

**STATEMENT OF POLICY AND  
INVESTMENT OBJECTIVES**

**HARBOR BRANCH OCEANOGRAPHIC INSTITUTE FOUNDATION, INC.**

**November 2005**

**August 2009**

**October 2009**

**April 2012**

**October 2012**

**August 2013**

**January 2014**

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## **I. INTRODUCTION**

The purpose of this Investment Policy Statement is to establish a clear understanding between the Investment Committee of Harbor Branch Oceanographic Institution Foundation (HBOIF), the Investment Consultant and the Investment Managers as to the investment objectives and policies applicable to HBOIF's investment portfolio.

This Investment Policy Statement will:

- establish reasonable expectations, objectives and guidelines in the investment of the assets;
- set forth an investment structure detailing permitted asset classes and expected allocation among asset classes;
- encourage effective communication between the Investment Consultant, the Investment Manager(s) and the Investment Committee;
- create the framework for a well-diversified asset mix that can be expected to generate acceptable long-term returns at a level of risk suitable for the assets.

This Investment Policy Statement is intended to be a summary of an investment philosophy that provides guidance for the HBOIF. It shall serve the Investment Managers as the principal source for developing an appropriate strategy. In addition, it shall serve as the basis for performance evaluation. Any changes in this Investment Policy Statement will be in writing and will be communicated to the Investment Managers.

## **II. PURPOSE**

The Harbor Branch Oceanographic Institution Foundation endowment was established in order to provide a future source of funding for operations, capital improvements and internal sponsored research at HBOIF.

## **III. SPENDING POLICY**

The spending policy reflects the fundamental objective of preserving and enhancing the resources of HBOIF, both at present and in the future. Current spending and the long term objectives of preserving and enhancing the assets are balanced by considerations given to reasonable expectations of investment returns, gift contributions, operating expenses and inflation. The spending policy rate is to be up to five percent (5%) of the assets, calculated on a rolling three year average of the market value.

#### **IV. INVESTMENT OBJECTIVE**

The objective is to earn the highest possible total return (capital appreciation and income return) consistent with prudent levels of risk. At a minimum, long-term rates of return should be equal to an amount sufficient to maintain the purchasing power of these assets and provide necessary capital to fund an annual spending policy of up to five percent (5%), based on a three year rolling average of the market value. Therefore, the desired minimum rate of return is equal to the Consumer Price Index (CPI) plus 500 basis points (5%) on an annualized basis. In light of this return requirement, the portfolio should be constructed using a total return approach with a significant portion of the funds invested to seek growth of principal over time. The assets are to be invested for the long term, and a higher short-term volatility in these assets is to be expected and accepted.

#### **V. TIME HORIZON**

The time horizon for these assets is perpetual. For strategic planning purposes, a minimum of twenty years will be considered for decision-making purposes. Capital values do fluctuate over shorter periods and the Investment Committee recognizes that the possibility of capital loss does exist. However, historical asset class return data suggest that the risk of principal loss over a holding period of at least three to five years can be minimized with the long-term investment mix employed under this Investment Policy Statement.

#### **VI. RISK TOLERANCE**

The Investment Committee recognizes that prudent investing requires taking reasonable risks in order to raise the likelihood of achieving the targeted investment returns. Research has demonstrated that portfolio risk is best minimized through diversification of assets. The portfolio of funds will be structured to maintain prudent levels of diversification. In terms of relative risk, the volatility of the portfolio should be in line with general market conditions.

## **VII. PROCEDURES**

The roles of the Investment Committee, the Investment Consultant, and the Investment Managers with regard to the funds are delineated as follows.

The Investment Committee, with active assistance and recommendations from the Investment Consultant, shall have responsibility for the following:

- Establishing overall financial objectives and setting investment policy;
- Setting parameters for asset allocation;
- Establishing a process and criteria for the selection and termination of investment managers, investment consultants and custodians;
- Selecting a qualified investment consultant;
- Selecting qualified investment managers;
- Selecting a qualified custodian;
- Monitoring investment results quarterly to assure that objectives are being met and that policy and guidelines are being followed;
- Communication on a structured and ongoing basis with those persons responsible for investment results.

The Investment Consultant will be proactive in advising and making recommendations to the Investment Committee regarding:

- Investment Policy;
- Asset Allocation;
- Manager Selection;
- Performance Evaluation;
- Other investment matters and responsibilities of the Investment Committee.

The Investment Managers will be responsible for the following:

- Determining investment strategy;
- Implementing security selection and timing within policy guideline limitations.

## VIII. ASSET ALLOCATION & STYLE DIVERSIFICATION

The Investment Committee recognizes the strategic importance of asset allocation and style diversification in the investment performance of the assets over long periods of time. Domestic and international equities both large and small capitalization, fixed income, cash equivalent securities and alternative investments in the form of fund of funds hedge funds have been determined to be acceptable vehicles for assets. Additional asset classes and style strategies may be incorporated into the investment philosophy in the future.

