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Public Plan Investing

Market Perspectives and Fiduciary Best Practices

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Topics

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America's New Retirement – *how we got here*

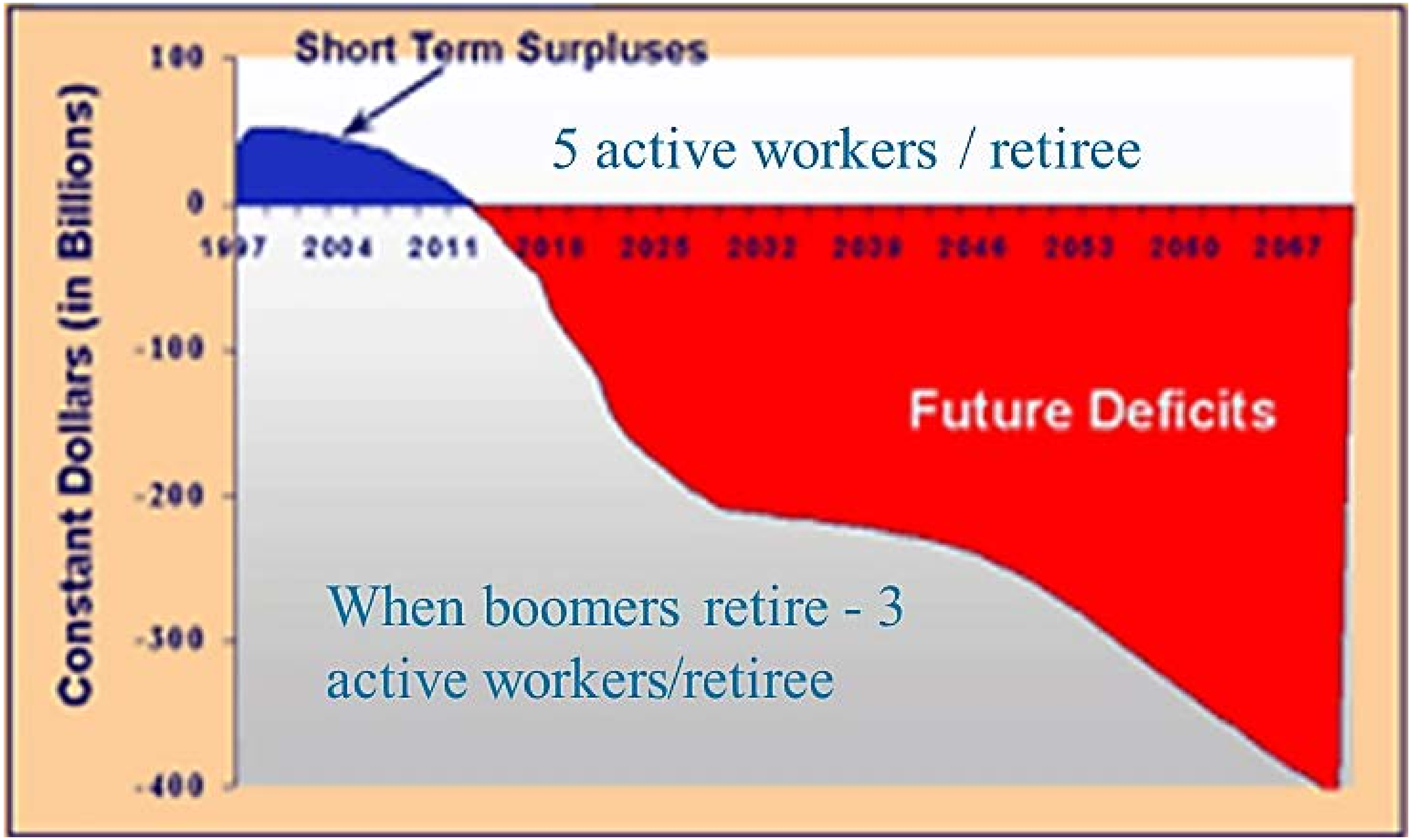
2014 In Review –
"It was a very good year…for some"

