

# **NEPC 2020 MARKET OUTLOOK**

## **THEMES AND OPPORTUNITIES**

**January 29, 2020**



BOSTON | ATLANTA | CHARLOTTE | CHICAGO | DETROIT | LAS VEGAS | PORTLAND | SAN FRANCISCO

# SPEAKERS



**Michael P. Manning, CFA, CAIA**  
**Managing Partner**



**Phillip Nelson, CFA**  
**Partner**



**William Forde, CFA, CAIA**  
**Senior Consultant**

# AGENDA

- **NEPC Update**
- **Markets In Review**
- **Key Market Themes & Opportunities**
- **NEPC's Diverse Manager Initiative**
- **Your Questions**

# NEPC UPDATE

NEPC, LLC

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# ABOUT NEPC

**OUR GOAL IS TO BE THE “CONSULTANT OF CHOICE”**

**296 Employees<sup>1</sup>**

**8 Regional Offices**

**Employees-owned  
44 Partners<sup>1</sup>**

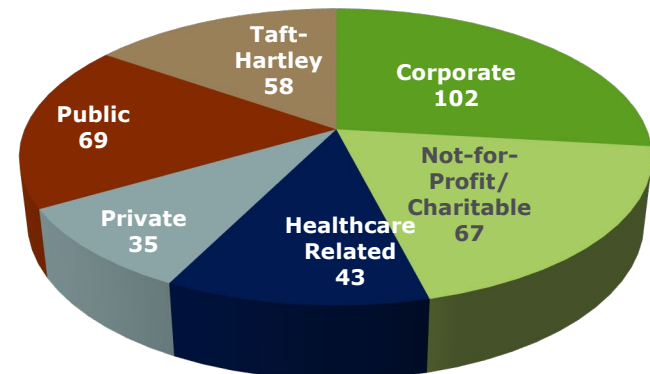
**100% of Revenue  
advisory and discretionary  
consulting services**

**7 Practice Groups  
deliver expertise by client type**

**362 Clients**

**\$1.1 trillion  
assets under advisement**

**Total Clients**



<sup>1</sup>As of 1/1/2020. All other stats as of 10/1/2019, including 62 clients with discretionary assets of \$29.5 billion.



**BOSTON | ATLANTA | CHARLOTTE | CHICAGO | DETROIT | LAS VEGAS | PORTLAND | SAN FRANCISCO**

# OUR FOCUS

## FEEL SMALL BUT BE BIG

### FEEL SMALL

- **Be flexible and customized in our partnership with you**
- **Dedicated segment experts to anticipate your needs**
- **Identify niche managers and investment ideas**

### BE BIG

- **Have deep resources at your disposal**
- **Benefit you by using our size for manager fees and access**
- **Share learnings and insights from all client segments**

# WHAT'S NEW FROM LAST YEAR

- **3 new Partners and 4 new Principals**
  - Sam Pollack, Matt Rowell, Gary Wyniemko
  - Margaret Belmondo, Erin Faccone, Sebastian Grzejka, Melissa Mendenhall
- **New senior leadership roles**
  - Kristen Colvin overseeing our Corporate Practice Group
  - Sarah Samuels leading the Public Markets and Hedge Fund teams
  - Scott Perry and Kristin Reynolds managing our E&F practice
- **New Portfolio Construction team in Research**
  - Led by Tim Bruce
  - Charged with institutionalizing best practices from all client segments
  - Also creating new tools and analytics
- **Diversity & Inclusion Advisory Board**
  - Tasked with improving diversity and inclusion within NEPC and in our engagement with clients and investment managers
- **Continued growth among all client segments & services**



Welcome, Intelligent Investor

Resources

Your Team

Admin

My Profile

Events

Sign Out

# WELCOME TO CLIENTHUB

Portfolio

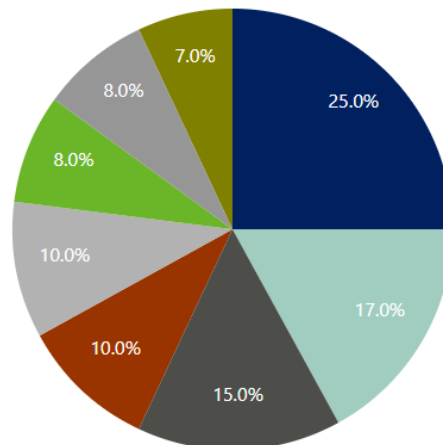
My Documents

NEPC Published

My Research Write-Ups

Focused Placement Lists

My Team



|                        |        |
|------------------------|--------|
| Domestic Equity        | \$ 25  |
| International Equity   | \$ 17  |
| Hedge Fund             | \$ 15  |
| Real Assets            | \$ 10  |
| GAA                    | \$ 10  |
| Domestic Fixed Income  | \$ 8   |
| Emerging Market Equity | \$ 8   |
| Global Fixed Income    | \$ 7   |
| Total                  | \$ 100 |

- **NEPC's ClientHUB: the place to get the latest information on your portfolio and NEPC Research**

- Maintain your portfolio's important documents
- Search for NEPC's Investment Manager Due Diligence
- Access NEPC's latest opinion on Investment Managers
- Read NEPC's published research

## Capital Onsite Meeting

Download PDF

This manager meeting note reflects our best effort to summarize a meeting between NEPC and representatives from an outside investment organization. This meeting note is not a full due diligence profile of the investment management firm, strategy or strategies described in the note. This note was prepared by and is the property of NEPC. It is provided for informational purposes only, and may not be re-distributed. The opinions expressed in the note should not in any way be considered a recommendation. It should not be construed as an offer to sell or the solicitation of an offer to buy the securities or instruments mentioned. Any information contained herein is subject to change at any time. For more information or a full profile of the investment manager or strategy (if available), please contact your NEPC consultant.