### A. Summary of Asset Allocation Guidelines:

After reviewing the long-term performance and risk characteristics of various asset classes and balancing the risks and rewards of market behavior, the following asset allocation strategy is incorporated to maximize the probability of achieving the objectives of the assets:

<b>Asset Category</b>	<b>Minimum</b>	<b>Target</b>	<b>Maximum</b>
<b>Cash</b>	<b>0.00%</b>	<b>5.00%</b>	<b>10.00%</b>
<b>Fixed Income*</b>	<b>15.00%</b>	<b>20.00%</b>	<b>35.00%</b>
<b>Equity</b>	<b>45.00%</b>	<b>60.00%</b>	<b>65.00%</b>
Large Cap	20.00%	30.00%	40.00%
Small Cap	5.00%	12.50%	15.00%
International	10.00%	17.50%	20.00%
<b>Alternative Assets</b>	<b>10.00%</b>	<b>15.00%</b>	<b>30.00%</b>

\*The global fixed income portion of the portfolio will have a minimum allocation of 0% and a maximum allocation of 10%.

### B. Rebalancing Procedures

From time to time, market conditions may cause the investment in various asset classes to vary from the established allocation. At least on an annual basis, the Investment Committee and their Investment Consultant will review both the specific asset allocation (equity versus fixed) and the style targets for possible rebalancing back to the target allocation, to ensure consistency with the asset allocation guidelines established by this investment policy. If the actual weighting goes above / below the maximum / minimum weighting intra-year, rebalancing may be recommended.

### **C. Adjustment in the Target Allocation**

The approved asset allocation displayed previously indicates both a target allocation and a range for each investment category. From time to time, based on changing circumstances of HBOIF as perceived by the Investment Committee and their advisors, it may be desirable to make changes in the target allocations. The Investment Committee and their advisors may determine such changes. Subsequent target allocation changes will be approved by the Investment Committee and the Investment Policy Statement will be updated accordingly.

## **IX. SELECTION AND RETENTION CRITERION FOR INVESTMENTS**

### **A. Investment Management**

Investment Managers (including mutual funds) shall be chosen using the following criteria:

- The investment style and discipline of the proposed manager;
- How well each proposed investment complements other assets in the portfolio;
- The size of the organization as measured by the amount of assets under management with respect to the investment style under consideration;
- Experience of the organization as measured by the tenure of the professionals with respect to the investment style under consideration;
- Past performance, considered relative to other investments having the same investment objective. Consideration shall be given to both performance rankings over various time frames and consistency of performance;
- The historical volatility and down-side risk of each proposed investment.

### **B. Individual Securities**

The Investment Committee desires to permit investment managers flexibility to maximize investment opportunities. However, it is cognizant of its responsibility to practice prudent management in order to conserve and protect the assets and to prevent exposure to undue risk. Exceptions to the guidelines stated below may be made upon special written approval of the Committee and shall be subject to annual review.

**The Investment Committee foresees the possibility of using mutual funds, collective trust funds and/or limited partnerships in the form of fund of funds hedge funds and understands that they would not have any control over the management of such funds with regard to guidelines and restrictions. However, they intend to utilize funds that generally comply with the investment guidelines stated in this Investment Policy Statement.**

## **i) Equity Holdings:**

### Security Types:

Equity securities shall consist of common stocks and equivalents (ADRs, issues convertible into common stock, etc.). Issues traded on the New York, American, Over the Counter, and Regional Exchanges and foreign exchanges are appropriate. There are no specific constraints as to earnings record and dividend policy.

### Diversification:

No more than five percent (5%) of the market value of the equity portfolio shall be in one issue. **If more than one investment manager manages equities, this restriction shall apply separately to each equity portfolio.**

### Quality:

There are no qualitative guidelines with regard to equity ratings, etc., except that prudent standards should be developed and maintained by the Investment Managers.

### Restrictions:

Investment in the following is prohibited unless written permission is granted:

- Derivative investments (futures or option contracts) for speculative purposes (as opposed to protection of asset value: *Covered call writing is permissible*)
- Direct ownership of letter stock
- Restricted stock
- Venture capital
- Short sales
- Margin purchases or borrowing money
- Stock loans

## **ii) Fixed Income Holdings:**

### Security Types:

Investment in obligations of the U.S. Government, including Treasury Inflation-Protected Securities (TIPS), U.S. Government Agencies, U.S. Corporate entities, Mortgage Backed Securities (MBS), Preferred Stock, Collateralized Mortgage Obligations, Asset Backed Securities, Municipal securities, Commercial Mortgage Backed securities (CMBS), REIT debt, non dollar denominated foreign bonds, and dollar denominated foreign bonds is permitted unless otherwise prohibited by investment restrictions.

