

GOELZER
INVESTMENT MANAGEMENT

The Importance of Alternatives in Times of Crisis

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*Looking Forward: Can Alternatives
improve outcomes*



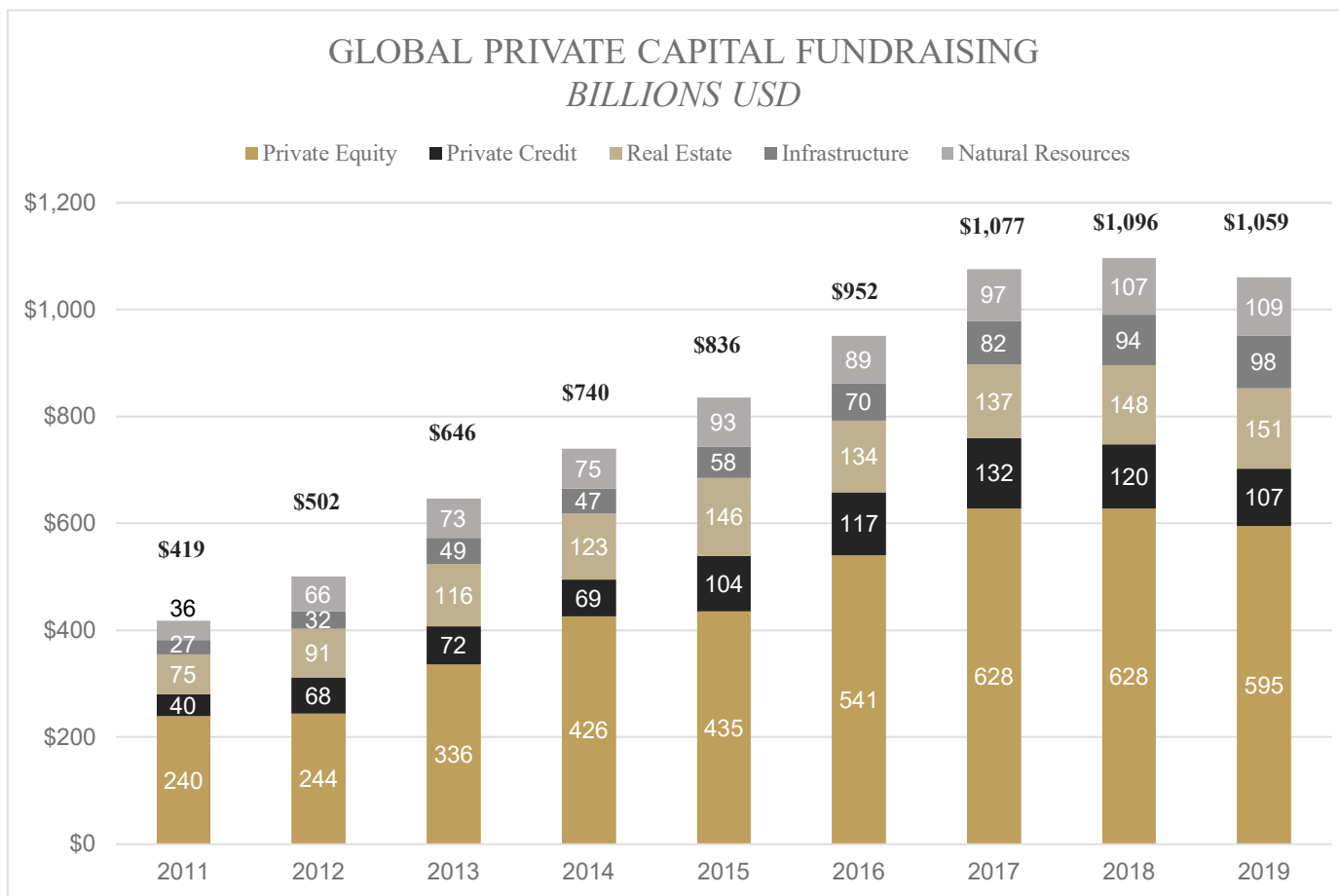
THE IMPORTANCE OF A STRONG IPS IN TIMES OF CRISIS

Interest in Alternatives has Grown Dramatically

As equities experienced two bear markets and interest rates declined in the 2000s, interest in alternatives became more pronounced.

This was coupled with innovation in financial instruments including the use of derivatives in hedging strategies.

