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Investment priorities in a world upended

Insights from our 2022 survey of non-profits and healthcare systems

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Foreword

From elevated inflation to the outbreak of the war in Ukraine, 2022 has presented endowment, foundation and healthcare investors with difficult market and macroeconomic conditions to navigate.

To better understand how investors are approaching the current investment landscape, BlackRock partnered with Coalition Greenwich to conduct a research survey of these investors' priorities. A total of 87 U.S.-based investors — 31 endowments, 31 foundations and 25 healthcare systems — completed a 38-question online survey between early February and early April of 2022.

The online survey was complemented by in-depth phone interviews with CIOs and senior decision-makers at six institutions: a private university endowment, a public university endowment, two foundations and two healthcare systems.

The survey topics included:

- **Investment objectives and challenges**
- **Priorities with respect to alternative investments**
- **ESG and DEI adoption**
- **Governance considerations**

The timing of the survey overlapped with Russia's invasion of Ukraine, providing useful insight into the respondents' reactions and potential repositioning as a result of the war. The survey spanned February 7th to April 7th, 2022, with 56 online survey responses received before and 31 responses after the invasion. As events unfolded, we followed up with qualitative interviews to better discern the impact of the war and related market volatility on asset allocation, particularly within alternative investments.

Respondents by type

Respondents by AUM

Respondents by decision-making status

Executive summary

Investors' top priority is to mitigate macro risks – yet many investors are embracing investment risk in pursuit of returns.

Inflation, rising interest rates and drawdown risks were respondents' primary concerns. Despite worries about the macro environment, almost half said it was still important to implement a risk-on investment view. Investors favored real estate, public equities, inflation-indexed bonds and natural resources to address inflation, and value stocks, real estate and floating-rate debt to position for rising rates.

Russia's invasion amplified macro concerns.

The portion of survey participants who said mitigating inflation was a top investment objective rose by 11 percentage points after the invasion, while the percentage calling rising rates an important investment concern increased by eight points. The conflict also appeared to increase concerns about the potential for outsized losses: the number of respondents who said reducing drawdown risk was a low priority fell from one in five to just one in 16. Greater focus on drawdowns did not cause investors to abandon risk, however. To the contrary, following the invasion, a slightly greater portion of respondents said implementing a risk-on view was important.

Private equity is a top choice, with an emphasis on risk mitigation.

Although investors expressed concern about market volatility, rising rates and equity valuations, nearly half of respondents were focused on generating idiosyncratic returns and maintaining a risk-on view. Private equity was the alternative asset class of choice for more than three-quarters of survey respondents, and more than half are increasing allocations to private equity to support a risk-on view. Almost one-third indicated an intention to increase their private equity allocations by up to 10%, and nearly one-fifth looked to boost exposure between 10 and 20%.

Respondents split on ESG adoption.

Roughly half of the investors surveyed have adopted ESG strategies, while the other half reported that ESG does not currently play a role in their portfolios. Among those who employ ESG strategies, the primary objectives were to have a positive impact, to enhance investment returns and to satisfy stakeholder demands and corporate standards. More than three-quarters of these investors preferred to incorporate ESG factors in their investment process; other popular implementation methods included sustainable investing and impact investing. Negative or exclusionary ESG screening was the least popular strategy.

ESG adoption is expected to increase, but some investors are reserving judgment.

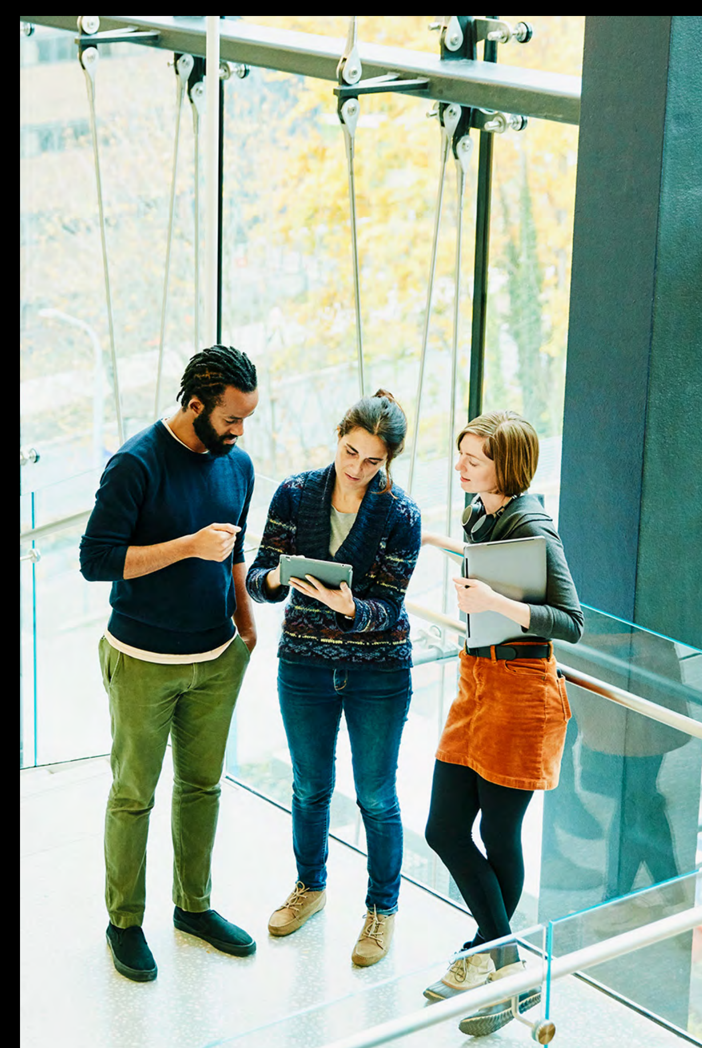
One-quarter of the investors not currently employing ESG indicated that they plan to adopt responsible investing practices within the next five years. Four in 10 respondents are not planning to integrate ESG, citing challenges with implementation and incorporation, and roughly the same ratio of non-ESG investors remained unsure whether they will implement ESG in the next five years. The last group of institutions may be waiting for conclusive data demonstrating that ESG factors generate long-term outperformance.

