Fiducient Advisors, Nonprofit Investment Stewards Podcast
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How Endowments (Especially Schools) Can Navigate Market Volatility With Katharine Wyatt

[00:00:00] Welcome to Nonprofit Investment Stewards with Bob DiMeo and Devon Francis from Fiducient Advisors. Bob and Devon are passionate about helping nonprofit organizations prosper. Whether you oversee endowment, foundation or retirement plan investments, this podcast exists to help stewards improve performance, reduce costs, and discover strategies that enable your charitable organization to prosper and advance its mission.

[00:00:26] Now onto the show. Hello, and welcome back to the Nonprofit Investment Stewards podcast. I'm Bob DiMeo, and it's nice as always to be joined by my business partner and co-host of the show, Devon Francis. Let's begin today by asking listeners to visualize the following. Think about a nonprofit organization with an incredibly important mission that impacts many.

[00:00:50] It's a complex organization contending with rising costs, challenged revenue streams, regulatory matters, and the entire sector is undergoing enormous

[00:01:00] transition that likely leaves some organizations thriving while others become less relevant or may even cease to exist. Some of you listening to my description are thinking, wait, that sounds like us.

[00:01:12] Fact is, it actually describes a lot of nonprofits, but here we're talking about higher education and our guest is about to share important insights that apply not only to schools, but to a wide array of nonprofits. Let's jump to Devon to introduce our super talented guest. Hi Bob. So today we are joined by Katherine Wyatt.

[00:01:31] Katie is the Chief Investment Officer at Loyola University, Chicago. Katie has over 20 years in the investment industry with experiencing managing large institutional portfolios and investing across public and private asset classes. At Loyola, she leads the university's investment office responsible for management of over one and a half billion in endowment, operating reserves and defined benefit pension assets.

[00:01:56] Prior to joining Loyola, she was director of investments for Abbott Laboratories retirement plans, which included over 18 billion in assets. Katie started her career as a research analyst at a multi-family investment office covering hedge funds, private equity, and private real assets. She attended the

University of Wisconsin-Madison for both her undergraduate and graduate degrees.

[00:02:18] She is a CFA charter holder, a member of the Private Equity Women's Investor Network, and a lot more. Katie, welcome to the show. We're so thrilled you're here. Thank you for having me on. Katie, it's great to have you here on the show, and you and I met not that long ago at the Catholic Investment Services Symposium in Chicago, and you were on a great panel led by former Vanguard Head Jack Brennan.

[00:02:40] And as I told you that day, I very much appreciated your perspective on investing and a lot more. So maybe we can begin with your role and some detail on how the endowment is viewed and frankly how it's used at Loyola in supporting mission, operations and so on. Sure. So, my role is Chief Investment Officer, and that means I'm responsible for oversight and management of all pools of capital at Loyola.

[00:03:06] We have the biggest pool, which is the endowment, but we also have the sizable operating portfolio. We run a closed and frozen DB plan. And in addition to that, I serve on the investment committee for our 403(b) plan. In addition to that, I serve on the investment committee for our 403(b) plan. And recently, I joined the investment committee for Christo Rage Jesuit High School, which is all in the Jesuit family, but actually unrelated to my role at the university.

[00:03:41] Our endowment is internally managed. I have a staff of four, myself included. Our team includes three investment professionals which is myself and two investment directors, and one director of investment operations. So, I joined in

[00:04:00] 2018 to build out this inside investment office. Spent most of the pandemic, uh, era building out technology infrastructure.

[00:04:11] And then I hired the investment staff in 21 after the hiring freeze was lifted here. So that's my background at Loyola. Let me tell you a little bit about the endowment. The endowment today is just a little bit over a billion dollars. That's a very nice size, but actually relative to the size of our student body, which is about 17,000 students, I would say we're actually relatively under endowed per student, especially compared to many other private universities, which just means that our endowment relative to how many students we have.

[00:04:48] Should be, and I think we all wish it was just a little bit bigger. But the endowment supports about 4% of the budget, which is actually relatively low. We are a tuition driven school, so we have a goal to really grow this endowment both through investment gains and also through an advancement campaign.

