FALL 2023

INNOVIEWS

Making Retirement Work

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

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NEW INSTITUTIONAL CLIENTS

Catholic Benefits Association

Fender Musical Instruments

San Diego Union Tribune

Union Square Advisors

University of Mary

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.

Should They Stay or Should They Go?

Troy Jensen, QKA, APA
Principal

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Vice President

For some 1980's nostalgia, think back to the staccato drum beats and strummed electric guitar chords of English rockers The Clash and allow your mind to drift into the lyrics. We apologize if the song is stuck in your head for the rest of your day. But there is a nice parallel in the lyrics when we're thinking about whether terminated participants – those no longer employed by your organization but still in your retirement plan – should stay or go, particularly those with smaller account balances.

Before we dive into the song, some background feels appropriate. IRS rules allow for plan sponsors, when optionally written into their plan provisions, to remove terminated participants with small balances. Prior to 2023, "small" was any amount up to $5,000. Congress' passage of the SECURE Act 2.0 now gives plan sponsors the option to further increase that threshold up to $7,000. Any participant with a vested balance of $7,000 or less can be forced to take their money out of the plan with required advance notice from the plan sponsor. If between $1,000 and $7,000, this is done as a rollover into an IRA opened in the participant's name. For amounts under $1,000, the rules permit that a check be sent directly to the participant and the money is taxably distributed out of their retirement savings.

Why would plan sponsors do this? For one, if the employer is generously covering the recordkeeping costs on behalf of its participants, it is an extra expense for them to keep paying for someone who is no longer employed. Secondly, it can be more costly to all participants remaining in the plan, over

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time, to hold onto these small balances. Recordkeeping providers generally price their services based on average account balance, so any smaller balance participants can drag down that average, increasing fees for everyone.

The Clash, Verse One: "If you say that you are mine, I'll be here 'til the end of time."

Consider another Englishman, Sir Issac Newton, admittedly less a rocker and more a scientist: his first Law of Motion taught that objects at rest tend to stay at rest unless compelled to change by the action of an external force. Inertia is just as real for plan participants. People tend to behave like those objects and can be resistant to change, or at least find change inconvenient. For participants in your retirement plan, expect that they will tend to stay in your plan "'til the end of time" unless you give them a polite nudge toward moving those assets out.

"If I go there will be trouble…so come on and let me know."

Participants don't always make the best financial decisions when they do things alone. Without proper education and guidance, some may do some 'emotional investing' (selling low when it doesn't feel good and buying high when things seem rosier) or take their funds out of their retirement plan to use for non-retirement purposes. Easy as it may seem to kick out former employees and leave them to fend for themselves, a sense of paternalism may instead spur plan fiduciaries to at least help oversee what little assets they have entrusted to them. Sound fiduciary processes should be in place for overseeing the investments you make available in your plan, and it arguably adds very little risk to maintain that oversight even for small balances.

"…and if I stay, there will be double."

If you allow terminated participants to stay in your plan, there is a fiduciary responsibility on your part to make sure that these participants don't go missing. Many move on, both physically and mentally, when they leave a job and often forget to provide an updated or forwarding address. Uncashed RMD checks, returned mail, no beneficiaries on file…all are signs that a participant may have forgotten or abandoned their retirement assets. Finding those participants is a necessary obligation for employers. For those plan sponsors who pay the recordkeeping fees on behalf of their participants, you're now paying for someone that no longer works for you and may not even be aware that they have an account in your plan. If participant-paid, recordkeeping and other fees may quickly and significantly erode whatever balance remains.

"This indecision's bugging me (esta indecisión me molesta)."

We know that participants tend to look to their employers to help them in making investment decisions for retirement savings. We also know that there is a cost to having these participants in the plan, and the soft costs to keep track of them. So, you gotta let me know, should I stay or should I go? Determine what is best for your participants, even the ones that no longer work for you. The 1980's are counting on us to let them know.