OCIO adopters seek access to risk management and unique alternatives.

One-quarter of survey respondents use an OCIO provider, with institution size a key factor: more than one-third of institutions with less than $1 billion under management reported using an OCIO provider, compared to only one in 11 respondents with more than $3 billion. The main reasons respondents outsourced the investment function were lack of internal resources, the desire for better risk management and access to top-performing alternatives managers.

Foundations are most likely to prioritize DEI.

More than one-third of investors consider DEI an important factor in manager selection, but only one in 10 would switch managers due to DEI priorities. Nearly half would not amend their manager roster but instead would encourage manager action. Foundations were most likely to say DEI is very important to manager selection and that they would change managers based on DEI priorities.



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Investment priorities:

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War in Ukraine exacerbates macro concerns and raises questions about China

The war heightened concerns regarding inflation, rising rates and drawdown risks, and also forced consideration of possible second-order effects.

As noted earlier, two-thirds of survey participants responded before the outbreak of the Russia-Ukraine war on February 24th. The portion of survey participants who named mitigating inflation as a top investment objective increased from 66% before Russia's invasion to 77% after the war started. Following a similar pattern, the percentage of respondents who called rising rates an important investment concern rose from 63% to 71%.

The war led many respondents to consider secondary effects of a market regime characterized by persistent inflation, reduced growth and accelerated decoupling between the U.S. and China. The Chief Investment Officer of a $3B+ healthcare system noted: "We're certainly thinking about the implications [of Russia's invasion of Ukraine] related to inflation and related to China and its future potential behavior."

Similarly, the CIO of a large public university endowment remarked: "The broader implications might be, longer term, thinking differently about China and other emerging markets. It does feel like this market volatility is different than the geopolitical risk here. It isn't going to be short-lived."

Central banks continue to balance the trade-off between promoting growth and restraining inflation, though as of late they have emphasized the latter. Russia's invasion upended global energy and food markets and aggravated concerns about surging inflation and rising interest rates.

Respondents ranked these macro concerns as top priorities, especially after the outbreak of the war. Many investors remained risk-on, however — not surprising given endowments' and foundations' long time horizons. Survey respondents were generally comfortable that their portfolios are sufficiently insulated from the current macroeconomic tempest. Nearly half (44%) of respondents reported looking for attractively priced pockets of risk, and slightly more than half (52%) of those investors are adding to long-term, strategic private equity allocations.

Q: On a scale of 1-5, where '1' is 'not important' and '5' is 'very important,' please rate the following investment sentiment and positioning by level of importance to your fund over the next 12 months.

● 5 - Very important ● 4 ● 3 ● 2 ● 1 - Not important

Respondents who rated 'positioning for rising rates' as important:
Q: Which investment categories (or products) does your fund employ to position for rising rates?

No surprise: Inflation and rising rates dominate concerns

Seven out of 10 institutions identified navigating inflation as their top investment priority. These respondents favor real estate (70%) and public equities (69%) to address inflation's impacts. Infrastructure appeared under-utilized as an inflation-mitigating asset class, especially among endowments: only 7% reported using the asset class to address inflation, versus 36% of foundations and 39% of healthcare systems.

Positioning portfolios for rising rates was the next highest priority, cited by two-thirds (66%) of respondents. When asked which asset classes they were using for this purpose, most selected value stocks (69%) and real assets (59%).

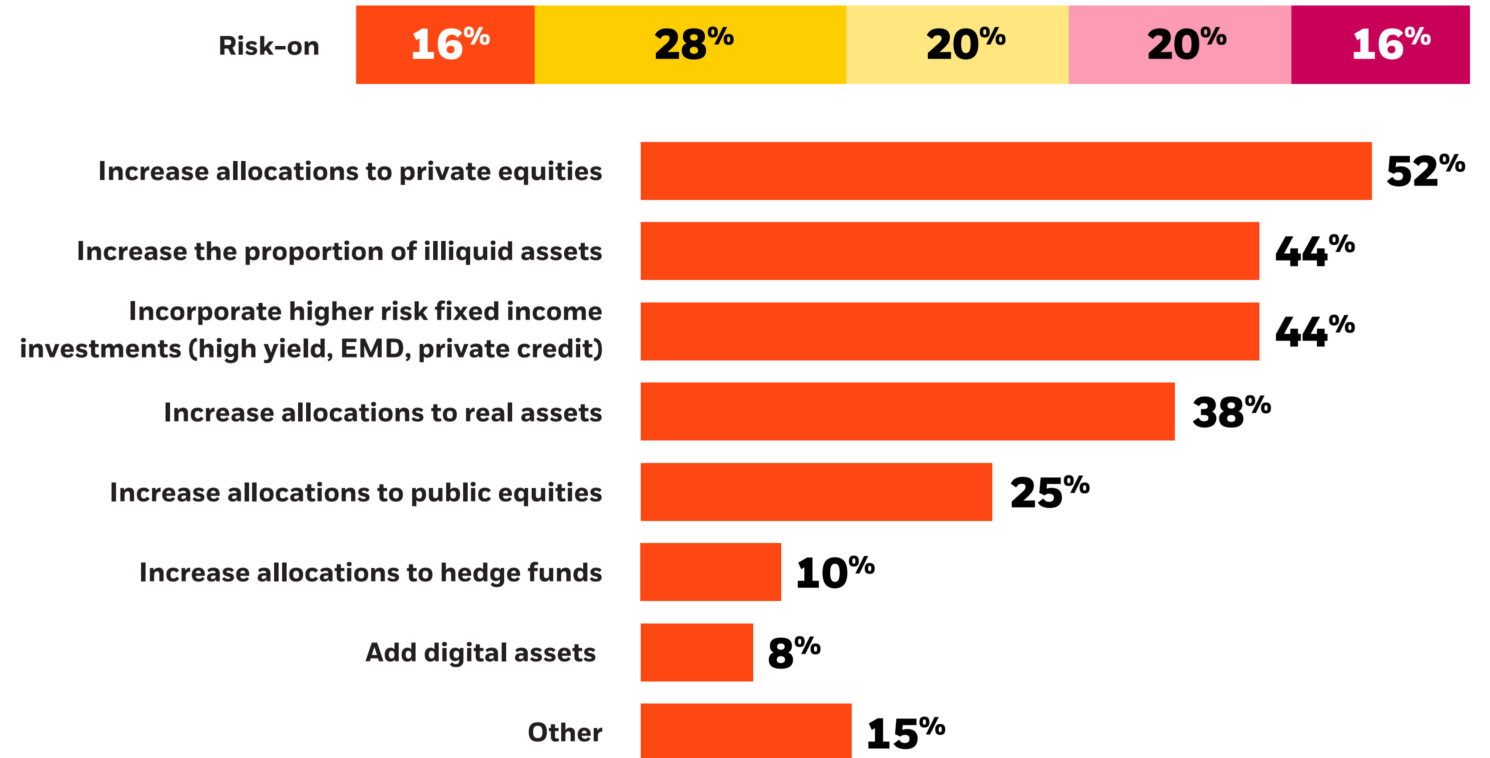
Alternatives allocations:

private equity in focus

While non-profit investors are mindful of heightened inflation and market volatility, they continue to recognize the need to maintain risk to pursue long-term returns.

Russia's invasion did not broadly suppress investors' risk appetites; the percentage looking to add risk to their portfolios nudged up from 43% to 46% in responses after February 24th. These investors' highest investment priorities, after managing inflation and rising interest rates, were to increase idiosyncratic sources of return (48%) and to implement a risk-on view (44%). More than half (52%) of risk-on respondents reported plans to implement greater risk by increasing their allocations to private equity.

Exhibit 3: Actions to support a risk-on posture



Respondents who rate 'implementing a pro-risk view' as important:
Q: What actions do you plan to implement in support of a pro-risk view?

Investors continue to assume illiquidity in exchange for higher expected returns. Two-thirds (67%) of all respondents said their funds were allocating less than 25% to illiquid assets — defined as assets with lockup periods greater than 12 months — while one-quarter held between 25% and 50% in illiquid assets.

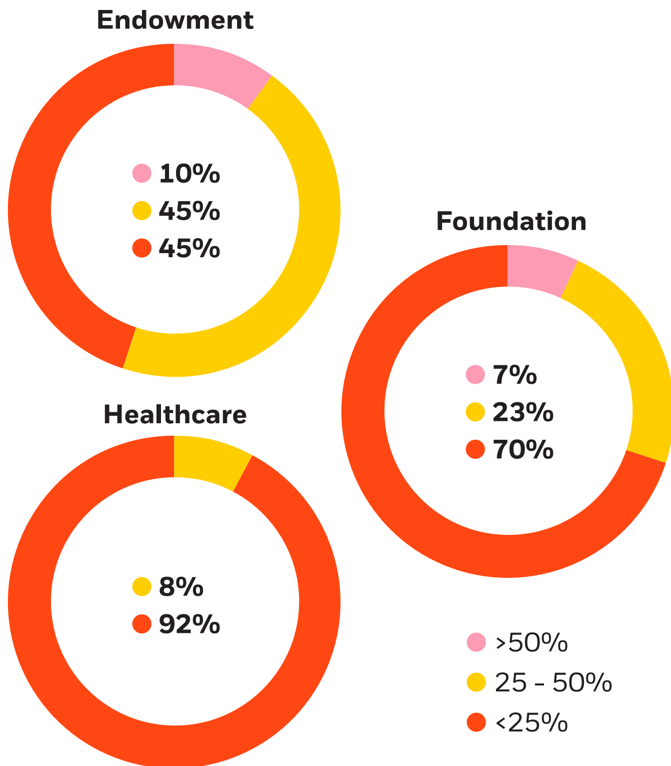
Endowments were most comfortable holding illiquid assets, which suit their longer time horizon for investments. Over half (55%) of endowments reported holding more than 25% of their portfolio in illiquid assets.

Meanwhile, most healthcare institutions — which face a unique set of pressures including volatile spending needs, lumpier capex and rating agency considerations — reported significantly smaller private markets exposures. The overwhelming majority of healthcare participants (92%) reported holding less than a quarter of their portfolio in illiquid assets — compared to 45% of endowments and 70% of foundations. Relative to endowment and foundation investors, healthcare systems tend to augment their alternatives exposures with higher hedge fund and liquid alternatives allocations.

Our discussions with allocators confirmed that a low-return environment has created pressure to accept greater risk in pursuit of alpha. One chief investment officer noted:

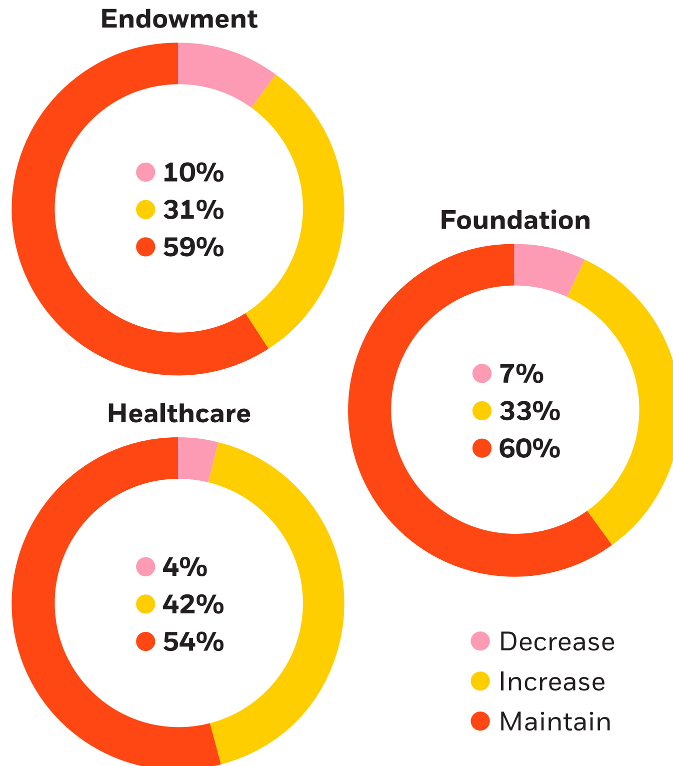
"Over the past one to two years, forward-looking expected returns have dramatically come down… you have to move further out on the risk spectrum to meet that return hurdle."

