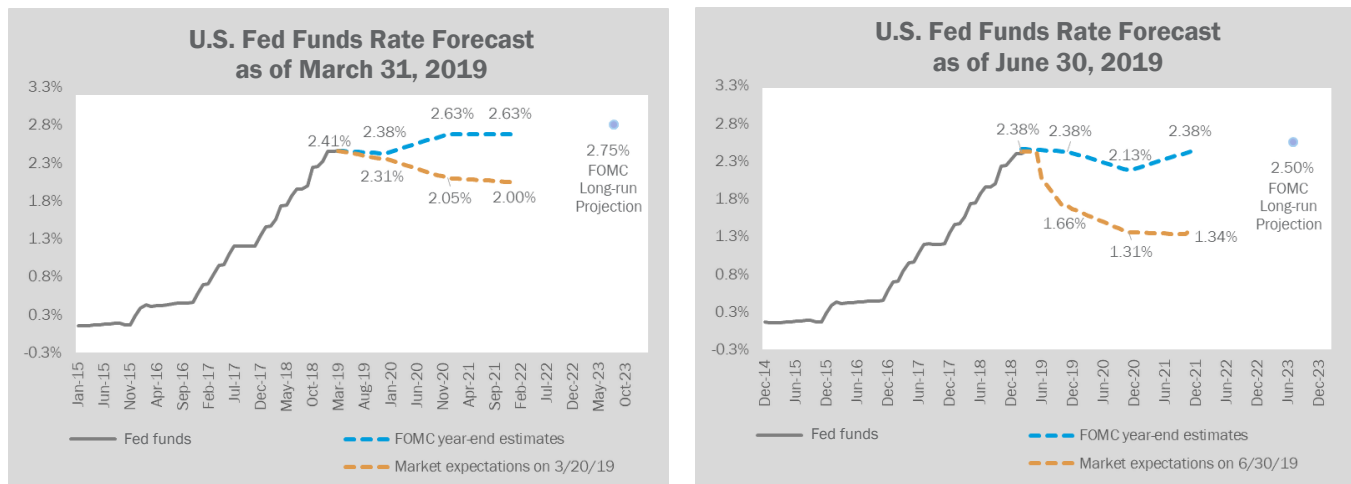




### Introduction

During the last decade, the “lower rates for a long period” scenario has arrived with mixed blessings for the global economy. Capital has steadily flown into riskier assets, but despite aggressive monetary policies, economic growth has not maintained pace with the appreciation of financial assets. Despite negative yields offered by major developed market sovereign debt, such as 10-year German Bunds yielding -0.36% and 10-year Japanese Bonds yielding -0.10%, economic data has been soft in most countries, indicating a slowdown in global growth. The Purchasing Managers’ Index for manufacturing globally has fallen below 50 to 49.4, indicating a deceleration of growth. The impact has been greater on export-oriented economies, such as Germany (45.0), Taiwan (45.5), Korea (47.5), and Japan (49.3).

In the U.S., the fear of economic slowdown has led to a drop in near and medium-term Fed Funds rates – as estimated by both the Federal Open Market Committee (FOMC) as well as the market.



The tariffs and trade restrictions being imposed by large economies have the potential to impact large players driving economic growth, and the impact has been weighing down on the stocks of these companies. Data on the S&P 500 Index, representing companies that make up over 70% of the market capitalization of the U.S. equity market, shows the exposure that companies in various sectors have to foreign sales. Figure 2 indicates that over 43% of total sales of the S&P 500 Index are generated from outside the U.S. Technology, which has seen one of the largest appreciations over the last 12 years and now represents over 21% of the index, is dependent on foreign sales for over half of the sector's revenues. Healthcare and Financials, which are just under 15% each, are less vulnerable.