**Investment Firm:** [REDACTED] **Meeting Date:** 04/13/2018  
**NEPC Author:** [REDACTED] **Location:** At Manager/Vendor  
**Primary Topic:** Traditional Assets **Meeting Type:** Introductory / Pre-Screening  
**Manager Representatives:** [REDACTED]

### Analyst Opinion

**Summary Opinion:** This global all cap core product is managed by [REDACTED] in a concentrated, benchmark agnostic, quality focused, best ideas, long term approach. They invest in 25 companies with returns on capital higher than peers, cash flows that are growing, and will wait patiently - sometimes years! - to buy companies at the right price. They liken themselves to long term business owners rather than stock holders. Portfolios will often end up heavy in consumer discretionary and staples names. With their all cap approach, the portfolio is an interesting variety of global holdings. With the good performance, clear approach and process, and long term investment acumen of the collaborative duo-portfolio managers, [REDACTED] is a candidate for the Global FPL.

### Positives:

1. Focused, experienced team putting all efforts and energy into one product and approach.
2. Exceptional performance since founding in 2008, with a #1 info ratio vs their MSCI ACWI peer group.
3. Product will be closed at a certain size that keeps them nimble and with plenty of options.
4. While not all managers agree meeting company managements is important, these two do. They travel a lot to do so; is a good step in the mosaic process. They gave numerous examples of how this has been successful for them.
5. Is a two person decision making process so someone is always checking the other's bias, but each has their strengths.

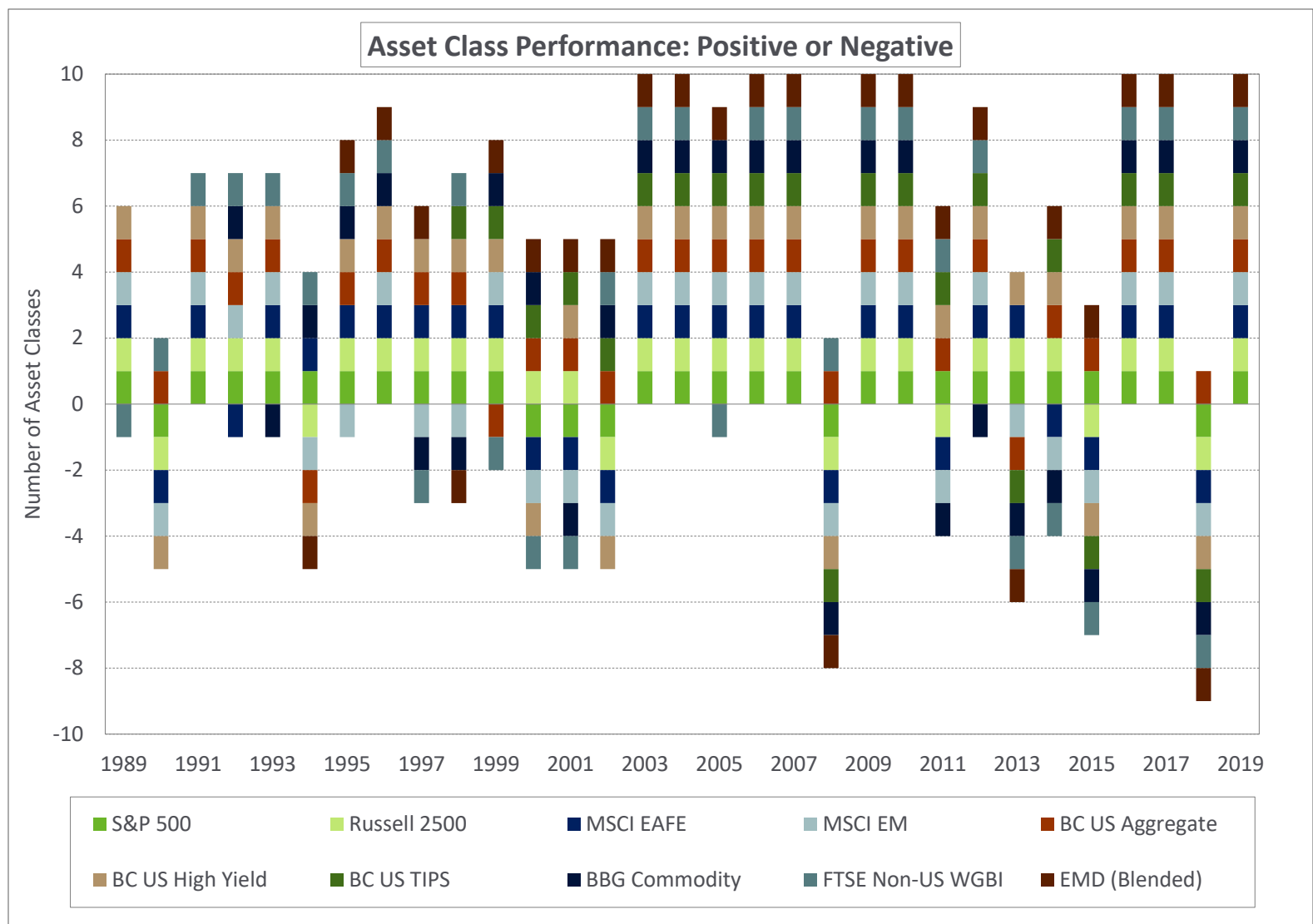
### Negatives:

1. No real successors to the founders/PMs, [REDACTED]
2. Some may feel they are not diversified enough with 40% in consumer discretionary names and nothing in energy, telecoms, utilities, real estate, and many financial companies. Also is possible this consumer and franchise heavy approach is becoming a crowded trade?