"We know that participants tend to look to their employers to help them in making investment decisions for retirement savings. We also know that there is a cost to having these participants in the plan, and the soft costs to keep track of them. So, you gotta let me know, should I stay or should I go?"

The Case for Mid Cap Equities

Brett Minnick, CFA
Vice President

Sydney Aeschlimann
Senior Analyst

Mid-cap equities, like middle children, can often be overlooked. It is easy to be captivated by large-cap equities, with their impressive scale or an up-and-coming small-cap tech company that is slated to be the next big thing, but nestled between these two extremes are mid-cap companies. With market capitalizations ranging from $2 Billion to $10 Billion, mid-cap companies inhabit a sweet spot in the market, balancing growth potential and security.

Mid-cap equities include components of both small- and large-cap stocks. Small-cap equities can be unpredictable and volatile and large-cap equities may have already experienced most of their exponential growth. Mid-cap companies often offer a more balanced approach, with the opportunity for considerable growth along with better stability. In many instances, mid-cap companies are more than just a good idea. Many have a demonstrated history that they can prosper through various market conditions in their respective industries, providing investors with desirable returns.

Rapid growth and expansion are common traits of mid-cap companies; new ideas and products are generated and tested leading to market expansion and brand recognition. This growth potential can lead to significant capital appreciation over time, especially if these companies transition into large caps. Apple, Amazon, Alphabet, and many other well-known large companies were once mid-cap stocks. Successful companies can experience significant growth over time, moving from mid- to large-cap status as their businesses expand and market capitalizations increase. Investing during the mid-cap phase can yield substantial returns if they continue to innovate and grow.

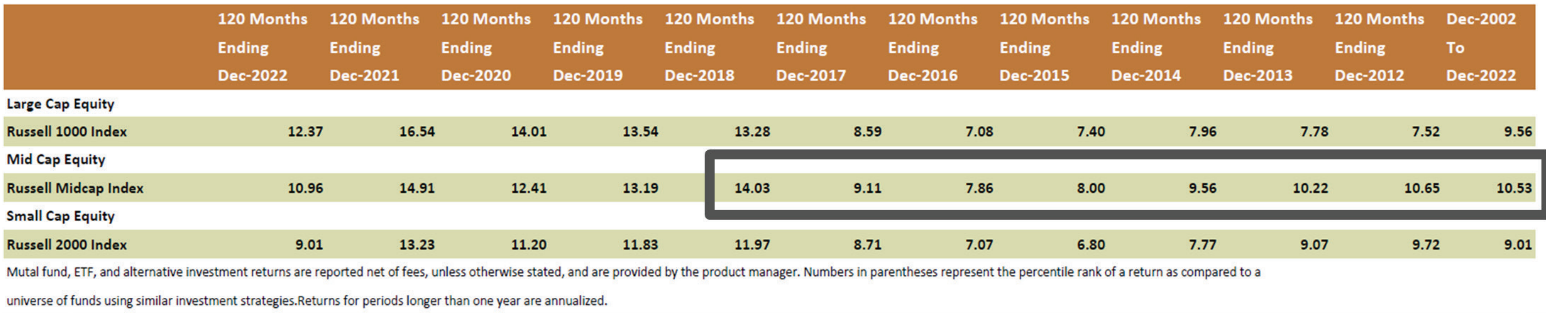
Another benefit of investing in mid-cap equities is that they typically trade at lower valuation multiples compared to large-cap equities. Investors can participate in companies with strong growth opportunities and avoid paying the premium valuations that typically accompany investing in large companies. For example, the price-to-earnings ratio for the Russell Mid Cap Index was 17.99 as of 8/31/2023, whereas the Russell 1000 index had a price-to-earnings ratio of 21.92.

Diversification benefits are another compelling reason to include mid-cap equities in an investment portfolio. A well-balanced and diversified portfolio allocates risk in a variety of ways, including across various asset classes and market capitalizations. Adding mid-cap equities to a portfolio of large- and small-cap equities can mitigate unsystematic risks pertaining to company size and certain sectors of the economy.

