Headwaters Foundation
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Headwaters Health Foundation of Western Montana

INVESTMENT POLICY STATEMENT

As of February 2020

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INVESTMENT POLICY STATEMENT

The Investment Committee met on Monday, October 16, 2017 and recommended to present the IPS for approval by the Board at the October 20, 2017 Board meeting. The Board approved the IPS on Friday, October 20, 2017.

UPDATES TO IPS OVER TIME

February 13, 2019: Investment Committee approved updated asset allocation

May 16, 2019: Investment Committee approved new target weighted benchmark language

February 10, 2020: Investment Committee approved new ranges to asset allocation

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INVESTMENT POLICY STATEMENT

OVERVIEW

MISSION

To work side-by-side with Western Montanans to improve the health of our communities.

PURPOSE

This Investment Policy Statement (IPS) was adopted by the Headwaters Health Foundation of Western Montana ("Headwaters") to establish a clear understanding of the Fund's philosophy and investment objectives. This policy will describe the standards utilized by the Finance Committee in monitoring investment performance, as well as, serve as a guideline for any investment manager retained.

The purpose of the Fund is to manage the pool of assets to support the current and future needs of beneficiaries consistent with the aforementioned mission. While shorter-term investment results will be monitored, adherence to a sound long-term investment policy, which balances short-term spending needs with preservation of the real (inflation-adjusted) value of assets, is crucial to the long-term success of the Fund.

SCOPE

This policy applies to assets that are a part of the Fund and for which the Finance Committee has responsibility.

FIDUCIARY DUTY

It is expected that the board, staff and contracted organizations associated with the Funds will discharge their respective responsibilities in accordance with generally accepted fiduciary standards by exercising the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent investor acting in like capacity and familiar with such matters would exercise in the conduct of an enterprise of a like character and of like aims, and diversifying the investments to attempt to moderate the risk of large losses.

BACKGROUND ON THE FUND AND ITS MANAGEMENT

Headwaters Health Foundation of Western Montana was formed as part of a 2015 Asset Purchase Agreement for the sale of Community Medical Center (CMC) of Missoula, a nonprofit corporation, to RCHP Billings. As part of this transaction, the Montana Attorney General oversaw transfer of the CMC sales proceeds to a newly formed non-profit entity that could maintain the charitable use of the assets. The entity that was formed was initially called Missoula Community Hospital Legacy Foundation and was renamed Headwaters Health Foundation of Western Montana in 2017.

As part of his approval of the transaction, and the disposition of the charitable assets, the Montana Attorney General approved this language which remains in the Foundation's Articles of Incorporation:

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The Corporation will be operated and managed on a permanent endowment model basis, using its revenues to fund its activities and preserving its principal, consistent however at all times with the Code and applicable Regulations governing private foundations.
Articles of Incorporation, Article VIII.

In 2019 the Foundation sought to clarify its obligations under Montana's Uniform Prudent Management of Institutional Funds Act with respect to the endowment envisioned in the Articles of Incorporation. Relying on the advice of legal counsel the Foundation found that the 2015 Asset Purchase Agreement did not create restrictions on Headwaters assets that would qualify the funds as institutional under Montana law. Therefore the endowment assets are unrestricted, and not subject to UPMIFA.

DEFINITION OF DUTIES

BOARD OF DIRECTORS

The Board of Directors has the ultimate fiduciary responsibility for the Fund's investment portfolio. The Board must ensure that appropriate policies governing the management of the Fund are in place and that these policies are being effectively implemented. To implement these responsibilities, the Board sets and approves the Investment Policy Statement.

FINANCE COMMITTEE

The Finance Committee is responsible for adopting the provisions of this Investment Policy. This responsibility includes approving investment strategy; hiring and firing of investment managers, custodians, and investment consultants; monitoring performance of the Fund on a regular basis (at least quarterly); and maintaining sufficient knowledge about the Fund and its managers to be reasonably assured of their compliance with the Investment Policy Statement.

CHIEF FINANCIAL OFFICER

The Chief Financial Officer (CFO) will have responsibility for administration of the Fund and will consult with the Finance Committee and the investment consultant on matters relating to the investment of the Fund. The CFO will serve as a contact for the Fund's investment consultant, investment managers, and custodian.

INVESTMENT CONSULTANT

The investment consultant is responsible for assisting the Finance Committee and CFO in all aspects of managing and overseeing the investment portfolio. The consultant is the primary source of investment research/education and investment manager information. On an ongoing basis the consultant will:

1. Provide proactive recommendations;
2. Supply the Finance Committee with reports (e.g., asset allocation studies, investment research and education) or information as reasonably requested;
3. Monitor each investment manager/fund;

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4. Provide the Finance Committee with quarterly performance reports; and
5. Assist the Finance Committee periodically, with a review of the Investment Policy Statement, including an assessment of the current asset allocation and investment objectives.