Exhibit 4: Illiquid allocations as a percentage of portfolio NAV



Q: What portion of your total portfolio is currently allocated to illiquid assets (‘illiquid assets’ have a lockup period greater than 12 months and are not easily exchanged for cash)?

Exhibit 5: Expected change to illiquid allocations



Q: Do you plan to increase, maintain, or decrease illiquid asset allocation in the next 12 months?

More than half (57%) of all respondents, including 70% of foundations, identified liquidity needs as the main hurdle to greater illiquid assets exposure. Investment policy constraints (43%) also hampered additional allocation to illiquid assets.

Looking ahead, nearly six in 10 respondents (58%) intend to keep the liquidity balance within their portfolios at existing levels, while 35% aim to increase exposures to illiquid assets over the next year and 7% plan to decrease it.

Private markets deliver outperformance

Investors largely expressed satisfaction with their alternatives' performance. Just over half of respondents (51%) said their alternatives investment allocations had exceeded performance objectives during the past three years, while 37% said their alternatives had met their performance targets. Only 12% said the returns of their alternatives allocations had fallen short of their aims.

> **The priorities and objectives haven't changed, but the allocations have to meet them. We had a 10% allocation to hedge funds. We've dropped that and we've replaced it with private equity, essentially, just to meet our 8% return threshold."**
>
> **The CIO of a $1 billion foundation**

Large institutions ($3 billion+) were by far the happiest with their alternatives managers: 70% reported that their alternatives had outperformed targets, compared to only 40% of smaller institutions (<$1 billion).

Investors expressed more favorable views toward venture capital and private equity than hedge funds. About 20% of the respondents expect to cut their hedge fund allocations due to mixed performance. One healthcare investor explained that their institution is decreasing hedge fund target allocations in order "to fund other areas of the portfolio".

However, an equal percentage of participants intended to increase hedge fund exposures; public market volatility and the potential for downside protection may be bolstering these investors' decision to increase their target allocations to the asset class.

Venture capital was the most cited asset class among participants seeking to increase idiosyncratic alpha, representing 80% of respondents and 92% of healthcare institutions surveyed. Mid-to-late stage growth equity was another area of interest, with healthcare systems (90%), endowments (88%) and $3 billion+ funds (92%) exhibiting the greatest preference for this category, and to a lesser extent, early-stage private equity, distressed scenarios and leveraged buyouts. Respondents who indicated an intention to reduce, pause or leave their private equity exposure unchanged cited liquidity issues and elevated valuations as their primary reasons.

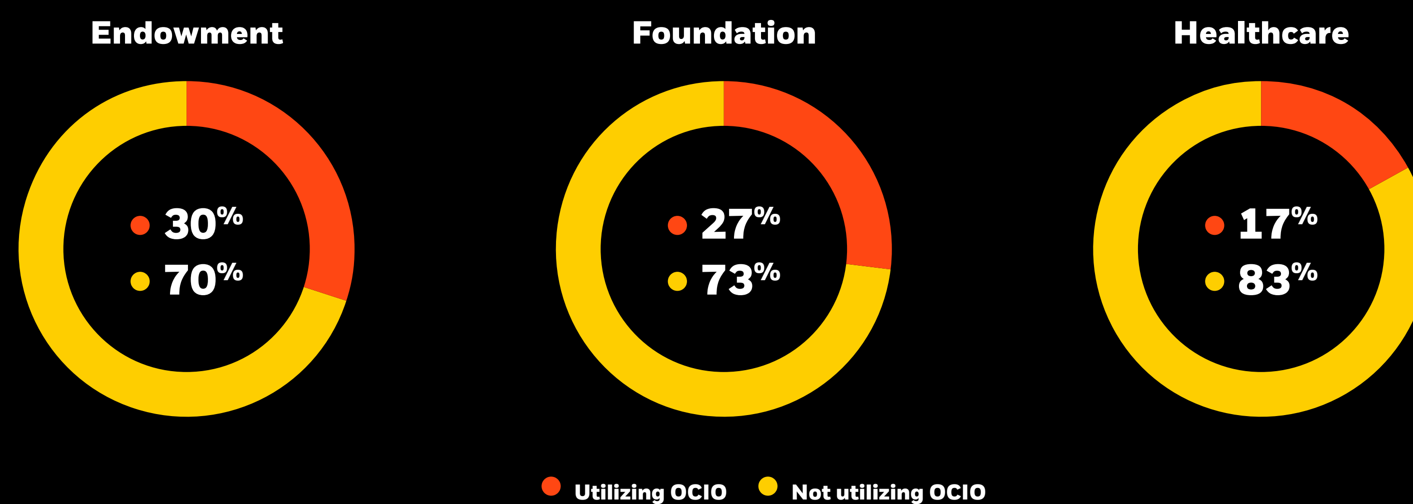
Exhibit 6: Expected shifts in alternatives target allocations

