The University of Iowa Center for Advancement (UICA) Quarterly Investment Summary – June 30, 2019

Overview

While U.S. and Chinese trade relations took a step backwards during the quarter, investors were buoyed by accommodative monetary policy from the European Central Bank, Bank of Japan, and the Federal Reserve. Led by domestic equities, every asset class saw positive returns for the second quarter in a row. The economic weakness seen outside the U.S. is threatening to come to

Global Equity

The global equity composite returned 1.7 percent during the quarter, 2.6 percent over the fiscal year and an annualized 11.5, 7.2, and 11.1 percent over the past three-, five- and 10-year periods.

Domestic equity markets continue to post the highest returns of any asset class. During the fiscal year, large cap stocks had double digit gains while small cap stocks were negative, but the last half of the fiscal year saw mid- to high-teen returns in both market caps. The year 2019 has been very good for U.S. stocks. Growth continues to outperform value and has now outperformed over the trailing one, three, five and 10 years for the second year in a row. Domestic markets carried their momentum into the next fiscal year, with the S&P 500 closing at an all-time high of 3,025.86 on July 26, 2019.

Uncertainty surrounding Brexit and weak economic data from the European Union affected international equity returns, but both developed and emerging markets were positive for the fiscal year. In developed markets, growth outperformed value during the fiscal year. Emerging markets saw value outperform growth, while large cap outperformed small cap in both markets. Europe (ex-UK) was the best performing developed market region, while Europe, Middle East, and Africa was the best performing region in emerging markets.

We have been writing about robust fundraising activity for several quarters and it does not appear that investors' appetite for private equity is diminishing. Pitchbook data shows that the average global buyout fundraise has more than doubled from $700 million to $1.5 billion and 2019 fundraising is on pace to surpass the $234 billion raised in 2018. Private equity has the strongest performance of any asset class in the endowment, beating public markets by 690 basis points annualized since our first investment in 2010. All of that has happened in an expanding economy and an equity bull market. It is doubtful that level of outperformance will continue.

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.

Real Assets

The real assets composite returned 0.2 percent for the quarter, 5.1 percent for the fiscal year, and an annualized 7.6, 4.9, and 9.6 percent over the past three-, five-, and 10-year periods. Similar to equity returns, domestic public real estate returns were strong while international markets lagged the U.S. for the fiscal year. Both markets were positive, but low unemployment and interest rates and a stable economy were favorable tailwinds to U.S. REITs. Oil prices experienced volatility due to the impact of the trade war and geopolitical tensions in the Middle East, hurting performance of the public natural resources portfolio. Private strategies in both real estate and natural resources had strong performance.

Diversifying Strategies

The diversifying strategies composite returned 2.0 percent for the quarter, 2.1 percent for the fiscal year, and an annualized 3.8, 3.8 and 6.1 percent over the past three-, five-, and 10-year time periods. Merger and acquisition activity picked up during the fiscal year, a tailwind for event driven strategies. Hedge fund beta continues to struggle, but trend following strategies have enjoyed strong performance. Royalty strategies performed well during the fiscal year, providing an uncorrelated return and double digit returns since their addition to the composite in 2011. The most attractive investments in the asset class continue to be in illiquid strategies.

Conclusion

Over the past few months, the economic slowdown that has taken hold outside the U.S. has been showing signs of moving on to our shores. Despite this, U.S. stocks are close to their all-time highs as the longest bull market in U.S. history continues. The low return environment predicted in 2009 is a fading memory after a more than 400 percent cumulative rise in the S&P 500. Investors tend to extrapolate trends and when everything seems easy, you often learn how hard something can be. Investing for the long-term is not easy. An endowment is meant to be a stable source of distributions with a long-time horizon. While the time horizon allows for the ability to ride out market volatility, the need for a stable source of funding to the University of Iowa takes precedence.

As always, our focus remains on achieving our target returns while lowering the probability of a permanent loss of capital, identifying investment managers that can deliver outperformance, and maintaining sufficient liquidity.