Looking Forward to 2015 –
Asset Allocation Considerations

Fiduciary Best Practices

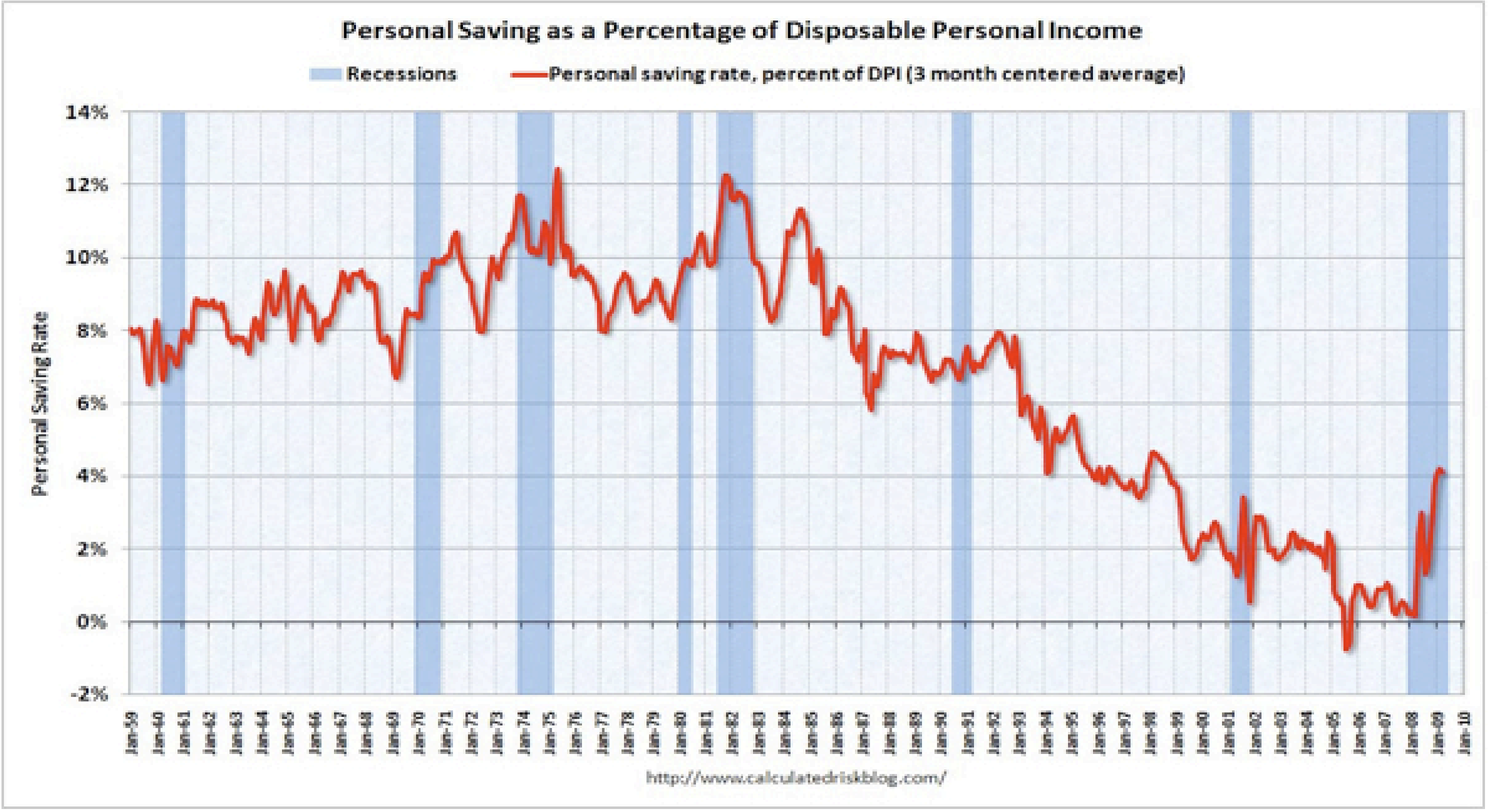
Corporate America's Shaky Retirement

- Social Security's Bleak Future



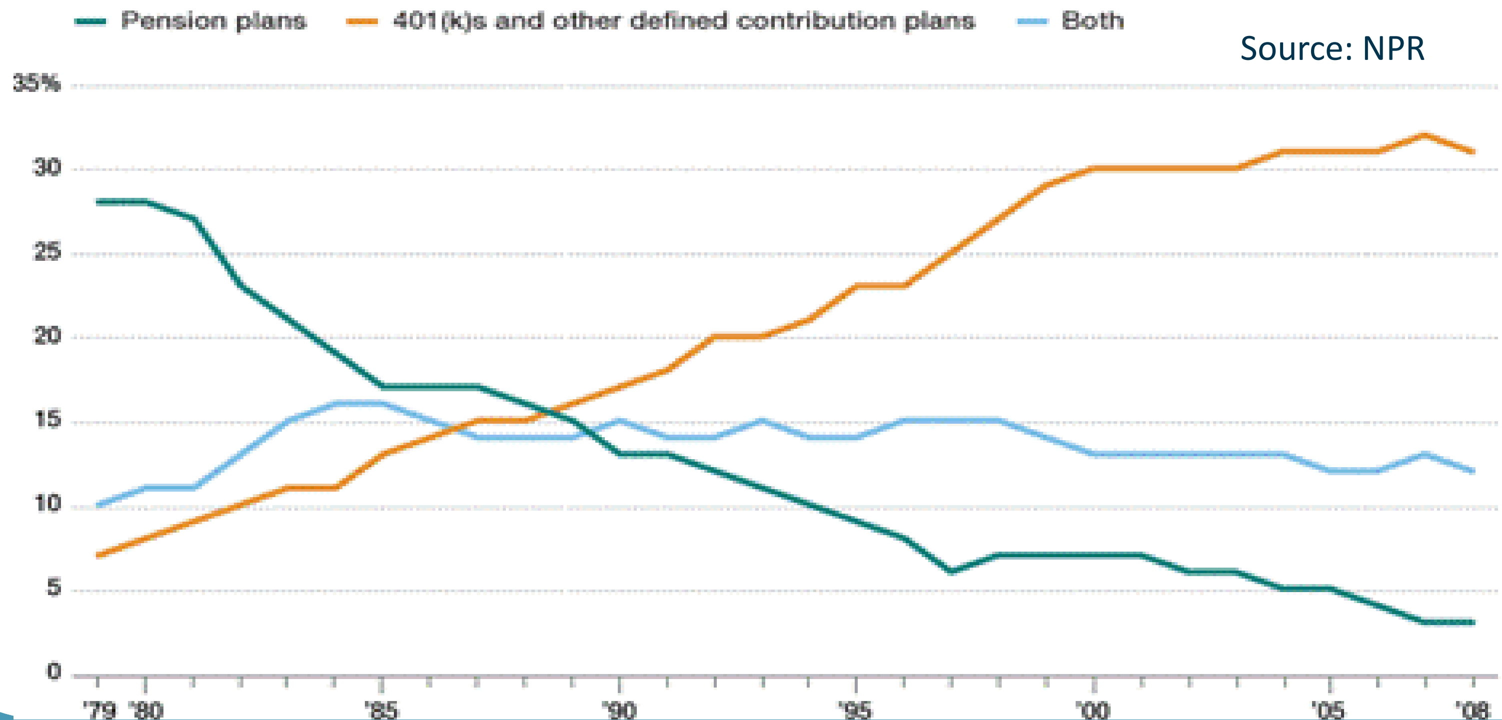
Corporate America's Shaky Retirement

- Social Security's Bleak Future
- Decline in Savings Rate



Corporate America's Shaky Retirement

- Social Security's Bleak Future
- Decline in Savings Rate
- Shift from DB to DC Plans



Source: NPR

Corporate America's Shaky Retirement

