# Ten Questions to Ask About Your Diocesan Investment Portfolios


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# About the Sponsors

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# Bob Doll, Crossmark Global Investments

Bob joined Crossmark in May 2021 as Chief Investment Officer (CIO), bringing over 40 years of industry experience to guide the investment process and serve as portfolio manager for multiple Crossmark large-cap strategies. He also utilizes his investment expertise to provide weekly and quarterly investment commentaries, as well as annual market predictions. Bob is a regular guest and contributor to multiple media outlets such as CNBC, Bloomberg TV, Moneywise, and Fox Business News. Prior to arriving at Crossmark, he held the roles of Senior Portfolio Manager and Chief Equity Strategist at Nuveen and Blackrock, President and Chief Investment Officer at Merrill Lynch Investment Managers, and Chief Investment Officer at Oppenheimer Funds, Inc.

Bob graduated from Lehigh University with a B.S. in Accounting and a B.A. in Economics. He later went on to earn an M.B.A. from the Wharton School of the University of Pennsylvania. He is a Certified Public Accountant (CPA) and holds the Chartered Financial Analyst (CFA®) designation, as well as the FINRA Series 7 and 63 securities licenses.

**Crossmark Global Investments** is a faith-based investment management firm that provides a full suite of investment strategies to institutional investors, financial advisors, and the clients they serve.

For over 30 years, the firm has delivered uniquely constructed products based on its proprietary, disciplined, and repeatable process. Crossmark is especially known for helping its clients align their investments with their values by creating socially conscious, responsible investment strategies. Founded in 1987, the firm is headquartered in Houston, Texas.

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# Joseph Marks, Capital Dynamics

Joseph is a Senior Managing Director, Head of Secondaries and a member of the Private Equity Investment Committee as well as the Executive Committee. He has over 20 years of experience in private equity. Prior to joining Capital Dynamics, Joseph was a principal at Coller Capital in New York where he was responsible for the origination, evaluation, and execution of secondary portfolio transactions. He holds a bachelor's degree in Economics (Honors) from Stanford University, and an MBA and a Juris Doctor in Law from the University of California, Los Angeles. Joseph also holds the professional designation of Chartered Financial Analyst (CFA).

**Capital Dynamics** is a global asset management firm that offers products in private equity, private credit, and clean energy infrastructure. Capital Dynamics has worked with Catholic clients to provide mechanisms to allow them to invest their private market allocations in a Catholic Socially Responsible manner.

# Overview

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## Ten Questions

1) How do you define risk?
2) Have you stress tested your interest rate sensitivity?
3) Have you explored alternate sources of income?
4) Is your portfolio protected against inflation?
5) Are you comfortable with/aware of your downside risk?
6) What is your optimal risk of actively managed versus indexed equity?
7) Are you overvaluing liquidity?
8) Is your portfolio invested in alignment with Catholic principles?
9) Is your asset allocation consistent with your long-term goals?
10) How do you evaluate your investment advisor?

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## Risk Framework for Catholic Portfolios

| Fiduciary Risk | Longevity Risk |
|---|---|
| Investment Policy/ Governance, Fee Analysis/Monitoring, Performance Reporting, Independent Third Party Oversight | Strategic Asset Allocation, Liquidity and Cash Flow Needs, Spending Policy Analysis |
| **Market Risk** | **Alignment Risk** |
| Tactical Asset Allocation, Investment Manager Evaluation/Selection, Disciplined Rebalancing, Stress Testing | Development, Implementation, and Monitoring of Socially Responsible Investment (SRI) Guidelines |

