

# Investment Performance Report

2007-08

OKLAHOMA CITY COMMUNITY FOUNDATION | FALL 2008

## High quality diversification reduces total portfolio risk

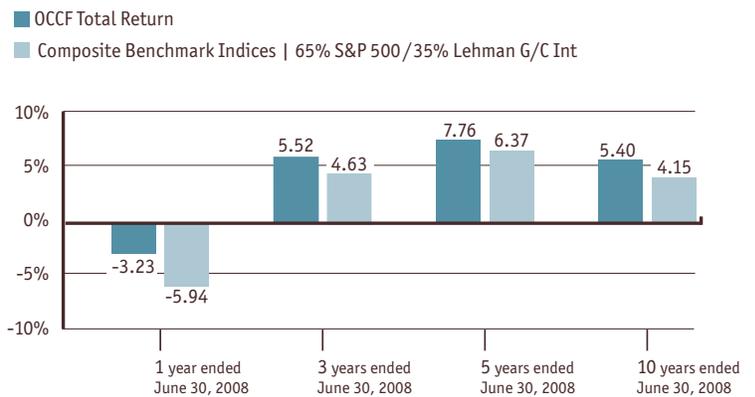
Diversification is a cornerstone of modern portfolio theory and allows better management of the risk involved with higher return assets. In FY2008, the Oklahoma City Community Foundation maintained its diversification between equity and fixed income investments and added to international stocks to broaden its asset allocation. While fixed income investments are often viewed as having little potential for much return over inflation, the safe harbor was very welcoming in a volatile market.

David Swenson, the well-regarded manager of the Yale Endowment, recently wrote, "Long-term bonds play a diversifying role in institutional portfolios, providing steady, reliable streams of income to investors. The security provided by bond investments becomes particularly significant in times of financial crises, when investors embark on a flight to quality, seeking to hold only the most secure, most liquid assets." Swenson would recommend that high quality is essential to diversify equity risk.

For the Oklahoma City Community Foundation's General Investment Pool, FY2008 was a year where the diversification of a very high quality bond portfolio accomplished both the goal of continuing a steady source of investment performance and providing significant out-performance at a time when the overall national financial markets were under significant stress. The Investment Committee revised and strengthened the fixed income policy during the year, allowing the managers a broader range of fixed-income options but maintaining quality criteria that proved to be very rewarding.

Our allocation of 32-35 percent to fixed income probably has dampened long-term total returns in some of the past years, but in

### Annualized Total Return of the General Investment Pool



each year with a negative equity return, the fixed income return was between 7.8 and 10.8 percent. While equity returns have varied between -14.4 and +29.8 since 1999, the fixed income portfolio has a positive return during each of the past 10 years.

Swenson sums up the case for diversification, "By creating portfolios of a variety of asset types, investors diminish the risk that an undiversified exposure to a single market will cause significant damage. If the strategy succeeds, portfolios generate high expected returns with low levels of risk."

## Large investment pool provides advantages

An investment program with assets of \$563 million benefits all endowments at the Oklahoma City Community Foundation. Even the smallest charitable organization endowment or scholarship fund reaps the benefits that a large investment pool provides at a cost that is significantly below normal investment management fees.

Our investment program benefits from its very low-cost and efficient operation. By balancing the use of active managers and index funds in a way that maximizes the opportunity for adding value but keeps the cost low, we have been able to produce annualized returns over 10 years that exceed the markets but at a cost which is much lower than mutual funds or other balanced fund alternatives. For FY2008, the cost of investments at the Oklahoma City Community Foundation was 37 basis points, compared to more than 100 basis points for the average mutual fund or active equity fund manager requiring a large minimum account.

For a \$50,000 fund that returns 8 percent over a 10-year period, this cost difference means approximately \$6,400 more in value to the fund. Over a 20-year period, the fee difference can amount to \$26,000 or more of added fund value over the alternatives who charge a significantly higher investment fee.

Diversification is a hallmark of a solid endowment investment policy and is one of the greatest advantages these funds receive. The general investment pool is invested in all classes of domestic equities, in a range of fixed income securities and also has exposure to international markets. We provide a "balanced" portfolio by allocating assets to highly qualified managers in a wide-range of investment classes. Due to the size of our investment pool, this level of equity exposure is available so that even the smallest funds benefit.

