**Pennsylvania Association of Public Employee Retirement Systems**
**PO Box 61543, Harrisburg, PA 17106-1543**
**Website:** ***www.pa-pers.org***

***Summer 2012***
***(Vol. 7 No. 2)***

**In This Issue**



**Looking Ahead at More PAPERS Opportunities**

**9th Annual PAPERS Forum**

**May 23-24, 2013**
(Thursday-Friday)
**Harrisburg Hilton Hotel**

**Don't Miss These Fall Workshop Deadlines**

**8/17/2012 - Hotel Reservations**

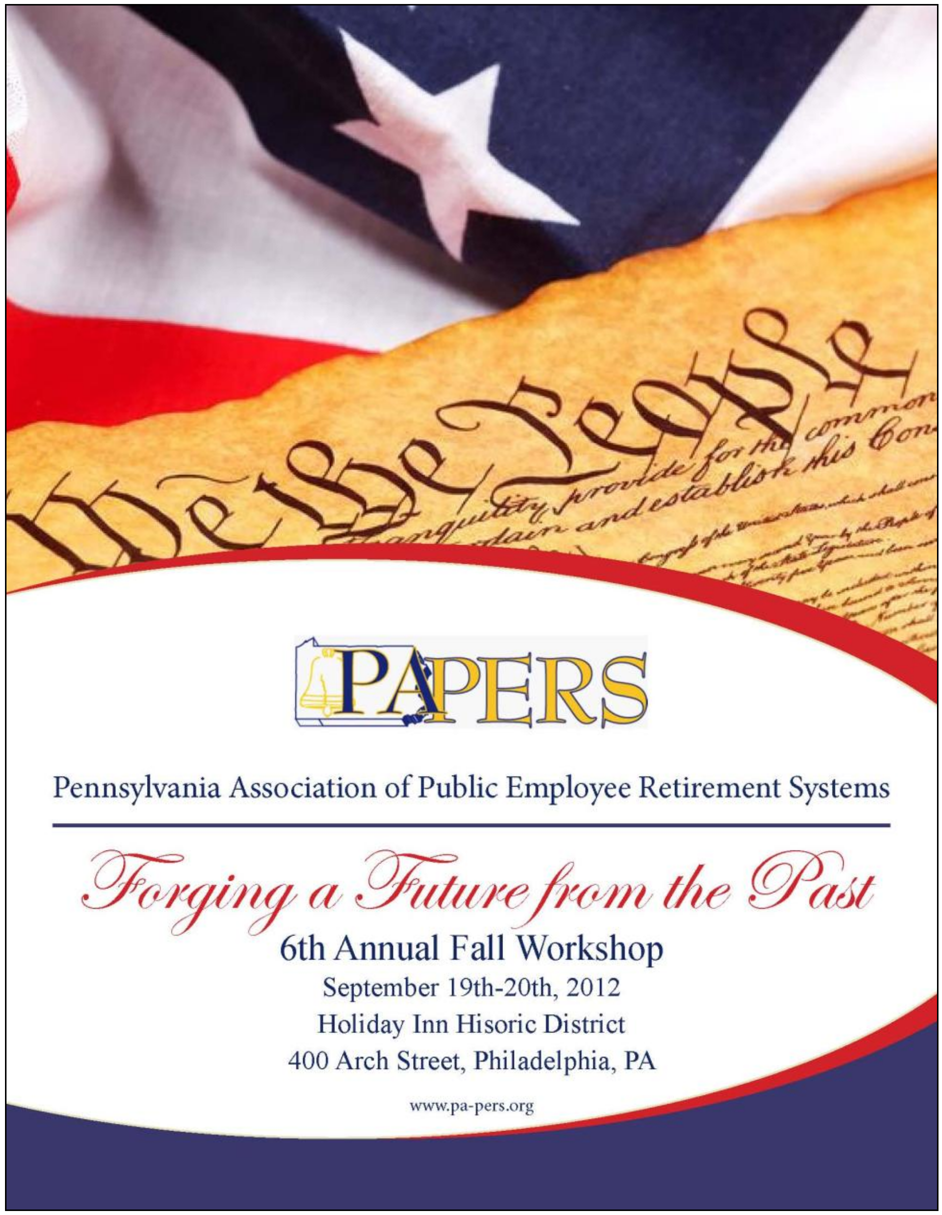
**9/1/2012 -**

- **Conference Registration**
- **RSVP for Constitution Center Reception**

**You'll find more details inside.**
You may also access Fall Workshop information and any updates on the PAPERS website **www.pa-pers.org**.

