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Outlook for OCIOs

Providing transparency into trends, challenges, and innovation

2024

Contents

Welcome to the Outlook for OCIOs

Earlier this year Vidrio Financial authored a blog on some of the clear benefits investment teams have when engaging with an Outsourced Chief Investment Officer, (OCIO) relationship.

An OCIO may bring in significant cost savings, much needed bandwidth resources, a second pair of eyes sharing advisory responsibilities, and improved risk management methodologies. Here at Vidrio Financial, we believe that OCIOs are an important asset to the overall health and scalability of investor portfolios, as these aspects also define how our best-in-class platform tools help serve the OCIO market.

Vidrio Financial has joined forces with AW Research to conduct an exclusive report that delvesinto the perspectives and beliefs of OCIOs. Gain invaluable insights into the future of private market investments, the challenges faced by OCIOs in today's market, the utilization of cutting-edge technology in the era of AI, and the OCIO perspective on the ever-popular ESG acronym.

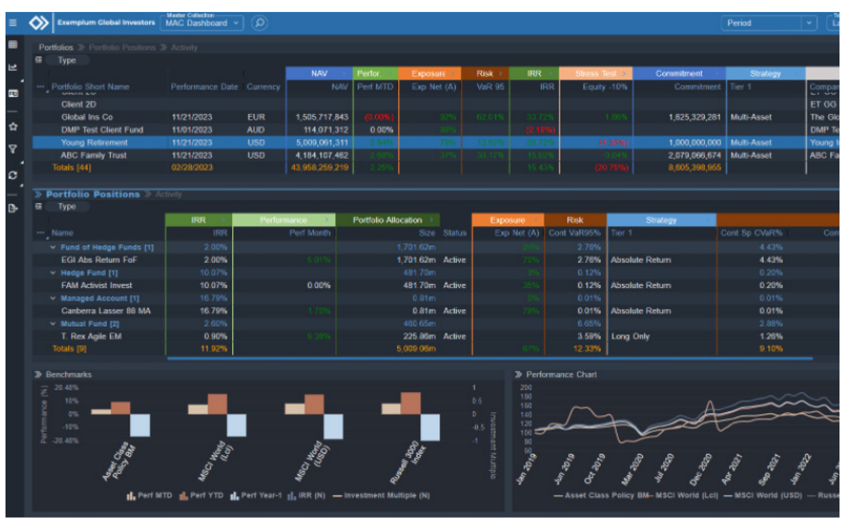
Vidrio's forward-looking perspective for OCIOs in 2024 and beyond acknowledges that the intricacy of multi-asset class portfolios will persistently expand as investors strive to enhance alpha amidst the challenges posed by inflationary pressures, geopolitical events, escalating interest rates, and overall market valuation and volatility.

Many OCIOs find themselves with outdated operating models that struggle to be future proofed when compared against client AUM expansion goals. Collaboration is key to an OCIOs success to help exchange ideas on investment best practices and evolve as investors needs change. The Vidrio platform helps to systematize this information exchange and reduce friction while creating a single source of truth that OCIOs and investment teams can rely upon to make future allocation decisions. Through our ongoing discussions at global events, podcast episodes, and client meetings, Vidrio Financial has heard that data organization, streamlining the portfolio planning and monitoring process, alignment between risk management, analytics, reporting, liquidity, and cash flow activity are a growing focus for OCIOs.

We hope that you enjoy this inaugural Alternatives Watch OCIO outlook report and find the insights across private markets, engagement factors, AI, ESG, and more, valuable for the future.

All the best and wishing you continued success.