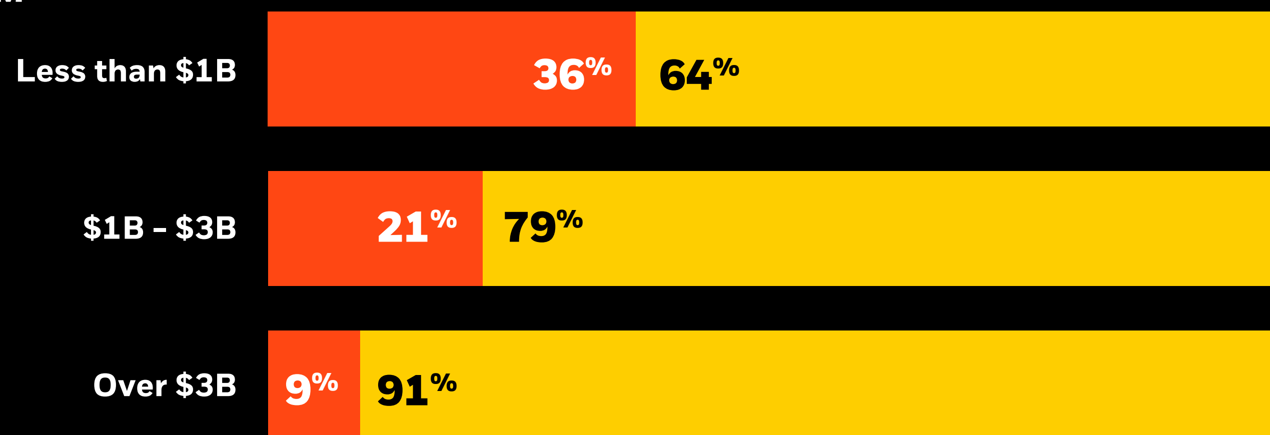
	>20% Increase	10-20% Increase	<10% Increase	Maintain	<10% Decrease	10-20% Decrease	>20% Decrease
Venture capital		8%	38%	48%	4%		
Private equity	4%	19%	30%	39%	5%		
Real estate	4%	5%	28%	57%	4%		
Private credit	6%	4%	26%	56%	7%		
Infrastructure	6%		21%	68%			
Hedge funds	4%		16%	57%	16%		

Q: Do you plan to increase, maintain, or decrease your target allocation to the following asset classes in the next 12 months?

Exhibit 7: OCIO adoption and drivers

Utilizing OCIO vs. not utilizing OCIO

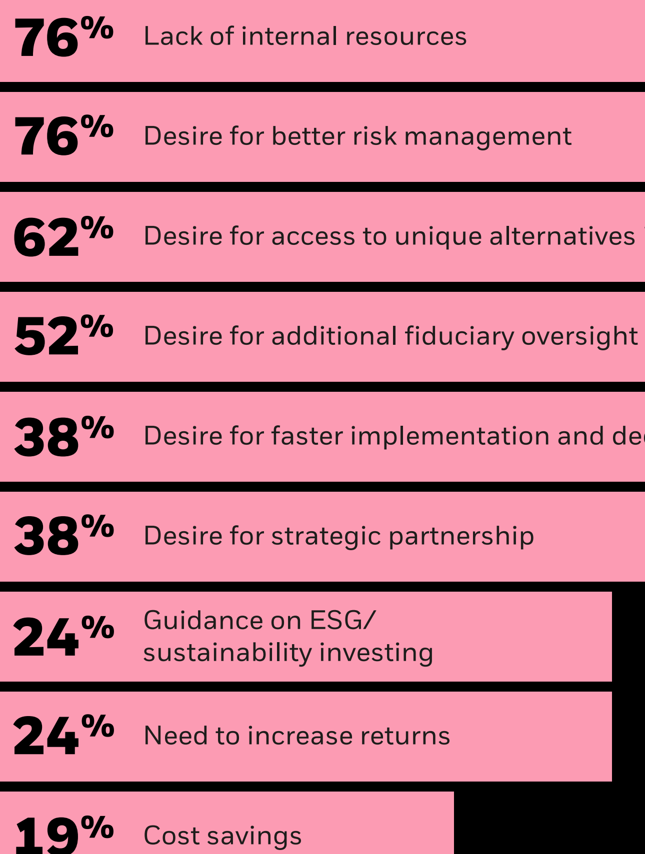




OCIO provides institutions with more resources

Some smaller investors are trying to address shortcomings with respect to alternatives through the use of OCIOs. One in four (25%) respondents reported hiring an OCIO, referencing lack of internal resources, desire for better risk management and access to unique or differentiated alternative investments as primary reasons.

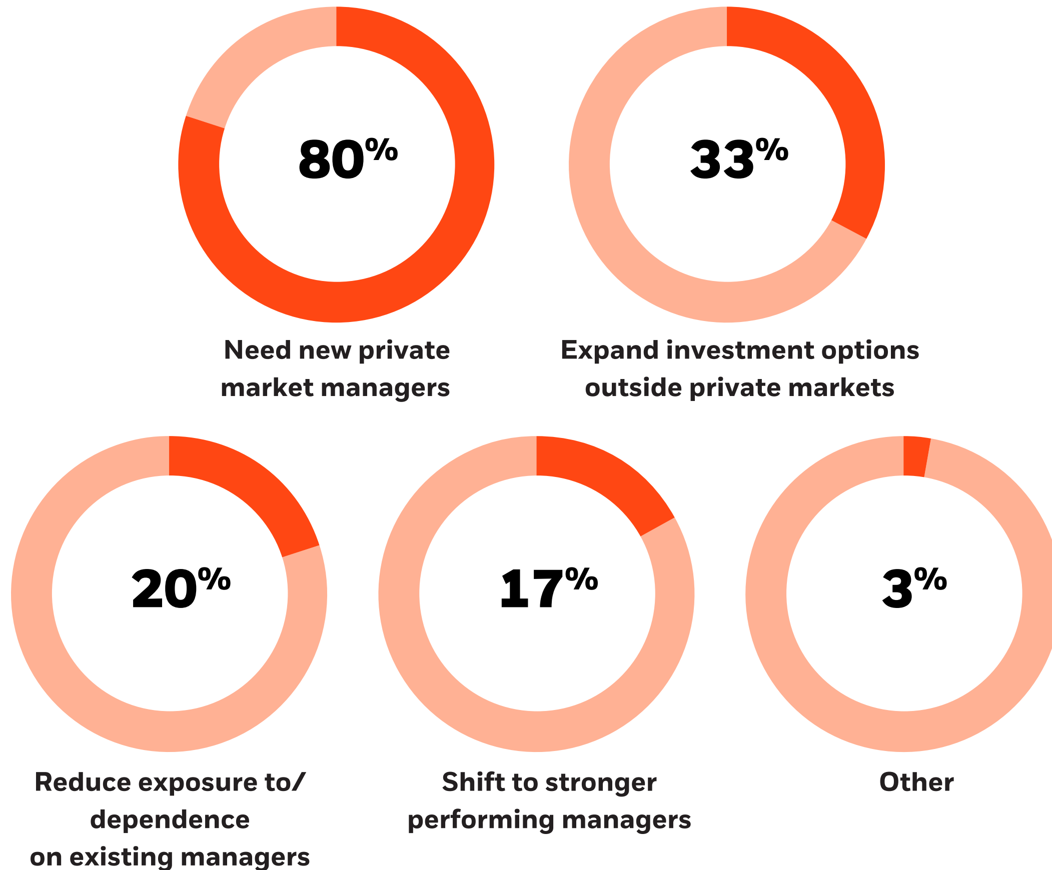
Reasons for hiring an OCIO



Q: Do you use an outsourced CIO (OCIO) provider for a significant portion (>50%) of your assets? Q: Which of the following were key drivers in your decision to hire an OCIO?

