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

Overview

Attached you will find the investment performance report for the period ending December 31, 2018. The final quarter of the calendar year showed a sharp reversal of positive trends that persisted until December. Equity and fixed income markets across the globe struggled, as cash was the only major asset to post positive returns, as a slowing global economy, continued US-China trade tension and another Fed rate hike created a "risk off" environment.

The Long-Term Pool (LTP) returned -5.6 percent during the quarter, -1.9, 7.0, 5.1, and 9.7 percent respectively for the 1-, 3-, 5-, and ten-year periods.

Global Equity

The global equity composite returned -9.1 percent during the quarter and an annualized 8.8, 6.2, and 8.1 percent over the past 3-, 5- and ten-year periods.

Equity markets saw the worst December performance since the Great Depression as volatility returned. While the US continued to show signs of growth, earnings outlooks were lowered due to trade tensions and rising interest rates. Growth stocks suffered more than value, a rare event since the market bottom of March 2009. Small cap stocks continue to trail large cap stocks, falling further behind in 2018. International markets held up better than the US during the volatile quarter, but the US outperformed international developed and emerging markets for the calendar year. Potential headwinds for international stocks are signs of economic weakness in Europe and slow growth in China. While the European central bank ended quantitative easing in December, China plans on implementing monetary and fiscal policy measure to help its economy.

Private equity valuations are not as sensitive to volatility as public equity markets. The negative sentiments of December went away in January and this could moderate year-end valuations. Private equity fundraising remains strong. Venture capital raised over $75 billion[1], the most since the peak of the technology bubble. Buyout fundraising fell from 2017s pace, with $125 billion being raised by North American-focused buyout funds[2]. Few PE funds are willing to negotiate terms due to the robust fundraising environment. It is becoming more common for funds to hold one close after short due diligence time frames. As almost all our peers increase allocations to private equity, GPs can pick and choose which LPs they want to partner with. We are concerned that this will lead to GPs raising funds that are too large for their strategies. Once again, the bar for adding a new general partner to the portfolio keeps getting raised. While market conditions are a factor in the higher bar, the returns of the existing portfolio are as well. Since the private equity portfolio was started in 2010 its performance has exceeded its passive benchmark by over 500 basis points per year, making it the best performing asset class in the LTP.

[1] Pitchbook, data as of December 31,2018

[2] Pitchbook, data as of December 31,2018

Global Fixed Income
The global fixed income composite returned -0.7 percent during the quarter, and an annualized 5.4, 3.7, and 7.5 percent for the 3-, 5- and ten-year periods. The Fed's December interest rate increase was not well received by the markets. Treasuries rallied as volatility increased as risk assets, like credit, sold off. High quality bonds protected capital in 2018, which was more difficult for lower quality, credit sensitive fixed income. Nearly all our credit strategies had negative returns in December that wiped away 11 months of positive performance. After the volatile December, the Fed seemingly reversed course and became dovish in January.

Real Assets
The real assets composite returned -4.4 percent for the quarter and an annualized 6.5, 9.5 and 8.6 over the past 3-, 5- and ten-year periods. Like equity and fixed income, real asset markets experienced elevated volatility in 2018. Real assets are seen as risk assets and fell during the "risk off" trade in December. REITs suffered as interest rates increased, but modest leverage and an historically tight labor market are positives. Commodities and MLPs were hurt by an appreciating US dollar, rising interest rates and a drop in oil prices during the quarter. Distribution yields for MLPs are over 9 percent while the asset class transitions from a retail investment base to an institutional investor base.

Diversifying Strategies
The diversifying strategies composite returned -4.7 percent for the quarter and an annualized 1.8 and 2.8 percent over the past 3- and 5-year time periods. Intuitively, diversifying strategies should hold up well when other asset classes struggle. This dynamic did not occur in 2018 due to the trend reversal in global equities, energy and interest rates. Managed futures was able to post a positive returns during the volatile month of December, but most other strategies struggled during the year. Hedge fund beta struggled as momentum and value trades hurt performance.

Conclusion
While performance for the calendar year was disappointing, we feel that it performed as expected in a difficult year. The strong equity market performance and low volatility seen in 2017 caused investors to question diversification. As volatility spiked and equity markets sold off in 2018, investors realized why diversification is necessary. Usually falling markets create opportunity, the short period of increased volatility saw few opportunities due to reversal that began after Christmas. As of this writing, the S&P 500 is within 5 percent of its all-time high closing price. As always, our focus remains on achieving our target returns of outperforming spending, inflation and fees while lowering the probability of a permanent loss of capital, identifying investment managers that can deliver outperformance, and maintaining sufficient liquidity.