

# **INVESTMENT POLICY STATEMENT**

*For*

**DIOCESE OF COVINGTON**

**POOLED INVESTMENT FUNDS**

Effective

January 1, 2020

## EXECUTIVE SUMMARY

Use of Assets: Pooled Investments – Diocese, Parish, School and Other – Endowments and other Long-term Investments

Planning Time Horizon: More Than Five (5) Years

Expected Return: 5% over CPI

Asset Allocation:	Lower <u>Limit</u>	Strategic <u>Allocation</u>	Upper <u>Limit</u>
Domestic Large Capitalization Equity	32%	42%	52%
Domestic Small Capitalization Equity	9%	14 %	19 %
International Equity	<u>9%</u>	<u>14 %</u>	<u>19 %</u>
Total Equities	60%	70%	80%
Fixed Income & Cash	20%	30%	40%

Overall Strategic Allocation 70 % Equity / 30 % Fixed

### Money Managers:

Domestic Large Capitalization Equity	State Street Global Advisors
Domestic Small Capitalization	Silvercrest Asset Management Equity Group Bahl & Gaynor Investment Counsel GW&K Investment Management
International Equity	Boston Common Asset Management Christian Brothers Investment Services
Fixed Income	Richmond Capital Management

Evaluation Benchmark: Total portfolio return to exceed customized Balanced Index<sup>1</sup>  
Total portfolio return to exceed CPI plus 5%.

<sup>1</sup> The customized Balanced Index is based upon the strategic allocation of the fund to the various broad asset classes and the corresponding market index. Specifically, the customized Balanced Index is comprised of 42% S&P 500, 14% Russell 2000 Stock Index, 14% Morgan Stanley Capital International's Europe, Australasia, and Far East (EAFE) Stock Index and 30% Bloomberg Barclays Aggregate Bond Index.

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## *PURPOSE*

The Purpose of this Investment Policy Statement (IPS) is to establish an understanding of the philosophy and investment objectives of the pooled investment funds and to assist the Diocesan Finance Council (Council) in effectively supervising, monitoring and evaluating the investment of these assets. The investment program is defined in the various sections of the IPS by:

- Stating in a written document the Council's objectives, attitudes, expectations, and guidelines in the investment of all assets.
- Setting forth an investment structure for managing all assets. This structure includes various asset classes, investment management styles, asset allocation and acceptable ranges that, in total, are expected to produce a sufficient level of overall diversification and total investment return over the long-term.
- Providing guidelines for each investment portfolio that controls the level of overall risk and liquidity assumed in that portfolio so that all assets are managed in accordance with stated objectives.
- Encouraging effective communications between the Council, Investment Committee, Investment Consultant and the money managers.
- Establishing formalized criteria to monitor, evaluate and compare the performance results achieved by the money managers on a regular basis.
- Complying with all fiduciary, prudence and due diligence requirements that experienced investment professionals would utilize, and with all applicable laws, rules and regulations from various local, state, federal and international political entities that may impact the assets.

This IPS has been arrived at upon consideration of the financial implications of a wide range of policies, and describes the prudent investment process that the Council deems appropriate.

## **BACKGROUND**

The investments in the pooled investment funds started with the accumulation of operating surpluses of the Diocese over the last 60 years. The investment pool has been expanded to allow for participation and investment by various schools, parishes and other institutions of the Diocese of Covington by creating another pool, the Parish Pool, which is overseen by Council using this IPS and managed in the same way as the Diocesan Pool.

Through the investment pools, professional investment management is brought to the participants in a cost-effective manner. The pools allows these institutions to be assured of good professional, unbiased advice in the management of these long-term funds. Minimum investment by participants is \$100,000 for a period of at least three years.

The following participants are invested in the Diocesan Pool:

- Diocesan Long-term investments
- Diocesan Endowment for Education
- Diocesan Endowment for Social Concerns
- Diocesan Endowment for Annual Appeal
- Diocesan Deposit & Loan Fund  
(to provide loans to parishes, schools, etc.)
- Diocesan Catholic Cemetery Endowment

The Parish Pool is available for any parish or school to place investment or endowment funds. The list of participants in this pool will vary over time.

