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THE NMS EXCHANGE

IN THIS ISSUE

Britt Harris
CEO & CIO
UTIMCO

Interview Conducted by:
Susanne Gealy
Senior Director
CommonSpirit Health

Building and Leading Great Investment Organizations Insights from Britt Harris, CEO & CIO of UTIMCO

In preparing to interview T. Britton Harris (Britt), my CIO for nearly a decade when at Texas Teachers, I expected the fertile ground of his deep experience building and leading investment organizations (including Verizon, Texas Teachers, UTIMCO.) To me, his insights are particularly relevant for this time of volatility, transition and vulnerability. From Britt to us, success and team effectiveness are not accidental, and not pixie dust. He shares his beliefs and wisdom in the conversation below.

Susanne (SG): Britt, there are so many that know you from your public and corporate CIO roles. You are now three years as CEO/CIO at UTIMCO, let's explore your insights and key elements of building great investment organizations for the NMS community of foundation, endowment and health care investors.

SG: How do you build and lead great investment organizations?

TBH: I have led a number of significant investment organizations in my career and have developed a playbook for building extraordinary organizations.

The components are:

- **Mission and Purpose:** deep clarity across the organization of our calling and service,
- **Culture**: a strong and widely held culture,
- **People:** excellence, curiosity and accountability-driven teams, and
- **Process:** critical processes drive excellence and repeatability for our success.

The starting point is clarity around our mission and purpose as an organization. Why the work we do matters.

The UTIMCO Mission Statement

We generate superior long-term investment returns to support The University of Texas/ Texas A&M University Systems as they provide world-class teaching, push the boundaries of discovery, and achieve excellence in patient healthcare for the people of Texas and beyond. It is important for each and every one of the team to wake up with clarity of purpose.

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NMS
MANAGEMENT

Nancy M. Szigethy
Founder, President and
Chief Executive Officer

ABOUT NMS

NMS is a membership-based organization serving as the primary educational resource for the endowment and foundation community through its high caliber meetings. Believing that successful business ventures are built on trust, and trust developed through relationships, NMS strives to facilitate relationships through its membership platform. As the chief source of unbiased educational forums, NMS promotes high standards of competence and ethics.

By Ana Marshall
Vice President and
Chief Investment Officer
The William and Flora
Hewlett Foundation

Behind the Hewlett Foundation's Top Decile Returns

When we reflect on what underpins the culture of a team or firm, or even a family, we can usually point to a handful of shared core values. Some organizations have strong cultures in which norms of behavior embody how members live their values. Other organizations have weaker cultures and leave more room for individual deviations. The norms in organizations with strong cultures define a cohesive organizational ethos that must be navigated by staff. These norms help everyone in the organization feel part of the "group," which hopefully provides them the safety to contribute to achieving the organization's mission.

Typically, each team within an organization has a set of values that fit the organization's overall mission and goals but are distinctly "theirs." The Investment team at Hewlett values intellectual curiosity, passion for investing, high performance/competence, and diversity. These values are reflected in our practices as investors and as the face of Hewlett in the investment community.

"Overcoming barriers to diversity means more than just adding people of different races or genders."

People have different things in mind when they talk about "diversity," but the common factor is expanding opportunity. Most often, we are talking about expanding diversity for people of different races, ethnicities, or genders. Overcoming barriers to diversity means more than just adding people of different races or genders. It means coming to appreciate people for who they are, recognizing that every member of the staff is a unique individual who needs to believe they are appreciated for who they are and what they can contribute. Our 11 member investment team has 8 women and people of color, and we work hard to empower all them to maximize their contribution to investment decisions.

This leads to a second aspect of diversity, one every bit as important, namely, diversity of thought. To solve the world's increasingly complex problems we need multiple toolkits and many ways of looking at problems. A group in which everyone thinks the same way is unlikely to do a lot of creative problem solving. Group think leads to blind spots that impede success in strategic initiatives. The best way to ensure that a team considers different ideas, viewpoints, and solutions is to have on that team people of different gender, racial, educational, and geographic backgrounds. Sometimes, of course, this diversity of thought can be messy and take more time, but the benefits are more than worth it.

Which takes us to a third aspect of diversity in a team: diversity in the ways people work. This aspect may not seem important at first blush, but for a team to collaborate effectively every member of the team must believe that every other member is working to the same level of excellence. In some firms, this is done by enshrining a process that everyone must follow. But diverse people and diverse thinkers naturally have diverse ways of approaching decisions, which leaders who want real excellence should appreciate and accept. With agreement on objectives and mission, good leaders can and should offer respect and support for differing work styles. In the end, it's outcomes that matter, not process.

Nine months of isolation has limited what any of us sees, which has, in turn, made the need for diversity more important than ever. Recognizing that a narrowed funnel of information is likely to impede good decision making, leaders must be particularly intentional in soliciting different views and viewpoints, because those truly superior "a ha" moments have the best chance of surfacing when different voices can be raised to challenge ideas. A diverse team in which every person can offer input from their unique perspective, based on their unique funnel of information, is more likely to develop a superior strategic vision in a complex world like ours.

By Alex Ambroz
Director
Cleveland Clinic Foundation

Only Pay For Alpha: A New Quantitative Framework For Manager Evaluation

"Beta estimates can be noisy depending on the time-period selected (e.g., change in market regimes can greatly affect the portfolio outcomes)."

The Current Market Environment Is Difficult and Ever Changing

Institutional allocators find no easy answers when managing portfolios in today's market environment. Sovereign curves across the board are at all-time lows on a nominal basis, deep into negative territory on a real basis. Corporate credit markets are likewise constrained as investors chase yield and drive down spreads across credit markets. Equity markets face tough prospects given high valuations and a Covid-19 induced uncertain future. Critically, then, selecting high quality asset managers for their portfolios is a key component in the goal of earning above-average or, at the least, above-benchmark returns. A new generation of very low cost tools has now made it easier for allocators to better assess whether asset managers are providing consistent idiosyncratic alpha, or are simply charging alpha fees for beta exposure. Positive alpha is excess return that is derived from security selection, tactical asset allocation, or other investment skill, given a similar level of risk. Alpha is scarce, and therefore, should be highly valued.

Many institutional allocators also use some variation of the four or five 'P's when assessing managers initially as well as on an on-going basis. Among those being: philosophy, process, performance, people, policies, procedures, etc. The performance evaluation side has historically been completed using standard heuristics and ratio assessments relative to peers and existing portfolio options.

Asset allocators often use an initial screen to narrow in on managers that fit certain investment parameters, usually followed by a quantitative ranking process based on different metrics across multiple time periods. Examples of metrics used include: Sharpe ratio, Sortino ratio, information ratio, tracking error, upside and downside capture, batting average, etc. This preliminary analysis is usually done strictly on a returns-based, ex-post framework, using data provided by the manager.

Traditional Quantitative Measures Face Difficulties

Even relatively long return series can be manipulated through the use of derivatives or dynamic trading strategies to achieve artificially high investment ratios. As an example, inception to present outcomes can provide misleading answers to the question of consistency of alpha generation. Beta estimates can be noisy depending on the time-period selected (e.g., change in market regimes can greatly affect the portfolio outcomes).

Standard deviation and the Sharpe Ratio, which uses standard deviation as a component, symmetrically penalizes positive performance and negative performance, whereas investors welcome positive upside volatility. Cross-manager comparisons can be difficult for managers having historical track records of varying length and start dates.

Cross-Section of Database of Managers' Excess Alpha Shows Deterioration

Most managers underperform passive alternative investment options after fees are taken into account. According to S&P's latest SPIVA Mid-Year Report (through June 30, 2020), less than 6% of U.S. large-cap equity funds are able to beat their benchmark over a 10-year time horizon. The reasons for underperformance are many and varied, but in examining a stratified sample of these funds, we find a common element: increasing AUM often leads to a decrease in alpha.