- Social Security's Bleak Future
- Decline in Savings Rate
- Shift from DB to DC Plans
- ➡ Decline in Employer Contributions
- ➡ Proliferation of Participant-Directed Individual Account Plans
    - 483,000 Plans
    - 72M Participants
    - $3 Trillion

Return Roadblocks

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America's Lost Decade

Return Roadblocks

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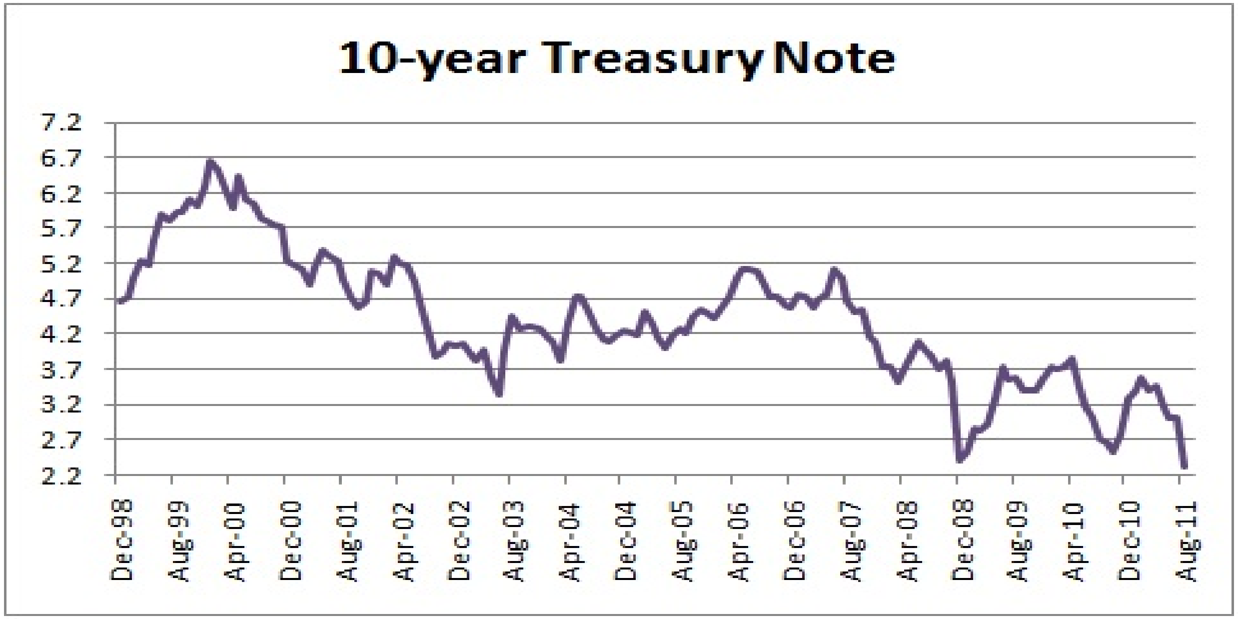
America's Lost Decade

