SPRING 2022

INNOVIEWS

Invested in Your Mission

INNOVEST'S LATEST UPDATES AND ARTICLES FROM THOUGHT LEADERS IN THE FIRM

IN THIS ISSUE

NEW INSTITUTIONAL CLIENTS

Paige Foundation
New York News
Tribune Publishing
OneChild
Diocese of Fort Worth
Augustine Institute

It is not known whether the listed clients approve or disapprove of the services provided. The new clients on page one are listed with their approval and permission.

The Ups and Downs of the Stock Market

Steven Karsh, MBA
Principal

The U.S. stock market at the beginning of 2002 seemed like a roller coaster ride at times; big ups, followed by big downs. Despite erratic market movements, often referred to as volatility, long-term investors have been rewarded by staying patient and riding out the volatility. The most recent example happened just over two years ago when Covid-19 caused the global economy to essentially shut down. The S&P 500 experienced its fastest 30% decline in history, taking only 30 days!

Investors who remained calm and added money to stocks to get to their target allocations reaped big rewards when the market rebounded to new highs in just over four months. In fact, from the low on March 18, 2020, to December 31, 2021, the U.S. stock market more than doubled, returning an astonishing 106% in just over 21 months. Even more astounding is that after the stock market was down over 50% during the Global Financial Crisis (GFC) in late 2008 and early 2009, the market rose over 580% from the 2009 lows through December 2021! Even if you include the 57% decline during the GFC, the market is still up over 180% from October 2007 through January 2022.

The chart from JP Morgan (next page) shows that intra-year declines in stocks are normal. Since 1980 stocks have fallen an average of about 14% in any given year.

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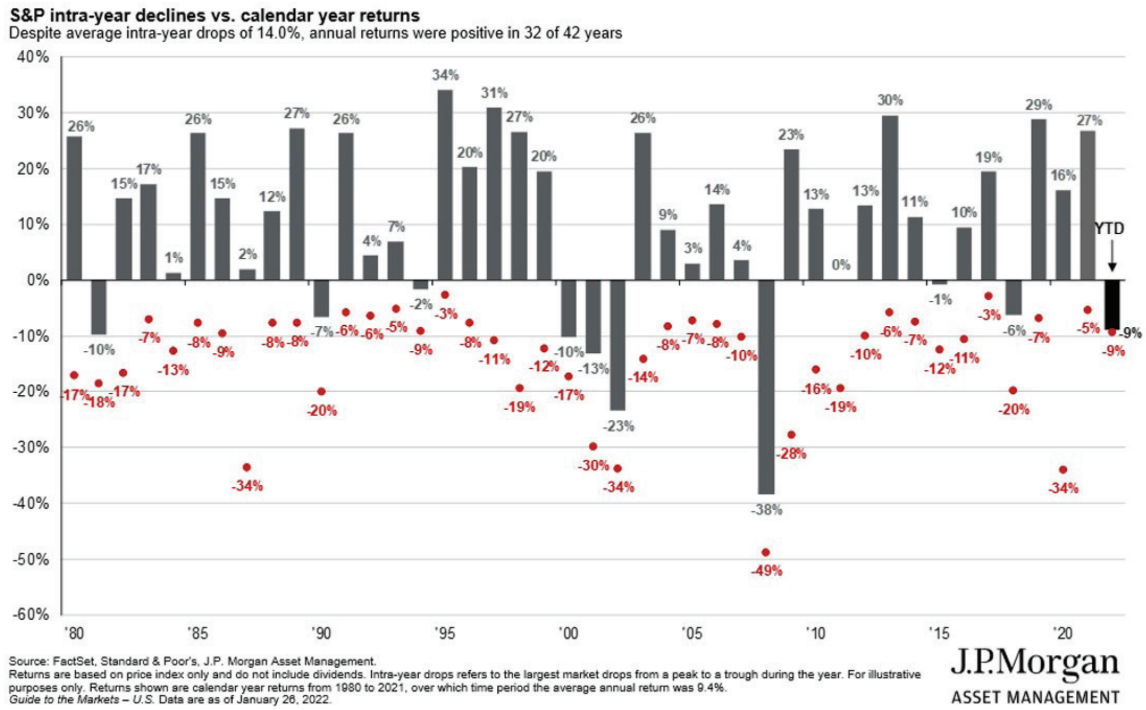
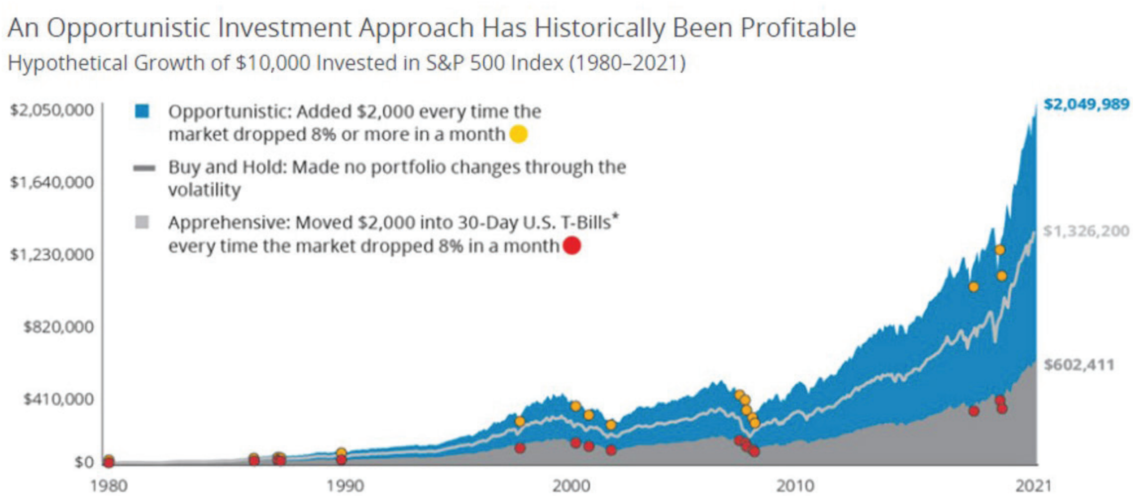


