Vanguard Charitable

Invest *in* philanthropy

Four considerations when investing to achieve charitable goals

Methodology

This paper looks at investing trends at six points in time within philanthropic accounts at Vanguard Charitable from December 31, 2009, through December 31, 2014. All philanthropic accounts (total: 6,152) opened on or before December 31, 2009, and still open as of December 31, 2014, are included in the analysis.

How philanthropic objectives inform investment decisions

Philanthropists are most effective and successful when their charitable giving reflects their personal philosophies. Knowing what they want to achieve with their giving enables them to set standards for how to achieve it. Successful philanthropists are able to translate their giving philosophy into specific strategies and thereby accomplish their short- and long-term goals.

Donor-advised funds are useful in this regard because they provide philanthropists with an opportunity to set philanthropic goals and identify strategies to achieve them. A donor-advised fund offers a tax-effective way to consolidate, accrue, and grant assets to charity.[1] Individuals who give to charity with a donor-advised fund have an opportunity to expand their philanthropy by identifying and sticking to an investment philosophy, allocating charitable assets according to goals and, ideally, growing them over time.

Vanguard Charitable is a leading, national donor-advised fund with a long history of successfully investing and growing our assets for the benefit of thousands of nonprofit organizations. This is due in large part to our alignment with our founder company, The Vanguard Group, Inc., and its principled investment philosophy, which we ourselves adopt, that includes a commitment to diversification, transparency, and cost-effectiveness. Although Vanguard is a separate entity, its principles for investing success—craft clear goals, remain balanced, minimize costs, and maintain a long-term perspective—shape Vanguard Charitable's investment approach.[2]

Vanguard Charitable has used this approach to investing to generate an additional $1.3 billion for charitable purposes since our inception in 1997.

Just as Vanguard Charitable's philosophy informs its investing strategies, so too should individual donors' philosophies inform their philanthropy.

So what are donors' philosophies? What steps do they take to meet their specific and often very personal giving goals? What can they do to invest more wisely in their philanthropy? To answer these questions, we examined the investing behaviors of more than 6,000 of our accounts—those that have shown a commitment to giving with Vanguard Charitable by maintaining a philanthropic account for 5 or more years. Through our research, we identified several considerations for donors who are invested in making a difference.

CONSIDER YOUR CHARITABLE INVESTING PATTERN

- Is your philanthropy grounded in a personal philosophy?
- Have you developed a strategy for your giving?
- How could you use financial investments to support your giving goals and charities?

[1] In a donor-advised fund arrangement, a donor contributes funds to a charitable organization, such as Vanguard Charitable, that sponsors individual donor-advised funds. Periodically over time, the donor recommends grants and investments to the sponsoring organization, and the sponsoring organization uses the funds contributed by the donor to make grants.

[2] *Vanguard's principles for investing success*. The Vanguard Group, Inc., 2014.

Craft clear goals

Successful giving strategies are focused around a mission statement—something a donor wants to accomplish broadly with his or her philanthropy. To be actionable, underlying that mission statement should be clear, measurable goals and thoughtfully noted steps to achieve them.

Perhaps you are saving to make a large gift to a favorite charity, or maybe you are focused on sustainability and want to build an account from which you can recommend grants annually for many years.

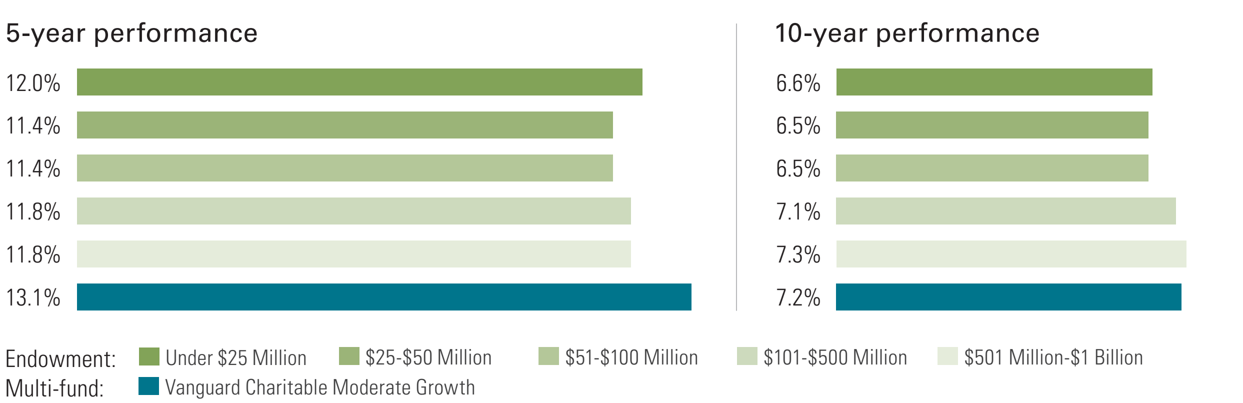
Maybe you want to give in your lifetime to your alma mater and religious affiliation, and you also want to diversify your giving by involving your children in granting decisions.