Mazen Jabban
Chairman and CEO
Vidrio Financial

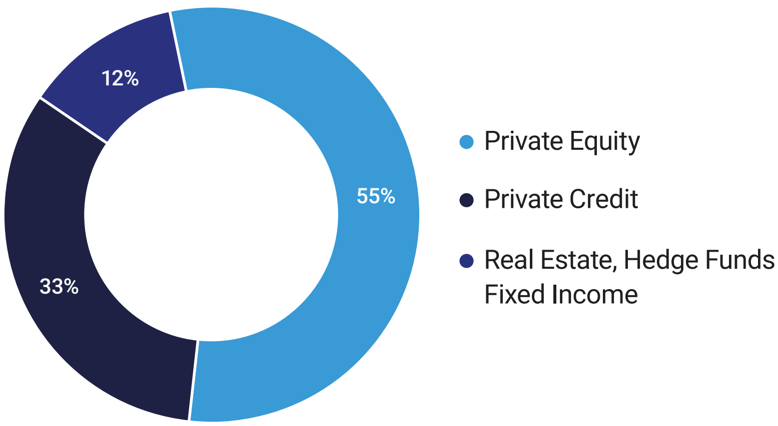


Overall state of the market

Private equity and credit are poised to continue to dominate asset mandates for the next 12 to 24 months, according to a survey of Outsourced Chief Investment Officer (OCIO) providers.

Vidrio Financial, in association with news and data provider Alternatives Watch, surveyed some of the longest-running OCIO businesses with assets under advisement totaling over $660 billion. The aim was to determine not only what was keeping them up at night but to find out the strategies and the operations that are refining what they provide to non-profits going forward.

THE HOME FOR NEW ALLOCATIONS (NEXT 12-24 MONTHS)



Over half (55%) said that private equity was the most likely home for new allocations, with another 33% viewing credit strategies, such as distressed debt, as offering greater opportunities over the next 12 to 24 months. Other asset classes mentioned included real estate, hedge funds and fixed income.

Private market popularity

The majority of OCIOs interviewed said that their clients' long-term investment horizons dictated greater reliance on less-liquid alternative investment strategies, such as private equity.

Non-profit endowment and foundation investors typically have higher return objectives to support spending. The perpetual time horizon allows clients to lock-up capital for five to 15 years.

> "We've been investing in private equity and venture capital for more than 30 years and so we have a great network."

Performance is also key in that one OCIO said that the rest of 2023 and 2024 present a "very attractive" opportunity set to clients.

Private equity has historically offered an illiquidity premium that is likely to continue to exist in the 200-300 basis points range at the low end and the 500-600 basis points range at the high end, another firm outlined.

> "If you look at portfolio performance in the E&F space, those with significant private equity exposure have definitively outperformed their peers."

While credit proponents were the minority, most interviewed OCIOs did view the asset class as holding some potential. Under consideration are a vast array of strategies ranging from distressed debt to real estate and corporate debt.

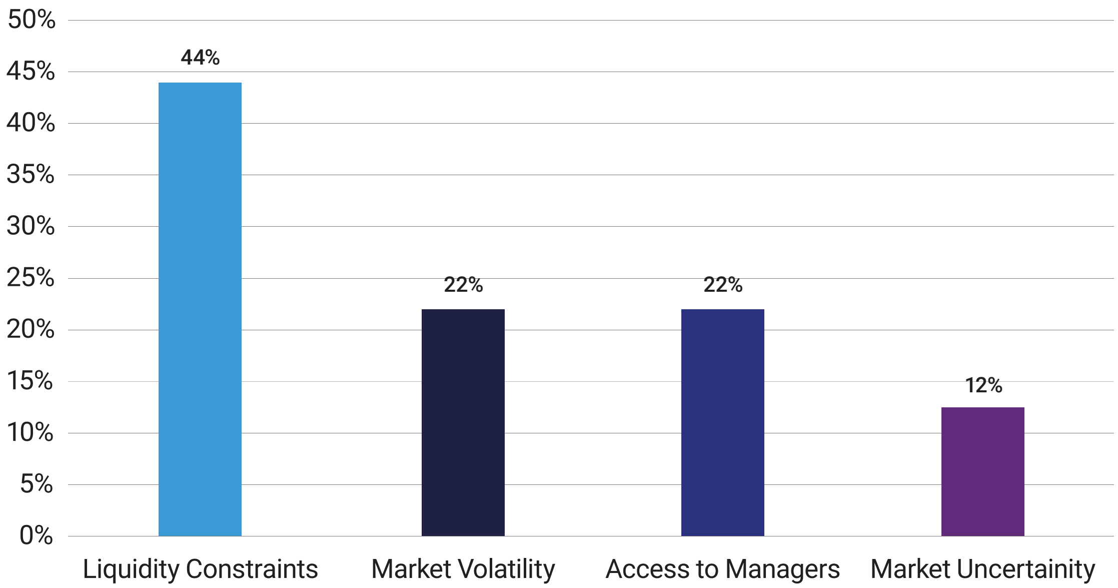
One executive observed that the market hasn't seen a lot of distressed opportunities for the last decade, and with that in mind few funds are ready to handle workouts. The thought is that over the next 24 months higher interest rates will likely cause ripple effects across markets.