Interest Rate Decline – Cost of Lifetime Income



2014 in Review

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"It was a very good year"

Source: CNN Money

US Equity Market

- **70-month bull market**
- **Longest bull run in equities since the Great Depression**
- **Both the Dow and S&P hit all time high closes**
- **The S&P had 53 record closes during 2014 and gained over 200% since the bottom in March 2009**

2014 in Review

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"It was a very good year"... **For Large Cap Stocks**

- S&P 500 gained 13.7%*
- Russell 2000 up only 4.9%*
- MSCI EAFE down 4.9%*

* Returns include dividends

2014 in Review

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Source: BigCharts, MarketWatch

Chart Returns do not include dividends

2014 in Review

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"It was a very good year"… For Index Funds

Large Cap –

- S&P 500 gained 13.7%, including dividends
- Average actively managed, large-cap stock rose 10.2%

Only 13% of active managers beat the S&P 500

Small Cap -

- Russell 2000 small-company index gained 4.9%, including dividends
- Actively managed, small cap stocks faired better with

37% of active managers beat the Russell 2000

Source: Tom Lauricella. Behind a Bad Year for Active Managers. Wall Street Journal. 1/5/2015

Active Management Factors

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Opportunity of Higher-than-market Returns

Potentially Reduced Volatility

Management Fees

Apples-to-Apples Performance Comparison

Long Losing Streak?

Improving the Odds - 5 and 10 year Success Rates

Active Management Factors

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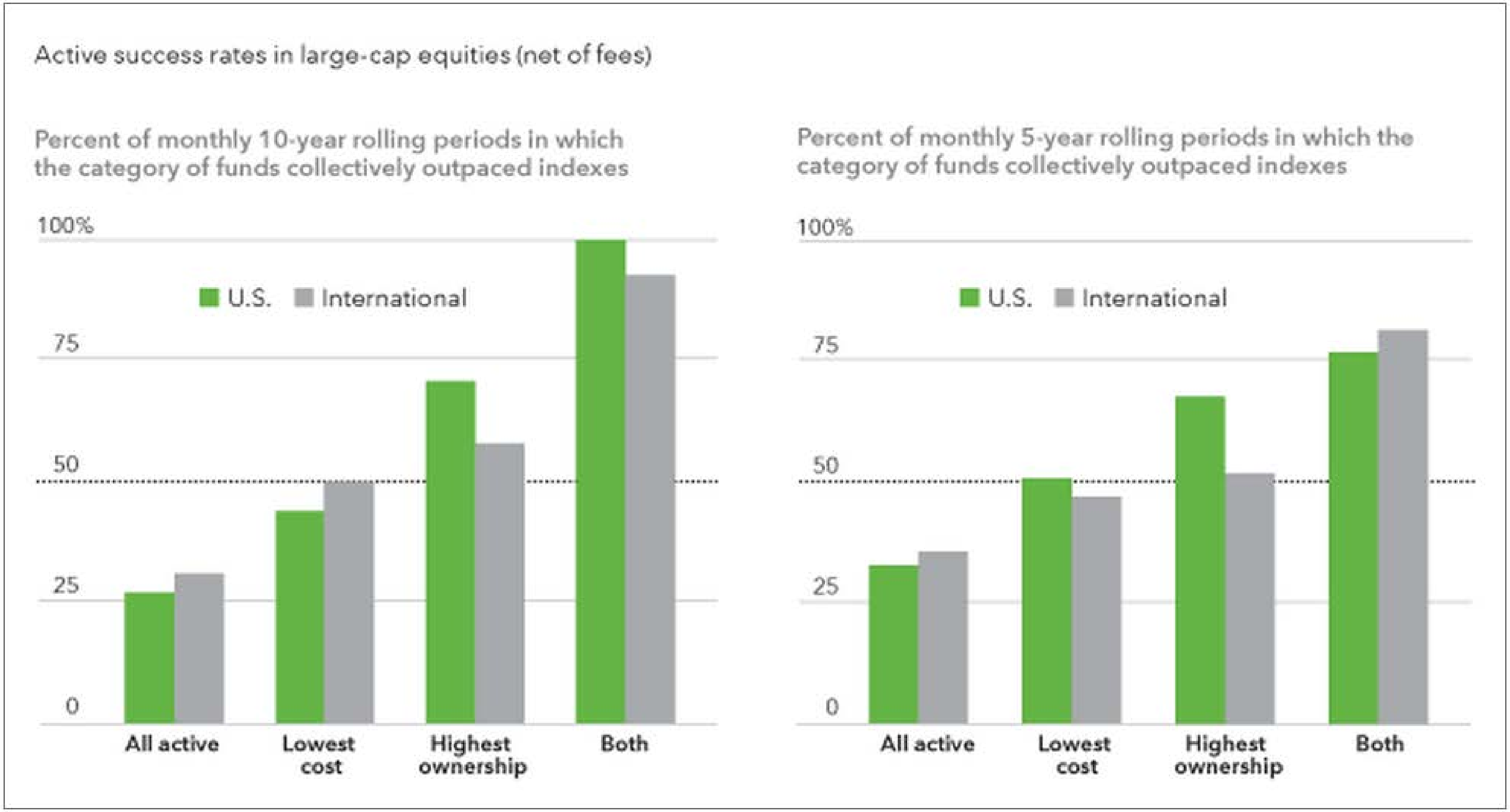

