The San Diego Foundation
Growing a Vibrant Region

INVESTMENT NARRATIVE
QUARTER ENDING JUNE 30, 2021

The global capital markets experienced strong performance for the second quarter of 2021. Equities were buoyed by the rollout of the COVID-19 vaccine, a strong drop in case numbers, steady longer-term interest rates, waning concern about inflation, and strong fiscal and monetary stimulus. The S&P 500 was up 8.5% for the quarter, outperforming the MSCI ACWI index, the best proxy for global markets at 7.2%. Both indices were up 40.8% and 40.9% for the trailing one-year period as the COVID recovery from the March 2020 lows continued. Emerging Markets equities were also up 40.9% for the trailing one-year period despite the inequities in the COVID vaccination roll-out effort.

During the first quarter, longer-term U.S. interest rates increased dramatically, due to both the prospect of an economic recovery and the threat of potential inflation. During the second quarter, stabilization in interest rates allowed the bond market to deliver positive results. Federal Reserve policy kept short-term interest rates at zero, meaning short-term fixed income instruments continue to produce near a zero rate of return.

Alternative assets have also performed well this calendar year. Private equity valuations continue to be elevated by strong public market comparatives. With some shift towards value-oriented strategies, hedge funds also produced strong results. Many hedge funds have value-based philosophies, given the long-term outperformance of value vs. growth. The most recent 10-year period proved difficult for hedge funds, particularly with low interest rates, but results have been much better over the last six months. The San Diego Foundation's hedge fund portfolio was able to significantly outperform the broad hedge fund index.

Endowment

The Endowment Portfolio was up 6.4% for the quarter, outperforming its Policy Index by 60 bps. Over the last year, the Endowment Portfolio was up 31.1%, also outperforming its Policy Index by over 2.5%. Longer-term results are also strong with the Endowment outperforming its Policy Index over the 3-, 5-, 7- and 10-year time horizons. The strength of the outperformance in 2021 has been driven by the Portfolio's exposure to alternative investments. The private equity component of the Portfolio produced a 1-year return of 78.6%, resulting in a huge premium over public markets. Hedge funds were also responsible for strong relative performance. Over the last 6 months, the hedge fund component produced an 8.9% rate of return, outperforming the broad hedge fund index by 400 bps. The largest detractor from relative results was our exposure to U.S. small cap equities. We employ active managers in this space in hopes of capturing some of the inefficiencies that exist in smaller companies. Unfortunately, the "meme stocks" widely publicized so far in 2021 (Game Stop, AMC) ended up becoming very large parts of the small cap index, causing active managers to underperform. We believe this problem will resolve itself on July 1 when the index is rebalanced. We don't blame our managers for not owning these widely hyped companies, largely trading on investor enthusiasm rather than fundamental valuation.

We are proud to say that over the last year, five of six of our investment portfolios outperformed their corresponding Policy Indices. The only exception to this was our Short-Term Portfolio, which is invested entirely in money market funds that are producing a zero rate of return due to short-term interest rate policy in the U.S, and the Intermediate-Term Portfolio that is new and does not yet have a 1-year track record (though it is outperforming since inception).

For the one-year period ending March 31, 2021, the Endowment posted a strong 35.8% return. As the stock market bottomed in late March 2020, this one-year period represents almost a full rebound from the bottom. The Endowment portfolio has also posted strong performance results over the 3-, 5- and 10- year periods, outperforming its long-term objective of CPI+5%.

Non-Endowment

The Long-Term portfolio was up 5.6% for the quarter, outpacing its policy benchmark up 5.2%. More importantly, the portfolio is now up 27.5% over the last one-year period. An overweight allocation to U.S. equities and strong performance out of the hedge fund portfolio resulted in the relative outperformance. Like the Endowment, the primary detractor from relative results was the exposure to active U.S. small cap equities, which underperformed due to the rise of the "meme stocks."

The Medium-Term Portfolio produced a 3.0% rate of return for the quarter, in line with its policy benchmark. Over the last year, the portfolio was up 12.8%. With 65% of its exposure to bonds, stabilization in long-term interest rates allowed our managers to produce positive results consisting of both income and some price appreciation.

On January 1, The San Diego Foundation launched a new non-endowment portfolio called the Intermediate-Term portfolio. With the Short-Term portfolio, invested entirely in money market funds, yielding zero, we attempted to create a new portfolio invested entirely in short to intermediate term bonds. The new portfolio posted a 1.2% return for the quarter, largely due to the stabilization of longer-term interest rates in the U.S. This followed a poor first quarter due to rising rates. Over the last six months, the portfolio is down 0.6%, but slightly ahead of its Policy Index.

The Sustainable portfolios posted a 7.0% rate of return for the quarter, outperforming their Policy Indices. Over the one-year period, the Sustainable portfolios were up over 32%, significantly outperforming their benchmark. Because the size of these portfolios are relatively small, they so far lack the diversification of other long-term TSDF portfolios. That lack of diversification was a strong benefit over the last year, as both stocks and bonds rallied significantly from their March 2020 lows.