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Q1 Was OCIOs' First Real Stress Test. Did They Pass?

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Outsourced CIOs (OCIOs) have pitched themselves as having a nimble investment process that allows for better portfolio protection in down markets. But new data shows the average OCIO, net of fees, barely beat a simple 60/40 index between January and March, when the stock market saw its worst quarter since 1987.

"Everyone was kind of waiting for a down market to see how [OCIOs] did, and they had a pretty rough first quarter, compared to the indices," says **Brad Alford**, founder and principal at OCIO search firm Alpha Capital Management.

Together with **Nasdaq**, Alpha Capital launched a suite of OCIO indices earlier this year, compiling anonymized, portfolio-level, net-of-fees return data from various OCIO firms. The first tranche of indices was published in May and included data up to Q4 of 2019.

The data for Q1, released Monday, showed that the overall universe of 645 OCIO portfolios, on average, outperformed a 60/40 portfolio by just 0.3 percentage points. The universe of endowment and foundation assets managed by OCIOs, however, underperformed with a -14.15% average return in Q1, while the 60/40 index lost 12.01%. Hospital operating funds performed worse than the 60/40 index, too, losing 13.06%.

Beaten by Simplicity

Many OCIO peer universes were beaten by a simple 60/40 portfolio over the past five years, with defined benefit plans the only notable exception.

	Q1 2020 returns		One-year returns		Three-year annualized returns		Five-year annualized returns		10-year annualized returns	
60/40 portfolio	-12.01%		-2.82%		3.62%		3.92%		6.18%	
	AlphaNasdaq	Investment-Metrics	AlphaNasdaq	Investment-Metrics	AlphaNasdaq	Investment-Metrics	AlphaNasdaq	Investment-Metrics	AlphaNasdaq	Investment-Metrics
Overall universe	-11.71%	*	-3.40%	*	3.06%	*	3.42%	*	6.26%	*
Endowments and foundations	-14.15%	-14.24%	-6.43%	-6.65%	2.17%	1.91%	2.87%	2.66%	5.66%	5.48%
Hospital operating funds	-13.06%	-10.46%	-5.82%	-3.99%	1.56%	1.69%	2.53%	2.19%	*	4.38%
Defined-benefit plans	-9.13%	-11.38%	0.07%	-2.90%	4.28%	3.39%	4.19%	3.72%	7.14%	6.38%

**data not available*

Notes: AlphaNasdaq and InvestmentMetrics data points are net-of-fee averages and do not inlcude portfolios smaller than $50 million. 60/40 portfolio does not include fees and consists of 42% MSCI ACWI index, 18% MSCI U.S. index, and 40% Barclays U.S. Universal index.

Source: AlphaNasdaq, InvestmentMetrics, BlackRock 60/40 target allocation fund benchmark data.

“Endowments and foundations [results] are somewhat disappointing,” says Alford. “Active has not been great over passive, and … the hedge fund components hurt a lot of these guys badly,” he notes, adding that endowment and foundation portfolios managed by OCIOs are often heavily invested in both styles.

University endowments have been particularly hard hit in Q1, as data released last week by the National Association of College and University Business Officers (NACUBO) showed. The group surveyed 333 institutions with varying investment management models in place, and showed that, net-of-fees, endowments lost 13.4% on average in the first quarter, putting further strain on an already challenged sector of the institutional investor landscape.

In addition to barely beating the 60/40 portfolio, data comparisons also suggest that whether endowments and foundations had an OCIO provider or not barely made a discernible difference in their Q1 performance, although institutions usually pay much higher fees for an outsourced provider.

Data from **InvestmentMetrics**, which included both non-discretionary and discretionary portfolios, shows that the OCIO-managed endowment and foundation portfolios from AlphaCapital’s indices returned, on average, just 0.1 percentage points more than the overall endowment and foundation landscape, including investment oversight models outside of OCIO as well. Even over the long run, the difference was only modest. OCIO-managed endowment and foundation portfolios returned 5.66% annually over the 10-year period ending March 31. InvestmentMetrics’ peer universe returned 5.48% annually over the same time frame.

Both InvestmentMetrics and AlphaNasdaq return data are averages and calculated net-of-fees. Portfolios with less than $50 million in assets were excluded in both datasets. The 60/40 portfolio index consists of 42% MSCI ACWI, 18% MSCI U.S., and 40% Barclays U.S. Universal index.

“OCIOs make a lot of money compared to non-discretionary consultants, so they’ve got to perform, or you’ll be replaced,” says Alford. If institutional investors were already unhappy, comparatively poor Q1 returns “could be the last straw” triggering a search for a new provider, he adds.

In fact, search consultants are already seeing a surge in searches, after activity slowed when the coronavirus first hit the U.S.

“Only in the last few weeks have we seen an uptick in searches, both normal searches as well as those due to performance-related catalysts,” **Tom Donahoe**, managing director for OCIO search and governance at Manager Analysis Services, writes in an email. “It’s likely that the poorest portfolio performers will be looking to consider new searches,” he adds.

Both Donahoe and Alford, however, say the current surge is likely not yet due to bad Q1 performance, since those results were released recently.

“It’s premature to predict how large this new wave will be,” says Donahoe.

Many investment and advisory firms are also expecting more activity: Half of the consultants and boutiques surveyed by Chestnut Advisory Group, a sample that includes firms collectively overseeing $18 trillion in assets, revised their post-pandemic OCIO growth projections upwards. Only 14% lowered it, and the remainder left their estimate unchanged. Alford says the OCIOs he's talking to are receiving more requests for proposals than ever.

AlphaNasdaq has also added a peer universe for insurance reserves to the Q1 report, which was previously not available. For those institutions, as well as for defined benefit plans, the indices brought good news. The OCIO index for insurance reserves returned -9.61% in Q1, and the defined benefit pension plan peer universe returned -9.13%, both beating the 60/40 portfolio by more than two percentage points. DB plans outperformed their respective InvestmentMetrics peer universes by at least two percentage points as well.

The OCIO index suite also breaks out returns based on the percentage allocated to risk-mitigating asset classes, separating its data into five different peer groups. Those OCIO portfolios with the most conservative allocations, with more than 75% in risk-mitigating asset classes, only lost 1.25% in the first quarter.

Alpha Capital is in talks with several large consultants about contributing to its indices as their popularity among OCIOs increases, says Alford. The firm also shortened the response time for OCIOs to put in their data after the quarter ends from 60 to 45 days, so Q2 data should be available in late August.

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