Market cycles are dynamic, and what has been performing well recently may not continue to do so. For many years, the markets have favored large technology stocks like Apple and Alphabet. The S&P 500 Index, which holds the 500 largest publicly-traded companies in the U.S., including the large technology names, has become incredibly concentrated. As of mid-August, the largest ten stocks in the index have accounted for around 90% of its year-to-date return in 2023. Investors looking to truly diversify their assets from a size and sector perspective might consider the addition of mid-cap equities to diversify some concentration risk away from the large-cap markets.

When it comes to performance, mid-cap equities have demonstrated their superiority over longer time periods. The Russell Mid Cap Index has outperformed large and small cap equities in a majority of the 10-year rolling time periods in the past 20 years as well as the 20-year return.

Mid-cap equities are often overlooked, but it is this underestimation that can make them a great opportunity. They can play a pivotal role for long-term investors, offering growth, diversification, and valuation benefits. Rather than likening mid-cap equities to middle children, consider them more akin to the middle finger. While it might seem unremarkable at first glance, it can make a significant impact when employed effectively.



	120 Months Ending Dec-2022	120 Months Ending Dec-2021	120 Months Ending Dec-2020	120 Months Ending Dec-2019	120 Months Ending Dec-2018	120 Months Ending Dec-2017	120 Months Ending Dec-2016	120 Months Ending Dec-2015	120 Months Ending Dec-2014	120 Months Ending Dec-2013	120 Months Ending Dec-2012	Dec-2002 To Dec-2022
Large Cap Equity												
Russell 1000 Index	12.37	16.54	14.01	13.54	13.28	8.59	7.08	7.40	7.96	7.78	7.52	9.56
Mid Cap Equity												
Russell Midcap Index	10.96	14.91	12.41	13.19	14.03	9.11	7.86	8.00	9.56	10.22	10.65	10.53
Small Cap Equity												
Russell 2000 Index	9.01	13.23	11.20	11.83	11.97	8.71	7.07	6.80	7.77	9.07	9.72	9.01

Mutal fund, ETF, and alternative investment returns are reported net of fees, unless otherwise stated, and are provided by the product manager. Numbers in parentheses represent the percentile rank of a return as compared to a universe of funds using similar investment strategies.Returns for periods longer than one year are annualized.

INNOVEST *on Mission*

Nonprofit Spotlight: WellPower

Innovest provides investment advice to many nonprofit organizations, and every month, we are honored to introduce you to one of our clients. This month, we are excited to feature WellPower.

WellPower, the largest community mental health center in Colorado, provides treatment, prevention, and crisis services to over 20,000 individuals at hospitals, assisted living centers, schools, shelters, and other locations. In addition, they reach 40,000 – 50,000 more people through outreach and community trainings. The organization was established in 1989 to serve the City and County of Denver and has since grown to nearly 1,000 staff members. WellPower stands behind the truth that treatment works and recovery is possible. WellPower's mission statement is enriching lives and minds by focusing on strengths and well-being.

WellPower wants to see Colorado thrive. They believe that they can and must change the landscape of behavioral health. WellPower has seen adults recover to live a more fulfilling life, children become more resilient, and families grow stronger foundations and healthier relationships through this work. To get involved with this mission, you can donate your time, talent, and skills by volunteering, contribute fiscally, join the community to share your personal experiences, or give other ways.