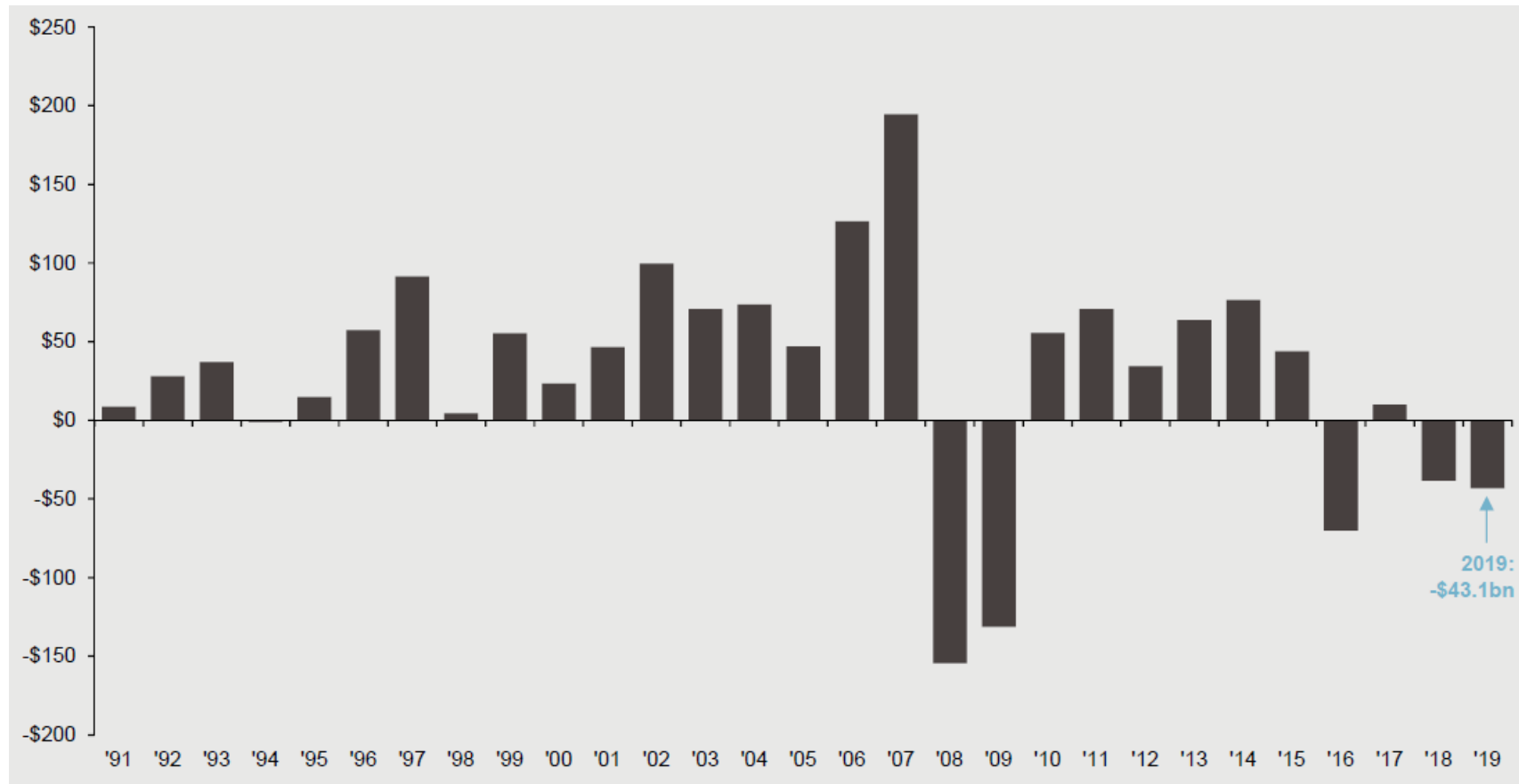
Major investments firms were looking to offer higher margin products and were happy to oblige investors by creating products that allowed them an opportunity to reach for better returns.



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Flows into Hedge Funds have Slowed

HEDGE FUND NET ASSEST FLOW
BILLIONS USD



Sources: HFRI, J.P. Morgan Asset Management.
Data is based on availability as of February 29, 2020.



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Community Foundations Asset Allocation

Fixed Income allocations have decreased over the past 20 years while alternatives have increased.

