Investment Objectives and Guidelines for East Stroudsburg University Foundation

(Investment Policy Statement)

Approved by the ESU Foundation Board February 9, 2017

Revised May 23, 2019

Revised August 13, 2020

Revised August 17, 2023

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I. INTRODUCTION

This Investment Policy established by the Board of Directors ("Board") of the East Stroudsburg University Foundation ("The Foundation") sets the investment philosophy and practices for the Foundation's portfolio of assets ("Portfolio").

II. INVESTMENT OBJECTIVE

Investment Philosophy

The Board recognizes a fiduciary responsibility to invest the Portfolio in a prudent manner, in sound investments, consistent with applicable law, ethical standards, and prevailing financial market conditions, and in furtherance of realistic return goals. The aim of the Board is to protect the assets of the Foundation and strive to maximize the total return to the extent possible without assuming excessive risk. Investment of the Portfolio shall conform to the standards stated herein, or such other Investment Policy as may be adopted by the Board from time to time.

In addition, the Board recognizes that there are different categories of funds within the Portfolio that vary with respect to purpose, liquidity and distribution requirements, time frame for use, source, donor restriction, and other characteristics, all of which the Board may appropriately consider when establishing investment guidelines and objectives.

That said, certain general tenets apply to the Portfolio as a whole. Investments in all classifications should seek to minimize investment risks while maximizing asset value. Adequate liquidity should be maintained so assets may be held to maturity. Reasonable portfolio diversification should be pursued to ensure that no single security or investment or class of securities or investments will have a disproportionate or significant impact on the total Portfolio. Investments may be made in U.S. dollar-denominated debt of high-quality U.S. and non-U.S. corporations. Investment performance should be monitored on a frequent and regular basis to ensure that objectives are attained and guidelines are followed.

Trust Funds:

Trust Funds include those funds which the Foundation has received in trust or to be held as restricted endowment funds, sometimes referred to as donor-designated funds. Consistent with the East Stroudsburg University Foundation, Inc. Resolution Regarding Investment and Distribution of Certain Trust Funds on a Total Return Basis ("Total Return Resolution"), the Investment Policy for the Trust Funds shall seek a total return for the assets, whether the return is to be derived from appreciation of capital or earnings and distributions with respect to capital or both. The primary investment goal is preserving the purchasing power by striving for long-term returns which exceed distribution, costs for administration and inflation. Ideally, the Trust Funds will perform at least in line with peers that are comparably situated, *i.e.*, institutions in the NACUBO universe with similar asset levels.

The Investment Policy for the Trust Funds will be based on the annual spending percentage being between 2% and 7% of the three-year average fair market value of the assets as required by the Total Return Resolution and by 15 Pa. C.S. § 5548 or 20 Pa. C.S. § 8113. A percentage will be made available to fund specific scholarships, programs and activities in any given year. Currently, the spending policy is set at 4%; this percentage is evaluated annually by the Finance Committee and may be revised as detailed in the Total Return Resolution.

Current-Use and Quasi-Endowment Funds:

This category includes current-use funds that are unrestricted, current-use funds with a donor-designated purpose, and funds allocated to the endowment by the Board, referred to as quasi-endowment funds. The assets in this category should be invested with the primary objective of preserving capital while maximizing current returns in order that returns exceed the intended 5% annual spending rate.

III. TIME HORIZON

The time horizon for the Portfolio is perpetual, although the liquidity needs vary based on the category of asset, whether that category is subject to an administrative fee in accordance with the Foundation's Administrative Fee Spending Policy ("Fee Policy"), and the Foundation's annual budget and spending decisions. For strategic planning purposes, a minimum of five 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 suggests 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.

IV. RISK TOLERANCE

The Investment Committee recognizes 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.

V. PROCEDURES

The Investment Committee is charged with the oversight of the investment of the Portfolio as a whole. The roles of the Investment Committee and the Investment Manager(s) with regard to the Portfolio are delineated as follows:

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

A. Establishing overall financial objectives and setting investment policy;
B. Setting parameters for asset allocation;
C. Establishing a process and criteria for the selection and termination of investment program managers and/or custodians;
D. Selecting a qualified investment management consultant, if applicable;
E. Recommending a qualified Investment Manager(s) for approval by the Board;
F. Selecting a qualified custodian;
G. Monitoring investment results quarterly to assure that performance objectives are being met and that policy and guidelines are being followed;
H. Communicating on a structured and ongoing basis with Investment Manager(s) and any others responsible for investment results;
I. Providing the Board with information regarding fund investment structure and performance against established objectives and policies.

