

Flagship Report: Mission-Aligned Investing

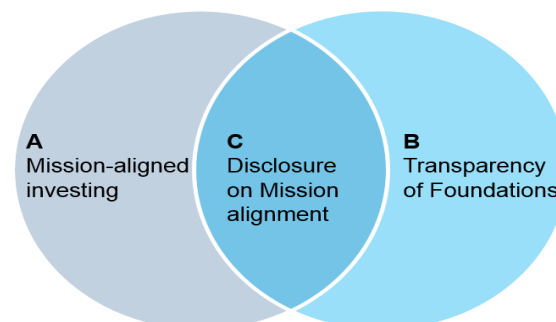
The Future of Foundations: Impact at Scale?



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- **Increasing size of foundations and recent regulatory changes makes mission-aligned investing more important and achievable than ever.** The most recent assessment of US-based foundation assets placed the total at \$715 billion in 2012, up from \$662 billion in 2011. Increased focus on transparency, improved data, and an evolving understanding of fiduciary responsibility by foundation boards and the Internal Revenue Service (IRS) means that foundations have more support to align their investments with their missions. The IRS recently released a notice which supports mission-aligned investing, stating that *“foundation managers may consider all relevant facts and circumstances, including the relationship between a particular investment and the foundation’s charitable purposes.”*
- **A look at the current landscape.** Cornerstone Capital Group, in conjunction with the Sustainability Business Lab (S-Lab) of MIT Sloan School of Management, undertook an assessment of foundations’ public disclosures on mission-aligned investing. The assessment focused on 25 large foundations and examined their publicly available data, including foundation information databases. In addition, we interviewed key experts in foundation investing, including Bruce DeBoskey of The DeBoskey Group.
- **Broad interpretation of transparency, limited information publicly available.** Foundations are moving deliberately but slowly toward mission alignment. Only 20% of the group explicitly mention mission alignment and 12% state they integrate Environmental, Social and Governance (ESG) factors into their investment decisions. It is possible that institutional barriers exist for foundations seeking to increase the transparency and extent of mission-aligned investing.

Mission-aligned investing and transparency



Sebastian Vanderzeil
Research Analyst

Dehao Zheng
Research Associate

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We would like to thank the following individuals for contributing valuable insights to this report:

Neerja Bharti, Allegra Fonda-Bonardi and Roseliny Genao, MIT Sloan School of Management

Jason Jay, Senior Lecturer, Sustainability and Director, Sustainability Initiative, MIT Sloan School of Management Professor

Robert G. Eccles, Professor of Management Practice, Harvard Business School and Visiting Lecturer, MIT Sloan School of Management

Antoinette LaBelle, Managing Director, Network Partnerships, Growth Philanthropy Network

Anne Sherman, Vice President, Nonprofit Strategy, Growth Philanthropy Network

Laura Berry, Executive Director, Interfaith Center on Corporate Responsibility

Mission alignment for foundations: overview

To aid and inform the movement towards mission-aligned investment and heightened transparency, Cornerstone Capital Group and the Massachusetts Institute of Technology's Sustainability Lab (S-Lab) have developed a set of observations on the relative transparency and mission alignment of a set of large foundations. Our goal is not to single out particular foundations but rather to increase broader understanding of mission-aligned investing and transparency.

Evolution of mission alignment

In 2014, the Gates Foundation Asset Trust—the entity managing the Bill and Melinda Gates Foundation's \$40.2 billion endowment—sold its stake in G4S, a private prison operator located in the UK, after public pressure.¹ G4S had been implicated in a range of incidents relating to their management of immigrant detention centers and prisons². Also in 2014, Bloomberg reported that the John D. and Catherine T. MacArthur Foundation had invested in a US-based payday loan business through its involvement in a private equity fund group. The payday lending business circumvented US law by establishing domicile on the Caribbean island of St Croix, enabling it to charge interest rates up to 600% per year³.

US-based foundations have become a major investment group in their own right...