INVESTMENT MANAGERS

Investment managers have the responsibility for managing the underlying assets consistent with their stated approach and with this policy. The investment managers will report investment results and meet with the committee, staff, and/or investment consultant as requested.

CUSTODIAN

The custodian's primary function will be to hold in custody the assets of the Fund, including individual securities and shares or other interests invested in commingled vehicles. The custodian also will reconcile account positions and activity with the investment managers, account for the collection of interest and dividends, account for security transactions, and prepare periodic (e.g., monthly) account statements.

OBJECTIVES

The overall, long-term investment objective of the Fund is to achieve an annualized total return (net of investment management expenses), through appreciation and income, greater than the rate of inflation (as measured by the Consumer Price Index) plus any spending and administrative expenses, thus protecting the purchasing power of the assets. The assets are to be managed in a manner that will meet the primary investment objective, while at the same time attempting to limit volatility in year-to-year spending.

STRATEGY

The Board and Finance Committee understand the long-term nature of the Fund and believe that investing in assets with higher return expectations outweighs their short-term volatility risk. As a result, the majority of assets will be invested in equity or equity-like securities, including real assets (real estate, natural resources, and infrastructure). Real assets also are expected to provide the added benefit of inflation protection.

Fixed income and diversifying strategies will be used to lower short-term volatility and provide stability, especially during periods of deflation and negative equity markets. Cash is not a strategic asset of the portfolio, but is a residual to the investment process and used to meet short-term liquidity needs.

SPENDING POLICY

Income available for spending is determined by a total return system with the spending policy itself set by the Board and its procedure outlined in a separate document. It is expected that, on average over time, Headwaters will spend approximately 5% of the previous year's quarterly market value average of the Fund.

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ASSET ALLOCATION/INVESTMENT STRUCTURE

Asset allocation will likely be the key determinant of the Fund's returns over the long-term. Therefore, diversification of investments across multiple markets that are not similarly affected by economic, political, or social developments is highly desirable. A globally diversified portfolio, with uncorrelated returns from various assets, should reduce the variability of returns across time. In determining the appropriate asset allocation, the inclusion or exclusion of asset categories shall be based on the impact to the total Fund, rather than judging asset categories on a stand-alone basis.

The target asset allocation should provide an expected total return equal to or greater than the primary investment objective of the Fund, while avoiding undue risk concentrations in any single asset class or category, thus reducing risk at the overall portfolio level.

Investments will generally fall into one of four asset categories. Each category serves a specific role within a portfolio. An allocation to all four categories can provide diversification to major market risk factors while establishing a simple framework to review the exposures within the portfolio. The categories are as follows:

GLOBAL EQUITY	Intended to be the primary source of long-term capital appreciation for the portfolio. While having higher expected returns than fixed income, they also have higher expected volatilities. Sub-categories include both public and private equities, as well as hedged equity mandates.
GLOBAL FIXED INCOME/CREDIT	Intended to offset the volatility of equities, particularly during market downturns, as well as provide deflation protection. These investments are comprised primarily of fixed income (debt) securities, and can be categorized as interest rate sensitive and credit sensitive. Sub-categories include both public and private debt.
REAL ASSETS	Intended to insulate the portfolio from inflation shocks and to provide a source of non-correlating returns with other asset categories. Includes both public and private investments in real estate, natural resources (e.g., energy, agriculture, timber, commodities), and infrastructure (e.g., power generation, mid-stream energy Master Limited Partnerships "MLPs").
DIVERSIFYING STRATEGIES	Intended to provide diversification from systematic market risk, with the primary determinant of returns typically derived from manager skill (alpha) rather than the market (beta). Sub-categories include both liquid and semi-liquid non-directional strategies that seek low correlations to the public equity and fixed income markets.