The traditional 60/40 stock bond mix has been replaced with a 60/20/20 mix.

This corresponds with declining interest rates.

What are the implications and trade-offs of this?

<i>Asset Class</i>	<i>Community Foundations</i>	<i>Under \$100 Million</i>
Domestic Equities	36	40
International Equities	22	21
Fixed Income	20	23
Cash & Equivalents	3	4
Alternatives	19	12



<i>Asset Class</i>	<i>Community Foundations</i>	<i>Under \$100 Million</i>
Private Equity	3	1
Private Credit	0	0
Marketable Alternatives	10	6
Venture Capital	1	0
Private Real Estate	2	2
Natural Resources	1	1
Managed Features/Commodities	1	2
Distressed Debt	1	0

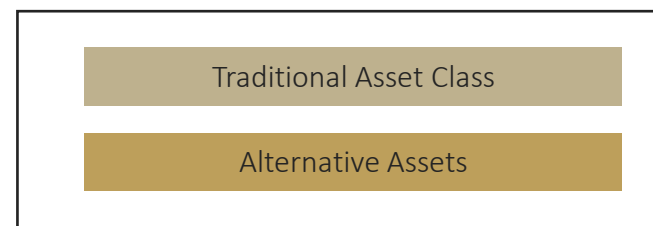


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Alternatives

- Alternative investments represent investments that are not public equity, public fixed income, or cash.
- This includes both additional asset classes (real estate and commodities) as well as private instruments (hedge funds, private equity/debt, and private real assets).
- Private investments, are not separate asset classes but a form of active management within illiquid private partnerships.
- Hedge Funds can mean many things. The strategies span the spectrum of asset classes

	<i>Asset Class</i>	<i>Equity</i>	<i>Fixed Income</i>	<i>Cash</i>	<i>Real Estate</i>	<i>Commodities</i>
LIQUID	Public	Stocks	Bonds	Money Market	REITs	Managed Futures
ILLIQUID	Private	Private Equity	Private Debt		Private Real Assets	
		Hedge Funds				



Source: Vanguard



What is their Role in the Portfolio?

- ❖ In order to evaluate incremental benefits/costs, investors should ask what is the role of alternative.
- ❖ The allocation came from somewhere (traditional equities or bonds). Given this, performance should be evaluated with this in mind.

Diversifier

- Should provide lower correlation to equities or bonds.
- Risk should be lower than equities.
- Returns should commensurate to the amount of risk taken.
- Lower volatility strategies. Arbitrage (merger, convertible), Long/Short, Market Neutral and relative value and credit.

Return Enhancer

- Higher expected returns than the public equity markets.
- Given the illiquid and long-term nature of the asset class a return premium should be expected.
- Private Equity, Venture Capital, Real Estate



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Questions to Ask

- ❖ Do we have the right type of organization to invest in alternative investments, like private equity?
- ❖ Do we need them to reach our goals?
- ❖ Do we understand the risks?
- ❖ Do we understand how these investments typically work?
- ❖ Do we have the patience and time horizon?
- ❖ Can we consistently pick the best managers who can overcome the high costs involved with alternatives?



Do we have the right type of organization to invest in Alternative Investments?

Structural Considerations (Hidden costs)

