



Prudent Fiduciary: Asset Allocation Decision

Conference Forum 2016

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Agenda

Review: Investment Oversight and Governance

Asset Allocation

Sample Asset Allocation Analysis

Next Steps

Investment Oversight and Governance

Best Practice



Strong committee chair

Best Practice



Committee size

Best Practice



Different expertise among members

Best Practice



Clearly define roles and responsibilities

Best Practice



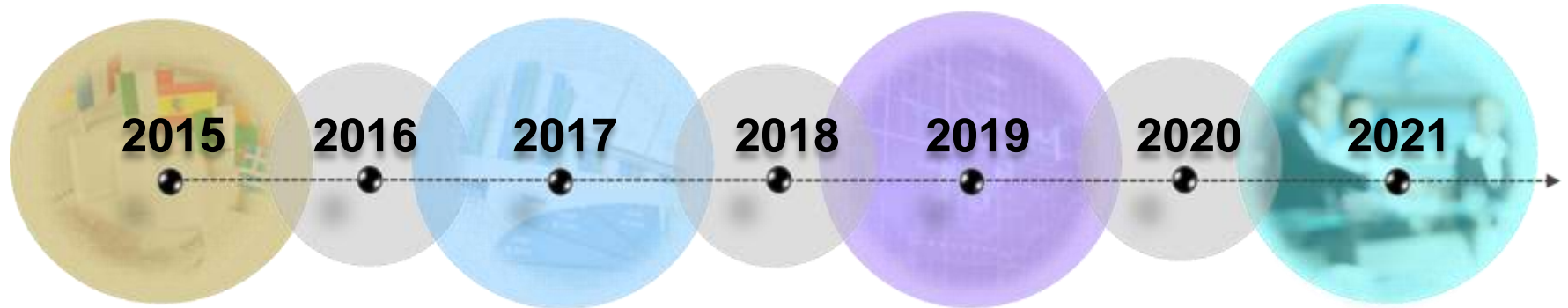
Identify and address potential conflicts of interest

Best Practice



Review and/or develop an investment policy statement

Best Practice



Set timeline for ongoing review of portfolio

Asset Allocation

What Is Asset Allocation?



The implementation of an investment strategy that attempts to balance an investor's risk and **expected return** by adjusting the percentage of each **asset class** in an investment portfolio according to the investor's **risk tolerance, goals** and investment **time horizon**.

Source: Wikipedia

Purpose/Goals



Set aside funds for an anticipated near term major capital expenditure



Minimize future contributions to an employee benefit plan



Provide a source of funds to support an organization's operating budget



Provide funding for a charitable cause



Set aside a reserve to meet a future expenditure

Time Horizon



- Heavy expected incoming/outgoing cash flows
- No time to recover from a loss in asset value