**S&P 500 Index as of June 30, 2019**

	Weight	Return Since Market Peak (10/2007)	Foreign Sales as % of Total Sales
Energy	5.0%	7.7%	31.2
Materials	2.8%	76.7%	52.7
Industrials	9.4%	124.9%	44.6
Consumer Discretionary	10.2%	280.6%	34.1
Cons Staples	7.3%	188.0%	32.5
Healthcare	14.2%	219.5%	38.2
Financials	13.1%	21.1%	31.2
Technology	21.5%	279.0%	56.9
Communication Services	10.2%	60.9%	--
Utilities	3.3%	128.0%	41.3
Real Estate	3.1%	97.1%	--
<b>S&amp;P 500</b>	<b>100.0%</b>	<b>141.40%</b>	<b>43.6</b>

Figure 2. Source: Standard and Poor's

At the end of June, the U.S. equity markets traded at 16.7x forward earnings, compared to the ACWI ex U.S. Index that was trading at 13.2x forward earnings. While non-U.S. equity markets have historically traded at a lower valuation than the U.S. equity markets, the discount at 21% is steeper today than the long-term historical average discount of 11%. For this reason, we have reduced our overweight to U.S. equities. Today, we have a neutral stance to the ACWI benchmark, with a 55% allocation to the U.S. and 45% allocation outside the U.S. The allocation to emerging markets equities is at 11%, which is close to that of the ACWI as well.

### Fixed Income

A decline in intermediate bond rates was the biggest driver of performance for the U.S. fixed income markets. Ten-year U.S. Treasuries dropped from 2.41% on March 31, 2019, to 2.00% at the end of June.

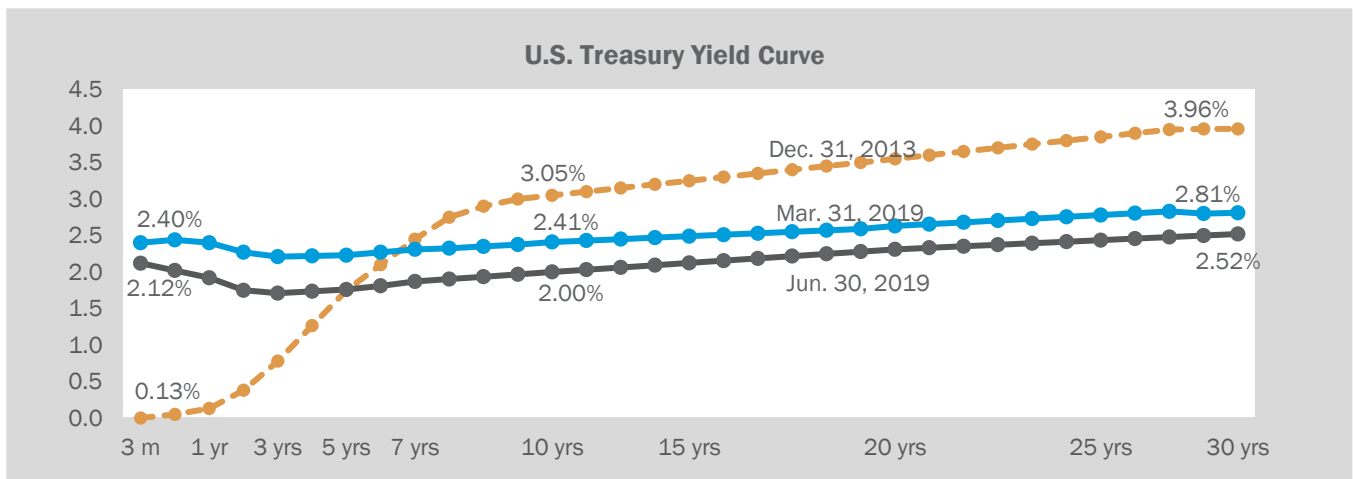


Figure 3. Source: U.S. Department of Treasury

The decline in yields across the yield curve lifted bond prices, leading to the Barclays U.S. Aggregate Index returning 1.3% for the quarter and 6.1% for the first six months; further, it was up 2.2% for the quarter and up 5.6% for the YTD period through June 30. Lower rates also improved the prospects for corporations to refinance their debt at lower rates. High yield bonds rallied during the period, with the BoA Merrill Lynch High Yield Master Index up 10.2% in the first six months of 2019.

