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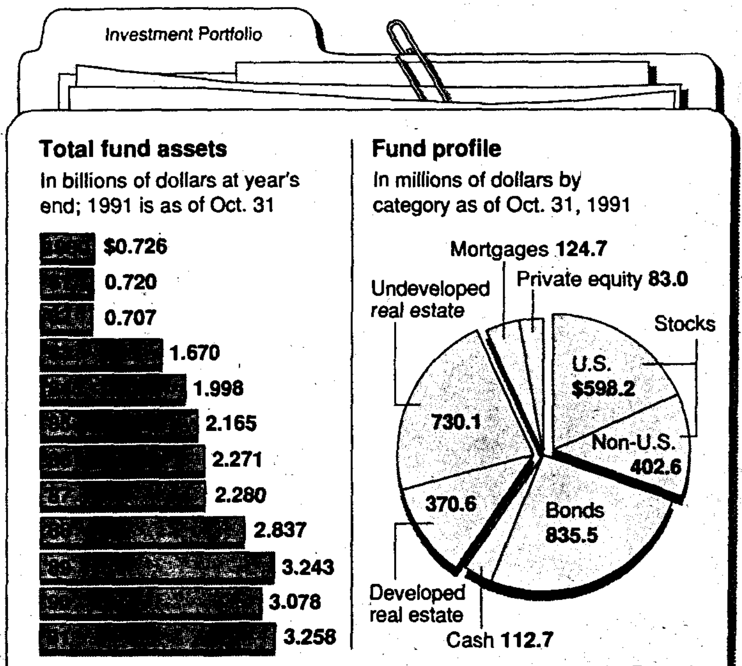
MacArthur Foundation investments

The assets of the John D. and Catherine T. MacArthur Foundation have evolved over 10 years from the stock of Bankers Life and Casualty Co. into a diversified portfolio. However, more than 20 percent is undeveloped land in Florida.

John D. and Catherine T. MacArthur



Source: John D. and Catherine T. MacArthur Foundation

Chicago Tribune/Rick Tuma and Martin Fischer

Tribune photo by Val Mazzenga

Investment analyst Jinde Guo (from left) and other members of the MacArthur Foundation investment group: Rodney Mebane, Lawrence Landry, Henry Robin and Will McLean.

MacArthur Foundation walks asset tightrope

By Bill Barnhart

If Chicago's John D. and Catherine T. MacArthur Foundation gave Larry Landry one of its celebrated "genius grants," it would be an outrageous conflict of interest. Other than that, he might qualify.

Landry, 48, sits atop the investment program of the $3.3 billion foundation, the sixth-largest foundation in the country, accord-

By all accounts, Lawrence T. Landry, a Massachusetts native, is one of those "exceptionally talented and promising individuals who have given evidence of originality, dedication to creative pursuits and capacity for self direction" that the foundation seeks in awarding its no-strings-attached MacArthur Fellows prizes.

This isn't the job description for a money manager that some foundations and endowments, known

originality and creative pursuits. But the MacArthur board apparently believes the unique history and current characteristics of its assets require special talents and not a little guts.

Hired away from Southern Methodist University in 1989, Landry, along with the board's investment committee that meets five or six times a year, has crafted an asset mix that one cautious adviser calls "ambitious." The in-

ation staff of 172.

Although the amount of money involved is staggering, the investment decision-making process, weighing costs and risks against potential income and capital gains, would be familiar to many individual and institutional investors.

Today, the foundation's non-real estate portfolio includes small-capitalization stocks, foreign stocks and numerous private in-

ships seeking corporate turnarounds and, still on the drawing board, a new venture capital fund for the Chicago area as well as other private investments related to the foundation's program goals.

The current strategy has replaced a program of investing more passively, with less overhead and transaction costs, in stock and bond index funds. That initial program was set up in the mid-1980s after the foundation sold Mac-

cels. An index fund mimics the performance of a well-known market index, such as the Standard & Poor's 500 stock index.

Landry and the team he has assembled over the last two years have the resources and the contacts to establish a state-of-the-art, global asset management operation. But a stagnant economy, especially a stagnant southeast Florida real estate market, where the foundation is heavily invested, will

MacArthur

Continued from page 1

Bank of Chicago chairman, Gaylord Freeman Jr., and the late RCA Corp. chairman, Thornton A. Bradshaw—both MacArthur Foundation board members in the 1980s—were right when they urged the foundation to adopt an activist investment strategy.