Source: American Funds. Expect More From the Core. September 2014

2014 in Review

"It was a very good year"… **For Utilities and Healthcare**

Sectors most credited for S&P's increase

- Utilities which rose 24.3%
  - Domestic focused, dividend paying, "bond proxies"
- Healthcare with a gain of 23.3%
  - Specialty-drug companies, biotech, M&As

Other top performers

- Information Technology with an 18.2% jump
- Financials which increased 13.6% overall
- Barclays US Gov't Long Treasury Bond 24.7%

2014 in Review

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It was a ***pretty*** good year…

For American Workers

- Unemployment Rate fell to 5.8%
- Best year of hiring since 1999 with employers added 2.7 million jobs
  - Wage growth remains sluggish
- Cheaper Gasoline and Increased Consumer Spending
  - Slow to improve housing market

Consumers ended 2014 upbeat, which may bode well for 2015 spending

Source: Bureau of Labor Statistics

2014 in Review

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Was it a good year concerning Oil Prices?

It depends who you ask…

Reasons for falling oil prices

- Weak Demand in many weak economic growth countries
- US, Canadian Surging production

Winners - Companies and Middle-class consumers; Import-dependent Countries like Japan and Germany

Losers - some oil producing countries: Russia, Venezuela

Pros and Cons - Europe, China, Japan, India

2014 in Review

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"It was a ***difficult*** year"… **For Hedge Funds**

Sector Return of just 1.4%[1]