All Oklahoma City Community Foundation investments are overseen by an active committee of community leaders with strong investment expertise and are led by Hotchkiss Associates, LLC, an investment counsel firm based in Chicago, Ill. All funds benefit from the expertise of this committee and their efforts to provide the best investment product at the most efficient price.

For many years, the Oklahoma City Community Foundation has been the leading advocate for building endowment funds in the community. Utilizing a large investment pool that allows us to keep fees low is one of the greatest advantages the Oklahoma City Community Foundation provides to charitable organization endowments.

# All Endowments benefit from Distribution Policy

Of primary importance to any endowment program are prudent distribution policies that will over a long-time horizon produce the maximum number of dollars for charitable causes or organizations. Spending rules are commonly used to provide a structured method of making distributions from an endowment fund that protects the distribution stream from inflation, provides a predictable annual distribution and allows the Investment Committee to focus on maximizing total investment return.

Since 1989, the Oklahoma City Community Foundation has employed a distribution policy that is designed to permit funds to capitalize on good investment years as well as protect in the event of a low or negative return market. The experience of the past few years, where returns were on both extremes of investment performance, have proven the wisdom of a policy which stabilizes the effects of market conditions on distributions from an endowment.

Cash distributions from most of the endowment funds of the Oklahoma City Community Foundation are based on a spending policy that calls for distributing 5 percent of the fund's average market value. The remaining investment return is left with the fund to add to the value, which protects the future distribution stream from inflation.

The annual distribution from the fund is more predictable because the amount is not tied to current income, which fluctuates due to shifts in market conditions, but is based on a rolling quarter average of the fund's market value, adjusted for additional contributions. The number of quarters used in the average ranges from 8 to 20, depending upon the type of fund.

"Large educational and institutional endowment managers across the country seem to agree that an amount close to 5 percent of the average market value is a safe amount to spend and still provide protection for the principal," says Carla Pickrell, director of administration for the

## Oklahoma City Community Foundation Investment Policy: A Summary

The investment policy of the Oklahoma City Community Foundation is designed for an endowment fund to provide annual distributions for charitable purposes in perpetuity. The investments need to allow the fund to generate distributions, grow to accommodate inflation and continue to exist in the future.

The Trustees have adopted an investment policy that has four major objectives: capital preservation; inflation protection; continuing source of annual distribution for charitable purposes; and investment return in the top third of professionally managed funds.

These objectives lead to a portfolio of high-quality equity investments and fixed-income securities. The portfolio is structured by asset allocation to a range of equity styles and then to style-specific managers who are among the best in their area. The asset allocation between equity and fixed-income investments allows for growth in value and stability in distribution expectations over time.

The benchmarks for measuring performance are currently the Standard and Poor's 500 stock index and the Lehman Government/Credit Intermediate bond index. Style-specific managers will be measured by appropriate benchmarks for that particular style. Managers are judged on a time horizon of three to five years.

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*The experience of the past few years, where returns were on both extremes of investment performance, have proven the wisdom of a policy which stabilizes the effects of market conditions on distributions from an endowment.*

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Oklahoma City Community Foundation.

The 5 percent figure is based upon an estimate of two factors over time: market return and inflation. A conservative prediction of average market return in a balanced fund over time is 8 percent. It is widely expected that inflation will average 3 percent over time. This leaves 5 percent to spend while still protecting the fund's value for the future. The Investment Committee's focus on long-term fund growth allows for a bias to equities in the asset allocation.

While there are other approaches to determining distributions, the 5 percent spending rule does not require a specific investment allocation to income-producing assets and is not subject to short-term market fluctuations. Investment managers are able to focus on achieving the best total return.

"The total return concept is especially important because of this active goal of growing endowment funds," Pickrell says. "There is an available annual distribution of 5 percent from the endowment that is increasing in value over time even if there are no additional contributions to the fund."

