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The University of Iowa Center for Advancement (UICA) Quarterly Investment Report – June 30, 2022

Overview

Attached you will find the investment performance report for the period ending June 30, 2022. What went up the previous fiscal year, came down in the most recent fiscal year. Risk assets struggled due to persistent inflation, rising interest rates and a slowing economy. Traditionally, fixed income acts as a hedge to equities, but the rising rate environment pushed correlations to one as prices fell. Real assets also fell in the quarter but remain a bright spot for the fiscal year.

The Long-Term Pool (LTP) returned -6.3 percent for the quarter, -2.4, 7.1, 6.9, and 7.6 percent respectively for the one-, three-, five-, and 10-year periods.

Global Equity

The global equity composite returned -9.8 percent during the quarter, -8.9 percent over the past year and an annualized 10.6, 9.5, and 10.1 percent over the past three-, five- and 10-year periods.

The worst year-to-date returns since 1970 pushed public equities into a bear market in the quarter, with the S&P 500, MSCI EAFE and MSCI EM markets falling -16.1 percent, -14.5 percent, and -11.4 percent respectively. In the US, value outperformed growth for the quarter and year, while large cap outperformed small cap. International developed and emerging markets overcame a strengthening dollar to outperform US stocks. Nearly every market faces the same headwinds: persistently high inflation, rising interest rates and increasing fears of recession. It is unclear when any of these headwinds will reverse.

In a theme that plays out across asset classes, private equity returns were much stronger than their public counterparts. Public markets roared back from the depths of the COVID-19 selloff, causing some to question why endowments invested in private equity at all. Benjamin Graham famously said that “In the short run the market is a voting machine, but in the long run it is a weighing machine”. Public markets act like voting machines, stock prices change by how investors feel about companies rather than by fundamentals. While public stock prices change every day, fundamentals change far less frequently. Private markets act like weighing machines with market values changing when the fundamentals do. Ultimately a private company’s value is realized when it is sold or recapitalized. For the most part our funds’ portfolio companies are increasing their earnings before taxes, depreciation, and amortization faster than interest rates are increasing or valuation multiples are falling, which results in positive returns. This cannot last forever, and some strategies like venture capital and mega-buyout are already seeing flat to negative returns. In the meantime, our funds are working hard to realize their investments and lock in returns.

Global Fixed Income

The global fixed income composite returned -2.8 percent during the quarter and -4.1 percent for the trailing year. Over longer time periods it increased an annualized 2.2, 3.0, and 4.4 percent for the three-, five- and 10-year periods. As high inflation continues around the globe, central banks increased their hawkish guidance along with interest rates. Investors now hope that central bankers can produce “soft landings” to combat inflation and avoid recessions at a time when US Gross Domestic Product growth was negative for two consecutive quarters. Rate sensitive and credit strategies struggled as the Bloomberg Aggregate Bond Index fell 10.3 percent for the year. Private credit was not immune to the headwinds brought on by rate increases, but it had positive returns for the fiscal year.

Real Assets

The real assets composite returned -0.8 percent for the quarter, 20.7 percent for the one year, and an annualized 7.9, 8.4, and 7.2 percent over the past three-, five-, and 10-year periods. Public real assets were a mixed bag as REITs struggled in the quarter and fiscal year while commodities had a tough quarter, but strong fiscal year. Private real assets had strong performance, as both real estate and natural resources had double-digit returns. Real assets are thought to have high correlations to inflation, but that theory is being tested by a disconnect between REITs and commodities and public and private real assets. We expect the composite to hedge unexpected inflation, which it has done over the past year.

Diversifying Strategies

The diversifying strategies composite returned 2.2 percent for the quarter, 5.5 percent for the one year, and an annualized 1.3, 2.4 and 4.6 percent over the past three-, five-, and 10-year time periods. Strong returns by managed futures and royalties offset event-driven strategies. Event-driven struggled as both equity and fixed income markets fell, an environment that served as a tailwind for managed futures.

Conclusion

Endowment portfolios are often measured against a portfolio made up of 60 percent equities and 40 percent fixed income. While the 60/40 portfolio is not as diversified as an endowment portfolio (one of the reasons it has outperformed recently), it benefits from the low to negative correlation seen between stocks and bonds. Rarely are both asset classes negative at the same time, as we saw in fiscal year 2022. Both the S&P 500 Index and the Bloomberg Aggregate Bond Index fell over 10 percent in the fiscal year, for a 60/40 return of -10.5 percent. What makes this more remarkable is the 180 degree turn this was from the previous fiscal year, where everything seemingly worked. Endowments have time horizons well beyond one year and diversification works over the long-term by providing stable returns that we expect will outperform a 60/40 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.

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