The OCIO Revolution

A 15-Year Retrospective

GLOBAL ENDOWMENT MANAGEMENT

The year 2022 marks our firm's 15-year anniversary. Over that time, we've grown our organization, executed our investment process, and served as a steady partner to our clients. We've navigated the worst recession since the Great Depression, a series of rolling European debt crises, the crashing end of a commodity super-cycle, a pandemic, a shutdown of the global economy by fiat, and the stimulus-fueled recovery and overheating that followed. The Outsourced Chief Investment Office (OCIO) model that we employ – built on clear governance and superior investing – has evolved to meet those challenges and others. The occasion warrants some reflections on the historical arc of the industry, and what it means as institutions – and OCIOs – plan for an uncertain future.

Key Takeaways

The OCIO landscape is completely transformed.

The outsourced investment model has exploded in popularity in the last 15 years. Industry assets globally swelled from just $100 billion in 2007 to roughly $2.5 trillion today.[1] Competitors of all shapes and sizes, with a range of models, serving distinct client types, have all jumped in with two feet. It is a veritable zoo, and it renders the job of an institutional trustee parsing options exceedingly difficult.

The market regime shifted dramatically…and may be shifting again.

The prevailing market environment since the Global Financial Crisis (GFC) has been benign, characterized by low volatility, low growth, and low interest rates, but high realized returns on conventional assets. That environment flattered many different types of portfolios, particularly those leaning into stock market risk over balance and diversification. As policy and economic winds shift, the pressure on OCIOs to generate superior risk-adjusted returns will increase.

The attributes of successful investment offices haven't changed.

Successful long-term investing is about process over outcomes. Features such as a high-integrity and experienced team, aligned incentives, and focused and disciplined decision-making, remain hallmarks of the world's extraordinary investment offices. We believe OCIOs that can nurture a culture rewarding those and other attributes have the best chance of sustained success.

More than ever, clients need a partner not a vendor.

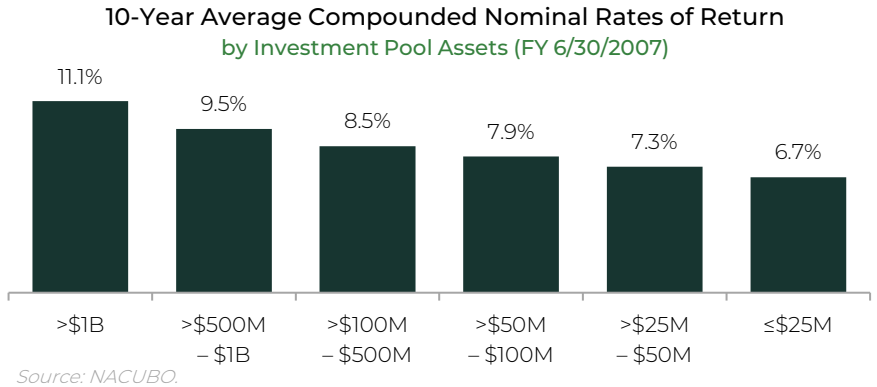
Another hallmark of extraordinary investment offices is that they were built to serve their institution. An investment program's optimal structure, policy, strategy, and tactics are always born from clear goals and a strategic vision. Today, serving as an extension of an institution's leadership team means integrating fully with the enterprise, customizing to specific objectives and constraints, and delivering holistic partnership. All client types are facing idiosyncratic challenges, and OCIOs must partner seamlessly to support the institution and its mission.

[1] Cerulli Associates.

Come One, Come All

An early entrant into the OCIO industry, Global Endowment Management (GEM) was founded in 2007 with a vision to be a preeminent investment office. Our mission was (and is) to deliver to clients the governance model and investment access of a preeminent university endowment. We also sought to nurture a boutique client-partner experience that functioned just like an in-house investment team would, because it's the approach we knew and one our founders employed successfully at Duke University and the Duke Endowment.

The premise at the time – corroborated by data – was that large endowments had distinct advantages in deploying pools of long-term capital that led to sustained outperformance. Institutions like smaller endowments and foundations, family offices, and other long-term investors that lacked the resources to hire their own internal investment teams could capture the benefits of scale by outsourcing investment decision-making to a specialized firm.