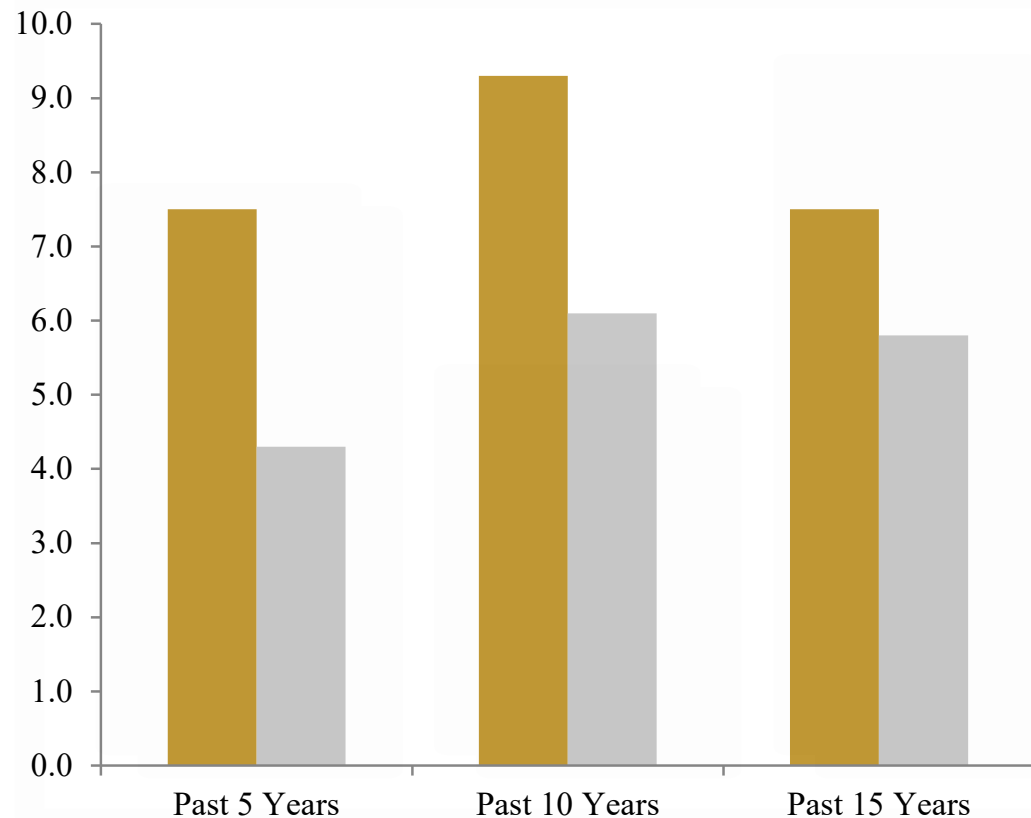
- ❖ Administration tasks to deal with capital calls, increased documentation and accounting
- ❖ Tax Reporting
- ❖ Legal
- ❖ Custody
- ❖ Performance Reporting



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Do we need them to reach our goals?

- 7% or Inflation plus 4.5% goal has been achievable with a simple allocation of U.S. Stocks and Bonds
- A portfolio with too much international exposure fell short
- Bonds returns ranged from 3%-4% during this time.



	PAST 5 YRS	PAST 10 YRS	PAST 15 YRS
70% S&P 500/30% Barclay Int. Gov.	7.5	9.3	7.5
70% MSCI ACWI/30% Barclay Int. Gov.	4.3	6.1	5.8



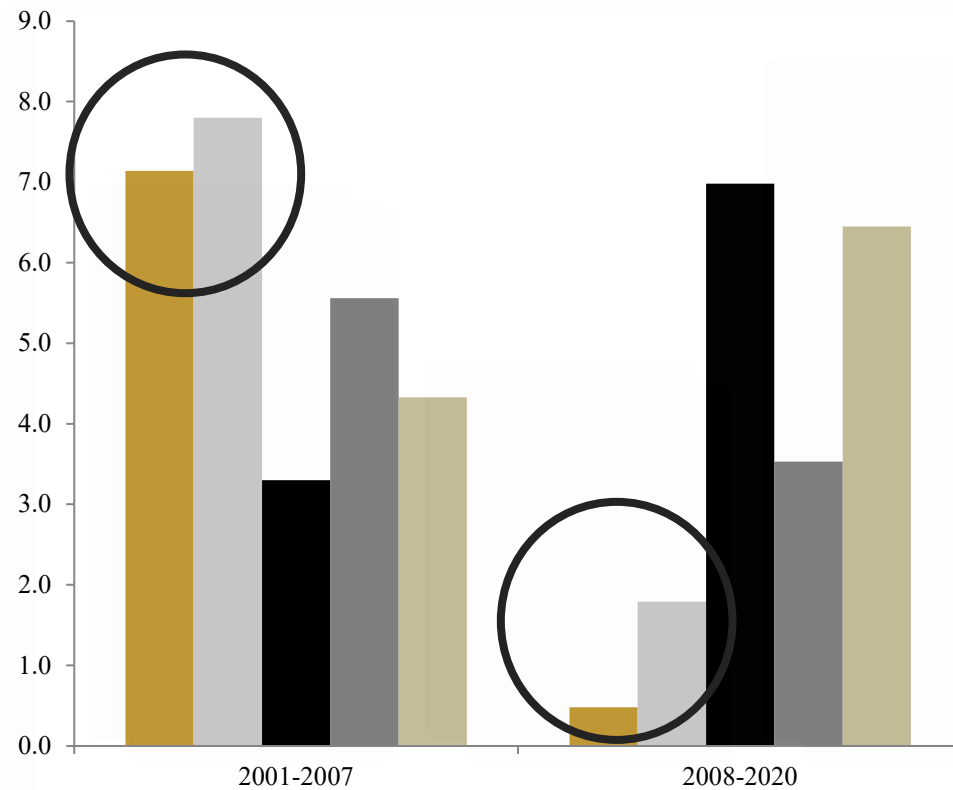
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Do we need them to reach our goals?

