CIO Quarterly Commentary
4Q2019

Where We Stand
As we enter a new decade, we thought it would be a good time to take stock of where capital markets stand, as well as where we stand. As we do so, we’ll be restating and updating several themes that we discussed at TIFF’s 2019 Investment Forum in October. We’ll also feather in a few topics we gleaned from a recent gathering of sophisticated investors. We’ll occasionally add a “TIFF Observation” or two.

Investment Landscape
Since TIFF’s inception nearly 30 years ago, achieving returns in excess of CPI +5% net of fees over the long run has been challenging, but doable. In recent years, however, daily liquid investment programs have unarguably had a harder time meeting that target. The total number of public companies today is about half (down 41%) of what it was 20 years ago. The size of the private equity market has grown dramatically (up 700%) over the same period. More companies are staying private longer. Companies going public today are, on average, about 8 years old; whereas, 20 years ago, companies were about 4 years old when they went public.

Number of Domestic Companies Listed on US Stock Exchanges

Source: Bloomberg

TIFF Observation: We think achieving 5% real rates of return by investing solely in public stocks and bonds is going to get harder and harder. Why? Because an increasing fraction of returns are being earned by investors in the private market BEFORE companies go public.
Deflation, Deficit & Debt
Many sophisticated investors believe that technology, demographics and globalization will combine to produce deflation. Hard as we try to avoid deflation in the US, those investors expect it to eventually arrive here and to bring negative interest rates with it.

Bernie Sanders’ economic advisor, Stephanie Kelton, a professor at Stony Brook, and a leading proponent of Modern Monetary Theory (MMT), says that the government’s deficit and society’s surplus are one and the same. If the economy runs too slow, MMTers say the government can just print money to speed it up, ultimately creating more jobs and a better economy for the American people. If the economy gets too hot, MMTers say the government can raise taxes to cool it off. Because the government prints its own money it can enter into this cycle - including running deficits forever - without limit.

TIFF Observation: The government cycle described above would require a lot more government debt at the very least – and is untested at worst.

A cutting-edge longevity scientist told us that in as few as five years most humans will believe they have the potential to live well beyond today’s life expectancy. If the science bears out, indefinite lifetimes likely won’t be the case until about 2035. To us, combining the effect of lifetimes with MMT would mean the government needs to issue a lot more debt. The US has crossed into $1T per year deficit territory in the last few months and no credible economist we read suggests anything but higher deficits for at least the next 10 years.

TIFF Observation: If traditional economics hold, somewhere along the way inflation will likely make it back at least to the Fed’s 2% target and may go higher. Going one step further, higher government debt issuance and higher inflation could mean meaningfully higher interest rates. Some may lament, while others may cheer such a development. We think rates are near the bottom and now seems like a pretty good time to borrow, but not a very good time to own fixed income (i.e., be a lender).

More on Equities
From an investment perspective, longer living people and institutions need to think longer term. During our October Investment Forum, we cited a recent interview with Bill Gates, whose $50B foundation continues to achieve strong investment returns. He was asked “How can your fund continue to grow at a rapid rate when it’s already so large?” And he said, “It’s easy. We’ve always had exposure to equities of 60% or more. That’s the plan.”

Mr. Gates also noted that he thinks it’s probable that returns during the next ten years will be lower than we’ve experienced over the last ten. That’s likely the result of the US being nearer to the end of an economic expansion, a historic economic expansion; the current expansion is the longest one in US history. If Mr. Gates is right, then investors will need to somehow augment the returns of traditional domestic stocks and bonds.

TIFF Observation: We think such a scenario suggests that investing in less efficient markets such as illiquid opportunities in the private space, emerging markets and other niche markets that are not as fully exploited as the bigger US and other developed markets, could represent opportunity. It also means partnering with exceptional managers who can add alpha.
Sustainability
At our Forum, we addressed the increasing popularity of Environmental, Social and Governance (ESG) considerations as they move from being simply “interesting” to having a real impact on investments.

As discussed in our 3Q2019 CIO Commentary, TIFF integrates ESG into our manager questionnaires and due diligence processes. In fact, we find that most investment firms today have incorporated some sort of ESG effort into their processes.

The big environmental issue, we noted at our Forum, will likely be carbon, and its effect on our climate. Since the Forum, our conviction on this point has only increased; the number of organizations talking about the harmful effects of carbon on our planet is steadily expanding. We would go so far as to predict that within the next 12 months we could see a major new “stakeholder” involved in corporate strategy – Mother Earth. Until now, most corporations have tried to avoid polluting rivers and spewing lethal chemicals into our air and water but going forward we suspect the discussion will explicitly include how corporations are helping to fix problems that exist today.

