## CIO Quarterly Commentary

*1Q2022*

# So Many Questions, So Few Answers

Rarely has the investing environment been as murky as it is today. We are making history – but in all the wrong ways. War in Europe for the first time in 75 years. Inflation hitting a 40-year high. US politics as divisive as they've been since the Vietnam War (some would say Civil). The emergence of China as a global economic powerhouse creating a new and uncertain geopolitical calculus. The first pandemic in 100+ years, easing haltingly into an endemic. The US reaches record-level peacetime debt-to-GDP. And, as if all that weren't enough, we may be nearing a planetary tipping point with carbon intensity.

As we noted in our last letter, doing nothing in response to new information is an active decision. We take the same counsel that we give our clients: In times of uncertainty, be disciplined in adhering to policy and process. Rather than being reactive, lower your center of gravity and exercise patience as you prepare to be opportunistic.

Below, we share our thinking on some of the more dramatic current events and their possible investment implications. We also summarize portfolio adjustments we have made to date to strengthen our – and your – positioning in the face of such unpredictability.

**Geopolitics**

Past Russian aggressions into Crimea, Georgia, and Chechnya resulted in short-lived public outrage, yet no NATO counteraction. The same held true when Russia intervened in the Syrian civil war that ultimately displaced half the Syrian population. None of these events had a lasting impact on markets.

Following Russia's invasion of Ukraine, however, President Volodymyr Zelensky soared from an approval rating in the low 20%s to a renowned war time leader compelling an unexpected and comprehensive response from all Ukrainians as well as Western nations. Russia has been ostracized in an unprecedented manner, with government sanctions freezing – or seizing – Russian assets, cutting off demand for Russian oil, and banning Russia from the SWIFT global financial system. A surprising number of corporations voiced dissent by exiting Russia. The international price of oil rose from $74.50 at year end to a high of $130.50 on March 7, 2022. With Russian and Ukrainian exports representing 12 percent of the food calories traded in the world, wheat prices have spiked from $7.74 to as high as $13.63 over the same time period. We watch for secondary effects of hunger and civil unrest globally, as well as the impact of higher oil and gas prices on those who are most dependent (yet least able to afford it).

While events in Ukraine dominate the news, the big geopolitical question many investors are asking themselves today isn't about Russia and Ukraine, but about China and Taiwan. Most of the conversations we have and commentary we read suggest China is unlikely to be emboldened by what is happening in Ukraine. The West has become more unified in the last month than at any time in the last decade or more. The level and swiftness of sanctions against Russia has surprised most. The tenacity of Ukrainians fighting for their country has likely surprised both Russia and China, raising doubt about the ease of conquest. Military experts pretty unanimously believe that an amphibious assault (China into Taiwan) would be much more difficult than a ground assault – which China surely knows. Japanese leader Abe has suggested Japan should break a long-standing taboo and hold an active debate on hosting US nuclear weapons. None of these developments appear to hasten a Chinese move to take Taiwan, especially as China views time as its friend in efforts to reincorporate Taiwan back into China. We do not anticipate a war between China and Taiwan and therefore are not presently positioning our portfolios for one.



