IOWA | Center for Advancement

The University of Iowa Center for Advancement (UICA) Quarterly Investment Summary – March 31, 2020

Overview

Attached you will find the investment performance report for the period ending March 31, 2020. The 11-year bull run in equities ended with the fastest bear market slide in the Dow's history, taking just 20 trading days to fall 20% as the economic implications of COVID-19 were taking shape. Risk assets across the globe sold off as volatility increased to levels not seen since the Global Financial Crisis. As the quarter came to a close, nearly 17 million people in the US had filed for unemployment. The Federal Reserve stepped in to help markets by lowering the Federal Funds Rate to a zero bound and announcing a $700 billion quantitative easing program. Several other fiscal policies were quickly announced and passed by lawmakers in an effort to stabilize an economy that was largely forced to shelter in place. As of the writing of this report, most states have reopened and equity markets are nearly back above water, the NASDAQ is already positive for the calendar year.

Global Equity

The global equity composite returned -17.3 percent during the quarter, -10.2 percent over the past year and an annualized 2.5, 4.0, and 6.6 percent over the past three-, five- and 10-year periods.

While it seems like a lifetime ago, the S&P 500 hit an all-time high of 3386.15 on February 19th before falling 34% until its bottom on March 23rd. After all was said and done, US stocks fell over 20% during the quarter with small cap and value continuing to underperform large cap and growth stocks. In previous market reversals, leadership has also reversed. More recently small cap has begun to outperform large cap, though growth has maintained its outperformance. Beyond our borders, developed country stocks outperformed emerging markets stocks as developed economies reacted quickly to the pandemic and were able to offer stimulus packages to offset the negative economic effects of the virus. While COVID-19 originated in China, it's stock market only dropped about 10% while helping the Asia region outperform other regions.

As the pandemic unfolded, we reached out to our private equity managers to get a sense of the effects on their portfolio companies and firms. Deal activity dried up as everyone was forced to work from home and GPs focused on protecting the investments in their portfolios. Credit lines were tested or drawn down completely and law firms poured over the $2 trillion CARES Act to see if underlying companies could benefit from its programs. The funds in our portfolio generally use lower leverage than larger competitors, while companies have been stressed nearly all were able to stay open as essential businesses or repurpose to help frontline workers. We expect longer hold periods as businesses take time to get back to the plans set before the pandemic took hold. Longer hold periods will lead to lower IRRs, but multiples of capital should hold. With a few exceptions, GPs have been unable to put capital to work while revenues and valuations have fallen. Travel restrictions have created a significant headwind to dealmaking, but banks were reluctant to lend and sellers were reluctant to sell for a discount to what they could have received a few months ago. Sellers are hoping for a "V" shaped recovery or they will try and wait out a sale until they have recovered. At the same time LPs such as ourselves are trying to get comfortable investing in a world where on-site due diligence is delayed for the foreseeable future.

Global Fixed Income

The global fixed income composite returned -3.1 percent during the quarter and 0.3 percent for the trailing year. Over longer time periods it increased an annualized 2.8, 3.2, and 5.8 percent for the three-, five- and 10-year periods. The first two months of the calendar year saw interest rates fall to near zero as the Fed cut rates twice in the early days of the pandemic. The Fed was also forced to improve liquidity in fixed income markets as bid/ask spreads widened in what are normally liquid markets, by buying corporate debt and fixed income ETFs. In spite of the market difficulties high quality fixed income had positive performance and is easily the best asset class in the endowment. Credit markets saw withdrawals toward the end of the quarter as losses mounted. Surprisingly, investment-grade credit had its highest issuance ever in March.

Real Assets

The real assets composite returned -21.6 percent for the quarter, -25.2 percent for the one year, and an annualized -4.1, -0.6, and 3.5 percent over the past three-, five-, and 10-year periods. While stocks suffered from the pandemic, real assets were hit on multiple fronts. Real estate was hurt as businesses were shut and many municipalities suspended evictions, giving businesses less incentive to pay rent. In the short term, retail, lodging, and senior housing has suffered. Longer term, it remains to be seen what the lasting impact to the commercial real estate landscape will be. A permanent move to Work from Home (WFH) would certainly hurt real estate but could boost stocks as rent is one of the largest expenses for most businesses. A bright spot in the real estate market are data centers, which benefitted from increasing data demands during WFH. Natural resources were hit with a double whammy of lowered demand and increasing supply in the oil market. Demand dropped as business travel dried up and work from home took hold. Russia and Saudi Arabia began a price war that increased supply at the wrong time. Commodities were further hit by a drop in livestock prices as meat processing plants were forced to closed as they became virus hotspots.

Diversifying Strategies

The diversifying strategies composite returned -16.7 percent for the quarter, -13.8 percent for the one year, and an annualized -3.4, -1.2 and 2.9 percent over the past three-, five-, and 10-year time periods. Event-driven hedge funds struggled during the March market upheaval as merger arbitrage spreads widened and deals were delayed. Managed futures strategies were able to take advantage of falling crude oil and stock markets, but still finished the quarter in negative territory. Royalty strategies had positive results, as people still listened to music and streamed movies while at home.

Conclusion

COVID-19 caused chaos on financial markets and economies around the world as volatility spiked and risky assets quickly fell out of favor. In the US alone over 53 million people have filed for unemployment since business shutdowns began and the unemployment rate spiked to 14.7% in April. Policy makers have responded with unprecedented resources including a $2 trillion fiscal package, quantitative easing that can purchase almost any type of asset, and near zero interest rates. As a result of this stimulus, markets have rebounded significantly. After falling nearly 34%, the S&P 500 is within single digits of its record high as I write this letter.

While the impact to the University of Iowa is still ongoing, the support from UICA did not drop during the quarter. The markets rebounded enough by March 31 to maintain spending within our 6% band. With markets continuing to rebound in the June quarter, spending should not be reduced for the fourth quarter either.

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.

Please let me know if you have any questions regarding the above information. You can reach me at (800) 648-6973.

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