Many Alternatives have struggled post 2008, there are several factors:

- ❖ Lower Interest Rates
- ❖ Increased Regulation
- ❖ Crowded Trades
- ❖ Better Equity Returns

	'01-'07	'08-'20
HFRI Fund of Funds Index	7.1	0.5
HFRI Equity Hedge Index	7.8	1.8
S&P 500 Index	3.3	7.0
Barclays Int. Gov/Credit Index	5.6	3.5
70% S&P 500 30% Barclay Int. Gov.	4.4	6.5



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Do we need them to reach our goals?

10 YEAR		DEC 2019	UPDATED MARCH 2020	
<i>Asset Class</i>	<i>Comparative Index</i>	<i>Projected Return</i>	<i>Projected Return</i>	<i>Historical Returns•</i>
US Large Cap Stocks	S&P 500	4.1%	8.3%	10.0%
US Mid Cap. Stocks	Russel Mid Cap	4.4%	8.6%	11.3%
US Small Cap. Stocks	Russell 2000	5.0%	9.2%	9.5%
International (non-US) Stocks	MSCI EAFE	5.7%	9.9%	4.9%
Emerging Markets	MSCI Emerging Markets	7.7%	11.9%	8.4%
US Taxable Bonds	Barclays Int. US Govt/Credit	2.5%	2.4%	5.9%
Cash	Citigroups 3 month T-Bill	2.0%	2.0%	2.8%
Commodities**	DOW UBS Commodity Index	2.5%	2.5%	1.7%
Hedge Funds**	HRRI Fund of Funds Comp	5.3%	5.3%	4.6%
Private Equity		7.3%	11.5%	
Goelzer Non-Traditional		3.6%	5.6%	7.5%
Consumer Price Index, SA (CPI)	January 1979 – November 2019	2.0%	2.0%	3.3%
Hypothetical Portfolio (60% Equity; 30% Fixed; 10% Non-Traditional)		3.8%	6.4%	

* Source Zephyr Associates: Historical Returns represent 30 years annualized total returns ended Dec 31, 2019.

** Source Zephyr Associates: Historical Returns represent 25 years annualized total returns ended Dec 31, 2019.

*** Historical Returns for Goelzer Non-Traditional represent model returns since inception January 2009 though Dec 31, 2019.

Projected returns and standard deviations are for planning purposes only. Actual results will likely differ from these projections.

Hypothetical Portfolio = 42% US Large Cap; 6% US Mid Cap; 3% US Small Cap; 9% International; 30% Fixed Income; 10% Goelzer Non-Traditional



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Do we need them to reach our goals?

If 7-8% is your organization's return goal than you may have to explore other trade-offs:

- ⌘ Higher allocation to equities; higher volatility
- ⌘ Allocation to private equity; less liquidity and more costs
- ⌘ Allocation to fixed income/equity alternatives (hedge funds and non-traditional)



Do we understand the risks?

Pros

- Higher expected returns than the public equity markets (private equity)
- Potential Diversification benefits
- Investment flexibility allows increased opportunity set and tactical trades
- Less efficient than public equity markets
- Long-term investment approach aligns with several investor's time horizons

Cons

- More chances for impaired capital and unconstrained active management bets
- Weaker legal standing and control
- Lack of transparency
- High Fees
- Illiquidity and use of leverage
- Administrative burden
- Wider dispersion of managers' returns



Understand the Risks

Many Private equity and hedging strategies have high correlations with Equities



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Diversification Benefits?

