SUMMER 2023

INNOVIEWS

Innovest's Latest Updates And Articles From Thought Leaders In The Firm

IN THIS ISSUE

NEW INSTITUTIONAL CLIENTS

Catholic Charities of Denver

City of Grand Junction

Washtenaw Community College

It is not known whether the listed clients approve or disapprove of the services provided. The new clients on page one are listed with their approval and permission.

Private Debt – The Appeal After Bank Failures

Sloan Smith, CAIA, MBA, CPWA®
Principal, Director

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Lead Senior Analyst

In March of this year the financial banking system experienced a significant disruption with the collapse and bankruptcy of Silicon Valley Bank. At the time, Silicon Valley Bank was the 16th largest financial institution in the United States, often the preferred bank for early-stage and venture capital-backed companies. Poor treasury management and dramatic outflows of deposits led the bank to declare insolvency. Other financial institutions with a similar customer base, including Signature Bank and First Republic Bank, saw a similar demise.

Fortunately, the Federal Deposit Insurance Corporation (FDIC) promised to make whole all customers of SVB, even those with assets above the insured deposits maximum of $250k. That step helped avoid a greater financial crisis, but the broader impact changed the lending environment. The appetite for financial institutions to provide credit diminished due to concerns of policy tightening, higher interest rates, and recessionary fears. With companies in search of financing, the private debt market has become an appealing option, as banks are reluctant to offer competitive quotes to borrowers. Private lenders are willing to provide the necessary capital but structure their loans so that they reside higher in the capital structure (they are first to be paid back, in the event of a default) and are floating rate (a hedge against rising inflation). Overall, private debt has become an attractive opportunity in the current

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marketplace, and investors can benefit from both higher yields and greater downside protection.

Advantages of Private Debt

The landscape for private debt has changed. Companies are utilizing the private markets more frequently for their borrowing. Investors in the asset class can benefit in the following ways:

1. Attractive Yields

Private debt offers a return premium relative to leveraged loans and high yield bonds. Though the asset class is illiquid, at the time of this writing private debt compensates investors with an 11.06% current yield (as measured by the Cliffwater Direct Lending Index) relative to 9.23% and 8.96% current yield for leveraged loans and high yield fixed income respectively.

2. A Hedge Against Rising Inflation

A majority of private debt is issued as floating- or variable-rate. If inflation were to persist and interest rates were to rise, then the yield on private debt would adjust. For example, at the end of 2021 the private debt market was yielding close to 8%. By 2022, as the Federal Reserve aggressively raised interest rates to slow inflation, the yield on private debt only increased. Now, the current yield is hovering around 11%.

3. Senior Secured

Private debt offerings have constructed loans that are mainly senior secured and first lien, where the actual loan is backed by collateral such as a building, inventory, or accounts receivable. These terms allow the lender to have first claim against these assets if the borrower were to default on the loans. This option is less risky, relative to more subordinated or mezzanine debt, where the loans are unsecured, only senior to equity in the capital structure, and demand a much higher interest rate.

4. Better Covenants

Over the last fifteen years, during a more accommodative and lower interest rate environment, terms of private loans were more favorable to borrowers. Structures such as delayed draw term loans (DDTLs), which permit borrowers to draw additional funds during the term of the loan, became more prevalent. Maintenance covenants, which provide lenders with early warning signs of potential issues, became weaker. However, in the current environment, where access to financing has diminished, lenders are demanding higher rates and improved terms. This has allowed private debt investors to better oversee their underlying portfolio companies and take necessary corrective action as needed.

