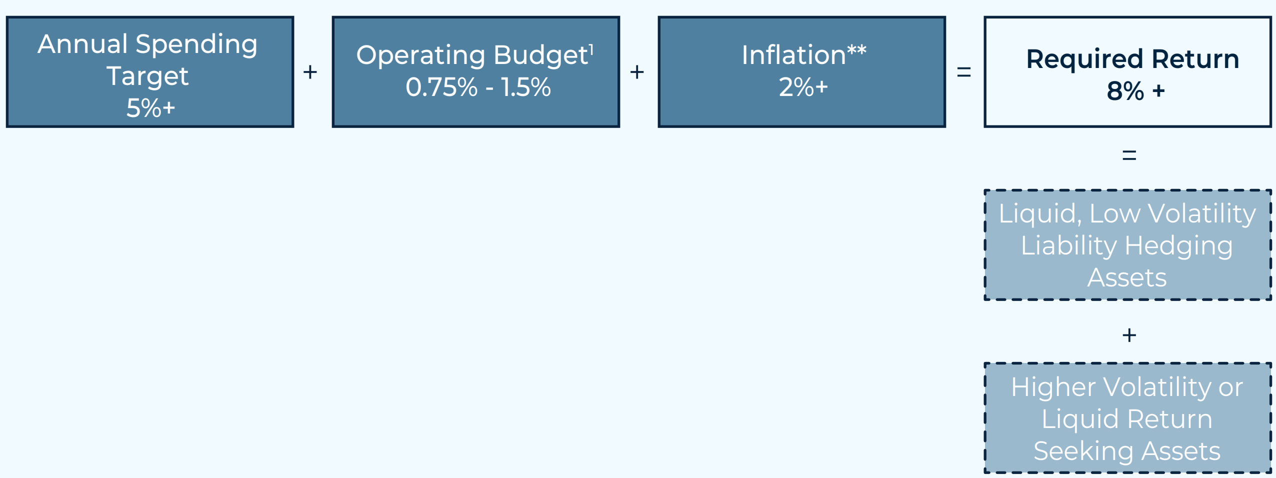
The Disbursement Dilemma
Bristol Gate as a Solution for Foundations

On August 9, 2022, Canada's Department of Finance released draft legislation to enact certain sections of the 2022 federal budget. Included in these changes is the proposal to increase the disbursement quota rate to 5% (from 3.5%) for charities that have fiscal periods beginning on or after January 1, 2023. This change will require a review of a charity's policies and procedures. In our view, this change will also require a critical re-examination of a charity's asset allocation.

Foundations and Endowments seeking perpetuity or even intergenerational longevity are entering a new era of higher disbursements and in a current era of lower real returns. There is always an inherent conflict in developing an asset allocation for these pools of capital: the need to support the permanence of the organization via capital growth is hard to balance with support for reliable (and ideally growing) payouts. When a Foundation or Endowment is required to annually disburse 5% of fund assets and absorb an annual operational budget, what is the way forward?

CONCEPTUAL RETURN VS SPENDING PROBLEM



[1] Source: Endowment-Benefits-of-Working-with-Your-Community-Foundation.pdf

[2] Target inflation rate of the Federal Market Open Committee and Bank of Canada

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Appropriate asset allocation will be critical in avoiding the erosion of capital with the requirement of 6+% annual payouts. This conclusion is reached without considering the impact of inflation, which will lessen the impact of disbursements and principal over time.

ASSET CLASS RETURN, ANNUALIZED

NAME	TICKER	5YR	10YR	15YR
S&P 500	SPY	9.35	12.46	8.72
S&P 500 Growth	IVW	10.08	13.39	9.90
S&P 500 Value	IVE	7.41	10.67	6.90
Dividend Aristocrats	NOBL	9.42		
S&P/TSX Capped Composite	XIC	6.86	7.69	5.26
Canadian Growth	XCG	7.05	7.69	4.34
Canadian Value	XCV	6.77	7.70	6.08
S&P/TSX Canadian Dividend Aristocrats	CDZ	5.99	6.81	6.26
EAFE	EFA	1.58	4.64	1.77
Emerging Markets	EEM	-2.09	0.77	0.16
Commodities	DBC	8.95	-0.82	-1.28
1-3 Year Treasuries	SHY	0.61	0.52	1.08
7-10 Year Treasuries	IEF	-0.32	0.56	2.90
20+ Year Treasuries	TLT	-2.81	0.32	3.32
Total Bond Market	BND	-0.01	1.01	2.61