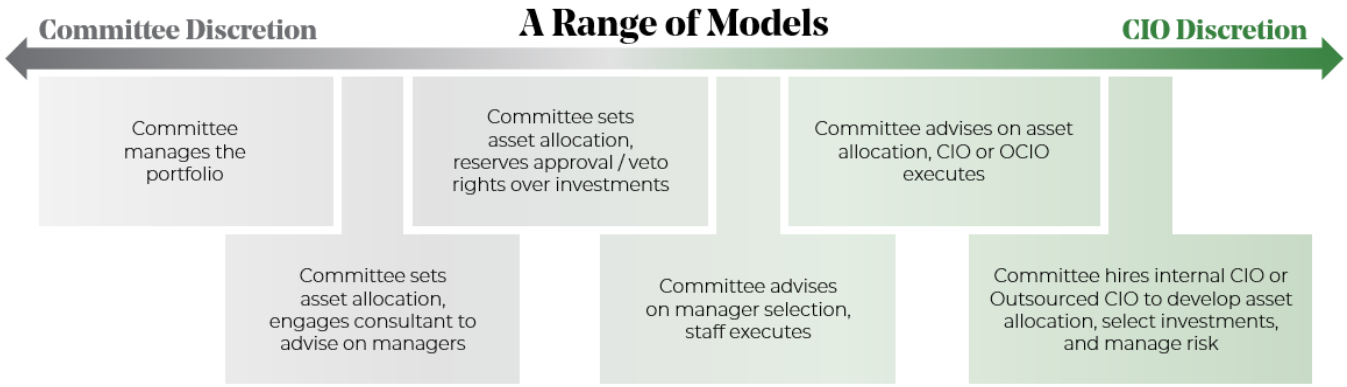
> The premise at the time was that **large endowments had distinct advantages that led to sustained outperformance.**

In 2007 it was still the early days of the OCIO model – the moniker hardly existed. Surely there were firms investing multi-asset portfolios – and some now claim to have "pioneered" the OCIO concept – but the pure model as we know it today, with clear lines of discretion and open architecture investment management, was not yet widely adopted. In GEM's early days, many institutional trustees and investment committees – those charged with overseeing an institution's financial resources – wondered aloud whether delegating an investment program to an outside party was consistent with fiduciary standards. The industry globally stewarded only $100 billion of assets.

Propelled by the hard lessons many investment committees learned through the harrowing Global Financial Crisis, the model exploded in popularity in the early 2010s. Many investment committees recognized that that world had become too complex, and risk management too critical, to leave decisions to a collection of volunteers meeting quarterly, even with the support of an investment consultant. It wasn't necessarily that committees made bad decisions during the GFC (although some did). It was that the strictures of committee governance were not adequate to deal with the dynamism of markets, or to keep up with the arms race for better manager access. Trustees "should govern; not manage," an industry association wrote, elevating their oversight of the investment program to focus on policy and strategy.[2] It slowly became conventional wisdom that just as an institution hires a CFO and finance team, and an advancement team to raise money, and a program team to engage in philanthropy, it could, and perhaps should, hire a dedicated investment team to drive results.

[2] Greenwich Roundtable, 2016.

Since then, the money management industry has done what the money management industry typically does – taken a good idea and contorted it to fit off-label use cases. Like the menu at a Cheesecake Factory, there's now an endless array of choices. Full discretion. Partial discretion. Narrow implementation in specific asset classes. Committee approval rights for manager decisions. Portfolios stuffed with proprietary products. Active. Passive. Custom. Turnkey. Et cetera.



Source: Greenwich Roundtable, GEM analysis.

Banks, traditional asset managers, consulting firms, multi-family offices, and dozens of boutiques all saw the industry tailwinds and got into the act, some with hundreds of millions under management, some with hundreds of billions. According to Charles Skorina, an industry observer and executive search consultant, 103 OCIO firms operate today. And in assets stewarded, the industry is now 25-times larger than when we started, at $2.5 trillion.[3]

Trustees diagnosing what they need and what's best for their institution face a paradox of choice today: how to compare and contrast firms? How to evaluate evolving results? How to prioritize what the institution needs? Our view is unchanged that successful OCIO engagements are primarily about good governance. An independent, dedicated team with discretion to make investment decisions and manage risk within the guidelines of a clear investment policy is still the best expression of that early OCIO spirit.