Because assets in a donor-advised fund are carved out from an overall portfolio and invested separately, you have the ability to recommend investments that further your specific goals. Once you have an objective, you can define saving and spending targets (How much will I contribute into my account each year? How much will be granted out?), set an allocation that works within your constraints, and then rebalance, monitor, and evaluate as needed.

Keep in mind that you may have multiple giving goals: Immediate, short-term support for a local food bank; a mid-term objective to help preserve a park in your neighborhood; and a goal 10+ years from now to pass charitable account privileges to your heirs. Each goal requires individual attention and, therefore, a different strategy.

Do not assume a far-reaching goal is unattainable or requires your philanthropic account to absorb significant risk. For example, donors sometimes refer to the endowment model—made popular

Figure 1. Returns of endowments vs. a Vanguard Charitable multi-fund



Note: All data are for periods ended June 30, 2014. Performance data are net of fees. Source: *2014 NACUBO-Commonfund Study of Endowments*. Vanguard Charitable Moderate Growth is a 60/40 multi-fund (fund of funds) portfolio comprised of Vanguard Balanced Index Fund, Vanguard Wellington™ Fund, and Vanguard Total International Stock Index Fund.

by large universities such as Harvard and Yale—as the pinnacle of charitable investment success. Over the long-term, and often through the use of privately held investments and a range of alternatives, these endowments earn a return that allows them to support charitable activities without reducing the principal. They also employ top tier investment managers to drive their investing choices.[3]

While effective, this specific strategy can be costly, time-intensive, and nearly impossible to replicate; the average donor and endowment will not have the expertise, resources, access, and pricing power to capture a similar result. However, thanks predominantly to very low costs and efficient markets, a portfolio allocated in 60% stocks and 40% bonds at a donor-advised fund can produce extremely competitive results over the long-term (Figure 1).

How donors invest in philanthropy

Follow the North Star

A family has one clear objective: "Develop a philanthropic legacy that supports the community—without putting economic pressure on any one family member—and enables future generations to carry on our giving spirit." To ensure success, the family established definitive policies, investing guidelines, and decision-making roles for their philanthropic account. This strategy has allowed them to recommend hundreds of grants while maintaining a steady account balance, thereby ensuring the next generation may continue to give in earnest in the family tradition.

APPLY TO YOUR GIVING

- What do I want to achieve with my charitable assets?
- Which charities do I want to support, with how many grants, and when?
- How often will I contribute assets into my account or recommend grants out to nonprofit organizations?

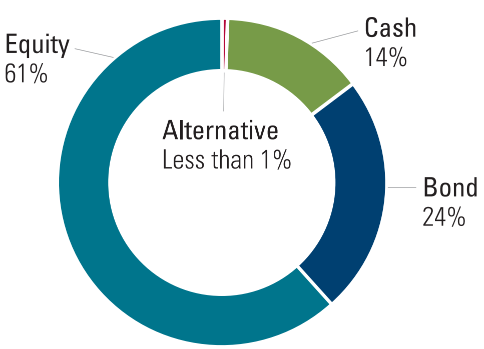
[3] *Assessing the endowment performance: The enduring role of low-cost investing.* The Vanguard Group, Inc., 2014.

Remain balanced

A balanced charitable portfolio is the key to meeting giving goals—within your personal constraints. As a donor, you must determine what level of risk you are willing to assume, over what period of time, and balance that against expectations for returns. Diversifying investment options, over the long-term, gives an account the best chance to minimize losses and maximize gains—for the benefit of your philanthropy.

At Vanguard Charitable, we offer donors access to a broad range of investment options, including international and domestic and across major asset classes. To date, the majority of account assets are concentrated in equity, followed by bonds (Figure 2). This allocation has remained fairly consistent over time.

Figure 2. Asset allocation of donors' accounts



Note: Asset allocation as of December 31, 2014, for active accounts opened on or before December 31, 2009.