Controversies such as these are raising public awareness of mission-aligned investment practices, and are fueling interest in transparency and better data regarding the financial-return-focused investments of foundations. With over \$715 billion in assets⁴ and growing⁵, US-based foundations have become a major investment group in their own right, and a category of asset owner whose choices are increasingly scrutinized by philanthropists and financiers alike.

...however, just 14% of foundations had taken steps to actively align their broader investing practices with their stated missions

Foundations and their asset managers are better equipped than ever to analyze the impact of their investments and understand the alignment of those investments with their mission, given the rapid expansion and heightened accessibility of Environmental, Social and Governance (ESG) data. Yet a 2011 survey of the sector concluded that just 14% of foundations had taken steps to actively align their broader investing practices with their stated missions⁶. This disconnect presents an opportunity, both for foundation managements to mitigate risk and enhance reputation, and for asset managers to create mission-aligned and financially attractive investment vehicles.

This disconnect presents an opportunity

Given the growing public awareness and debate, philanthropic organizations may find it increasingly difficult to isolate return-focused investing from mission-related investing. In our view, foundations, endowments, and other large philanthropic asset holders should consider adopting policies that minimize internal values contradiction, or they may risk the reputation erosion—and potential philanthropic harm—associated with mission-agnostic investing.

Fiduciary responsibility

The fiduciary responsibility of foundation board members to appropriately manage their assets is often cited as a concern in considering mission-aligned investing. However, there is strengthening evidence that the practice of aligning foundation investments with foundation mission, when conducted in a measured and responsible way, in fact represents an ideal fulfillment of board members' fiduciary duty.

All investment decisions must be motivated by the interests of the fund's beneficiaries and/or its purposes ...

In the US, the most important duties of a fiduciary are (1) to act prudently and (2) to demonstrate loyalty. In other words, a fiduciary must ensure that all investment decisions are motivated by the interests of the fund's beneficiaries and/or its purposes; no investment should be made purely to give effect to the personal views of the decision-maker⁷. There is growing acceptance among law professionals that an organization's investment in assets whose operations impede progress towards that organization's philanthropic goals may constitute a breach of fiduciary duty. This is particular true in the case of the financial assets of foundations, whose core missions are inherently philanthropic.

... and foundations may have a duty to consider the effect of their investment decisions on their organization's central mission.

As early as 1997, legal briefings have noted that foundations may have a duty to consider the effect of their investment decisions on their organization's central mission, or at least to avoid running counter to that mission⁸. In November 2014, the law firm of Reinhart Boerner Van Dueren s.c. went further, asserting that fiduciaries of foundations may have a legal obligation to ensure that investment decisions fit with the purposes of the foundation⁹. In other words, mission-aligned investment may be viewed as a fiduciary responsibility.

In September 2015, the US Internal Revenue Service (IRS) released "Notice 2015-62: Investments Made for Charitable Purposes," which explicitly enables foundations to consider mission when undertaking investment¹⁰. The relevant section states that:

*When exercising ordinary business care and prudence in deciding whether to make an investment, foundation managers may consider all relevant facts and circumstances, **including the relationship between a particular investment and the foundation's charitable purposes.***

Foundation managers are not required to select only investments that offer the highest rates of return, the lowest risks, or the greatest liquidity so long as the foundation managers exercise the requisite ordinary business care and prudence under the facts and circumstances prevailing at the time of the investment in making investment decisions that support, and do not jeopardize, the furtherance of the private foundation's charitable purposes.

For more on the relationship between mission alignment and investment returns, see our earlier report, "[Sustainable Investing: The Myth of Underperformance.](#)"

Foundations can “achieve their mission from the engine of their philanthropically committed capital rather than from the fumes”

Success comes when foundations recognize the full impact potential of their investments

Interview with Bruce DeBoskey – Philanthropic Strategist, The DeBoskey Group

Bruce DeBoskey, founder of the philanthropic strategy consulting firm The DeBoskey Group and nationally syndicated columnist “On Philanthropy,” is a leading proponent of mission-aligned investing for foundations and donor-advised funds. In his words, mission alignment enables foundations and donor advised funds “to achieve their mission from the engine of their philanthropically committed capital (PCC) rather than just from the fumes.”