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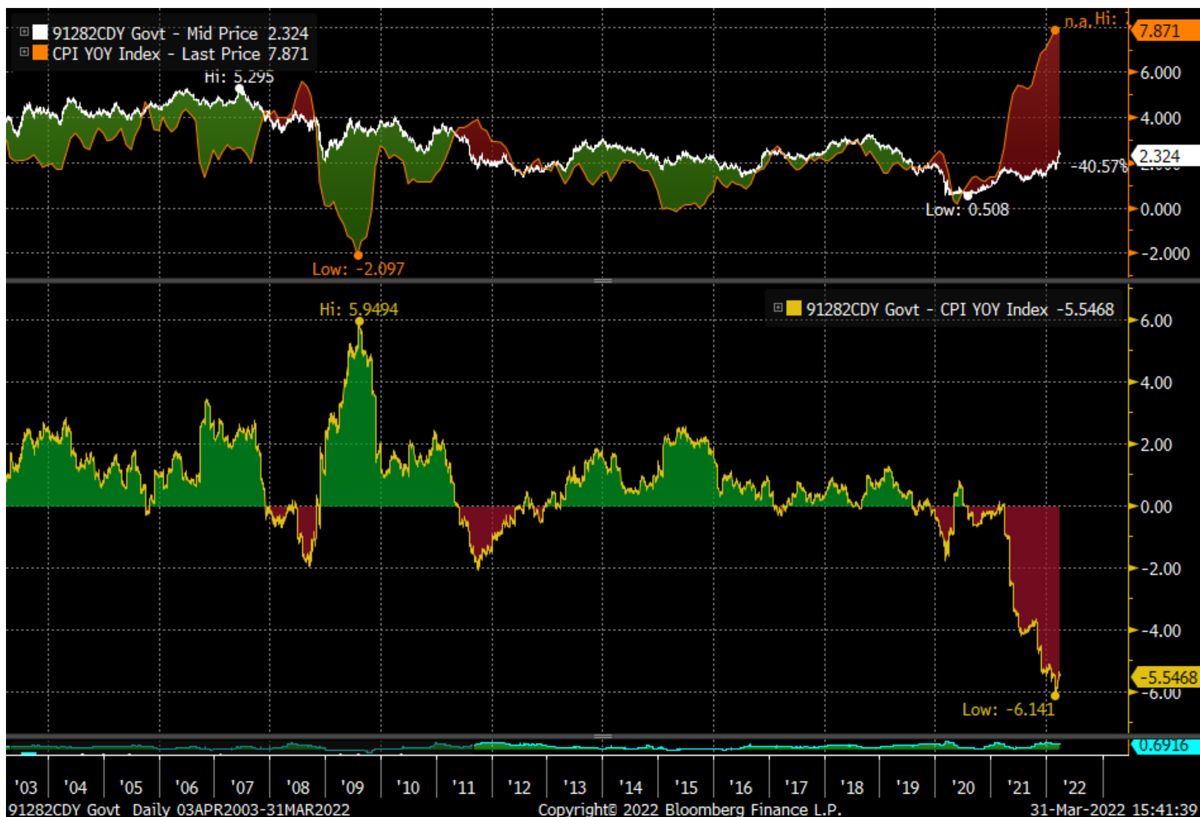
Less ominous, but more painful economically, would be the decoupling of China and the US as global economic leaders. In 2021, China launched its common prosperity drive and forced private (many publicly listed) companies to change business practices to benefit the average Chinese citizen, often to the detriment of shareholders. In some sectors such as education, public company valuations have fallen by as much 98%. The Chinese government now has homeownership and data security in its crosshairs, with names like Ant Financial (and parent company Alibaba) and DIDI Chuxing (UBER in China) suffering. Concern grows over the prospect of delisting Chinese companies traded in the US. This ongoing effort by the Chinese is hurting investor confidence. We reduced an overweight in China at the end of 2020, but with hindsight should have cut our weight even more. For 2022, we expect China's easier monetary policy (countercyclical vs. the rest of the world) and a softening of the common prosperity measures will support a better Chinese equity market.

**Inflation**

We have been concerned for years that inflation could cause the next stock market correction. It typically pushes up interest rates, reducing bond prices and making bond yields relatively more attractive vs. stocks and at the same time devaluing expected corporate cash flows. Accordingly, we have: 1) kept approximately 20% of our capital invested in hedge funds where we anticipate better reward-to-risk possibilities; 2) remained underweight fixed income; and 3) kept the fixed income we do own below benchmark duration. Initially, this positioning faced a few headwinds that flowed through to returns. To date, however, this long-term strategy has both improved our returns and protected capital in periods of stressed equity markets. As our concerns about inflation come to fruition, we face a new paradox: as expected, the rise in inflation is hampering stock markets – but bonds so far have seen only modest rate rises. Yes, yields have risen – the 10-year Treasury has gone from a low of 1.35% in December 2021 to 2.35% today – but year-over-year CPI inflation is now running at 7.90%! The real yield on a 10-year Treasury remains at nearly -6%. To us, this is very surprising. Nevertheless, the Bloomberg Barclays AGG had one of its worst quarters ever, losing 5.93%, before yields have risen anywhere close to inflation.