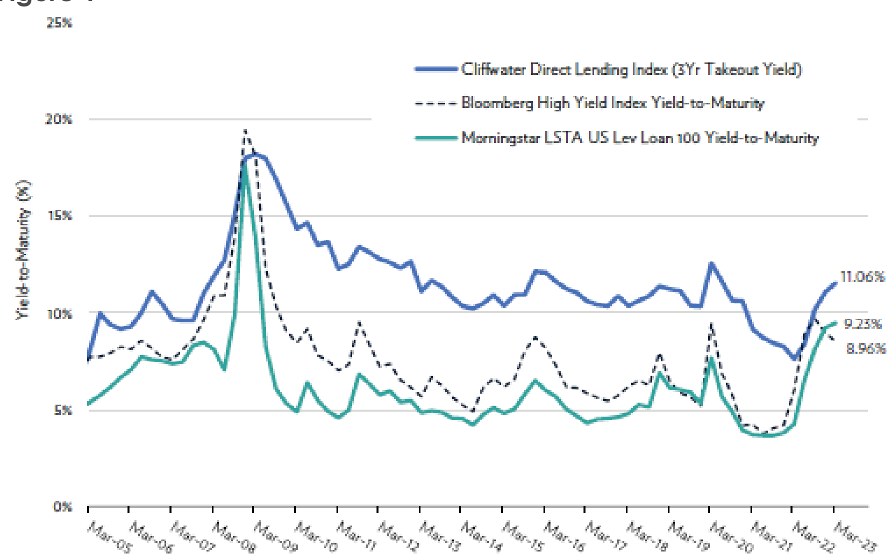
5. Diversification and Active Management

Private debt investment managers have been thoughtful in lending to firms in numerous sectors, including information technology, healthcare, industrials, consumer discretionary, and business services. The objective is to diversify their exposure where they can generate a strong yield while minimizing default risk due to an economic downturn.

The biggest area of concern in private debt is defaults. While private debt offers an attractive investment opportunity in the current market environment, the risk of default remains as one of the greater headwinds in the asset class. Longer term and legacy private debt issuers face the concern of higher interest rates, which makes servicing debt more difficult, coupled with a slower economy and potential margin erosion. If the United States were to experience a severe recession, private debt portfolio would be negatively impacted.

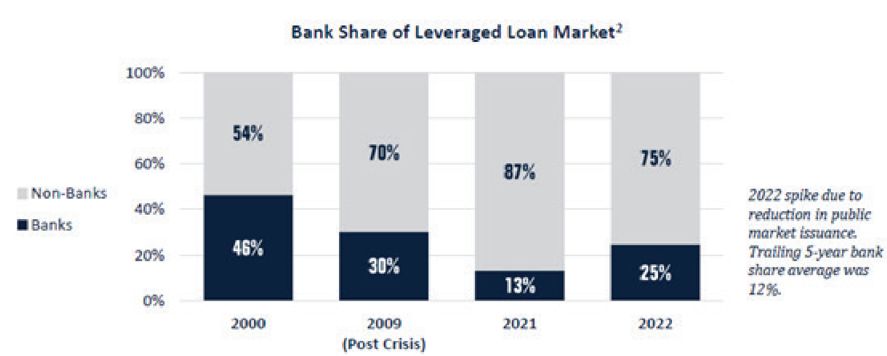
The bankruptcy of Silicon Valley Bank and other financial institutions created a disruption in the lending market. Banks are more cautious about who they lend to, going forward, which has minimized access to financing to many companies across various sectors. Private debt markets identified this issue and have been willing to provide the necessary capital for these firms in order to assist in their growth, restructuring, or other long-term objectives. These loans offer high yields, stronger covenants, inflation protection, diversification, and the additional provision of being senior secured. The recessionary risks of default are still prevalent, but the asset class potentially provides a more favorable risk-adjusted return, especially relative to public equities and fixed income. In an uncertain time in the markets and economy, private debt may better a portfolio by enhancing return while minimizing risk.

Figure 1



Source: Cliffwater

Figure 2



Source: HPS

Wall Street Conflicts were the Catalyst to Form Innovest

Richard Todd
Principal, CEO, and Co-founder

Wendy Dominguez, MBA
Principal, President, and Co-founder

It should be no secret that many of the investment managers, funds, and products that are utilized by advisors at Wall Street banks are also clients of that same Wall Street firm. These firms can be active clients on the proprietary trading desk, are buying research, are sub-advisors to their funds, and are banking and lending clients, just to name a few. The passing of the Dodd-Frank Act, which was signed into law in 2010, allows banks to be in nearly all lines on financial services. Consequently, conflicts of interest are very rampant on Wall Street.

Conflicts of interest were also very prevalent in 1996 and were the catalyst for the founding of Innovest as an independent, fee-only firm with no conflicts of interest.

