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The University of Iowa Center for Advancement (UICA)
Quarterly Investment Report – September 30, 2023

Overview

Attached you will find the investment performance report for the period ending September 30, 2023. Though the Federal Reserve (Fed) has paused interest rate hikes since March 22, 2023, interest rates increased in the quarter. The yields on 10-year Treasuries increased 73 basis points during the quarter, putting pressure on all asset classes. Few strategies posted positive returns in the quarter, with most down low-to-mid single digits.

The Long-Term Pool (LTP) returned 1.0 percent for the quarter, 10.6, 9.5, 6.0, and 6.6 percent respectively for the one-, three-, five-, and 10-year periods.

Global Equity

The global equity composite returned 0.3 percent during the quarter, 17.3 percent over the past year and an annualized 11.4, 9.1, and 9.4 percent over the past three-, five- and 10-year periods.

Though the quarter started off with positive equity returns, eventually rising interests and hawkish monetary policy language caused all markets to fall. Emerging markets suffered the smallest losses, while international developed suffered the largest. US equities were hurt by a reversal in several of the "Magnificent Seven" stocks of Alphabet, Amazon, Apple, Meta Platforms, Microsoft, NVIDIA, and Tesla that have driven equity returns in 2023.

Last year we remarked on the "return smoothing" that private equity provides, and that was evident in the quarter as public markets fell, but private equity performance improved on earnings before interest, taxes, depreciation and amortization (EBITDA) growth. While it is true that private equity debt costs increase as rates increase, our bias toward lower middle market buyout helped our portfolio due to lower leverage than other buyout strategies. Nevertheless, the debt costs of larger buyout funds affect our portfolio because larger funds are the most common buyer of portfolio companies from our general partners. This has resulted in slower than expected exit activity. The downside of fewer exits is less liquidity, but that is less of a concern for the LTP where over 50 percent of the fund has daily liquidity. The upside is that we are closer than expected to our private equity target weighting, though this means we will likely overshoot the target as we continue to make fund commitments.

Global Fixed Income

The global fixed income composite returned -0.7 percent during the quarter and 5.0 percent for the trailing year. Over longer time periods it increased an annualized 1.5, 2.6, and 3.4 percent for the three-, five- and 10-year periods.

To combat high inflation, the Fed has increased rates 525 basis points since 2022. While base rate increases have paused since March, fiscal policy and economic developments helped push market rates up in the quarter. Longer duration rates suffered more than short duration as the 10-year yield moved to its highest level since 2007. The decrease in risk appetite also hurt credit markets, but high yield strategies eked out a slight gain. Correlations between fixed income and equities have increased recently as both strategies have been stressed at the time when diversification from equities has been needed.

Real Assets

The real assets composite returned 4.5 percent for the quarter, 0.2 percent for the one year, and an annualized 13.1, 3.7, and 5.4 percent over the past three-, five-, and 10-year periods.

Despite slowing inflation, real assets posted positive returns in the quarter. Private real estate bounced back from a poor showing from last quarter. While our portfolio does not hold many office properties, most real estate sectors have felt the weight of higher interest rates and have seen valuations fall. Energy funds were helped by increasing oil prices and record production. Middle East production cuts and sanctions against Russian oil have put the US and Canada on track to produce the most oil of any region in the world.

Diversifying Strategies

The diversifying strategies composite returned 1.3 percent for the quarter, 0.9 percent for the one year, and an annualized 7.4, 1.8 and 3.4 percent over the past three-, five-, and 10-year time periods.

Event-driven strategies and managed futures boosted performance while private strategies were slightly down in the quarter. While all royalty strategies are still cash flowing, valuations fell as interest rates increased, decreasing the value of future cash flows.

Conclusion

The fiscal year is off to a slow start, but few would guess that equity returns have been strong over the past year. While much attention has been paid to the Magnificent Seven, the Russell Mid Cap (+13.4 percent) and 2000 (+8.9 percent) Indexes have posted strong returns over the past year. Higher interest rates have been a headwind, but public and private equities have been immune to their effects so far. Private equity must figure out how to generate more liquidity events, but the ever-expanding private capital industry is finding new opportunities to “help” PE funds. Continuation vehicles, anchored by secondary funds, offer liquidity while allowing general partners to maintain portfolio company ownership. NAV loans, financed by private credit funds, provide liquidity based on the fund's underlying assets without selling a portfolio company. These strategies can be beneficial to general partners but are not always helpful to limited partners. We like strategies that benefit all partners. 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.

Jim Bethea
Vice President & Chief Investment Officer