> The focus is on taking advantage of the opportunities that we believe are likely to present themselves because of the disruptive change that has been (and is likely to continue to be) happening."

Credit is offering the best risk-adjusted return with the least amount of uncertainty, according to another firm that predominantly works with pension funds. While many see volatility emerging due to refinancing risk, the returns in credit are around 10%, officials said.

What's getting in the way?

When asked what the greatest impediment is to putting assets to work in client portfolios: 44% said liquidity constraints, while 22% market volatility, another 22% said access to managers and 12% said market uncertainty.



Private equity managers have reported slower fundraising across the board as fewer realizations have had a knock-on effect on re-ups. Overall, however, more allocators' portfolios are becoming less liquid as industry surveys see a greater percentage allocation going to illiquid investment strategies within private markets.

Long lockups are a constraint on the manager, but shouldn't be a problem for investors, added one OCIO. Another respondent said that an impediment could be a discussion on how much illiquidity a client can take vs. what they are comfortable taking on.

Market volatility can complicate putting money to work in a portfolio, but it also has implications for portfolio performance, with 70% listing it as the top challenge to market performance over the next 12 to 24 months. The remaining 30% listed valuation as their top concern.

Market uncertainty was also viewed as a market challenge and impediment to putting assets to work. This uncertainty takes many forms, whether it is over terminal interest rates, liquidity or market regulation.

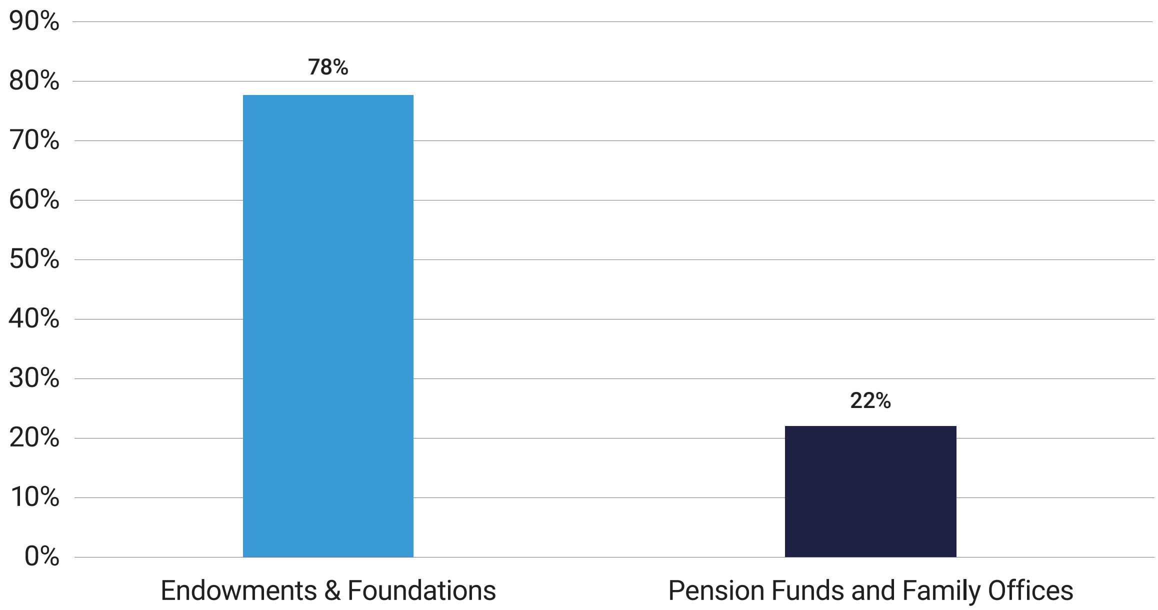
> "We've been telling clients for quite some time now that the uncertainty in the environment creates complications with having top/down portfolio tilts. It's really broad uncertainty – including geopolitical – you know name your risk."