Working for a regional Wall Street bank at the time, our unit was providing investment consulting to a large union pension plan. Our advice to the client, based on our research, was to terminate a poorly performing investment manager that also had qualitative problems. As a consequence, the president of our Wall Street bank informed us that the manager that we were terminating from the portfolio on behalf of the pension plan client, was the single largest trading client of our Wall Street employer. He encouraged us to forgo our fiduciary responsibility to the client and retain that manager for the sake of the shareholders.

Without hesitation, we continued with the manager termination but the response by the firm certainly turned our stomachs. We concluded that leaving the Wall Street employer was the best action for our clients and our team. Our view was that being compromised was not fair to our clients and was in conflict with our values.

Hence, Innovest was created! We negotiated an amicable separation with the Wall Street firm and started a fee-only firm with around 25 clients with assets of just over $250 million, 5 employees, and the need to grow to survive. We were convinced that being a fiduciary to our clients was our only route.

Our 27 years have been terrific thanks to our wonderful clients and great Innovest team. Today, we have over 300 clients with assets of over $35 billion and 60 employees. We are committed to our original fee-only and fiduciary structure which is the only wat that we can truly commit to our Innovest culture of stewardship.

INNOVEST *on Mission*

We've Rebranded Our Community Service Initiatives!

Innovest is built on the foundation of stewardship, the careful and responsible management of something entrusted to one's care. It is the fabric of our culture and demonstrated daily in our firm.

Innovest on Mission describes our purpose of being sent out to positively shape and transform our world. All of our efforts unite to the same mission of doing the right thing for our clients, coworkers, and the community around us. *Innovest on Mission* captures our objective of intentionally upholding stewardship, integrity, and authenticity.

We actively give back to our community, but we believe that our mission of stewardship goes beyond our charitable efforts. Rather, it encompasses everything we pursue.

Nonprofit Spotlight:

Mercy Housing

As a provider of investment advice to numerous nonprofit organizations, Innovest has the privilege of introducing you to some of our fantastic clients. This month we are proud to feature Mercy Housing.

Mercy Housing, the country's largest nonprofit for affordable housing, builds and provides affordable homes with onsite Resident Services for people with low income. Mercy Housing, founded by the Sisters of Mercy, has affordable housing communities across 21 states, where 43,000 residents call it home. These communities offer a range of programming, classes, and events focused on Financial Literacy, Health & Wellness, Out-of-School Time activities for youth, and more.

Founded in 1981, Mercy Housing believes that housing justice is social justice. The organization lives by the values of respect, justice, and mercy for over 40 years. Mercy Housing's mission is to develop, finance, and operate affordable, program-enriched housing for families, seniors, people with special needs, and people exiting homelessness who lack the economic resources to access quality, safe housing opportunities.

There are several ways to support Mercy Housing. Learn more about how to give by visiting www.mercyhousing.org/give-help. Mercy Housing has actively worked to address the shortage of affordable housing across the country. Every day, the organization strives to achieve more than constructing buildings – they aim to build communities in cities like San Francisco, Seattle, Chicago, Denver, and Atlanta, where every person has the tools to live up to their full potential.