# Interest Rates

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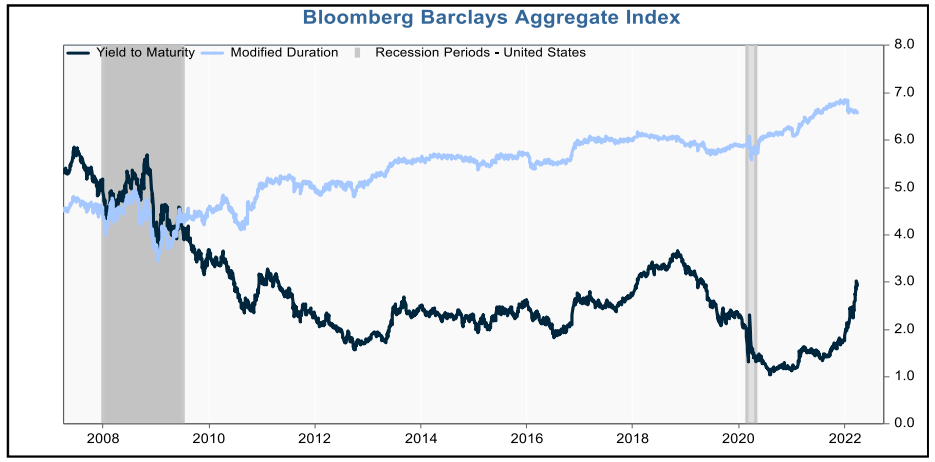
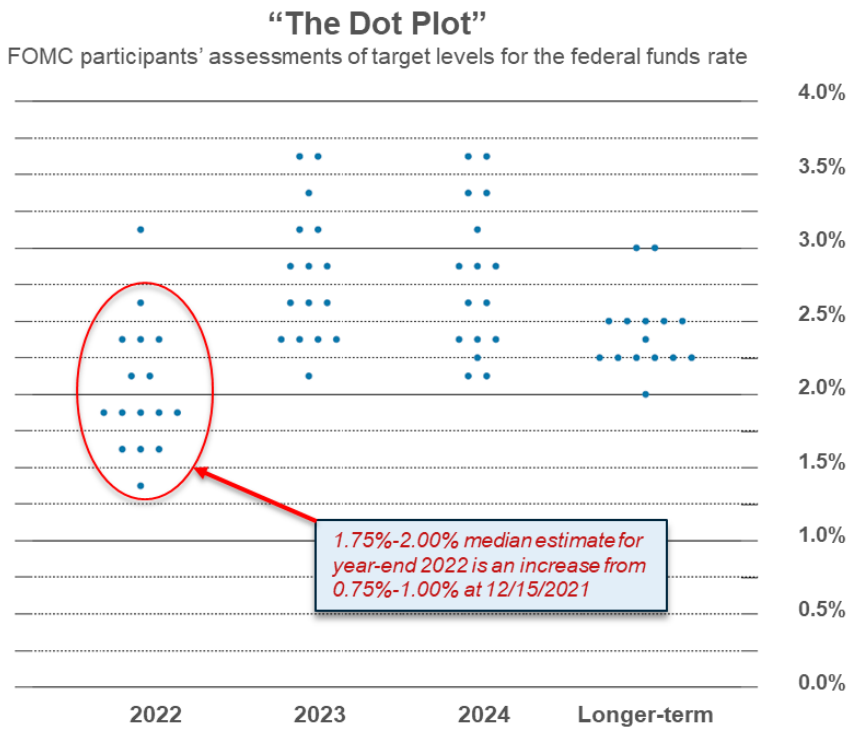
# Interest Rate Risk

- Bond yields are low and rising, which are ingredients that produce negative returns for bonds (Aggregate Bond Index -5.9% in 1Q ‘22)
  - The yield on the bond portfolio is the first line of defense against price declines, but the duration risk of intermediate and core bond portfolios far exceeds the income
- The yield curve has also steepened dramatically over the last twelve months, and has various points where the curve is inverted, which creates different opportunities and risks for fixed income portfolios based on duration structure
- This is exceptionally important for portfolios with higher fixed income allocations, such as deposit and loan funds or insurance assets.




