Investment Narrative

Quarter Ending June 30, 2024

U.S. markets in general responded well to signs of slowing inflation over the second quarter. June was the first month of negative month-over-month inflation change, which made investors hopeful that the worst may be behind us. The move lower was driven in part by a drop in shelter costs, which previously posed a hurdle to improving inflation. Consumers and overall household security were resilient, bolstered by relatively low unemployment rates and continued wage growth. Although there were early signs of softening in both wage growth and labor markets in June, this was somewhat to be expected given the higher interest rate environment and could be a sign of normalizing economic data. Given the consumer resiliency and the continued trend of spending, U.S. GDP growth came in stronger than expected; however, economists and investors are beginning to question how much longer consumers will be able to absorb higher costs and continue the spending trend seen over the last few quarters. With inflation believed to have reached its peak levels, investor confidence grew in the likelihood of the Federal Bank cutting rates later this year and its ability to manage a soft landing. The uncertainty surrounding the Fed's capabilities, as well as future economic health, led investors to favor certain segments of the domestic equity market.

Similar to what the market has experienced over the last 12 months, most of the domestic equity strength has been bolstered by growth stocks. Technology companies that make up the "Magnificent 7" were in favor, and there was a clear preference for large-cap growth names over value stocks and smaller market cap companies. As such, the broad U.S. stock market, tracked by the S&P 500 Index, returned 4.3% for the quarter and 24.6% over the trailing one-year period. The U.S. small cap market, represented by the Russell 2000 Index, was down 3.3% for the quarter, but up 10.1% over the trailing one-year period. Additionally, market participants continue to believe that interest rates will likely remain somewhat higher for longer and that a 0% interest rate environment is very unlikely to occur anytime soon. At the same time, the possibility of a recession was still on the table. In general, the higher rate environment and defensive characteristics of bonds made the fixed income asset class more attractive over the last year, though the volatility of interest rates over the quarter resulted in muted performance. The U.S. bond market, reflected by the Bloomberg U.S. Aggregate Bond Index, returned 0.1% for the quarter and 2.6% over the trailing one-year period.

Internationally, economic data improved over the quarter and last 12 months. Inflation across most developed countries has normalized to a range of 2% to 3%. As in the U.S., many economists and investors believe that economic growth will slow, but a recession will be avoided. Europe and Japan showed the most concerning signs of softening economic growth, posting year-over-year GDP growth numbers of 0.4% and -0.7%, respectively. International developed equity markets posted soft returns relative to U.S. and emerging market equities. With the delay in rate cuts in the U.S. and concentration of strong performing technology stocks, international developed markets were less attractive in comparison. On the other hand, emerging market equities became very attractively priced after the effects of the pandemic and issues with military tensions/conflict. The pandemic effects have been mostly resolved and fears surrounding geopolitical tension have somewhat subsided since the beginning of the year. Paired with attractive valuations and the growing possibility of the U.S. dollar already reaching peak strength, investors began flowing into emerging market equities which ultimately led to a strong performance over the quarter. The international developed markets, tracked by the MSCI EAFE Index, posted a -0.4% return for the quarter and an 11.5% return over the trailing one-year period. The emerging markets region, represented by the MSCI Emerging Markets Index, was up 5.0% for the quarter, outperforming both U.S. and international developed markets for the period, and returned 12.5% over the trailing one-year period.

Endowment

The Endowment Portfolio was up 1.3% for the quarter and 10.1% for the fiscal year. Performance lagged the benchmark slightly by 0.3% and 0.5%, respectively. Domestic large-cap equity exposure was the most additive to performance over the quarter and trailing 12 months. The biggest detractor to performance over the quarter was the allocation to international developed equities. Over the trailing 12 months, the biggest detractor to performance was the portfolio's allocation to non-U.S. equities, as well as the allocation to private equity. The deal flow in private equity over the last 12 months was very slow, keeping valuations pinned and preventing private equity managers from being able to sell their investments. Deal flow is starting to pick up in private markets, which could allow for more exit opportunities in the market and valuation updates. Despite a slight lag against the benchmark over the quarter and trailing year, we are pleased with the portfolio's performance over the trailing 3-year and 5-year periods ranking in the top decile and the 7-year trailing ranking in the top quartile.

Non-Endowment

The Long-Term Portfolio delivered a 1.2% return over the quarter against the benchmark's 1.6% return and an 11.7% return for the fiscal year against the benchmark's 12.2%. Performance was bolstered by domestic large-cap equities. Detractors from performance were the non-U.S. equity and hedge fund allocations. The hedge fund book was largely flat to moderately up for the quarter, though a handful of strategies experienced more material negative performance and dragged down overall performance. We are in the process of reducing our allocation to hedge funds and reallocating to equities and fixed income. We believe this will reduce the overall volatility of the portfolio and give the opportunity to capture more of the strength in public equities and fixed income.

The Medium-Term Portfolio performed in line with its benchmark. For the quarter, performance was 0.9% compared to the benchmark's 1.0% and 7.4% for the fiscal year, compared to the benchmark's return of 7.6%. The portfolio's allocation to domestic large-cap equities was the most additive to performance over the quarter and trailing 12 months, whereas the allocation to international stocks was a detractor and muted the domestic equity performance. The portfolio's 70% allocation to fixed income helped keep performance in line with the benchmark.

The Intermediate Portfolio slightly outperformed its benchmark for the quarter, posting a 0.7% return against the benchmark return of 0.5%. For the fiscal year, outperformance was slightly higher with a 4.6% return over the benchmark return of 3.9%. The core fixed-income allocation performed well over the quarter and fiscal year, as was the allocation to low-duration fixed income. Higher rates in general have been a positive tailwind for the portfolio and the allocation to low duration has served well as a buffer to interest rate volatility.

The Short-Term Portfolio continued to perform as expected and in line with its benchmark, delivering a 1.3% return over the quarter and 5.4% for the fiscal year. Performance is attributable to the current macro environment of higher interest rates; if interest rates begin a downward trend, we expect the performance of the portfolio to move in tandem.

Sustainable Endowment and Non-Endowment

The Sustainable Endowment and Non-Endowment Portfolios delivered a positive 2.3% for the quarter and posted a slight lead against their benchmarks. In previous quarters, relative performance had been difficult due to the volatility of the previous equity allocation, as seen in the fiscal year performance results where the portfolios underperformed their benchmarks by 3%. To mitigate performance volatility, we transitioned the equity allocation to a passive strategy at the end of last quarter. Since then, performance has been in line with the benchmark and offers the same fossil fuel-free exposure to donors.