Source: Bloomberg



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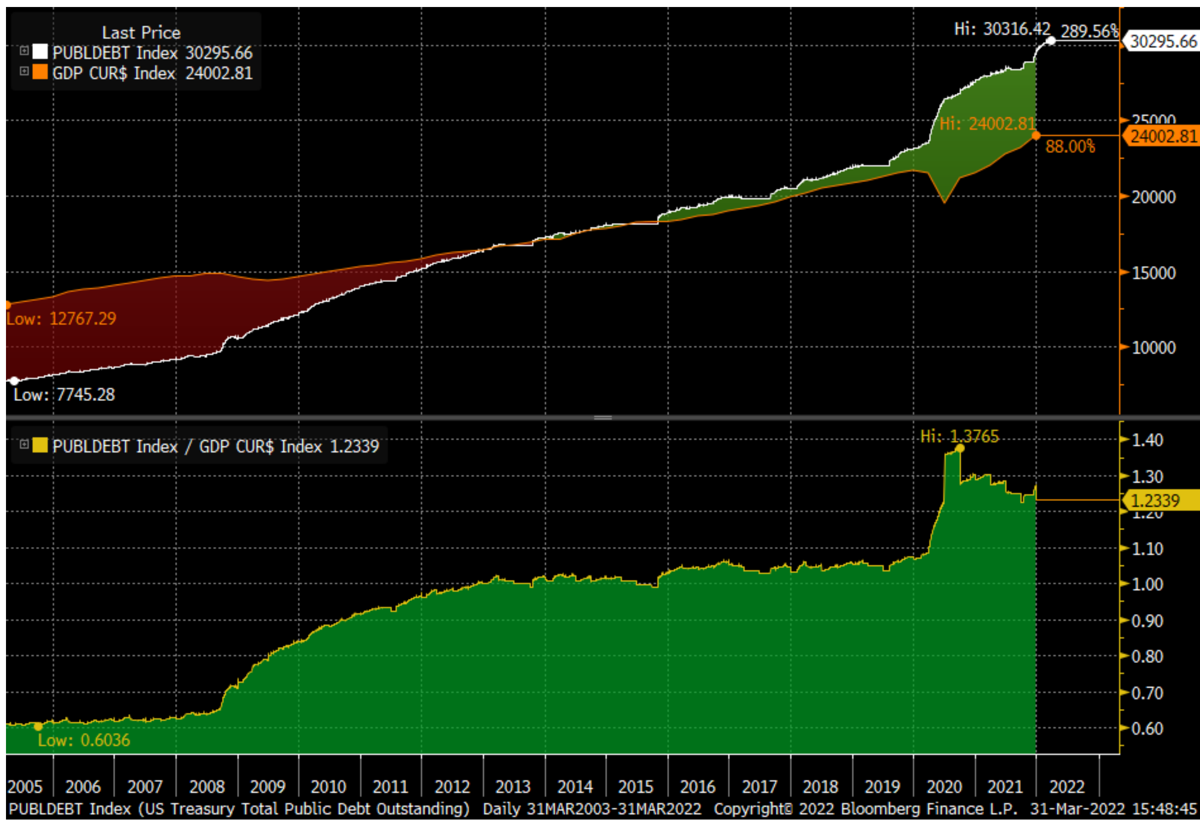
### US National Debt

Some believe that higher debt levels incentivize the Fed to keep rates low, making interest payments more manageable. In addition, as interest payments rise, less capital is available to spur growth – and the GDP. Others worry that excessive debt deters foreigners from buying US debt, drying up a vital source of capital. Modern Monetary Theorists (MMT) dismiss these cares about the size of our national debt, suggesting we can always print more money as needed. Our view? We remain concerned about any situation that would cause the rest of the world to question the US's ability to repay our debt, thereby potentially sending the dollar into decline. However, we do not believe that we are there. We are not afraid to own Treasuries, and most of our portfolios are exposed significantly to US dollar-based investments. We are prepared, nonetheless, for a materially reduced fiscal stimulus over the next decade.