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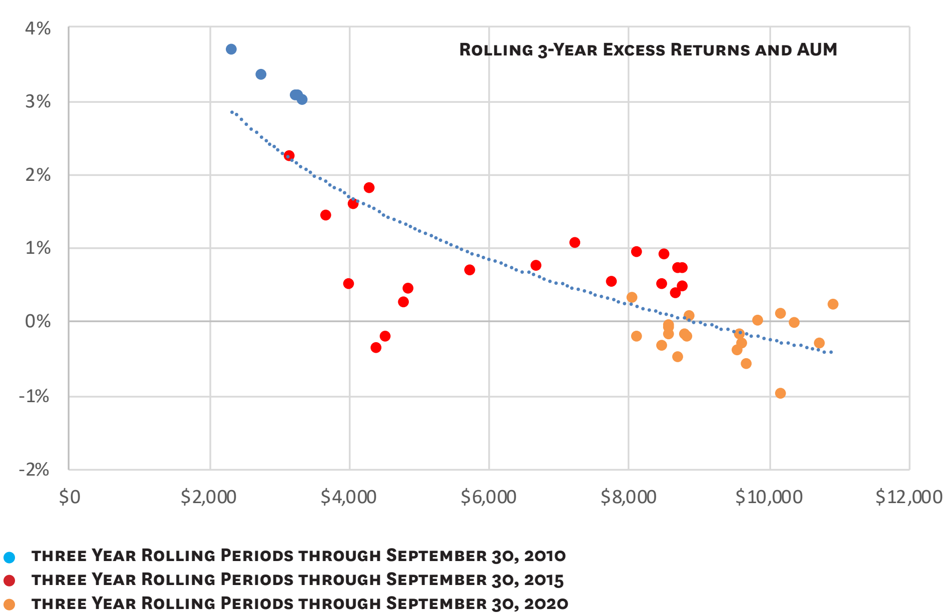
Figure I: Secular Decline in Alpha as AUM Increases



By Rob Rahbari
Senior Investment Officer
and Assistant Treasurer
University of Rochester

By Stephanie Westen
Investment Analyst
University of Rochester

"For university endowments, improving DEI metrics also promotes closer alignment with stakeholders, and may also encourage greater donations from socially-conscious donors."

Exploring and Supporting the Diverse Manager Landscape

Tragic events in 2020, such as the death of George Floyd, and the disproportionate impacts of Covid-19 on communities of color, have sparked a cultural reckoning on racial injustice in the United States. Among other organizations taking action to address structural inequalities in education, finance, housing, health, and other areas, academic communities are re-examining structures and policies that perpetuate these inequalities, such as hiring policies for faculty, staff, and external vendors and contractors. University Investment Offices have an opportunity to support positive social changes while also furthering their investment objectives by actively seeking to invest in firms managed by women and people of color.

The stark lack of racial and gender diversity in asset management has become a focal point for research, discussion, and calls for change in recent years. A 2019 study by the Knight Foundation found that less than 1.3% of global AUM across mutual funds, hedge funds, real estate, and private equity is managed by women and people of color[1]. Another study conducted by Illumen Capital and Stanford SPARQ in 2018 presented evidence that implicit racial bias impacts investment decisions made by asset allocators, and that investment managers of color experience greater allocator bias after they have established strong performance track records.[2]

This problem is compounded by the many systemic obstacles to career advancement that racial minorities face along the professional pipeline. People of color are less likely to have access to educational programs, mentorships, and wealth networks that are often critical to success in the investment industry.

There are numerous advantages to successfully implementing diversity, equity, and inclusion ("DEI") objectives within an institutional portfolio, the most tangible of which is the potential to achieve higher returns. A 2019 article in this publication by Kim Lew and Alisa Mall (then of the Carnegie Corporation) argued that generating alpha in traditional asset classes is more difficult than ever. The authors asserted that outperformance in today's environment requires identifying new areas of opportunity, and that investors who represent a broader portion of the population will have a competitive advantage due to their diverse perspectives. Beyond the "business case" for diversity, many organizations are also sensing a growing moral imperative to address issues surrounding DEI. There is a clear social impact motivation to seek out and invest in diverse managers: increased capital flowing to minority-led firms and businesses will, over time, lead to greater generational wealth in underrepresented communities. For university endowments, improving DEI metrics also promotes closer alignment with stakeholders, and may also encourage greater donations from socially-conscious donors. A number of foundations and endowments have led the industry's efforts to improve in the areas of diversity, equity, and inclusion.[3]

At Rochester, we are preparing to take action on DEI issues using a three-pronged approach: 1) engaging more deeply with our current managers on these topics and tracking their progress over time, with the results to factor into our portfolio management decisions; 2) making new investments in firms led by women and underrepresented minorities, and sharing information about diverse investment firms with institutional peers; and 3) supporting initiatives that empower women and minority professionals in the investment industry pipeline.

We will focus here on the second initiative above, though we plan to continue engaging actively with our peers and other market participants on the other two topics. Over the last several months, we have been working on a project to survey peers and other contacts to learn of diverse-led firms across asset classes, and we have created a spreadsheet of over 500 women and minority-led firms, as well as funds that focus on DEI as part of the investment strategy. Because Rochester's direct financial impact on these firms will be limited (as our portfolio construction will not allow for significant new illiquid investments in the near term), we have "open sourced" this list to our peers and other interested parties, in hopes of doing our part to help these firms get more attention (and investment) from allocators, and to help our peers access these under-appreciated opportunities. The current version of the list is shown as Figure 1 (one page shown as an example; the entire list is available upon request). We recognize that the landscape is changing quickly, and our list is far from complete; corrections/additions are welcome.[4]

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Manager	Type	Asset Class	Stage/Sector/Strategy	DEI FOCUS	Woman/Minority status	Key People
Reach Capital	Private	Venture Capital	Ed Tech		Woman; African American	Shauntel Garvey, Jennifer Carolan,
Renegade Partners	Private	Venture Capital			Woman	Roseanne Wincek, Renata Quintini
Rethink Impact	Private	Venture Capital		YES	Woman	Jenny Abramson, Heidi Patel
Scale Venture Partners	Private	Venture Capital			Woman	Kate Mitchell, Co-Founder
Scribble Ventures	Private	Venture Capital			Woman	Elizabeth Weil
SemperVirens Venture	Private	Venture Capital			Woman	Allison Baum
Share Ventures	Private	Venture Capital	Venture Studio	YES	African American	Hamet Watt
SKU'D Ventures	Private	Venture Capital	Pre-seed, consumer products	YES	African American	Kofi Ampadu
SteelSky Ventures	Private	Venture Capital	Early-stage - Women's health tech		Woman; African American	Maria Velissaris, Buffy Alegria
Storm Ventures	Private	Venture Capital	Early-stage; B2B		Diverse Leadership	Ryan Floyd, Alex Mendez, Tae Hea Nahm
Syncom Venture Partners	Private	Venture Capital	Media/Communications		African American	Duane McKnight
TenOneTen (10110) Ventures	Private	Venture Capital			Woman partner	Minnie Ingersoll
The Engine	Private	Venture Capital			Woman	Katie Rae
TI Platform Management	Private	Venture Capital	Venture Platform backing emerging & div	YES	Woman; Minority	Alex Bangash, Trang Nguyen
Trail Mix Ventures (TMV)	Private	Venture Capital	Early Stage		Woman	Soraya Darabi, Marina Hadjipateras, Suzette Dutch
Triathlon Medical Ventures	Private	Venture Capital	Healthcare & IT		Woman	Marcus Stroud, Brandon Allen
TXV Partners	Private	Venture Capital	Early/Mid; health, fitness, wellness		Minority	

Zoom to the Point: Effective Group Communication in the Post-COVID Workplace

The author is indebted to the contributions of the many colleagues with whom he has discussed this topic over the past months, and in particular to Jessica Schechter, an executive coach, professional public speaker, educator at the collegiate level in the art of public speaking, and, more recently, his wife.

By Ahron Herring
Chief Investment Officer
Yeshiva University

"This stilted and fractured environment is not conducive to the meaningful sharing of ideas."