He believes that PCC is a unique form of capital and that foundations should work to align their investments with their missions. Donations to foundations and donor-advised funds are tax advantaged in order to achieve a “public good” and have been passed to foundations with the explicit expectation of helping the foundation achieve its mission.

On the governance side, the focus of fiduciary duty is for foundation managers to exercise ordinary business care and prudence. Acting prudently, achieving a return on investments, and aligning investments with mission are no longer necessarily mutually exclusive. According to DeBoskey, foundations can now “abandon the notion that they can only invest for a single bottom line—financial return—rather than a double bottom line—financial return *and* social impact.”

As an advisor, DeBoskey asks many questions of his philanthropic clients, often including, “Do you know where your money is ‘spending the night’?” He finds that many foundations—even very large ones—do not know what questions to ask of their financial advisors, let alone be in a position to talk fluently about the impact of their investments. Most foundations are invested in mutual funds and commingled funds where there is plenty of opportunity for conflicts between investments and missions. For example, take a foundation with a health-related mission, whose endowment is invested in tobacco stocks, rather than in research to cure diseases. Or a foundation with an environmental mission invested in coal and oil and gas exploration, rather than in clean-tech. This list goes on.

His second focus is on educating the foundation’s board—demonstrating that nearly **all** investing has a potential impact on both the public good and mission, for better or worse. Success comes when foundations recognize the full impact potential of their investments. There is evidence that program-related investments can be effective in serving as initial steps that enable boards to become comfortable with greater mission alignment.

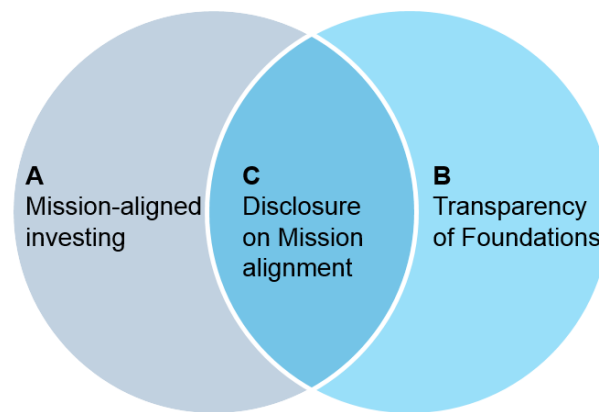
The growing involvement of millennials also has positive implications for mission-aligned investing. Millennials, in DeBoskey’s view, often see the world of PCC through a different lens. They want to make a difference *now* and are more willing to roll up their sleeves and actively engage with nonprofits. Also, millennials are more likely to seek careers that are focused on double or triple bottom lines (financial, social and environmental).

Ultimately, DeBoskey hopes that leaders of foundations and donor-advised funds will recognize that grant-making is not the only way to achieve their missions and that mission-aligned investing gives them additional powerful tools with which to change the world.

Mission alignment and transparency

As interest in mission-aligned investing grows, so has attention to foundation transparency. In a survey of existing practices and perspectives, the Foundation Center’s GlassPockets initiative has found that foundations tend to consider transparency in terms of how it benefits grantees and external audiences, and particularly in terms of its ability to strengthen credibility, build public trust, and improve relations with grantees and other stakeholders. Moreover, the value of increased foundation transparency may be even greater for foundation professionals themselves, as transparency also serves to reduce duplication of effort, to facilitate greater collaboration, and to cultivate a community of shared learning and best practices¹¹. Conversely, these trends may create risk for those organizations slow to change.

Figure 1: Mission-aligned investing and transparency



Source: Cornerstone Capital Group

Focus of assessment

The assessment undertaken by the MIT S-Lab endeavors to show how relative differences in mission-aligned investing and transparency among foundations might be measured. The study was kept intentionally narrow so that a number of indicators could be examined.