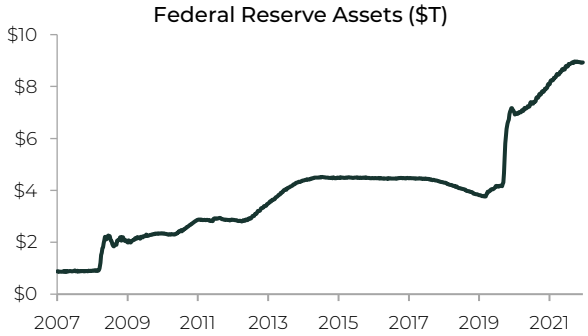
Successful OCIO engagements are primarily about good governance.

[3] Cerulli Associates.

Shifting Market Winds

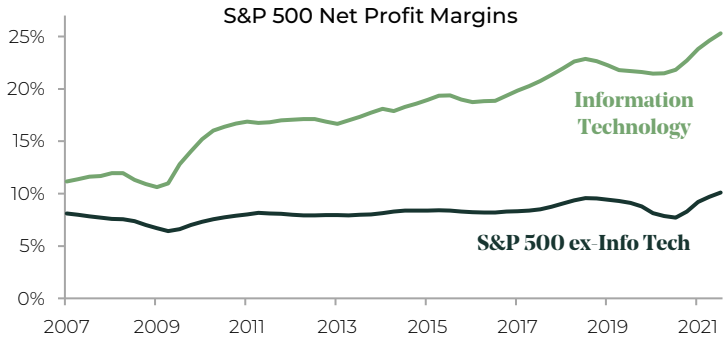
For much of the last 15 years, the market environment has been benign, characterized by low volatility, low inflation, low interest rates – "low everything," wrote Antti Ilmanen from AQR, "except realized investment returns."[4] Practically any investment strategy with a healthy dose of market beta has had the wind at its back. According to asset management writer and consultant Larry Siegel, even a passive mix of stocks and bonds since the GFC has been like "racing against Secretariat."[5] What happened?

For one, the Federal Reserve changed the game. As the Great Depression set in motion events that led to the creation of the FDIC and other institutions, the GFC set in motion events that changed the role of monetary policy. Those monetary innovations – "policy tools" like lending facilities, purchase programs, negative yields, yield curve control, and others, were not all novel, but their enthusiastic use outside of wartime surely was. Moreover, they suppressed the central pricing mechanism for capital markets, which lifted valuations. The Fed's balance sheet ballooned by roughly 10x since 2007 – from $860 billion to nearly $9 trillion – and that quantitative easing drove discount rates down and asset prices up.[6]



Source: Federal Reserve Economic Data.

In addition to rising valuations, we've seen extraordinary corporate profitability, especially in the technology sector. Tech-enabled businesses have grown to comprise roughly 50% of the stock market, and many are remarkable franchises: monopolistic platforms with high free cash flow, margins, returns on equity, pricing power, and growth runway that provide much of the internet's infrastructure. They've been able to achieve spectacular scale at incredible speed because of their digital reach. Over 15 years their rise has transformed the roster of the world's largest ten companies by market cap.



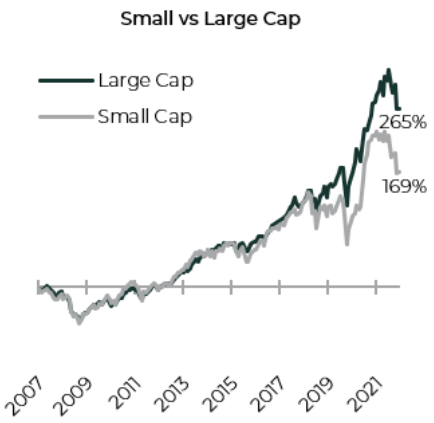
Source: Goldman Sachs.

Largest 10 Companies by Market Cap	
2007	2022
Exxon	Apple
GE	Aramco
Gazprom	Microsoft
Microsoft	Alphabet
citi	amazon
Bank of America	Tesla
Shell	Berkshire Hathaway
bp	Meta
PetroChina	tsmc
HSBC	Johnson & Johnson

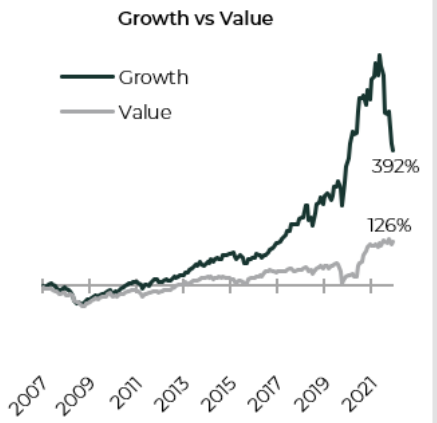
Source: Bloomberg.