Widespread adoption of Zoom©, Microsoft Teams©, and other virtual conferencing platforms has transformed the way we communicate in groups at work, and we are unlikely to fully revert to entirely in-person interactions for some time. Giving new meaning to the phrase "meeting face to face", these technologies offer benefits that were not imaginable just a year or two ago. Our teams are more integrated across cities, time zones, and continents, and we arrange meetings with current and prospective investment managers without the constraints of locale or travel itineraries. We can connect more regularly with peers at distant institutions, and when we find opportunities to be in "two places at once" we make more effective use of our limited time and travel budgets. As we have gained experience with this new way of life, however, many are recognizing that there are elusive and intangible costs.

Virtual interactions are simply not as rich as the superficially simple but psychologically layered, and often serendipitous, interactions that occur in person. To borrow a technical metaphor, the "bandwidth" in a virtual engagement is much narrower than a live conversation in the same way that a text message carries less content—and context—than an email, and an email filters out the tone of voice present in a phone call which can avoid miscommunication and inadvertent offence. While more cut-and-dried discussions often translate effectively to the virtual realm, it is more difficult to encourage the brainstorming and free flow of ideas that are critical to creative work, and we risk failing to nurture tenuous threads of insight into fully developed ideas.

In particular, interaction with our boards and investment committees can become more challenging, as the extended and probing dialog of the board room becomes more constrained, and we are far less likely to notice and fully explore the unexpected observation that emerges from the thoughtful silence of a dinner discussion. On a more prosaic level, these new technologies are less than robust, and we encounter all manner of technical glitches, delays, and a whole host of distractions.

In spite of all this, we find ourselves engaging out of necessity in the high-stakes decisions of investing, hiring, and strategic planning using these platforms, and it appears that this may be a permanent fixture. I would like to offer strategies to make this mode of communication as effective as possible, whether in daily conversations with staff, meetings with investment managers, or when engaging with our boards and investment committees.

Practical Remedies

Much the same as in-person interactions, the key to overcoming the limitations of virtual communication is connecting with your audience. There are five areas that tend to be particularly challenging online. The following suggestions, while not uniquely applicable to the digital experience, are particularly relevant as we navigate the specific constraints of the medium.

1. Eye Contact

One of the most effective means of connecting with a person is making eye contact. It directly engages them, and helps an individual in an audience feel accountable, heard, and that their presence matters. It also allows the speaker to gauge the audience's attention and understanding from their body language and facial expression. To recreate this in the virtual context consider the following "hacks":

- **Look into the camera.** Position the camera close to the application window that is showing your audience, or move that window near the camera, so that your audience perceives you as frequently looking directly at them. This also allows you to scan the audience without shifting your eyes away from the camera, and your audience.
- **Turn off Self View.** Some applications display all speakers, including yourself. You may find the motion of an image mirroring your actions particularly distracting. Many platforms allow you to turn off the display of your own image.

2. Engagement

There is a natural ebb and flow to an in-person discussion, which provides openings for participants to express their ideas. The limitations of current technology, not in the least the (sometimes) subtle and inconsistent audio delays between participants, can create cacophony as participants attempt to speak at the same time. Their natural response is to then mute their session, or simply refrain from speaking unless called on. This stilted and fractured environment is not conducive to the meaningful sharing of ideas.

- Advance communication. Especially for infrequent meetings of a strategic nature, such as with an investment committee, connecting in advance of the meeting with members individually or in small groups offers time and space to develop and

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Chinese Assets: Diversification and Return

By Louis Finney
Co-Head of Strategic Asset Allocation Modeling
Investment Solutions
UBS Asset Management

By Max Luo
Director
Investment Solutions
UBS Asset Management

Key takeaways:

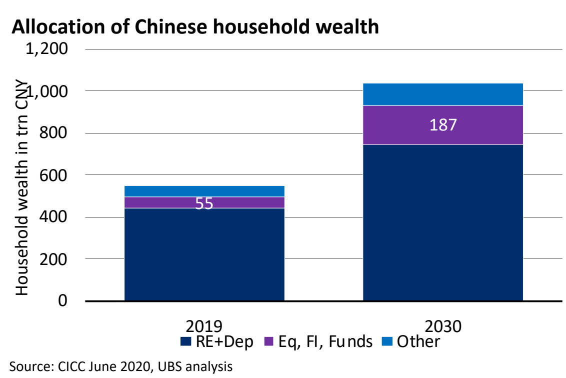
- We expect Chinese stocks and bonds to outperform their developed-market peers in the coming years
- Capital markets in China continue to evolve, helping offset demographic and trade headwinds
- For domestic investors, the demand for publicly traded assets should grow significantly as a growing middle class begins to diversify their wealth
- For global investors, Chinese capital markets offer welcome diversification benefits

Introduction

The demand for Chinese financial assets continues to grow at a rapid pace, bolstered by maturing domestic appetite and liberalized foreign access.

Chinese household wealth rose from about RMB140 trillion (about USD 20 trillion) in 2010 to RMB552 trillion in 2019 (USD 75 trillion), almost doubling in size every five years. During this period, the allocation to real estate and bank deposits dropped 10% (from about 90% to 80%) as the share of publicly-traded assets (bonds, equities, funds) increased from about 3% to 10%[1]. If Chinese households' exposures continue to trend towards their developed-market counterparts, we expect publicly-traded securities to gain by 10 to 20 percentage points as a share of wealth over the next generation.

Fig. 1 Allocation of Chinese household wealth



During the next five years, we expect economic growth in China to be lower than the last 20 years, due to aging demographics and downside risks from ongoing tensions with the US on trade and other issues, as well as a natural convergence downwards towards developed markets as the economy matures.[2]

However, Chinese activity is still expected to be strong relative to the global average, with abundant and distinct opportunities for investment. Domestic equities have a relatively low correlation with their developed-market peers, and benefit from a vast local customer base as well as a government committed to macroeconomic stabilization. Financial deepening that brings China's share of capital markets closer to its standing in the global economy should be accompanied by additional inclusions and higher weightings in important market benchmarks, supporting flows from foreign investors as the process of liberalizing market access continues.

We expect Chinese equities will outperform the MSCI World Index over the next five years, with its sovereign debt also poised to post superior returns compared to G10 nations. Therefore, Chinese securities are attractive to global investors looking to maximize returns. In addition, history shows that these assets provide diversification benefits to an already well-balanced portfolio, a dynamic which we expect to continue over the next five years.

UBS-AM 5-year projections

We forecast Chinese macroeconomic variables and financial market expectations from 2021 through 2025 to avoid short term, pandemic-induced distortions. Five-year expected returns are derived from market pricing as well as our assessment of projected economic factors in conjunction with our valuation models.

Figure 2: Expected 5-yr performance of growth and inflation

Annualized Rmb terms—August 2020	
Economic Growth	4.8%
Inflation	2.5%
Nominal Growth	7.4%

Figure 3: Expected 5-yr equity return

Annualized Rmb terms—August 2020	
Inflation	2.5%
Real earning growth	4.3%
Dividends	2.0%
Valuation	-0.1%
Total return in Rmb	8.9%

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Building and Leading Great Investment Organizations Insights from Britt Harris, CEO & CIO of UTIMCO
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"The best way to be creative is to have order and structure. Creativity requires a platform (process)."

It is deeply important to our unity and effectiveness to adopt at every level and across every person a deep connection to the mission and purpose of our organization. It is our "first principles" and unifies the individual contributions. It also can sort out our differences or allow us to get to agreement on some matters.

Culture & People: Culture is very important and misunderstood. I believe that organizations should have strong, well defined cultures. Lots of people talk about culture, but merely do it at a cursory or cosmetic level. You need to go deep.

Culture includes your collective agreement on your behaviors and priorities. Mission and purpose comes from the organization. Culture comes from the team as it aligns priorities and behaviors with the organization. As CIO, it is my responsibility to frame the environment for investment success, and to build leaders and empower them to carry out their responsibilities. Carrying the culture is a top responsibility for how it defines our work environment.

Culture & People

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Build a culture that suits your organization and make it as extreme as possible. Job candidates will know if they fit with your organization or not. The culture you build is shaped in conversation with the team in place. So at UTIMCO, an already successful organization, from strength, we refined and clarified our UTIMCO values-to do what is **RIGHT**.