Below is another chart that shows taking advantage of stock market dips by adding to equities can lead to significantly better long-term performance than a buy-and-hold approach. The worst approach was to panic and take some money out of the market after prices had fallen.



Past performance does not guarantee future results. Indices are unmanaged and not available for direct investment. Assumes reinvestment of capital gains and dividends and no taxes. For illustrative purposes only. Data Sources: Thomson Reuters and Hartford Funds, 1/22.

* T-Bills are guaranteed as to the timely payment of principal and interest by the US government and generally have lower risk-and-return than bonds and equity. Equity investments are subject to market volatility and have greater risk than T-Bills and other cash investments.

Chart courtesy of The Hartford

Keeping in mind that past performance is no guarantee of future returns, history has demonstrated that large dips have been buying opportunities, not reasons to become more risk averse. Market rebounds have rewarded patient investors and those who keep their focus on the long-term.

The most pressing question during a downturn is WHY? Many factors can cause a down market, depending on the economic environment. Many believe the recent volatility has been caused by the sharp rise in inflation and the Federal Reserve's plans to reduce it, ranging from increasing interest rates to quantitative tightening (taking liquidity out of the market). Other factors for the recent downturn may include geo-political events such as Russia/Ukraine and China/Taiwan. And we can't forget another ongoing variable, the persistence of Covid.

Regardless of the reasons for pullbacks in stocks, if you have a long-term time horizon, the ups and downs of the market shouldn't cause you to panic and make emotional investment decisions. Time and again, the market has trended upward and adding to stocks when they are down can be beneficial for your long-term investment results.

Employee Spotlight

Claire DeLine

INNOVEST MANAGER

WHERE IS YOUR HOMETOWN?