We see little room for bonds to generate strong returns from such a low level of yield, but if economic conditions decline and this causes a downturn in the equity markets, we project that core bonds would be able to provide a defensive anchor. Currently, about 60% of the fixed income segment is allocated to core fixed income strategies. The remaining allocation is to non-U.S. bond managers that are able to take advantage of the divergence of interest rates across countries to selectively capture higher yielding non-U.S. sovereign bonds. We have allocated about 10% in a dedicated credit strategy, which has benefitted from the performance of high yield bonds, but the smaller size of the allocation also reflects our caution at this late stage of the economic cycle.

### Hedge Funds

Positive gains in both the equity and fixed income markets proved conducive to the performance of hedge funds over the first half of 2019. Where the long holdings in equities and credit fixed income had negative returns during the market downturn in the fourth quarter of 2018, these securities bounced back in the last six months.

Our experience has been that while hedge strategies can reduce their net exposures during a period of prolonged downturn to immunize their portfolio from the market impact, most cannot react quickly to short spikes of market volatility. Even when hedge strategies state that they rely largely on security selection and not on market direction, most are biased towards long exposure to the market to keep up with market gains.

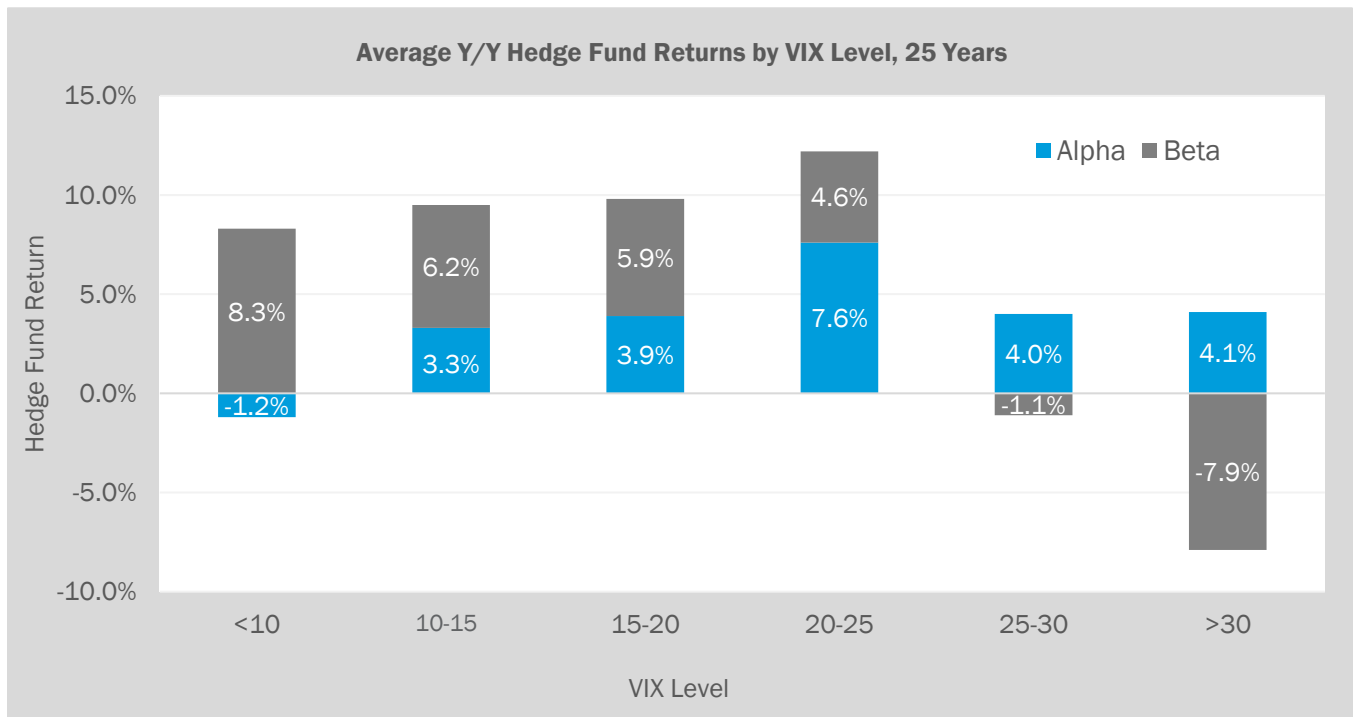


Figure 4. Source: Hedge Fund Research, JP Morgan