Equity Market Concentration and the AI Revolution

Steven Fraley, CFA, MBA
Principal, Director

Brett Minnick, CFA
Vice President

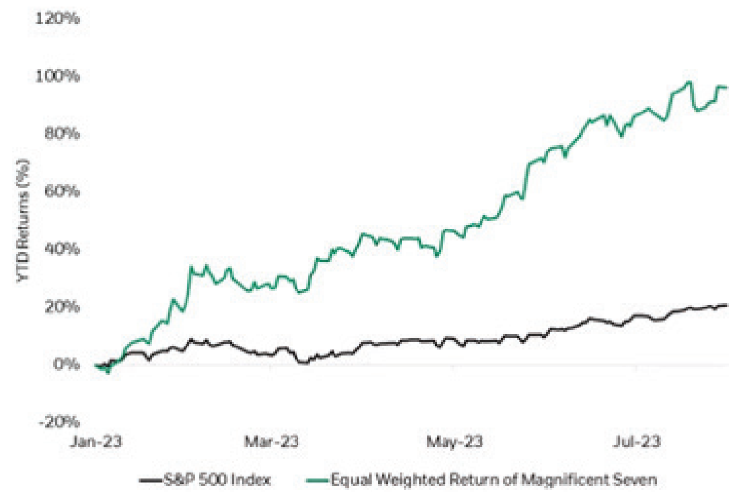
The Rise of Market Giants

Equity market concentration has been a topic of growing concern as seven mega cap tech giants, Apple, Microsoft, Amazon, Nvidia, Alphabet, Meta Platforms, and Tesla, have dominated the global stock market. There has been so much hype around these companies that they have commonly been referred to as the "Magnificent Seven," the largest U.S. companies by market capitalization.

The performance of these stocks has been predominant, contributing nearly 65% of S&P 500 returns, through July, from just ~28% of the S&P 500 Index. This means that most of the other 493 stocks in the index are generally underperforming. A large driving factor of strong performance so far in 2023 has been the latest boom in artificial intelligence, bolstering the success of these high-growth stocks.

Impact on Diversification

Why does this matter and why should investors care if the market is concentrated? Many indices are market capitalization-weighted,



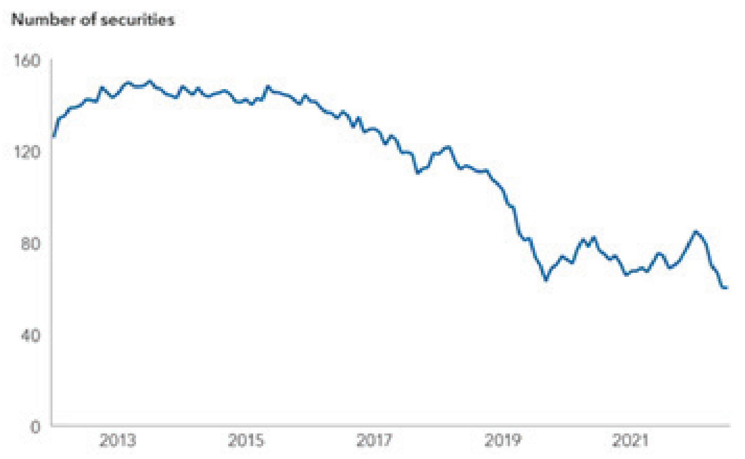
Source: BlackRock, Morningstar Direct

meaning that the larger a stock's size, the larger their share of the overall index. As these companies become a larger portion of the global stock market, they have a bigger impact on overall returns, which could lead to greater portfolio risk. The concentration of market returns in just a few mega-cap stocks, dominated by the information technology and communication services sectors, could lead to heightened volatility, reduced diversification, and increased systematic risk for investors.

Most of these companies are more alike than different and are, in various ways, exposed to the same secular trends. Consider artificial intelligence, cloud technology, augmented/virtual reality, and autonomous vehicles as examples. This overlap increases the systematic risk of owning these stocks within an index or portfolio, as these companies generate a large portion of their revenues and future expected returns from similar risk factors, diminishing diversification and its related benefits.

We have seen a significant decrease in the effective number of securities in the S&P 500 index, as measured by the Herfindahl-Hirschman Index (HHI). The HHI seeks to measures how many securities it would take to create an equally-weighted portfolio with the same level of diversification as the S&P 500 index. This figure is at its lowest level in recent history, which means the index itself is thereby also providing the least amount of diversification.

An overly concentrated market can also have a significant impact on active management and stock selection, as narrow leadership can be challenging for managers and strategies that favor greater breadth. When considering the Magnificent Seven, there is significant factor exposure to quality and momentum and negative exposure to size (small companies) and value (inexpensive companies), which has a big impact on the overall index.



