Diverse perspectives from the Investment Advisory Group

Diversifying with diversity shows favorable portfolio outcomes

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Introduction

Following a challenging year for both stocks and bonds in 2022, the outlook for diversified balanced portfolios is now more attractive over the coming decade, albeit with more volatility.

Yet, as allocators in uncertain economic and market environments, we seek unique opportunities that help our clients maximize financial returns over time through different ways of thinking. Such strategies include those led by diverse investment teams – including women, ethnically/racially diverse individuals, those identifying as LGBTQ+, veterans, and the uniquely-abled.

Historically, portfolio diversification applied to asset classes and strategies, not necessarily to the asset managers' backgrounds. **Whether from cultural differences, differentiated viewpoints, or access to distinctive networks, growing empirical evidence suggests diverse investment teams can lead to better decision making, which can be additive in portfolios over time**[1]**.** Diversity tends to broaden a team's point of view, which may help in identifying potential risks and opportunities in complex financial markets.

While there's been an industry surge in recent years in support of diversity in investment portfolios, in general, investors are minimally allocated. Some perceived misconceptions are that investing in diverse managers will come at the expense of competitive returns, that diverse firms lack scale (and may be too small or too new) to garner significant assets, or that cognitive diversity is not considered meaningful in the selection criteria of managers.

In our view, wealth industry inequities hinder innovation and performance when it comes to investor portfolios.

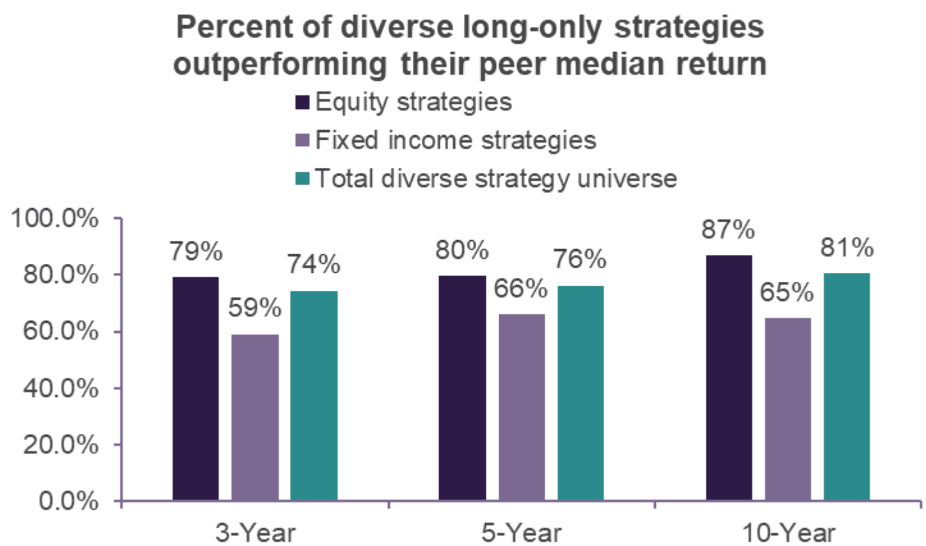
Allocations to actively managed, diversely-led investment strategies, moreover, are warranted in portfolios given competitive performance, agility which drives innovation, and access to unsaturated markets where competitive opportunities exist.

[1] "*Is there Alpha Available from Emerging and Diverse Managers*" (2021), Verus, "*The Boutique Difference,*" F/M Acceleration (2020), "*Diversity in the Asset Management Industry,*" Willis Towers Watson (2020),"*Diversity Wins: How Inclusion Matters*," McKinsey & Company: Diversity Wins (2020),"*Does Gender Diversity Impact Performance and Corporate Social Responsibility Investment Decisions in Mutual Funds"* (2019),"*Examining the Returns: The Financial Returns of Diverse Private Equity Firms*," NAIC (2019, 2017)

Diverse perspectives can lead to positive outcomes

According to studies, diverse teams minimize groupthink, and this diversity of thought is a key element in the research process, in identifying opportunities and in making better decisions[2]. Much of this empirical research has been centered on women and racially-diverse teams, where data is more widely available. Our team continues to explore the risk and return profiles of other diverse segments.

For now, our work shows most of the 1,000+ long-only equity and fixed income strategies – with at least 25% ownership by women and/or people of color – outpaced their peer median return within their respective asset classes during the past three-, five- and ten-year periods.