An assessment of the correlation of performance of fundamental hedge fund strategies to market volatility shows that when equity market volatility, as measured by the VIX, is between 20 and 30, there is enough dispersion in performance between stocks for hedge funds to generate alpha from security selection. When the VIX is above or below that range, the impact of beta – both positive and negative – is greater.

## Real Assets

During the second quarter, we made a transition from some of our dedicated MLP, natural resource equities, commodities strategies, and TIPs to a more diversified, multi-manager fund, providing a broader scope of exposure to hard assets. This includes our previous four strategies with the inclusion of infrastructure securities, water-related strategies, REITs, and other strategies that ultimately derive their value from real assets or are tied to interest rates—which correlate positively to inflation.

Our prior exposure to single hard-asset strategies was designed to provide a high level of positive sensitivity to inflation. However, despite a long period of low rates and economic expansion, we have not observed any meaningful increase in inflation. This likely indicates that there is still value in broad exposure to hard assets, and we see substantial resources allocated to address the structural long-term need for infrastructure, water, and real estate development in both developed and emerging countries. These strategies present a positive correlation to long-term inflation but have a lower volatility profile given the more diversified approach.

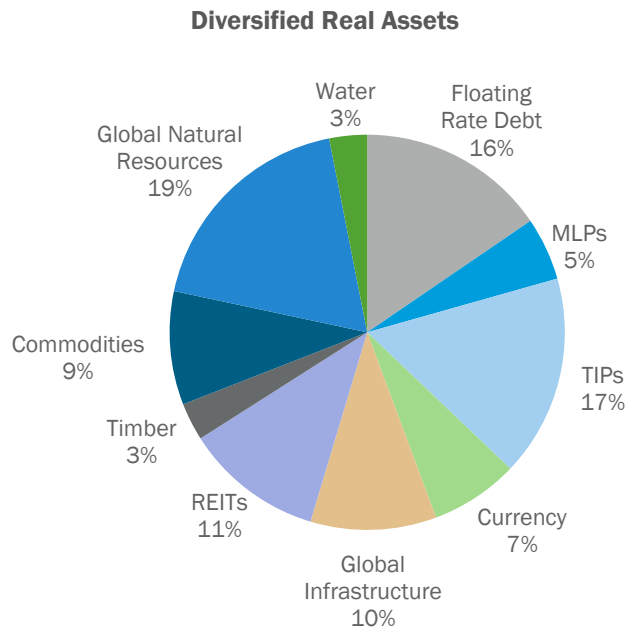


Figure 5. Source: Principal Diversified Real Assets Fund, Principal Group, March 2019