Source: Factset, Data as of 3/31/22




Source: Federal Reserve, as of 3/16/2022

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# Inflation

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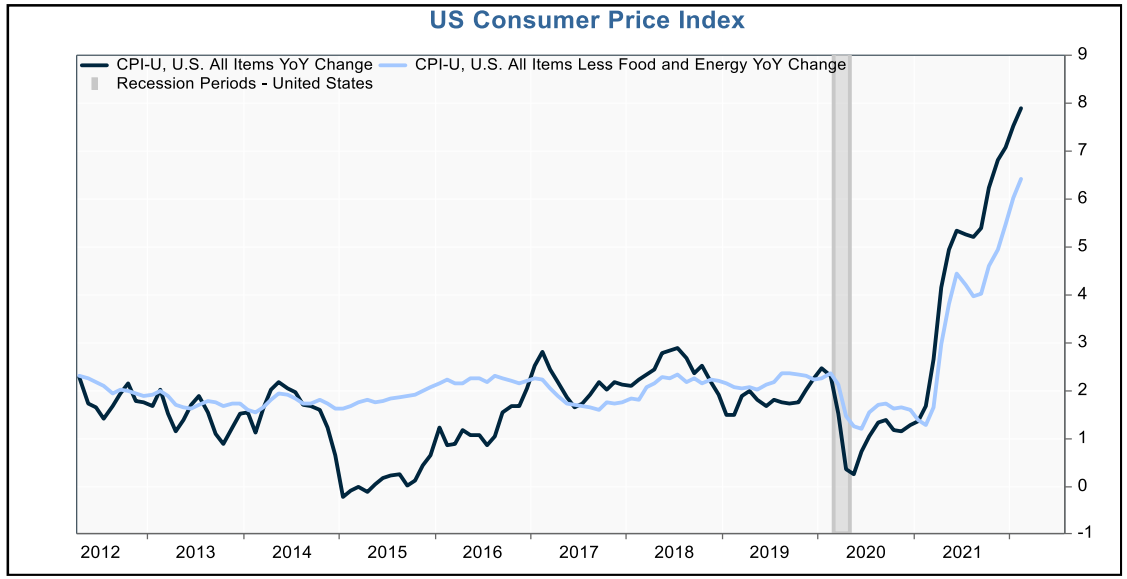
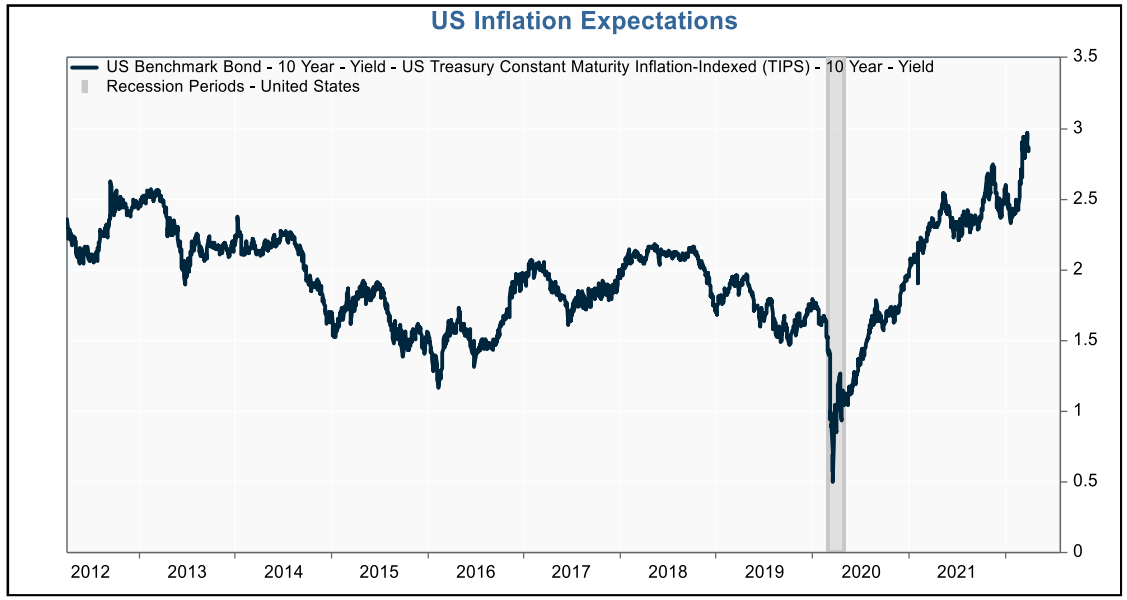
# Inflation