Diversification:

With the exception of U.S. Treasury and Agency obligations, no more than five percent (5%) of the fixed income portfolio at market shall be invested in a single issue or corporate entity. If more than one investment manager manages fixed income, these restrictions apply separately to each portfolio.

Maturity:

The investment managers shall have responsibility for setting the appropriate maturity schedule for the fund based on the fund's investment objectives and risk profile. Based on current and expected market conditions, the manager should determine the structure that will yield optimal performance.

Quality:

Each debt instrument selected for investment shall be subjected to credit analysis by the investment manager prior to inclusion in the portfolio. The minimum acceptable quality is investment grade at the time of purchase by Moody's Investor Service (Baa) or Standard and Poor's (BBB) with the exception of 15% of the value of fixed income portfolio, which could be invested in below investment grade securities. The weighted average quality of the fund shall be A or better.

Restrictions:

Investment in the following is prohibited without written permission:

- Private Placements (However, private placement medium term notes and securities issued under SEC Rule 144A are permitted)
- Margin purchases or borrowing money to effect leverage into the portfolio
- Inverse floater, interest only and principal only mortgage structures

**iii.) Alternative Investments:**

Fund of Funds Hedge Funds will be held in the forms of professionally managed pooled limited partnership investments offered by professional investment managers with proven records of superior performance over time. The commodity fund will also be of the fund of fund structure.

**X. PERFORMANCE OBJECTIVES**

The overall fund performance will be reviewed on a quarterly basis, with long term emphasis placed on results achieved over a three to five year period. Objectives will be reviewed annually and adjusted, if necessary, after consultation with the Investment Committee, Investment Consultant and Investment Managers.

### **A. Total Fund:**

Fund performance will be compared to the performance of a similarly structured balanced index in line with the target allocation in each strategy. This custom index will be comprised of the S&P 500 Index, Russell 2000 Index, EAFE International Index, Barclays Capital U.S. Aggregate Bond Index, Citigroup World Government Bond Index, and Citigroup 30-day Treasury Bill Index and/or other appropriate indices. The Fund should at least equal the performance of the custom balanced index

### **B. Equity Segment:**

The performance of the domestic large cap equity portion of the Fund is expected to meet or exceed the performance of S&P 500 Composite Index, S&P/ Citigroup Growth/Value Index, Russell 1000 Growth/Value Index or other appropriate index depending on the manager's investment style.

The returns of the large capitalization equity portion of the Fund should rank in the top thirty-three percent (33%) of a nationally recognized evaluation service's universe for comparable funds and investment styles over rolling three to five year time periods.

The performance of the small capitalization equity portion of the Fund should meet or exceed the performance of the Russell 2000 Index or the Russell 2000 Value/Growth Index, depending on the manager's investment style.

The returns of the small capitalization equity portion of the Fund should rank in the top thirty-three percent (33%) of a universe for comparable funds over a rolling three to five year time periods.

The performance of the international equity portion of the Fund should meet or exceed the performance of the Morgan Stanley Capital International's Europe Australia Far East (EAFE) Index.

The returns of the international equity portion of the Fund should rank in the top thirty-three percent (33%) of a universe for comparable funds over a rolling three to five year time periods.

### **C. Fixed Income Segment:**

The performance of the fixed income portion of the Fund is expected to meet or exceed the performance of the Barclays U.S. Aggregate index, Barclays Govt/Credit, Citigroup World Government Bond Index, or other appropriate index or mix of indices, which reflect the fixed income portion of the portfolio.

The returns of the fixed income portion of the Fund should rank in the top forty percent (40%) of a universe for comparable fixed income funds over a three to five year time period.

#### **D. Alternative Investments:**

The Investment Committee recognizes that benchmarks for alternative investments, more specifically fund of funds hedge funds, are relatively new in their creation and there is no perfect benchmark in existence for these types of investments. Hedge fund indexes are created from hedge fund databases. There is no complete database because inclusion in these databases is voluntary and they are subject to survivorship bias. Additionally, each hedge fund, including fund of funds, has diverse investment objectives and characteristics making like comparisons difficult.

To aid in the on-going evaluation of the alternative investment portion of the portfolio, Diversified Fund of Funds Hedge Fund investments will be compared to the following benchmarks:

- Appropriate HFRI Fund of Funds Index
- Other benchmark designated by fund of funds manager and agreed upon by the Investment Consultant and the Investment Committee

Conservative Fund of Fund Hedge Fund investments will be compared to the following benchmarks:

- Appropriate HFRI Fund of Funds Index
- Other benchmark designated by fund of funds manager and agreed upon by the Investment Consultant and the Investment Committee

## **XI. CONTROL PROCEDURES**

#### **A. Review and Evaluation of Investment Objectives:**

The achievement of investment objectives will be reviewed on an annual basis by the Investment Committee. This review will focus on the continued feasibility of achieving the objectives and the continued appropriateness of the investment policy. It is not expected that the investment policy will change frequently. In particular, short-term changes in the financial markets should not require an adjustment in the investment policy.