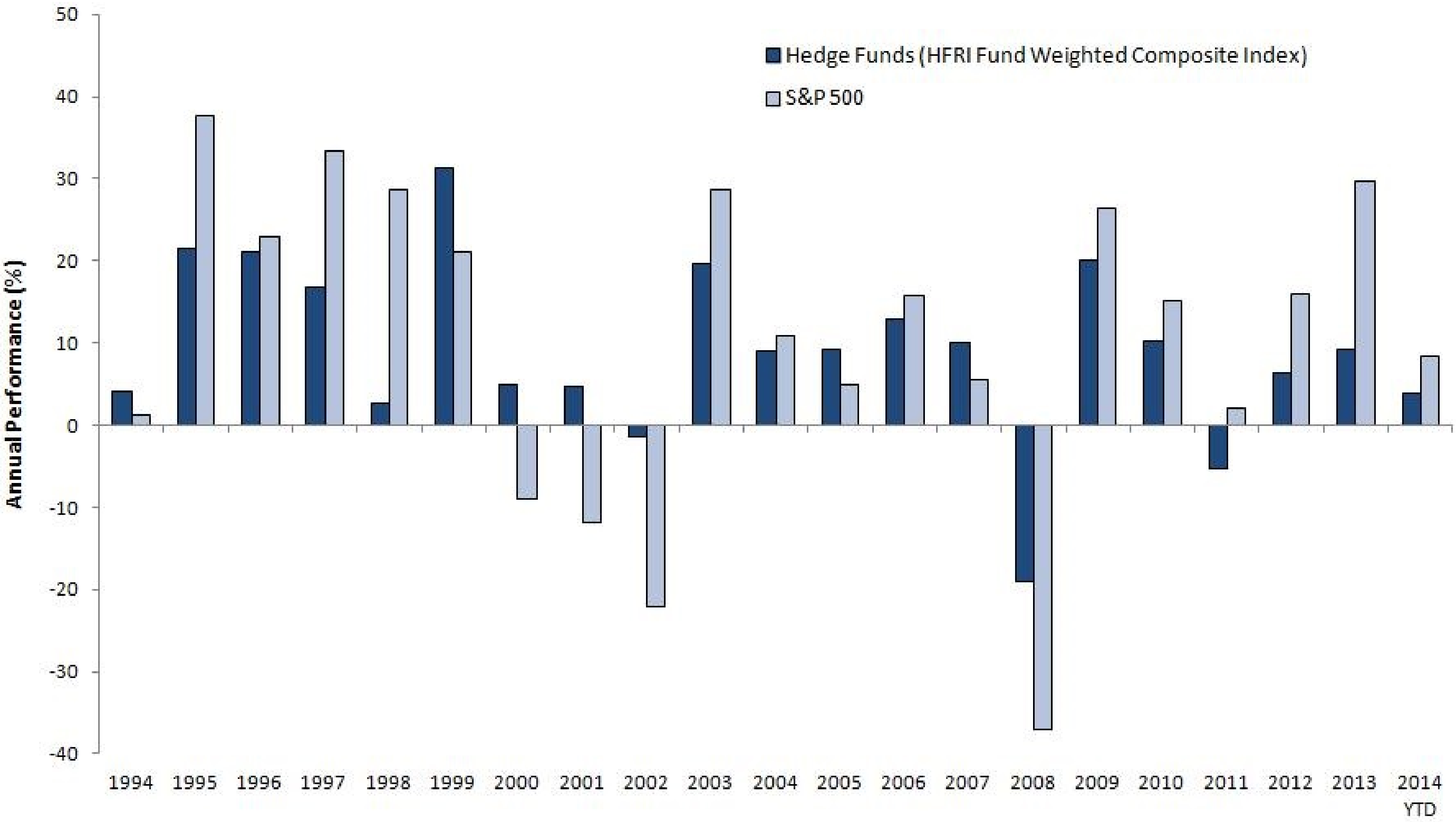
- Returns were all over the board
- Fallen short of S&P for past several years
- Funds closing at a fast rate

Large Investor Exodus

- PFZW – 3rd largest pension fund in Europe
    - Citing high costs relative to returns[2]
- CalPERS
    - Do not justify the time and expense they require[3]

[1] Bloomberg. Hedge Fund Roundup: The Year in Review. 1/12/2015
[2] Rob Copeland. Hedge Funds Take Cautious Line on Stocks. WSJ. 1/11/2015
[3] Dan Fitzpatrick. Pension Funds Eye Reducing Hedge-Fund Investments. WSJ. 10/19/2014

2014 in Review



Source: Forbes

Volatility – Anticipating a Storm?

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Slowing Global Economic Growth

Emerging Market Weakness

Geopolitical Tensions

Plummeting Oil Prices

Surprisingly Low Interest Rates

Volatility – Anticipating a Storm?

