Overview

Attached you will find the investment performance report for the period ending September 30, 2020. The rebound from the COVID-19 pandemic continued to push risky asset prices higher. Although the economy has not completely recovered, economic data in the US continued to surprise on the upside. The Federal Reserve announced a commitment to keeping rates near zero through 2023 adding to the risk-on sentiment. Stock markets across the globe were generally positive, with US investors aided by a weakening dollar.

Global Equity

The global equity composite returned 8.1 percent during the quarter, 10.5 percent over the past year and an annualized 7.1, 10.1, and 9.0 percent over the past three-, five- and 10-year periods.

The S&P 500 reached an all-time high in August, making up all the ground lost due to the pandemic after the index’s previous high in February 2020, and was up 8.9 percent in the quarter. Renewed consumer confidence pushed stocks higher as consumers not only spent more, but industrial production increased, and unemployment decreased. The quarter, and 2020, have been dominated by large cap, growth stock returns largely driven by Apple, Microsoft, Amazon, Tesla, Alphabet (Google), Facebook, and Netflix. September saw a reversion toward value as the “re-opening trade” gained some steam.

Emerging markets, as measured by the MSCI EM Index, were up 9.6 percent in the quarter. India and China were the best performing countries in the index, but a weakening dollar also provided a tailwind. Spain and France reinstated lockdown measures, slowing growth in Europe. The seemingly never-ending concerns over Brexit hurt UK stocks, but Japan was a bright spot as the MSCI EAFE Index lagged US and EM counterparts but finished the quarter up 5.4 percent. Small cap stocks in EAFE and EM outperformed large cap as the public equity composite outperformed MSCI ACWI IMI.

Last quarter, we mentioned that our private equity portfolio held ground after several businesses closed due to government mandates. While some portfolio companies are still working to regain the ground lost from the pandemic, others are firing on all cylinders and the distributions from our PE portfolio are back to normal levels. Deal volume for the PE industry is down, but after a brief pause in capital calls from March until June, our partners seem to be back on pace. The financial impact of the pandemic was less severe than anticipated, but the fundraising impact was real. Fundraising cycles were delayed as general partners rightly focused on companies in their portfolios rather than raising new funds. This has put our portfolio slightly behind our capital
allocation pacing model. We do not expect to make up all the ground lost in one vintage year and will remain disciplined.

Global Fixed Income
The global fixed income composite returned 1.9 percent during the quarter and 4.0 percent for the trailing year. Over longer time periods it increased an annualized 4.0, 4.7, and 5.8 percent for the three-, five- and 10-year periods. The Fed remained in the headlines during the quarter announcing a shift in its inflation policy toward “average inflation targeting” and a commitment to keep rates at zero through 2023. Additionally, Fed Chair Jerome Powell hinted more fiscal stimulus was needed creating a risk-on environment. Performance was driven by high yield and distressed credit strategies, but all segments of the market were positive during the quarter.

Real Assets
The real assets composite returned 2.6 percent for the quarter, -15.2 percent for the one year, and an annualized -2.1, 2.3, and 3.9 percent over the past three-, five-, and 10-year periods. Real estate showed some improvement in the quarter, but REIT sectors retail, hospitality and office have uncertain futures. Private real estate fared better, though funds have some ground to make up to reach positive territory for the year. The natural resources portfolio was led by a commodity rebound as demand continued to increase.

Diversifying Strategies
The diversifying strategies composite returned 3.1 percent for the quarter, -14.6 percent for the one year, and an annualized -3.1, -0.5 and 2.9 percent over the past three-, five-, and 10-year time periods. Event-driven hedge funds were once again helped by merger arbitrage, with distressed also aiding performance. Alternative beta posted positive returns while managed futures performance was volatile.

Conclusion
The first quarter of the fiscal year saw a continuation of the economic and market recovery that started back in March. US stock markets seem to shrug off any bad news as they move toward all-time highs. The economic recovery has not been as steep. The Fed’s pledge to keep rates near zero until 2023 lessens the effects of net present value on future earnings. While this is a tailwind for investors, the Fed’s move to “average inflation targeting” could be a headwind. As a reminder, our endowment uses a banded inflation spending policy that increases the dollar amount available for spending by inflation (as measured by the Bureau of Labor Statistics Consumer Price Index) as long as that amount is no less than 4 percent and no more than 6 percent of the market value of the endowment. An increase in inflation would increase the returns needed to maintain the purchasing power of the endowment.

Increasing fiscal stimulus has been the bogeyman for runaway inflation since the bailouts approved during the Great Financial Crisis. More recently, US money supply accelerated to 23 percent year-over-year growth in August, the fastest rise on record. Deflationary forces are also present as seen by labor force participation rate declines, population growth slows, an aging demographic and an increasing federal deficit. Time will tell if inflation levels increase, but we are prepared in case they do.
Monetary and fiscal stimulus have helped most risky assets recover faster than anticipated and that momentum shows no sign of stopping. Higher returns today lower future long-term expected returns, making investors jobs more difficult in the future. Nevertheless, an endowment must invest to at least maintain the purchasing power of its assets. 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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