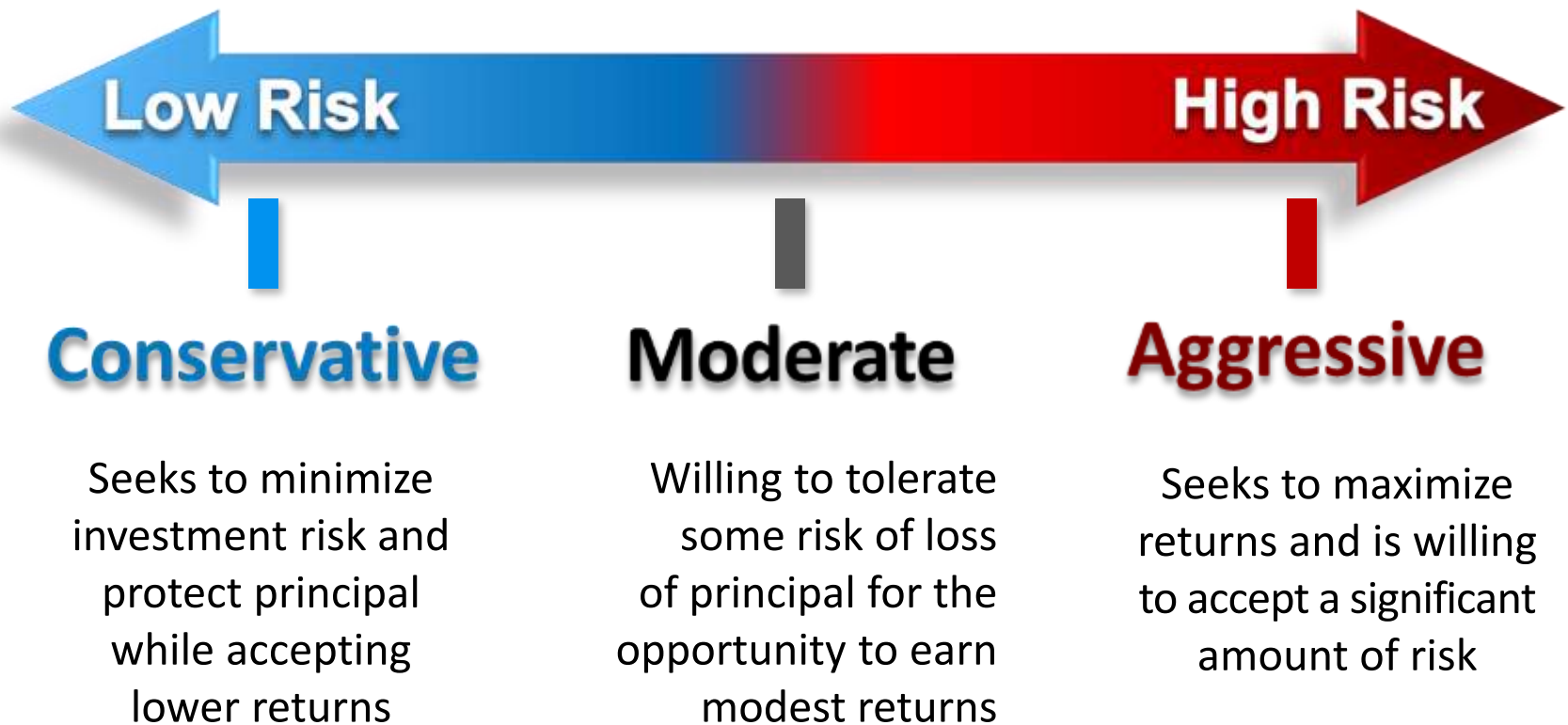
- Consider allowing for some volatility in the portfolio
- Reasonable opportunity to recover a loss in asset value



- Highest tolerance for variability of asset value
- More time to recover from a loss in asset value

Risk Tolerance

Variability in investment returns that one is willing to withstand



Assessing Risk Tolerance

- Specify the time horizon
- Identify the primary objective for investing
 - Preservation of principal?
 - Current income?
 - Growth?
 - Combination?
- Forecast future cash flow needs
- Assess the committee's investment experience
- Determine amount of potential losses willing to incur over a time period
- Identify suitable investments

Examples—Risk Tolerance Statements

- We are willing to attain a very low return with a near 0% probability of loss of principal
- We are willing to accept significant short-term market risk (up to 10% annual loss with a 90% confidence level) to build our long-term mission related to our asset pool
- We would like to increase our charitable grants in the long-term. Our long-term return target is 2% over inflation