## *Key Information:*

Finance Council Members:	Appointed by the bishop, 11 members
Custodian:	U.S. Bank Institutional Trust & Custody Shaun Tillman 50 S 16 <sup>th</sup> St. Suite 2000 Philadelphia, PA 19102 (215) 761-9355
Investment Consultant:	Fourth Street Performance Partners, Inc. Neil Heppler & Ken Dorger 211 Garrard Street Covington, KY 41011 (859) 491-5556
Accountant:	Barnes, Dennig & Co. Rob Ford 150 East Fourth Street Cincinnati, OH 45202 (513) 241-8313
Attorney:	Dressman, Benzinger LaVelle, PSC ("DBL Law") Mark Guilfoyle 207 Thomas More Parkway Crestview Hills, KY 41017-2596 (859) 341-1881

## *STATEMENT OF OBJECTIVES*

The primary objective of the pooled investment funds is to protect the future purchasing power of these assets while providing meaningful annual financial support to the participants.

In recognition of its responsibility, the Council recognizes the need for careful investment of these resources which will maximize the total return earned over the long term while minimizing the risk of capital loss in the short term in a manner that is consistent with sound fiscal management practices.

The Council also recognizes both its right and obligation to challenge the policies and actions of companies and other social institutions which in any way limit human freedom or cause social, political, or economic injustice. In addition, the Council will make recommendations to exclude investing in securities of companies whose products or specific policies run counter to the moral and ethical norms of the Catholic Church.

## ***GUIDELINES AND INVESTMENT POLICY***

The Council may elect to manage the pooled investment funds by selecting one or more investment managers. Investment managers may manage assets in separate accounts or through commingled or mutual funds. If individual investment managers are used, the general guidelines that follow shall apply. If commingled or mutual funds are utilized, then the Council has the responsibility to review the funds' investment guidelines and procedures from time to time to insure that these meet the general, but not necessarily the specific criteria established herein. If a commingled or mutual fund follows policies that the Council cannot support, sale of the fund investment shall be considered.

### ***Time Horizon***

The investment guidelines are based upon an investment horizon of greater than five years, so that interim fluctuations should be viewed with appropriate perspective. Similarly, the strategic asset allocation is based on this long-term perspective.

### ***Spending Policy***

The total return concept will be used and is defined as the sum of capital appreciation (or loss) and current income achieved in the form of dividends and interest. The pooled investment funds will make quarterly distributions to participating entities based upon a fixed percentage (presently set at 4.5%) of the three year historical moving average of the market value of all pooled investments. Participants are permitted to take more or less of this calculated distribution upon discussion with, and permission from, the Chief Financial Officer of the Diocese. The amount of distribution will be calculated annually and directions given to the investment managers for the quarterly distributions. This spending policy will be reviewed annually by the Budget Committee of the Council.

### ***Risk Tolerances***

The Council recognizes the difficulty of achieving the investment objectives in light of the uncertainties and complexities of contemporary investment markets. The Council also recognizes that some risk must be assumed to achieve the long-term investment objectives. In establishing the risk tolerances of the IPS, the ability to withstand short and intermediate term variability were considered.

In summary, the current financial condition, the Diocese's prospects for the future, and several other factors, suggest collectively that the participants can tolerate minor interim fluctuations in market value and rates of return in order to achieve long-term objectives.

It is expected that the volatility of the total portfolio, in aggregate, will be within 20% of the volatility of the custom index. The standard deviation of return of the total portfolio should be less than 80% of the standard deviation of the S&P 500 over any one year period.

### ***Performance Expectations***

The desired investment objective is a long-term rate of return on assets that is at least 5% greater than the rate of inflation as measured by the Consumer Price Index (CPI). The target rate of return has

been based upon the assumption that future real returns will approximate the long-run rates of return experienced for each asset class in the IPS.

The Council realizes that market performance varies and that a 5% real rate of return may not be meaningful during some periods. Accordingly, relative performance benchmarks for the fund as well as the managers are set forth in the "Control Procedures" section.

### ***Asset Allocation Constraints***

The Council believes risk and liquidity posture are, in large part, a function of asset class mix. The Council has reviewed the long-term performance characteristics of various asset classes, focusing on balancing the risks and rewards of market behavior.

- The asset allocation should reflect the following structure:

	<u>Lower Limit</u>	<u>Strategic Allocation</u>	<u>Upper Limit</u>
Domestic Large Capitalization Equity	32%	42%	52%
International Equity	9%	14%	19%
Domestic Small Capitalization Equity	<u>9%</u>	<u>14%</u>	<u>19%</u>
Total Equities	60%	70%	80%
Fixed Income & Cash	20%	30%	40%

Overall Strategic Allocation is 70% Equity/30 % Fixed

- The allocation between investment managers and asset classes will be reviewed on a quarterly basis and rebalanced as necessary.
- To the extent the Council decides to allocate pooled investment fund assets to nontraditional, illiquid, and/or nonmarketable securities including, but not limited to, high yield bonds, emerging market bonds, private equity partnerships, hedge funds, and real estate investments (including real estate investment trusts), these assets will be treated collectively as alternative investments for purposes of measuring the Portfolio's asset allocation. While not specifically considered within this policy, alternative investments may comprise up to 15% of total Portfolio assets and, to the extent they are owned, will proportionately reduce target allocations to the two primary asset classes designated in the previous table.