I am very proud to be a fourth generation Denver native.

TELL US SOMETHING UNIQUE ABOUT YOU:

I met my husband when I was just 14 years old, and we've been "going steady" since junior prom!

WHAT DO YOU LIKE BEST ABOUT WORKING AT INNOVEST?

Far and away, the culture – Rich and Wendy have relentlessly pursued a culture of stewardship since the day they founded our firm, and it continues to shine through today. The people at Innovest are all tremendous stewards of our clients, each other, and the community outside our doors. I am humbled to be a part of such a selfless and driven team.

HOW DO YOU GIVE BACK TO THE COMMUNITY?

We serve in numerous ministries at our church, though our favorite has to be mentoring engaged couples who are preparing for marriage. I am also involved with a number of faith-based organizations, including serving on the Finance Committee for an education-focused nonprofit called Seeds of Hope and volunteering at Arrupe Jesuit, a local high school with an incredible mission.

WHAT ARE YOUR HOBBIES AND INTERESTS?

I love to read, cook, play tennis, go for neighborhood walks, escape to the mountains for a weekend, and above all, spend time with loved ones. I am also trying to pick up golf – it's safe to say my ego has never been more in check!

TELL US ABOUT YOUR FAMILY:

My wonderful husband Chad and I were married in 2019, and we are over the moon to be welcoming our first child, a baby girl, this October! We are blessed to have our parents (and all four sets of grandparents!) living nearby in Denver. We get together every week for family dinner. Our siblings have each married amazing spouses, and we look forward to welcoming more nieces and nephews to dote on in the coming years!

WHAT IS YOUR FAVORITE DESSERT?

I am an ice cream fanatic. A favorite summer pastime of my family's is creating a March Madness style bracket of the best local ice cream shops and trying out each place until we narrow it down to a winner. We call it the "Game of Cones" and our current reigning champion is Sweet Cooie's in Denver.

The Importance of High Quality Manager Access in Alternative Investing

By Sloan Smith, MBA, CAIA, CPWA®
Principal, Director

Alternative investments have become more influential in portfolios, especially since the onset of the COVID-19 pandemic in 2020. Over the last two years, equity valuations have become stretched and bond yields have fallen considerably. This has led to lower expected returns going forward and forced investors to look at areas such as private equity, private debt, real estate, real assets, and hedge funds to enhance return and mitigate risk.

The results of utilizing some of these asset classes over the last few years have been beneficial. They have been able to mitigate rising inflation, higher energy prices, and lower bond yields while further diversifying portfolios. However, the range in performance between the various alternative managers in each of these areas has been dramatic. For example, the difference in return between a top and bottom quartile private equity manager is approximately 20%.[1] Therefore, when allocating to alternative strategies it is paramount to get access to funds managed with a proven process that can generate top tier performance.

In order to identify the most reputable managers in the alternative investment space, it is important to focus on the following characteristics:

1. Team – the key decision makers within an alternative investment firm must have a sound relationship where they are identifying unique opportunities within their particular asset class while retaining talent, evolving their business, and instilling a culture of collegiality and competition.
2. Track Record – the firm must show a history of consistent performance in different market environments while continuing to act as a diversifier to equities and fixed income. For example, a sought-after hedge fund strategy is able to generate strong returns with minimal volatility, correlation, and beta to public markets.
3. Investor Base – reputable alternative managers have a large number of institutional investors that include pension plans, endowments, foundations, family offices, and high net worth individuals. If a strategy is not heavily diversified among these different investors, it could lead to issues, particularly during times of underperformance when redemptions are more prevalent.
4. Capacity – respected alternative managers are thoughtful about their assets under management (AUM) and too many assets could potentially hinder their ability to generate consistent long-term returns. If any alternative investment manager becomes too large, it is important to ask whether they can execute their strategy with even more capital. If AUM becomes an issue, many strategies will close their fund to new dollars in order to avoid any risk of return degradation.
5. Fee arrangements – there are typically two types of fees in the alternative space. First, there is a management fee which is charged by the strategy to operate the fund. Second, there is a potential incentive fee which is rewarded to the strategy if they achieve a particular return threshold (i.e. above 10%). Highly regarded managers do not share their fee with any outside vendors or service providers. For example, in some cases private banks and other institutions will take a piece of the management fee to assist with marketing and distribution. Top tier alternative managers do not need to follow this exercise since they are comfortable with their asset and investor base.
6. Deal flow – the ability to source a sufficient volume of high-quality investment opportunities is key. Strong alternative managers have robust networks and can identify unique ideas that enhance the risk and return profile of their funds. This item is especially critical in the private equity and private debt space where return dispersion is significant. If capital is consistently invested in strong deals, then returns can be substantial.
7. Terms - the best alternative investment strategies have a fee structure that is aligned with both the money manager (i.e., general partner) and the investor (i.e., limited partner). These managers are mostly compensated for consistently generating outsized absolute and relative performance. If management fees represent a significant amount of the manager's total compensation, it may reduce the incentive for the team to generate strong returns. So, it is important to identify this issue at the onset before any allocation is made.

If each of the following criteria are met when researching an alternative investment manager, then the probability of identifying a top-quartile strategy is high. It is important to consistently stay in contact with manager, build a relationship, and learn about the strategy's performance, team, and opportunity set. These tasks are accomplished through on-site due diligence visits, research calls, and ongoing conversations. Unfortunately, there are times when successful teams may break up or a strategy may diverge from its core investment competency. At that point it may make sense to reevaluate the manager and determine whether an allocation going forward is adequate.

Alternative investing has become mainstream and transitioned from optional to an essential part of portfolios. Adding to different asset classes such as hedge funds, private equity, private debt, real estate, and real assets should improve the risk and return profiles of portfolios, especially relative to a more traditional equity and fixed income portfolio mix. It is vital, though, that the alternative strategies that are implemented are top tier and have outstanding qualitative and quantitative characteristics. Otherwise, investors will suffer and miss out on opportunities that are currently not heavily available in the public markets.

Figure 1 (Public versus Private Manager Performance Dispersion from 2013 to 2021)[2]