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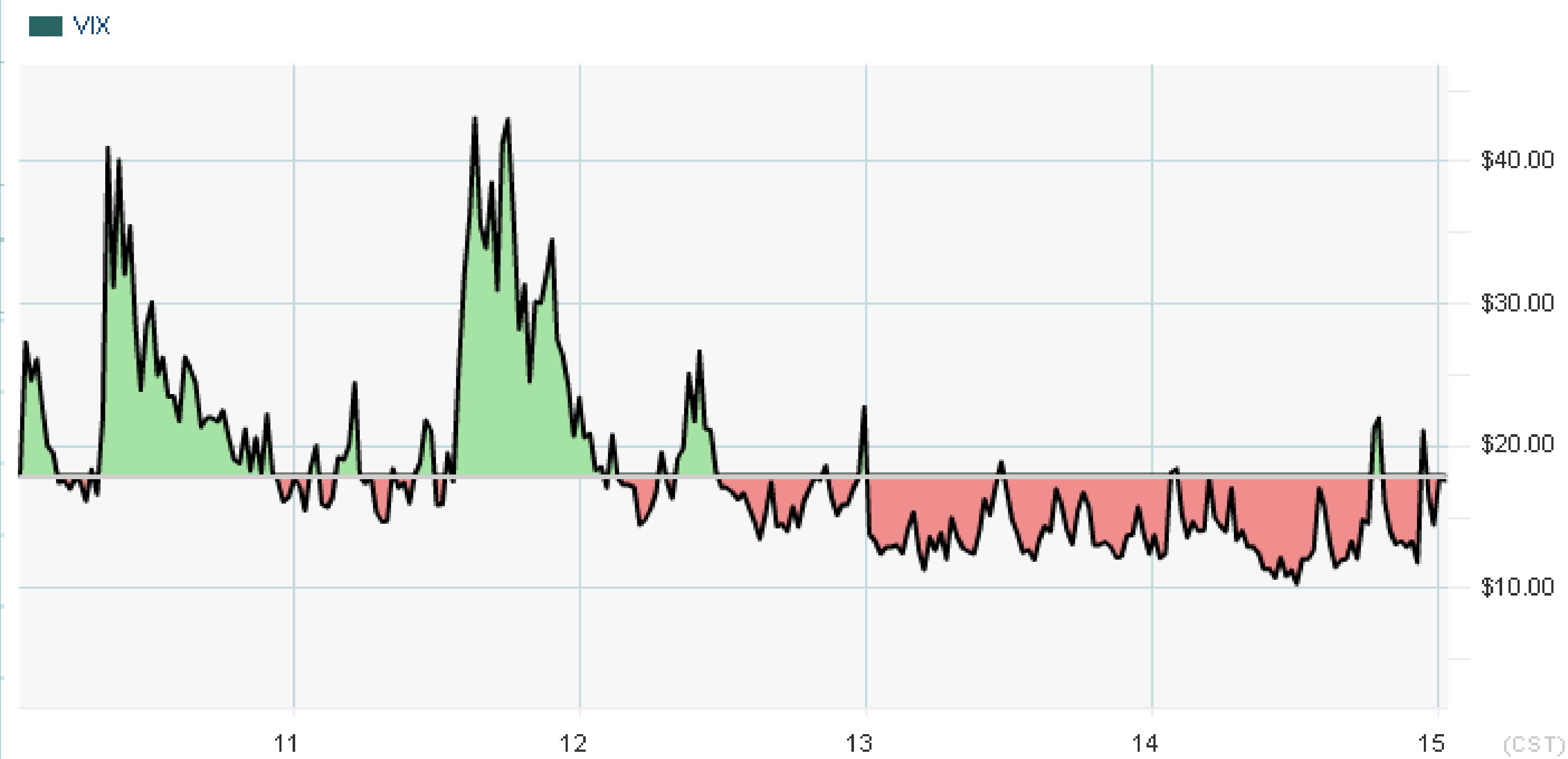

Source: BigCharts from MarketWatch

Volatility – Anticipating a Storm?

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" Given uneven global growth and the impending tightening of U.S. monetary conditions, investors can expect more bouts of volatility"

Russ Koesterich, CFA,
Chief Investment Strategist at BlackRock

Looking forward to 2015

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Stock Market Forecasts – *a mixed bag*

Market Concerns:

- Fed Normalizing Monetary Policy
- Higher than Average Stock Valuations
- Potentially Unsustainable Profit Margins
- Geopolitical Tensions
- Stagnant World Growth

Looking forward to 2015

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ANNUAL RETURNS FOR KEY ASSET CLASSES (2000-2014)
Ranked in order of performance (best to worst)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Best	Commodities 31.8%	Fixed Income 8.4%	Commodities 25.9%	Real Estate 40.7%	Real Estate 38.0%	Commodities 21.4%	Real Estate 42.3%	Commodities 16.2%	Fixed Income 5.2%	Real Estate 38.3%	Real Estate 20.4%	Fixed Income 7.8%	Real Estate 28.7%	U.S. Equity 33.6%	Real Estate 15.89%
	Real Estate 13.8%	Cash & Cash Alternatives 4.1%	Fixed Income 10.3%	Non-U.S. Equity 39.4%	Non-U.S. Equity 20.4%	Real Estate 15.4%	Non-U.S. Equity 25.7%	Non-U.S. Equity 12.4%	Cash & Cash Alternatives 1.8%	Non-U.S. Equity 33.7%	U.S. Equity 16.9%	Diversified Portfolio 4.0%	U.S. Equity 16.4%	Non-U.S. Equity 21%	U.S. Equity 12.56%
	Fixed Income 11.6%	Diversified Portfolio -3.7%	Real Estate 2.8%	U.S. Equity 31.1%	U.S. Equity 11.9%	Non-U.S. Equity 14.5%	U.S. Equity 15.7%	Fixed Income 7.0%	Diversified Portfolio -22.1%	U.S. Equity 28.3%	Commodities 16.8%	U.S. Equity 1.0%	Non-U.S. Equity 16.4%	Diversified Portfolio 17.6%	Diversified Portfolio 10.61%
	Cash & Cash Alternatives 6.0%	Real Estate -3.8%	Cash & Cash Alternatives 1.7%	Commodities 23.9%	Commodities 9.1%	U.S. Equity 6.1%	Diversified Portfolio 11.1%	Diversified Portfolio 6.0%	Commodities -35.6%	Commodities 18.9%	Diversified Portfolio 12.1%	Cash & Cash Alternatives 0.1%	Diversified Portfolio 11.3%	Real Estate 4.4%	Fixed Income 5.96%
	Diversified Portfolio -1.0%	U.S. Equity -11.5%	Diversified Portfolio -9.8%	Diversified Portfolio 18.5%	Diversified Portfolio 8.3%	Diversified Portfolio 4.0%	Cash & Cash Alternatives 4.8%	U.S. Equity 5.1%	U.S. Equity -37.3%	Diversified Portfolio 18.4%	Non-U.S. Equity 9.0%	Real Estate -5.8%	Fixed Income 4.2%	Cash & Cash Alternatives 0.1%	Cash & Cash Alternatives 0.03%
	U.S. Equity -7.5%	Commodities -19.6%	Non-U.S. Equity -15.8%	Fixed Income 4.1%	Fixed Income 4.3%	Cash & Cash Alternatives 3.0%	Fixed Income 4.3%	Cash & Cash Alternatives 4.7%	Non-U.S. Equity -43.6%	Fixed Income 5.9%	Fixed Income 6.5%	Non-U.S. Equity -12.2%	Cash & Cash Alternatives 0.1%	Fixed Income -2.0%	Non-U.S. Equity -4.32%
Worst	Non-U.S. Equity -13.4%	Non-U.S. Equity -21.4%	U.S. Equity -21.5%	Cash & Cash Alternatives 1.1%	Cash & Cash Alternatives 1.2%	Fixed Income 2.4%	Commodities 2.1%	Real Estate -6.9%	Real Estate -47.7%	Cash & Cash Alternatives 0.2%	Cash & Cash Alternatives 0.1%	Commodities -13.3%	Commodities -1.1%	Commodities -9.5%	Commodities -17.01%