There are no free rides. In down markets alternatives capture less of equity decline but still exhibit more volatility than traditional bonds

Asset Class	Global Fixed Income	Global Equities	US Core Real Estate	Venture Capital	Private Equity	Equity Long/Short	Relative Value	Macro
Global Fixed Income	1							
Global Equities	0.3	1						
US Core Real Estate	-0.3	-0.5	1					
Venture Capital	-0.2	0.2	0.2	1				
Private Equity	0.2	0.8	-0.3	0.5	1			
Equity Long/Short	0.2	1	-0.4	0.3	0.9	1		
Relative Value	0.2	0.9	-0.6	0.1	0.7	0.9	1	
Macro	0.2	0.5	-0.2	0.1	0.3	0.5	0.4	1

PRIVATE
MARKETS

HEDGE
FUNDS

Source: MSCI, Bloomberg Barclays, NCREIF, Cliffwater, Burgiss, HFRI, J.P. Morgan Asset Management. RE – real estate. Global equities: MSCI AC World Index. Global Bonds: Bloomberg Barclays Global Aggregate Index. U.S. Core Real Estate: NCREIF Property Index – Open End Diversified Core Equity component. Europe Core Real Estate: IPD Global Property Fund Index – Continental Europe. Asia Pacific (APAC) Core Real Estate: IPD Global Property Fund Index – Asia-Pacific. Global infrastructure (Infra.): MSCI Global Quarterly Infrastructure Asset Index (equal-weighted blend). U.S. Direct Lending: Cliffwater Direct Lending Index. Global Private Equity: Cambridge Associates Global Private Equity Index. U.S. Venture Capital: Cambridge Associates U.S. Venture Capital Index. Hedge fund indices include equity long/short, relative value, and global macro and are all from HFRI. All correlation coefficients are calculated based on quarterly total return data for the period 06/30/09 – 09/30/19. Returns are denominated in USD. Data is based on availability as of February 29, 2020.



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Do We Understand How These Work?

ALTERNATIVES SCORECARD

Strategy	Objectives	Liquidity	Leverage	Fees	10 Year Performance		Batting Average	
					vs. Barclays Intermediate Bond Index	vs. traditional 60/40 mix	vs. Barclays Intermediate Bond Index	vs. traditional 60/40 mix
GIM LIQUID NON-TRADITIONAL	Diversifier	Daily	No	0.86% (embedded in funds)	4.03% vs 3.14%	4.03% vs 5.04%	73%	45%
OPPORTUNISTIC LOW VOLATILITY HEDGE FUND	Diversifier	Quarterly (90 days)	Available but does not use	1.0% + 20% Performance Incentive	2.72% vs 3.14%	2.72% vs 5.04%	53%	63%
HEDGE FUND OF FUNDS	Diversifier/Global Absolute Return	*Quarterly (65 days)	Not an fund level but underlying managers can use leverage	0.8% + 10% Performance Incentive	2.93% vs 3.14%	2.93% vs 5.04%	57%	36%
				Underlying Fund Fees: approx. 1.3% + 16.6% Performance Incentive		60% MSCI ACWI (net) + 40% Barclay Int. Gov/Credit		

