Staying the Course During Volatility – Strategies & Tips to Keep Your Board on Course
June 20, 2023

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“There, there it is again—the invisible hand of the marketplace giving us the finger.”
“And, while there’s no reason yet to panic, I think it only prudent that we make preparations to panic.”
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“I’m looking for a hedge against my hedge funds.”
"In an unexpected development, the market behaved rationally today."
Review / Reaffirm Overall Investment Strategy & Approach

- “The primary objective...is to prudently invest the System’s assets to fund benefits and to defray reasonable expenses”

- “The Fund’s assumed actuarial rate of return will constitute a minimum goal for investment return”

- “The Board will employ strategies to maximize the advantages of diversification for optimal capital protection and to implement appropriate risk acceptance strategies for optimal investment return”

- “The portfolio will be allocated across a variety of strategies and managers that each have unique risk and return characteristics and liquidity provisions”
Review / Reaffirm Overall Investment Strategy & Approach

- Portfolio is diversified across three primary components:
  - Describe / explain the component parts and their respective roles
  - Sub-strategies allow for complementary styles / approaches and more nuanced exposures
  - Ranges around targets can vary by allocation size and volatility measures
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New Trustee Education

- First, understand their backgrounds and experiences
- What are their perspectives / biases?
- Trustees often wear multiple hats; for this role, there is only one
- Reminder that this is “other people’s money”, it’s public, and thresholds are different than with personal investments
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Board Education

New Trustee Education

- Who are the parties involved and their relationships?
- What are their respective fiduciary responsibilities?
- What is our overall investment approach?
- Explain why we are structured as we are
- Contrast the mindset of a 100% funded situation / lower hurdle rate vs. a 60% funded situation / higher assumed ROR
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Board Education

Historical Performance Review

- COVID experience *(should have taken a looong vacation)*:
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Board Education

Historical Performance Review

Benefits of Remaining Invested – Growth per $1 Million
S&P 500 Index Total Return
Trailing 10 Years, 12/31/22

All Trading Days: $3.3 ($12.6%)
Missing 10 Best Days: $1.8 (6.0%)
Missing 20 Best Days: $1.3 (2.6%)
Missing 30 Best Days: $1.0 (0.0%)
Missing 40 Best Days: $0.8 (-2.4%)

Source: Bloomberg, ACG Research.
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Board Education

Historical Performance Review

How Often is the S&P 500 Positive?

- Daily: 53%
- Weekly: 57%
- Monthly: 62%
- Quarterly: 68%
- 1 Year: 73%
- 5 Year: 87%
- 10 Year: 93%
- 20 Year: 100%
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Asset Allocation

Portfolio Structure & Investment Behavior

- Priority #1: Setting (and managing) expectations – 1st percentile

- Back to basics: Must get the asset allocation compatible with overall objectives and reaffirm / refine as appropriate

- Revisit the risk / return discussion – tradeoffs; quantify

- Stress test the portfolio for confidence intervals; key on factors most germane to the System
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Asset Allocation

Portfolio Structure & Investment Behavior

- Remind the group of the goal – “matching” of long-dated investment approach to fund long-dated liabilities
- Find the common ground – directionally – between more / less sophisticated Board Members
- Don’t “try too hard” to get target rate of return every year – it’s a long-term average; take what markets are offering
- It is not the Board’s job to make up for any underfunding that has occurred
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Asset Allocation

**Portfolio Structure & Investment Behavior**

- **Top-down** emphasis
- **Data** is a powerful tool
- **Ibbotson** study / quilt chart – asset allocation has ~90% of the impact, but managers get 90% of the airtime
- **Portfolio performance** in extreme conditions; **Keynes** quote
Investment Strategy

Strategy Allocation

- Revisit the “playbook” for asset classes / sub strategies
  - The merits of each strategy
  - Why each is incorporated into the portfolio
  - Historical relationships among component parts
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Investment Strategy

- **What does each piece bring** to the portfolio?
- **Thesis** for funding
- **Expected risk / return profile**; expected behavior in various market environments
- **Assess managers** on a risk-adjusted basis, over rolling periods; did you get what you paid for?
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Manager Implementation

Even the “Best” Managers Underperforms – Be Patient

Peer Rank Path of Best Emerging Markets Manager – 10 Years Ending December 2021
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Summary

Lessons Learned

- **Tech Wreck (2000):** Volatility has a downside, too – from Goldman Sachs to Pets.com
- **GFC (2008):** Leverage has consequences; fear and greed are alive and well
- **COVID (2020):** Ready, fire, aim – investors sell first, ask questions later

Common Themes:
- Strategic approach; periodically challenged
- Disciplined rebalancing through market volatility and cash flows
- Increased manager latitude can help navigate volatile markets
- Longer-term report card; portfolio refinements as appropriate
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Summary

Mitigating Factors

- Staff and Board *continuity*
- Continuing / continual *education*
- *Remain disciplined* – don’t react
- *Stick with the plan* – the best opportunity to achieve what we planned for
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Summary

What Do We Do About It?

- We’ve already done it
  - We’ve structured a **sound, diversified, risk and fee aware** portfolio
  - Positioned the portfolio to meet its primary objective – to **fund the System’s long term obligations**
  - **Incorporated risk mitigation at every level:** asset allocation, sub strategies and across the manager lineup
  - **Accounted for** higher / lower rates, stronger / weaker USD, higher / lower equity valuations, etc.
  - **Resist the urge** to outsmart ourselves
  - When volatility emerges, it is usually too late to react. **Timing is a fool’s errand – cannot get it right consistently**
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“Now we just have to sit back and wait for the Fed to bail us out.”
“From the violent nature of the multiple stab wounds, I'd say the victim was probably a consultant.”
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