### ***Prohibited Activities***

The following securities and transactions are not authorized: letter stock and other unregistered securities, commodities or other commodity contracts, or margin transactions. Securities lending,

options and futures, real estate, and precious metals are restricted, except by petition to the Council for approval.

As mentioned above, the Council recognizes both its right and its obligation to challenge the policies and actions of companies and other social institutions which in any way limit human freedom or cause social, political, or economic injustice. In addition, the Council will make recommendations to exclude investing in securities of companies whose products or specific policies run counter to the moral and ethical norms of the Catholic Church. In that regard, the Council will seek to avoid investments in the securities of companies that are engaged in the activities described below.

a) Abortion

1. Derive any revenue from direct participation in or support of abortions.
2. Derive any revenue from the manufacture of abortifacients.
3. Derive any revenue from performing abortions unless absolutely required by law to do so.

b) Contraception

1. Derive any revenue from the manufacture of contraceptives.
2. Derive significant revenue (>5%) from the sale of contraceptives.

c) Embryonic Stem Cell and Human Cloning

1. Engage in scientific research on human fetuses or embryos.
2. Make use of tissue derived from abortions or other life ending activities.
3. Violate the dignity of a developing person.
4. Engage in embryonic stem cell research, fetal tissue research, stem cell research derived from embryos, and human cloning

d) Weapons

1. Primarily engage in military weapons production.
2. Develop biological and chemical weapons, arms regarded as first-strike nuclear weapons, or other indiscriminate weapons of mass destruction.
3. Have direct involvement in the manufacture, sale, use of landmines.

e) Tobacco

1. Derives significant revenues (>5%) or have leading market share in production and marketing of tobacco products, including components.

f) Pornography

1. Derives significant revenues (>5%) from products and services intended exclusively to appeal to prurient interest in sex.
2. Engage in X-rated films, videos, publications, software, topless bars and strip clubs, sexually oriented telephone and Internet services.

g) Labor and Employment

1. Have discriminatory policies against people of varied ethnic and racial backgrounds that have been historically disadvantaged.
2. Have discriminatory policies against women.

## ***SECURITIES GUIDELINES***

Every money manager selected to manage pooled investment fund assets must adhere to the following guidelines.

### ***Domestic Equities:***

- Equity holdings in any one company should not exceed more than 8% of the manager's total equity portfolio.
- Concentrations to any economic or industry sector should not be excessive.
- There shall be no purchase which would cause a position in the portfolio to exceed 5% of the issue outstanding.
- The managers shall have the discretion to invest a portion of the assets in cash reserves when they deem appropriate. However, the managers will be evaluated against fully invested passive indices and their peers on the performance of the total funds under their direct management.
- Equity holdings shall be readily marketable securities of corporations that are actively traded on the major U.S. exchanges.

### ***International Equities:***

- Equity holdings in any one company shall not exceed more than 8% of the manager's total equity portfolio.
- Country and Economic Sector allocations should not be excessive.
- The manager may enter into foreign exchange contracts on currency provided the use of such contracts are conservative in nature. Primary use of such contracts shall be to dampen portfolio volatility rather than leverage the portfolio. There shall be no direct foreign currency or futures speculation.

### ***Domestic Fixed Income:***

- All fixed-income securities purchased in the portfolios shall have a Moody's, Standard & Poor's and/or a Fitch's credit quality rating of no less than investment grade "Baa-/BBB-/BBB-", with an average rating of "A." In no event may more than 5% of the Domestic Fixed Income portfolios be in securities rated below investment grade "Baa-/BBB-/BBB-". U.S. Treasury and U.S. government agencies, which are unrated securities, are qualified for inclusion in the Domestic Fixed Income portions of the portfolios.
- The exposure of the portfolio to any one issuer, other than securities of the U.S. government or agencies, shall not exceed 10% of the market value of the portfolio.
- Holdings of individual securities shall be large enough (round lots) for easy liquidation.