- Inflation has been mostly absent in the U.S. economy for over a decade, but the economic rebound from the COVID-19 slowdown coupled with supply chain disruptions has injected inflationary pressure

- The Federal Reserve initially believed that inflation was “transitory” and was willing to accept above-trend inflation, but now their views have changed and inflation is a more pressing concern




Source: Factset, Data as of 3/31/22

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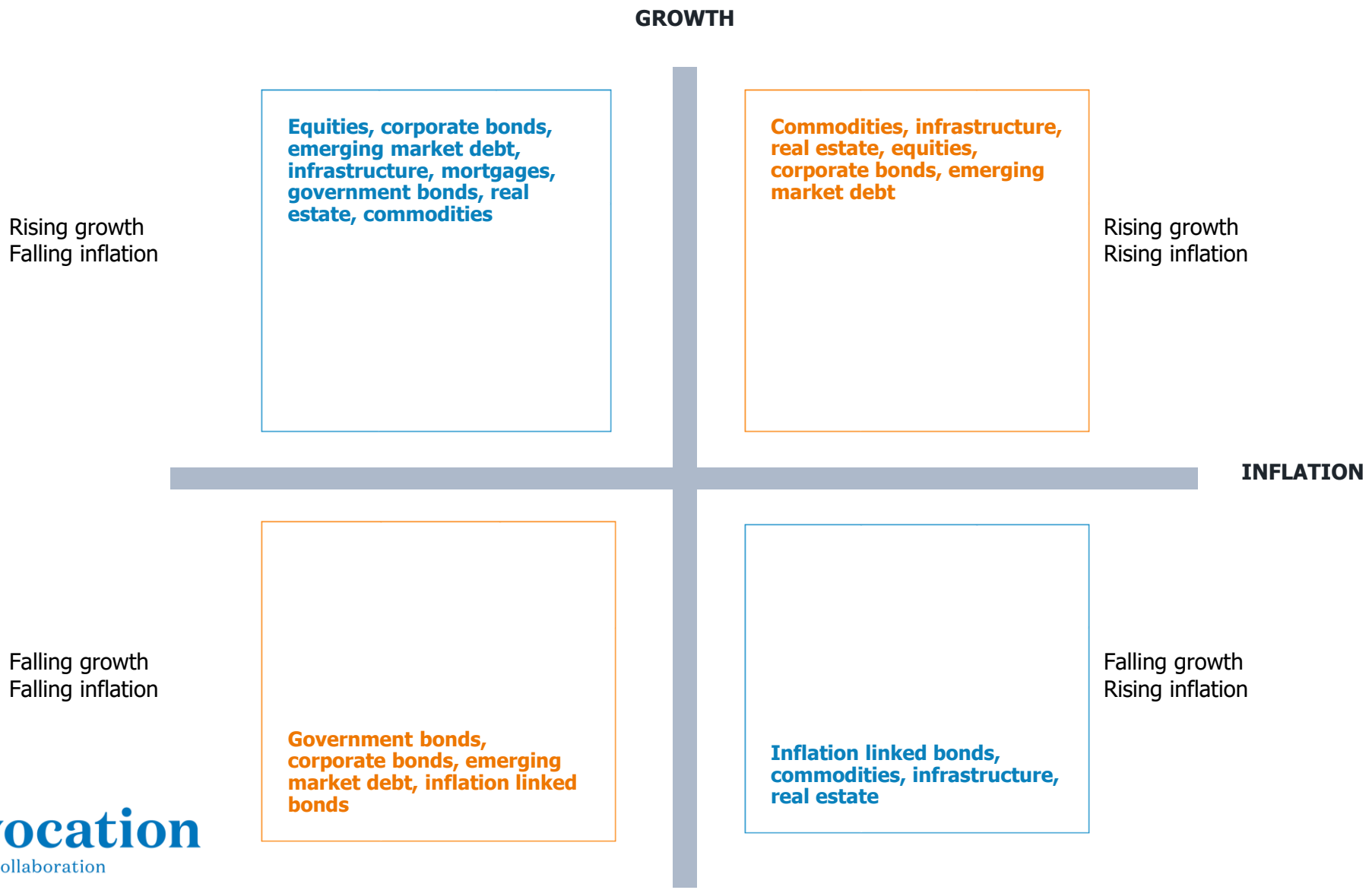
# Inflation