## Investment Terms | Definitions

**Growth Stock** | Shares of a company that is growing earnings and / or revenues faster than its industry or the overall market. Typically, these companies pay little or no dividends, preferring to use income to finance further expansion. Growth stocks tend to have higher P/E ratios than the overall stock market because investors expect future earnings growth will be higher than it is currently.

**Value Stock** | A stock that appears undervalued relative to the value of its assets. A stock may be a "buy" as a value stock if its cash per share (or its book value) is high relative to its stock price. P/E ratios tend to be below growth stocks and the market's because investors expect future earnings growth to be less than it is currently. Dividend yields tend to be relatively high.

**The Core Equity style** | Designed to produce a market rate return with similar volatility (risk). This makes for a consistent investment strategy that is unaffected by short-term investment style themes such as growth vs. value. These assets are characterized by low stock turnover and low transactions cost. Core equity investing is a prudent way to preserve assets while at the same time participating in the long-term growth of the economy. Both large cap and small cap core equity investments are utilized.

**Definitions of large, mid and small market capitalization** vary, but could be reasonably considered as: **small cap** - less than \$1 billion; **mid cap** - greater than \$1 billion but less than \$5 billion; **large cap** - greater than \$5 billion.

**Price-to-Earnings (P/E) Ratio** | A stock's price divided by its earnings per share, used as a method of valuation.

**Market Capitalization** | Stock price multiplied by shares outstanding.

# General Pool Investment Managers *Effective 6/30/08*

## EQUITY

### LARGE CAP VALUE

Wedge Capital Management, *Charlotte, NC*  
Barclays Global Investors, *San Francisco, CA*

### LARGE CAP GROWTH

Barclays Global Investors, *San Francisco, CA*

### SMALL/MID CAP VALUE

Earnest Partners, *Atlanta, GA*

### SMALL/MID CAP GROWTH

Columbus Circle, *Stamford, CT*

### INTERNATIONAL

Barclays Global Investors, *San Francisco, CA*

### LARGE CAP CORE

Barclays Global Investors, *San Francisco, CA*

### SMALL CAP CORE

Kalmar Investors, *Wilmington, DE*

Barclays Global Investors, *San Francisco, CA*

## FIXED INCOME

JP Morgan Asset Management, *Columbus, OH & Oklahoma City, OK*

Bank of Oklahoma, *Oklahoma City, OK*

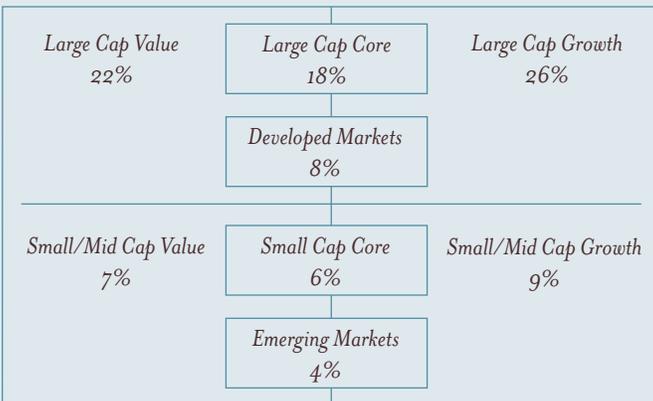
Barclays Global Investors, *San Francisco, CA*

TOTAL RETURN	Year Ended June 30, 2008	Three Years Ended June 30, 2008	Five Years Ended June 30, 2008	Ten Years Ended June 30, 2008
Oklahoma City Community Foundation	-3.23%	5.52%	7.76%	5.40%
S&P 500/Lehman G/C Int *	-5.94%	4.63%	6.37%	4.15%

\* Composite benchmark indices based upon applicable asset allocation.

## Asset Class Target Percentage Allocation

As of 6/30/08



## Asset Allocation Model - General Pool

	Target	Range
Equity	62.5%	40-70%
Fixed Income	32.5%	30-60%
Cash	5.0%	0-10%

## Targeted Asset Class Ranges

Large Cap Value	12-24%	Small/Mid Cap Value	4-16%
Large Cap Growth	12-24%	Small/Mid Cap Growth	4-16%
Large Cap Core	20-48%	Small Cap Core	7-24%
Developed Markets	0-10%	Emerging Markets	0-5%

For Investment Definitions see page 2.

