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Foundations and Endowments 'Ripe' For OCIO Services: Report

By Justin Mitchell October 21, 2021

Foundations and endowments are seeking to diversify their portfolios in response to a changing investment horizon and are looking to outsourced chief investment officers for help, according to a recent report from Cerulli Associates.

“If you’re trying to run a portfolio that’s heavily based in fixed income right now, there’s a good chance you’re going to be very challenged to meet your investment goals and returns,” said Cerulli Associate Director Laura Levesque.

A Cerulli survey found that over 80% of OCIOs expected their endowment and foundation clients to increase their allocation to private equity and 67% expected an increase in other private investments, which is one of the key reasons for the interest in outsourcing manager selection.

OCIOs' Anticipated Changes

OCIOs responding to a 2020 survey reported where they planned to see their endowments and foundations clients make allocation changes over the next year.

	Private Equity	Other Private Investments	Equity	Hedge Funds	Cash	Fixed Income
Increase	81%	67%	20%	13%	8%	8%
Stay the Same	19%	29%	60%	58%	88%	38%
Decrease	0%	4%	20%	29%	4%	54%

Source: Cerulli Associates.

Consequently, 87% of OCIOs polled said both the endowment and foundation client segments were “very important” to the growth of their assets over the next two years and an additional 10% of respondents said that segment was “somewhat important.”

Over the next five years, Cerulli projected OCIO assets coming from foundations to grow 12.6% per year, and assets from endowments and foundations to expand 8% per year through 2024. Much of that growth will come from new clients, Levesque said, though some will also come from changes in the capital markets.

"Endowments and foundations are absolutely the fastest-growing area of our business," said Michael Cagnina, vice president and managing director in the institutional group at SEI, an OCIO with $300 billion in assets under management

There are several reasons for this. Nonprofits were put under a lot of pressure following the coronavirus pandemic, said Matt Bank, a principal at Global Endowment Management, an OCIO with $12 billion in assets under management that serves mostly mission-driven nonprofits. Crises like that often lead committees to realize they need help.

"COVID, as well as prior market drawdowns in past eras, certainly revealed to committees and institutions that maybe they didn't have the optimal investment program for their long-term perpetual goals" he said.

OCIOs can help institutions answer questions about what level of market drawdowns their portfolios can weather, what level of liquidity they need and can handle, and how to optimize their portfolio for the long term, Bank added.

"On top of that, I think you have this wave of recognition around primarily private markets exposure that can be a powerful driving force for investments results," he said.

Alternatives investments also provide some practical challenges, said Matthew Wright, president and chief investment officer of Disciplina Group, a $1.6 billion OCIO that works with foundations and endowments. Often, institutions turn to an OCIO to solve these problems.

"When you add the alternatives, that adds a layer of complexity, in terms of due-diligence monitoring, and there are administrative components to that," he said. "Given the nature of some of the investments, some of them require greater responsiveness because providers are capacity-constrained in their offerings."

That can be an issue regardless of how sophisticated a nonprofit's investment committee or board might be, said Cagnina.

"Since there's more embedded volatility in the global markets, it still makes that challenge hard regardless of your committee structure or your governance process," he said.

This is especially true of opportunistic investments, both Wright and Cagnina stress.

"If there are dislocations or opportunities in the market, the OCIO can react quickly," Cagnina said.

Another critical aspect of private markets investments is manager selection, which can determine whether or not a private markets program will make a positive difference for an institution.

"The OCIO needs to have an infrastructure and a long heritage and track record of providing access to private equity managers," Cagnina said. "If you're able to get good managers, they're not as correlated to the public markets, and you can certainly add to your portfolio if public markets and interest-sensitivity investments are not doing well."

This can help position investors to do better going forward, Bank said.

"It's not a slam dunk relative to public markets on a valuation basis, but if you have selection skill, you can do a lot better," said Bank. "It's going to be interesting to see over the next decade whether institutions that really have capabilities there, and can discern good from bad and really benefit from that dispersion, can separate themselves a bit from those who maybe can't benefit as readily from that kind of dispersion."

When choosing an OCIO, it is important for institutions to know the broad level of options at their disposal, from larger firms to smaller, boutique groups, all of which can provide different kinds of services and differing levels of personalization.

"It's a broad landscape. It continues to evolve," said Wright. "I think the biggest challenge is when you have a mismatch in terms of expectations and deliverables on the client side with the provider side."

The same is true on the client side.

"Every endowment and foundation has a different relationship between growing their portfolio and having stability to support annual payout," said Bank. "I think ensuring that you've got the group that understands that balance at an enterprise level is really important."