The University of Iowa Center for Advancement (UICA) Quarterly Investment Summary – March 31, 2018

Overview

Attached you will find the investment performance report for the period ending March 31, 2018. Domestic equity markets hit all-time highs in January but finished the quarter in negative territory. The U.S. dollar depreciated, helping international and emerging markets equities, but international developed equities were still down during the quarter. The Federal Reserve welcomed a new chairman and raised rates as inflation edged toward its 2 percent target.

The Long-Term Pool (LTP) returned 0.9 percent for the quarter, 11.2, 6.9, 7.4, and 6.5 percent respectively for the one-, three-, five-, and 10-year periods.

Global Equity

The global equity composite returned 2.7 percent during the quarter, 13.0 percent fiscal year to date and an annualized 10.3, 10.5, and 7.2 percent over the past three-, five-, and 10-year periods.

Public equity markets across the globe posted their first negative quarter in several years. In the U.S., equity markets reached all-time highs before volatility spiked and markets turned in February and March. International developed markets suffered the same fate, while emerging markets rebounded in March. In U.S. and international developed markets, value continued to lag growth while small cap outperformed large cap. Value outperformed growth in emerging markets, but large cap outperformed small cap. U.S. investors' returns in developed and emerging markets returns were also boosted by the depreciating dollar.

The increase in market volatility and reversal from market highs helped the hedged equity portfolio outperform long only benchmarks during the quarter. The hedged equity portfolio reduces the volatility of the global equity, but a case can be made that long-term investors can ride out market volatility. When the hedged equity portfolio was created, our public equity exposure was three times the size that it is today. The lower public equity weighting itself reduces the volatility risk of the LTP. The role of hedged equity is now less about risk reduction and more about market performance.

While public equity markets fell amid increased volatility, private equity hasn't been hit yet due to the performance reporting lag. Fundraising remains strong for buyouts but has slowed for venture capital. Venture capital has seen the median deal size and pre-money valuation rise over the past five years in every financing round from seed to Series D. The first quarter of 2018 saw the number of acquisitions and initial public offerings fall from 2017s level. While portfolios are largely unrealized, performance has fallen since 2011. We have not made a venture capital commitment since 2000 and the bar is quite high to make a new one in this market environment. Since our return to private equity in 2010, we have outperformed equity markets by more than 500-700 basis points annualized. We continue to increase our weighting to private equity through follow on investments with existing managers, but there is an appetite for general partners that can consistently achieve our return hurdles and maintain an alignment of incentives with limited partners.

Global Fixed Income

The global fixed income composite gained 0.4 percent during the quarter and 2.4 percent for the fiscal year to date. Over longer time periods it has increased an annualized 3.9, 4.1, and 7.3 percent for the three-, five-, and 10-year periods. The Federal Reserve raised interest rates 25 basis points in March and rates across the yield curve increased as well. Against this backdrop, all U.S. fixed income sectors fell during the quarter. Credit strategies were able to make up for the underperformance of rate sensitive strategies, particularly distressed debt and bank loans.

Real Assets

The real assets composite returned negative 0.4 percent for the quarter, 6.8 percent for the fiscal year to date, and an annualized 5.2 and 5.0 percent over the past three- and five-year periods. Both real estate and natural resources saw significant declines in the quarter, led down by REITs and MLPs. Commodity futures were modestly negative as volatility spiked in agriculture and energy. Private real estate and natural resources buoyed performance as both saw robust performance. Within real estate, the performance gap between REITs and private real estate could lead to opportunities for private managers to take REITs private. We have seen some general partners taking positions in public REITs to exploit this valuation disparity.

Diversifying Strategies

The diversifying strategies composite returned negative 1.3 percent for the quarter, 7.0 percent for the fiscal year to date, and an annualized 3.7 and 6.0 percent over the past three- and five-year time periods. The short-term performance of the composite was hit from all sides, as only two strategies were able to post positive returns. Performance beyond the most recent quarter remains strong. The composite continues to have the highest Sharpe Ratio of our four asset classes while maintaining an equity market beta of less than 0.4. Strategies that generate income regardless of the direction of equity markets that might be overlooked by other investors are more likely to make it into the composite than an absolute return hedge fund.

Conclusion

At the end of the calendar year investors were worried about market valuations around the world. The increased volatility seen in the first quarter of 2018 brought valuations down, but rhetoric around trade and tariffs has put markets on edge. As long-time horizon investors we hope that this is short-term noise which might lead to market dislocations. The portfolio remains liquid and in today's environment the bias will be toward liquid investments. Our return goal remains outpacing spending, inflation and fees while lowering the probability of a permanent loss of capital.