Pension Investments

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Asset Allocation and Modern Portfolio Theory

- **MPT says investors should focus on the portfolio, not individual securities**

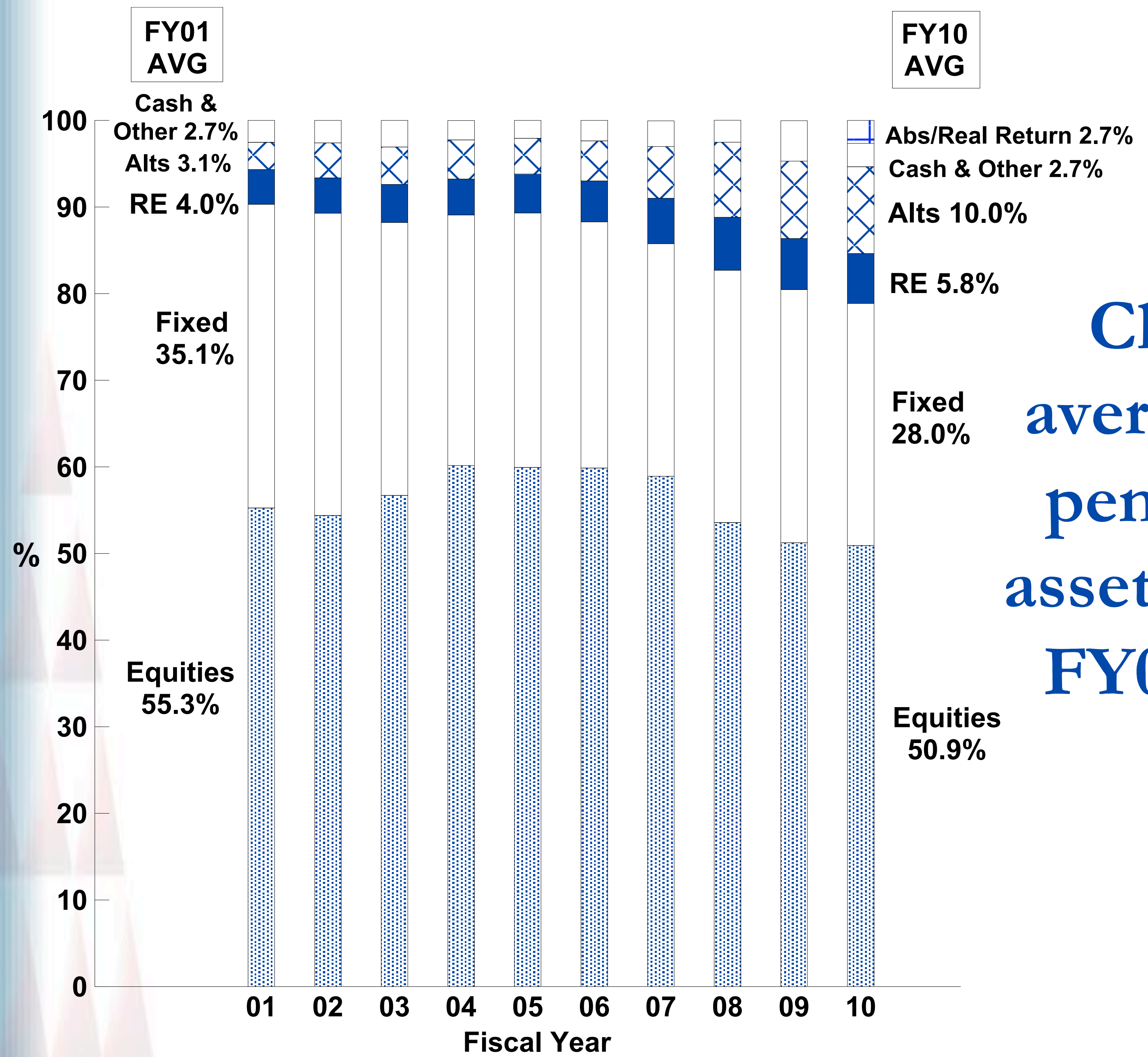
- **Portfolio selection should focus on <u>overall</u> risk-reward characteristics rather than risk-reward features of <u>individual holdings</u>**

- **Individual asset classes—stocks, bonds, real estate, foreign assets, hedge funds, and private equity—**
  - **behave differently in response to economic and market events, and**
  - **have their own expected risks and rewards**

Asset Allocation and Modern Portfolio Theory (cont.)