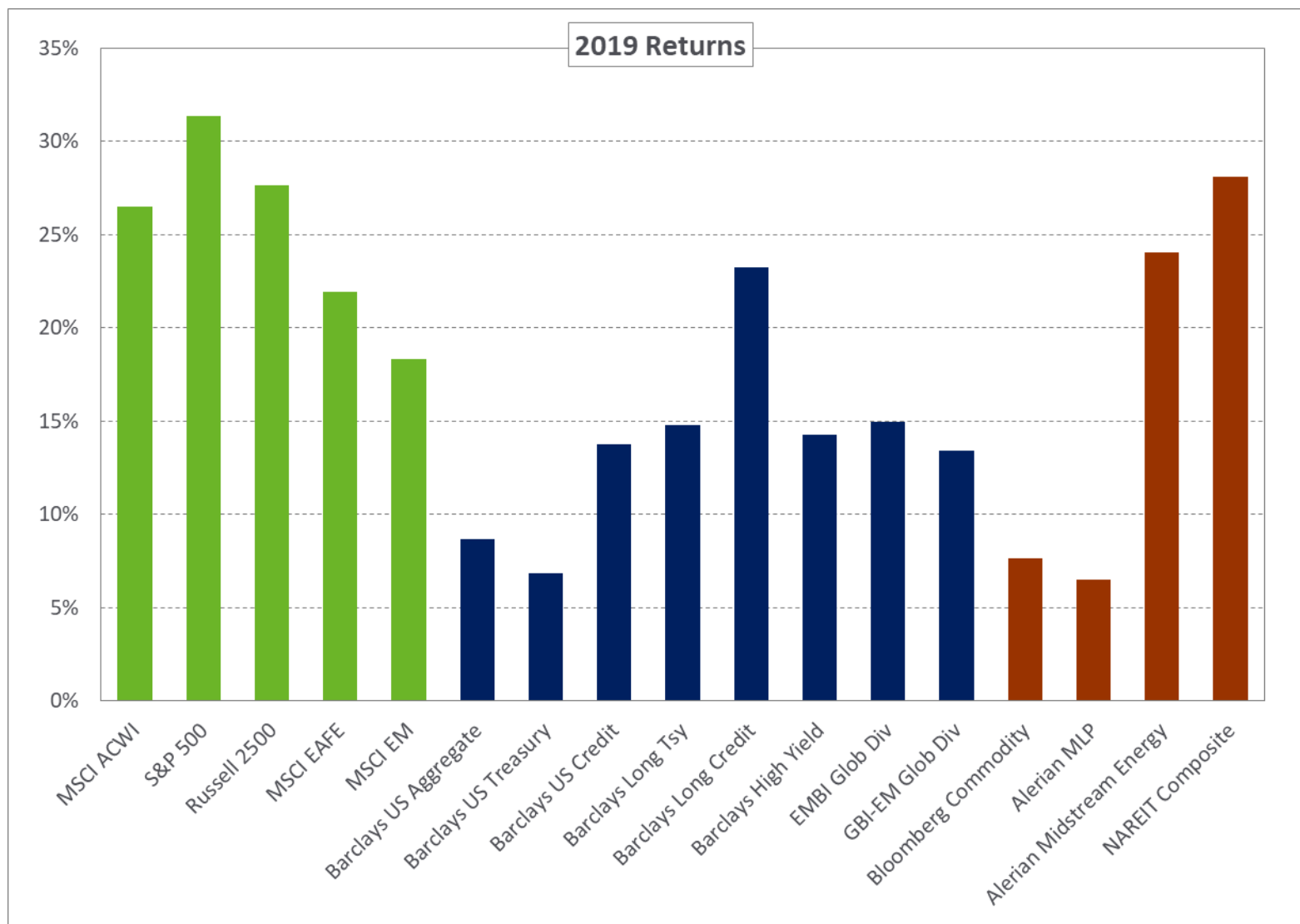
# **MARKETS IN REVIEW**

# CALENDAR YEAR PERFORMANCE ACROSS ASSETS



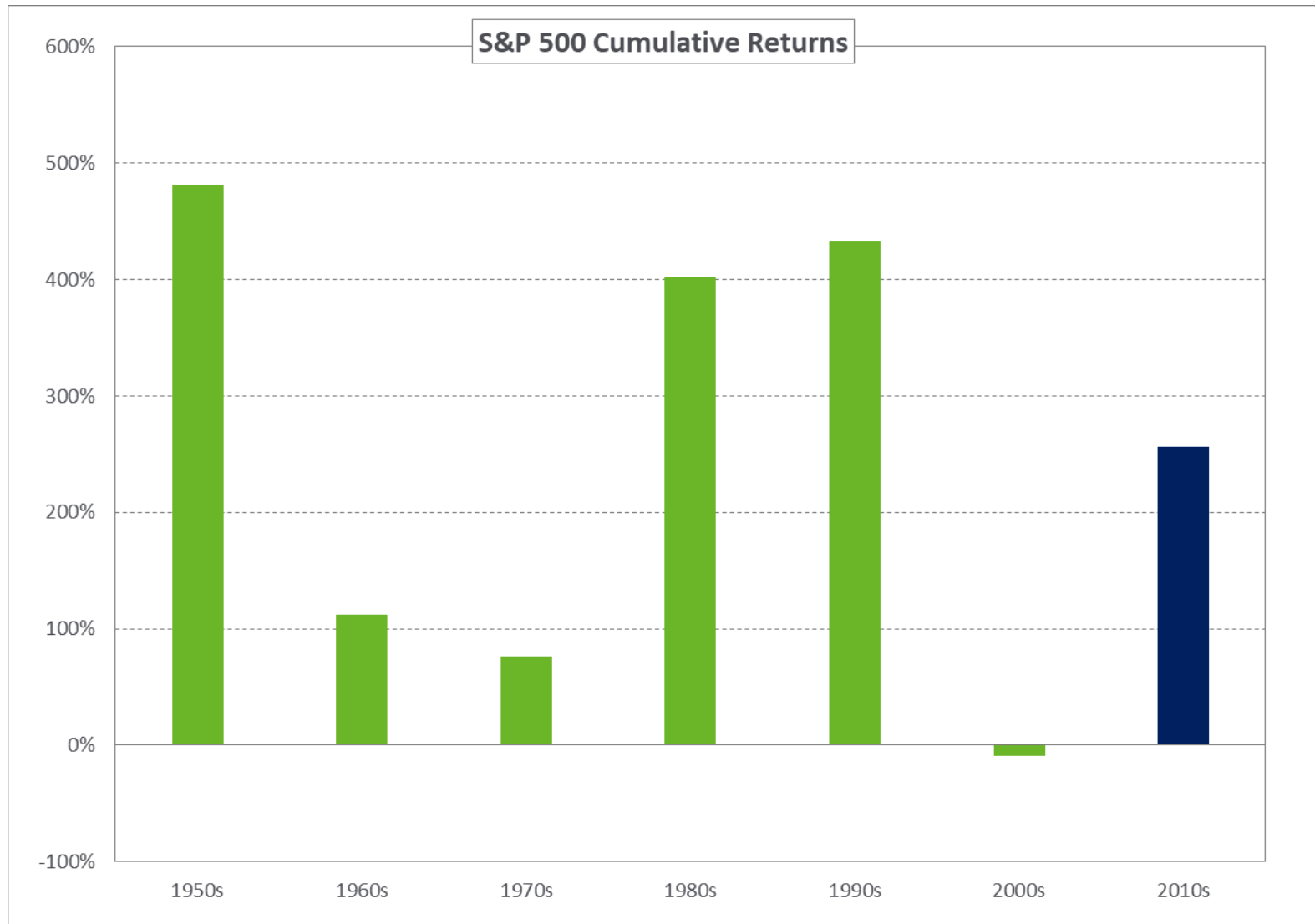
Source: S&P, Russell, MSCI, Bloomberg, FTSE, JPM, FactSet