**TIFF Observation:** The good news is that the costs of wind and solar electricity generation are declining quickly and in some places are approaching the cheapest forms of electricity. We are one big breakthrough in battery technology or the electric grid away from accelerating the transition away from carbon. Non-carbon energy sources could become a very important investment theme soon.

Staying the Course
At our Forum, we reminded the audience of TIFF’s long tradition of investing in a consistent fashion that doesn’t outperform every year but has proven its worth over the long term.

A decade ago, David Salem, our then CIO, had a consistent message in the TIFF quarterlies. We won’t reprint the entire passage here, but the following excerpt will give you a good sense of TIFF’s thinking then and today. In 2008, David wrote:

> Our long-term goal of generating 5% or higher annualized real returns echoes a commonly articulated aim for the entirety of the endowment portfolios whose returns TIFF seeks to enhance.

> This is no coincidence, as our portfolios are designed to serve as a comprehensive solution to the investments needs of endowed charities. A substantial fraction of our holdings are indeed highly liquid, although TIFF staff seeks to exploit fully return premium that illiquid holdings have the potential to generate.

He went on to say that:

> Endowed charities electing to shift all their assets to a TIFF fund doesn’t trouble staff provided that such organizations recognize that TIFF’s idiosyncratic asset mix, and its reliance on active management could expose them to, potentially, prolonged periods of disappointing results.

This aspect of TIFF’s investment approach hasn’t changed over the years. We continue to set our asset allocation strategy with a very long-term view and with the input of our board.
remain committed to finding and partnering with what we believe are the very best asset managers in the world. And that means that we have the potential to underperform benchmarks for periods of time. The period since the great financial crisis has been one of the most difficult times for active managers that we’ve seen. It’s been a record long economic expansion, and a pretty consistent bull market, with relatively low volatility, especially here in the United States.

However, we did see an encouraging sign recently that other firms are following our long-standing belief in active management. A Vanguard advertisement said, “We’re a low-cost shop, not a passive one.” This statement might surprise you, coming as it does from the largest index fund provider in the world. We hope it suggests that maybe even Vanguard believes it’s time for investors to start moving away from pure passive and to start looking for some sort of active management.

It is a very challenging time in the asset management business. AUM growth has been slowing, fee compression is mounting, and costs keep rising. This past summer, several large asset management firms rolled out zero-cost passive funds. More recently, online brokers have eliminated commissions for most all US stock trades. The backdrop for traditional asset managers is about as tough today as we can remember.

**TIFF Observation:** At TIFF, we continue to seek the best terms from our managers; pushing them to lower both incentive and management fees and create optimal alignment between TIFF, our members, and the managers.

**Current Political Wildcards**

As for our President, our bottom line is “business as usual” – if there is such a thing with him. The Republican-held Senate still seems highly unlikely to remove the President from office on either of the two articles of impeachment approved by the House. Impeachments seem to have little direct effect on stock markets, which continue to discount future economic conditions. For reference, the stock market fell sharply with the economy during Nixon’s impeachment, but rose strongly during Clinton’s.

An old actor rejoined the stage recently with the elimination of either a) one of the world’s leading terrorists responsible for the killing of hundreds of Americans and thousands of people across the Middle East or b) a man who “has remained above factional conflicts in Iran and is respected by a variety of segments of the Iranian elite, and he enjoys popularity in Iran as a nationalist symbol.” We are either edging toward WW III or have made the world a safer place; only time will tell. Our expectation is that markets, as they always do, will ultimately focus on the economics of the situation – which, in this case, probably means oil. With the Permian Basin pumping more oil every day, Russia and Saudi Arabia curtailing production, Venezuela and Iran producing far less than a year or two ago, and the world economy moving forward at a modest growth rate, it would take a lot to destabilize oil for now. Peace also seems to be a better alternative for both sides, so hopefully the threats will die down quickly.

**TIFF Observation:** As investors (versus citizens), we are very aware of potential impacts Trump and current geopolitical events may have on global economies. However, we try not to focus too heavily on political fighting, but on how various scenarios could impact the broader market and investment landscape over the long term.
China Outlook
The past several years have shown Chinese markets to be extremely volatile despite the country maintaining its growth over the same period. At our Forum we predicted the Chinese economy would survive the most recent round of doomsday talk and continue to grow. Since the TIFF Forum in October, a partial trade deal with China seems to have taken hold and the equity markets finished the year at all-time highs, suggesting the global economy may improve next year.