[00:05:09] We've been historically very conservative in how we budget and spend. We've been spending only about 2.75% every year, and there are some years when gifts and inflows exceed spending and outflows. So actually, we've been able to compound capital inside the long-term pool quite nicely. But the endowment is a critical piece of our financial picture, and I expect that endowment support will increase as the endowment grows larger.

[00:05:43] Since our mission is educating students in the Jesuit tradition, and I'm very proud to wake up in the morning and come to work knowing that my work directly contributes to that. Given our Jesuit heritage and mission, we emphasize both intellectual excellence

[00:06:00] and spirituality. So as a Jesuit institution, one of our priorities is supporting students, especially from backgrounds who haven't been quite as financially advantaged as other students.

[00:06:14] We have a significant number of students here with help from Pell Grants and the scholarships that we provide. And additionally, we have a school which supports a two-year degree program where students achieve an associate's degree and then can further matriculate onto a four-year program. That's Rupe College.

[00:06:33] And Rupe is specifically targeted to a diverse population, many of whom are the first in their family to pursue higher education. The Rupe model ensures affordability while providing care for the whole person intellectually and spiritually, so there is a lot going on here. That's really great that the endowment directly contributes to.

[00:06:59] So Katie, it's a confusing and tumultuous time in the markets and in the world broadly. And in his, uh, introduction to this episode of the podcast, we mentioned some of the challenges. Bob mentioned some of the challenges that anyone overseeing a nonprofit portfolio contends with. Can you share some of the things that you and your team are diligently attempting to navigate these days?

[00:07:23] Sure. You know, it is a confusing time, that's for sure. I would say that's not just recent. Since I started here, I've managed through three bear markets in four years, so that was a lot of fun. I started in December of 2018, in the middle of that sort of fourth quarter bear market. So welcome to work.

[00:07:44] Uh, 2019 was a great year, and then we had Covid and that was a bear market and quite confusing. Uh, then, you know, after that, of course the market went on to rally in the back half of 20 and 21. And, but then we got 22 and another bear market and that was brought on by the highest inflation we've had in 30 or 40 years, and aggressively rising interest rates.

[00:08:07] So, it is very confusing. It's been a strong start to 2023, which is surprising because everyone is talking about a recession later this year. So, Yikes. You know, trying to manage a long-term pool of capital through that is a little bit tricky, but what we're trying to navigate here is just how to make sense of this current environment, but most of all, make sure that the portfolio stays positioned for the long-term in the midst of a lot of short-term noise.

[00:08:36] But trying to identify structural regime changes that could impact long-term strategic asset allocation. So I think the biggest questions right now are, are we in a new reflationary regime and how could that impact asset prices? I think the biggest thing we've seen so far is that, TINA, that there is no alternative.

[00:09:01] Our friend TINA, who's been with us for a couple a decade, is dead now, and the role of fixed income could be, is, you know, more important now in the portfolio than it has been and has just been a drag for years, and in fact, didn't even diversify you last year when equities drew down. So we've been spending time talking internally about inflation and how to position for that, especially as our spending, which is tied to inflation will go up commensurately.

[00:09:31] So Katie, one of the biggest challenges facing the higher-ed landscape, uh, that, that folks have been spending a lot of time talking about is the demographic cliff. Can you comment on that? Sure. Yes. That is a very real phenomenon that we're starting, even now, starting to incorporate into our financial projections, and this is only now a few years out.

[00:09:53] The impact of the demographic cliff will be significant at Loyola, but we are in a great position to navigate that. Our institution has exercised outstanding physical discipline in past years. Even as we've seen increases in our enrollment, we've been budgeting to running an operating surplus, usually has been in the ballpark of 20 million dollars.

[00:10:19] Which is unusual, I think, for private higher-ed, but which we have saved to reinvest in the institution. So, we have taken that operating surplus and reinvested that into our capital budget. We've reinvested that into debt pay down at a significant rate and other capital and operating needs. We really are in a good position going into this demographic cliff, but that's not to say changes won't be coming.