# 2019: A YEAR OF STRONG, POSITIVE RETURNS



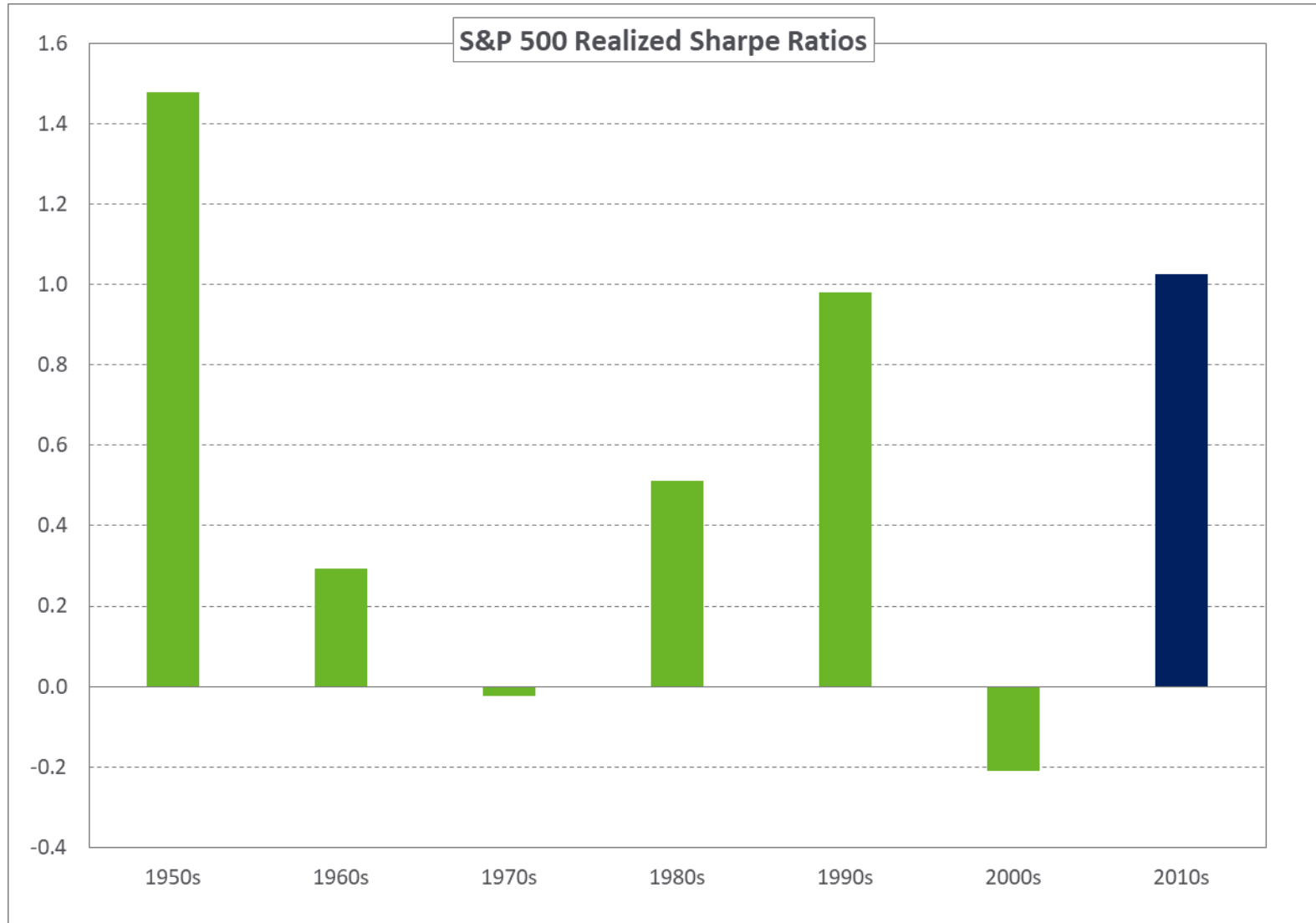
Source: S&P, MSCI, Bloomberg, JPM, Alerian, NAREIT, FactSet, NEPC

# WHAT WILL THE 20'S BRING?



Source: S&P, FactSet

# BEST RISK-ADJUSTED DECADE SINCE THE 1950S



Source: S&P, FactSet

# **KEY MARKET THEMES**

# NEPC THOUGHTS TO START THE NEXT DECADE

## **The 2010s:**

The 1<sup>st</sup> decade in US history with no recession. Characterized by accommodative monetary policy, falling interest rates, low inflation, global growth concerns, rising profit margins, elevated asset class risk premia, and falling market volatility

## **2020:**

US recession concerns appear far removed. But what has changed with the exception of elevated profit margins, subdued asset class risk premia, and low market volatility

## **Falling interest rates and inflation were broadly positive for assets over the last decade, but what will drive asset class returns for the 2020s?**

Low interest rates and subdued inflation levels support higher equity valuations, but expected returns over the next decade are expected to be lower than the last decade

## **A regime shift over the last 12 months has materially altered the global market environment and the outlook for both equity and fixed income**

Central bank market interventions and fiscal support from governments are beneficial for equity markets relative to fixed income, but overall return expectations are subdued