The Investment Manager(s) will be responsible for the following:

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

VI. COMMITTEE OPERATIONS

A. The Investment Committee shall meet as required, but not less than four times each year;
B. The actions of the Investment Committee shall be recorded in formal minutes;
C. The Investment Committee may adopt procedures necessary to conduct its affairs;
D. The Investment Committee authorizes members of the Executive Committee to execute or deliver any instrument on its behalf;
E. The Executive Director of the Foundation, or his/her representative, is authorized to carry out all administrative functions required by Investment Committee action.

VII. ASSET ALLOCATION

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. The Investment Committee has determined that domestic and international equities both large and small capitalization, fixed income, cash equivalent securities, and alternative investments including real estate, private equity, and hedge funds are acceptable vehicles for these 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, the following asset allocation strategy is incorporated to achieve the objectives of these assets:

Asset Category	Minimum	Target	Maximum
Cash	**2.00%**	**3.00%**	**10.00%**
Fixed Income	**30.00%**	**40.00%**	**60.00%**
Equity	**35.00%**	**55.00%**	**60.00%**
Alternative Investments	**0.00%**	**2.00%**	**10.00%**

B. Liquidity

Adequate liquidity should be maintained as required for budgeted distribution and the payment of administrative fees when charged pursuant to the Fee Policy and to meet any set minimum cash requirement. It is intended that Investment Manager(s) will be given ample notice for any withdrawals to reduce the probability of adversely affecting the Portfolio. Additionally, any withdrawals will be funded on a pro-rata basis to ensure that the asset allocation after the withdrawals is within the investment guidelines as listed above.

C. **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 the Board will review both the specific asset allocation (equity vs. fixed income) 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.

VIII. SELECTION AND RETENTION

A. **Investment Management**

The Investment Committee shall recommend, and the Board shall approve, Investment Manager(s) (including mutual funds) using the following criteria:

1. The investment style and discipline of the proposed manager;
2. The size of the organization as measured by the amount of assets under management with respect to the investment style under consideration;
3. Experience of the organization as measured by the tenure of the professionals with respect to the investment style under consideration;
4. 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;
5. The historical volatility and down-side risk of each proposed investment;
6. How well each proposed investment complements other assets in the Portfolio.

B. **Portfolio Composition**

1. For purposes of investment policy, Portfolio assets shall be considered as four parts: an 'equity fund,' a 'fixed income fund,' an 'alternative fund,' and a 'cash fund' (together, the "Funds"). The Investment Committee will establish a long-term policy range or band for all Funds, as well as a current target exposure for each asset class;

2. The 'equity fund' (including domestic stocks, foreign stocks, ADR's) is intended to provide long-term capital appreciation and a growing stream of income. It is recognized that the 'equity fund' by itself will likely entail the assumption of greater price variability than the 'fixed income fund' and possibly the 'alternative investment fund';

3. The 'equity fund' should normally represent 35-60% of total Portfolio assets at market value. The actual percentage of equities will vary with market conditions, within a band set by the Committee;

4. The purpose of the 'fixed income fund' is to provide a hedge against deflation, to produce a source of current income, and to help diversify the total Portfolio;

5. The 'fixed income fund' should normally represent 30-60% of total Portfolio assets at market value;

6. The purpose of the ‘alternative investment fund’ is to give exposure to certain market specialists who can produce outsized returns with limited volatility;

7. The ‘alternative investment fund’ should normally represent 0-10% of total Portfolio assets at market value;

8. The purpose of the ‘cash fund’ is to provide sufficient liquidity to satisfy the upcoming quarter’s budgeted distributions and any administrative fees being charged per the Fee Policy. The Investment Manager(s) should transfer enough assets to the ‘cash fund’ at the beginning of the quarter and any unused amounts may be added back to the other Funds, or rolled over, at the end of the quarter.