The sample of foundations was limited to 25 that provide information to The Foundation Center’s list of the 100 largest grant-making foundations in the United States^A. They include major foundations and family foundations with asset sizes ranging from \$300 million to \$50 billion.

^A The AUM in this list is updated as of April 25, 2015.

Alignment and transparency indicators

For each foundation on the list, S-Lab collected data across 14 indicators of mission alignment. These indicators were selected based on discussions with leading foundation and not-for-profit professionals, with an emphasis towards cross-foundation comparison of mission-aligned investing and transparency practices. Key data sources included IRS Form 990 filings, foundation websites, The Foundation Center and databases made available to the MIT S-Lab. Below is an overview of the data points populated for each foundation.

Figure 2: Key elements of MIT S-Lab’s analysis

Data Point	Description
Lifespan	A foundation’s lifespan was noted to be in either spend-down mode or perpetuity (when this information was explicitly available). Lifespan both affects and is indicative of how a foundation manages its assets.
Mission	The stated mission text found on a foundation’s website.
Program Focus	A foundation’s program focus, e.g. education, health or environment.
PRI Signatory?	The United Nations-supported Principles for Responsible Investment (PRI) Initiative is an international network of investors seeking to put the six Principles for Responsible Investment into practice (United Nations Environment Program Finance Initiative). The PRI initiative analyzes the implications of sustainability for investors and encourages signatories to incorporate these issues into their investment decision-making and ownership practices. By implementing the six voluntary and aspirational principles, signatories contribute to the development of a more sustainable global financial system.
At Least One Asset Manager is a PRI Signatory	Noted if at least one of the asset managers or asset management firms reported in Form 990 is a PRI signatory for a given foundation.
Investment Policy Statement: Standard Investment Language	Language contained in the Investment Policy Statement (IPS) that reflects standard investment management practices including diversification, minimization of risk, and maximizing returns, among other strategies.
Investment Policy Statement: Mission-Alignment Language	Language contained in the Investment Policy Statement that reflects mission-aligned investment management practices including negative screening strategies, balancing short-term investments with long-term impacts, proxy voting and shareholder engagement, among other strategies.
Asset Size	Asset under management (AUM), sometimes called funds under management (FUM), refers to the assets held by a foundation.
Form 990	Public availability of IRS Form 990 – “Return of Organization Exempt From Income Tax”.
Target Rate of Return	This marks whether or not a foundation reports their target rate of return on their website or IPS.
Investment Managers Listed in 990 Form	Form 990 requires a listing of all officers, directors, trustees, and foundation managers together with a complete description of each person’s compensation and time devoted to the position. Information about who the investment managers are for a given foundation can be indicative, albeit not conclusive, of how a foundation’s assets are managed in accordance to its mission.
Chief Investment Officer	Remarks and public statements from Chief Investment Officer (CIO). The CIO’s purpose is to understand, manage, and monitor the organization’s portfolio of assets, devise strategies for growth, act as the liaison with investors, and recognize and avoid serious risks, including those never before encountered.
Mission-Related Investments	This field notes whether a foundation has either mission-related investments or program-related investments. These are investments made by foundations to support charitable activities that involve the potential return of capital within an established time frame. Program-related investments include financing methods commonly associated with banks or other private investors, such as loans, loan guarantees, linked deposits, and even equity investments in charitable organizations or in commercial ventures for charitable purposes.

Source: Cornerstone Capital Group

Trend analysis

Following the data collection, the S-Lab team identified several key trends regarding:

- Transparency on investment securities selection;
- Differences across investment statements;
- Prevalence of PRI signatory status; and
- Focus on program- and mission-related investments.

Security selection

Twenty of the foundations in our study reported the specific securities they own via their asset managers. For most foundations, the individual securities are listed in the appendix of Form 990. This is a positive sign, indicating these foundations are comfortable with public accountability regarding their investments. There are foundations, however, that do not report the names of individual stocks and bonds. Instead, they assign a serial number to each security and list the value of that security. Intentionally or not, this prevents stakeholders from gaining insight into whether their investments are consistent (or, at least not contrary to) their missions.