# KEY MARKET THEMES OVERVIEW

**Key Market Themes are factors that define global markets and can be expected to both evolve and remain relevant without a clear timeline of conclusion. At times, themes may be challenged or disrupted and generate market volatility. The conclusion of a theme likely alters both market dynamics and our market outlook. Our intent is for clients to be aware of these themes and understand their implications for asset allocation and portfolio implementation.**

**NEPC currently has four Key Market Themes:**

**Late Cycle  
Dynamics**

**Permanent  
Interventions**

**China  
Transitions**

**Globalization  
Backlash**

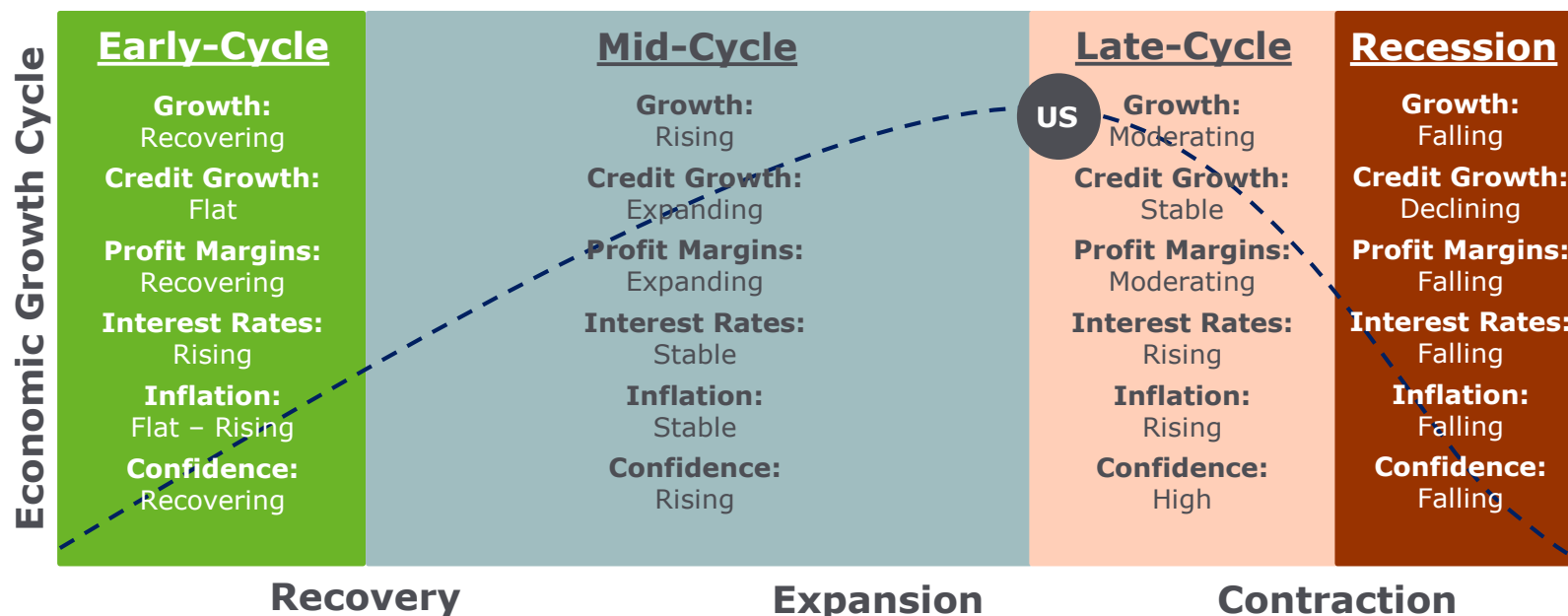


# KMT: LATE CYCLE DYNAMICS

The US economy is in the late stage of the economic cycle as evidenced by classic late-cycle indicators including a tight labor market, a flat yield curve, and strong investment returns

Late cycle does not mean end of cycle; equity markets can offer strong returns and abandoning long-term allocations may detract from results

There is minimal evidence in economic/financial indicators to suggest that a US recession is imminent



# KMT: PERMANENT INTERVENTIONS

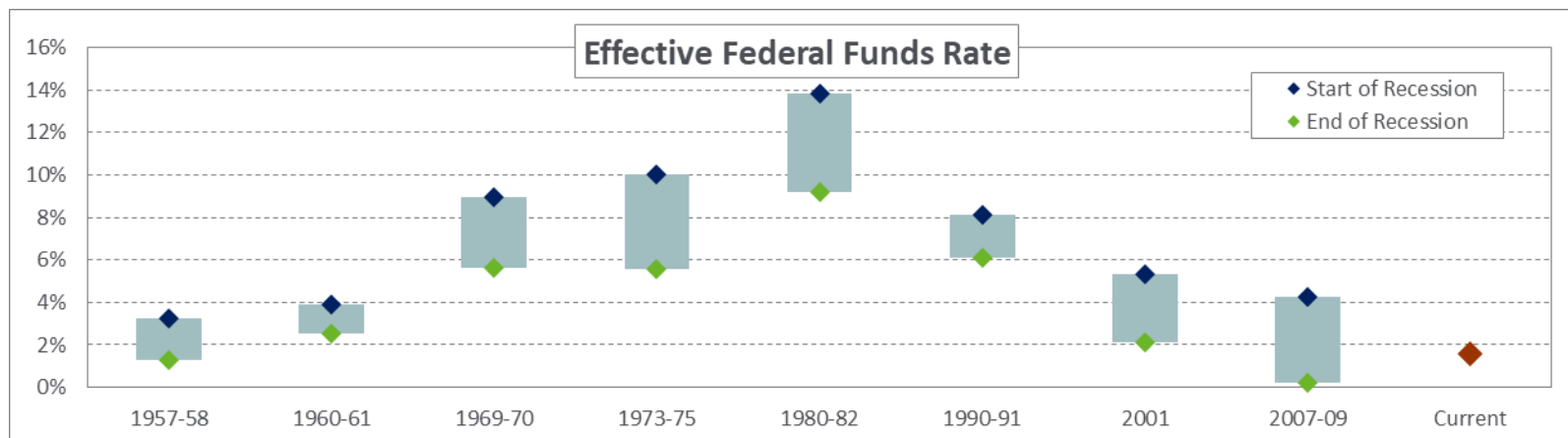
**We believe central banks across the globe will continue to expand balance sheet assets to sustain an environment of excess liquidity**