## Investment Committee 2007-08



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303 W. Madison, Suite 1050, Chicago, Ill. 60606

# Investment Performance Report



2007-08

## Pooled Investments Performance Summary

Manager	% of Total		Rate of Return
	Portfolio	% of Asset Class	Year Ended
	June 30, 2008	June 30, 2008	June 30, 2008
<b>EQUITY</b>			
<b>LARGE CAP VALUE</b>			
Wedge Capital Management	7.04%	11.81%	-17.79%
Barclays Russell 1000 Value Index Fund	5.08%	8.51%	-18.67%
Russell 1000 Value			-18.79%
<b>LARGE CAP GROWTH</b>			
Barclays Russell 1000 Growth Index Fund	15.87%	26.61%	-5.79%
Russell 1000 Growth			-5.96%
<b>SMALL/MID CAP VALUE</b>			
Earnest Partners	4.33%	7.27%	-9.54%
Russell 2000 Value			-16.19%
<b>SMALL/MID CAP GROWTH</b>			
Columbus Circle Investors	5.35%	8.98%	9.36%
Russell 2500 Growth			-9.20%
<b>INTERNATIONAL</b>			
Barclays EAFE Index Fund	4.85%	8.14%	-8.04%
MSCI EAFE (US\$) Net			-10.61%
Barclays Emerging Markets Index Fund	2.53%	4.24%	8.05%
MSCI EMF (Gross) Index			4.89%
<b>CORE</b>			
Barclays Russell 1000 Index Fund	10.93%	18.33%	-13.18%
Russell 1000			-12.37%
Kalmar Investments	3.63%	6.09%	-6.57%
Barclays Russell 2000 Index Fund	0.01%	0.02%	-15.69%
Russell 2000			-16.19%
<b>TOTAL EQUITIES</b>	<b>59.61%</b>	<b>100.00%</b>	<b>-9.24%</b>
S&P500 Stock Index			-13.11%
<b>FIXED INCOME</b>			
JPMorgan	20.53%	58.41%	8.13%
Bank of Oklahoma	13.91%	39.56%	7.38%
Barclays 1-3yr. Treasury Bond Index Fund	0.71%	2.03%	7.83%
<b>TOTAL FIXED INCOME</b>	<b>35.15%</b>	<b>100.00%</b>	<b>7.82%</b>
Lehman G/C Int. Index			7.39%
Lehman 1-3 Gout			7.08%
<b>CASH</b>			
JPMorgan Money Market Fund	5.24%		NA*
<b>TOTAL POOLED INVESTMENTS</b>	<b>100.00%</b>		<b>-3.23%</b>
<b>Composite Indices</b>			
65% S&P500/35% Lehman G/C Int.			-5.94%

Year Ended	General Pool Rate of Return	Composite Indices (Note A)
June 30, 2008	-3.23%	-5.94%
June 30, 2007	13.68%	15.40%
June 30, 2006	6.82%	5.54%
June 30, 2005	7.52%	5.76%
June 30, 2004	15.03%	12.39%
June 30, 2003	5.28%	3.96%
June 30, 2002	-5.58%	-8.83%
June 30, 2001	-5.65%	-5.78%
June 30, 2000	10.30%	6.19%
June 30, 1999	12.51%	16.26%
<b>Ten Years Compounded (Note A)</b>	<b>5.40%</b>	<b>4.15%</b>

Note A: Equity performance is compared to the Standard and Poor's 500 stock index (S&P500); fixed income performance is compared to the Lehman Government/Credit Intermediate bond index (Lehman G/C Int.); and total return is compared to the composite of these indices with weighting based upon applicable asset allocation. For the past 10 years, the allocation benchmark has been 65% equity and 35% fixed income.

OKLAHOMA CITY COMMUNITY FOUNDATION

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2007-08

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Notes: Investment managers are measured against the index selected for that manager's specific style with the overall performance of the equities being measured against the S&P500 stock index. All performance returns are gross of management fees and custody/transaction charges and net of sales commissions.