One OCIO we spoke with runs a database that tracks performance, which the firms uses as a way to provide clients with better understanding of how their peers work. The greatest challenge to the firm's OCIO clients is facing the possibility of not being able to support their mission at the same level they are currently, due to inflation. From that standpoint, the investment portfolio needs to take the level of risk to ensure that purchasing power is preserved.

The non-profit conundrum

The majority of OCIOs (78%) claim endowments and foundations as being their typical client. The remaining 22% of respondents counted pension funds and family offices as being clients.

OCIOS TYPICAL CLIENT BREAKDOWN

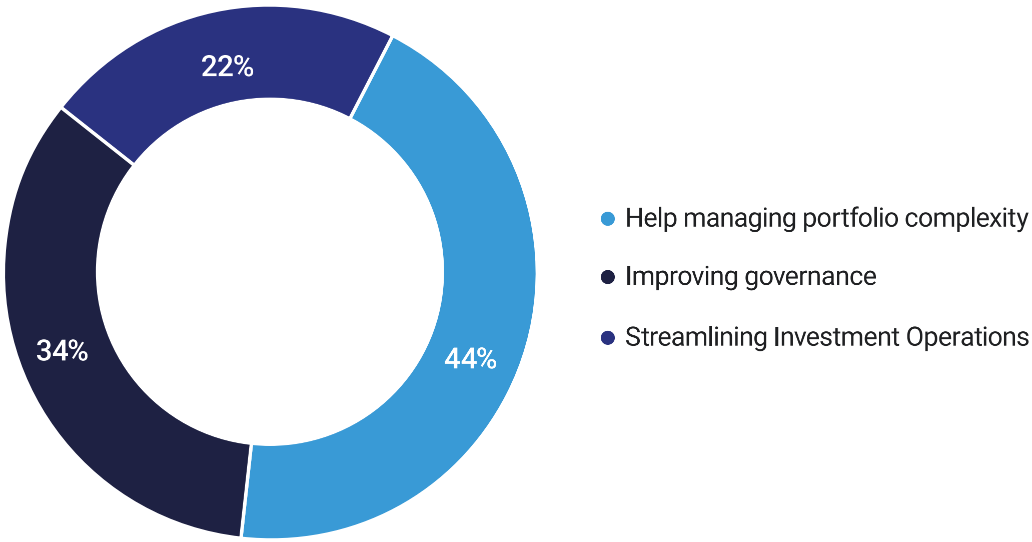


> “We see ourselves as an extension of staff.”

We asked what is the reason that clients choose the OCIO model as opposed to hiring internal staff and/or hiring a traditional investment consultant.

The OCIOs were mixed in picking the top reasons for their usefulness, with 44% responding that non-profits needed help managing portfolio complexity. Roughly 34% said it was about offering improved governance, while 22% said it was about streamlining investment operations.