Low to negative interest rates and a fragile economic environment force central banks to continue to grow balance sheets and liquify the global financial system

**Weak economic growth trends in the developed world underpin political tensions, which we believe will motivate significant fiscal debt expansion**

**Permanent Interventions suggest low yields and higher P/E multiples and a supportive policy environment would appear favorable to equities**

**However, there is a low margin of error if an economic downturn is on the horizon as current low interest rates can be reduced only so far**



Source: FactSet, Federal Reserve

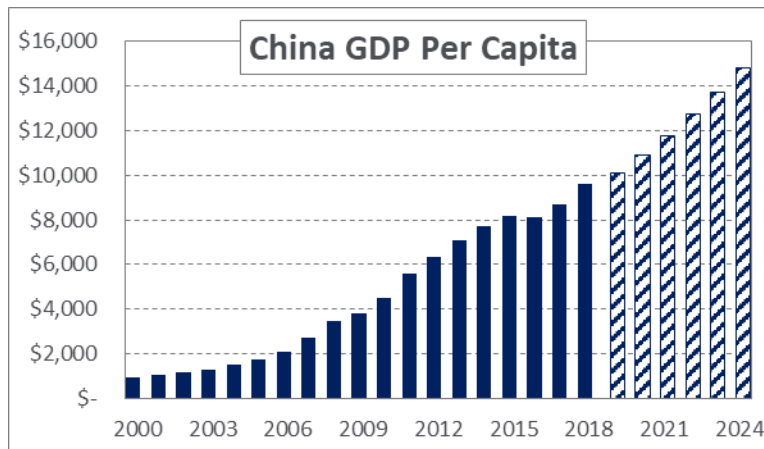
# KMT: CHINA TRANSITIONS

**China is undergoing a multi-faceted evolution as the economy transitions to a services and consumption-based model, while China's role on the global stage shifts to reflect its ascending geopolitical power**

**China's ascendancy as a strategic competitor to the US across innovative fields, such as artificial intelligence and 5G technologies, has provoked social and political angst regarding China's transition to a global power**

**China continues to experience slowing economic growth, but remains on a growth path to equal the size of the US economy over the next 25 years**

**China is the global growth engine and any disruption to these significant transitions will be transmitted globally due to the country's expanding role in the world economy**



Source: IMF



Source: IMF

# KMT: GLOBALIZATION BACKLASH

**Stagnant wage growth and growing wealth inequality are fueling political discontent across the developed and emerging world**

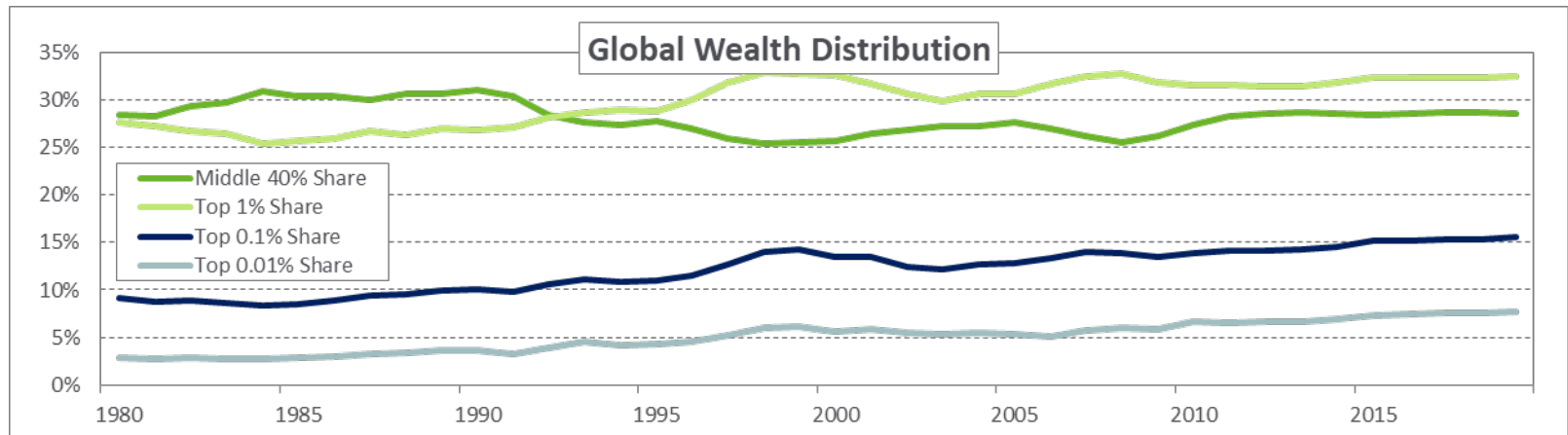
**Globalization is viewed with suspicion by a growing percentage of voters, shifting multiple countries to more nationalist policies**

Fatigue over globalization is changing political platforms and increasing trade tensions. A reevaluation of established multilateral relationships likely increases geopolitical risks

**The growth of populist movements, on the “left” and “right”, destabilizes the political order and materializes as Globalization Backlash**

The extremes of the political spectrum across the developed world are likely to have a greater role in government as moderation is stretched

**US-China trade tensions are a full expression of our backlash theme**



Source: World Inequality Lab

# **CURRENT OPPORTUNITIES**

# CURRENT OPPORTUNITIES OVERVIEW

**Current Opportunities** are investment ideas that represent an action with the goal of improving investment outcomes relative to an investor's strategic asset allocation. It is not our intent that the full list of opportunities be implemented. Rather, we encourage a focus on the actions that offer a material benefit to each client's strategic allocation relative to their unique objectives and constraints. These investment ideas are likely to change more frequently as market dynamics and valuations shift over time.