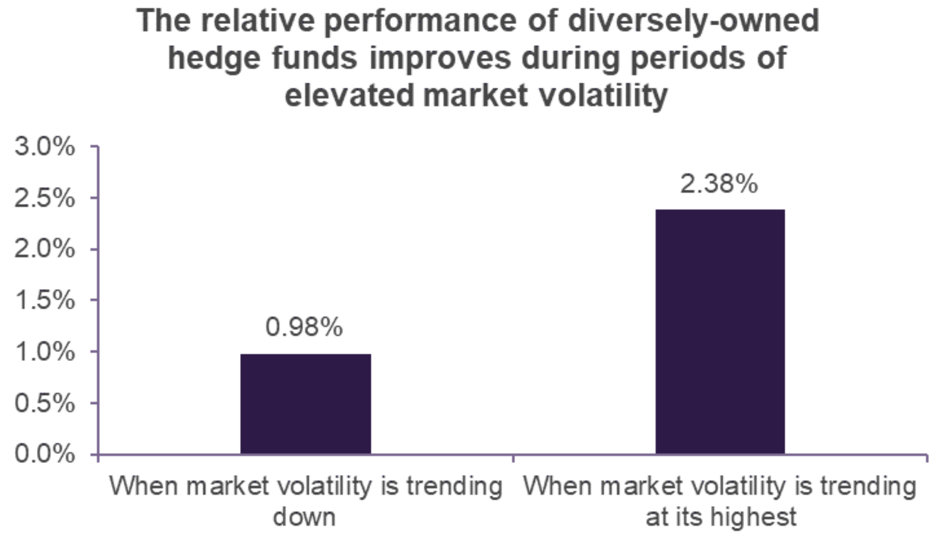


Data source: IAG, eVestment, Morningstar. Data as of 12/31/2021

A similar study conducted by Willis Towers Watson in 2020 found investment teams that were racially/ethnically diverse tended to generate higher excess returns when analyzing 400 investment products across several asset classes over long time periods.

We see similar conclusions across the diverse hedge fund and private capital markets. Our analysis of diverse hedge funds – as measured by the HFRI Diversity Index – outperformed the global hedge fund industry by a wider margin, on a forward 12-month basis, during periods of elevated market volatility.

[2] "*Is there Alpha Available from Emerging and Diverse Managers*" (2021), Verus, "*The Boutique Difference,*" F/M Acceleration (2020), "*Diversity in the Asset Management Industry,*" Willis Towers Watson (2020),"*Diversity Wins: How Inclusion Matters*," McKinsey & Company: Diversity Wins (2020),"*Does Gender Diversity Impact Performance and Corporate Social Responsibility Investment Decisions in Mutual Funds*" (2019),"*Examining the Returns: The Financial Returns of Diverse Private Equity Firms*," NAIC (2019, 2017)



Data source: IAG, Hedge Fund Research. Data as of 9/30/2022

Hedge funds often engage in leveraging and speculative investment practices that may increase the risk of investment loss, can be highly illiquid, and are not required to provide periodic pricing or valuation information to investors. Hedge funds may involve complex tax structures and delays in distributing tax information. Hedge funds are not subject to the same regulatory requirements as mutual funds and often charge higher fees

Likewise, studies show minority-owned venture capital and private equity firms continue to make strides in sourcing deals and delivering competitive returns.

While significant causality is difficult to demonstrate, research supports the notion that diverse investment teams are not sacrificing investment performance, and instead, have a good track record of delivering positive outcomes in portfolios over time.

Agile firms drive creativity

While many diverse investment firms have been around for decades, there has certainly been a rise in “boutique” investment firms, who often manage less in assets than their larger peers and offer specialized expertise in one or a few markets.

This enables them to often capitalize on market inefficiencies and offer an opportunity to complement larger managers or even passive investment options within a portfolio.

Moreover, the small size advantage enables them to be creative and nimble in their decision making. With a lean organization, led largely by investment professionals, these agile firms focus on what they do best – driving results.

Access to a broader opportunity set of untapped talent

The universe of diversely-led investment firms continues to grow, yet a funding gap persists, and investors remain under allocated. But these firms tend to build networks or invest in unsaturated markets and communities where competitive opportunities may exist.

Diversely-led investment teams understand the problems underrepresented communities face. They explore the ideas and innovation diverse founders bring to the table and have the potential to invest in differentiated solutions. Biases, though, may cause investors to leave money on the table and miss accessing a pool of untapped, diverse talent, who have the potential to deliver favorable outcomes. Moreover, it is important that we not overlook good managers and the contributions of diverse investment teams due to inherent biases.

Bottom line

Investment strategies led by diverse teams should be considered in investor portfolios in an environment where we expect improved market returns, albeit with higher volatility. Diverse asset managers across the global landscape have the potential to offer competitive returns, are agile, and can access differentiated networks that many investors miss.

We cannot overstate, though, the importance of proper due diligence when adding investment strategies to a portfolio. Moreover, as fiduciaries, we are rethinking how we can differentiate portfolios in the coming years and, at the same time, ensure good managers do not fall through the cracks. To help meet clients' goals, both personally and financially, diverse asset managers have proven they should be part of the discussion going forward.

Please reach out to your advisor as they can help guide you in determining what diverse opportunities are appropriate for your investment portfolio.

Disclosures

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The risk profile of a private equity investment is higher than that of other asset classes and is not suitable for all investors. There are inherent risks in investing in private equity companies, which encompass financial institutions or vehicles whose principal business is to invest in and lend capital to privately held companies. These risks include a long-term investment horizon, rigid liquidity restraints, and high bankruptcy rates among portfolio companies. Generally, little public information exists for private and thinly traded companies and there is a risk that investors may not be able to make a fully informed investment decision.

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