Asset Classes



Stocks

- Domestic (U.S.)
- International developed
- International emerging markets



Bonds

- Corporate
- Government



Cash

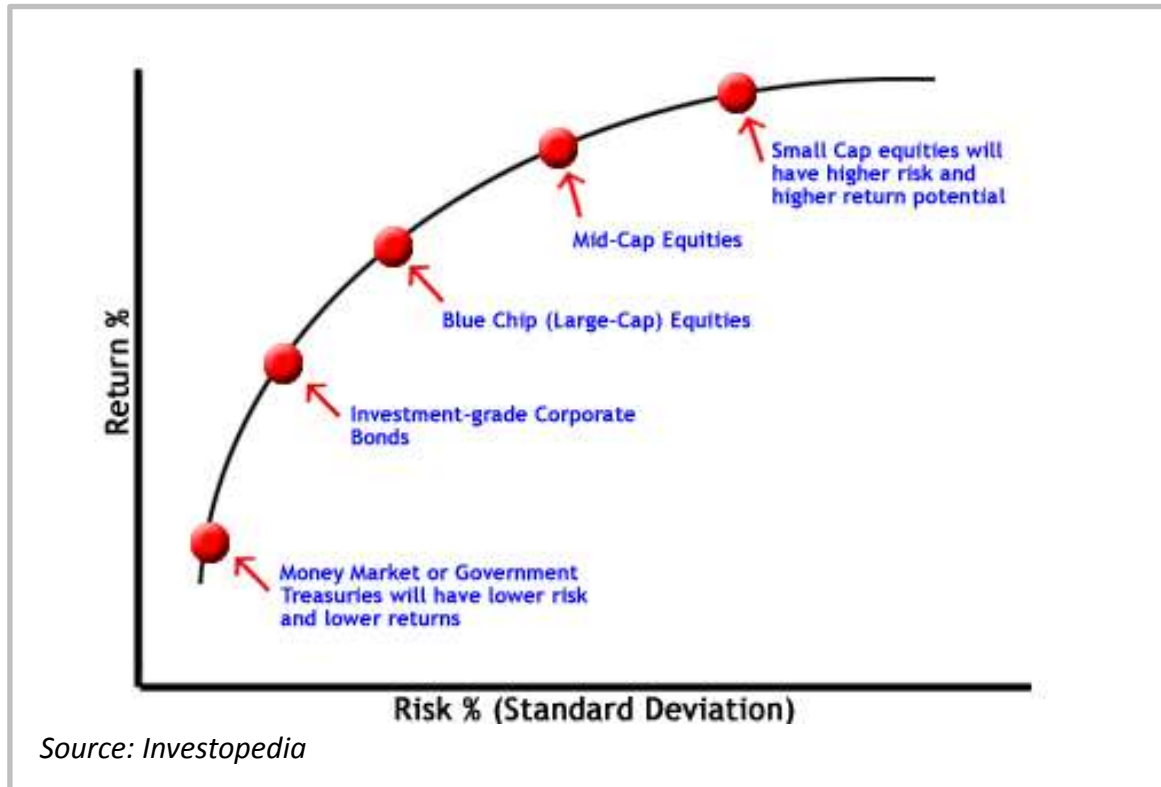
- Short-term investments



Alternative

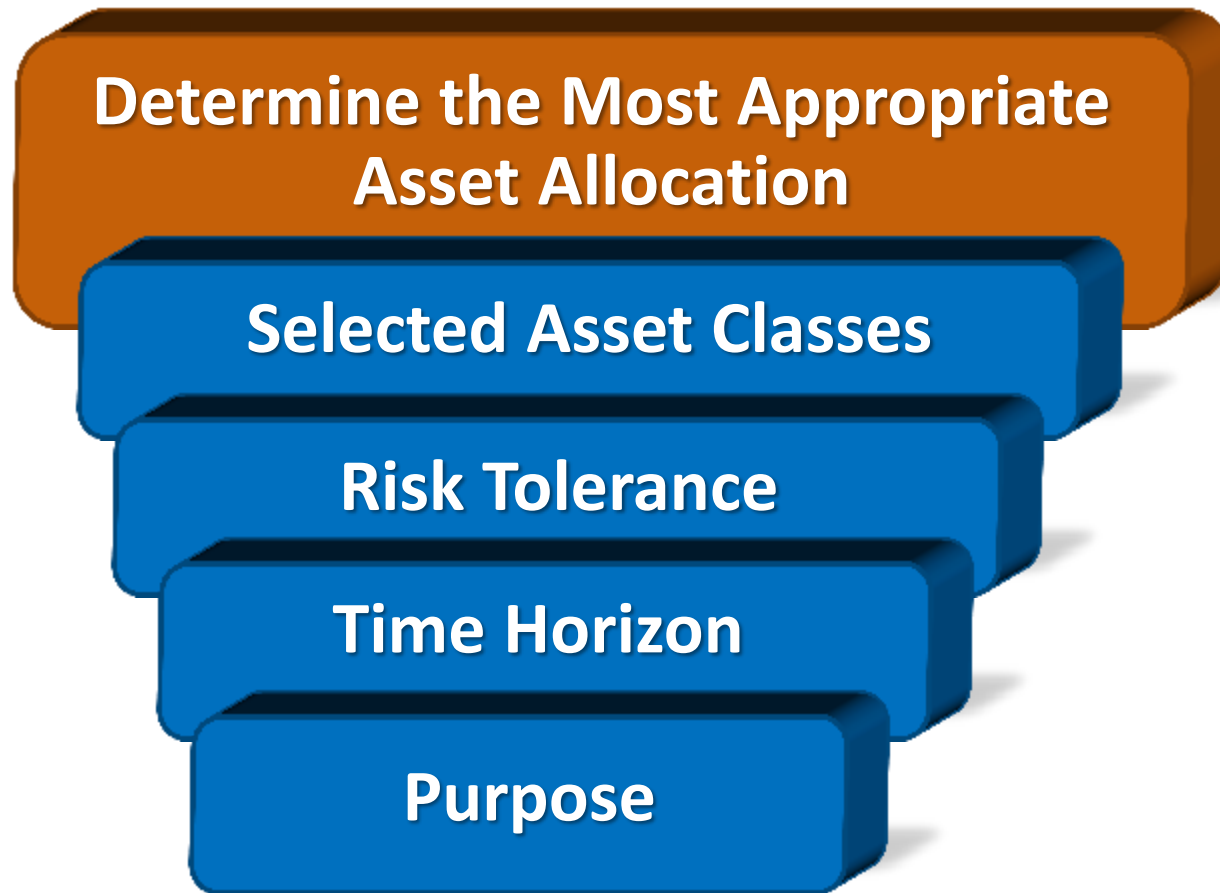
- Private equity
- Private real estate
- Hedge funds

What Is the Expected Rate of Return?



The expected rate of return is how much your investments need to gain in order to fulfil future obligations, liabilities, payments, etc.

Determining the Optimal Asset Allocation



Asset Allocation Sample Analysis

Sample Asset Allocation Analysis

Goal: To fund future liabilities

Time Horizon: Five years

- **Risk Tolerance Assessment:** We want **95% assurance** that we will not incur a loss on the \$10 million that we have set aside to fund our future liabilities.
- Asset allocation options:
 - **Option A:** 100% equities
 - **Option B:** 65% equities/35% fixed income
 - **Option C:** 50% equities/50% fixed income
 - **Option D:** 50% fixed income/50% short-term investments

30-Year Capital Market Return Assumptions

As of December 31, 2015