Exhibit 8: Drivers behind manager roster size

Increasing manager roster



Q: What is driving the change in the number of managers with whom your fund partners?

Investors expect to add new managers, particularly in private markets mandates

Nearly four in 10 respondents (38%) said they anticipated increasing the number of managers, with 63% of mid-sized investors ($1-3 billion) in hiring mode. The need for new private markets managers was the main reason for adding managers, suggesting that new manager mandates will likely be in private equity and venture capital.

Just one in ten expected to trim their manager pool, with those in the $1-3 billion range most likely to do so (19%). Those respondents seek to consolidate with stronger-performing managers or forge strategic partnerships.

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ESG adoption and governance priorities

Views on ESG adoption were bifurcated amongst endowments, foundations and healthcare institutions. Just under half of the investors surveyed have adopted ESG practices and strategies, driven largely by a desire to make a positive impact, while the other half who haven't adopted ESG are split on their intentions.

Investor type correlated closely to the use and adoption of ESG processes. More than two-thirds of foundations employed ESG or sustainable approaches, while almost three-quarters of healthcare systems reported that they did not, given other priorities resulting from the pandemic.

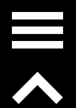
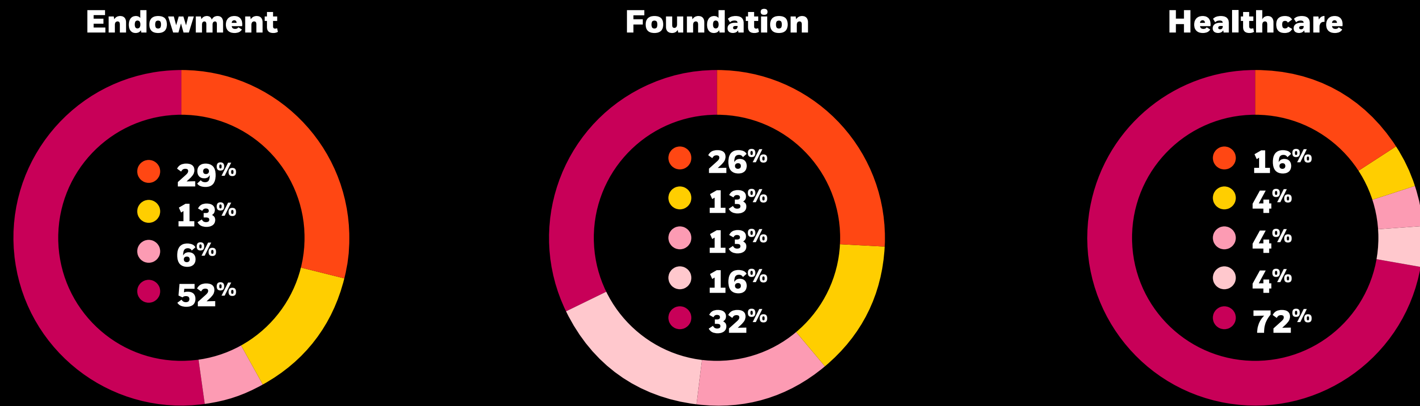
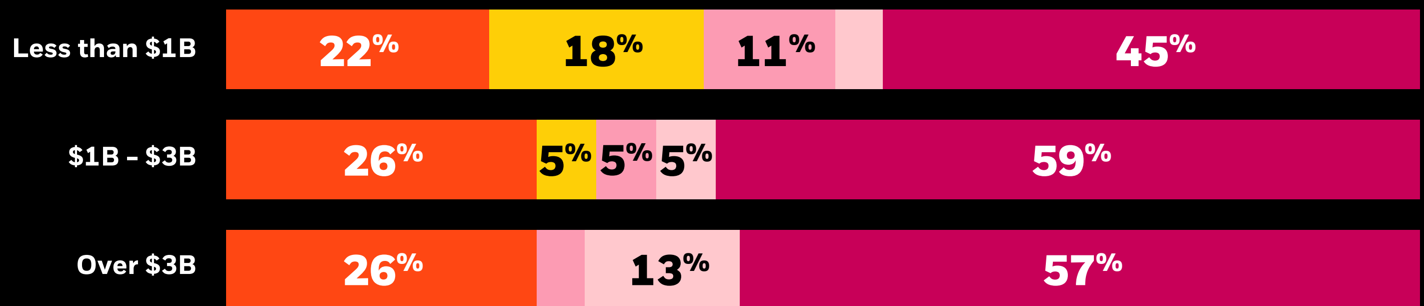


Exhibit 9: Current ESG utilization rates





Q: Do you currently employ ESG integration or sustainable strategies in your portfolio?

Among investors not currently employing ESG, almost one-quarter intend to do so within the next five years. However, 38% said they had no plans to integrate ESG and 39% were unsure. These findings suggest many organizations may be taking a wait-and-see approach. As the CIO of one foundation remarked:

“We want to make sure that we’re making well-informed and good decisions. So, it’s a process to learn where the committee stands and then develop that into implementation.”

Exhibit 10: Expected ESG adoption rates

	Yes	No	Unsure/don't know
Endowment	18%	44%	38%
Foundation	20%	20%	60%
Healthcare	28%	44%	28%

AUM	Yes	No	Unsure/don't know
Less than $1B	10%	40%	50%
$1B – $3B	36%	36%	28%
Over $3B	31%	38%	31%

Respondents who do not currently employ ESG integration: Q: Do you plan to employ ESG integration or sustainable strategies in the next 5 years?