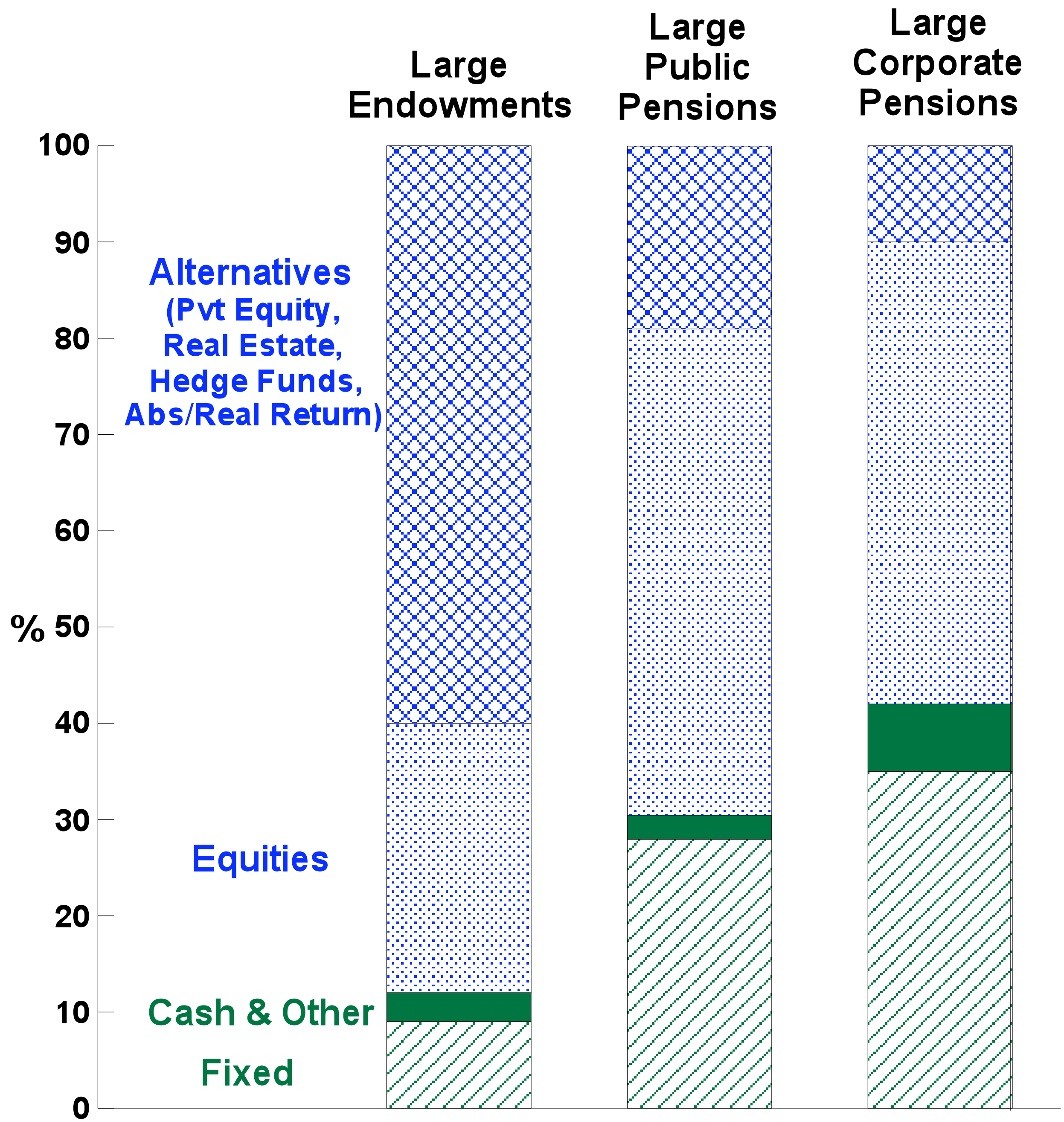
- MPT demonstrates the power of diversification: adding an asset class that, by itself, is “riskier” can produce a higher level of expected return at the same level of risk, or the same expected return at a lower level of risk
- Every pension plan and every institutional portfolio is unique
- MPT requires that portfolio managers construct their portfolio on the sponsor’s unique characteristics, including:
  - Time horizon
  - Risk tolerance
  - Liquidity

Change in average public pension fund asset allocation, FY01 to FY10



PUBLIC FUND SURVEY

Average asset allocation for large endowments and public and corporate pension funds, 2010-2011



NACUBO, Public Fund Survey, Milliman

The discipline and efficiency of public fund investing

- The largest 75 public pension funds account for ~80 percent of all public pension fund assets
- The smallest of these funds is roughly $7 billion
- These funds typically display a high level of transparency and investment discipline:
- Financial reporting; establishment of investment processes, targets and policies; due diligence; risk management; rebalancing; and regular review
- Median investment expenses for this group are ~30 basis points (0.30%) of assets annually
- "In It For the Long Haul," NIRS, 2008: Key finding: Public funds are prudent and employ best practices