Investment policy statements

An Investment Policy Statement (IPS) describes the investment priorities for a foundation. These statements may or may not provide language around mission alignment. We noted that 15 out of the 25 foundations in our study, or 62%, post their IPS online. Within each of these statements, we analyzed the kind of language used that would give some indication to priorities around mission alignment, if any. Key terms that we looked for include: mission alignment, negative screening, long-term, socially responsible, shareholder advocacy, proxy voting and social entrepreneurship.

PRI signatories

Being a PRI signatory is voluntary, and there are no enforceable rules regarding the level of participation or proportion of funding that must be managed responsibly in order for an organization to qualify as a signatory. Our analysis suggested that the PRI is not a high priority as none of the foundations examined in our study were signatories to the PRI. A third of the foundations in our study have asset managers that are signatories to the PRI.

The fact that a foundation and/or its managers are signatories shows intent to integrate ESG factors into their investment process; however, it does not imply action on aligning mission with investments. This lack of clarity means that future assessment should determine whether the PRI signatories actively integrate ESG considerations into their investments.

Program- and mission-related investments

Program-related investments and mission-related investments are types of financial investments made by foundations to further their philanthropic goals. Such investments are intended both to achieve positive impact in line with the foundation's mission and to contribute to the foundation's financial growth (though this is not always required). In our study, 64% of foundations surveyed (16 out of the 25) have program- or mission-related investment schemes. Evidence from The DeBoskey Group suggests that program-related investments appear to be correlated with a foundation's acceptance of investing in line with mission.

Example scorecard tool

A useful method for measuring relative mission alignment and transparency might be a scorecard system. Scorecards are developed by selecting several criteria that the evaluator deems to be important and then providing weights for each criterion so that a score can be developed. These scores can then be compared across a set of foundations.

For instance, one criterion could be the inclusion of a section in a foundation's IPS dedicated to discussing how investments will be screened or developed in order to avoid those that contradict a foundation's mission. This criterion would be weighted heavily, since its existence would be a strong indication of a commitment to mission alignment and transparency.

S-Lab developed an example scorecard tool to explore how foundations could be compared. The tool was informed by a combination of interviews with industry experts and used on the 25 selected foundations.

Elements of the scorecard

The criteria on S-Labs' scorecard are:

- Mission alignment and transparency language in the IPS;
- Transparency on the financial status of the foundation;

- Public availability and detail on the foundation’s 990;
- Program-related and mission-related investments; and
- Barriers to mission-aligned investments.

These criteria reflect an understanding of how foundations communicate their investments as well as the dearth of information publicly available.

The scorecard does not include information relating to current spending focus of foundations (spend-down or perpetuity)^B.

Investment policy statement

The scorecard uses investment policy statement language—or lack thereof—as a measure of mission-alignment strategy and transparency. It screens for the terms listed below.

Figure 3: Key words for investment policy statement analysis

Mission Alignment	Triple Bottom Line
Environmental, Social, Governance (ESG)	Tri-Sector Competency
Percentage of Investment Dedicated to a Sector	Program-Related or Mission-Related Investments
Negative Screening Strategy	Impact Investing
Long-term Investments	Venture Philanthropy
Blended Value	Diversity
Socially Responsible	Engagement
Double Bottom Line	Legacy
Sustainability	Values-Based
Beneficiary Risk	Governance
Shareholder Advocacy	Fundamentals-Driven
Proxy Voting	Mission and Social Performance Risk

Source: Cornerstone Capital Group

Financials status

The scorecard checks whether the foundation reports its assets. The criteria are the availability of financial statements and whether the foundation reports assets under management either on their website or annual report outside of Form 990.

990 Tax Forms

This criterion refers to information found within 990 filings, such as stocks and other investment details. Factors included:

^B There is little indication in the available literature about the effects of spend-down mode on mission alignment. It is possible that organizations with a target spend-down date may be more willing to align their investment strategy with their mission because the marginal gains they stand to accumulate through non-mission-aligned investing are small compared with the task and potential impact of spending down the endowment in an impactful way. However, foundations looking to rapidly spend down their funds may be less likely to spend time developing and implementing an IPS.