Other investors have integrated ESG as a risk factor when evaluating investment opportunities but stop short of incorporating explicit ESG factors in their investment policy statement. The CIO of a public university endowment told us:

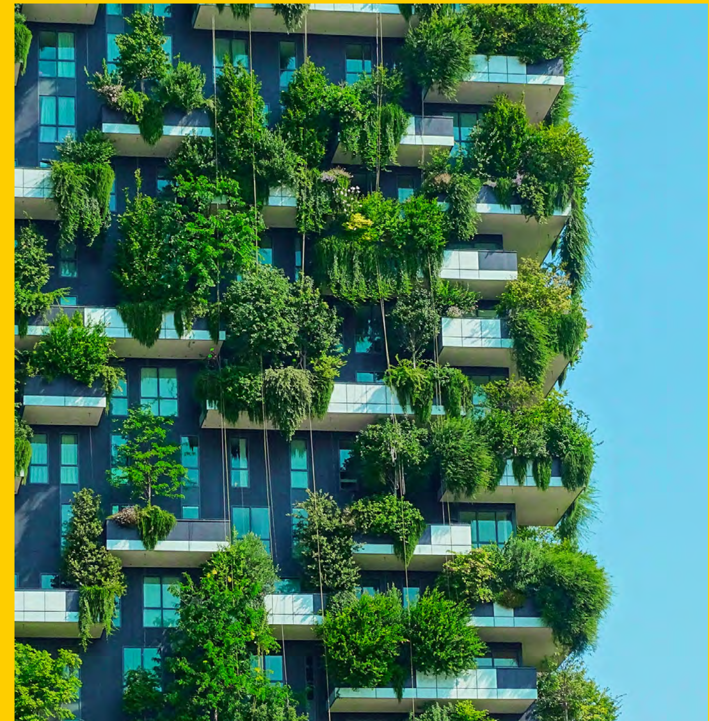
"We don't typically view ESG as an asset class in itself... we're looking to integrate it as an important and fundamental factor that will help us define the risks and opportunities, but we don't list all of those factors in our policy statement."

Respondents also noted the practical challenges of applying ESG screens. The CIO of a $1 billion foundation pointed to the difficulty in identifying which ESG metrics to apply and how far to apply them: "I frankly think that's the Pandora's box that we haven't opened yet", he said.

Motivations for implementing ESG varied. The most noted reasons were a desire to have a positive impact on society and the environment, a wish to satisfy stakeholder demands, and risk reduction. A majority of investors (58%) also said they decided to use ESG or sustainable strategies because they believed these approaches might help enhance investment returns. Some are still becoming familiar with ESG and how it is defined. One healthcare system CIO told us, "Governance is really the only investing factor that our team has found to have any true predictive factor as far as outsized investment returns."

Investors who currently employ ESG preferred to incorporate it through integration — systematic inclusion of ESG factors into the investment process. Respondents also commonly used sustainable or thematic approaches (60%) and dedicated impact investment strategies (56%). The latter was especially popular among healthcare systems (80%) and foundations (62%).

Negative or exclusionary screening (36%) received the least support, suggesting reservations about narrowing the investment opportunity and adversely impacting performance.