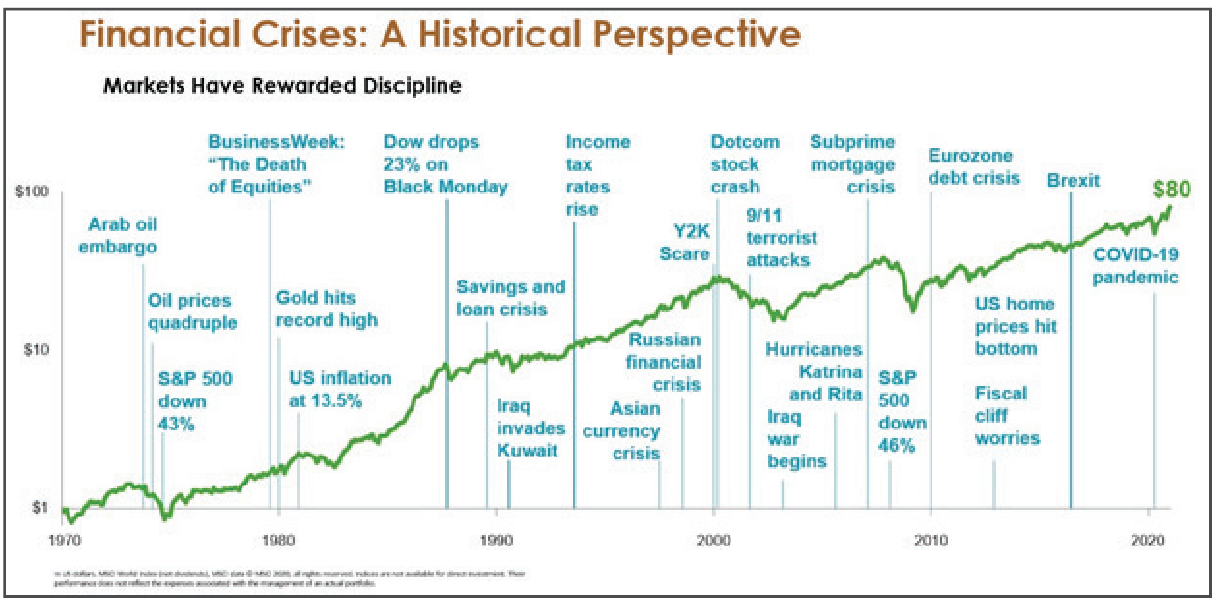
Cyclical Markets: Predictable Unpredictability

Frank Cornett, CFP®
Vice President

It would be an understatement to say that Americans and broader the population worldwide have experienced several significant events with a profound impact on their lives. Advisors and economists often field questions around prediction of the next economic decline or recession. The Y2K scare, 9/11, the DotCom crash, the global recession of 2008, and, most recently, the COVID-19 pandemic are each etched in our individual and collective memory. Apprehension that the next recession will have as much impact as these events is pervasive.

"But it's different this time..."

To illustrate how these predictably unpredictable events affect investors, consider this popular chart depicting the growth of the world stock market from 1970 to 2020. The data incorporates major headlines from the period that may lead one to assume that [insert each event here] will trigger an economic decline, prompting individuals to safeguard their finances and avoid the stock markets.



That desire for safety is understandable, but we can challenge this line of thinking by examining the events on the chart starting from the mid-1990s, then working backward, drawing comparisons to our present-day news cycle.

Let us start with the rise in income tax rates in the mid-1990s. It is worth noting that unless legislative action is taken, our current income tax rates are set to increase at the beginning of 2026 upon expiration of the 2017 tax act. Under this scenario, the 12% tax bracket will rise to 15%, the 22% to 25%, the 24% to 28%, and so on. Continuing the headlines, as of early 2022 and ongoing, the world faces geopolitical risk with Russia's invasion and ongoing war with Ukraine, echoing the Iraqi invasion of Kuwait in the early 1990's. Defaults of Silicon Valley Bank and First Republic Bank in the spring of 2023 created concerns about potential ripple effects within our current banking system, similar to the Savings and Loan crisis of the late 1980s and the Global Financial Crisis of the late aughts. Although the stock market in 2022 did not experience an event on par with Black Monday, the S&P 500 saw 87% of trading days with swings of 1.0% or greater and the VIX volatility index remained above 20 for over 91% of trading days, indicating significant stock market upheaval.

The echoes do not end there. Inflation has been the most prominent headline item since the beginning of 2022, reminiscent of the late 1970s and early 1980s. Since the start of 2022, the Federal Reserve has raised rates to unprecedented levels to curb the current inflation, mirroring the approach taken in 1980 to combat inflation. That led to the highest 30-year fixed mortgage rate of 18.63%, in October 1981. While gold prices may not be in the headlines, Bitcoin has risen by 83.88% from January 1, 2023, to July 1, 2023, consistently generating inquiry to if Bitcoin can be an investment alternative. Continuing through the chart, the decline of the NASDAQ by 33% in the calendar year 2022 falls short of, but does emulate, the S&P 500's 43% fall from 1973 to 1974. Although they have not quadrupled, as oil prices did from 1973 to 1980, gas prices in the United States have increased by 67% from January 2015 to June 2023.

