Investment Narrative

Quarter Ending June 30, 2022

Since the beginning of the year, concerns surrounding the global economy have begun to solidify and thus created an overall negative sentiment in the short- to intermediate-term time horizons. As inflation continues to climb, consumer spending has started to slow down and buying behavior is shifting. To combat inflation and aim for a soft landing out of a stimulated economy, the Federal Reserve has been on a mission to tighten monetary policy by reducing its balance sheet of securities and implementing short-term interest rate hikes. These actions have spurred volatility across the fixed-income market as prices continue to fall and in the equity markets as investors attempt to price in a possible recession. While the verdict is still out on if and when we will see a recession, some economic indicators have been signaling a contraction. The unemployment rate sits around a 20-year low which has given some optimism to individuals that the economy is still strong and growing. However, some companies, mainly in technology and consumer discretionary industries, have rolled out notable layoffs and hiring freezes. These events stoke a more pessimistic outlook on the intermediate future of the economy. The lack of economic consensus creates uncertainty which leads to volatility. Volatility generates fear and fear tends to lead to a risk-off approach in the market. As such, the S&P 500 was down 16.1% for the quarter and Bloomberg Bond Index was down 5.1%.

Developing issues occurring abroad and heightened geopolitical tensions have only added to the uncertainty of what is to come.

Many countries outside of the United States have been experiencing moderate to severe inflation partially due to supply constraints. The Russian-Ukraine conflict has had a collateral effect on the supply chain of several industries within the European/Asian regions, but oil and gas were some of the most impacted. Many European countries receive some of their oil and gas from Russia, but have either stopped or significantly slowed imports in protest of the invasion of Ukraine and to weaken the Russian economy. As a result, oil and gas prices in the European Union have drastically increased due to this drop in supply but have also been amplified by an increase in demand. As Europe experiences one of its hottest summers, inhabitants have been turning to high-energy consuming solutions like air conditioning to keep cool. With the recent actions of the members of NATO to approve the addition of Sweden and Finland, it is of greater uncertainty if tensions will alleviate in the immediate future.

The COVID-19 pandemic is still in the news as new variants and cases ebb and flow throughout the world. China continues to work towards a zero-COVID policy by implementing drastic measures mainly in the form of strict lockdowns. They believe these actions have been helpful in slowing the spread of the virus, however, it does come at a price. With many residents locked inside their homes and traveling heavily restricted, economic growth has slowed and some businesses are struggling. Many real estate developments have halted without warning, leaving homebuyers holding the bag. This has resulted in many mortgage borrowers halting payments altogether in a boycott against these events. The Chinese government has stepped in to relieve some of these tensions, but it is unclear how effective their actions will be.

Endowment

The Endowment portfolio was down 7.9% for the second quarter, outpacing its policy index by 1.1%. Over the year-to-date, one-year and three-year periods, the Endowment portfolio ranked in the top decile relative to its peer set of similarly sized endowments and foundations. Most of the asset classes were hit hard during the quarter, but the portfolio's diversification was key in limiting negative performance for the period. The two best performing asset classes in the portfolio were Real Estate and Private Credit, with a 2Q return of 8.2% and 2.0%, respectively. The bulk of the Endowment's 1.1% outperformance is attributed to the private markets exposure across real estate, private credit and real assets, which all provided positive attribution. The portfolio was slightly underweight in developed markets and emerging markets, which also delivered positive attribution for the quarter.

Non-Endowment

The Long-Term portfolio was down 10.4% for the quarter, outpacing its policy index by 0.8%. The portfolio benefitted from having a diversified asset mix which helped minimize losses. Although all positions were down for the period, strategic positioning and some key underweighting provided some positive attribution to the portfolio.

The Medium-Term portfolio was down 7.3% for the quarter and performed in line with its policy index. The first quarter was especially tough for the portfolio due to hard hit fixed-income prices experienced. Bond prices continue to drop, but at a slower rate, however, not enough to offset losses in the equity markets during Q2. Continued rate hikes pose a potential for further headwinds for the portfolio's fixed-income allocation. As evidence of a recession solidifies, equity markets continue to experience volatility and money outflows as behaviors turn more conservative. To diversify the portfolio and better utilize our cash, we have reallocated the 5% cash position to real assets.

The Intermediate-Term Portfolio, which is 100% allocated to bonds, was down 3.9% as bond prices continue to decline. The portfolio underperformed its policy index, however, it outperformed the US aggregate bond index. The portfolio's 40% allocation in low-duration bonds continue to aid in outperforming the bond index.

The Short-Term portfolio delivered a 0.2% return for the quarter. The portfolio has benefitted from the Federal Reserve's tightening policy. As rate hikes continue, it is reasonable to assume returns will remain slightly positive and move in correlation to rates.

The Sustainable Endowment and Non-Endowment portfolios were down for the quarter 11.9% and 12.0%, respectively, compared to their policy index down 12.8% in the same period. Year-to-date performance has dragged longer-term annualized returns; however, 2020 and 2021 calendar years were impressive. As we saw in Q1, equities and fixed-income portfolios were hit hard and the results were amplified by these portfolios' avoidance of fossil fuels. To better diversify the portfolio and reduce its fixed-income exposure in a rising rate environment, we have reduced 10% from fixed income and reallocated it to two real assets positions.