## Private Equity

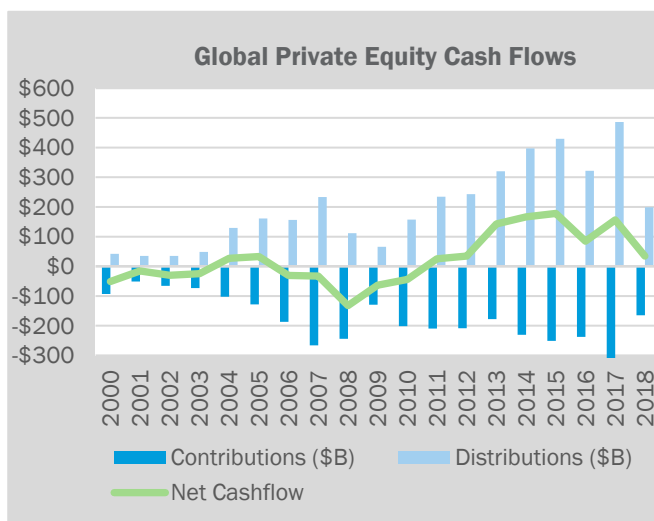


Figure 6. Source: Pitchbook through December 31, 2018

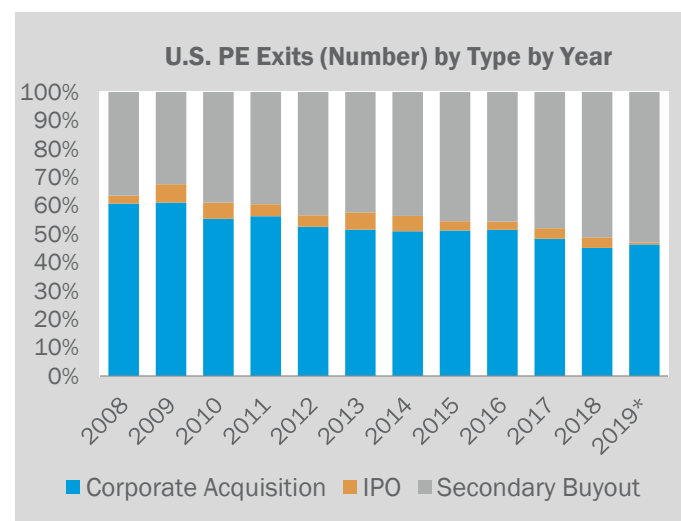


Figure 7. Source: Pitchbook through March 31, 2019

Over the last decade, a robust environment for public equities has been positive for deal activity in private equity. Net cash flow has been positive and strong from funds, as exits have surpassed new investments. Managers have been able to sell out of positions faster, generating higher IRRs. This has in turn been the reason for more capital moving into private equity across most investor types.

However, at the same time, a larger portion of the transactions consist of sales to other buyout funds. In 2018, over half of the transactions consisted of sales to other buyout funds. There are very few IPOs, and less than half of the exits result from corporate acquisitions. As a result, we have been more cautious with our private equity manager selections, looking for small to mid-size buyout funds that have less money to deploy and are more disciplined and valuation conscious in their purchases.

## Overall Remarks

We have a positive outlook regarding the overall results of our OCIO portfolios and continue to find more solutions that will be accretive to overall performance. We work diligently with our managers to reduce fees where possible and continue to review the current portfolio positioning in light of changing market conditions. Our strategic perspectives remain the same, but we continue to be very responsive to each client and have customized portfolios per their situations.

We appreciate your trust in us and welcome your feedback.

Sincerely,



**Poorvi R. Parekh, CFA**

*Director of Outsourced Investments*

Ms. Parekh is a member of the Board of Directors, a shareholder of Canterbury, and directs the Canterbury Outsourced CIO platform, which caters to institutions and private clients seeking to outsource the day-to-day management of their portfolios. In this role, Ms. Parekh is the chair of the Canterbury Outsourced CIO Committee and a member of each of the firm's five Manager Research Committees. Joining Canterbury in 1996 as the manager of analytics, she directed the firm's account analysts and client services group, securing many of the asset allocation modeling and research software tools we use today. In 2001, she became the director of manager research — responsible for oversight of all manager, fund, and product research; maintenance of Canterbury's proprietary research database; and chairing the Investment Manager Research Committee. Ms. Parekh graduated from the University of Hong Kong with a Bachelor of Arts in economics and completed her Master of Business Administration at Shenandoah University.

### About Canterbury

Canterbury Consulting is an independent investment advisory firm based in Newport Beach, CA, overseeing \$20.2 billion in assets as of December 31, 2018. Canterbury provides consulting services to tax-exempt organizations — including community foundations, educational endowments, religious organizations, arts and cultural foundations, health care organizations as well as individuals and family offices. Founded in 1988, the firm designs and manages custom investment programs aligned with each client's specific goals. Canterbury acts as the investment office for its diverse clientele and provides objective investment advice, asset allocation, manager selection, risk management, implementation, and performance measurement. Canterbury strives to deliver performance and service that exceeds client needs and expectations.

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