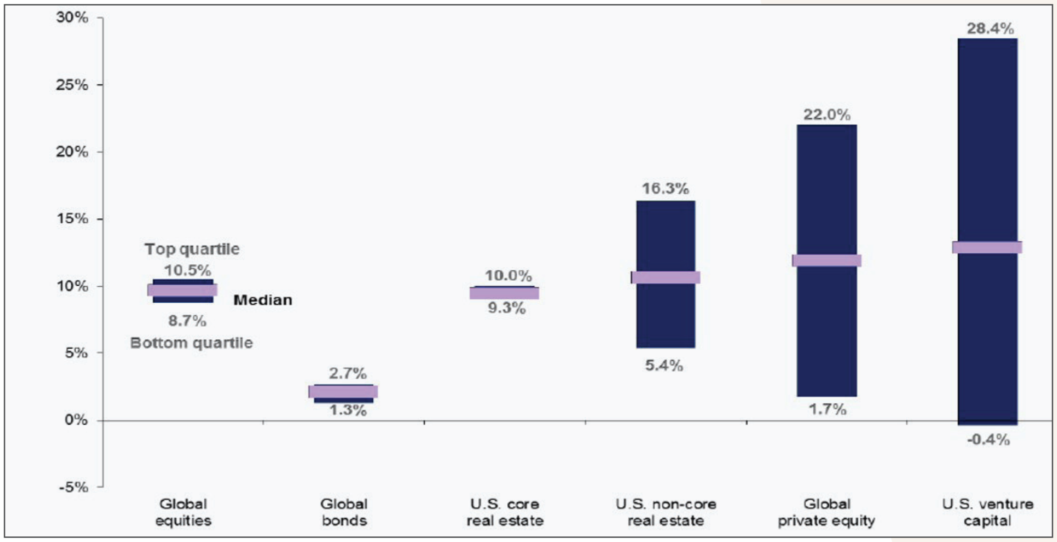
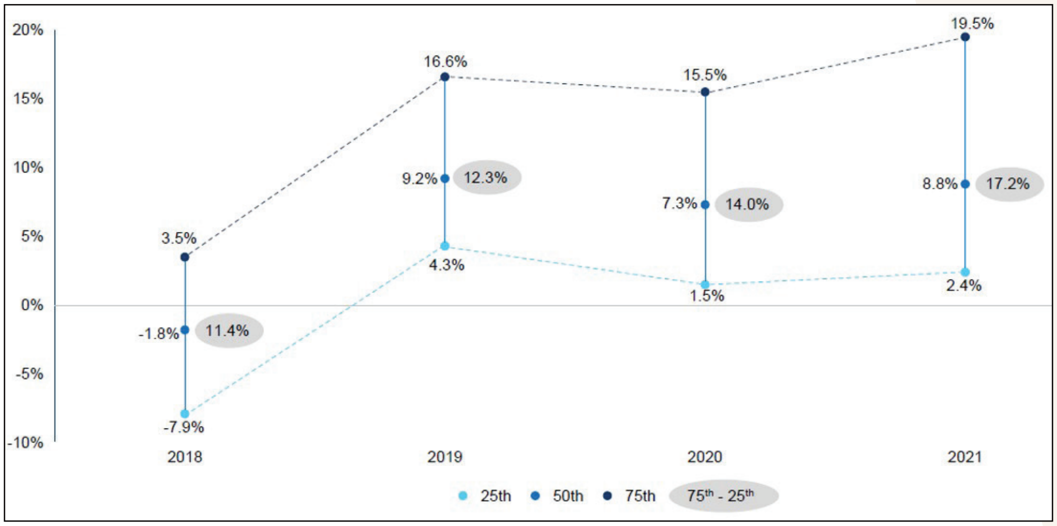


Figure 2 (Dispersion of hedge fund returns among top and bottom quartile managers)[3]



[1] "A Year of Disruption in the Private Markets" https://www.mckinsey.com/~/media/mckinsey/industries/private%20equity%20and%20principal%20investors/our%20insights/mckinseys%20private%20markets%20annual%20review/2021/mckinsey-global-private-markets-review-2021-v3.pdf
[2] Source; Lipper, NCREIF, Cambridge Associates, HFRI, J.P.Morgan Asset Management, Data is as of August 13, 2021.
[3] Source: HFR, HFM, Capital Solutions, Barclays

Fixing the 40

Cos Braswell, M.S., Applied Quantitative Finance
Lead Senior Analyst

The historical baseline for what an investor considers a diversified portfolio is often referred to as the 60/40: 60 percent of an investor's assets invested in equities and 40 percent in fixed income. The 60 is generally global exposure, proxied by the MSCI ACWI Index, and the 40 by the Bloomberg Aggregate Bond Index. While this portfolio has generated satisfactory risk/return metrics in the past, there are several challenges that investors face moving forward.

Let's consider those challenges and what alternative solutions investors can look into to mitigate the deterioration of the risk/return profile that the 60/40 faces. We have all felt the effects of inflation in recent months, and it seems the term 'transitory' was retired as quickly as it was created. Persistent inflation could lead to lower real returns (returns after the effects of inflation), which would hit the more conservative bond market much harder than equities.

While bonds may be more sensitive to growing inflation, the low correlation between fixed income and equities is in danger of being challenged as well. In the equity portion of the 60/40, stretched valuations have led investors to question whether stock prices have room to grow. Even so, equities are a good place to park investments if one believes inflation will continue to rise, as companies will adjust prices to keep up with expenses.

Another consideration for fixed income investors is the potential for rate increases. Rates increasing, coupled with higher-than-usual inflation, could not only diminish the value of the underlying bonds in a portfolio, but could also reduce the purchasing power investors have once they redeem their bonds.

