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OCIOs Unpack Blockbuster Year for Equities

Some firms are examining their exposure to equities while remaining interested in private markets.

By Justin Mitchell

October 7, 2021

Some firms offering outsourced chief investment officer, or OCIO, services are plotting their next moves after a year of remarkable equity returns which some firms may use to separate themselves from the pack.

“The returns over five years or seven years have been fairly clustered…it’s a year like this where you are going to see true differentiated results, where people will have meaningful outperformance,” said **Luke Proskine**, co-managing partner of Makena Capital Management**.**

Makena serves mostly foundations and endowments, which have seen historically great returns in asset classes like public equities, private equity and venture capital in the last fiscal year, as reported. Some endowments and foundations that do not see themselves getting the windfall returns of their peers might re-think their investment programs, Proskine said.

“At the end of the day, it’s the bottom line that really matters,” he said.

Indeed, OCIO portfolios that took more risk had better returns in fiscal year 2021, which ended June 30, according to recent data from **Alpha Capital Management** and **Nasdaq**. The universe split return indices into aggressive, moderately aggressive, moderate, moderately conservative and conservative asset allocations. The most aggressive allocation returned just over 34% over one year, while the most conservative asset allocation return came in just under 5%. Equities, especially private equity and venture capital, have more risk than other asset classes.

While the strong results might be exciting for many, reading too much into one-year returns can be “dangerous” for an investor focused on the long term, as foundations and endowments often are, said **Nikki Kraus**, chief client officer at OCIO Strategic Investment Group.

“Investors could chase the returns of a group who very much overallocated to a particular category that did well, but that may not work going forward,” she said.

Since foundations and endowments tend to be long-term investors, and those longer-term returns tend to be clustered, it could mean returns are not the best way for OCIOs to

differentiate themselves, said **Brad Alford**, the founder of Alpha Capital Management. All OCIOs say they have excellent returns and an excellent track record, he added.

"Competing on performance is a loser's game," Alford said. Firms would be better served by focusing on other services they can do in support of their clients, he said.

Alford's firm provides clients with eight criteria, of which track record is only one. Clients then arrange the criteria in the order that works for them. Alford said track record is usually the first or second option investors choose.

While the OCIO professionals who spoke to FundFire said ancillary services are important, especially to foundation and endowment staff, they added that performance is "paramount."

"For OCIO to work the way it was intended, it does have to deliver the returns," Kraus said.

As OCIOs plan for the future, they are looking to rebalance portfolios slightly away from equities, to ensure they stay within their target allocation ranges.

"Eighteen months ago, we were adding aggressively to equities, but of late we've been doing just the opposite," said **Trevor Graham**, managing director of equity-oriented strategies at TIFF Investment Management, an OCIO that works exclusively with nonprofits.

Rebalancing is especially important at times like this when some asset classes have outperformed others, Graham said.

"Without that, there starts to be some creep in the portfolio, like the basic integrity of the portfolio design starts to be impaired," Graham said.

The popularity of private equity, both on the demand and supply side, is also causing OCIOs to pivot.

"We still think there's a return premium to be captured. But we're being really careful about selection right now just because it's so popular," Graham said.

Commonfund, another OCIO which focuses on serving nonprofits, has also chosen to pare down its equities allocation from a modest overweight, said Co-Chief Investment Officer **Deborah Spalding**. She and other OCIOs cited the rising valuations of assets as one source of concern.

"As we have seen markets rise commensurate with the recovery [from Covid-19], the question always remains, can this be sustained?" she said. "Despite the fact that we are continuing to see a recovery in earnings, the rising valuations did give us pause."

"We don't get swept away by particular environments and we know our job is to focus on the long-term," Kraus said. "This is an environment where you don't want to make big bets, because big bets could be wrong, and it could wipe out a lot."

Still, private investments remain vitally important for separating the best-performing investors from the pack.

“When we see the biggest difference in terms of performance spreads among foundations and nonprofits in general, it’s usually driven by the allocation to private investments,” Spalding said. “Those foundations that have the higher allocation to privates over the long term have tended to outperform those that do not.”

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