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OCIOs Aimed to Add Value as Markets Recovered. Did They Succeed?

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Outsourced CIOs (OCIOs) are fighting to shake off first-quarter losses and prove they can stand out from the pack in a busy year that has served as their first real stress test.

So far, OCIOs at large are “still struggling” performance-wise, says **Brad Alford**, founder and principal of search firm Alpha Capital Management, which formally co-launched the first suite of OCIO performance indices with **Nasdaq** earlier this year. The indices, called **Alpha Nasdaq**, show that the average OCIO across a sample of close to 700 anonymized portfolios returned 11.9%, net of fees, in the second quarter.

A 60/40 portfolio, with 60% consisting of the MSCI All Countries World Index, and 40% representing the Bloomberg Barclays U.S. Aggregate Bond Index, for comparison, would have returned 12.5% that quarter.

While the OCIO-run portfolios included in the indices produced an average return of 11.9%, earning slightly more than the average loss reported by Alpha Nasdaq for the previous quarter, some types of client portfolios didn’t make up earlier declines. Endowment and foundation assets managed by OCIOs, for instance, failed to catch up on their first-quarter losses throughout the recovery: They lost, on average, 14.2% net of fees in Q1, but only gained 12.5% in Q2.

“These high [alternative investment] fees and hedge fund returns are really just killing them,” Alford says of endowment and foundation performance results.

The dispersion among returns was also significant, with the top quartile returning 14.2% in the second quarter, and the bottom quartile only 9.6%, according to Alpha Nasdaq data. OCIO firms and industry observers say they expect an unprecedented wave of requests for proposals for the coming months, both from institutions outsourcing for the first time, and from those that were unhappy with their provider’s performance this year.

OCIOs took varying approaches to guiding clients through the tumultuous market recovery of the second quarter. And only time will tell how their approaches hold up over the long run.

Throughout this year’s market turmoil, **TIFF Investment Management** rebalanced back to its portfolio targets diligently and made a few strategic shifts, says **Kane Brenan**, CEO of TIFF.

The nonprofit investment management firm trimmed some of its China exposure in the second quarter, "as we've had real strong outperformance there," says Brenan. Beyond that, the OCIO also reduced allocations to some of its underlying individual managers "that have had dramatic outperformance."

Regarding its client portfolios' fixed income allocations, Brenan says TIFF continues to expect that there, at some point, will be at least "a partial normalization in rates." For now, the group holds less fixed income and, within that allocation, holds more bonds with shorter durations than various well-known benchmarks, "and we continue to hold that view," Brenan notes.

Within alternatives, TIFF is sticking with its conviction that there is "alpha in the private markets and hedge fund world," Brenan says. "I wouldn't say we're adding, but we're chronically looking for new emerging managers in the private equity and hedge fund space that we think will have outsized returns."

Willis Towers Watson went into the year underweight equities and was looking at tail-protection strategies, such as using more government bonds than credit to hedge pension fund portfolios, says **Jon Pliner**, the firm's head of delegated portfolio management for the U.S.

In the second quarter, when markets started to recover, the firm went overweight on corporate credit in its alternative credit portfolio and allocated more to the asset class overall. Today, the firm is also overweight on real assets, with a preference for non-listed ones, "but without allocating significantly to parts of the market that we thought would have headwinds going forward, like hotels and retail," Pliner says.

Overall, the company hasn't made any meaningful shifts in its long-term allocation, however. Pliner notes that Willis Towers Watson remains slightly underweight public equities and slightly overweight alternative credit.

"We remain fairly cautious," he says, noting that there are still concerns over the broader economy, and what the median-term or shorter-term recovery will look like.

In fixed income, Commonfund **Asset Management** made some "pretty significant shifts in terms of exposures and risks in our client portfolios" during this year's market turmoil, says **Kris Kwait**, co-CIO at the firm.

The company, for instance, increased its exposure to investment-grade corporate bonds right in the middle of the downturn, when spreads widened to significant levels. Throughout the second quarter, Commonfund continued to increase its exposure to corporate bonds, as well as increasing allocations to treasury inflation-protected securities.

"We had inflation expectations for the future that were very, very low – direly low. And we were able to take advantage of that," says Kwait.

Within equities, Commonfund reduced its quantitative exposure and increased allocations to fundamental sector-focused stock pickers instead. “We thought there were a lot of dislocations, and we thought it would be easier for bottom-up stock pickers rather than quantitative processes to take advantage of [them],” Kwait explains.

On the real estate side, Commonfund has focused on digital infrastructure, data storage, as well as last-mile industrial fulfillment, the final leg of delivery processes, given the amount of e-commerce, Kwait says.

“There are some neat dynamics there,” he notes.

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