Source: FactSet as of June 30, 2023

Influence of AI on Future Returns

Artificial intelligence hype hit an all-time high in 2023. A lot of this can be attributed to the belief that it is more than just a new market and, rather, is a foundational technology by which other markets will be created. Investors are expecting that the productivity increase realized from AI could drive macroeconomic growth for years to come.

We believe that AI will likely have a sustained, significant impact on market returns over the next decade and beyond as economic growth is primarily driven by three main factors: capital, labor, and technological advancement. Many countries and geographic regions around the globe are currently experiencing decreased labor and capital growth. We believe a growing portion of future economic growth will come from technological advancement, and specifically artificial intelligence. According to a recent study by McKinsey & Company, generative AI has the potential to deliver significant economic benefits, adding between \$2.6 and \$4.4 trillion in global corporate profits annually[1].

At a micro level, we are approaching AI-based investments with cautious optimism, as it often takes time to see meaningful adoption when it comes to disruptive technology. This is likely a major competitive advantage for early adopters, primarily the Magnificent Seven, who have spent billions of dollars building out their technology and have expansive customer bases to tap. While there will be several new entrants and disruptors, over time, it will likely take years to see meaningful market penetration.

How to Mitigate Concentration Risks

While risks are inherent with investing, we believe investors can reduce the overall risks in their portfolio by incorporating key best practices. Within the overall equity allocation, exposure to different investment styles (value and growth) as well as different-sized companies (large cap, mid cap, and small cap) to achieve broader diversification away from the largest names in the stock market can help reduce portfolio volatility. Beyond style and size, diversification outside of the United States provides exposure to investment trends and the economics in other growing parts of the world. Additionally, employing a prudent rebalancing process helps ensure that investors do not get overly concentrated in any particular asset class or style box.

Because of the robust performance of the Magnificent Seven, portfolios have generally become overweight to large cap stocks, resulting in an underweight to small and mid-cap stocks, as well as international equities. Rebalancing portfolios back to target weights helps reduce risk and prevent overexposure to high-performing assets, ensuring the portfolio remains consistent with the investors long-term risk and return objective.

1McKinsey & Company. (2023, August 25). What is the future of generative AI? An early view in 15 charts. Retrieved from https://www.mckinsey.com/featured-insights/mckinsey-explainers/whats-the-future-of-generative-ai-an-early-view-in-15-charts

Employee Spotlight: Steven Fraley

Where is your hometown?

I was born in St. Louis, Missouri and moved out to Denver with my family at the beginning of 2020.

Tell us something unique about you.

Not sure if it is unique or just crazy, but my wife and I took some time off from our careers to travel. We spent six months in Asia and Europe when our oldest son was nine months old. I truly believe that travel provides us with incredible opportunities to learn and grow by exposing us to diverse cultures, perspectives, and ways of life that we do not experience every day.

What do you like best about working at Innovest?

I really enjoy the people and culture at Innovest. We have an amazing team that always goes above and beyond for our clients, our community, and each other. This is embedded in who we are as a firm and makes coming to work every day very rewarding.

How do you give back to the community?

One of the great things about working at Innovest is our dedication to the community. We typically have monthly on-site volunteer opportunities I try to contribute to. Additionally, my wife and I are very active in supporting our local neighborhood/community and our sons' schools.

What are your hobbies and interests?

At this point, most of my time is spent running our kids from activity to activity. Right now, we have soccer, baseball, taekwondo, and horseback riding, to keep us busy. We also love to ski and hike as a family. When I do have time to sneak away, I am usually golfing or hunting.

Tell us about your family.

I am very lucky to have been married to my amazing wife, Meg, for over 11 years. We have been blessed with three wonderful and wild sons, Charlie (5), Harrison (3), and Weller (2). All of our immediate family is back in St. Louis, so we try to get back to visit when possible and love to host our families in Denver. We also try to spend a lot of time enjoying the mountains in Steamboat Springs.