**NEPC currently has five Current Opportunities:**

**Reduce Lower  
Quality Credit  
Exposure**

**Overweight  
Emerging  
Market Equities**

**Add Long  
Volatility  
Exposure**

**Fund Public  
Midstream  
Energy Exposure**

**Fund Emerging  
Local Debt**

# REDUCE LOWER QUALITY CREDIT EXPOSURE

## Funding Destination: "Dry Powder", Safe-Haven, and Short-Term Debt

### **Lower-rated credit exposure does not provide adequate compensation to investors for the risk relative to safer alternatives**

Late-cycle markets generally exhibit higher- than-average credit default rates, acutely impacting debt rated BBB and below

With index credit spreads trading below median levels, we encourage moving away from lower quality credit and look to alternatives such as safe-haven fixed income, IG CLO's, and short-term debt

### **Look to build "dry powder" with short-term safe-haven fixed income**

Short-term Treasuries and cash equivalents offer better value due to the level of rates across the yield curve. We encourage tapping lower quality credit segments as a funding source to raise "dry powder". In addition, equity rebalancing is a potential source of funds for "dry powder" and short-term fixed income



Source: BofA Merrill Lynch, FactSet

# OVERWEIGHT TO EMERGING MARKET EQUITIES

## Funding Sources: US Equity and EAFE Equity

### **Emerging equities offer the highest total return potential for investors**

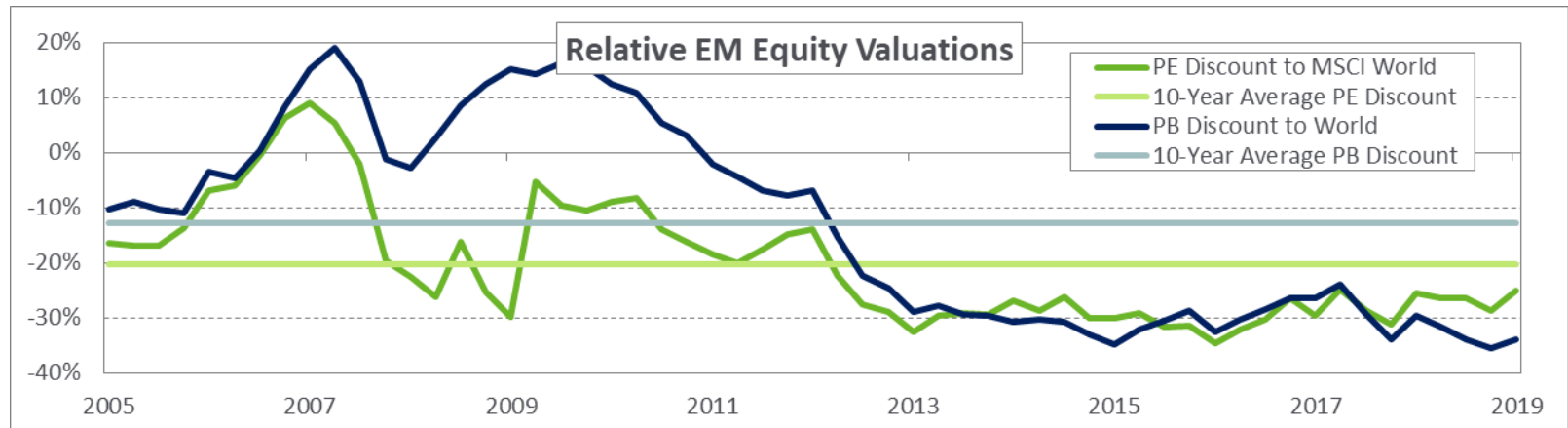
Valuation levels and fundamentals suggest an overweight relative to global equity market cap weights (e.g. 15% to 20%)

Growth premium relative to the developed world persists as economic conditions in EM remain supportive despite the negative sentiment associated with US trade policies

### **High tracking error strategies offer greater flexibility to invest across emerging countries and are preferred to benchmark-focused mandates**

Opportunity set for active management and excess return appear more abundant in emerging versus developed markets

We encourage the use of multiple emerging market strategies to mitigate the risk of an unintended value-growth style or size bias



Source: MSCI, FactSet, NEPC



# 2020 ASSET CLASS OVERVIEW

**Low interest rates and subdued inflation levels support higher equity valuations, but asset class return assumptions have materially declined**

**NEPC has adopted a 10-year return horizon and shifted from a 5-7 year outlook for capital market assumptions**

**10-year capital market return assumptions provide a greater focus on the strategic asset allocation process as the asset class assumptions are representative of a long-term view**

**Forward-looking asset class models are based on a building block framework to capture the core drivers of returns across asset classes**

**The combination of falling interest rates, robust returns in the prior year, and lower growth and inflation expectations generate declining return expectations for nearly all asset classes**

These significant market movements resulted in a secular decline in NEPC's outlook – impacting both the 10-year and 30-year assumptions

# CORE GEOMETRIC RETURN ASSUMPTIONS

|              | Asset Class Return Assumptions           | 2020<br>10-Year | 2019<br>10-Year | Annual<br>Change |
|--------------|--|-----------------|-----------------|------------------|
| Equity       | Cash                                     | 1.8%            | 2.6%            | -0.8%            |
|              | Large Cap Equities                       | 5.0%            | 6.2%            | -1.2%            |
|              | International Equities (Unhedged)        | 6.0%            | 7.3%            | -1.3%            |
|              | Emerging International Equities          | 9.0%            | 9.2%            | -0.2%            |
|              | <i>Global Equity*</i>                    | 6.2%            | 7.3%            | -1.1%            |
|              | <i>Private Equity*</i>                   | 9.4%            | 10.1%           | -0.7%            |
| Fixed Income | Treasuries                               | 1.9%            | 2.5%            | -0.6%            |
|              | <i>Core Bonds*</i>                       | 2.5%            | 3.2%            | -0.7%            |
|              | TIPS                                     | 2.2%            | 3.2%            | -1.0%            |
|              | Municipal Bonds (1–10 Year)              | 1.9%            | 3.0%            | -1.1%            |
|              | High Yield Bonds                         | 4.1%            | 5.5%            | -1.4%            |
|              | <i>Private Debt*</i>                     | 6.7%            | 7.6%            | -0.9%            |
| Real Assets  | Commodities                              | 4.0%            | 4.4%            | -0.4%            |
|              | REITs                                    | 5.4%            | 6.9%            | -1.5%            |
|              | Core Real Estate                         | 5.2%            | 6.0%            | -0.8%            |
|              | Private Real Assets: Infrastructure/Land | 5.9%            | 6.4%            | -0.5%            |
| Multi-Asset  | <i>US 60/40*</i>                         | 4.3%            | 5.2%            | -0.9%            |
|              | <i>Global 60/40*</i>                     | 4.4%            | 5.1%            | -0.7%            |
|              | <i>Hedge Funds*</i>                      | 5.0%            | 6.0%            | -1.0%            |