Examples abound that connect these historical events to more recent developments. Arguably the most noteworthy headline from the referenced chart is the August 13, 1979 BusinessWeek declaration of "The Death of Equities: How Inflation is Destroying the Stock Market." Shortly after this publication, spurred by the Federal Reserve's implementation of a rate hike cycle: the S&P 500 delivered an annualized return of 17.88% from 1980 to 1999, while international stocks yielded an annualized 14.26% return, and the US Aggregate Bond Index achieved a 10.04% return during that same period.

Importantly, past performance does not guarantee future results. Nonetheless, it is crucial for prudent advisors and investors to remain disciplined and focus on long-term goals instead of day-to-day or even quarter-to-quarter news cycles. As we ask ourselves, "Is it different this time?" Undoubtedly. There will always be distinct global variables and events that shape our outlook and viewpoint. However, adopting a broader perspective may help alleviate anxiety and uncertainty. As credited to Jean-Baptiste Alphonse Karr, a French journalist and novelist, "plus ça change, plus c'est la même chose": the more things change, the more they stay the same.

Building Relationships that Produce Results

Innovest helps our family and high net worth individual clients through a unique wealth management perspective, experienced team, custom portfolio solutions, and uncommon service.

Employee Spotlight:

Peter Mustian

Where is your hometown?

I was born in Sterling, Colorado but have lived in the Boulder area since I was two years old.

Tell us something unique about you.

While I am not particularly musical; I enjoy studying a nd practicing Byzantine chant.

What do you like best about working at Innovest?

I love Innovest's culture and mission of stewardship. We have a tremendous team that seeks to serve our clients, community, and each other. We have a strong vision and recognize the importance of our culture, hard work, and humility as keys to success. We also have dedicated and servant leaders with shared values and sense of purpose.

How do you give back to the community?

I serve my local Church in variety of ways. I also serve as a board and investment committee member for a religious organization. I am part of a steering committee planning to open a classical elementary school in the northern metro area.

What are your hobbies and interests?

I have three children, so my hobbies are their hobbies. My two sons participate in football, basketball, and swim almost year-round. My daughter swims, dances and is learning tennis.

Tell us about your family.

I am very blessed to have a wonderful wife Amira and three children, David (11), George (9), and Sophia (5). My wife and I are also very close to our parents who live near us. We spend a lot of time with our parents, siblings, and extended family.

What is your favorite dessert?

My wife and her family make incredible Middle Eastern and Greek desserts. It's hard to pick just one. My kids love Sweet Cow Ice Cream, and we enjoy going there as a family.

Around the Firm

Promotions & Team Updates

We have some exciting updates to share regarding our incredible team at Innovest! First and foremost, let's extend a warm welcome to Jason Romero, our newest team member who has joined us as Vice President. We are also delighted to announce the well-deserved promotion of Franklin Cornett, CFP®, to the position of Vice President. Throughout his time with us, Frank has consistently demonstrated a deep commitment to our clients, our team, and our mission of stewardship. We take great pride in having him as part of our leadership team. In addition to these exciting updates, we are thrilled to welcome a talented group of summer interns who have joined us at Innovest. Welcome to Parker Cadieux, Nick Domek, Ian Gilbert, and Jack Roode.

Innovest Vice President, Brett Minnick, CFA recently passed the third and final level of the CFA program. Brett's dedication and hard work have been instrumental in our success, and we congratulate him on this significant accomplishment. Furthermore, we are proud of Jose Huerta, our intern and a recent graduate of Arrupe Jesuit High School, for being awarded one of the prestigious Daniels Scholarships for the Class of 2023. This is a remarkable achievement, and we commend Jose for his dedication and excellence.

Lastly, we would like to recognize the outstanding individuals within our team who embody our core mission of stewardship. In April, Christine Attai received the Service to Others monthly award, and in May, the honor went to Natalie Kuzia. Their exemplary contributions and unwavering commitment to our shared values serve as an inspiration to our team.

