IOWA | Center for Advancement

The University of Iowa Center for Advancement (UICA) Quarterly Investment Report – December 31, 2021

Overview

Attached you will find the investment performance report for the period ending December 31, 2021. Despite elevated inflation and Federal Reserve asset purchasing tapering, risk assets had a strong performance in 2021. Domestic assets did particularly well, as the S&P 500 recorded 70 closing highs in 2021, the most in a single year since 1995's 77. Fixed income markets also favored risk, as rate sensitive bonds trailed credit sensitive bonds due to inflation fears and expected interest rate increases. Supply/demand imbalances caused by the pandemic's economic slowdown continues to help the performance of real assets.

The Long-Term Pool (LTP) returned 3.5 percent for the quarter, 17.3, 12.3, 9.5, and 9.0 percent respectively for the one-, three-, five-, and 10-year periods.

Global Equity

The global equity composite returned 3.6 percent during the quarter, 17.6 percent over the past year and an annualized 19.1, 14.6, and 12.2 percent over the past three-, five- and 10-year periods.

Global equity markets experienced increased volatility in November due to the COVID-19 Omicron variant. It was short lived, as data showed the variant to be less severe than previous strains. Continuing the theme that started with the end of the Global Financial Crisis (GFC), US markets outperformed both non-US developed and emerging markets during 2021. The US outperformance over emerging markets was the second largest calendar year outperformance ever at 31.2 percent. Domestic performance was led by energy and financial stocks, with every sector up double digits. Large cap stocks slightly outperformed small cap, while growth outperformed value.

According to Thomson One, from 2000-2009 the median buyout fund outperformed the median venture capital fund. That trend reversed in 2010 and has continued through the most recent vintage year available (2017). Fundraising in both types of private equity have increased since the GFC as investors look to enhance returns and dampen volatility. This has resulted in record amounts of uncalled capital commitments, commonly referred to as "dry powder". At the same time interest rates are low and credit remains cheap and easy to obtain. So easy that S&P Global Market Intelligence estimates that more than 90 percent of US leveraged loan new debt issued in 2021 was covenant lite. This has made us uneasy about investing in leverage loans, but it also makes us uneasy about investing with funds that utilize financial engineering rather than creating value by operational improvements. We focus on finding general partners that grow small companies by improving processes and identifying new areas for growth. Often, these partner's funds sell to much larger funds that employ the financial engineering we seek to avoid.

Global Fixed Income

The global fixed income composite returned -0.1 percent during the quarter and 3.9 percent for the trailing year. Over longer time periods it increased an annualized 5.2, 4.6, and 5.6 percent for the three-, five- and 10-year periods. Interest rate volatility continued as the Federal Reserve initiated the reduction of its asset purchases and doubled the speed of the reduction during the quarter. Inflation remains well above the 2% target resulting in the market expecting at least six 25 basis points rate hikes in 2022. The COVID-19 Omicron variant created a temporary flight to quality, but credit strategies outperformed rate sensitive strategies in the quarter and longer time periods.

Real Assets

The real assets composite returned 3.2 percent for the quarter, 31.8 percent for the one-year, and an annualized 7.7, 6.2, and 6.6 percent over the past three-, five-, and 10-year periods.

Public real assets like REITs and commodities had strong quarters and were some of the few strategies that outperformed the S&P 500 return for the year. While much is made that these returns were due to rising inflation, it is more likely that they are due to base effect (REITs) and supply/demand imbalance (commodities). Private real assets also showed strong performance. Real estate has been driven by retail and housing sectors, but all sectors had double digit returns in the year. Energy prices were volatile in the quarter, but like nearly every natural resource had strong performance in the calendar year.

Diversifying Strategies

The diversifying strategies composite returned -0.9 percent for the quarter, 8.4 percent for the one-year, and an annualized 2.3, 1.8 and 4.5 percent over the past three-, five-, and 10-year time periods.

Public diversifying strategies struggled during the quarter, but event-driven strategies had a strong year. Royalty strategies continue to perform well, though the music royalty space is beginning to get crowded. Royalties are often viewed as fixed income alternatives due to the low interest rate environment. While rates will rise, it will be some time before they are near historical averages. Most investors focus on music and health care royalties. We have exposure to those strategies, but new entrants have bid those assets up and we are looking for other entertainment and hardware royalties.

Conclusion

Performance improved in the second quarter of the fiscal year, but inflation and rising interest rates are top of mind for all investors. Former Fed Chair Paul Volcker tamed the last bout of high inflation by increasing interest rates. It will be some time before interest rates increase to their long-term averages, but many investors have not experienced an upward interest rate path toward. The definition of “high” interest rates is relative. There are challenges to nearly every investing environment, which is why we maintain a diversified portfolio. 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.

JB:kk