[4] Ilmanen, Antti. Investing Amid Low Expected Returns. 2022.
[5] Siegel, Laurence. Don't Give Up the Ship: The Future of the Endowment Model. The Journal of Portfolio Management. Volume 47, Issue 5. February 2021.
[6] Federal Reserve Economic Data. St. Louis Fed.

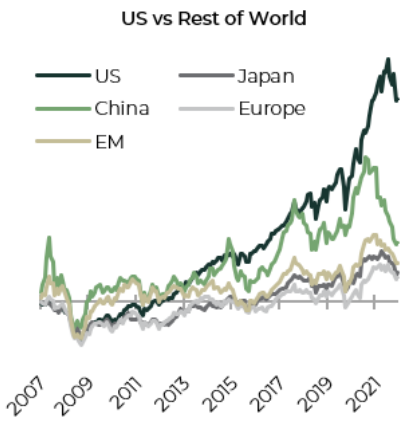
At the same time, tech's rise broke certain concepts that were considered conventional wisdom in finance for decades. Profit margins – what money manager GMO has called the most reliably mean-reverting series in finance – climbed inexorably. Certain exploitable risk premia with empirical support either reversed or disappeared altogether, e.g., small-cap stocks outperforming large, traditional conceptions of value outperforming growth, etc. Global diversification failed too as US stocks dominated foreign stocks.



Source: Bloomberg. Small Cap is Russell 2000; Large Cap is Russell 1000.



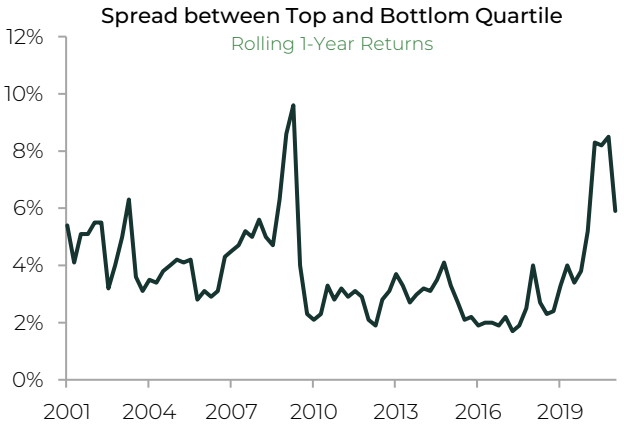
Source: Bloomberg. Growth is Russell 1000 Pure Growth Index; Value is Russell 1000 Pure Value Index.



Source: Bloomberg. US is S&P 500; Japan, China, Europe, and EM are MSCI indices for relevant market.

Even the vaunted "illiquidity premium" (which was probably always a mirage) underperformed expectations. Although the average college endowment nearly tripled its allocation to private assets over the last 15 years (from 8.8% to 23.2%),[7] the US buyout market over that time outperformed the S&P by roughly 1% per annum. That hardly seems sufficient compensation for the illiquidity incurred. There's still plenty of dispersion among private managers – roughly 20% over the last decade between top and bottom quartile managers – and that makes it a fertile hunting ground for skilled teams with access advantages.[8] But there's been no prize simply for bearing illiquidity.

Despite all of that, it's been a terrific time to be an asset owner. Pension funded ratios improved, nonprofits earned more than annual spending plus inflation, and risk management frameworks were tested infrequently. In between the GFC and Covid crisis, Cambridge Associates data shows that the spread between the top and bottom quartile endowments was as narrow as at any time in history, reaching a low of roughly 2%, with a median return during the period well in excess of annual spending rates and inflation. A true rising tide, with OCIO firms benefiting too. The median ten-year return of the AlphaNASDAQ OCIO index is over 9%.[9]



Source: Endowment & foundation data as reported to Cambridge Associates.