- Responsible and accountable
- Integrity
- Great alignment
- High Performance
- Transparent and Open

A team that is deeply engaged and aligned with your shared culture matters because it is a "force multiplier" resulting in a vast increase in team effectiveness.

My metaphor for successful investment organizations is the Viking ship—a symbol of heading off to war and conquests. It is propelled by oars and everyone has an oar. It is critical to the mission for each to know its oar and why it is important. And yes, there are master rowers and they are fully engaged and excellent examples to young rowers. Our success relies on each person pulling in the same direction and in sync. Otherwise you go in circles.

Successful organizations have highly effective PEOPLE, from the leader to the analyst. Individual effectiveness is not accidental. Developing your people

also includes encouraging their effectiveness – learned and practiced skills. As CIO, delegation is one of those critical and practiced skills. Delegation is intentional and interconnected to our culture. At UTIMCO, our deeply held mission and values are the starting point to successful delegation. Expectations of excellence, curiosity and follow through on our critical processes are requirements for delegation. A strong culture makes the team more effective. It is important to hire "A" players – those that are curious and passionate for the work. As far as developing people, analysts and junior team members are gaining mastery – learning their oar and achieving excellence. Even here there is process for developing your team.

SG: Can you elaborate on Process?

TBH: All successful organizations have processes.

People resist process because they think it takes away from their creativity. They think their ideas are pixie dust and they are the only ones to come up with it. But think of piano keys – they are in an order versus on the floor. The best way to be creative is to have order and structure. Creativity requires a platform (process). Having processes provides the advantage of enabling everyone to gain mastery, excel and become more productive. Processes sustain and optimize effectiveness.

If, as an individual, you have a great critical process and don't share it, you are working against the organization. Which gets me back to the absolute importance of having a well-defined mission, values and culture, it creates alignment with the organization. It really starts there.

Beyond systematic and repeatable, Process is transparency. Transparency is the cornerstone of the RIGHT culture at UTIMCO because it builds trust. As an organization, the UTIMCO team knows the work that will be completed, to hire managers or other important work—and that the critical work will be excellently executed. Our processes are our mutual agreement and a statement of best practices. That is trust building and is the foundation of delegation. I've got my oar, the leader of private equity, real assets, risk, etc., they have their oars, and the analysts have their oars. Know your oar and pull in sync.

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"You do not become an amazing giver later on in life, after you achieve success. The discipline is to be generous now."

Above all, an effective organization is also a continuously improving organization. That is another aspect of creativity, creativity within a framework.

SG: Do you have an example of building great investment organizations for us that highlights Mission & Values, Culture, People and Process?

TBH: I will share about UTIMCO's preparations and plans for action during times of trouble. Our collective, deep commitment to our mission and values focuses us on those we serve and why. Our culture and individual character shapes how we behave under stress. 'Peace time' development of people and relationships, trust, excellence and transparency are very necessary and don't get built on choppy seas. Your effectiveness in times of trouble will be shaped by the strength of your critical processes, which can't be formed during periods of stress.

Firstly, create the plan in 'peace time.' My 5 P's come from James Baker, "Prior preparation prevents poor performance." Don't start on the day of crisis. All expansions end and they end badly. When they occur, "Are we still in control?" "Where are the potential points of pressure on the organization?" My process is to engage a multi-asset class team of specialists led by risk management. These are not ideas or talking points, these are contingency plans drafted to describe scenarios and our response. We vet and debate them internally and present them to the Board.

This brings up an element of good leadership that is not often brought up – transparency, truthfulness, building trust. As a leader and as a team, is our word our bond? In times of trouble, trust and transparency elevate effective organizations. It does not mean that everyone knows everything. But it does mean that if it's important, even if difficult, that I will be open with the team.

In times of trouble, a leader's job is to absorb fear and to define reality through transparency about the situation, our challenges and our plans. To the Viking ship metaphor, the leader has to go to the wheel. During the GFC, while at TRS, I needed to be more visible with the team, the Trustees and especially the participants. People expect you to be present, not perfect. I told a group of retired teachers, "This is the worst crisis since the Great Depression and we have lost a lot of money."

Then bring HOPE. We had data on the prior 13 market cycles, and history is a guide. To the teachers I continued, "We will come through this and make it back." Be authentic. People can take the truth. But if you are not speaking to them, they will think the worst. They need to see that the captain cares and is on deck.

Then, bring the Plan. When people are not in action, they are anxious. For example, generals planning the war are not anxious. When the battle plan is delivered and the soldiers are in action, they are not anxious – but the generals are.

Lastly, remember to focus on the solution. In times of trouble, people will focus on the problem (we've lost a lot of money, we have a liquidity crisis…). This is where your 'peace time' contingency plan is put to work. Your scenarios won't be the same, but your mindset as a team are focused on solutions, even new ones as needed.

SG: Britt, giving back and building relationships is central to who you are. Where did that come from and can you tell us about the class you started at Texas A&M, Titans of Investing?

TBH: I was mentored by Bob Buford, a media mogul guy who was big on principles and wrote the book, Half Time. From him and others, I developed a discipline of generosity. You do not become an amazing giver later on in life, after you achieve success. The discipline is to be generous now.

To Bob, significance is the ultimate destination, not success. At half time, a coach can evaluate with his team "what just happened?" "How did we play the first half?" "What do we know now that we didn't know then?" The first half of your career is about success (starting to attain skills, building your reputation, family, etc. You are in BUILD mode.) At half time, whatever that means to you, is the time to focus on SIGNIFICANCE and your second half. Your significance flows from your particular giftedness and avenues of impact.

That's where the class, Titans of Investing, came about. I was in Connecticut and transitioning as CEO of Bridgewater to CIO of the Teacher Retirement System of Texas. I'm an Aggie (Texas A&M) and wanted to do something for the University. I started with "what does A&M not have that is really important?" The students are already technically competent, ambitious, and hard working. No need for more of that. For me, wisdom supersedes all of that excellence. So how do you teach wisdom, in life, as well as, investing? That took a while to figure out. Building people is like an airplane. The left wing is technical, the skills you need to succeed. The right wing is relationships; building the character to use the success you achieve to help others.

My goals for Titans, the students in my class, are to take high performing, highly regarded students and go beyond their motivations and ambitions and teach them the difference between "practice and Game Day." From this hand-picked group of 20, their opportunity (and mandate) is to become lifelong friends. (By the way, 10% of Titans have married another Titan.) Food is a unifying theme for any college student, and I facilitate their relationships by hosting a catered dinner at my home.

The class is "Titans of Investing," so across the real world of investments, they are to build their brand within their network, as well as mine. Reading is central to my beliefs about success, as Charlie Munger has said, "In my whole life, I have known no wise people…who didn't read all the time –none, -zero." So Titans read foundational books on investing, as well as, many of the current books my network of CIOs and investment industry titans are trying to get to. The Titans write briefs on the books and share them with each other and my network. Now that I am also teaching at the University of Texas, at Austin, we are covering about 40 books a semester.

SG: Anything else to add?

TBH: I want to go back to Culture and at UTIMCO

Building and Leading Great Investment Organizations Insights from Britt Harris, CEO & CIO of UTIMCO
[Continued from Page 8]

our pursuit to do what is RIGHT. The "T" stands for transparency and openness. Number 1, we want our people to be curious and not defensive when receiving feedback. To be self-aware and open to areas of improvement, and we give our people the tools to enhance themselves.

Number 2, **"Speak the truth with love."** Breaking it down:

- **Speak:** Contribute to the discussion; feedback is important. (Do you need to learn how to speak up?)
- **Truth:** "story vs. fact" know the difference and be open about if your fact could be a story. Fact checkfullness. Hold yourself accountable for the truth.
- **Love:** Can you share your message with love so that people hear you and feel good about it.

Only Pay For Alpha: A New Quantitative Framework For Manager Evaluation
[Continued from Page 3]

Collective assets in the figure above represent nearly $900 billion of actively managed funds. That said, not all managers show evidence of decreasing alpha over time. The question then, is how to better discern those who have shown the ability to provide desired factor exposures as well as a decent amount of consistent, idiosyncratic alpha.