What is your favorite dessert?

My favorite dessert is authentic key lime pie, you just can't beat it. Our favorite family tradition is walking or riding our bikes up to Bonnie Brae ice cream!

Around the Firm

Promotions & Team Updates

We are excited to announce the addition of exceptional talent to our team! Firstly, we welcome Tomas Jansson, our new Vice President and Consultant on the Retirement Plan Practice Group. Tomas brings more than two decades of experience in optimizing company-sponsored retirement plans. In addition, Christian O'Dwyer, CFA, returns to Innovest as a Principal. Christian, with a wealth of experience acquired during his previous five-year tenure at Innovest and roles at UBS Financial Services and BOK Financial, will guide families, foundations, endowments, and nonprofits in investment strategy and financial planning. Next up, Analyst Assistant, John Walsh, joins the team. John is a graduate in finance and business analytics from Santa Clara University. Finally, we welcome Analyst Assistant Austin Cleveland, a University of Missouri alum with degrees in finance and French. Welcome aboard, Tomas, Christian, John, and Austin!

Welcome Arrupe Interns!
Angel
Osmar
Diego
David

School is back in session, and our Arrupe interns have returned to the office. We are thrilled to have Angel (senior), Osmar (junior), Diego (sophomore), and David (freshman) in our office this year!

Lastly, we would like to recognize the outstanding individuals on our team who embody our core mission of stewardship. In June, Sydney Aeschlimann and Joanne Cinalli, CPFA™ received the Service to Others monthly award, in July, the honor went to Lori Foster, in August, to Christine Hudek, and in September to Tracey Blackford. They inspire our team with their steadfast dedication to our core values.

Awards & Publications

Principal Sloan Smith, CAIA, MBA, CPWA®, recently shared his thoughts on "Private Debt – The Appeal After Bank Failures" in *Advisor Perspectives.* Vice President Frank Cornett, CFP®, provided a deep dive into the dynamics of cyclical markets with his article "What Cyclical Markets Mean For Clients," featured in *Financial Advisor*. Finally, Vice President Paul D'Alessandro explored the changing landscape of fundraising jobs in his article "The End of Traditional Fundraising Jobs and What to Do About It," recently published by NonprofitPRO.

Service

Innovest actively volunteers to support impactful organizations. This quarter, Innovest partnered with Brothers Redevelopment, Inc., an organization that offers affordable housing solutions for low income, elderly, and disabled residents, to complete a "Paint-a-thon." We also participated in the Denver Public Schools Foundation Back to School Bash 2023, where Innovest employees cleaned up a pavilion at a local elementary school. Finally, our team worked alongside Habitat for Humanity of Metro Denver, to assist in the construction of a home. At Innovest, we prioritize providing our employees with opportunities to actively engage with and serve our community.

Brothers Redevelopment
Paint-A-Thon
This Home Painted By:
INNOVEST
Call (720)339-5864

Conferences, Speaking, Events, & Sponsorships

Innovest proudly supports community initiatives, emphasizing our commitment to social responsibility. We sponsored Sam's Supper, a fundraiser for Samaritan House at Mile High Station on September 16th. Additionally, we were honored sponsors of the Focus on Finance Gala with Economic Literacy Colorado on October 19th. Innovest also proudly supported the Dig Deep Community Block Party at DIRT Coffee in Littleton, CO. DIRT actively addresses neurodivergent employment disparities by collaborating with individuals, employers, and communities. Through training and support, they foster inclusive workplaces, promoting the hiring, promotion, and retention of neurodivergent individuals and enhancing organizational culture.

Finally, Innovest's Sloan Smith gave the Economic Update for AmPhil's Office Hours webinar on August 29th, discussing the projections of the world economy and financial markets for the next five to ten years.

INNOVEST   CliftonLarsonAllen

Spring 2024 | Denver, CO

ROCKY MOUNTAIN BENEFITS CONFERENCE

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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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