We also remain favorably disposed to our Chinese equity investments for a couple of reasons. Fundamentally, Chinese markets are the second largest and most liquid in the world and trade at only about two-thirds of the price earnings ratio of the US stock market. More importantly, we have partnered with three managers in China that we believe are three of our very best. In a large and volatile market with little institutional participation, we believe those three managers can continue to generate meaningful alpha. China is one market where we think volatility can be our friend over time.

*TIFF Observation: We think the Chinese economy could continue to stabilize in 2020 and that Chinese equities continue to represent above average opportunities.*

Focus on Value and Global Diversification
At the Forum we speculated that value could outperform growth in the future, in part because it has underperformed in 8 of the last 10 years. Prior to 2010, value had outperformed growth in 7 of the preceding 10 years. These things do rotate from time to time (mean reversion) and starting from fuller valuations can sometimes provide the needed catalyst. We also noted that if the Democrats win the presidency in 2020 and go after the big tech companies on anti-competitive grounds, the rotation towards value could start sooner rather than later.

We have a similar view on US vs non-US market performance. The US has outperformed (blue bars) non-US in 8 of the last 10 years, but the US underperformed (green bars) in 7 of the 10 preceding years. Recently, our global equity managers have been finding what they believe are better investment opportunities outside the US; therefore, reducing their US weightings and investing more overseas.
US vs Non-US Market Performance
S&P 500 vs. MSCI ACWI ex-US (net total return)

Source: Bloomberg

What’s Next for Private Markets
We remain generally bullish on private markets over the long term while acknowledging that the recent difficulty of some high-flying IPO’s (Lyft and Uber among them) suggest a cooling in private equity fervor right now. Private market managers’ ability to time their investment entry and exit points seems a permanent advantage vs the public markets in which managers invest on the day you give them money and sell when you ask for it back. While far from perfect in our opinion, private markets do provide a better opportunity to buy low and sell high. This advantage should enable private markets to continue to grow and outperform liquid public markets over time.

The US Dollar’s Ride
Lastly, we point out what we call the biggest wildcard that nobody is talking about - the US dollar. While it seems hard today to imagine anything supplanting the US dollar as the world’s trade currency, some combination of ideas like modern monetary theory, trade tariffs, cryptocurrencies issued by the likes of Facebook, JP Morgan, the government of China, or all three of them, could over the next decade or so undermine the US dollar’s dominance. In addition, most economic forecasters believe that by 2030 China will be the largest economy in the world.

TIFF Observation: We think the US dollar is likely to face a serious primary challenge in our lifetimes. At the margin this challenge will probably hurt US debtholders but have little impact on US stockholders because stocks are traded more on a global basis.
What’s Next
So, given all this what are we doing in your portfolios? Largely staying the course. Our allocations are meant to be strategic. Until there is some meaningful change in the investment environment requiring us to make a meaningful adjustment, we think our allocation is about right. We continue to overweight equities vs our benchmarks and China within equities. With the trade friction abating (at least for now) and China easing policy to support economic growth, Chinese equities could post another solid year. If value and growth perform more alike than in past years, we think our manager roster could shine. We still like hedge funds over fixed income and have even read others writing as much. Hedge funds will be blasted again in the press for not keeping up with equities, but that’s not what they’re supposed to do. We will be adding a few new managers to our roster this year as a result of some fortuitous meetings/discussions we’ve had lately. And finally, as you might guess, we remain cautious on fixed income. If the world economy somehow got going, then fixed income could get hurt. On the other hand, if we start to see increased prospects for recession, we could become more open to increasing our fixed income allocations and/or duration.

We look forward to sharing more information about our 2020 outlook during our upcoming Investment Update webinar scheduled for January 28th.

We very much appreciate the opportunity to manage your capital and help you achieve your financial goals. Our team continues to travel the world looking for the very best managers we can partner with to exceed your expectations.

Here’s to a prosperous 2020!
TIFF Investment Management
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Not all strategies are appropriate for all investors. There is no guarantee that any particular asset allocation or mix of strategies will meet your investment objectives. Diversification does not ensure a profit or protect against a loss.

One cannot invest directly in an index, and unmanaged indices do not incur fees and expenses.

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