At first blush, Landry's job looks simple. The foundation—like its peers with such names as Ford, Kellogg, Getty, Lilly, Pew, Johnson and Rockefeller—is required by federal law to pay out in grants at least 5 percent of its assets every year to retain its tax exemption. Therefore, the foundation's investment objective is to achieve at least a 5 percent "real" rate of return, above the rate of inflation.

After the go-go financial markets of the 1980s, a period blessed by moderating inflation, 5 percent sounds like an easy target; so easy it might leave sharp, restless minds too much leeway for experimenting in ostentatiously sophisticated investment schemes fraught with risk.

But here's the catch: The MacArthur Foundation was established in 1978 to exist in perpetuity, and a reading of economic history will show that achieving a 5 percent inflation-adjusted rate of return indefinitely is difficult.

Inflation took a heavy toll on all foundation assets in the 1970s. In 1974, the mighty Ford Foundation—the largest U.S. foundation with $6 billion—walked right off the cliff after an aggressive strategy of investing in stocks. Ford grants were cut by 50 percent, and hundreds of the foundation's workers lost their jobs. It took 12 years to recover the investment losses.

The Wall Street Journal disclosed in October that the $5 billion Harvard University endowment—a pioneer in nontraditional investments by institutions—has taken heavy losses this year in its private investments in oil and gas operations, venture capital and Boston real estate. Two private placement managers, who were paid according to their investment performance, were put under stricter oversight.

Matt Lincoln of Boston-based Cambridge Associates, one of two firms called in the early 1980s to advise MacArthur on developing an investment strategy, says a portfolio needs 70 percent in equities and 30 percent in fixed-income securities (bonds) to return 5 percent after inflation over the long haul within prudent risk

Pew Memorial Trusts, the Robert Wood Johnson Foundation, Lilly Endowment and W.K. Kellogg Foundation—lacks a cushion of concentrated stock ownership in such long-term performers as Sun Co. (despite current problems), Johnson & Johnson, Eli Lilly and Co. or Kellogg Co.

Instead, 30 percent of MacArthur's current equity (22 percent of total assets) is concentrated in undeveloped land in north Palm Beach County, Fla., where the MacArthur Foundation is the biggest landowner. Recently, that land has been a drag on the total return of the foundation's assets. Thirty-six staff members (not part of Landry's group) are assigned to manage and maintain the real estate.

Despite the land's prestigious location, its investment prospects are tied closely to the national economy and to the now more worrisome economic, political, environmental and demographic trends in southeast Florida.

Jonathan L. Smith, a partner in the New York investment firm of Weiss, Peck & Greer and a member of the MacArthur investment committee, put the point delicately: "The bull case for land is to be on the front end of demographics, not the rear end."

Landry said, "There is no question that our asset-allocation decisions are different at the MacArthur Foundation because a third of our assets are in real estate and two-thirds of that is undeveloped land."

M. Hallene, president of Montgomery Elevator Co. in Moline and chairman of the MacArthur investment committee. "We can sort of wait it out."

Landry notes that the foundation's growth through the 1980s was propelled largely by real estate proceeds—especially the timely sale of two portfolios of Manhattan real estate in 1984 and 1985 for $900 million. But that engine has slowed, and other investments must pick up the slack, Landry and his advisers believe.

Shifting assets into high-grade bonds, now paying about 8 percent, would help the cash flow, but Lincoln notes that reducing the equity proportion of the fund would violate the rule of thumb that says equities outperform bonds over time.

"We are really treading a tightrope here," Lincoln said. "Larry's group has become much more active in investing in less efficient securities, hoping to achieve excess returns and to increase the chances of meeting the 5 percent goal."

Landry calls his strategy "intelligent asset allocation—not market timing." He and his staff don't pick stocks but rather oversee independent money managers who do. Nevertheless, Landry believes that within various classes of equity and debt, his team can spot opportunities that don't require guessing precisely the turns in stock and bond prices.

One of his first moves in 1989, for example, was to get out of an

stocks. Being in foreign stocks at all is a daring step for foundations. But Landry moved from passive investing overseas to active stock selection—including small-capitalization stocks—through four money managers, even though passive indexing had been a better tactic for the previous five years.

"We made a bet that the reverse was going to occur," Landry said. He was right. The overseas stock-index fund did poorly last year. Landry thinks foreign stocks overall are less efficient—that is, less well researched and less actively traded—than U.S. stocks.

Global stock managers include Walter Scott, a 6-foot, 4-inch Scotsman with a doctorate in physics who showed up at an investment committee meeting in Chicago last year wearing a kilt.

Another decision was to extend maturities in the bond portfolio in June 1990, a move that correctly foresaw a bond rally.