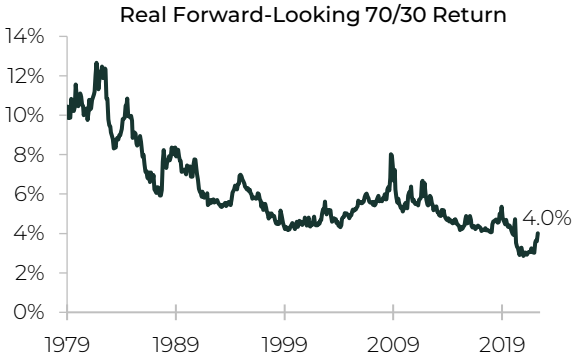
[7] Cambridge Associates.
[8] Burgiss.
[9] Alpha Capital Management. See Important Notes for further information about the Alpha Nasdaq OCIO index.

Unfortunately, the winds are shifting. Starting yields on most asset types are historically low. We're also likely facing one or more economic headwinds:

1. Inflationary pressure from deglobalization, supply chain rejiggering, and decarbonization efforts
2. Slowing growth from debt and demographics
3. Removal of excess liquidity injected from loose fiscal and monetary policy

Furthermore, the last decade of forgiving asset returns has likely masked some suboptimal investing across the industry – inadequate diversification, imbalanced portfolio construction, and less compelling manager picks. In the environment to come, in which passive stock and bond portfolios aren't priced to deliver an institution's required returns, the OCIO's charge becomes both more challenged and more important. We believe that the upcoming environment will reinforce the value of sound decision-making, disciplined execution, and the potential for alpha generation. It will solidify the need for clear policy development, active management, manager selection, and private market expertise. For institutions with a claim on invested resources from either fixed liabilities, an annual budgetary draw, or other strategic imperatives, "good investing means the most when markets offer the least."[10]

> In the environment to come, the **OCIO's charge** becomes both **more challenged** and **more important**



Source: Bloomberg and GEM analysis.

Auspicious Attributes

There is no singular investment approach best suited to navigate the coming challenges. Every approach has its day, and there are merits to a great many strategies: the "endowment model," the "Norway model," the "Canadian model," the "low-cost index model", etc. We've studied them, and the investment offices that utilize them successfully have more attributes in common than meets the eye:

1. **They know themselves.** The key is not which model you choose, but how well you execute it – how clearly you understand what advantage you and your institution have. Once you know that, all your resources can be directed to building the team, structures, and capabilities that reinforce that advantage. Longtime Yale investment committee member Charley Ellis has commented on how tailored the school's strategy is to its scale – that what Yale does "couldn't be done at $1 billion or $80 billion."[11] Rewards in investing come to those who not only "know thyself," but also have the confidence to stick with their strategy even during the painful, inevitable periods when it's out of favor.

The key is not what model you choose, but how well you execute it.

[10] Ilmanen, Antti.
[11] Ellis, Charley. Wise Words with Charley Ellis. AQR.

2. **They have experience.** Most models can't be spun up within larger organizations on a dime. They must be cultivated and crafted over years. Leadership must have established networks, proven credibility, and demonstrated wisdom to make good decisions amid turbulence. The best teams reinforce good governance at every turn, effectively managing trustees and the stakeholders that care about and are dependent on the investment program. Comprehensive portfolio management with all its disparate components also requires teamwork and collegiality, so culture matters too. The best firms in any industry are values-driven, cultivating a spirit that allows them to attract and retain talented people.

3. **They are aligned.** To the great investment offices, investing is a profession. To many OCIOs, it is a business. The difference in those two postures is profound. We believe that to be an enduring independent enterprise, the firm – not shareholders or a parent company – needs to dictate its own future. Succession planning should be embedded in the fabric, any potential conflicts with clients should be dealt with head on, success should be measured over relevant time horizons, and the team should have skin in the game. The best investment offices incentivize and treasure institutional alignment.

To the great investment offices, investing is a profession. To many OCIOs, it is a business.

4. **They are focused.** The great offices stick to their knitting and are circumspect about opportunities to broaden their scope. We see some firms deploying capital in vastly different ways for vastly different clients under vastly different arrangements. The great offices know that you don't go to an auto mechanic for a cholesterol check. That mechanic and your doctor may be the best in their respective fields, but specialization matters.

These are surely difficult attributes to find and preserve. But confidence in a dedicated team that understands the institution it serves, that has its best interests at heart, and that trustees enjoy working with, is a holy grail worth pursuing.