9. The ‘cash fund’ should remain liquid and should generate a modest return given market conditions.

10. Any alternative investment requires a unanimous vote of approval by the Investment Committee and a majority approval from the Board to make an allocation;

11. The Investment Committee may, within the band approved by the full Board, at its discretion; change the ratio of each fund, but it is anticipated that such changes will be infrequent. Board approval is required to change the asset allocation band. The table in the Summary of Asset Allocation Guidelines sets forth the assets allocation policy ranges and the current target;

12. New cash flows shall be allocated to the Investment Manager(s) by the Investment Committee with assistance of the Board. As a general rule, new cash will be used to rebalance the total account in the direction of the target allocation agreed to at the most recent Investment Committee meeting;

13. The Portfolio allocation will be diversified both by asset class (e.g., common stocks, bonds, cash) and within asset classes (e.g., common stock of economic sectors such as, but not limited to, Consumer Staples, Health Care, Financials, Energy, Telecommunications, and Utilities, as well as by industry such as, but not limited to, Beverages, Household Products, Insurance, Software, and Media, as well as by quality, and market capitalization). The purpose of diversification is to provide reasonable assurance that no single security or class of securities will have a disproportionate impact on the total Portfolio.

IX. PERFORMANCE OBJECTIVES

The overall Portfolio 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 and Investment Managers.

A. <u>Total Fund Objectives</u>

Overall fund performance will be compared to the performance of a similarly structured balanced index in line with the target allocation in each fund strategy. This custom index will comprise of the S&P 500 Index (or Russell 1000 Index), Russell 2000 Index, EAFE International Index, MSCI Emerging Markets Index, Barclays Capital U.S. Aggregate Bond Index, cash equivalent and/or other appropriate indices.

B. Equity Fund Objectives

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

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

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

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

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

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

The performance of the emerging markets equity portion should meet or exceed the performance of Morgan Stanley Capital International's Emerging Markets Index.

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

The International Small Cap equity portion of the Portfolio is expected to exceed the performance of the MSCI All Country World (ACWI) ex US Small Cap Index. The returns should rank in the top thirty-third percent (33%) of a universe for comparable funds over a rolling three-to-five-year time period.

No more than 30% of the ‘equity fund’ shall be invested in any one industry. No more than 8% of the ‘equity fund’ shall be invested in any company. The equity managers may not sell securities short, buy securities on margin, buy any Limited Partnerships (or any illiquid investment), borrow money or pledge assets, or buy or sell uncovered options, commodities or currencies without the advance approval of the Investment Committee.

The volatility of investment returns, as measured by the standard deviation of quarterly returns, should be comparable to that of the segment’s appropriate index. As stated above, volatility greater than the benchmark is acceptable so long as returns are commensurate.

C. Fixed Income Fund Objectives

The performance of the core fixed income portion is expected to meet or exceed the performance of the Barclays Capital U.S. Aggregate 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 should rank in the top 40% of a universe for comparable fixed income funds over a three-to-five-year time period.

Bond investments will consist solely of taxable, fixed income securities that have an investment-grade rating (BBB or higher by Standard & Poor's and Baa or higher by Moody's) that possess a liquid secondary market. Liquid secondary market will be understood as at least $400mm of outstanding debt (defined by industry standards). If the average credit quality rating disagrees between the two rating agencies, then the lower of the two should be used as a guideline.

In general, the 'fixed income fund' shall be diversified with respect to type, industry, issuer in order to minimize risk exposure. A maximum of 8% of the Portfolio will be held in any one issue. However, obligations issued or guaranteed by the U.S. government may be held without limitation.

The volatility of investment returns, as measured by the standard deviation of quarterly returns, should be comparable to that of the segment's appropriate index. Again, volatility greater than the benchmark is acceptable so long as returns are commensurate.

D. Alternative Investment Fund Objectives:

The Investment Committee recognizes that benchmarks for alternative investments, more specifically 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 has diverse investment objectives and characteristics making comparisons difficult.

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

The Morningstar Board Hedge Fund Index·
Any benchmark designated by the Investment Manager(s) and agreed upon by the Investment Committee.

The Investment Committee recognizes private equity returns are not meaningful in the early years of investment and that the evaluation of this type of investment should be considered over the long term, defined as a ten year time horizon. To aid in the on-going evaluation of private equity investments, they will be compared to the Cambridge Associates LLC U.S. Private Equity Index, which tracks the performance of U.S.-based private equity funds.

