Several recent articles claim that endowments have significantly underperformed the “passive” 60/40 equity/bond investment strategy (e.g., see Hammond, 2020 *The Journal of Investing*). Further, they identify allocations to alternative asset classes as the primary reason behind this underperformance (e.g., see Ennis, 2020 *The Journal of Portfolio Management*). I want to demonstrate that some of these results are functions of questionable assumptions, and some of them are incorrect. In particular, I want to show that

- Endowments have significantly outperformed globally diversified portfolios of equities and fixed income. Hammond (2020) restricts his benchmark to US indices, which means the only free lunch in financial markets is ignored—the benefits of global diversification. Further, these articles ignore the cash holdings of endowments.
- Endowments may have underperformed the US 60/40 benchmark, despite their allocations to alternatives. Since 2000, a diversified portfolio of alternatives has outperformed the US 60/40 benchmark over every 10-year window. In fact, the figures suggest that endowments should have increased their allocations to alternatives. If there is any underperformance, the blame lies somewhere else.

Below is an exhibit from Hammond (2020), where I have added the last four columns using MSCI World Free and Barclays Global Aggregate Total Return Unhedged Indices to construct the global 60/40 portfolio, and a portfolio of alternative assets. The articles mentioned assume endowments hold no cash and that all of their funds are fully invested at all times. This assumption is not supported by figures reported by NACUBO and the fact that endowments have many restrictions on their investment process. In this note, I ignore the issue of cash holdings and investment restrictions.

### Performance of Endowments, Various 60/40 Benchmarks & Alternatives

<table>
<thead>
<tr>
<th></th>
<th>Small Cohort</th>
<th>Average</th>
<th>Large Cohort</th>
<th>US Indices</th>
<th>Global Indices</th>
<th>Alternative Assets Portfolio</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>60/40</td>
<td>60/40</td>
<td>60/40</td>
<td>60/40</td>
<td>Quarterly Rebalancing</td>
</tr>
<tr>
<td>FY 1990–1999</td>
<td>12.3</td>
<td>12.9</td>
<td>14.0</td>
<td>14.6</td>
<td>10.8</td>
<td>10.6</td>
</tr>
<tr>
<td>FY 2000–2009</td>
<td>3.9</td>
<td>4.0</td>
<td>6.1</td>
<td>1.5</td>
<td>1.6</td>
<td>1.3</td>
</tr>
<tr>
<td>FY 2010–2019</td>
<td>7.7</td>
<td>8.4</td>
<td>9.0</td>
<td>10.5</td>
<td>7.7</td>
<td>7.4</td>
</tr>
</tbody>
</table>

*Equal Weighted portfolio of CISDM and Cambridge Associates Indices.

Source: Hammond (2020), Bloomberg, and Authors Calculations.
Two important conclusions can be drawn from this exhibit:

- Endowments have significantly outperformed a globally diversified benchmark. This can be seen by comparing the figures under Global Indices with the performances of Endowments. Almost every group of endowments has outperformed the global benchmarks over every subperiod.

- Endowments have underperformed the US 60/40 benchmark despite their allocations to alternative assets. This can be seen by comparing the performance of the US 60/40 portfolio with that of the Alternative Assets Portfolio. Over every subperiod, the alternative portfolio has outperformed the US 60/40 portfolio. Clearly, alternatives are unlikely to be a source of underperformance. Perhaps, endowments should increase their allocations to alternatives!

Some caveats are in order. The indices used in this analysis are not investable, and their performances are sure to differ from the performances of the alternative buckets of endowments. There is no argument that some endowments lack the needed skills and connections to construct an alternative portfolio that could deliver the “average” return represented by these indices. This study clearly shows that a diversified portfolio of alternatives that provides “average return” has performed far better than the US 60/40 portfolio. Therefore, the right recommendation for endowment managers is not that they should dump their alternative assets in favor of the 60/40 portfolio, especially now with rates at historical lows and equity valuations at historical highs. The right approach is for them to use these indices as rough benchmarks. If their alternative portfolios have underperformed them in the past, then they should reconsider how they have selected and managed their alternative assets.

This issue of *The Journal of Alternative Investments* begins with “On the Importance of Manager Selection: The Case of Timber Funds” by Chung-Hong Fu, who offers one of the few published results on the importance of manager selection in for timber funds. The article examines the long-term upper quartile and lower quartile returns of commingled funds and separate accounts managed by timberland-specific investment managers. The results indicate that differences among the better and poorer performers exceed those observed in many other asset classes, including real estate.