A high percentage of assets are invested in cash, a very low risk option used to preserve principal. This finding raises questions about the long-term strategies of donors. If investing charitable dollars for five years or more, what are they hoping to achieve? Are they wary of the markets and risk-averse to the point that they are comfortable with the rate of inflation increasing more quickly than returns? Do they even need growth to reach their goals, or are they content with preservation?

Historically, cash investments have tended to underperform stocks and bonds over longer periods of time. So while cash investments may reduce the risk of losing money, it may increase the risk of falling short of investment goals—and as a result charitable goals—over time. Therefore, for most donors with a long-term charitable investment horizon, excess cash holdings may not be prudent.

Constructing a charitable portfolio

More than 40 percent of Vanguard Charitable accounts are invested in Moderate Growth, a 60% stock and 40% bond allocation that seeks to provide growth of capital and a reasonable level of current income. This is followed by Gift Preservation, Growth, and Total Equity—also multi-fund options. These simple yet sophisticated fund-of-funds are managed by professionals who set the allocation and then rebalance the funds daily. Like other balanced funds, these multi-fund options diversify risk to try to more efficiently achieve longer term investment goals—with no involvement from a donor.

Single fund options, such as Vanguard Charitable Total Bond and Total U.S. Stock, allow donors to construct a portfolio and then recommend exchanges and rebalance—mixing options to create a custom balanced allocation. These options require consistent oversight to ensure the set allocation is maintained as the markets move.

While Vanguard Charitable's investment lineup has remained fairly consistent over the past 10-15 years—allowing tracking and showcasing of performance over the long-term—occasionally new options are introduced. For example, we added Vanguard Charitable Emerging Markets Stock, an especially popular option due to significant exposure in the public media. It grew by 45 percent in its first two years. We caution donors to take care when recommending investments of charitable assets in new options and to consider their giving horizons.

Diversifying with actively managed funds

Although they may be more costly to buy into and maintain than index funds, actively managed funds can offer significant diversification and an opportunity to improve the risk-adjusted performance of a charitable account over time.

The long-term strategy and balance of an actively managed fund may help donors with high account balances meet aggressive, endowment-like goals over time. However, donors also must be comfortable with the active manager risk inherent in options like this that are designed to try to outperform a certain benchmark, as well as the additional expenses often incurred.

How donors invest in philanthropy

It pays to pay attention

"Things change," one donor said. "It pays to pay attention." This donor considers her philanthropic account an investment in the future and, therefore, actively monitors its allocation and rebalances when needed. The donor recommends 5% a year in grants to educational and environmental causes, while allowing a portfolio of domestic and international equity to grow the overall account balance over time.

APPLY TO YOUR GIVING

- What risks am I willing to take with my charitable assets?
- Am I choosing allocations that align with my risk tolerance and support my goals?
- How actively will I monitor my account? Do I rebalance my account holdings when I contribute new assets or recommend a grant?
- Does my allocation align with my giving timeframe and expectations for returns?

Minimize cost

It's counterintuitive: To give money to charity successfully, money must be spent. Investment fees, which support the management of and exchanges within a giving portfolio, play a crucial role in long-term philanthropic plans. Over time, a high expense ratio may erode returns—minimizing total charitable impact.

However, charitable assets can be invested cost-effectively, and without compromising value to beneficiary nonprofit organizations. At Vanguard Charitable, we are committed to offering low-cost active and index investments with expense ratios that have a history of being decreased over time (Figure 3).

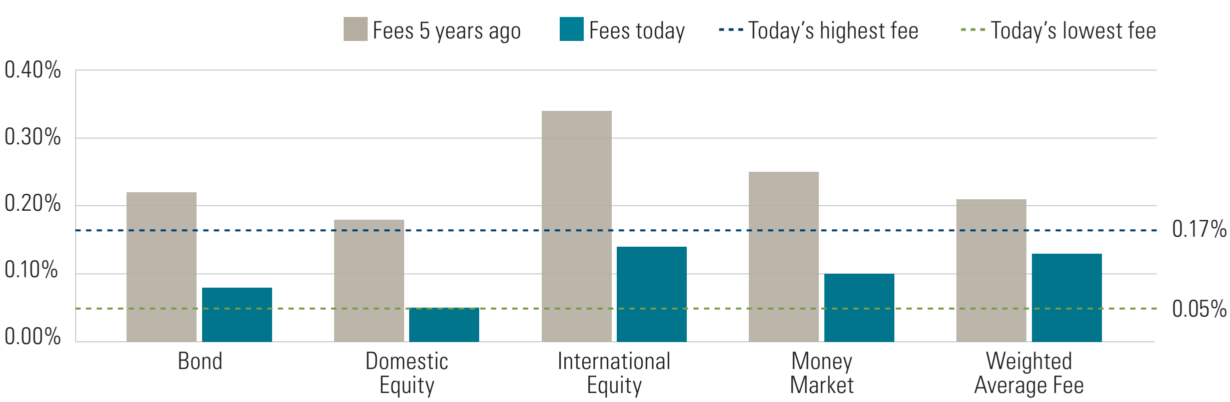
Because the charitable assets in philanthropic accounts are pooled and then invested, Vanguard Charitable secures access to even lower investment pricing than may traditionally be assessed—savings that are passed directly to donors' accounts.