Knowing all of this, we want to highlight some alternative investment asset classes that investors might consider. In this rapidly changing environment, risk-averse investors are looking to maintain the amount of risk they are exposed to, even if it means sacrificing returns. Others are looking to maintain their expected return, but with the understanding that risk will increase. Both investors have options to meet their needs.

For investors looking to keep a similar risk level, a simple solution might be to adjust the weighting of the 60/40 by decreasing equity allocation. Investors attempting to maintain target return would, by contrast, increase their equity allocation. But it is our belief that considerations for change are better focused on the fixed income portion of the portfolio. This opens a multitude of possibilities for increased diversification through uncorrelated asset classes, and it can be done without slashing income expectations. We'll highlight a few general asset classes that fit this type.

An investor looking to maintain a similar level of risk and keep income steady might look to real assets, such as farmland or timberland. Farmland is a fantastic income-driver and tends to be rooted (pun intended) in long-term contracts, as less than 1% of domestic farmland is traded annually. High quality managers find farmland with both row (annual) and permanent crops to reduce cyclicality and provide an attractive risk/return profile when used in conjunction with equities. Timberland is uncorrelated to traditional markets and is historically positively correlated to inflation. The harvesting cycle also offers optionality to be efficient in taking advantage of underlying economics in real estate and other material intensive industries. Apart from real assets, core real estate is another great place to find smoother returns and consistent income. Key characteristics to achieve these metrics are high quality buildings with occupancy generally greater than 95%.

An investor looking to preserve capital while maintaining a similar return expectation might allocate to private debt. Allocators have many options within the private debt market, but in the context of a fixed income replacement with high return expectations, corporate direct lending fits this bill the best. Direct lending is when lenders other than banks finance companies without a private equity sponsor or investment bank intermediary. The opportunity set is vast, and while these companies won't be rated at investment grade, yields continue to be attractive even with favorable senior secured debt terms.

Higher inflation expectations, increasing interest rates, and low fixed income yields have pushed investors to think outside the box of traditional investments. Thankfully, asset managers are in tune with client needs and the ever-evolving investment landscape. Hopefully the aforementioned alternative asset classes have prompted curiosity to uncover investment options that work best for your needs. Investors must first establish and prioritize their goals, whether capital preservation, income, total return growth, etc., and then investigate alternatives to the traditional 40% fixed income allocation.

Nonprofit Spotlight

The Investments & Wealth Institute

As a provider of investment advice to numerous nonprofit organizations, Innovest has the privilege of introducing you to some of our fantastic clients. This month we are proud to feature The Investments & Wealth Institute.

The Investments & Wealth Institute, previously known as Investment Management Consultants Association IMCA®, was founded in 1985 in Colorado to provide investment consulting and wealth management credentials and educational offerings for its members. Its eight original investment consultants founded IMCA® to broaden public understanding of investment consulting and increase the professionalism of those providing consulting services through education, ethics, and certifications. The organization was renamed the Investments & Wealth Institute in 2017. Today the Institute is a strong professional association, providing advanced education and standards for financial advisors, investment consultants, and wealth managers who embrace excellence and ethics. The Institute currently serves more than 12,000 members and certificants in 38 countries.

Through their events, continuing education courses, and certifications, the organization offers advanced credentials and highly practical education: Certified Investment Management Analyst® (CIMA®), Certified Private Wealth Advisor® (CPWA®), and Retirement Management Advisor® (RMA®). Innovest professionals hold several of these designations. Innovest believes that these designations add measurable value to clients due to the rigorous education and the high emphasis on integrity; these values are aligned with Innovest's values.

To learn more about the Investments & Wealth Institute, please visit investmentsandwealth.org.

Around the Firm

PROMOTIONS & TEAM UPDATES

Innovest's Colorado office has moved! We are now located just across the street: 7979 E. Tufts Avenue, #1700, Denver, CO 80237.