Source: Bloomberg

### Greenflation

If rising national debt is the evil twin of low interest rates, "greenflation" is the sibling of rising energy costs. When carbon-based energy supply is reduced faster than green alternatives are brought online, fossil-fuel energy costs rise too far, too fast. Eliminating Russian oil brought this phenomenon to life. The resulting relatively lower cost of greener alternatives makes them more attractive, but if providers can't rise up to meet the massive demand spike quickly enough, then the world could enter a recession. A global recession might then limit the capital available to invest in new alternative energy sources. Regrettably, this could slow our transition at a time we need it most, both economically and from a conservation standpoint.

Can the world remain rich enough to make the green transition as planned? Best case scenario is that green supply can meet energy demand, paving the way for a permanent path to clean energy. We have selectively made a very modest investment in fusion energy although this technology is likely a decade away from being



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realized. We continue to view greenflation as a threat today and will invest in green transition opportunities when and where we see attractive potential in the space.

**Pandemic**

The pandemic is transitioning into an endemic. Although we could encounter more mutations of COVID on par with Omicron, we anticipate a seasonal COVID bump in developed countries that could be offset by annual shots as with the flu. We also hope that vaccine access and uptake in less developed countries accelerates, allowing for equity in pandemic recovery.

**The TIFF Portfolios**

As we stated above, we have been disciplined about adhering to our strategy as we navigate this large current spate of geopolitical and economic events. This discipline of sticking to our strategic allocations, however, does not pre-empt us from taking advantage of near-term inefficiencies created by all of this disruption. “Opportunistic” is often thought of as a dirty word – or worse, a synonym for “impulsive” or “spontaneous.” Hopefully you know from our history, that we are thoughtful in anticipating possible outcomes from current events and use “opportunistic” to refer to the deliberate expressions of these views in our portfolios, primarily tilting away from perceived risk and toward opportunity. We remain committed to the financial Hippocratic oath – before making significant changes in the portfolios we always try to ensure that what we are proposing to do will be neutral to beneficial under most circumstances. Now, we believe, is a particularly important time to be thoughtful and deliberate.

So how are we positioned this quarter, when faced with so many types of events, each with such a wide range of possible outcomes? We have slightly trimmed equities back to benchmark (-1.5%), we remain about neutral to our hedge fund benchmark weight, and slightly underweight fixed income. The Russian invasion has greatly complicated the inflation outlook and also complicates global growth assumptions. Coupled with a late March equity rally, we viewed this as a good time to remove some equity risk from the portfolio. Because Europe seems most in harm’s way, we have trimmed our prior slight overweight to Europe to a slight underweight (-2% to -3% in most cases) to Europe. We shifted this exposure to Australia where financial and materials stocks – both expected beneficiaries of higher inflation and interest rates – comprise a larger portion of the benchmark. We executed this move in the passive portion of the portfolio, so it was quick and painless. For now, we are resigned to living with higher volatility than last year and we believe that, as usual, equities will earn a higher return for accepting this volatility. We also remain vigilant in searching for more inflation protection. Lastly, we turned our attention to high-quality financial equities that we believe have unusual upside and limited downside. Other than these shifts out of harm’s way and into potentially higher prospective return areas, we have done little except to continue to scour the landscape for opportunities.

As always, we want you to know we very much appreciate the opportunity to steward your capital and to help you achieve your organization’s financial goals. We are here to assist you in any way possible, so please reach out and let us know how we can help.

Your TIFF Investment Team



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