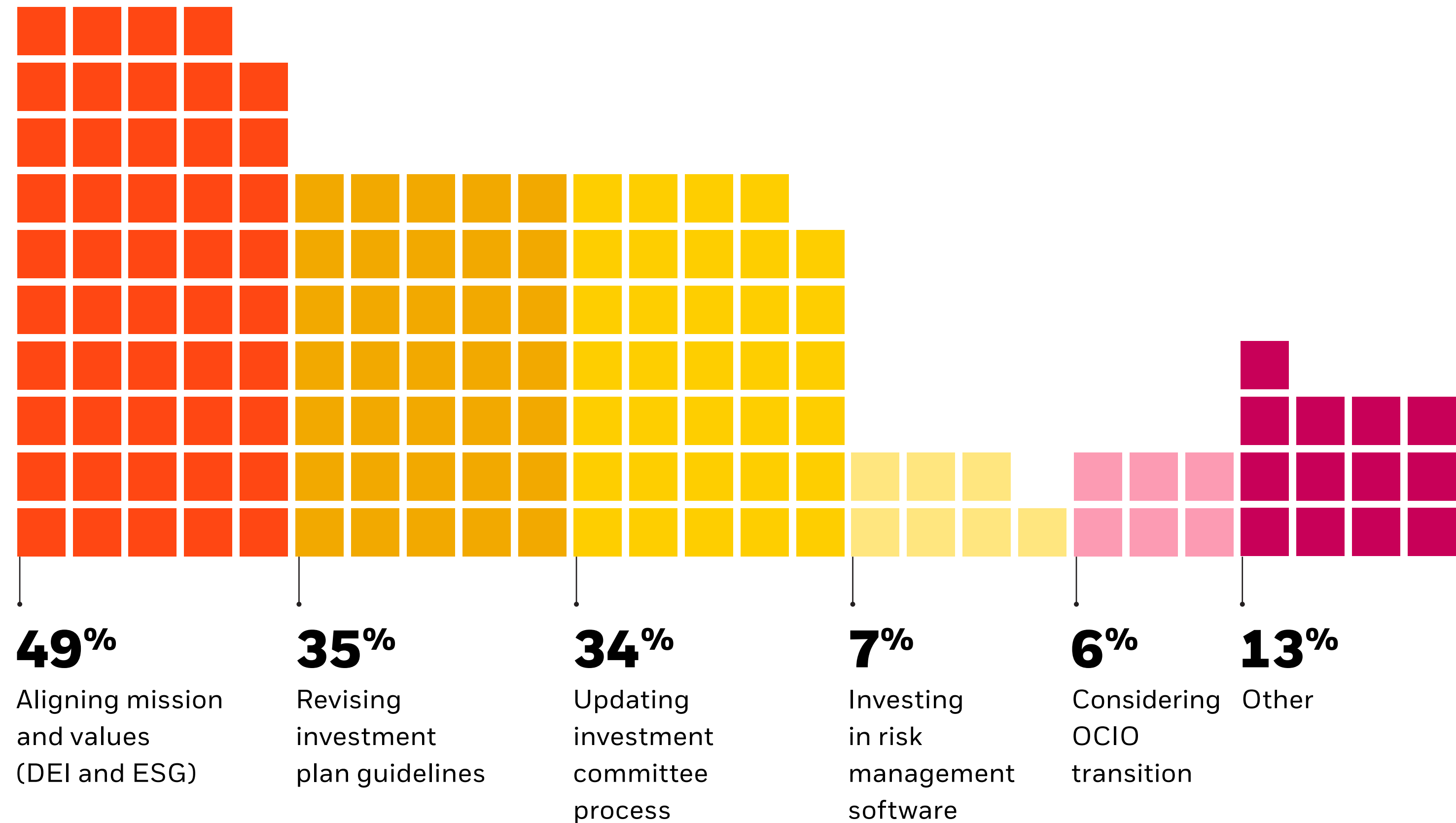


DEI continues to be a consideration, but action lags

Our respondents reported a variety of governance challenges. They included the need to align mission and values, revise investment plan guidelines and update their investment committee process.

Roughly one in three respondents (35%) felt DEI factors had a vital role to play when selecting asset managers. However, only 10% said they would switch fund managers because of a manager's DEI shortcomings. Almost three-quarters (73%) would not make a manager change for this reason, but nearly half (44%) said that instead they would encourage managers to act on DEI priorities. Foundations were most likely to rank DEI as important to manager selection and most likely to change managers based on DEI priorities.

Exhibit 11: Investment governance priorities in 2022



Q: Which, if any, of the following represent priorities for your plan governance process in 2022?

The CIO of one small foundation described its approach to DEI as “still collecting our thoughts”. Others have made qualitative DEI considerations explicit in their guiding principles documents but are still exploring a quantifiable approach to incorporating DEI policies. The CIO of a large healthcare system noted, “we’ve become more thoughtful about trying to track data in a more quantifiable way. There were areas that we paid attention to on a qualitative basis, but now we’re also trying to do a better job at collecting data from our managers on their diversity, equity and inclusion efforts and attributes.”

Investors say they lack agility

The large majority (85%) of survey participants do not plan to change the size of their management teams within the next 12 months. This finding seems to indicate that investors generally believe they are suitably resourced — in a quarter of cases, with the support of an OCIO.

At the same time, a minority of investors said they have the agility to exploit investment opportunities in dynamic market conditions. Only 35% of respondents said they had the flexibility to implement opportunistic investments quickly.

Healthcare systems, in particular, were slightly less likely than endowments and foundations to have tactical capabilities, with 18% of healthcare respondents reporting that they can make opportunistic investments swiftly. Manager sourcing and capacity constraints led to investment challenges for 36% of healthcare systems in making tactical opportunistic investments. By comparison, only 28% of endowments felt that these barriers prevented them from pursuing tactical investments.

Conclusion

We found that decision-makers at U.S. endowments, foundations and healthcare systems are acutely aware of the macro challenges they face, but those concerns have not prevented them from assuming investment risk opportunistically in pursuit of long-term returns. Taken as a whole, our findings suggest that investors are watching the current climate carefully, with a measured appetite for risk that is underpinned by long investment horizons and well-diversified portfolios.

Private equity looks to be the biggest beneficiary of these organizations' judicious embrace of risk, along with asset classes with the potential to help navigate high inflation and rising rates. With the heightened market uncertainties, some non-profit institutional investors, especially those at the smaller end of the scale, are choosing to bolster their expertise, resources and reach by drawing upon OCIOs.

ESG adoption continues to accelerate amongst non-profits; however, many continue to wrestle with the ever-present tension between fiduciary investment performance-related responsibilities and broader societal obligations.

We thank the surveyed institutions and our six interviewees who graciously committed their time and provided us with their insights.

Respondent numbers:

Respondents by type, AUM & decision-making status (87)

Exhibit 1: Investment priorities of respondents before and after February 24th (Russian invasion of Ukraine)
- Pre-Russian invasion of Ukraine (56)
- Post-Russian invasion of Ukraine (31)

Exhibit 2: Asset classes currently utilized by respondents to mitigate inflation and rising rates
- Navigating higher inflation (84)
- Positioning for rising rates (78)

Exhibit 3: Actions to support a risk-on posture (52)

Exhibit 4: Illiquid allocations as a percentage of portfolio NAV
- Endowment (29)
- Foundation (30)
- Healthcare (24)

Exhibit 5: Expected change to illiquid allocations
- Endowment (29)
- Foundation (30)
- Healthcare (24)

Exhibit 6: Expected shifts in alternatives target allocations
- Venture capital (73)
- Private equity (79)
- Real estate (75)
- Private credit (70)
- Infrastructure (66)
- Hedge funds (68)

Exhibit 7: OCIO adoption and drivers
- Endowment (30)
- Foundation (30)
- Healthcare (24)

Exhibit 7: AUM
- Less than $1B (42)
- $1B - $3B (19)
- Over $3B (23)

Exhibit 8: Drivers behind manager roster size (30)

Exhibit 9: Current ESG utilization rates
- Endowment (31)
- Foundation (31)
- Healthcare (24)

Exhibit 9: AUM
- Less than $1B (45)
- $1B - $3B (19)
- Over $3B (23)

Exhibit 10: Expected ESG adoption rates by investor type and size
- Endowment (16)
- Foundation (10)
- Healthcare (18)

Exhibit 10: AUM
- Less than $1B (20)
- $1B - $3B (11)
- Over $3B (13)

Exhibit 11: Investment governance priorities in 2022 (87)

Source of all chart data: BlackRock — Coalition Greenwich survey. Q1 2022.

Risk warnings

Capital at risk. All financial investments involve an element of risk. Therefore, the value of the investment and the income from it will vary and the initial investment amount cannot be guaranteed.

Important information

Clients were surveyed over a ten-week period from February 7, 2022.

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