[00:10:47] Obviously. The demographic cliff will be a huge revenue impact, and as I mentioned earlier, Loyola is a very tuition-dependent university. The way that impacts my role in the investment office is that it's fair to say that we'll be seeing an increase in our spending probably to the full budgeted amount.

[00:11:11] So we have always budgeted 4%, but we've only spent about two and three quarters percent as most departments have first drawn from their operating budget before utilizing their endowment budget. So that's been great for me anyway, the rest has remained in the pool. We've been able to grow our private equity quite easily because we don't have a lot of liquidity constraints.

[00:11:37] But going forward, we'll be spending our endowment budgets more fully to offset revenue decreases and more fully support the operation.

[00:11:53] So that, uh, when, when you speak of the demographic cliff, the impact of inflation, the impact of, of sort of spending policy and your spending maybe ratcheting up to the full amount. Curious how that has you and, and your team thinking about target rates of return, right? The overlayer backdrop is, you know, what's happening in the capital markets and the world and such, but it, but as you're, you know, I think I hear you saying like the endowment might have to work a little bit harder.

[00:12:19] So how are you translating that into target rate of return and how has that evolved? Yeah, um, that's a great question and that's probably the biggest part of my job right there in a nutshell. Um, you know, it starts of course, like you mentioned, with what we need to spend and then we kinda work our way up from there.

[00:12:39] So the way we think about it is the typical CFPI plus five, even though we spend four, but then we leave a little bit left to compound into the pool. So I guess with that, we need to figure out where CPI is heading. So maybe someone can tell me that, it's wandering down, but um, you know, I don't know if, maybe I'm not thinking about it the right way, but the inflation piece over the long term doesn't keep me up as much at night.

[00:13:09] Obviously, it has not been transitory, but you know, if you look at the five year, five year forward, you know, even through the worst of inflation last year, didn't really get too much over two and a half percent. So the market is telling us that inflation isn't going to be really high for really long.

[00:13:29] Now, I don't think we get back down to 2% or sub 2% on a go forward basis, but you know, I think it's reasonable we could level out in the 3ish zone, not an economist, but that's kind of where I see we might be shaking out. Asset prices will adjust. And I am of the opinion that equity is the best long-term inflation-beating asset.

[00:13:53] So our portfolio remains very equity centric. But we are getting more out of our bond portfolio these days and, um, we're really utilizing our hedge fund portfolio, building a hedge fund portfolio to provide both the high returns that we're going to need and hopefully a lot lower correlation. And I guess the last thing I'll mention is, we have a portfolio that can withstand a fair amount of volatility, especially since it's supporting, at this point, just a relatively small piece of our budget.

[00:14:27] So, we're taking the returns the market gives us, but we're trying to be smart about it through positioning and manager selection. Great. So let's dig into asset allocation and how the portfolio is positioned. You know, we talked about how uh, our good friend TINA has sadly now passed and the decade of free money is behind us, and, what are you, um, how has your asset allocation profile changed or how do you anticipate that it may change in the future given this, uh, kind of revamped environment we're in?

[00:15:03] Yeah, you know, I just, I don't know that it's changing a lot. You know, we're going through an asset allocation exercise for our upcoming meeting and portfolios, our asset allocation is designed for the long term, so I don't see it changing a lot, at least at the headline, but we are making incremental changes, I'd say under the hood.

[00:15:29] So, yeah, with the, you know, with that decade of free money over, obviously we're not expecting a market that's been just up and to the right, like we've enjoyed for the past decade with a couple exceptions. But, um, you know, I continue to believe in hedge fund strategies, and I believe that they can deliver high returns that are not dependent on market beta.

[00:15:52] If you pick the right managers. So, I've heard a couple of institutions, bailing on hedge funds.

[00:16:00] Yes, they're high fee. Yes, they haven't always delivered in these markets that are just a beta play. But I think going forward, this will be a good era if you can pick the right strategies and the right managers.