Has a 25% quarterly gate applied to total fund assets, not individual investors



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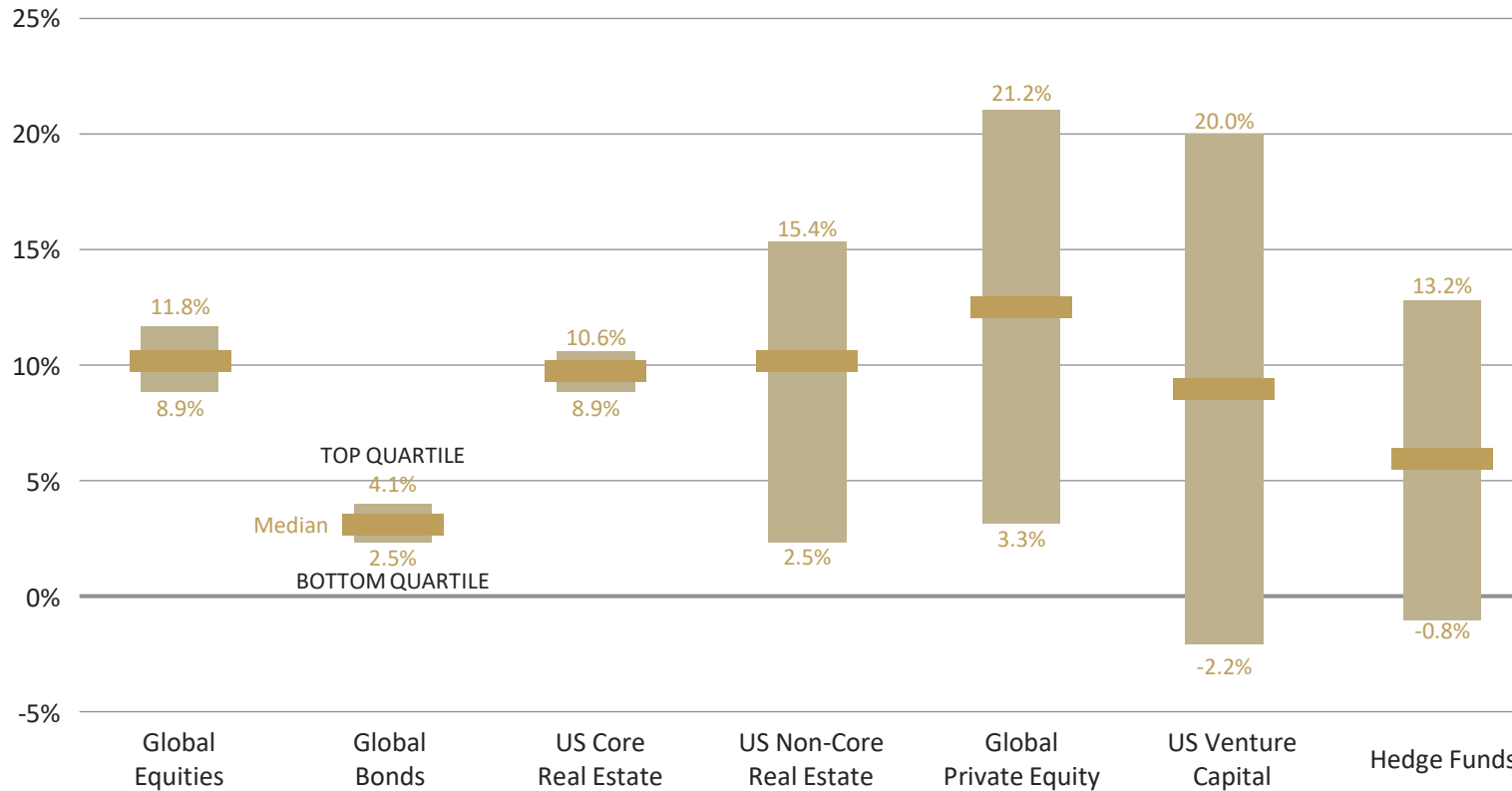
Strategy	Correlation		Volatility		Drawdown	
	To Fixed Income	To Equities	vs. Barclays Intermediate Bond Index	vs. S&P 500	Amount	Length
GIM LIQUID NON-TRADITIONAL	0.05	0.94	6.35 vs. 2.45	6.35 vs. 14.73	-9.45%	1 Quarter
OPPORTUNISTIC LOW VOLATILITY HEDGE FUND	-0.13	0.82	5.82 vs. 2.45	5.86 vs. 14.73	-9.77%	6 Quarters
HEDGE FUND OF FUNDS	-0.33	0.63	4.58 vs. 2.45	4.58 vs. 14.73	-7.55%	1 Quarter
	Bloomberg Barclays Intermediate Gov/Credit	MSCI ACWI (net)	Standard Deviation 10 Year Trailing Period		January 2009 — March 2020	



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Manager Selection in Alternatives is Paramount

PRIVATE AND PUBLIC MANAGER DISPERSION
 BASED ON RETURNS OVER A 10 YEAR WINDOW *



Sources: Lipper, NCREIF, Cambridge Associates, HFRI, J.P. Morgan Asset Management.

Global equities (large cap) and global bonds dispersion are based on the world large stock and world bond categories, respectively. *Manager dispersion is based on: 2Q 2009 – 2Q 2019 annual returns for global equities, global bonds and U.S. core real estate. Hedge funds are based on 4Q 2009 to 4Q 2019 annual returns. U.S. non-core real estate, U.S. private equity and U.S. venture capital are represented by the 10-year horizon internal rate of return (IRR) ending 2Q 2019. Data is based on availability as of February 29, 2020.



Thank you



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