Sources: Standard & Poor's, Russell, Dow Jones, Barclays Capital, U.S. Treasury and Morgan Stanley Capital International, as of 12/31/14.

Looking forward to 2015

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Back to Basics

Focus on your core investment strategy with an eye towards:

- Fee and Performance Management
- Well Run Investment Firms
- Taking Measured Risk

Being Your Best Fiduciary

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Fiduciary Requirements are the same regardless of Plan size or structure.

But, ***execution*** *will be different.*

Large or Small

- Defined Benefit Plans
- Defined Contribution
- Participant Deferral Plans
- Participant Directed Plans

Differences in Execution

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- Large Pension Systems
  - In-house Plan Administrator & Staff
  - Multiple Investment Managers
  - Investment Consultant
    - Selects/Monitors investment managers
    - Ranks Performance

Service Provider Review

Differences in Execution

- Large Pension Systems
  - In-house Plan Administrator & Staff
  - Multiple Investment Managers
  - Investment Consultant
    - Selects/Monitors investment managers
    - Ranks Performance

How can smaller pension funds and DC participant directed plans utilize this institutional approach?

Being Your Best Fiduciary

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- Review Service Providers
- Evaluate Investment Allocation
  - Large, Mid, and Small Cap
  - International Exposure
  - Active and Passive Strategies
  - Sector Funds
  - Alternative Investments
- Fully Understand Plan Fees – *use corporate plan required disclosures as a guide*

3 Pronged Regulatory Initiative

1. Form 5500 Schedule C
2. 408(b)(2) Fiduciary disclosures
3. Participant Directed disclosures

Insights from Corporate Plans

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Performance Disclosures

Facilitate Comparative Review of Alternatives

Increase Informed Decision-Making

Improved Performance

Fee Disclosures

Strengthen Competition Between Investment Products

Drive Down Fees

Where's the fee?

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U.S. Rep. George Miller (D-CA), chairman of the House Education and Labor Committee authored the ***401(k) Fee Disclosure and Pension Funding*** provisions of HR 4213–

" Workers should have the right to know how much Wall Street intermediaries siphon off from their savings. Just a 1-percentage-point in excessive fees can reduce a worker's 401(k) account balance by as much as 20 percent or more over a career"

Being Your Best Fiduciary

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- Afford Same Oversight to Supplemental Plans
- Exclusively Participant Funds
- Institutional versus Retail Mentality

Being Your Best Fiduciary

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- Embrace Your Responsibility
- Utilize Know-how of Appointed Experts
- Be an Informed Consumer
- Consistently Review Performance, Fees, and Services Provided

Complying with H.B. 1882

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105.702. All retirement plans defined under section 105.660 shall develop a procurement action plan for utilization of minority and women money managers, brokers, and investment counselors. Such retirement systems shall report their progress annually to the joint committee on public employee retirement and the governor's minority advocacy commission.

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