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The University of Iowa Center for Advancement (UICA) Quarterly Investment Report – December 31, 2022

Overview

Attached you will find the investment performance report for the period ending December 31, 2022. The calendar year saw the Federal Reserve raise interest rates 425 basis points to combat inflation that peaked at 9.1 percent in June. Increasing rates lead to double digit losses in the Bloomberg US Aggregate Bond Index (-13.0 percent) and S&P 500 (-18.1 percent). Rising rates and negative equity returns were not limited to the United States, as countries around the world worked to combat inflation.

The Long-Term Pool (LTP) returned 4.1 percent for the quarter, -6.1, 6.6, 5.5, and 6.9 percent respectively for the one-, three-, five-, and 10-year periods.

Global Equity

The global equity composite returned 6.7 percent during the quarter, -10.6 percent over the past year and an annualized 9.3, 8.0, and 9.7 percent over the past three-, five- and 10-year periods.

Global equity markets finished a volatile year with positive performance for the quarter. US equities reached all-time highs way back in January before posting the worst calendar year performance since 2008. International developed markets outperformed US markets, while emerging markets underperformed both developed markets for the year. A weakening US dollar helped international stock performance. Value continued its outperformance over growth, while large cap outperformed small cap in the quarter by enough to outperform for the year as well.

I wrote last quarter about the return smoothing that quarterly valuations cause in private equity. While public market returns were positive for the quarter, the calendar year's negative public equity returns continue to diverge from private equity. Our private equity general partners continue to see earnings before interest, taxes, depreciation, and amortization (EBITDA) growth in most portfolio companies. Conservative GPs will lower EBITDA multiples, but EBITDA growth can outpace the reduced multiple and increase the value of a company. Rising interest rates are slowing deal volume across the private equity landscape. While our portfolio has below industry average debt, our GPs sell to larger private equity funds that have higher debt costs. Higher debt costs could lower the returns of more levered funds and we could see increased competition in the lower middle market as other limited partners look for higher returns if higher rates last through a fundraising cycle.

Global Fixed Income

The global fixed income composite returned 1.5 percent during the quarter, -5.8 percent for the trailing year and annualized 1.4, 2.4, and 3.6 percent over the past three-, five- and 10-year periods.

The Fed's battle against inflation created interest rate volatility in the quarter and calendar year. While market participants hope for inflation to cool, the Fed expects rates above 5 percent, or at least 75 basis points from where they ended 2022. Credit strategies performed well in the quarter, but rates

are much higher than one year ago. As an example, mortgage rates ended 2022 at 6.4 percent, doubling the 3.2 percent rate to end 2021. While credit has become more expensive, demand for credit has fallen. Mortgage applications and high yield issuance fell dramatically during 2022.

Real Assets

The real assets composite returned 2.0 percent for the quarter, 4.7 percent for the one-year, and an annualized 8.6, 6.1, and 6.0 percent over the past three-, five-, and 10-year periods.

Real estate investment trusts (REITs) rebounded in the quarter, but still finished the year with their worst performance since 2008. Office REITs have struggled due to the decline in demand caused by remote work. They underperformed all other property types. Our private real estate portfolio has limited exposure to office and outperformed public REITs. Commodities helped the performance of natural resources strategies. While energy and industrial metal prices fell in the quarter, agricultural commodities had strong performance. Commodities and cash were the only two public market asset classes with positive performance in 2022.

Diversifying Strategies

The diversifying strategies composite returned -1.3 percent for the quarter, 1.6 percent for the one-year, and an annualized 1.2, 0.7 and 3.9 percent over the past three-, five-, and 10-year time periods.

Public diversifying strategies struggled during the quarter as managed futures finished an otherwise strong year with a down quarter. Royalty performance was positive, driven by music and entertainment strategies. We continue to search for strategies that are uncorrelated to equity markets. These strategies have been perceived as fixed income alternatives. Now that fixed income is offering attractive yields, it remains to be seen if fewer dollars chase uncorrelated assets. Certain strategies that looked frothy a year ago could see a return to more rational pricing.

Conclusion

At the beginning of every calendar year, consultants and asset managers update their capital market assumptions which predict the expected risk and return of the different asset classes that are available to investors. Coming off a year that saw few asset classes exhibit positive returns, it might be surprising to learn that capital market return assumptions went up across the asset class spectrum. Investors tend to extrapolate the recent positive and negative return experience into long-term trends, higher (lower) than normal returns negatively (positively) affect the long-term average. All things equal, 2022's negative performance should make the next 10 years easier for investors. Unfortunately, for an endowment, inflation does not make things equal. Endowments are meant to last forever, keeping up with inflation to provide intergenerational equity. A higher rate of inflation results in a higher required rate of return. Increased asset class return assumptions help, but the longer higher inflation lasts, the more likely endowments will need to take additional risk. 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.

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