Source: Morningstar in USD (unless noted otherwise) as of December 31, 2022

The dispersion in asset class returns over the longer term underscores a potential problem for charities. Whether a foundation is seeking longevity or just maximum real impact over a finite life, thoughtful exposure to growth looks like a requirement in this context.

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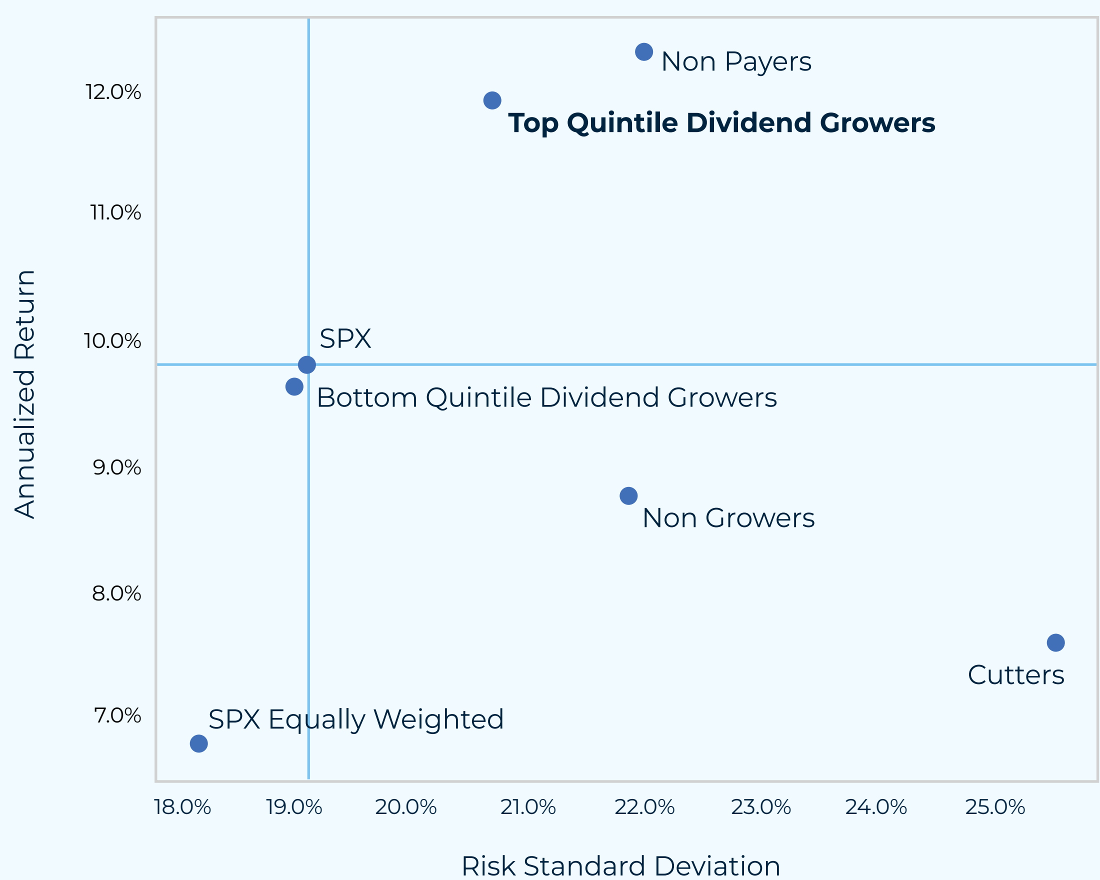
Historically, equity allocations in foundations have skewed towards high yielding and lower volatility strategies. While large dividends may have better short-term cash-flow matching capacity, a portfolio of companies with consistently superior dividend growth has been an efficient way of providing total return for investors over time and is an excellent complement to the more stable dividend and bond allocations:



The chart above illustrates that if you had the foresight to invest in the best dividend growth stocks ("Top Quintile") in the S&P 500 over the past 20 years then you would have the most attractive risk return profile. The 20-year period referenced is from Dec 31, 2001 to Dec 31, 2021 where each theoretical portfolio presented for the stated category was constructed from an equal weight basket of stocks selected from the S&P 500 universe and reconstituted annually. For illustrative purposes only. Past performance is not indicative of future results.