When we work with our investment partners to keep costs low, we are able to keep more charitable dollars working for the causes donors care about most.

The positive effects of low costs are compounded over time. Take this comparison of Vanguard Charitable's Moderate Growth to another investment option—with the exact same performance but a higher expense ratio. Assume similar granting patterns and that both accounts are sponsored by a donor-advised fund (Figure 4).

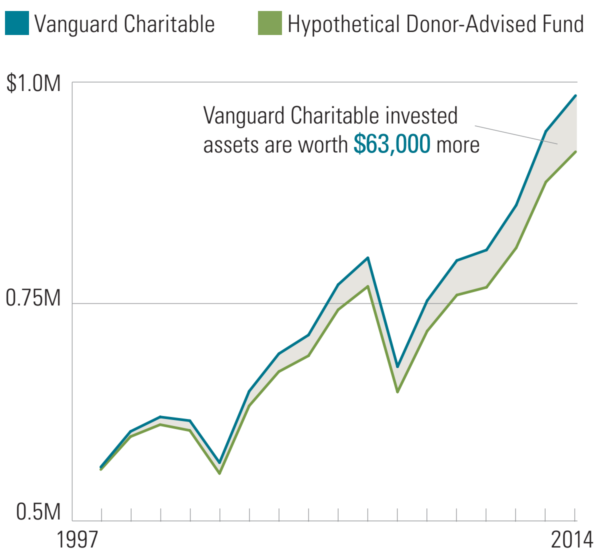
Over 17 years, the assets invested in the low cost option are worth $63,000 more than the alternative—making nearly 7% more dollars available for charitable causes.

Figure 3. Fees over time, by asset class



Note: Bond is based on 100% Vanguard Total Bond Market Index Fund. Domestic Equity is based on 100% Vanguard Total Stock Market Index Fund. International Equity is based on 100% Vanguard Total International Stock Index Fund. Money Market is based on 100% Vanguard Prime Money Market Fund. All fees for Standard accounts (ongoing balances below $1 million) as of December 31, 2014. "Fees 5 years ago" is as of December 31, 2009. "Fees today" is as of December 31, 2014. "Today's lowest fee" is Vanguard Charitable Total U.S. Stock. "Today's highest fee" is Vanguard Charitable Moderate Growth. Weighted average fee is comprised of and calculated based on invested assets as of December 31, 2014. Excludes TIFF Multi-Asset Pool.

Figure 4. Total charitable impact: High versus low fees



Assumptions

Initial contribution	$500,000
Years invested	17
Grants	5% balance annually
Portfolio allocation	60% stocks, 40% bonds
Administrative fee	First $500K: 0.60% Next $500K: 0.40%
Average expense ratio	0.25% (Vanguard Charitable) 0.75% (Hypothetical)
Average annual return	6.67%

Note: Allocation is based on Vanguard Charitable Moderate Growth. Average annual return as of December 31, 2014, is calculated as a time-weighted return annualized over a 17-year period.

How donors invest in philanthropy

Minimize cost to maximize impact

"We don't want our charitable account to get eaten up by fees," said a couple whose account is invested in 85% equities and 15% bonds. Each year, they strategically plan their contributions and grant recommendations and, no matter the markets, stay focused on consistently supporting their favorite charities. "We've calculated it, and due to low fees and strong performance, our account has $200,000 extra for the nonprofit organizations we support."

APPLY TO YOUR GIVING

- What am I willing to pay to invest my charitable assets?
- How can I use low cost investments to further my goals?
- Do I consider the price of my investments—and how it may impact my favorite charities—before allocating or exchanging options?

