity	**MSCI All Country World ex U.S. Index**
Total Marketable Equities	**MSCI All Country World Index**
Marketable Alternatives	T-Bills + 5% HFRI Fund of Funds Diversified Index
Inflation Hedge Assets	CPI-U + 5% Blended Composite
U.S. Fixed Income	Barclays Capital Aggregate Bond Index/Barclays Capital Intermediate U.S. Treasury Bond Index *CA Bond Manager Median*
Private Equity / Venture Capital	*C|A Private Equity/Venture Capital*
TOTAL PORTFOLIO	**Custom Benchmarks**[1]

[1] The current Total Fund Benchmark consists of 18% Russell 3000 Index / 14% MSCI EAFE Index / 8% MSCI Emerging Markets Index / 20% HFRI FOF Diversified Index / 10% *C|A Private Equity/Venture Capital* / 15% Blended Inflation Hedging Benchmark / 13% Blended Fixed Income Benchmark / 2% BofA ML 91-Day Treasury Bills Index