Source: Bristol Gate, Bloomberg, Dec 31, 2001-Dec 31, 2021, in USD

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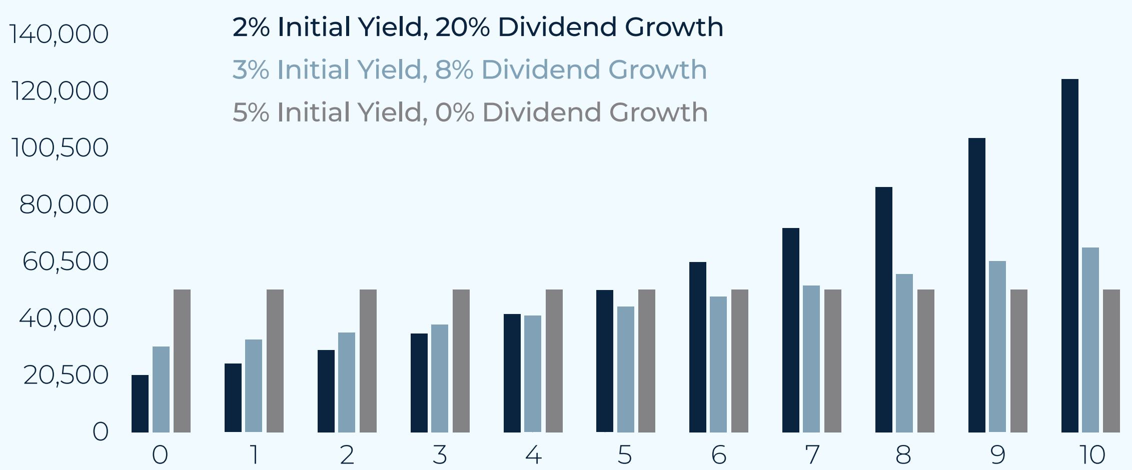
Growing yield on cost is an important factor in providing adequate income to liquidity-sensitive investors such as endowments and foundations. An investment that can grow its income and principal over time has the right characteristics for these new circumstances: (1) the ability to grow investors' income streams to meet spending targets and (2) the connected benefit of rising values, as stock prices historically tend to increase in the long term with increases in dividends. For these reasons, Bristol Gate's unique high dividend growth strategy fits well in the equity sleeves of foundations and endowments.

ANNUAL DIVIDEND INCOME ($1MM PORTFOLIO)



For illustrative purposes only

Bristol Gate is a strong, independently owned company with a solid track record of helping its clients and partners. Our approach has consistently been focused on finding companies that can grow dividends substantially and has seen average annual dividend growth of 19.3% since inception. By focusing on a concentrated portfolio of high dividend growth companies, our strategy has realized a meaningful gap between its upside and downside capture against its benchmark S&P500 and our returns since inception demonstrate this strength.

Bristol Gate has proven a resilient piece of foundations' equity allocations. By taking a measured view of growth and driving yield on cost our differentiated strategy has helped foundations deepen their impact. Our repeatable process and unique focus help provide complementary value for those looking for diversification and thoughtful growth exposure.

The change to the distribution requirements in 2022 forces charities to critically re-examine their investment strategies. Going forward, obtaining a higher investment return in what some see as a low-return world will be difficult. Conservative asset allocation and lower volatility strategies have worked well in the past. However, the hurdle to longevity has gone up due to rising rates and costs. Capturing the right kind of growth will help charities fulfil their ambitions. At Bristol Gate, we see our focus on quality companies and high dividend growth as part of the solution.
Please feel free to contact us to discuss further.

[1]As at December 31, 2022

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IMPORTANT DISCLOSURES

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