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The University of Iowa Center for Advancement (UICA)
Quarterly Investment Summary – June 30, 2020

Overview

Attached you will find the investment performance report for the period ending June 30, 2020. Economies across the globe reopened spurring a decisive risk-on environment aided by monetary and fiscal stimulus. US economic data surprised on the upside as the $2 trillion CARES Act and $3 trillion in monetary support from the Federal Reserve provided needed support. US stocks nearly reversed their losses from the previous quarter while every developed and emerging market country index finished in positive territory, many improving by double digits.

Global Equity

The global equity composite returned 13.5% percent during the quarter, 0.0 percent over the past year and an annualized 5.2, 6.0, and 9.3 percent over the past three-, five- and 10-year periods.

The headline on US stocks is that they had their highest quarterly return in 20 years, but the details of what lead that return are important. The FTSE Russell 1000 Index was up 7.5 percent for the fiscal year. The contribution to return from Apple, Microsoft, Amazon, Tesla, Alphabet (Google), Facebook, and Netflix as those seven stocks accounted for 113 percent of the return. In other words, the remaining 1,001 stocks in the index detracted from performance. Only 46 percent of the index had positive performance for the year, while 13 returned over 100 percent. Across market caps growth outperformed value, but the degree of that outperformance has rarely been seen. Using the FTSE Russell indices, growth outperformed value by 32 percent in large cap, 15 percent in mid cap, and 12 percent in small cap. In large cap, growth outperformed the core index by over 15 percent. At the same time large cap outperformed small cap by nearly 9 percent. Our public equity portfolio has long held a value bias and an overweight to small cap due to their historical outperformance, both were significant headwinds during the fiscal year and continued a multi-year run for large cap and growth stocks.

Outside the US, the fiscal year saw emerging markets outperform developed markets. The growth/value dynamic played out in these markets similarly to how it did in the US, though it was more pronounced in emerging markets with growth outperforming by over 26 percent than it was in developed ex-US markets where growth outperformed by 20 percent. Small cap stocks also underperformed large cap stocks in developed and emerging markets.

Our private equity portfolio has weathered the storm from several businesses closing due to government mandates, producing positive returns for the fiscal year. As mentioned last quarter, nearly all underlying portfolio companies were able to stay open as essential businesses or repurposed to help frontline workers. Several funds had initiated selling companies before the pandemic hit, and for the most part those sales are delayed. With travel limited, buying companies was also difficult. We are likely to see funds look for extensions of their investment periods, but it is too early to tell if this will affect portfolio returns. A positive sign is that banks are lending again, and we expect deal-making to increase its pace as life returns to some level of normalcy.

Global Fixed Income

The global fixed income composite returned 4.1 percent during the quarter and 2.6 percent for the trailing year. Over longer time periods it increased an annualized 3.6, 4.0, and 9.3 percent for the three-, five- and 10-year periods. The Fed's actions of cutting interest rates to nearly zero and purchasing $3 trillion of corporate debt, fixed income ETFs, mortgage-backed securities and Treasuries increase market liquidity and saw bonds rally in the quarter. Investors moved back in to fixed income securities, as both investment-grade and high yield markets witnessed record inflows.

Real Assets

The real assets composite returned 7.9 percent for the quarter, -19.4 percent for the one year, and an annualized -1.3, 0.8, and 5.2 percent over the past three-, five-, and 10-year periods. Real estate remains under pressure from the effects of COVID-19 and the REIT rally in the quarter was not enough to offset the drop during the previous quarter. Private real estate funds are finding opportunities, but they are cautious to call capital until there is more certainty on cash flows. Natural resources were hit hard at the beginning of the pandemic and have yet to recover. Energy and other commodity prices moved higher during the quarter as demand increased as businesses reopened, and manufacturing facilities came back on line. It is likely that supply will remain high in the short term as commodity producers adjust to the new normal.

Diversifying Strategies

The diversifying strategies composite returned -0.7 percent for the quarter, -16.1 percent for the one year, and an annualized -3.6, -1.2 and 3.0 percent over the past three-, five-, and 10-year time periods. Event-driven hedge funds were helped by merger arbitrage spreads recovered from their March levels. Managed futures strategies struggled during the sharp move to risk-on. Alternative beta strategies hurt performance due to their bias to value. Royalty strategies provided a ballast to the volatility of other strategies and remain a source of reliable income.

Conclusion

Fiscal year 2020 was a wild ride. No one foresaw a pandemic ending the 11-year bull market with a 34 percent drop in the S&P 500, only to see it rebound and reach a new all-time high on September 2, 2020. Along the way real estate was hit by businesses closing and rent payments stopping. Commodity prices plummeted as manufacturing facilities closed, drying up demand. The Fed reduced interest rates to nearly zero and started expanding its already large balance sheet by trillions.

Typically, the solution to buoying returns in difficult times is diversification. In 2020, diversification has not helped. Returns were determined by how much exposure investors had to US large cap growth. Core fixed income had solid returns as well, but nothing could match the returns of Apple, Microsoft, Amazon, Tesla, Alphabet (Google), Facebook, and Netflix. Our endowment has a value bias based on decades of value outperforming growth. Investing is cyclical, strategies go in and out of favor. From 2009-2012 hedge funds helped reduce the risk of the portfolio and outperformed fixed income while real assets outperformed equity markets and helped hedge inflation risk. The portfolio then evolved by building a private capital program across all asset classes that have beaten their public market equivalent benchmarks by at least 600 bps. Diversification works in the long-term, but performance may suffer short-term pain when only one strategy is working.

Markets evolve and portfolios need to adjust to what we think will work in the future not the past. The forward looking return expectations of a 60/40 US stock and bond portfolio has never been lower as US equity returns for the last 5 years are well above their long-term average and fixed income rates are nearly zero. An endowment has a long-term time horizon, and we try to take advantage of investment opportunities over that horizon and not chase what is working in a quarter or year. We feel that the portfolio is positioned appropriately to take advantage of the current market environment and to meet our return objectives into the future.

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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