[00:16:13] On the asset allocation side, we're making, um, any changes we're making is more at the margins and more incremental tilts. So, within global equity, we like emerging markets. We're going to, we're starting to lean into that. The region is growing. Growth is still there but valuations are much lower there than they are in the U.S.

[00:16:38] We like non-US developed equity and we're looking for opportunities in European credit. You know that across the portfolio, we're looking for opportunistic ways to take advantage of pullback and bank lending, especially with what has gone on with, you know, regional banks in the wake of Silicon Valley.

[00:16:56] It's gone on with Credit Suisse in Europe. I think that will provide us with some good potential returns. So, you know, overall, we're looking for areas of dislocation and in fact, that's one of the biggest themes we have in the portfolio is a return to dispersion. So, with the free money era over now, we believe that there will be areas of differentials that we can take advantage of.

[00:17:22] We've funded a couple new global macro managers recently. That's been an area we haven't really trafficked in for a while. But, you know, the thesis here is that central banks are now dealing with inflation. And instead of sort of global coordinated monetary policy that you saw for the decade after the financial crisis, we believe there will be more dispersion in interest rates, in inflation rates and FX.

[00:17:50] Also geopolitical challenges are top of mind. Certainly, that's not a good thing, but it drives dispersion in a way that hopefully some more macro oriented funds can trade and take advantage of. Um, macro, it's been kind of a disappointing strategy for a long time during the era of free money because there was no, there was no volatility, there was no dispersion.

[00:18:13] But I think that's over now. That's great, and frankly, we concur with you on pretty much everything you just mentioned from emerging markets to, uh, you know, you think of hedge funds, it was sort of the, uh, the term was a punching bag for Wall Street for how many years, but dispersion should change that.

[00:18:32] Uh, uh, on a go forward basis. Maybe a quick thought, uh, I'd love to hear your quick thought on active versus passive. I assume that, uh, your theme plays into that as well. Oh yeah, active. Definitely active. We're trying to move, uh, as we search for new managers. One of the reasons is we're trying to get money out of the index funds and, you know.

[00:18:57] I think we are too heavy in index funds. So yeah, Bob, that is the same thesis as the macro managers, but implemented in global public equity. In the era of free money, I know it's not like, you know what, our job, it would not have been good for our jobs, but we could have just bought the S&P 500 and gone home. A rising tide lifted all boats and it was easy to make money, especially.

[00:19:18] The index got increasingly concentrated in a handful of tech oriented mega caps. Correlations among individual stocks was very high. Everything was moving in lockstep, and active management didn't really work. You just, if, if you didn't own the index, you probably underperformed. But we also see a return to dispersion in public equity, um, is now, I think there's gonna be winners and losers with the cost of debt not being able to bail out all bad companies.

[00:19:49] So what we're seeing already, uh, is a return to valuation discipline and a chance to make money on companies that can still grow their earnings in this economic uncertainty. And that means active management. So Katie, let's shift, uh, gears and, and talk about one of the, um, most frequently raised topics in, um, the endowment space, and in particular higher-ed, which is ESG and DE&I.

[00:20:19] What are your, your staff, your investment committee's views on this space? And have you made, or do you anticipate making any meaningful changes in, in the way that you approach this? Yeah, no, we have been giving this topic a lot of thought. Actually, it goes back a couple of years. In 2020, we started a journey together with the investment policy committee to more fully incorporate Jesuit mission and values into our investment policy.

[00:20:50] So, you know, actually concurrently in the market is when you know the ESG as an investing priority really took off. [00:21:00] For us, it was really a focus university wide on making sure we emphasize Jesuit mission and values. So, it was concurrent but it was really driven by things that were institutional priorities for us.

[00:21:15] And, um, a couple of quarters we really dived into this topic, and we ended up with a mission-aligned investment policy that provides a framework for how we view managers and choose investments. I'll highlight a few things that we've done. One of the universal apostolic preferences is the environment caring for our common home.

