Institutional Advisors

Optimizing Investment Selection for Foundations: A Look Beyond Underlying Manager Fees

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For foundation investment committees, selecting the right investment managers is paramount to achieving their financial objectives and maximizing their charitable mission. While fees are a consideration, prioritizing solely on underlying manager fees can be detrimental. This paper explores why a comprehensive approach that prioritizes value over cost is essential for foundation investment committees.

Performance as the primary consideration

Foundation investment committees should prioritize selecting managers with a demonstrably strong track record of generating risk-adjusted returns. A lower fee associated with a fund that consistently underperforms its benchmark or similar funds might not be the most attractive option. Net returns, which account for all investment costs including fees, provide a clearer picture of a fund's true value. A manager with a slightly higher fee but a demonstrably strong record of generating alpha may ultimately deliver a superior return.

Beyond underlying fees: A multifaceted cost analysis

Underlying manager fees are just one component of the overall cost structure. Investment committees should also carefully evaluate the following:

Transaction costs

Fees incurred when buying and selling securities within a fund can erode returns. These costs can vary depending on the fund's trading strategy and asset allocation. High portfolio turnover, for instance, can result in significant transaction costs.

Custodial fees

The charges for holding assets in a custodian bank can add up over time. Committees should compare custodial fees among different providers to ensure they are getting the best value.

Carried interest

In private equity investments, carried interest refers to the performance fee managers collect on profits. While carried interest can incentivize strong performance, it's important to negotiate reasonable fee structures.

A comprehensive cost analysis allows committees to make informed decisions about which funds offer the best value for their foundation's mission.

Alignment with mission and values

Foundations may prioritize aligning their investment strategy with their charitable mission, even if it means selecting managers with slightly higher fees.
This could involve the following strategies:

Impact investing

Impact investing involves investing in companies or funds that generate positive social or environmental impact alongside financial returns. This can range from supporting renewable energy initiatives to funding affordable housing projects.

Sustainable investing

Considering environmental, social, and governance (ESG) factors alongside traditional financial metrics when making investment decisions is a key aspect of sustainable investing. By incorporating ESG factors, foundations can invest in companies that are not only financially sound but also environmentally and socially responsible.

By focusing on total value, mission alignment, and a nuanced understanding of all costs, foundation investment committees can make investment decisions that support their long-term goals and maximize their charitable impact.

For more information, please contact your KeyBank Institutional Advisor.

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