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# Broad Outlook

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# Bob Doll 10 Predictions – 2022

1. **For the first time since 1958/1959, 10 year Treasuries provide a second consecutive year of negative returns.**
2. **US real growth and inflation remain above-trend but decline from 2021 levels**
3. **Inflation falls, but core inflation remains stuck at around 3%**
4. **Stocks experience their first 10% correction since the pandemic and fail to make the gains widely expected.**
5. **Values-based investing continues to gain share.**
6. Cyclical, value and small stocks outperform defensive, growth and large stocks,
7. Financials and energy outperform utilities and communication services.
8. International stocks outperform the U.S. for only the second year in the last decade.
9. After a 60+ year low in 2021, federal interest expense as a percentage of revenue begins a long-term move higher.
10. Republicans gain at least 20-25 House seats and barely win the Senate.

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# Focus Five: 2022 Factors

1. **Economy**
2. **Equities**
3. **Fixed Income**
4. Sectors
5. International

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# Economy

1. No playbook for the current environment
2. Largest GDP drop in modern history
3. Strongest recovery in 50 years
4. COVID reverberations will be with us for years
5. Massive monetary and fiscal stimulus

What To Do:

Public Markets

- Be flexible
- Emphasize security selection
- Expect more modest returns

Private Capital

- Seek out PE/VC historically less volatile than S&P 500
- Adopt a long term view
- Take advantage of public/private market arbitrage

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# Equities

1. No recession
2. Earnings growth positive
3. High valuation levels a negative

What To Do:

Public Markets

- Overweight cyclicals; underweight defensives.
- Overweight value; underweight growth
- Buy dips/trim rallies

Private Capital

- Stay invested: poor exit period, but excellent vintage year
- Take a ‘back to basics’ approach (long term view)

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# Fixed Income

1. The Fed shifted (belatedly) from fighting unemployment to fighting inflation.
2. The Fed is slowly taking away the proverbial punch bowl.
3. Will eventually raise rates

What To Do:

Public Markets

- Low Duration
- Underweight U.S. Treasuries
- Own inflation-protected securities

Private Capital

- Consider floating rate loans, which tend to outperform in rising interest rate environments
- Seek lower middle market opportunities for additional protections from headwinds

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# USCCB Updated SRI Guidelines

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# USCCB Guidelines

- Gallagher has prepared a detailed white paper outlining the changes to the USCCB Socially Responsible Investment Guidelines passed in November 2021

| 2003 | 2021 |
|---|---|
| 1. Protecting Human Life | 1. Protecting Human Life |
| 2. Promoting Human Dignity | 2. Promoting Human Dignity |
| 3. Reducing Arms Production | 3. Enhancing the Common Good |
| 4. Pursuing Economic Justice | 4. Pursuing Economic Justice |
| 5. Protecting the Environment | 5. Saving Our Global Common Home |
| 6. Encouraging Corporate Responsibility | |

- **In addition to new negative screening criteria, the revised guidelines place a heavier emphasis on corporate engagement and the application of Catholic values in security and manager selection**
  - Language states that investment advisors should be prepared to include examples on how their active ownership produces real-world outcomes