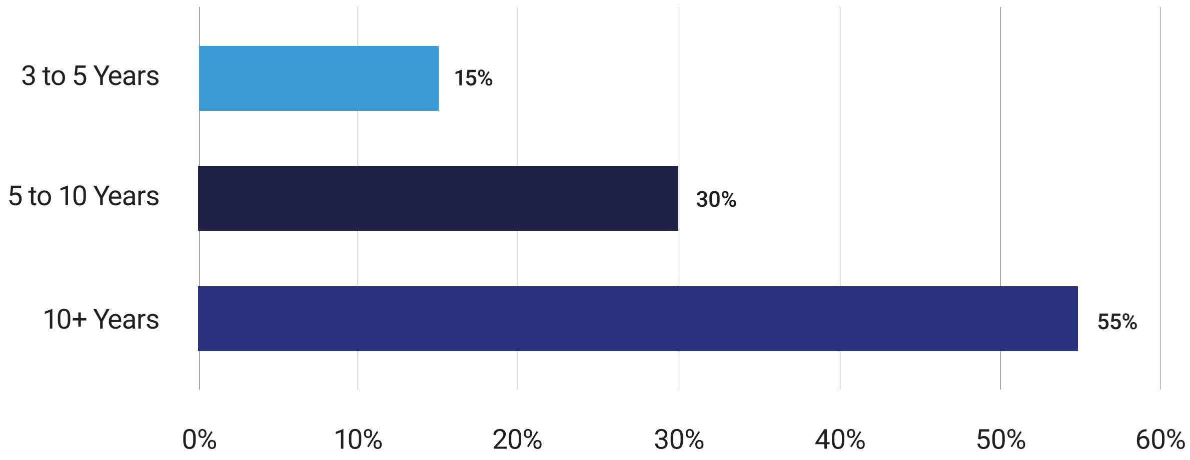
WHY ARE OCIOS BEING SOUGHT AFTER?



> “It comes down to the complexity of managing the endowment and the resources to apply to that task. Unless you are a $2 billion endowment or more – it is challenging to build a team, in an environment where it is harder to run a non-profit.”

Interestingly, while the OCIO concept seems to be relatively new on the scene and more clients are hopping on the bandwagon, the survey found that overwhelmingly firms are being retained for a decade or more. We asked how long the majority of their clients have used them for OCIO services.

OCIO CLIENT RETENTION TIMEFRAMES



While the first days on an account can vary greatly by client, OCIOs said the key is keeping the conversation going with managers new and old.

Some models call for the categorical firing of all existing managers in a client's portfolio on day one, while others may take a more tailored approach depending on the client's direction. Much depends on an initial assessment of an investor's managers and ongoing due diligence being done with the existing managers.

Should an OCIO choose to liquidate, the approach generally is to dump all liquid and semi-liquid holdings first and rebuild with the OCIO's preferred managers. Still, respondents said there is space to be sensitive to pre-existing relationships and build a portfolio around those initial managers. Illiquid strategies may be maintained unless there are causes for concern or red flags, officials said in the survey.

A liquid portfolio transition can take anywhere from three to six months, but experts said that the time frame may be years for an illiquid private capital portfolio.

Should a legacy manager need to stay due to the relationship with the client or illiquidity, the OCIO is expected to take over the day-to-day management of that account. This would include managing capital calls and distributions. For large clients, the OCIO may also perform due diligence as well. OCIOs said that the aim in onboarding a client is ultimately getting the client down to one K1 and that the OCIO meets with all managers on behalf of the client.

It bears repeating that respondents stressed that each portfolio is customized and designed to meet client needs. That means understanding existing holdings and relationships, and driving whatever change is necessary cautiously but systematically over time to achieve good results for the client, one OCIO concluded.

Curing portfolio complexity with technology

An overwhelming majority of firms interviewed by Alternatives Watch (90% to be exact) expected technology to have a major impact on the OCIO business over the next five years. What's expected to change varies widely by firm and is well worth watching as clients decide with whom to engage over the long term.