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- Whether the foundation lists details of stocks and bonds they invest in
 - Whether they report the names of their investment managers
 - Whether they report specific sectors in which they invest

Program-related investments / mission-related investments

This criterion identifies if a foundation is investing in program-related or mission-related investments, which indicates that the foundation is actively investing in line with its stated mission.

Potential barriers to alignment

The scorecard checks if there are any potential barriers in investment policy and investments to mission-aligned investing. Barriers included:

- If the foundation's IPS and other communications define fiduciary duty without consideration of the broader interpretation of greatest risk-adjusted return where this duty includes the consideration of investments which may contradict or lessen the impact of their stated mission;
- If the foundation is focused on maximizing target return and does not take ESG factors into consideration while making those decisions; and
- Any other investment conflicts such as if the investment pool is divided in multiple buckets and one or more buckets is slated to be invested in opaque or difficult-to-identify financial instruments.

Results

The MIT team developed a notional weighting for each criteria so that the relative positions of each foundation could be examined. The weighting of each criteria is subjective and is used to highlight potential differences in the way in which the 25 foundations perform under the scorecard criteria.

The results of the scorecard place the majority of the foundations within the bottom quartile of the scorecard. The major reasons for the low scores were:

- A lack of clear mission-alignment-related language in the IPS, with only 20% of the group explicitly mentioning mission alignment and 12% stating they integrate ESG into their investment considerations; and
- No foundation publicly provided the names of sectors or specific stocks to enable easy comparison of mission to investments.

Implications for mission-aligned investing

Overall, the majority of foundations provide *some* public information on how their investments impact the broader society, particularly in the explicit use of mission-alignment language. However, it is difficult to determine the actual extent of this alignment as there is little detail about the investment process.

Importantly, there does not appear to be explicit evidence of foundations shunning mission-aligned investing. One might infer that foundations are either, as a group, still looking for further support for transparently pursuing mission-aligned investing or other barriers exist across the foundation sector.

Barriers to mission-aligned investing

The question of institutional barriers to mission-aligned investing was outlined in an article for the Stanford Social Innovation Review¹². Potential barriers to mission alignment include:

- **Delegation of investment authority:** Most institutions (and individuals) use fund managers because it is economically efficient to do so. Gaining an understanding of a foundation's holdings through these managers can be difficult as it may raise costs and their investments are constantly shifting.
- **Fund structure:** Many institutional investors use investment vehicles that are time-bound and have liquidity constraints. Some private equity funds also lack transparency around the companies they acquire, which can lead to unpleasant surprises.
- **Lack of standardized data:** While the amount of data available to investors to assess an investment's sustainability performance is increasing, there is a lack of standardized data. This can make it difficult to compare companies' sustainability performance across different industries so that investors remain mission-aligned.

The emergence of managers and advisors that monitor investments using publicly available and proprietary data can assist foundations to appropriately and effectively address these barriers.

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Sebastian Vanderzeil is a research analyst with Cornerstone Capital Group. He holds an MBA from New York University's Stern School of Business. Previously, Sebastian was an economic consultant with global technical services group AECOM, where he advised on the development and finance of major infrastructure across Asia and Australia. Sebastian also worked with the Queensland State Government on water and climate issues prior to establishing Australia's first government-owned carbon broker, Ecofund Queensland.

sebastian.vanderzeil@cornerstonecapinc.com



Andy Zheng is a Research Associate at Cornerstone Capital Group. Andy graduated from Bowdoin College with an interdisciplinary major in Mathematics and Economics and a minor in Visual Arts. He spent his junior year studying abroad at the University of Oxford and the summer prior to that at the Sorbonne in Paris. Andy passed Level I of the CFA Program in January 2014.

dehao.zheng@cornerstonecapinc.com



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