Maintain perspective and long-term discipline

The benefits of a sound strategy are best realized over the long-term; the same is true for charitable giving. Try not to let donation solicitations or the volatility of the markets distract from a charitable goal. Stay focused on what you set out to achieve with your philanthropy, and maintain control of what you can, such as costs and spending (i.e. donations, fees, and grant recommendations).

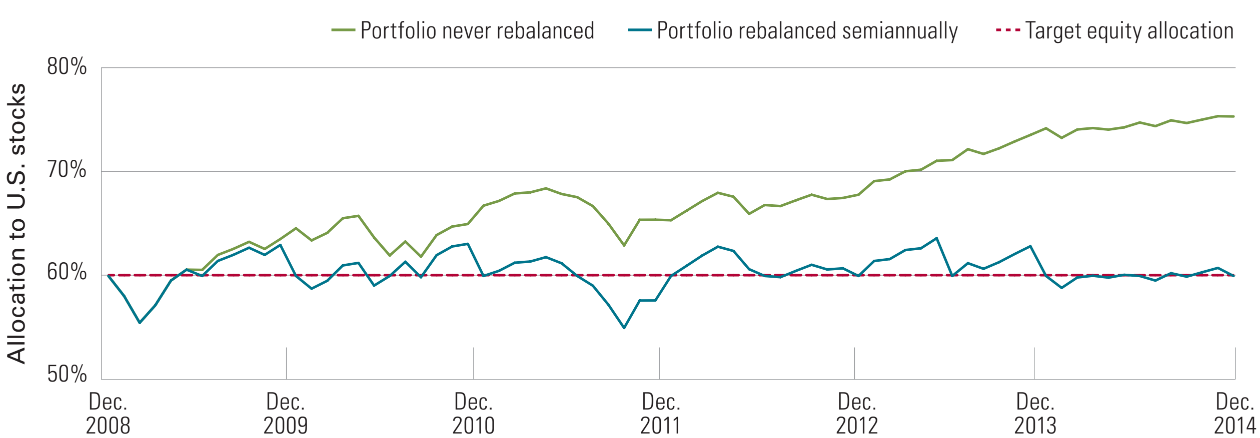
Many Vanguard Charitable donors have maintained a consistent charitable investment strategy over the tenure of their account. This commitment to a set strategy is admirable and ideally met with a commitment to periodically check the allocation and rebalance funds appropriately to stay on track to meet goals.

Take an example of a 60% stock and 40% bond portfolio. Over time, an account that is not rebalanced may drift, and more of the assets may be invested in equity. This opens the account to unplanned risk—potentially compromising charitable goals (Figure 5).

A rebalanced portfolio, however, avoids additional risk by returning to the 60/40 allocation semiannually. Donors who wish to minimize risk and stay within a set plan can recommend investments in multi-fund options, which rebalance daily and ensure traction toward established goals.

Ideally, even a set strategy is occasionally assessed against current constraints. For example, a change in contribution patterns, such as retirement, or a shift in granting patterns, such as a large gift for a new charity, may require a shift in strategy.

Figure 5. Change in stock exposure for a rebalanced portfolio and a "drifting portfolio"



Note: Bond refers to Vanguard Charitable Total Bond, which is based on Vanguard Total Bond Market Index Fund. Stock refers to Vanguard Charitable Total U.S. Stock, which is based on Vanguard Total Stock Market Index Fund.

How donors invest in philanthropy

Unless the time horizon changes

A tax advantageous situation led a donor to open an account. Now, he's focusing on achieving a range of goals. In the short-term he is making smaller gifts to charities he likes. "As I see how they operate and use the money, I'll give more," he said, and gradually increase his grant recommendations. His account will stay invested in 100% equities, "unless my time horizon changes," because of a long-term goal: He plans to donate a rare book and manuscript collection to an institution and wants to accompany that gift with a grant for operating expenses needed to catalogue and archive the collection.

APPLY TO YOUR GIVING

- How committed am I to my giving plan?
- Do I allocate charitable dollars to meet long-term objectives, or am I focused only on tomorrow?
- Do I occasionally rebalance funds to ensure I'm on track with my goals?

For examples of donors who recommended charitable investments to reach specific, long-term goals, read *Save to give: Managing and investing assets to maximize philanthropic potential.*

Vanguard Charitable was founded by The Vanguard Group, Inc., as an independent, nonprofit, public charity in 1997. Although Vanguard provides certain investment management and administrative services to Vanguard Charitable pursuant to a service agreement, Vanguard Charitable is not a program or activity of Vanguard.

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