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To achieve these goals, the asset allocation will be set with the following target percentages and within the following ranges. It is understood that given the infancy of the Fund as of the initial drafting of this investment policy, it will take an extended period of time to achieve this target asset allocation:

Asset Category	Target		Range	
GLOBAL EQUITY	**55%**		**45-65%**	
Public Equities	***45***		***30-55***	
U.S.		22		15-30
International Developed		15		10-25
Emerging Markets		8		0-20
Hedged Equity	***5***		***0-10***	
Private Equity	***5***		***0-15***	
GLOBAL FIXED INCOME/CREDIT	**20**		**10-40**	
Interest Rate Sensitive	***10***		***5-40***	
Core (Investment Grade)		10		5-40
Inflation Protected (TIPS)		0		0-10
Credit Sensitive	***10***		***0-20***	
Liquid Credit		5		0-10
Semi-Liquid Credit		0		0-10
Private Debt		5		0-10
REAL ASSETS	**10**		**5-20**	
Real Estate	***4***		***0-10***	
Public Real Estate		2		0-10
Private Real Estate		2		0-5
Infrastructure	***3.5***		***0-10***	
Public Infrastructure		3		0-10
Private Infrastructure		0.5		0-5
Natural Resources	***2.5***		***0-10***	
Public Natural Resources		0		0-10
Private Natural Resources		2.5		0-5
DIVERSIFYING STRATEGIES	**15**		***5-25***	
Liquid Funds	***0***			0-25
Semi-Liquid Hedge Funds	***15***			0-25

REBALANCING

The CFO and investment consultant will monitor the asset allocation structure of the Fund and attempt to stay within the ranges allowed for each asset category. An asset allocation review and determination for re-balancing shall be made by the CFO and the Investment Consultant for review at the Finance Committee meeting. Transactions related to portfolio cash flows (private capital calls or distributions/spending) will be executed at the discretion of the CFO with the assistance of the Investment Consultant. Any special re-balancing instructions due to changes in market conditions and long-term capital market expectations would be implemented by the CFO and the Investment Consultant at the direction of the Finance Committee.

ACTIVE AND PASSIVE MANAGEMENT

The asset allocation will be implemented using both active and passive investment managers. Highly efficient areas of the capital markets will be managed using index funds and other structured strategies (e.g., smart beta, enhanced index, portable alpha).

INVESTMENT STYLES / MARKET CAPITALIZATION

The Finance Committee understands investment styles (growth and value) are cyclical, but believes that over the long-term, value stocks will outperform growth stocks and this is more pronounced for smaller market capitalization (cap) stocks. Therefore, the Fund will employ a strategic overweight to value stocks, with a larger value overweight to mid and small cap stocks.

Additionally, the Fund will employ a strategic tilt towards smaller market cap stocks, due to the Finance Committee's belief that over the long-term, small cap stocks will outperform large cap stocks, although with higher volatility relative to larger cap stocks.

LIQUIDITY

The Fund will seek to maintain a balance between investment goals and liquidity needs. Liquidity is necessary to meet the spending policy payout requirements and any extraordinary events. In many instances, the most appropriate investment option is one that comes with liquidity constraints.

Illiquid investments include private equity, private debt, and private real assets. Hedge funds are considered semi-liquid due to lock-up periods, redemption restrictions, and in some cases, illiquidity of the underlying investments. The tradeoff between appropriateness and liquidity will be considered throughout the portfolio construction process, but with the following limits:

CLASSIFICATION OF ASSET	LIMITS
Liquid	At least 60% of the portfolio
Semi-Liquid	No more than 20% of the portfolio
Illiquid*	No more than 20% of the portfolio

* A private capital implementation plan (with target amounts and timing of capital commitments) will be used to manage the allocation prudently, strive to maintain the target allocation, and maintain vintage year diversification. Market movements could cause the total illiquid allocation to move outside ranges, in which case, rebalancing will not be necessary, but future commitments may need to be adjusted.

PERFORMANCE MEASUREMENT

TIME HORIZON

The Finance Committee seeks to achieve the investment objectives over a full market cycle, but does not expect that all investment objectives will be attained each year. Furthermore, the Finance Committee recognizes that over various time periods, the portfolio may produce over or under performance relative to the broad markets. For this reason, long-term investment returns will be evaluated over a full market cycle (for measurement purposes: at least 5 years).

PRIMARY BENCHMARK

The primary objective of the Fund is to achieve a total return, net of fees, in excess of spending, administrative fees, and inflation. The Primary Benchmark is the minimum return needed to achieve the portfolio's long-term investment objectives.

Total Return greater than Consumer Price Index + 5% spending

TARGET WEIGTHED BENCHMARK

Another investment objective is to achieve a total return in excess of the Target Weighted Benchmark, comprised of each asset category benchmark weighted by its target allocation. Once the strategic target allocation is adopted and subsequently updated, the relative target weighted benchmark will be assigned, subsequently updated, and disclosed in the consultant's performance report.

MANAGER EVALUATION

QUALITATIVE MEASURES

Each investment manager will be reviewed by the Finance Committee on an ongoing basis and evaluated upon the criteria listed below.