### *Cash/Cash Equivalents:*

- Cash equivalent reserves shall consist of cash instruments having a quality rating of A-1, P-1 or higher. Eurodollar Certificates of Deposits, time deposits, repurchase agreements are also acceptable investment vehicles.
- Not more than the current FDIC insurable limit shall be invested in the bank certificates of deposit of any single issuer.
- Any idle cash not invested by the investment managers shall be invested daily through an automatic sweep managed by the custodian.

## *SELECTION OF MONEY MANAGERS*

The Council, with the assistance of a consultant, will select appropriate money managers to manage the assets. Managers must meet the following minimum criteria:

1. Be a bank, insurance company, investment management company, or investment adviser as defined by the Registered Investment Advisers Act of 1940.
2. Provide historical quarterly performance numbers calculated on a time-weighted basis, based on a composite of all fully discretionary accounts of similar investment style, and reported net and gross of fees.
3. Provide performance evaluation reports prepared by an objective third party that illustrate the risk/return profile of the manager relative to other managers of like investment style.
4. Provide detailed information on the history of the firm, key personnel, key clients, fee schedule, and support personnel. This information can be a copy of a recent ADV-II completed by the manager.
5. Clearly articulate the investment strategy that will be followed and document that the strategy has been successfully adhered to over time.
6. The money manager candidate should have positive historical risk-adjusted investment performance when compared to their peers.

## ***CONTROL PROCEDURES***

### ***Duties and Responsibilities of the Money Managers***

The duties and responsibilities of each money manager retained by the Council include the following:

1. Managing the assets under its care, custody and/or control in accordance with the IPS objectives and guidelines set forth herein, and also expressed in separate written agreements when deviation is deemed prudent and desirable by the Council.
2. Exercising investment discretion [including holding cash equivalents as an alternative] within the IPS objectives and guidelines set forth herein.
3. Promptly informing the Council in writing regarding all significant and/or material matters and changes pertaining to the investment of assets.
4. Promptly voting all proxies and related actions in a manner consistent with the long-term interests and objectives set forth herein. Each manager shall keep detailed records of said voting of proxies and related actions and will comply with all regulatory obligations related thereto.
5. Utilize the same care, skill, prudence and due diligence under the circumstances then prevailing that experienced, investment professionals acting in a like capacity and fully familiar with such matters would use in like activities.

### ***Performance Objectives***

Investment performance for the pooled investment funds is expected to exceed the Consumer Price Index (CPI) by 5% as well as a customized Balanced Index comprised of 42% S&P 500, 14% Russell 2000 Stock Index, 14% Morgan Stanley Capital International's Europe, Australasia, and Far East (EAFE) Stock Index and 30% Bloomberg Barclays Aggregate Bond Index over rolling 5 year periods.

Investment performance will be reviewed at least annually to determine the continued feasibility of achieving the investment objectives and the appropriateness of the IPS for achieving those objectives.

It is not expected that the IPS will change frequently. In particular, short-term changes in the financial markets should not require adjustments to the IPS.

### ***Monitoring of Money Managers***

The Investment Committee of the Council will review performance reports four times a year and will meet to focus on:

- Managers' adherence to the IPS guidelines;
- Material changes in the managers' organizations, investment philosophies and/or personnel;
- Managers' maintenance of positive risk/reward characteristics - (ie: ALPHA) over 3 and 5 year periods.

- Comparisons of the managers' results to appropriate indices, specifically:

<u>ASSET CLASS</u>	<u>INDEX</u>	<u>PEER UNIVERSE</u>
Large Cap. Equity:	S&P 500 Index	Core
Small Cap. Equity:	Russell 2000 Index Russell 2000 Value Index Russell 2000 Growth Index Russell 2500 Growth Index	Growth/Value
International Equity:	MSCI Europe, Australasia, and Far East (EAFE) Index	International Equity
Domestic Fixed Income:	Bloomberg Barclays Aggregate Bond Index	Core Bond
Cash:	90-Day U.S. Treasury Bills	

An investment manager will be placed on a "Watch List" for a 6-month/2-quarter period of time if the following occurs:

- The Manager's investment results are consistently below those of both the Manager's passive market index and the median manager (50th percentile) of their peer group over rolling 5-year periods, and
- The Manager's investment results consistently produce negative risk-adjusted returns against its passive market index and peer group over rolling 5-year periods.

After being placed on the "Watch List" for 6-months/2-quarters, if the investment manager's investment results still fail to meet the criteria above, the investment consultant will provide a recommendation on whether to conduct an in-depth analysis of the investment manager in question for the Sub-committee. If the investment manager's performance is deemed inadequate after this review, then the Sub-committee may replace the investment manager with a new investment manager.