Asset Class	Expected Annualized Long-Term Compound Returns (Nominal)	Expected Annualized Long-Term Compound Returns (Real)	Expected Annualized Standard Deviation (Nominal)
U.S. Equities	8.00%	5.50%	16.00%
Non-U.S. Equities	8.25%	5.75%	20.00%
Fixed Income (Global)	4.00%	1.50%	5.00%
Inflation Protection	3.65%	1.15%	7.00%
40/25/25/10 Mix	6.63%	4.13%	13.35%

The long-term capital market return assumptions are developed and updated on a calendar quarter basis by the members of Wespath's Investment Management team.

The expected returns for each individual asset class are based on a benchmark index that we believe to be representative thereof. For U.S. Equities, we use the Russell 3000 Index. For Non-U.S. Equities, we use the MSCI All Country World Index (ACWI) ex-USA Investable Market Index (IMI). For Fixed Income (Global), we use the Barclays Capital U.S. Universal ex-Mortgage Backed Securities Index. For Inflation Protection, we use the Barclays Capital U.S. Government Inflation Linked Bond Index. The 40/25/25/10 Mix represents a portfolio invested 40% in U.S. Equities, 25% invested in Non-U.S. Equities, 25% invested in Global Fixed Income, and 10% invested in Inflation Protection assets.