1. Maintaining a stable organization;
2. Retaining key personnel;
3. Avoiding regulatory actions against the firm, its principals, or employees;
4. Adhering to the guidelines and objectives of this Investment Policy Statement; and
5. Avoiding significant deviations from the manager's stated investment philosophy.

Although there are no strict guidelines that will be utilized in selecting managers, the Finance Committee will consider the criteria above, as well as, the unique role the manager may play, the length of time the firm has been in existence, its track record, assets under management, and the amount of assets the Fund already has invested with the firm.

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SUMMARY OF QUANTITATIVE PERFORMANCE

Public Liquid and Semi-Liquid Active Managers

Liquid and semi-liquid (hedge fund) active managers will be measured against an appropriate market index and a peer universe of portfolios managed in a similar investment style. The Finance Committee expects the managers to outperform the benchmarks over a full market cycle, but does not expect that all investment objectives will be attained each year. Furthermore, the Finance Committee recognizes that over various time periods, the managers may produce significant over or under performance relative to their benchmarks. For this reason, long-term investment returns will be evaluated over a full market cycle (for measurement purposes: at least 5 years).

Managers failing to meet these criteria over a full market cycle will undergo extensive qualitative and quantitative analysis. This analysis will focus on the manager's personnel, philosophy, portfolio characteristics, and peer group performance to determine whether the manager is capable of implementing their defined portion of the overall portfolio structure.

Public Liquid Passive Managers

Passive (or index) managers are expected to approximate the total return and risk of its respective benchmark.

Private Illiquid Managers

Private partnerships typically range from 7-15 years in life, during which time the Fund may not be able to sell the investment. Additionally, the partnership may not produce meaningful returns for 3-5 years (depending on the strategy). New investments will create a drag on fund performance (known as the J-curve) in the early years (3-5 years) until these investments begin to mature.

Private, illiquid manager performance will be measured utilizing internal rate of return (IRR) from the inception of the partnership and compared to an appropriate peer group and/or public market equivalent benchmark.

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GUIDELINES AND RESTRICTIONS

GENERAL

In today's rapidly changing and complex financial world, no list or types of categories of investments can provide continuously adequate guidance for achieving the investment objectives. Any such list is likely to be too inflexible to be suitable of the market environment in which investment decisions must be made. Therefore, the process by which investment strategies and decisions are developed, analyzed, adopted, implemented and monitored, and the overall manner in which investment risk is managed, will determine whether an appropriate standard of reasonableness, care, and prudence has been met for the Fund's investments.

DERIVATIVE SECURITY GUIDELINES

For the purposes of this policy, derivatives include, without limitation, futures contracts; options; options on futures contracts; forward contracts; swap agreements, including swap contracts with embedded options; any instrument or contract intended to manage transaction or currency exchange risk in purchasing, selling or holding investments; and any other instrument commonly used by institutional investors to manage institutional investment portfolios.

At the Total Fund level, derivatives may be used to maintain the program's strategic asset allocation, including securitizing excess cash, and to provide portfolio hedging, but derivatives shall not be used for leverage at the portfolio level.

Investment managers may be permitted to utilize derivatives to implement their strategies, including the following:

1. Equity and Commodities Index Funds – Derivatives (typically futures contracts) may be used to securitize cash in order to fully replicate the performance of the index being tracked.
2. Portable Alpha – Derivatives (typically futures or swaps) may be used to generate "beta", while the notional exposure amount is actively managed to generate "alpha".
3. Fixed Income – Derivatives may be used as a cost efficient means to control and/or hedge risks such as duration, credit, and currency.
4. International Investments – Derivatives may be used to hedge currencies.
5. Overlay/Transition Management – Derivatives (typically futures contracts) may be used to securitize cash to maintain the target asset allocation without buying and selling physical securities.
6. Hedge Funds – Derivatives may be used for many purposes. These uses include hedging, risk management, leverage, and market exposure.

Under no circumstances may derivatives or leverage be used to circumvent the intent or limits otherwise prescribed by this policy.

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ACKNOWLEDGEMENT

We recognize the importance of adhering to the mission and strategy detailed in this policy. We agree to work to fulfill the objectives stated herein, within the guidelines and restrictions, to the best of our ability. We acknowledge that open communications are essential to fulfilling this mission, and therefore, recognize that suggestions regarding appropriate adjustments to this policy or the manner in which investment performance is reviewed are expected.

__________________________________ _________________________

Headwaters Date

__________________________________ _________________________

Fund Evaluation Group, LLC Date

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