MAJOR ASSET CLASSES

Daniel Johnson, FPPTA Education Committee
Investment strategy of investing in multiple asset classes with the objective of balancing total portfolio risk and returns.
CASH AND EQUIVALENTS

- Short term investments that provide capital preservation and earn interest (i.e. money market funds, certificates of deposits).
- All plans need access to cash periodically for expenses, pension payments, etc.
- Used via money market funds.
FIXED INCOME/BONDS

- Most commonly in the form of bonds.
- Debt instruments with defined interest rates (fixed or variable rates) and maturities; the investor is entitled to interest and repayment of the principal. The investments are typically issued by corporations or governments and includes pools of fixed income investments.
EQUITY/STOCKS

- Large allocation for pension plans, allocated across many different areas.
- Publicly traded securities that represent ownership in a corporation (holders are entitled to the company’s earnings and assets); investors may profit from dividends (distributions of the company’s profits) and increases in the value of the stock.
REAL ESTATE

- Ownership in commercial, residential, or land.
- Investors are entitled to rental income and appreciation of the asset.
- Commonly used by pension plans through an investment fund where fund owns pool of commercial properties.
- The return is made up of income from rental activity and property appreciation or depreciation.
ALTERNATIVE ASSET CLASSES

- **Hedge Funds**: A investment strategy that may invest across asset classes and generally has broader investment guidelines and an absolute return target. These strategies tend to invest in stocks, bonds, and derivatives.

- **Private Equity**: Ownership of a company that is not publicly traded on a stock exchange; the objective is to increase the value of the investment through management expertise.

- **Others**: Private Debt, Infrastructure, Timberlands/Farming, Commodities…
INVESTMENT STYLES

- Utilizing a preferred approach within the selection process for investment decisions.
  - **Value**
    - Stocks out of favor (underpriced)
    - High dividend
    - Low growth rates
    - Consumer staples, financials, utilities
  - **Growth**
    - Fast growing companies
    - Low dividend – reinvesting
    - High sales and earnings growth
    - Technology, Health care, Telecom
MARKET CAPITALIZATION

- The value of a company as calculated by the number of shares outstanding multiplied by the share price. General classifications include:
  - Large Caps (> $10 Billion)
  - Mid Caps ($2 Billion - $10 Billion)
  - Small Caps ($250 Million - $2 Billion)
IDENTIFYING INVESTMENT PARAMETERS

- Statute 175 or 185 as well as Statute 112.
- Under these statutes, there is permissibility allowed to the plans to introduce more flexibility for their investment program.
- Plan can make these adjustments through modification of the local ordinance, but local ordinance dictates what the plan can invest in.
- Board can then adopt their own investment policy statement that dictates the Boards allowed investments, targeted asset allocation and other criteria for Boards investment objectives and goals.
PURPOSE OF AN INVESTMENT POLICY STATEMENT

- Provide evidence of a prudent investment decision making process
- Serve as defense against potential fiduciary liability
- Supports continuity in decision making as plan fiduciaries change
- Protects sponsor from making decisions based on emotions
ESTABLISH ASSET ALLOCATION TARGETS

• Clear target allocations for each asset class
• Compliment the target allocations with allowable investment ranges in each asset class.

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Target</th>
<th>Range</th>
<th>Benchmark Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic Equity</td>
<td>55%</td>
<td>45% - 65%</td>
<td>Russell 3000</td>
</tr>
<tr>
<td>International Equity</td>
<td>10%</td>
<td>5% - 15%</td>
<td>MSCI-ACW ex US</td>
</tr>
<tr>
<td><strong>Total Equity</strong></td>
<td><strong>65%</strong></td>
<td><strong>55% - 75%</strong></td>
<td></td>
</tr>
<tr>
<td>Broad Market Fixed Income</td>
<td>30%</td>
<td>20% - 40%</td>
<td>Barclays Capital Aggregate</td>
</tr>
<tr>
<td><strong>Total Fixed Income</strong></td>
<td><strong>30%</strong></td>
<td><strong>20% - 40%</strong></td>
<td></td>
</tr>
<tr>
<td>Real Estate</td>
<td>5%</td>
<td>0% - 10%</td>
<td>NFI-ODCE Fund Index</td>
</tr>
<tr>
<td><strong>Total Non-Traditional Assets</strong></td>
<td><strong>5%</strong></td>
<td><strong>0% - 10%</strong></td>
<td></td>
</tr>
</tbody>
</table>
EACH INVESTMENT HAS A ROLE

- Clear target allocations for each asset class
- Compliment the target allocations with allowable investment ranges in each asset class.
KEY TERMINOLOGY

- Stocks - Publicly traded securities that represent ownership in a corporation
- Bonds – Debt instruments with defined interest rates (fixed or variable rates) and maturities
- Real Estates – Ownership in commercial, residential, or land.
- Style - Utilizing a preferred approach within the selection process for investment decisions.
- Market Capitalization - The value of a company as calculated by the number of shares outstanding multiplied by the share price.
- Asset Allocation - Investment strategy of investing in multiple asset classes with the objective of balancing total portfolio risk and returns
- Investment Policy Statement – A written document indicated how an investment program will be managed including investor objectives and constraints.