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# USCCB Guidelines

- There has been an expansion of products specifically catering to the Catholic marketplace, both in traditional and alternative investment asset classes
  - Mutual Fund families dedicated to Catholic Socially Responsible Investing expand the universe of viable options for Catholic defined contribution plans
  - Index vehicles (Mutual Fund, Collective Trust, ETF, or separate account) to get low cost market exposure in a Catholic Socially Responsible manner
  - Catholic-oriented products are available in alternative asset classes such as:
    - Private Debt
    - REITs/Liquid Real Assets
    - Hedge Fund-of-Funds
    - Private Equity
    - Impact Investing
- No single Catholic investment manager has best-of-breed offerings in every asset class
  - An independent investment consultant can help you evaluate and incorporate this wide range of offerings into your portfolio as appropriate
  - **Important: We will not recommend any investment vehicle solely because it is Catholic Socially Responsible**

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# Values-Based Responsible Investing in the Private Markets

- Focus on protecting human life, promoting human dignity, avoiding arms production, protecting the environment, and encouraging corporate responsibility
- Making commercial reasonable efforts to not knowingly investing in businesses that are not socially responsible, such as ones that exploit forced labor or child labor, manufacture or trade ammunition , manufacture, sell or distribute adult entertainment, etc.
- These are investments which won't be knowingly made irrespective of investment returns or other considerations
- For investors with additional value-based exclusion criteria, a side letter that removes such economic exposure may be made available
  - There can also be an opportunity for value-based investors to true-up the economic interest in an agreed-upon list of prohibited investments, eliminating all economic gain or loss related to a defined investment

# Asset Allocation Considerations

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# Asset Allocation Considerations

- Asset allocation policy often represents a series of tradeoffs with the goal of finding the proper balance for your specific objectives:
  - Risk versus return
  - Income versus growth
  - Diversification versus liquidity
- Time horizon is another important factor in asset allocation policy
  - Capital market assumptions can differ materially across intermediate and long-term horizons
  - Intermediate (10-year) assumptions are muted relative to historical averages
  - Investor psychology can adversely impact portfolio returns making illiquid private market funds attractive for long time horizons
- Defined Benefit Plans
  - Consider asset allocation in the context of liability structure and actuarial return assumptions
  - Time horizon for defined benefit plans can change materially if you are exploring pension risk transfer strategies
- Endowments and Foundations
  - Important to evaluate spending policy in the context of asset allocation and vice versa
  - Determine optimal spending policy to balance both short-term and long-term spending objectives

# Conclusions and Additional Resources

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# Conclusions

- We believe it is vital for Catholic fiduciaries to take a more comprehensive view of risk in their investment portfolios
- Interest rates and inflation are likely to produce additional volatility in publicly traded equity and fixed income markets over the short- and intermediate-term time horizon
- Investors should focus on making sure they are comfortable with the downside risk present in their portfolio and to seek additional diversification as necessary
- Investors can potentially achieve better risk-adjusted returns if they are willing and able to sacrifice liquidity in portfolios with long-term time horizons
- Asset allocation decisions should be based on long-term goals, objectives, and risk tolerance and not focused on trying to time short-term market movements
- The USCCB Socially Responsible Investment Guidelines were revised in 2021, with the most significant change being the increased emphasis on active ownership and positive security selection
- Although Catholic Diocesan portfolios are not governed by ERISA, it is still useful for Catholic fiduciaries to follow governance best practices in monitoring their investment portfolios and periodically evaluating their investment advisors

# Additional Resources

- *Ten Questions for Catholic Investment Portfolios,* Gallagher, August 2021
- *Revisions to USCCB Socially Responsible Investment Guidelines,* Gallagher, November 2021
- *Quarterly Financial Markets Update Webinar*, Gallagher
- *Doll's Deliberations,* Crossmark
- *The Evolution of ESG in Lower Middle-Market Direct Lending*, Capital Dynamics, February 2022

***If you're interested in reviewing any of these referenced resources, please reach out to me or your primary Gallagher representative.***

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# Discussion

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# Thank you.

## Contact Information


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