An Additional Quantitative Framework to Assess Active Managers

The new framework proposed extends upon current quantitative methodologies, tools, and capabilities found at many asset allocators. Though many third-party providers and tools available use holdings-based (or securities-based) data as a starting point to provide a much richer understanding of manager skill, this framework extension will rely for now only on manager return data. This is done for the simple reason that almost all allocators have access to this data, though they may not have the resources or capabilities to analyze holdings-based portfolios. A useful starting point is the Fama-French 5-factor model with:

$$R_{it} = R_f + b_1(R_{Mt} - R_{ft}) + b_2(SMB_t) + b_3 HML_t + a + e_{it}$$

Where:

R_{it} is the return in month t of the portfolio

R_f is the risk free rate

$R_{Mt} - R_{ft}$ is the excess return from a broad market index (i.e. market beta)

SMB_t is the return spread of small minus large stocks (i.e. the size effect)

HML_t is the return spread of cheap minus expensive stocks (i.e. the value effect)

b is the factor weight assigned to each factor time period t

a is alpha

e is the error term, or residual

The outputs from this or other similar models are useful to an extent. For many non-profit allocators managing a portfolio of managers, it can sometimes prove difficult to extend the output from these models to specific manager assessment / hire-or-fire decisions, let alone understanding what the alternative investment option could be on a passive basis.

Extending this model to managers with whom we have historical return data and a good understanding of their investment philosophy, we can then add to existing quantitative assessment frameworks using cheap (and often free!) tools.[1]

Accessible, Low-Cost Tools Are Available for Allocators

A key concern for allocators in implementing this type of quantitative analytical framework is the potential time, cost and effort perceived in doing so. In fact, the cost for some of these tools is often zero. As an example, tools used for the analysis in this article include the coding languages R and Python, both of which are freely available. Other tools, such as MatLab, are similarly useful and not that expensive[2]. Further, coding repositories such as GitHub provide templates (again, free) for the analytical engines that can drive this type of analysis.

The unavoidable cost, though, is the availability of capable analysts who can set up, run, and maintain these types of models in order to provide consistent value in the investment decision making process. As allocators consider the currently available resources in their own offices, one avenue of approach that can prove useful in building or supporting tools like this are local universities. In particular, many new programs have been created that focus specifically on quantitative data analytics or data science. Students from these programs can be a great resource as allocators build out these tools and, separately, can be a potential pipeline to analyst programs.

Specific Examples Highlight the Value of This Analysis

Figure one represents a cross-sample (n=197) of equity managers. Diving deeper into a specific example using this extended framework can be helpful to examine the straightforward utility, analytical value, and potential cost savings available when assessing managers. Doing so can provide asset allocators stronger evidence, for or against, the manager's ability to provide consistent, idiosyncratic alpha over multiple time periods and market regimes.

Below we present the outputs from the analysis of two multi-billion dollar funds, one equity and one fixed

[Continued on Page 10]

Only Pay For Alpha: A New Quantitative Framework For Manager Evaluation
[Continued from Page 9]

income. Using Python, factor models were created to try and ascertain the main drivers of return for each manager[3]. A key goal is to find orthogonal factor model outputs that are useful for analysis. The models were constrained in several ways in order to provide utility to most asset allocators who move assets among managers and are usually prohibited from taking direct leverage. First, the factor inputs represent investible indices that have direct, low-cost corollaries[4] in the market. This is done so as to provide the most direct answer to two specific questions: is the manager providing consistent, idiosyncratic alpha over time and if not, what are the alternative, investible ways in which we could replicate the manager's exposure? Second, specific factor exposures were constrained such that they sum to zero. This reflects the inability of most allocators to take excessive or, in many cases, any direct portfolio leverage.

The first example is insightful as it represents the output of model returns versus a large-cap U.S. equity manager with a long track record and a strong reputation in the marketplace. Knowing the general investment philosophy and process for this manager, we can zero in on prospective factors in a fashion similar to below:

Rit = Rf + b1(U.S. Equity Exposure) + b2(Small or Large-Cap U.S. Equity Exposure) + b3(World Equities) + eit

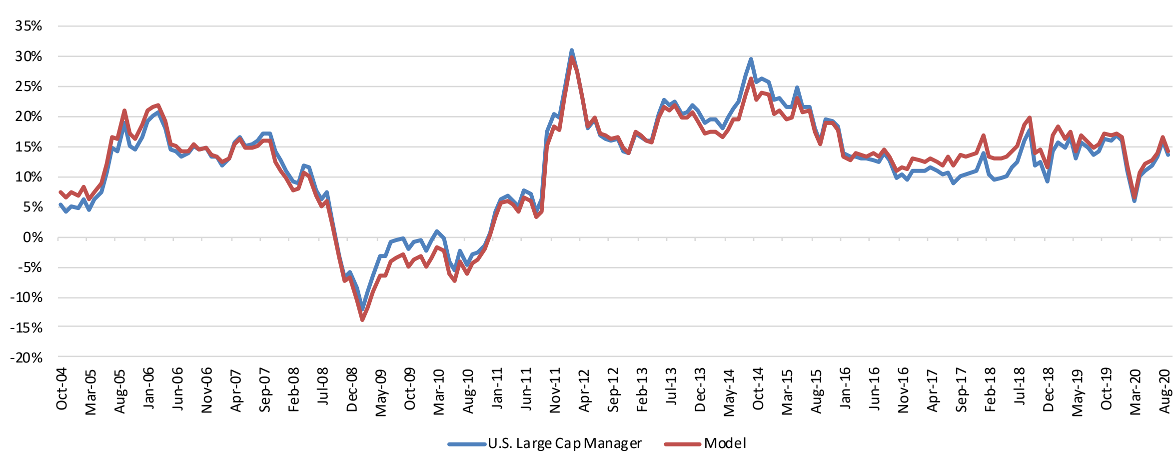
The above is only a *stylized* example and not necessarily indicative of the actual factor model used in the output below. It's important to note that the sample model above does *not* include alpha, as it would represent a passive implementation of the active managers' volatility and return outcomes. An important issue to consider as well: inception to present factor models can provide misleading outputs as a given managers' investment style and ability to provide positive alpha can change over time. Instead, it is critical to assess these models, factors, and alpha over rolling time periods, as that will provide better insight as to the managers' ability to provide consistent alpha. Critically, then, assessing a manager on their ability to provide *since-inception* alpha—and understanding their factor exposures—is not as useful as understanding the manager's ability to *consistently* provide positive alpha.

The below model outputs provide similar volatility and return characteristics of the sample equity and fixed income managers, though with much lower cost and implementation effort. For allocators looking to assess their current active managers, such analysis can provide insight as to which managers are providing true alpha versus those that are providing expensive beta.

Question for allocators given the above output:

- Is the time and effort required to properly perform the necessary investment and operational due diligence, as well as the ongoing monitoring,

Figure 2 U.S. High Yield Manager vs. Model

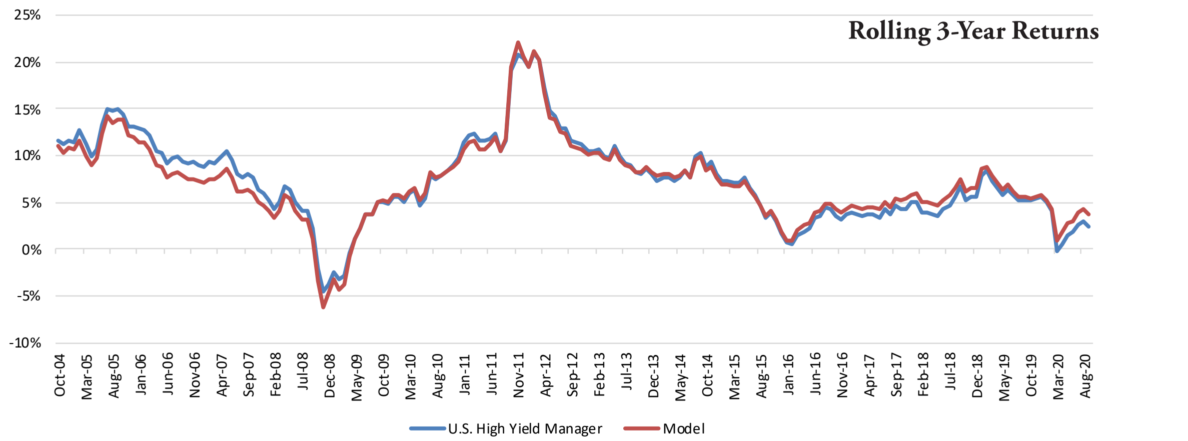


Fund and Model Characteristics

	U.S. High Yield Manager	Model
AUM:	>$10 billion	
Management fee[5]:	2%	0.03%
Incentive fee[5]:	20%	0.00%
Lockup:	1 Year	N/A
Redemption Periods	Quarterly	Daily
3 Year Return	15.8%	16.5%
5 Year Return	14.9%	16.5%
10 Year Return	17.2%	17.7%
Volatility:	15.3%	15.1%
Sharpe Ratio:	0.65	0.67
Sortino Ratio:	0.96	0.99