In the lead article of this issue, “Being Right Is Not Enough: Buying Options to Bet on Higher Realized Volatility,” Roni Israelov and Harsha Tummala examine if and when long option positions benefit from an increase in realized volatility. They find that buying one-month S&P 500 options is only consistently profitable in the highest decile of changes in one-month volatility. Buying options consistently results in losses in the lowest seven deciles of changes in volatility.

In “A Performance Update—Hedge Funds versus Hedged Mutual Funds: An Examination of Long–Short Funds,” David McCarthy and Brian Wong update the 2014 study that examined the performance of equity long–short mutual funds. Their findings confirm that these equity long–short mutual funds provide investment exposure like leading equity long–short hedge fund indexes. However, in this later period of 2013–2019, these equity long–short mutual funds underperformed the S&P 500 Index and traditional hedge fund indexes.

Gueorgui Konstantinov and Jonas Rebmann study the common factor exposures of single hedge funds and funds of hedge funds in “Different in Nature, Common in Style: View Commonality of Single Hedge Funds and Funds of Hedge Funds.” Despite the different nature and characteristics of the two categories, there are significant style similarities through the various business cycles. They report that in general, funds of hedge funds use substantially more leverage than single hedge fund strategies and find a positive trade–off between leverage and style exposure for the former and a negative one for the latter.

In “Manager Characteristics and Hedge Fund Returns, Liquidity, and Survival,” Hyuna Park reexamines previous empirical findings that manager characteristics such as education affect cross-sectional variation in the risk-adjusted returns of hedge funds. She points out that prior research does not control for the difference in liquidity. Interestingly, the article reports that a
manager’s prior education affects the liquidity of hedge fund shares and assets. Managers educated in elite institutions, on average, impose stronger share restrictions and thus can better manage illiquid assets to generate liquidity premium. The author argues that educational background may be used as a signal to reduce due diligence costs.

The next article, “Carry and Time-Series Momentum: A Match Made in Heaven” by Marat Molyboga, Junkai Qian, and Chaohua He introduces a novel approach to combining time-series momentum and carry trade strategies—they condition trading signals of time-series momentum on the sign of the basis, which is an essential input for the carry trade. The authors find that this new technique applied to four major asset classes improves the Sharpe ratio of time-series momentum by approximately 0.17 net of fees. The improvement in performance is more considerable during recessions and, therefore, conditioning time-series momentum signals on the sign of the basis improves performance when it matters the most.

In “Hidden in Plain Sight—The Impact of Undrawn Commitments,” Thomas Meyer argues that undrawn commitments are a critical characteristic of investments in largely illiquid limited partnership funds. The key question discussed by Meyer is whether undrawn commitments form part of the allocation to private equity and, importantly, whether there are opportunity costs associated with them. Many analysts and most regulators do not view undrawn commitments as part of an allocation to the asset class. Market experience, however, suggests that undrawn commitments be of higher relevance than widely perceived. This article proposes a framework to reconcile these differing perspectives.

Jack Clark Francis and Roger G. Ibbotson compare and contrast investments in residential, farmland, and commercial real estate in “Real Estate Returns.” Price-change returns, rental returns, and total returns from 1991 through 2018 are the focus of the analysis. It is vital to include rent in the analysis because rent makes up a significant part of the returns. Therefore, the author empirically derives implicit net rent data from owner-occupied residences and owner-occupied farmland.

In “Value Investing for Commodities,” Thijs Markwat, Jelmer Quist, and Casper Zomerdijk argue that although value investing is a thoroughly researched and applied investment style across numerous asset classes, little is known of this style within commodity futures investing. The authors use the well-known approach employed by Asness et al. (2013) but find disappointing stand-alone results. The authors show that by using factor and sector neutrality, the performance of the strategy can be improved significantly.

In “Investigating the Investment Behaviors in Cryptocurrency,” Dingli Xi, Timothy Ian O’Brien, and Elnaz Irannezhad investigate the factors that go into investors’ decisions to invest in different Initial Coin Offerings (ICOs). A web-based revealed-preference survey was conducted among Australian and Chinese blockchain and cryptocurrency followers. The goal was to learn which factors determine the choice of investing in “cryptocurrency coins” versus other types of ICO tokens. Age, gender, education, occupation, and investment experience were some of the factors affecting their decisions.

Daniele Bianchi investigates some of the critical features of cryptocurrency returns and volatilities, such as their relationship with traditional asset classes, as well as the main driving factors behind market activity in “Cryptocurrencies as an Asset Class? An Empirical Assessment.” The main empirical results suggest that while there is a mild relationship between returns on cryptocurrencies and commodities, precious metals, in particular, such a relationship does not translate into volatility spillover among these markets.

Hossein Kazemi
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