#### **B. Review and Evaluation of Investment Manager(s):**

The Investment Committee will meet at least annually with the Investment Managers or their representatives (for separately managed accounts only). Additionally, with or without the Investment Managers, the Investment Committee will review investment results quarterly.

These reviews will focus on:

The Investment Managers' adherence to the policy guidelines;

- Comparison of the managers' results to the objectives established for each fund or Investment Manager as the case may be;
- Comparison of the managers' results against funds using similar policies (in terms of the stock/bond ratio and style);
- Opportunities available in both the equity and bond markets; and,
- Material changes in the Investment Managers' organizations, such as philosophical or personnel changes.

The Investment Committee may discharge or replace a manager at any time it deems such action necessary and appropriate.

Guidelines for evaluation, retention, and replacement of Investment Managers will be as follows:

- Establish appropriate benchmark/index to which to compare Investment Managers' performance.
- Establish performance target: To outperform benchmark/index and to achieve investment returns:
  - in the top thirty-third percentile (33%) of peer manager/fund groups for equities over a three to five year period;
  - in the top fortieth percentile (40%) of peer manager/fund groups for fixed income over a three to five year period;
  - Monitor managers'/funds' performance on a quarterly basis and compare to selected index and peers with similar styles and objectives.

An Investment Manager will be rated in a "Favorable Status" if they are delivering favorable performance and there are no outstanding organizational issues.

An Investment Manager will be in a "Caution Status" if:

- For Equities:
  - Investment Manager's three year performance is below the 50<sup>th</sup> percentile of their peer universe, or they are trailing the style benchmark, or
  - Investment Manager's five plus year performance is below the 33<sup>rd</sup> percentile of their peer universe, or they are trailing the style benchmark
- For Fixed Income:
  - Investment Manager's three year performance is below the 50<sup>th</sup> percentile of their peer universe, or they are trailing the style benchmark, or
  - Investment Manager's five plus year performance is below the 40<sup>th</sup> percentile of their peer universe, or they are trailing the style benchmark.

- For Alternative Investments:
  - Investment Manager’s one year performance is negative, failing to preserve capital, or
  - Investment Manager’s three year performance is below any of the indexes as listed below and in the Investment Consultant’s opinion, represents sub par results.
    - For Diversified Fund of Fund Hedge Funds
      - Appropriate HFRI Fund of Funds Index
      - Other benchmark designated by the fund manager
    - For Conservative Fund of Fund Hedge Funds
      - Appropriate HFRI Fund of Funds Index
      - Other benchmark designated by fund of funds manager and agreed upon by the Investment Consultant and the Investment Committee

An Investment Manager will also be considered on “Caution Status” if there is a material change in the ownership structure of the Investment Manager’s organization, or there is a departure of key investment professionals.

An Investment Manager that falls in “Caution Status” should undergo a formal review by the Investment Consultant. The review will address how the Investment Manager will move back to “Favorable Status” or recommend termination. An Investment Manager can move back to “Favorable Status” by improving its performance above the criteria as listed above. Highest priority will be given to those failing to meet the five-year target and next to those failing to meet the three-year target. There may be situations where immediate problems, questions or short-term performance issues arise regarding an Investment Manager and the priority will shift to review these situations first.

In addition to the above, immediate termination of investment managers should be considered:

- When they deviate from the Investment Committee’s instructions;
- When they deviate substantially from their investment disciplines and process;
- When Investment Committee members have any material problem or concern regarding the Investment Manager.

## **XII. COMMUNICATIONS**

Month-end accounting of transactions and portfolio holdings, ending portfolio and holdings values will be provided by the custodians.

Quarter-end regular accounting of transactions, portfolio holdings, yields, current market values, summary of cash flows, calculations of the portfolio's total rate of return on a latest quarter, year-to-date and since inception basis will be provided by each Investment Manager.

The Investment Managers will maintain communication with the Foundation and the Investment Consultant with as reasonable frequency as market conditions and the portfolio warrant. Major market conditions and major portfolio changes should be called to the attention of the Foundation and the Investment Consultant by the Investment Managers.

Significant changes within the Investment Managers' operations of personnel and the anticipated impact on the funds should be brought to the attention of the Investment Committee and the Investment Consultant immediately. If any changes are made to key personnel, ownership or any other critical areas of the firm, the client should be promptly informed.

The Investment Consultant will provide comparative performance evaluation reports quarterly.

Accepted by:

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Date

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Date