With the right team, committees and boards can ask simpler, more important questions. Instead of "are we winning the performance horse race?" they can ask:

- "Are we meeting our goals?"
- "Does our team have the necessary attributes and process to continue to meet our goals?"
- "Are they investing in a way that we believe works over time?"
- "When it stops working (as all investment strategies do from time to time), can we stick with it?"

The best investment offices support that governance logic continuously.

Partnership

No matter the changes in markets and in OCIO firms since 2007, by far the most consequential shifts have come from the clients. Early studies of OCIOs suggested that the hiring decisions were made to enable "timelier decision making, deeper manager due diligence, and greater oversight of portfolio risks,"[12] but the engagement between client and OCIO has broadened. In a 2019 Cerulli survey, more than one-third of respondents said that client service was a critical part of their OCIO's value proposition, and many of the decisions to switch OCIO providers was attributable to softer issues like "chemistry." More than ever, institutions need a partner and not a vendor.

Superior client support requires a number of capabilities:

1. **Enterprise integration.** Every institution is unique, and different needs demand different portfolios. OCIOs must have a framework for mapping an enterprise to an appropriate investment program, accepting only dimensions and degrees of risk tolerable to the trustees and consistent with the institutional mission. Examining an institution's operating condition, reliance on annual draw, balance sheet health, net contribution rates, and other factors will dictate portfolio construction. The goal is to marry the institution's strategic goals with its investment policy and allocations.
2. **Impact investing and ESG.** A growing majority of institutions and stakeholders care deeply how investment decisions affect people and planet, so having a method for evaluating that impact is critical. It's not easy – it doesn't lend itself to simple quantitative scoring rubrics – but OCIOs must develop the frameworks and competency to integrate mission and values into portfolio construction without compromising on risk-adjusted returns.
3. **Breadth of service.** Beyond simply an investment engine, OCIOs are now more actively engaged in supporting capital campaigns, engaging with rating agencies around debt raises, liquidity planning, tax preparation, annual audits, and other front and back-office functions. Clients should expect an OCIO to serve as an extension of their team, an important resource for capacity constrained staff, and a key voice at the leadership table to help navigate a dynamic operating environment.
4. **Support with best practices.** Whether related to governance, investment committee recruitment, committee charters, DE&I, or other topics, OCIOs must be fluent on the prevailing trends across like institutions – what's working, and what isn't.
5. **Confidence and trust.** They say trust is earned in drops and lost in buckets. OCIOs have a lofty obligation to devise the right investment program, to deploy capital wisely, and to communicate clearly. Acting always in the best interests of clients demands unimpeachable independence and integrity.

More than ever, institutions need a partner, not a vendor.

[12] Cerulli Associates.

Clients need much more than investing – they need expertise, resources, best practices. They need the OCIO to sit at the table and work through a plan, or facilitate introductions to an ecosystem of peers and experts. They need a rich and streamlined experience and to know their institution and their unique challenges matter. With these many institutional needs on top of portfolio complexity, OCIO selection today is more like a marriage than dating. That puts a premium on evaluating not just a firm's investment capabilities – *can the OCIO successfully execute its strategy?* – but its fit with the organization's goals and people.

Beyond governance and investing, the future of OCIO is more expansive partnership.

Looking Ahead

The governance virtues of the OCIO model will always be relevant. A committee is not a sound framework for decision-making amid the complexity and dynamism of modern markets. And the advisory model of portfolio oversight that prevailed for many years suffers from muddy lines of accountability.

Moreover, we expect lower, more volatile investment returns ahead, which means it will be harder for most nonprofits, pensions, and other institutional asset owners to earn enough to support their historical draw rates or to fund liabilities. The answer for some will be cutting spending. For others, it will be adding more active management, equity, illiquidity, or tactical asset allocation to squeeze the stone of return. In a world of budgetary pressure, "good investing," or disciplined, efficient portfolio construction and risk management, is paramount.

But beyond governance and investing, the future of the OCIO is more expansive partnership. That's because OCIO relationships should be long-lived – switching horses mid-race is costly. It's also because clients require more engagement now than ever before. OCIOs will need the capabilities to support strategic planning, with the flexibility to then integrate the strategic plan, client goals, and any constraints into the portfolio management process. We believe firms with the resources, clarity, and candor to encourage evaluation of the strategic inputs to long-term success – process, team, culture, integrity, independence – will be well positioned to drive superior client outcomes.