[Continued from Page 10]

Figure 3 U.S. High Yield Manager vs. Model



Fund and Model Characteristics

	U.S. High Yield Manager	Model
AUM:	>$10 billion	
Management fee[6]:	0.99%	0.40%
Incentive fee[6]:	0.00%	0.00%
Lockup:	N/A	N/A
Redemption Periods	Daily	Daily
3 Year Return	2.44%	3.76%
5 Year Return	4.95%	6.07%
10 Year Return	5.24%	5.84%
Volatility:	8.05%	7.95%
Sharpe Ratio:	0.71	0.72
Sortino Ratio:	0.99	1.03

worth it for a manager whose returns can be so easily replicated with low-cost passive investments?

- What internal resources and capabilities would be required to implement such a model portfolio?
- If the resources or desire to implement such a model are not available, is the above analysis still useful in the investment decision making process when evaluating managers?
- For which managers would the above type of analytical framework not be useful?

Conclusion

After asset allocation, choosing managers that are appropriate and can add value is one of the most important skills that institutional allocators can have. Central to great outcomes in manager selection are strong experience in qualitatively assessing investment managers. Just as important, expanding the quantitative tool-kit, especially in a low-cost way, can give institutional allocators an edge over their benchmark. Doing so can help towards the ultimate goal of preserving and growing assets for the ongoing and continued use of the institution's beneficiaries. The new framework presented here will hopefully prove useful for allocators looking to better assess the alpha that managers say they provide.

Managers providing expensive beta or deteriorating alpha need to be recognized as such. Alpha is hard to find and, when found, should be valued.

Disclaimer: This article solely represents the opinions of the author and not the opinions or policies of the Cleveland Clinic Foundation or the Cleveland Clinic Investment Office.

1. The programming languages R and Python and necessary libraries to fully realize their value are free to all users
2. An annual license for MatLab is $860, whereas a perpetual license is $2,150.
3. The lasso function in Python is particularly useful as it helps to quickly deduce which factors provide insight vs. noise.
4. Thus we exclude from here some of the traditional Fama-French factors such as size, value, momentum, etc.
5. Management fee for model fund implementation represents assumed composite fee based on the investible fund equivalents.
6. Management fee for model fund implementation represents assumed composite fee based on the investible fund equivalents.

Exploring and Supporting the Diverse Manager Landscape

[Continued from Page 4]

Ulu Ventures	Private	Venture Capital	Seed-stage; actively seeks diverse & wom	YES	Woman; Hispanic American/I	Miriam Rivera, Clint Korver
Valmo Ventures	Private	Venture Capital		YES	Woman; African American	Valerie Mosley
VamosVentures	Private	Venture Capital	Early-stage tech, impact	YES	Hispanic American/Latinx	Marcos C. Gonzalez
Wing	Private	Venture Capital	Enterprise Tech		Woman; Minority	Sara Choi, Gaurav Garg
WOCstar Fund	Private	Venture Capital	Early-stage, Women of Color	YES	Woman; African American	Gayle Jennings O'Byrne
WomensVCFund	Private	Venture Capital	Series A/B, Enterprise SaaS/Consumer Int	YES	Woman	Edith Dorsen
Zeal Capital	Private	Venture Capital			African American	Nasir Qadree
Zetta Venture Partners	Private	Venture Capital			Woman	Jocelyn Goldfein
DigitalDx Ventures	Private	Venture/Growth	Healthcare & AI		Woman	Michele Colucci
Fenwick Partners	Private	Venture/Growth	Consumer brands		Woman	Melissa Baker, Elizabeth Stewart
Goldman Sachs Launch Fund	Private	Venture/Growth		YES	Woman	Jemma Wolfe
Pacific Community	Private	Venture/Growth	West Coast U.S.	YES	Woman; Diverse Team	Bulbul Gupta
Parker Global Strategies	Public	Energy	MLP		Woman	Virginia Parker
Bluebay Asset Management	Public	Fixed Income			Woman	Polina Kurdyavko
New Century	Public	Fixed Income	Inflation-linked securities		Woman	Ellen Safir
Payden & Rygel	Public	Fixed Income			Woman	Joan Payden
Quadratic Capital	Public	Fixed Income	Interest Rate Vol and Inflation Hedge ETF (IVOL)		Woman	Nancy Davis
Semper Capital Management LP	Public	Fixed Income	Structured Products		African American	Greg Parsons
Academy Investment Management	Public	Hedge Fund	Statistical Arbitrage		Woman; Asian American	Ellen Wang
Addend Capital Management	Public	Hedge Fund	L/S Equity; Market Neutral; TMT		African American	Jethro Townsend
Advent Capital Management	Public	Hedge Fund	Convertible Arbitrage		African American; Diverse Te	Tracy Maitland
AHL Partners	Public	Hedge Fund	Macro - CTA / Managed Futures		Woman	Giuliana Bordigoni, Matthew Sargaison
Alba Capital	Public	Hedge Fund	L/S Equity; Consumer		Woman	Laura Cheng
Ally Bridge Group	Public	Hedge Fund	L/S Equity		Woman	Anna Yaeger
Alpine Peaks Capital	Public	Hedge Fund	L/S Equity; Corporate Social Responsibility		Woman	Jennifer Ralph Oppold
Altum	Public	Hedge Fund	Credit Opportunities; Structured Credit		Woman	Marjorie Hogan
Alua Capital Management	Public	Hedge Fund			Hispanic American/Latinx	Marco Tablada

As enthusiasm around DEI has gained momentum in recent months, there is a growing network of endowment and foundation investment professionals, in the U.S. and internationally, who are collaborating to address the challenges of defining, measuring, and prioritizing these attributes. Initiatives are underway to create a standardized DEI survey for investment managers, and industry organizations including NACUBO are working with a group of endowment CIOs to formulate a set of DEI principles that endowments can adopt. Following an innovative suggestion from Harisha Haigh at Northwestern, the University of Rochester hosted a "pitch session" in early December to introduce select women- and minority-led venture firms to a group of endowment and foundation LPs.[5] This event was well-attended, and planning for additional sessions focusing on managers in other asset classes is already underway. Sessions will also be held to discuss topics such as best practices for communicating with Investment Committees about DEI, and a Slack channel is being developed to facilitate discussions on related topics. Please contact us with any interest in these initiatives, or others you may be working on that we could join. We look forward to continuing momentum in this area, with positive social change and enhanced alpha generation to follow.

1. For an executive report on the study, see Josh Lerner and Bella Research Group, "Diversifying Investments: A Study of Ownership Diversity and Performance in the Asset Management Industry," Knight Foundation (January 2019).
2. Sarah Lyons-Padilla, et al., "Race Influences Professional Investors' Financial Judgments," Proceedings of the National Academy of Sciences 116, no. 35 (August 2019), https://doi.org/10.1073/pnas.1822052116
3. We recognize the insights and advice provided by contributors such as Ana Marshall of the Hewlett Foundation (in this issue), John Hall of the Mellon Foundation, Bhakti Mirchandani and Sophia Tsai of Trinity Church, Michael Billings of Vanderbilt, Elise McDonald of Harvard, and the teams at the Kellogg Foundation and Robert Wood Johnson Foundation, University of Chicago, Cambridge Associates, and many others.
4. Updating our list will be a continual process, with input from peers and other market participants, as well as industry sources such as the recently-published Diverse Manager Directory from Financial Investment News.
5. We do not mean to assert that this was our original idea; for example, as noted in their article referenced above, the Carnegie Corporation used to hold similar sessions.