Unsurprisingly, artificial intelligence is likely to have significant impact across workflows, investment research, manager research and even marketing with the advent of ChatGPT.

> "We think we could feasibly be on the brink of another technological precipice much like we were in the 80s and 90s. Artificial intelligence could create a great deal of efficiencies across our business."

The leveraging of AI is likely to be client-specific and will be designed for business growth and competitiveness.

One respondent viewed AI solutions ultimately fitting into the current technology stack in order to align with the clients' workflow. These end investors could see better transparency and reporting as a result that could essentially be given in a timely manner for decision makers.

Another firm described investing in systems to make the client experience better and more efficient. One OCIO described plans to use AI to read the documentation for capital calls in order to make their investment operations more efficient.

Another executive described their firm's transparency demands drilling down to the shorts owned by a long/short equity hedge fund manager. If a manager refuses to give such detail, even over a phone call, it can be problematic as in this case it became evident that the manager was dabbling in technology stocks, which was not the firm's remit in the client portfolio.

While such information can be given over a phone call, the detail ultimately is shared electronically, where such data can be analyzed using AI to see broader trends. Some are looking at AI as a note-taker at manager meetings as well as a streamlined way to handle compliance needs.

Describing AI as a great tool, executives stressed that it is not new that the analysis can be done as that has been done by computers for years. What they say the new system offers is faster data processing and a decision that will be a lot more instantaneous.

OCIOs said they are much more apt to use AI in the initial screening of managers. One OCIO exec said their team has analysts rely on ChatGPT as they research potential managers. The process offers much more “insightful information” and provides “granularity.” The team also relies on outside tools as a way to handle portfolio optimization via algorithms to assess risk scenarios and conduct factor analysis.

By the same token, OCIOs are asking a lot of questions of managers in terms of how they are leveraging AI effectively. One OCIO shop simply remarked that they are looking to identify, in public and private markets, the sectors, industries, and firms that stand to benefit from AI technology.

One respondent firm said it is starting to use AI when communicating with clients, but declined to go into detail.

Another OCIO’s marketing team and compliance team have joined forces to boil down what was essential that had been detailed in three paragraphs down to a single paragraph. This allows the marketing team to spend more time pitching to clients what truly differentiates their firm from the rest of the pack, they said. The outcome is a smoother and faster process of filling out client RFPs.

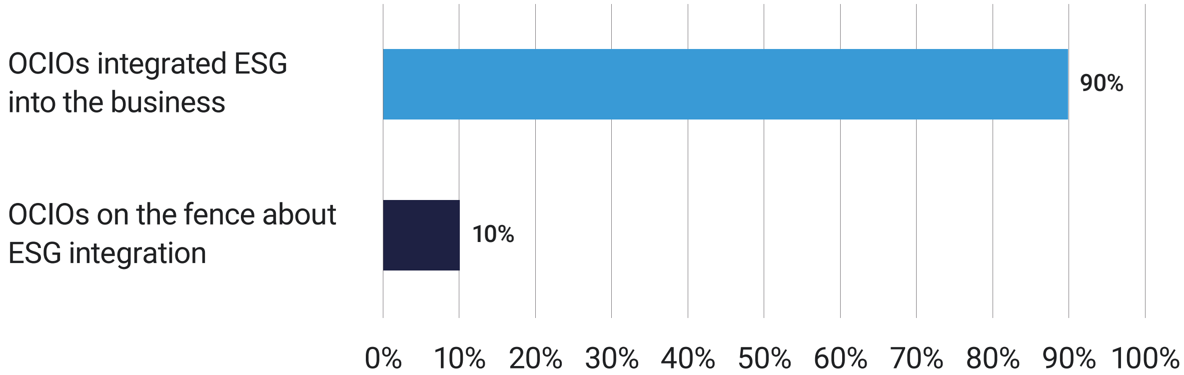
They are ultimately not worried about AI taking away their “secret sauce,” as the efficiencies gleaned from artificial intelligence will be such a boost to the business. One executive stressed that at the end of the day it is very much about the team’s judgement. He said that the work of designing portfolios and listening to clients can’t be replaced by AI technology.