Landry, a philosophy and economics major in college, acknowledges that these "bets" can go wrong. He's disappointed about a recent decision to shift U.S. stock preferences toward so-called value stocks (generally, cyclical stocks with low price/earnings ratios) away from so-called growth stocks (stocks believed to have greater potential for rapid capital gains).

But he says the fund's performance, net of expenses, has outstripped the performance that would have been achieved by remaining in index funds for each month since the decision to go ac-

vestment portfolio produced a 25 percent gain. He adds that he keeps these records for the foundation's board members, not all of whom were 100 percent behind the more aggressive investment posture.

"I've been somewhat persuaded by some of the advisers we've had that it's hard, if not impossible, to beat the index funds," said John E. Corbally, a board member and retired president of the foundation who was at the helm when Landry was hired. "The members of the board simply were persuaded that there was reason to pay attention to some of the opportunities that were coming along that we would not have had with indexing."

He said the investment committee will review the investment strategy and asset mix early in 1992. He agreed that the currently unproductive real estate holdings require looking for investment opportunities "that will have unusual results—hopefully, unusually positive."

"We felt it would be very difficult to select a group of managers who could consistently beat the indexes," recalled David Murdoch, an alum of the former A.G. Becker & Co. of Chicago who worked for the foundation from 1981 to 1985 and is now president of Health Plans Capital Services Corp., a financial-services affiliate of Blue Cross-Blue Shield. But Murdoch said it was never contemplated that the foundation would remain solely a passive manager.

Managing U.S. stocks for MacArthur are the firms Grantham, Mayo, Van Otterloo & Co. in Boston; Aronson Fogler & Co. in Philadelphia; and Quest Advisory Corp. in New York. Landry says the funds were chosen because they are small, have different investment styles and provide a good sounding board of asset-allocation decisions.

The foundation also has an asset class called private equity, including a stake in the Zell/Chilmark Fund L.P., which invests in troubled companies. About $83 million is placed in non-public investments, and Landry believes the amount could reach $300 million. Henry Robin was hired from Goldman, Sachs & Co. this year to focus on private equity and debt transactions, which Landry hopes will continue to provide an extraordinary, positive kick to the portfolio's returns.

Will McLean, formerly of the Duke University endowment, joined to oversee public securities investments; Rodney Mebane, who followed Landry from SMU, is director of investment research and asset allocation.

Now Landry is working on the development of an investment pool for small foundations that would give them access to a better range of investment choices and techniques.

"I'm a big fan of Larry's," said John W. English, vice president and chief investment officer of the Ford Foundation. "MacArthur is on the leading edge; they're willing to try new things and new approaches. They were among the first to invest money overseas, and that took courage."

For foundation, charity work begins at home

Chicago's MacArthur Foundation is a relative newcomer to the world of big-league grant-givers. Formed in 1978 upon the death of insurance tycoon John D. MacArthur, the foundation has established a worldwide reputation for championing the power of the individual, for its hands-off attitude toward its grant recipients and for breaking down institutional barriers to solving problems.

Of the foundation's $140 million in annual grants, $20 million are earmarked for Chicago-area projects. The foundation is in its third year of a 10-year, $40 million commitment to aiding school reform in Chicago.

Nationally, the foundation is the largest funder of mental health research outside the government. It focuses on understanding the characteristics of people who develop successfully their emotional and mental capacities as a key to understanding those who don't. MacArthur takes a multidisciplinary approach.

"Instead of funding a single program at a single university, the board chose to identify the most able and creative scholars and scientists in a range of fields and a range of institutions working on a particular question, such as how people age," said Woodward A. Wickham, vice president for public affairs. "This is an important antidote to research that is so field-specific and where ideas seem not to penetrate from one field to another."

The foundation also makes international grants focusing on peace, the environment, energy and population. Again, the foundation wants its money to go to people who will work collaboratively within these general themes and among them, Wickham said.

Collaboration begins at home, with the MacArthur foundation program and investment staffs under president Adele Simmons urged to work together. MacArthur is one of only a few foundations, for example, that takes advantage of a tax rule that enables them to make "program-related investments."

These investments, managed by Paul E. Lingenfelter, usually take the form of loans that the foundation expects to have repaid, but are recorded as grants. About $40 million has been invested since 1983, partly in an effort to inject market discipline on community organizations and other recipients. Only one $200 million loan to a documentary film project has failed to meet its obligations so far, Lingenfelter said.

Lawrence T. Landry, who manages the foundation's investments, also is developing a separate operation he calls "investments related to program," which will take the form of venture capital stakes in Chicago-area companies, energy projects and environmental enterprises.