Congratulations are in order! Senior Analyst Brett Minnick passed Level II of the CFA Program. The CFA charter designation represents one of the highest levels of recognition financial professionals can earn and demonstrates a finance professional's work ethic, analytical skills, and grounding in ethics. Well done, Brett!

Help us welcome Lead Senior Analyst Franklin Cornett , CFP® to Innovest! Frank is a Certified Financial Planner and brings strategic financial planning experience to the firm. Frank moved to Colorado from Texas shortly before starting at Innovest. Welcome, Frank!

Innovest is excited to announce that Brett Minnick has progressed to Senior Client Manager, Constantine (Cos) Braswell and Brooks Urich progressed to Lead Senior Analyst, and Sydney Aeschlimann, Jack Schutzius, and Marleen Zakovich progressed to Analyst.

The recipients of the Service to Others monthly awards were Lori Foster in January, Sydney Aeschlimann in February, and John Brock in March.

AWARDS & PUBLICATIONS

Innovest was ranked by *AdvisoryHQ* as a best financial advisor in Denver, Colorado Springs, and other cities in Colorado for 2022-2023.

The National Association of Plan Advisors (NAPA) ranked Innovest on their list of 2021 Top Defined Contribution Advisor Teams.

Innovest CEO Richard Todd authored "On-site Due Diligence is Going by the Wayside to the Detriment of the Investor," published by *Denver Business Journal* Leadership Trust.

Innovest Principal Scott O. Middleton, CFA, CIMA®, and Analyst Peter Girard co-authored "China: In The Red" published by *Financial Advisor Magazine.*

Innovest Senior Client Manager Brett Minnick authored "Collective Investment Trust Considerations for Plan Sponsors" recently published by *BenefitsPRO.*

Innovest President and Co-founder Wendy Dominguez was interviewed on the *Faith and Finance Podcast.*

An interview with Innovest Principal and Director Sloan Smith appeared in the Allocator Sentiment chapter of the *Hedgeweek Global Outlook* 2022 report.

Innovest Principal Steven Karsh authored "The Ups and Downs of the Stock Market" published in the finance section of *Articulator Magazine's* 1st quarter 2022 issue.

SERVICE

Our team collected baby items for Marisol Homes. Marisol Homes provides safe healthcare and secure emergency and community-based housing for pregnant women and single women with children.

Innovest employees volunteered with Project C.U.R.E., a nonprofit that delivers life-saving medical equipment and supplies to hospitals and clinics throughout the under-resourced world.

CONFERENCES, SPEAKING, EVENTS, & SPONSORSHIPS

Innovest partnered with Denver-based accounting firm Kundinger, Corder, and Montoya, PC., to host the 2022 Rocky Mountain Nonprofit Conference. Over 200 nonprofit professionals came to hear from industry experts on cryptocurrency, mission-aligned investing, 2022 fundraising insights, economic updates, tax and accounting updates. Innovest's Scott Middleton and Sloan Smith gave an economic update for nonprofits while Steven P. Fraley presented on mission-aligned Investing. In lieu of ticket sales, we raised money from attendees for the Kempe Foundation.

Innovest's Sloan Smith, MBA, CAIA, CPWA® held a webinar with Dennis Hammond, Co-founder of Veriti, to review the new U.S. Conference of Catholic Bishops (USCCB) "Socially Responsible Investing Guidelines" for Catholic investors, Catholic dioceses, and Catholic organizations.

Innovest Vice President Steven P. Fraley, MBA, CFA and Eide Bailly LLP's Pam Eggert presented on "Endowments for Nonprofits: Mission-Aligned Investing"
as part of Eide Bailly's spring webinar series.

Innovest Vice President and Director Steven P. Fraley, MBA, CFA spoke at the Markets Group 9th Annual Mountain States Institutional Forum. Steven interviewed Wellington Management's Matthew Lipton on "Fintech: Volatility, Opportunities, and Challenges."

INNOVEST

At Innovest Portfolio Solutions, we are more than an investment firm. We are thoughtful stewards responsible for our clients, professionals and community.

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