\*Calculated as a blend of other asset classes

# **NEPC'S DIVERSE MANAGER INITIATIVE**

NEPC, LLC

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# DIVERSE MANAGERS COMMITTEE

## Consultant Teams

**Sam Austin**, Partner  
*Public Funds Team*  
Co-Chair, DMC

**Kristin Finney-Cooke**, CAIA  
Senior Consultant  
*Public Funds Team*  
Co-Chair, DMC

**Michael Cairns**, Partner  
*Taft-Hartley Practice Team*

**K.C. Connors**, CFA, CAIA,  
Partner,  
*Philanthropic Practice Group*  
Leader

**Chenae Edwards**, CPA  
Senior Consultant  
*Healthcare Team*

**John Kimmel**, CPA, CFA,  
Partner

**Douglas Moseley**, Partner

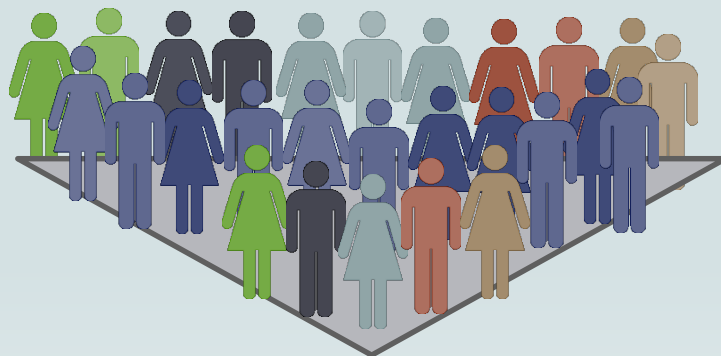
**Carolyn Smith**, Partner

**Will Forde**, CFA, CAIA,  
Senior Consultant

**DeAnna I. Jones**, Consultant  
Specialist

**Kim Kaczor**, Analyst  
*Public Funds Team*

## Deep Expertise Across NEPC



## Research Teams

**Sarah Samuels**, CFA, CAIA,  
Partner  
*Head of Public Markets  
Research*

**Neil Sheth**, Partner  
*Head of Alternatives  
Research*

**Timothy Bruce**, Partner  
*Portfolio Construction*

**Oliver Fadly**,  
Research Consultant  
*Public Markets Research*

**Chris Miers**,  
Senior Research Consultant  
*Real Assets*

**Hayley Tran**, CFA,  
Research Consultant  
*Public Markets*

# DIVERSE MANAGER ENGAGEMENT

## CLIENT EXPOSURE

**Over 40% of NEPC clients utilize  
Diverse Managers**

**NEPC has historically defined our diverse  
manager exposure based on client assets  
invested with MWDBE firms**

### Diverse Manager Inclusion by the Numbers

**\$32.5 billion**

Amount of client assets  
invested with Diverse firms

**170**

Number of our clients who  
have mandates with Diverse  
firms

**182**

Number of investment  
strategies managed by Diverse  
firms our clients currently have  
in their portfolios



# CLOSING THE GAP

## NEPC'S DIVERSE MANAGER POLICY 2.0



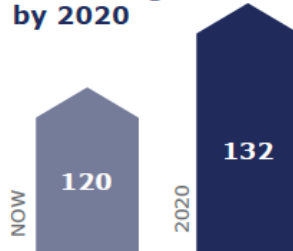
**DIVERSE  
INVESTMENT  
MANAGER DAY**  
CLOSING THE GAP



### Responsiveness Target

DMC will seek to respond with preliminary feedback within 3 months after initial contact.

**10%**  
Target for Increase  
in Meetings  
by 2020



### Accountability Target

NEPC will include manager diversity objectives in annual evaluation process of Research and DMC professionals.

### Multiple Pathways to Engage NEPC Clients



#### Standard NEPC DD Process

1-Rating or 2-Rating



#### Discovery Platform Process



#### First Major Consultant to Rate/Use Emerging MoMs/FoFs



#### Client-Directed Search

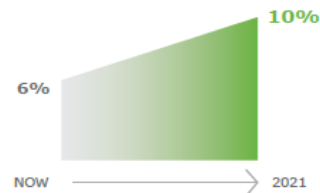
1-Rating, 2-Rating or 3-Rating

### Search Inclusion Target



NEPC will make best efforts to include a diverse manager in searches where an appropriate manager is available.

**10%**  
Target for FPL  
Strategies by 2021



### Transparency Target

NEPC will publish annual progress toward Diverse Manager Policy targets.

Data as of June 30, 2019

# QUESTIONS?

# QUESTIONS?

While we answer your questions, we encourage you to read about our upcoming conference.

## NEPC's 25<sup>th</sup> Annual Investment Conference



# FUTURE IN FOCUS

- Our theme for the conference this year is the Future in Focus. Please join us as we and our distinguished lineup of industry experts explore the potential changes and challenges facing markets in the new decade. We look forward to discussing innovative investment ideas and concepts, and new key areas of focus such as sustainability and diversity. Please save the date for our 25th Annual Investment Conference on **Wednesday, May 20 and Thursday, May 21** at the Renaissance Boston Waterfront Hotel.
- Please reach out to Sarah Winrow: [swinrow@nepc.com](mailto:swinrow@nepc.com) if you have any questions



Stay up to date on our latest updates and publications at [www.nepc.com/insights](http://www.nepc.com/insights).



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- **Information on market indices was provided by sources external to NEPC. While NEPC has exercised reasonable professional care in preparing this report, we cannot guarantee the accuracy of all source information contained within.**
- **The goal of this report is to provide a basis for substantiating asset allocation recommendations.**
- **All investments carry some level of risk. Diversification and other asset allocation techniques do not ensure profit or protect against losses.**
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