The University of Iowa Center for Advancement (UICA) Quarterly Investment Summary – March 31, 2019

Overview

Global markets returned to embracing risk in the first quarter of 2019 with every major asset class posting positive returns. U.S.– China relations improved and central banks around the world laid the groundwork for more accommodative policy. The economy continues to expand, but the Treasury yield curve inversion in March has caused some to worry that signs are pointing to an end of the cycle.

Global Equity

The global equity composite returned 8.5 percent during the quarter and an annualized 11.5, 7.6, and 13.2 percent over the past three-, five-, and 10-year periods.

Equity markets rallied in the quarter, with the S&P 500 posting its strongest quarter since 2009 and strongest first quarter in 20 years. Led by the technology sector, every U.S. equity sector had positive returns and only two, health care and financials, failed to generate double digit returns. International developed and emerging markets also posted strong returns as both made up 2018's losses during the quarter. While the ECB announced further economic stimulus and the difficulties of Brexit captured the attention of investors, the dominant concern is U.S./China relations.

While the public equity markets rebounded from their fourth quarter 2018 fall, private equity valuations are still coming in from calendar 2018. The median IRR for venture and buyout funds has been low to mid-teens since the 2009 vintage year[1]. Public equity returns have been 12 percent to 15 percent annualized for similar time periods indicating that median funds are not delivering much, if any, of an illiquidity premium. Interestingly, fundraising remains robust with buyout off to a strong start as venture is below 2018's pace to start 2019[2]. The bargaining power pendulum remains tilted toward the GP indicating that LPs might be investing more on the hopes of high private equity returns rather than the realities seen in their portfolios. The results of our private equity portfolio are a little different. Since the private equity portfolio was started in 2010 its performance has exceeded its passive benchmark by almost 500 basis points per year, making it the best performing asset class in the LTP. We remain concerned about the amount of capital investing in PE and expect the asset classes returns to fall as our peers continue to increase their allocations.

Global Fixed Income

The global fixed income composite returned 2.3 percent during the quarter, and an annualized 5.8, 3.5, and 7.6 percent for the three-, five-, and 10-year periods. Major central banks around the globe became more dovish to start the year, but part of the U.S. yield curve inverted in March. This concerned investors and saw interest rates drop helping rate sensitive fixed income strategies. Credit sensitive fixed income also benefitted from the risk-on environment, with spreads tightening during the quarter.

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[1] Pitchbook, data as of September 30, 2018
[2] Pitchbook, data as of March 31, 2019

Real Assets

The real assets composite returned 9.2 percent for the quarter and an annualized 11.0, 6.0, and 12.7 percent over the past three-, five-, and 10-year periods. Every strategy in the real asset composite had strong performance, but MLPs had the strongest gain of any asset class buoyed by rising oil prices and new fund flows. The increase in energy prices also helped commodities, which posted strong gains on the improved U.S./China trade deal prospects. Real estate returns were helped by improving fundamentals and net operating income growth.

Diversifying Strategies

The diversifying strategies composite returned 3.2 percent for the quarter and an annualized 3.5, 3.9, and 6.6 percent over the past three-, five-, and 10-year time periods. Event-driven strategies had a strong first quarter, aided by increased deal flow in the merger arbitrage space. Royalties continue to provide stable cash flows during volatile markets. The composite faces a headwind in hedge fund beta while momentum and value continue to out of favor.

Conclusion

After a disappointing end to 2018, the LTP rebounded and moved back above its high watermark by the end of January. While the past six months have been volatile, they also demonstrate why an endowment needs to invest with a long-term time horizon. Markets will fluctuate from quarter to quarter, but the goal of our endowment is to provide a stable source of income for our campus partners. In order to achieve that goal and grow the endowment to outpace spending, inflation and fees we need to see beyond short-term market movements. Over long time periods we expect the global equity composite to provide the highest return. Over short time periods we are not confident in our ability to pick the best performing asset class, so we maintain a diversified portfolio. Real assets act as our inflation hedge, while the global fixed income and diversifying strategies composites provide total return and equity diversification. As always, our focus remains on achieving our target returns while lowering the probability of a permanent loss of capital and identifying investment managers that can deliver outperformance while maintaining sufficient liquidity.