The Nominal Rate of Return does not reflect an adjustment for inflation. The Real Rate of Return reflects an annual downward adjustment of 2.5%, which represents our long-term inflation expectation.

The return assumptions do not include value added from active strategies or alternative investment strategies, and do not consider the impact of fees or expenses. Returns presented herein are gross of fees.

The assumptions contained herein do not constitute investment recommendations and are not a promise of future performance. Actual performance may vary significantly from the return assumptions presented herein due to market conditions. See *Appendix* for additional information. For educational purposes only.

Sample Asset Allocation and Risk Analysis

Fund/Class	100% Equities	65% Equities/ 35% Fixed Income	50% Fixed Income/ 50% Equities	50% Fixed Income/ 50% Cash
Cash	0%	0%	0%	50%
Inflation Protection	0%	10%	15%	15%
Fixed Income	0%	25%	35%	35%
U.S. Equities	62%	40%	31%	0%
International Equities	38%	25%	19%	0%
Expected Return	8.20%	6.97%	6.36%	3.26%
Standard Deviation (Risk)	16.91	11.55	9.36	2.59
Probability of Loss*	31%	27%	23%	10%

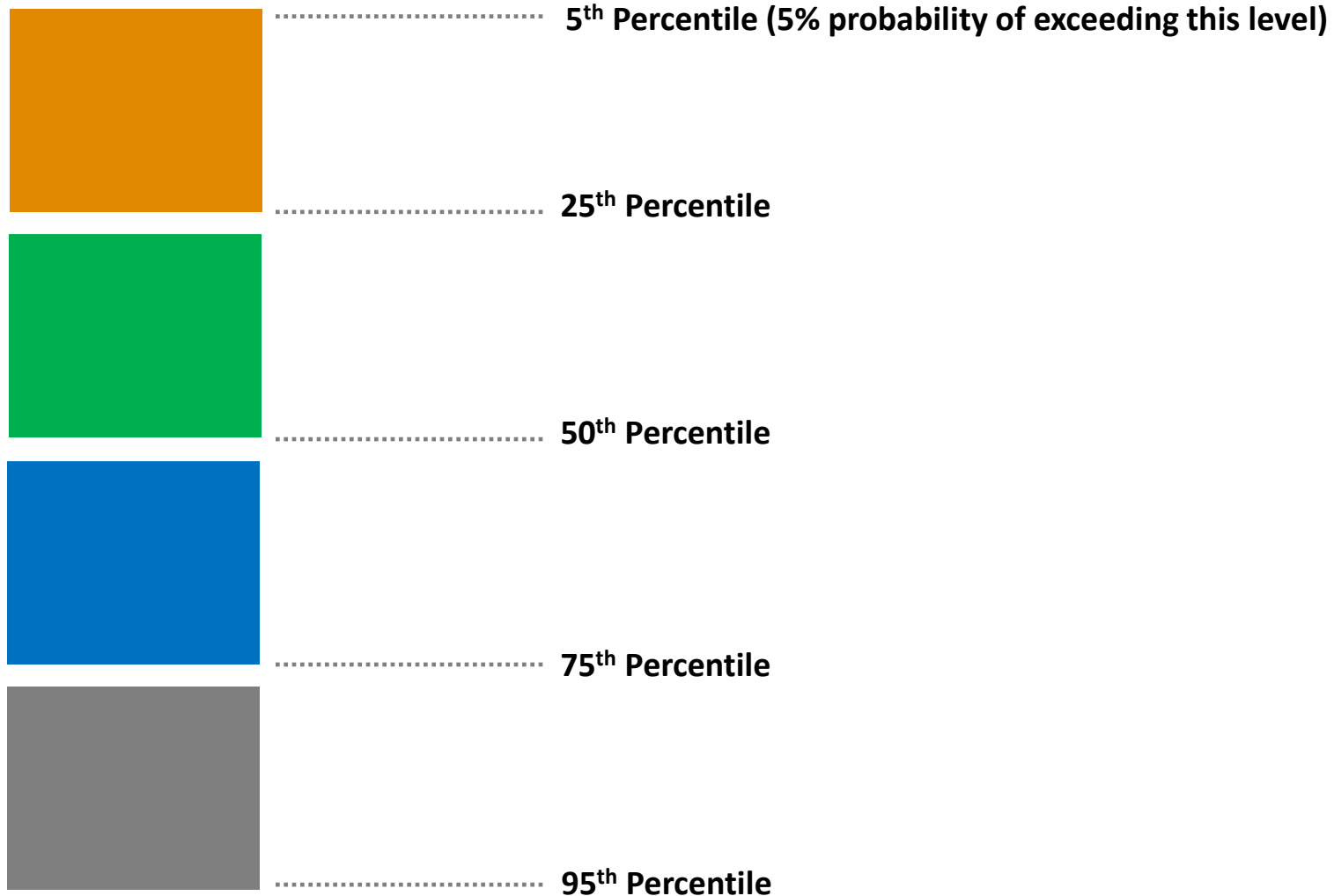
*Data for the one-year time horizon

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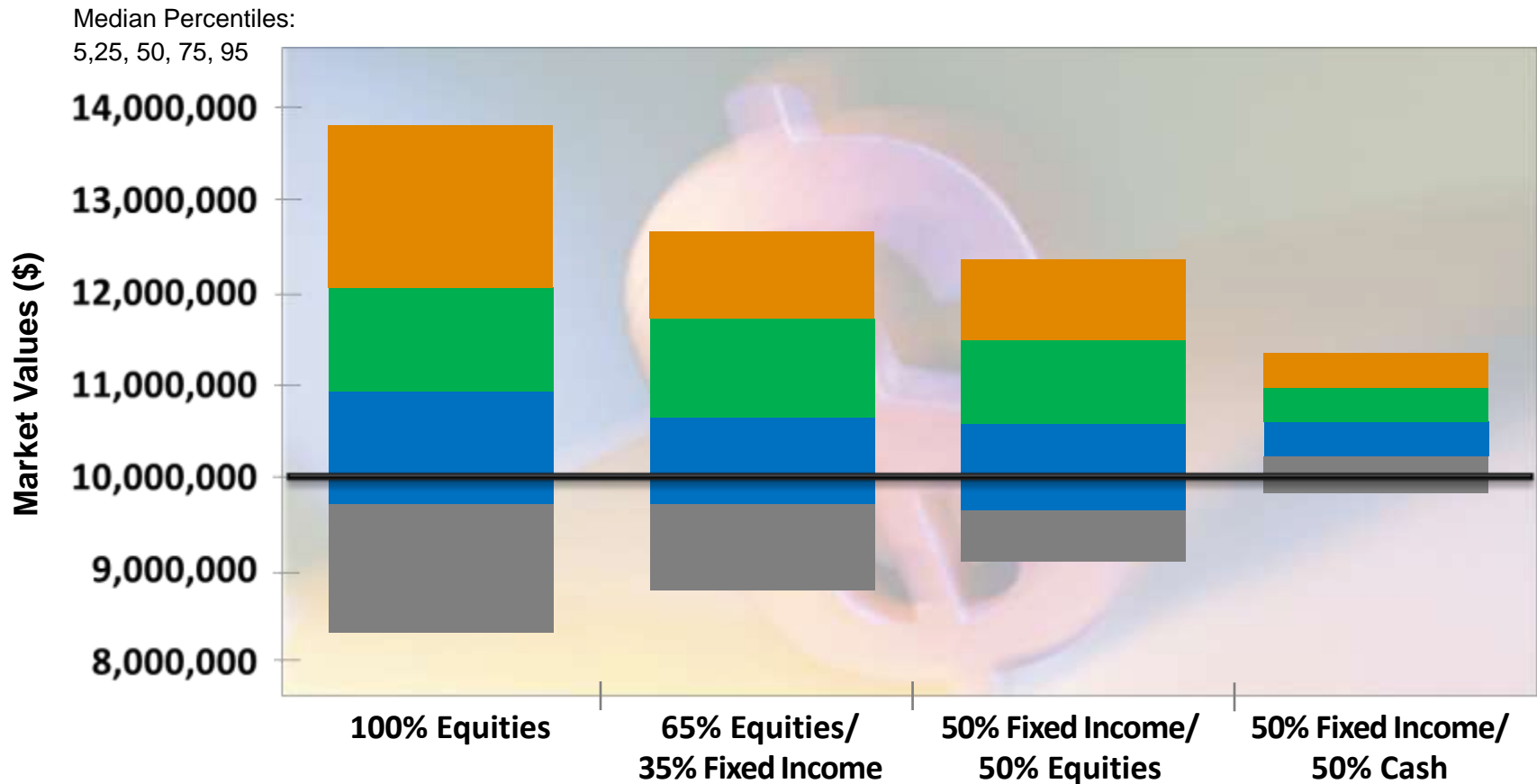
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Explanation of Percentile Chart