Zoom to the Point: Effective Group Communication in the Post-COVID Workplace

[Continued from Page 5]

articulate a perspective, and potentially share it with you in advance. This becomes particularly helpful when the meeting medium makes this less likely on-the-fly.

- **Audience participation.** Adding "questions and answer" sessions after "presentation" sections of a meeting creates a space for participants to engage and voice their opinions.
- **Personalize the discussion.** Where feasible, pre-arrange for a question or observation from an individual participant. This initiates a more personalized engagement in the group and helps start the discussion.
- **Limit screen sharing.** While there may be situations where group viewing of a document is essential, dominating the screen with a document disconnects you from your audience, and them from each other. Where possible, send the document in advance so that they have it at hand for reference. (This also addresses potential technical glitches.) Keep in mind that some participants are joining from small phone or laptop screens that do not allow viewing a document simultaneously with the meeting participants, so it may be worthwhile providing a separate shorter document that they can print ahead of time.

3. **Distractibility.**

"Thank you for all taking the time to be here today. We will start our discussion with...JOEY, THAT IS NOT A TOY! PUT THAT AWAY! DADDY IS IN AN IMPORTANT MEETING! I'm sorry about that,where was I?"

Working from home has its benefits as well as its distractions.

- **Create your environment—**Find the quietest spot possible to conduct your meeting, carve out a clean, focused, and uncluttered space.
- **Norms of behavior.** Verbalize the norms of behavior that you and your audience will abide with -- video on, no cell phone use, etc. Make a commitment to be present.
- **Minimize distraction.** Turn off your phone (and if enabled, ring-from-computer), email notifications (visual and auditory), perhaps

Zoom to the Point: Effective Group Communication in the Post-COVID Workplace

[Continued from Page 12]

even turning email offline or closing the app.

- Inform individuals around you of the importance of quiet time
- Place a "do not disturb / meeting in progress" sign on the door
- When all else fails, be flexible and understanding in working with the constraints that both you and your audience are operating under.

4. Screen Fatigue

Headaches, eye strain, and depleted energy are just some of the many symptoms that one can experience after staring at a computer screen for hours on end. While digital communication platforms have enabled us to "see" each other, it comes at a higher physical and emotional cost than in-person interactions.

To counteract "screen fatigue":

- Keep it Brief. Keep meetings short, structured, and efficient. The more preparation you do beforehand, the better they will flow.
- Break it Up. For longer meetings, make sure there are scheduled breaks with clearly defined time frames.
- Pick up the Phone. Just because we can use videoconferencing doesn't mean we always should. Don't dismiss the value of the old-fashioned phone call, especially when you find yourself exhausted from back-to-back meetings in the digital sphere.

5. Technical glitches

As with all technologies, things can and will go wrong. Plan a backup: extra devices, additional platforms to conduct your meeting on, etc. Then plan a backup to the backup. And when even the best laid plans go awry, roll with the punches! Laugh at that which is beyond your control. Patience, grace, and a sense of humor are invaluable leadership skills as we collectively navigate this new terrain.

And finally, if you absolutely must use the bathroom, deal with a crisis, or yell at a neighbor, please please please remember to triple check that you have muted your meeting audio and video. We all have enough to worry about these days without cringing at your (hopefully first, and only) viral video.

The author is indebted to the contributions of the many colleagues with whom he has discussed this topic over the past months, and in particular to Jessica Schechter, an executive coach, professional public speaker, educator at the collegiate level in the art of public speaking, and, more recently, his wife.

Chinese Assets: Diversification and Return

[Continued from Page 6]

Our current projections call for 4.8% real GDP growth in China over the next five years, and some of this growth may be front-loaded due to the rebound from the pandemic. We expect consumer based-inflation to be 2.5% annually over the next five years with strong short-term disinflationary pressures initially. These combine to produce a nominal growth rate of 7.4%.

Recent gains in the market over the last few months now have equities closer to fair value, resulting in no multiple expansion in our base case scenario. We expect earnings growth to fall short of nominal growth by about 0.5 percentage points, which equates to nominal earnings growth around 6.8%. Dividends are expected to stay around their current level of 2%.

The commitment of the Peoples Bank of China (PBoC) to a relatively stable currency means that there is a bit less uncertainty to the intermediate term movement of the renminbi. When we look at the returns in other currencies, we view the CNY (Chinese Yuan Renminbi) as very near fair value (again short-term views are different), so we see a near direct pass through of the total expected RMB 5-year equity returns of 8.9% into USD terms. We expect the renminbi to depreciate relative to the Euro, but appreciate relative to the CHF, but even after these currency effects the returns for Chinese equities are higher than the local equity markets.

We expect the current differentials in short rates to continue for the next few years. Thus, hedging costs reduce the attractive 8.9% equity return by 1.7 to 2.8 percentage points. As for fixed income and cash, current yields are always the starting point for expected returns. We expect cash rates in China to be quite low—around 1.5% to 2.0% for the next few years, with more downside risk than upside. These are well above rates in other developed markets.

We have a similar expectation for the Chinese 10-year bond yield: it should hover around these levels for the next few years, generating a return of 2.9%. The Chinese 10-year bond is expected to post superior performance compared to similar-dated debt in developed markets.

For example, consider the US 10-year bond, which had a starting yield of 0.5% at the end of July. That starting yield coupled with a rising interest rate environment produces an expected return over the next five years of -1.6%, but a hedged Chinese 10-year government bond should earn 1.2% (a 2.8% percentage point differential). Similarly, for a Eurozone investor investing in the 10-year German bund, this expected premium from investing in Chinese bonds grows larger, estimated at -2.6% over this period.
Source: CICC June 2020, UBS analysis

[Continued on Page 14]

Chinese Assets: Diversification and Return
[Continued from Page 13]

Figure 4: UBS-AM 5-year projections—August 2020

	In CNY Terms			In USD Terms		
Asset Class	Geometric Return	Standard Deviation	Sharpe Ratio	Geometric Return	Standard Deviation	Sharpe Ratio
Cash [1]	2.0%	1.3%	0.00	0.3%	1.3%	0.00
China 10-yr Gov	2.9%	5.9%	0.25	1.2%	5.9%	0.18
China Gov Bonds	3.0%	4.6%	0.31	1.2%	4.6%	0.23
China Policy Bank Bonds	3.3%	4.2%	0.41	1.5%	2.7%	0.50
China Corporate Bonds	3.4%	4.7%	0.38	1.7%	4.7%	0.32
China Aggregrate Bonds	3.1%	4.6%	0.35	1.4%	4.6%	0.27
Chinese Equities	8.9%	21.5%	0.45	8.9%	22.9%	0.50
Global Equities	7.8%	16.7%	0.42	7.2%	16.0%	0.50
Inflation	2.5%			1.4%		

