The University of Iowa Center for Advancement (UICA) Quarterly Investment Report – March 31, 2023

Overview

Financial markets started the year with a strong start in January before giving back a little performance in February. March came with two major bank failures and a Federal Reserve interest rate increase. At a high level, equity and bond returns were positive while real assets returns were more mixed.

The Long-Term Pool (LTP) returned 2.8 percent for the quarter, -2.8, 13.6, 5.8, and 6.7 percent respectively for the one-, three-, five-, and 10-year periods.

Global Equity

The global equity composite returned 2.4 percent during the quarter, -2.5 percent over the past year and an annualized 18.4, 8.5, and 9.6 percent over the past three-, five- and 10-year periods.

Global equity markets finished the quarter with positive returns driven by strong performance in January. In the US, financial stocks took a hit after the bank failures at Silicon Valley Bank (SVB) and Signature, while large cap and growth stocks continue to dominate performance. International developed markets outperformed the US. Emerging markets had positive performance but continue to trail developed markets.

Private equity has driven endowment returns for decades and will likely continue to do so in the future. Today both venture capital and buyouts are facing the headwind of overallocation by endowments. This has resulted in declines in both the number of funds fundraising and the dollars those funds are trying to raise. At the same time, interest rates have been increasing and purchase price multiples have been falling. Debt is more expensive, which causes funds to use less of it, but sellers are reluctant to sell at a lower valuation. While we favor smaller funds that use less debt and have lower earnings before interest, taxes, depreciation, and amortization (EBITDA) multiples than larger funds, we are seeing fewer capital calls and distributions as deal volume has fallen. The fundraising environment will likely lead to fewer general partners starting new firms but does provide more discipline on follow-on fund size increases. We expect some compression of private equities outperformance over public equities, but the ability to accept illiquidity should still be rewarded. Endowments have long time horizons and high real return targets, so the strong relationship between private equity and endowments should persist while these market conditions are worked out.

Global Fixed Income

The global fixed income composite returned 1.4 percent during the quarter, -0.7 percent for the trailing year and annualized 3.4, 2.9, and 3.6 percent over the past three-, five- and 10-year periods.

Strong labor, inflation and housing reports in the quarter caused investors to expect more interest rate increases before the SVB and Signature collapse gave investors hope for a pause. Credit standards are tightening, which should help cool the economy but could also push borrowers away from traditional banks and toward private credit markets.

Real Assets

The real assets composite returned -2.5 percent for the quarter, -7.0 percent for the one-year, and an annualized 16.5, 5.5, and 5.3 percent over the past three-, five-, and 10-year periods.

Remote work continues to weigh heavily on real estate investment trust (REIT) performance, once again office was the worst performing sector. Despite that headwind, REITs were up for the quarter. Commodities also fell in the quarter, led down by falling energy prices.

Diversifying Strategies

The diversifying strategies composite returned -1.8 percent for the quarter, -1.3 percent for the one-year, and an annualized 7.0, 0.7 and 3.3 percent over the past three-, five-, and 10-year time periods.

Public diversifying strategies were a mixed bag as event-driven strategies had strong performance but could not overcome managed futures struggles. Managed futures had a strong start to the quarter, but struggled after the bank failures in March, Royalties continue to offer strong performance, led by energy, music, and entertainment strategies.

Conclusion

Not so long ago it appeared that investors could not get enough risk into their portfolios. Equity markets only went up and fixed income yields were too low to be attractive. Today money market yields are nearly 5 percent and stocks are not far off their all-time highs. Higher interest rates have slowed private capital purchases and exits, but investor enthusiasm for those assets has mostly been limited by the denominator effect of being over allocated compared to targets. The Fed looks like it will slow inflation without causing an economic recession, but investors are tempering their return expectations. As always, our focus remains on achieving our target returns while lowering the probability of a permanent loss of capital and identifying investment managers that can deliver outperformance while maintaining sufficient liquidity in the 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.

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