ESG slams into OCIO frameworks

When asked whether they're leverage ESG to bring in more OCIO clients, executives seemed divided on whether it was part of the investment process or distinct solutions that works for some non-profits and not others.

The majority (approximately 90%) said that they have integrated ESG into their business in some way due to growing client demand predominantly from mission-oriented foundations.

OCIO ESG INTEGRATION INTO BUSINESSES OPERATIONS



ESG guidelines have been of waning interest over the last 18 months, according to one firm that is not focused on the acronym. Another firm described their participation in the U.N. PRI signatory program as a sign to allocators that they incorporate ESG themes in their investment process.

Another OCIO said that they saw an ESG philosophy as being necessary, as clients may ask about it, but it has become less of a focus than previously as attention has shifted to DEI concerns.

In 2021, the U.S. Securities and Exchange Commission announced the creation of a Climate and ESG Task Force in the Division of Enforcement. Since then, a variety of cases have gone forward against investment advisors as well as companies making claims regarding ESG. One such case against DWS Investment Management Americas resulted in penalties. The firm was charged with making misleading statements about its controls for incorporating ESG factors into research and investment recommendations for ESG integrated products, including certain actively managed mutual funds and separately managed accounts.

Such regulatory action may be part of the reason firms may not play up more of their ESG focus. For those that did include ESG considerations as part of the allocation process, much of the focus is on the energy transition and the allocation strategies that best meet ESG guidance while still driving performance across private market strategies. One firm said that if they were going to add energy to the portfolio, the team needed to be thoughtful of the constraints on clients. This has led them to look to innovate energy investments and allocations to impact investments that have been heavily oriented to technology companies.

Another described being flexible on the topic of ESG, but are often asked in a finals presentation about it and even within RFP. Less discussion is had on the topic after a mandate is won.

One chief investment officer at an OCIO we interviewed said they were hearing from existing clients, as well as marketplace overall, that there is increased interest in aligning portfolios with missions, and so from that standpoint their firm has been on the leading edge. The number of clients really interested in ESG at endowments and foundations is growing not shrinking, the firm added.

ESG is as indicative as any other investment topic to be a client-driven approach. One official said that the client's ESG approach and goals drive the process, rather than adopting a specific approach for the firm.

> "This approach – independence but close collaboration with each client – allows us to provide appropriate service for clients across the spectrum of ESG approaches. We believe this approach will be attractive to all kinds of clients, with a wide range of views," they said.

About Alternatives Watch Research

AW Research is a data- and analysis-driven research platform. The team compiles the facts and figures behind the larger trends within the alternative asset management industry. From fund launch and investor mandate data to strategy-specific insights, we seek to offer the most comprehensive view of salient trends in the marketplace today.

alternativeswatch.com

About Vidrio

Vidrio Financial is the first Technology Enabled Service for allocators — providing managed data services and portfolio management software to institutional investors globally. Vidrio's multi-asset class data services, analytics, and workflow applications empower allocators to take control of their complex investments and external manager relationships while helping to reduce costs, optimize resources, and mitigate operational risk. Vidrio's success is based on our capacity to efficiently collect and extract layers of external fund manager data across multiple asset classes, enrich that data with dynamic investment analytics, and then deliver the information together with rich analytical tools seamlessly across your critical investment management and stakeholder business reporting processes.

vidrio.com

Methodology

Alternatives Watch in collaboration with Vidrio Financial did a broad survey of the OCIO landscape conducting both phone and email interviews from late August through October. We would like to thank the firms for their candor and time in helping us to understand what impact alternative asset management trends and technology are having on how they work with clients and how they see their work evolving in the quarters to come.