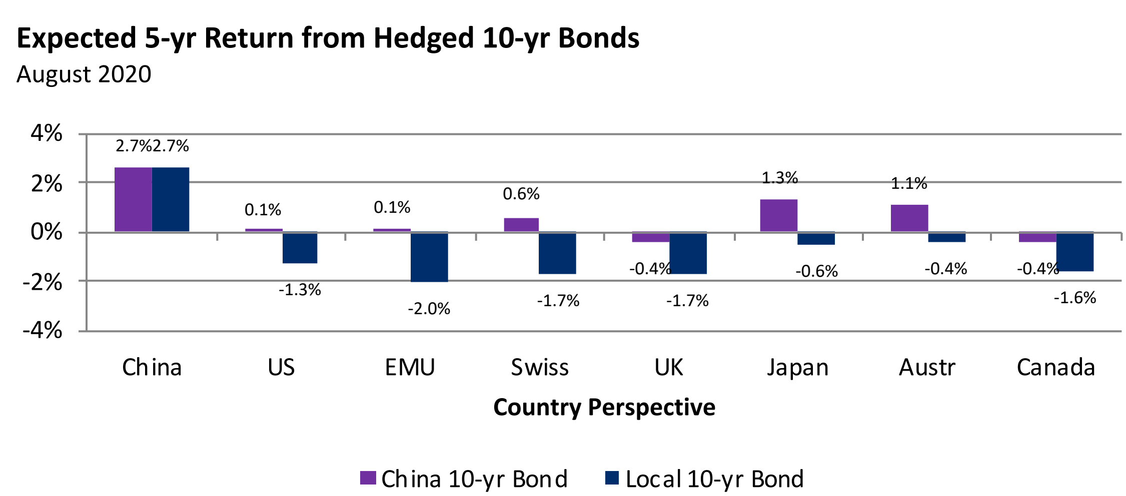
[1] 1-month Treasury bills. Notes: Fixed income in USD terms are hedged. Chinese equities in USD terms are unhedged. Global equities are unhedged in both CNY and USD terms. Note: These estimates are UBS Asset Management's forward looking estimates of local equity market returns and currency impacts. Proxies for the local markets are can be represented by the MSCI series with China-A shares, S&P 500 for the US, MSCI EMU for the Euro, and MSCI Switzerland for the CHF indices.

Figure 5: 5-yr Chinese equity returns and currency perspectives

	Currency Perspectives			
Annualized RMB Terms	CNY	USD	EUR	CHF
China Equity Local	8.9%	8.9%	8.9%	8.9%
Local Market Return	8.9%	5.9%	8.1%	7.2%
Unhedged Currency Impact		0.0%	-0.7%	0.4%
Total Return Unhedged		0.0%	8.2%	9.3%
Hedged Currency Impact		-1.7%	-2.6%	-2.8%
Total Return Hedged		7.2%	6.3%	6.1%

Note: These estimates are UBS Asset Management's forward looking estimates of local equity market returns and currency impacts. Proxies for the local markets are can be represented by the MSCI series with China-A shares, S&P 500 for the US, MSCI EMU for the Euro, and MSCI Switzerland for the CHF indices.

Figure 6: Expected 5-yr return from hedged 10-yr bonds—August 2020



Source: UBS Asset Management, August 2020

[Continued from Page 14]

Figure 7: Measuring diversification benefits for global investors

	Initial Allocation	Move 5% into a 50/50 Chinese portfolio			
	60/40	A	B	C	D
MSCI China NR USD	0.0%	2.5%	0.0%	0.0%	0.0%
MSCI China All Shares NR USD	0.0%	0.0%	2.5%	0.0%	0.0%
MSCI China A NR USD	0.0%	0.0%	0.0%	2.5%	0.0%
MSCI China H NR USD	0.0%	0.0%	0.0%	0.0%	2.5%
S&P 500 TR USD	30.0%	30.0%	30.0%	30.0%	30.0%
BBgBarc US Agg Bond TR USD	40.0%	37.5%	37.5%	37.5%	37.5%
BBgBarc China Aggregate TR Hedged	0.0%	2.5%	2.5%	2.5%	2.5%
FTSE Treasury Bill 1 Mon USD	0.0%	0.0%	0.0%	0.0%	0.0%
MSCI EAFE NR USD	20.0%	18.0%	18.0%	18.0%	18.0%
MSCI EM ex China NR USD	10.0%	9.5%	9.5%	9.5%	9.5%
Total	100.0%	100.0%	100.0%	100.0%	100.0%
Total Equity	60.0%	60.0%	60.0%	60.0%	60.0%
Total FI and Cash	40.0%	40.0%	40.0%	40.0%	40.0%
Total Intl Eq	30.0%	30.0%	30.0%	30.0%	30.0%
Total China Eq	0.0%	2.5%	2.5%	2.5%	2.5%
China FI	0.0%	2.5%	2.5%	2.5%	2.5%
Total China	0.0%	5.0%	5.0%	5.0%	5.0%
5-yr Statistics					
Geometric Return	6.38	6.54	6.45	6.39	6.31
Arithmetic Return	6.59	6.74	6.66	6.61	6.53
Standard Deviation	8.81	8.83	8.83	8.83	8.78
Sharpe Ratio	0.625	0.641	0.632	0.625	0.620
10-yr Statistics					
Geometric Return	7.15	7.20	7.20	7.23	7.08
Arithmetic Return	7.27	7.32	7.31	7.33	7.20
Standard Deviation	8.29	8.30	8.27	8.21	8.29
Sharpe Ratio	0.809	0.815	0.817	0.825	0.800

Volatility, correlations, and liquidity

Equity volatility has declined from elevated levels from 2013 through 2015. Currently, we expect volatility to continue to be in the low 20% area, but would not be surprised to see it decline into the high teens.

The stock-bond correlation in China has been unstable over the past decade. In the early part of the 2010s, it was positive, but subsequently declined and has been slightly negative over the last five years (-0.11 for CSI 300 versus ChinaBond Treasuries). We model the stock-bond correlation to be slightly above zero, matching the experience since 2013 (0.09 correlation. However, if inflation remains low, we would not be surprised to see a continued negative stock-bond correlation, providing an important tailwind for balanced investors.

Our projections for above-average performance in Chinese equities and fixed income provide a compelling case to add or increase exposure to these securities to increase returns. Importantly, history has shown that even when Chinese financial assets have underperformed, there are diversification benefits from including them in the portfolio as well – a difficult achievement when making additions to an already well-balanced set of holdings.

Chinese equities lagged their developed and emerging market peers over the past five years, but the introduction of Chinese stocks and fixed income to a diversified global portfolio denominated in US dollars tended to produce incremental improvements in the Sharpe ratio during this period.

Applying a similar analysis to our five-year return projections, we find a similar enhancement in diversification and risk reduction on a forward looking basis for USD investors.

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Chinese Assets: Diversification and Return
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Figure 8: Diversification benefits from USD perspective -60/40 Portfolio

	Starting Portfolio	Add 5% to Chinese Assets
Developed Market Equites	55.0%	55.0%
Emerging Markets x China Unh	5.0%	2.5%
China Eq Unh	0.0%	2.5%
Global Aggregate Hedged	40.0%	37.5%
China Aggregate Hedged	0.0%	2.5%
Total	100.0%	100.0%
5-Year Expected Return	4.2%	4.3%
Standard Deviation	10.3%	10.2%
Sharpe Ratio	0.43	0.44%

Conclusion

Our expected returns for the next five years for Chinese equities are generally higher than for other global markets, but along with the higher return comes higher risk. The fixed income markets add another dimension—current yields are meaningfully more attractive than other markets, and the growing corporate bond market in both CNY and USD terms offers another vehicle to increase exposures to the country. We expect demand for Chinese assets to be strong domestically, with an additional steady flow of funds from abroad as new equity and bond markets evolve.

We have always maintained that China is distinct and unique. It is neither a typical emerging market nor one completely in synch with other developed nations. The economy is huge and has tremendous technological and manufacturing expertise. These phenomena help foster a suite of relatively uncorrelated financial assets that will continue to offer diversification benefits to investors.

1. CICC, "When Chinese families begin to own more financial assets", Thematic Strategy report, June 2020
2. See Mankiw, N Gregory; Romer, David; and Weil, David, "A Contribution to the Empirics of Economic Growth", Quarterly Journal of Economics, , 407-437, May 1992

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Sitting from Left to Right: Meghan Cuddihy, *Vice president, Investor Relations, Merit Energy Company;* Teresa Sanacore, *Membership & Client Development Manager, NMS Management, Inc.;* Laura Figlina, *Stahl, Director, BlackRock, Inc.*

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NMS
MANAGEMENT

NMS MANAGEMENT, INC.
68 S. Service Road, Suite 100
Melville, NY 11747
tel 516-933-3700

www.nmsmanagement.com