Distribution of Market Values— One-Year Time Horizon



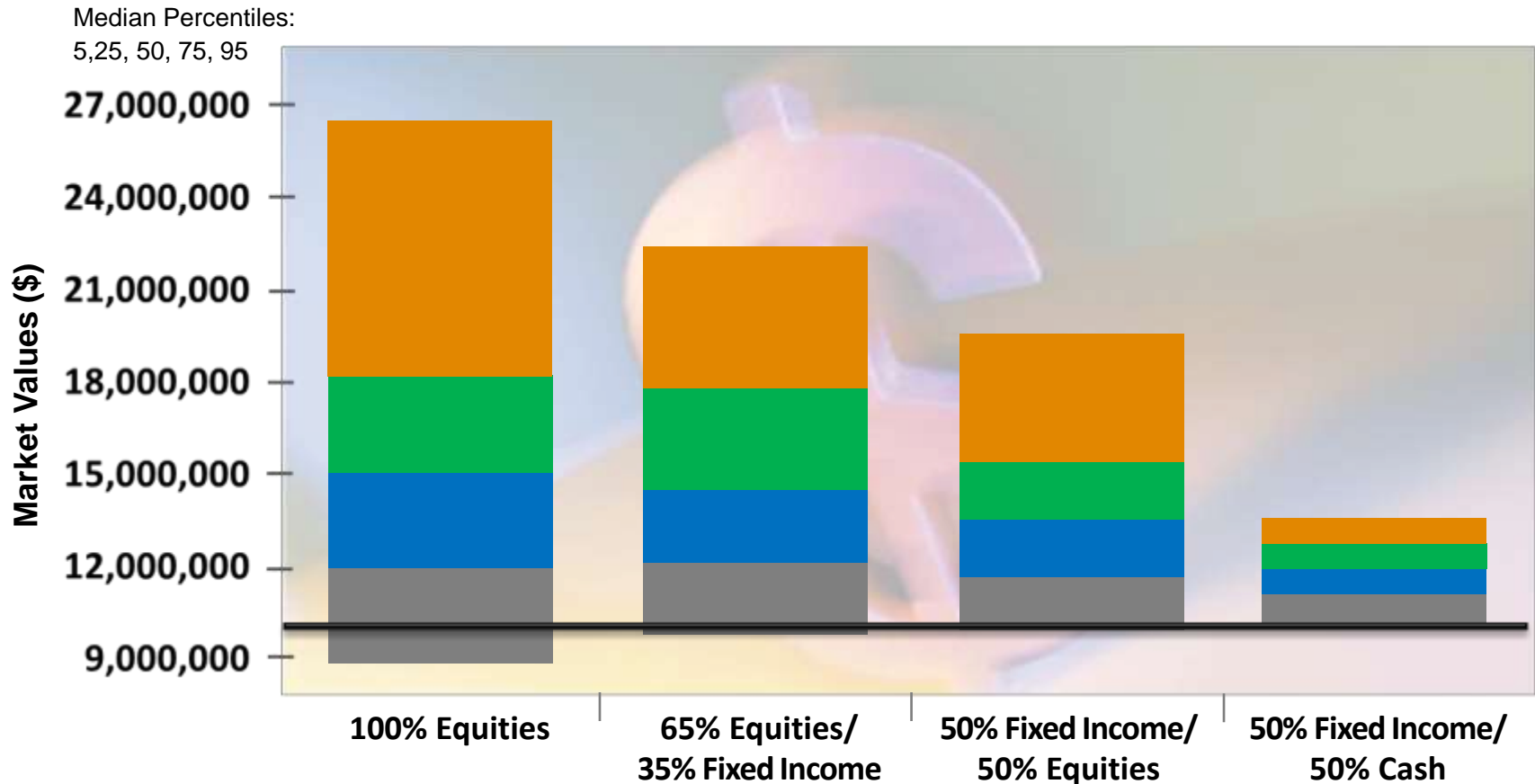
Information based on an original investment of \$10 million.