[00:21:36] So we do incorporate environmental sustainability into our investments. We're no longer making investments directly in fossil fuels, public or private, but we are looking for investment opportunities in areas of energy transformation, which I do believe is a long-term secular trend. Another of our Jesuit [00:22:00] apostolic preferences is walking with the excluded, and I'll say that this is where the DEI comes in.

[00:22:06] We make a dedicated effort to source and invest with the best managers out there. And I'm proud to say that many of our best managers are women and people of color, so we don't have a dedicated allocation, but I don't think we need to, because the way our framework and sourcing works is that we've found excellent investors who happen to be women and people of color.

[00:22:28] So I think that that's terrific. We do incorporate ESG into the way we evaluate managers. But you know, I'd say that the term is getting a little overused these days, in my opinion. And so, I would just say at the end of the day, we incorporate thoughtful Jesuit discernment into how we manage investments, which does take into consideration the environment and being reflective of multiple cultures and backgrounds.

[00:22:56] Right. So, let's talk a bit about, uh, committee best practices and governance, broadly speaking. So, as we already introduced, you're at the helm of one and a half billion dollars across various asset pools. Can you talk a little bit about how you utilize your investment committee and then also perhaps, thoughts or suggestions for what you think helps an investment committee be most effective?

[00:23:19] Sure, of course. Our investment committee is excellent and very well put together. We have many perspectives on the committee, including a Jesuit and a number of trustees who are investors themselves. We have experience around the table in real estate, private equity, hedge funds and venture capital. So, our team has frequently reached out to our investment committee members for references, market intelligence in their respective areas.

[00:23:48] General thoughts on how should we be thinking about a topic or positioning. And they've all been very excellent resources. It's a great relationship. Governance really is one of the most important things to get right. Devon, to your point, we have found the right balance of separating governance and management.

[00:24:07] So we have a committee that is engaged, thoughtful, helpful, stays on top of what we're doing, but they don't micromanage us. They trust our judgment on manager selection, but they're not hesitant to weigh in with questions or comments. And I think one of the biggest, one of the biggest highlights or changes that we've made is in the investment committee meetings themselves. We have made them a lot more geared towards strategy and way less geared towards implementation.

[00:24:33] So manager selection is, for the most part, left up to us and we keep the investment policy committee meetings focused on topics, strategy. We do asset class deep dive, so they know exactly how we're positioned and where risk is, but we try to raise the level of the conversation up to policy and strategy, which is the best use of their time and expertise.

[00:24:58] That's great. Keeping the eye on the, the big picture, um, framework is, is really important. Exactly. So, this has been really excellent. As we wrap it up, let's finish with Katie Wyatt away from the office. So, for you, what would like a perfect Saturday look like? Well, my Saturdays are usually spoken for with all the activities with my three children.

[00:25:20] So my kids have basketball, golf, activities of every kind. So, I'm usually either at a game or a tournament or I'm driving somebody to a game or a tournament. But I love spending time with my kids. They're at the age where they're doing really fun stuff. It's amazing to watch your own kid compete and cheer them on, even though they get very embarrassed.

[00:25:41] But that's okay. So, you know, if I'm not at a game or driving to one, my best Saturday is spending time outside, I love to go to outdoor activities or even just sit on my patio and listen to the birds. Sometimes, a lazy day is a luxury. Excellent. I totally agree. And I am in the same season of life as you.

[00:26:02] So those, uh, those moments of leisure are few and far between, but greatly appreciated. Indeed. So, Katie, it's been wonderful to have you on the show. We really appreciate your expertise and the time that you have generously given to us. So, thank you for joining us. Well, thank you so much for having me.

[00:26:20] Yeah, Katie, it was just terrific, and it's very clear. It comes out, your passion for not only your profession, but the tie to the mission, and that's just wonderful. So I, I'm so glad we met, uh, recently and so glad to have you on the show. Thanks, Bob. Thank you. So as always, we thank our listeners and viewers for all your support.

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[00:27:23] Always seek the advice of qualified professionals familiar with your unique circumstances.