The University of Iowa Center for Advancement (UICA) Quarterly Investment Summary – June 30, 2018

Overview

Attached you will find the investment performance report for the period ending June 30, 2018. The biggest concern among markets and investors during the quarter was global trade wars. U.S. equity and most fixed income markets rallied while international equity markets fell. Economies that rely heavily on U.S. demand suffered some of the largest losses as trade policies are being reviewed. Inflation and economic growth continue to increase and are expected to lead to more interest rate hikes throughout the fiscal year.

The Long-Term Pool (LTP) returned 0.6 percent for the quarter, 9.6, 6.6, 7.7, and 6.8 percent respectively for the one-, three-, five-, and 10-year periods.

Global Equity

The global equity composite returned -0.6 percent during the quarter, 12.5 percent over the fiscal year and an annualized 8.8, 10.6, and 7.4 percent over the past three-, five- and 10-year periods.

While equity markets around the globe have produced positive returns during the quarter, domestic markets have led the way. U.S. markets saw small caps produce the highest returns for the fiscal year, with all capitalizations posting double digit performance. Growth continues to outperform value and has now outperformed over the trailing one, three, five and 10 years.

Internationally, emerging markets posted a dismal quarter, but remained ahead of developed markets for the fiscal year. Like domestic equities, growth outperformed and has also beaten value over the past one, three, five and 10 years. Small caps outperformed large caps in developed international markets, but in emerging markets large cap stocks had the highest returns during the fiscal year. U.S. investors underperformed local currency investors in international markets as the dollar strengthened as the trade war rhetoric heated up.

A hedged equity portfolio has a place in some equity biased portfolios. For true long-term investors that can withstand long only volatility, hedged equity might not have a place. As the LTP has become more diversified and equity risk has decreased, the need for hedged equity has diminished. It has been a struggle to source hedged equity strategies that justify their fees and produce attractive net returns. We have sent redemption notices to the managers within the hedged equity portfolio and expect most of the assets to be redeemed at the end of the calendar year.

At this time last year, we wrote that “public equity markets at or near all-time highs, robust private equity fundraising is a concern”. Buyout fundraising has slowed, but venture capital fundraising is on pace to beat 2017. The private equity market continues to be in the general partners favor. It is becoming more difficult to source firms that will not be swayed by the siren song of management fee income associated with larger funds. Some of our best returns have been in the private equity asset class, often beating public markets by 400 or more basis points, and we don’t want to risk that by investing with the wrong general partner.

Global Fixed Income

The global fixed income composite gained 1.2 percent during the quarter and 3.6 percent for the fiscal year. Over longer time periods it increased an annualized 4.3, 4.2, and 7.7 percent for the three-, five- and 10-year periods. The Federal Reserve increased interest rates three times during the fiscal year, detracting from returns for interest rate sensitive strategies during the quarter. The yield curve has flattened since the Fed started hiking interest rates more rapidly in December 2016. Some economists fear that rates will rise too far and tighten monetary policy more than needed, though few are calling for a recession. Credit strategies were positive for the fiscal year, with distressed debt continuing to outperform other fixed income strategies.

Real Assets

The real assets composite returned 5.9 percent for the quarter, 13.6 percent for the fiscal year, and an annualized 7.2, 6.6, and 4.0 over the past three-, five-, and 10-year periods. Real estate was led by private investments for the fiscal year. Public real estate returns were strong domestically, but international markets lagged the U.S. Rising interest rates hurt REIT performance at the beginning of 2018, but property owners increased rents in anticipation of rising rates and inflation. Natural resources benefitted from increased oil prices during the fiscal year. MLPs had a strong quarter, while the threat of a trade war hurt agricultural commodities.

Diversifying Strategies

The diversifying strategies composite returned -2.2 percent for the quarter, 4.6 percent for the fiscal year, and an annualized 3.1 and 5.2 percent over the past three- and five-year time periods. The composite's equity biased managers had the best performance during the quarter, while hedge fund beta and global macro strategies struggled. Liquid, uncorrelated strategies with attractive net returns have been difficult to source, but opportunities among private strategies have presented themselves during the fiscal year. A moderate increase in illiquid investments within diversifying strategies is likely to meet the return objectives of this asset class.

Conclusion

Last year at this time we commented that many of our investment partners questioned if markets were overvalued. On September 20, 2018 the S&P 500 closed at an all-time high. Meanwhile, the Fed continues to hint at further rate hikes to keep the economy from overheating. The LTP remains highly liquid as we wait to take advantage of market dislocations. This has likely cost us some performance as our peers allocate more and more to private strategies and general partners find it ever easier to raise funds. Against this backdrop the bar to make a private capital investment with a new partner is very high. Nevertheless, we feel that the portfolio is positioned appropriately to take advantage of the current market environment and to meet our return objectives for today and into the future.