The distribution of returns are calculated using Wespath Investment Management assumption inputs in an asset allocation modeling system, Wilshire Compass.

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Distribution of Market Values— Five-Year Time Horizon



Information based on an original investment of \$10 million.

The distribution of returns are calculated using Wespath Investment Management assumption inputs in an asset allocation modeling system, Wilshire Compass.

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Next Steps

Ongoing Review

- ✓ Set timeline for account review
- ✓ Determine if there are any changes and make necessary adjustments
 1. Time horizon
 2. Purpose
 3. Risk tolerance
 4. Cash flows
- ✓ Adjust account asset allocation as needed

Appendix

Performance Disclosure

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Collectively, the corporations are responsible for the general supervision and administration of retirement, disability, death and health benefit plans, programs and funds as authorized by General Conference, the highest legislative authority of The United Methodist Church (sometimes referred to as the “Church”). One of the functions of the General Board is to act as the plan administrator of various retirement, disability, death and health benefits plans, programs and funds that the General Board administers. The Benefit Board acts as the trustee of all funds received, including the funds discussed in this presentation.

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Historical returns are not indicative of future performance. Except as otherwise noted, the performance in this presentation is presented net of fees—that is, with the deduction of investment advisory fees, custodial fees, withholding taxes, trading expenses and all other fees and expenses. Our investment advisory fees and expenses are described in the *Investment Funds Description*. The returns will be reduced by the amount of investment advisory and other fees and expenses incurred in the management of the funds.

Disclosures

The expected returns are annualized and net of fees. All returns assume investment commenced on January 1, 2014.

The investment assumptions are developed by the Wespath Investment Management Team based on the historical performance, the current market environment and judgment. We do not present the assumptions are actual or guaranteed future performance. This material is approved only for the institutional investor identified on the cover page and is not for distribution.

Risk is presented as units of one standard deviation. For example, the U.S. Equity Fund expected rate of return of 8.0% has a risk of 16 (i.e. one standard deviation) in a single year. This means that in a single year there is an approximately 68% probability the return will be between -8.0% and +24.0% (that is, contained within the 16% spread that equates to one standard deviation).

Correlation is a measure of how similar investments return relative to one another. For example, a correlation of 1.0 means investments are perfectly correlated. 0.0 implies there is no correlation. Positive correlation means that the investments move in the same direction (positively and negatively). A negative correlation means the investments will perform oppositely (if one investment performs positively than the other investment will perform negatively).

An offer for the sale of interests in the funds will only be made through the *Investment Funds Description* for the funds. *The Investment Funds Description* is available upon request. Our investment advisory fees and other fees are described in the *Investment Funds Description*. The return of any client will be reduced by the amount of investment advisory and other fees or expense incurred in the management of the funds.

Past performance is not a predictor of future results. The returns identified are projections and do not represent any actual performance.



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