Awards & Publications

Innovest recently received recognition from *ColoradoBiz* Magazine as one of the prestigious 2023 Colorado Companies to Watch (CCTW) award winners. Out of a staggering 1,050 nominations, CCTW meticulously selected 50 exceptional companies as finalists. Furthermore, Innovest proudly secured a place among the top 25 Denver-Area Corporate Philanthropists, as recognized by the esteemed *Denver Business Journal* in 2022. This acknowledgment is truly an honor for Innovest.

Innovest Vice President Paul D'Alessandro recently published three thought-provoking articles in *NonProfitPRO,* "Demystifying the Overreliance on Tax Filings as Predictive of Future Results," "Why Impact Investing is Better for Social Good," and "The Donor-Centered Approach to Major Gift Fundraising." Innovest Principal Sloan Smith's article, "Hot Spot: Private Equity Secondaries," provides valuable insights and was published in the *Citywire* Due Diligence Report in April. Additionally, Innovest Principal Steven P. Fraley, CFA, and Vice President Nancy Rimington's collaborative article, "Hard Landing, Soft Landing, or No Landing at All?," was recently featured in *Advisor Perspectives.*

Thanks for 27 years!

Innovest celebrated 27 years of bringing custom, innovative solutions to our clients with authenticity and expertise on July 1, 2023. Innovest would like to thank our clients, friends, and family who have supported us all these years!

Service in the Community

Innovest has been proud to support the mission of Arrupe Jesuit High School for nearly a decade. With a bold vision to strengthen the competence, confidence, and aspirations of their students by offering a college preparatory education and a unique Corporate Work Study Program, Arrupe Jesuit is changing the educational game. Innovest has been proud to have over 20 students work at the firm over the years, giving the students real-world career and work opportunities that we hope will encourage them to find and pursue their unique calling.

Innovest actively volunteers to support impactful organizations. This quarter, we assisted Food Bank of the Rockies in supporting the mission of nourishing those facing hunger and volunteered at Food For Thought Denver, which combats childhood hunger by providing PowerSacks to students. We also supported Rosie's Ranch, who fosters inclusive therapeutic riding for children with and without special needs. Additionally, we planted flowers at the historic Central City Opera House, an organization that celebrates the performing arts in a scenic Colorado mountain setting. At Innovest, we believe making a difference requires active involvement. We prioritize providing our employees with opportunities to actively engage with and serve our community.

Conferences, Speaking, Events, & Sponsorships

As a proud sponsor of the Christian Leadership Alliance conference in Chicago, Innovest had the privilege of supporting the event. Sloan Smith delivered a compelling talk on "Building a Biblically Responsible Portfolio," while Nancy Rimington provided an insightful "Economic Update - Looking Ahead in 2023 and Beyond: Key Implications for Portfolio Design.

In Ft. Lauderdale, FL, Innovest Principal Rick Rodgers, AIFA®, participated as a panelist at the Institutional Investor Retirement Plan Advisory Summit. The discussion focused on "Staying Ahead of the Game" and best practices that incorporate valuable lessons from litigation.

Furthermore, Innovest Director and Principal Sloan Smith, CAIA, CPWA® hosted a webinar featuring Steve Nesbitt, Chief Executive Officer of Cliffwater LLC, where they discussed opportunities in private debt.

In Washington, DC, Innovest Principal Paul Nacario attended the 2023 NAGDCA Industry Roundtable. This significant event centered around critical legislative, administrative, and strategic issues faced by DC plans in the public sector. Innovest proudly sponsored the fundraising luncheon "My Bold Future" for Girls Inc. of Metro Denver, an organization that inspires girls to be strong, smart, and bold. In Arizona, Innovest sponsored the Not-for-Profit Conference organized by the Arizona Society of CPAs. This conference provided CPAs with cutting-edge industry updates, and we were delighted to be a part of it. Finally, Principal Paul Nacario represented Innovest at the 2023 State of Arizona Professional Firefighters Annual Convention. This convention, organized by the Professional Fire Firefighters of Arizona, is dedicated to caring for past, present, and future firefighters.

The Rocky Mountain Nonprofit Conference, a highly successful in-person event, received tremendous support from Innovest, along with co-sponsors Kundinger, Corder & Montoya, P.C., and AmPhil.

INNOVEST

At Innovest Portfolio Solutions, we are more than an investment firm. We are thoughtful stewards responsible for our clients, professionals and community.

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