E. Cash Fund Objectives:

The guideline for cash returns can vary depending on a variety of factors, including current market conditions, the investment vehicle, and the Foundation's current risk tolerance and liquidity needs. Performance will be evaluated based on whether cash returns are in accordance with the current interest rate environment, meaning, the return is somewhere between the national average rate for money markets and the Fed Fund rate.

X. 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 statement will change frequently. In particular, short-term changes in the financial markets should not require an adjustment in the Investment Policy.

B. <u>Review and Evaluation of Investment Manager(s)</u>

The Investment Committee will meet at least annually with the Investment Manager(s) or their representative(s). Additionally, with or without the Investment Manager(s), the Investment Committee will review investment results quarterly.

These reviews will focus on:

A. The Investment Managers' adherence to the policy guidelines;
B. Comparison of the Investment Managers' results to the objectives established for each Investment Manager;
C. Comparison of the Investment Managers' results against the universe of comparable funds investment styles;
D. Opportunities available in both the equity and bond markets; and;
E. Material changes in the Investment Managers' organizations, such as philosophical or personnel changes.

The Investment Committee shall make recommendations to the Board regarding the discharge and replacement of an Investment Manager at any time it deems such action is necessary and appropriate.

Guidelines for evaluation, retention, and replacement of Investment Manager(s) will be as follows:

A. Establish appropriate benchmarks/indexes to which to compare Investment Managers' performance;
B. Establish performance target: to outperform benchmarks/indexes and to achieve investment returns;
C. Ranking in the top thirty-third percentile (33%) of peer universe groups for equities over a three-to-five-year period;
D. Ranking in the top fortieth percentile (40%) of peer universe groups for fixed income over a three-to-five-year period;
E. Monitor Investment Managers' performance on a quarterly basis and compare it 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:

<u>For Equities</u>

- Investment Manager's three-year performance is below the 50th percentile of their peer universe, or they are trailing the style benchmark, or;
- Investment Manager's five plus year performance is below the 33rd percentile of their peer universe, or they are trailing the style benchmark.

<u>For Fixed Income</u>

- Investment Manager's three-year performance is below the 50th percentile of their peer universe, or they are trailing the style benchmark, or;
- Investment Manager's five plus year performance is below the 40th percentile of their peer universe, or they are trailing the style benchmark.

For Alternative Investments

Hedge Funds

- 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 Committee's opinion, represents sub-par results, or;
- The Investment Committee has concerns resulting from the review of on-going documentation.

Private Equity

- Since these types of investments are illiquid and long-term in nature, there are no specific performance criteria for Caution status. A manager managing these types of investments may be put on "Caution Status" if in the Investment Committee's opinion, the "Caution Status" is warranted.

An Investment Manager will also be considered on "Caution Status" if there is a material change in the ownership structure of their 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 Committee. 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 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 concerns regarding the Investment Manager.

XI. COMMUNICATIONS

Month-end accounting of transactions and Portfolio holdings, ending Portfolio and holdings values, including a roll forward (monthly, fiscal and calendar year to date) will be provided by the Investment Manager(s). This roll forward will agree with the Portfolio book activity.

Quarter-end regular accounting of transactions, Portfolio holdings, yields, and 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 Manager(s) will maintain communications with the Investment Committee as frequently as necessary as market conditions and the Portfolio warrant. The Investment Manager(s) shall notify the Investment Committee, as soon as reasonably possible, of any material changes in market conditions or material changes to the Portfolio.

Significant changes within the Investment Manager's operations of personnel and the anticipated impact on the assets should be brought to the attention of the Investment Committee immediately.

To be consistent with the Foundation's values and philosophy, the Investment Manager(s) must vote proxies with respect to the Portfolio.

XII. ADMINISTRATIVE AND MANAGEMENT EXPENDITURES

In order to cover the administrative and investment management expenses associated with operating the Foundation and investing the Foundation's endowed assets, the Foundation may charge an administrative fee to each account, in an amount and at such frequency as determined from time to time by the Board as necessary to equitably and efficiently operate the Foundation and manage the assets of the Foundation in accordance with the Fee Policy.

Such an administrative fee shall be charged against the earnings of each account, if any, which remain after annual spending amounts have been distributed from such account pursuant to the Foundation's Total Return Resolution.