Throughout our history, GEM has been gifted with thoughtful clients with a long-term view – that's an enormous structural and intellectual advantage for us when making decisions about the firm and about portfolios. We've learned a multitude of lessons in the last 15 years, and we'll learn new ones in the future. But we'll stay disciplined. We'll improve. We'll nurture the team and the investment process to replicate the best of the great investment offices. And we'll align ourselves with our clients' missions, which inspire us every day. Over 15 years, they've funded roughly $4 billion of scholarships, scientific and medical innovations, artificial intelligence research, community development, support for indigenous peoples, health systems, college access, summer camps, clean oceans, and honored so many other worthy causes.

The OCIO industry will surely change, adjust, and adapt to new pressures. Crises will reveal cracks in different governance models, investing styles will come into and out of favor, and consolidation in the industry will continue as the market matures. Whatever happens to the industry, though, our core process – codify an objective, balance across risk factors, diversify widely, partner with elite managers, manage risk, and put the client first – will be our mantra for the next 15 years and long after.

About Global Endowment Management

Global Endowment Management (GEM) is a leading outsourced Chief Investment Office (OCIO) providing institutional investment capabilities for endowments, foundations, and other long-term investors. For over fifteen years GEM has stewarded the financial assets of our clients to enable them to fulfill their missions. GEM's history is deeply rooted in endowment-style investing, with today's approach modernized to offer custom solutions tailored to each client's unique investment needs. For more information visit www.globalendowment.com.

Important Notes

The enclosed materials are being provided by Global Endowment Management, LP ("GEM") for informational and discussion purposes only and do not constitute investment advice, or a recommendation, or an offer or solicitation, and are not the basis for any contract to purchase or sell any security, or other instrument, or for GEM to enter into or arrange any type of transaction as a consequence of any information contained herein. Any such offer or solicitation shall be made only pursuant to a confidential private placement memorandum ("Memorandum"), which will describe the risks and potential conflicts of interest related to an investment therein and which may only be provided to accredited investors and qualified purchasers as defined under the Securities Act of 1933 and the Investment Company Act of 1940.

GEM is an investment adviser registered with the U.S. Securities and Exchange Commission ("SEC"). Registration does not imply a certain level of skill or training. More information about GEM's investment advisory services can be found in its Form ADV Part 2, which is available upon request.

Unless otherwise noted, any opinions expressed herein are based on GEM's analysis, assumptions and data interpretations. We cannot guarantee the accuracy of this information, and it should not be relied upon as fact. GEM does not accept any responsibility or liability arising from the use of the presentation. No representation or warranty, express or implied, is being given or made that the information presented herein is accurate or complete, and such information is at all times subject to change without notice.

GEM reserves the right to modify its current investment strategies, exposures and techniques based on changing market dynamics or client needs.

GEM generally considers environmental, social and governance ("ESG") factors when evaluating third party managers. However, GEM may determine to allocate assets to a third-party manager notwithstanding the results of its ESG evaluation for certain portfolios, and GEM is not subject to any firm-wide policies or procedures relating to ESG. Defining and implementing ESG considerations into investment evaluation processes is an inherently subjective exercise, and it is likely that other managers or investors would define and implement ESG considerations differently than GEM.

To select impact investments, GEM uses a model that incorporates Impact Management Project ("IMP") framework in several aspects of the model, including data inputs for each dimension, manager and strategy risk ranges, and dedicated impact risk considerations for managers during the impact underwriting process. For more information on the Impact Management Project, visit their website at https://impactmanagementproject.com.

The third-party sources of information used in this report are believed to be reliable. GEM has not independently verified all of the information and its accuracy cannot be guaranteed.

This presentation may include forecasts, projections, or other predictive statements based on currently available information. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. Actual performance results may differ from those presented. No guarantee is presented or implied as to the accuracy of specific forecasts, projections or predictive statements contained herein.

Alpha Nasdaq OCIO index data is proprietary to Alpha Capital Management and/or its content providers. Neither Alpha Capital Management nor the eVestment Company provide any representations as to the accuracy, completeness or timeliness of such data and expressly disclaim any liability for damages or losses arising from any use of this information. Past performance is no guarantee of future results