# PAPERS Fall Workshop

*September 19-20, 2012 – Philadelphia, PA*




**This conference brings together 50-60 attendees from Pennsylvania's public pension plans and service providers in one location. Plan to attend the 6th annual Workshop September 19-20, 2012 at the Holiday Inn Historic Area in center city Philadelphia.**

# From the PAPERS Executive Director

**Hear Ye!! - Hear Ye!!**

All public pension trustees and local government officials associated with public pension funds in the Commonwealth of Pennsylvania. Come to the 6th annual PAPERS Fall Workshop to sharpen your pension management skills and meet with your peers and service providers to discuss the latest developments and issues associated with the public pension industry.

Trustees are facing ever increasing challenges in the current economic and political environment. The very survival of public pensions as you have come to know them is in serious jeopardy as conservative think tanks work to distort the condition of public plans in an attempt to eliminate these benefits for the members of your system. It is critical that you work together with other trustees to thwart these efforts.

Being a pension board member and **trustee** brings with it a serious responsibility for public officials and others appointed to local pension boards. As a trustee you have a **fiduciary duty** to protect and nurture the funds that have been entrusted to your care. The employees you represent deserve the best possible management of their trust funds.

To that end, you as a trustee have an obligation to seek out the best education you can find in the subject areas related to your duties to manage the funds and control the liabilities of these pension plans. PAPERS' mission is to provide the most cost efficient high quality education possible for local trustees in Pennsylvania. We hope that you will give us a chance to show you what we have to offer by attending one of our Fall Workshops or our Spring Forums.

This summer PAPERS staff and Board are working hard on the production of our 6th annual Fall Workshop which will be held on September 19th and 20th at Holiday Inn in the Philadelphia Historic District at 400 Arch Street. We planned for two half days to provide an opportunity for families to explore the National Constitution Center and Museum and other historic locations in the city in addition to attending the conference.

The PAPERS Fall Workshop provides an opportunity for you to participate in an excellent series of educational workshops. In addition it gives you a chance to meet with your plan sponsor peers and with professionals who provide consulting, investment, actuarial and legal services to the pension community.

All PAPERS Participating Member pension systems receive one complimentary registration to both the Spring Forum and the Fall Workshop. To qualify you must submit a registration form so that we will be able to plan for the proper number of attendees. This year you can also earn credits toward your Certified Public Pension Trustee (CPPT) certificate at the Fall Workshop.

We have put together an agenda that addresses some of the basic skills trustees must master to fulfill their fiduciary duty to the members of their Plan. The success of the Fall Workshop and of PAPERS as an organization is dependent on your participation and support. I look forward to seeing you at the PAPERS Fall Workshop on September 19th and 20th in Philadelphia. You'll find the Workshop reservation form waiting for you to complete on Page 6.

*Jim Perry*

James A. Perry,
PAPERS Executive Director

## Check Out the PAPERS e-Library

From time to time PAPERS Associate & Affiliate (corporate) members provide research papers on timely topics related to public pension fund administration that are too long to be included in the PAPERS newsletter. We are pleased to share these important documents with our readers by posting them in the PAPERS e-library on our website. Access the library at: http://www.pa-pers.org/newweb/library.html.

Recently posted were there two articles submitted by NAREIT (National Association of Real Estate Investment Trusts):

- ***REITs & Private Equity Real Estate Funds***
- ***Weathering the Storm***

## Next PAPERS On-Line Event

Details are still being worked out but we are pleased to announce that the next PAPERS On-Line Event (sometimes called a "Webinar") will be held on Wednesday, September 12, 2012. This is a training opportunity for PAPERS members to hear and participate in a discussion of a pertinent topic. Credits for the PAPERS Certified Public Pension Trustee Certification program may be earned for participation in these on-line events.

Associate Member firm Chimicles & Tikellis LLP of Philadelphia will present: ***Pressure Points – Understanding Institutional Investors' Power to Effect Positive Change through Merger & Acquisition and Derivative Litigation.*** Details will be forthcoming; watch for an e-mail announcement soon.

## Special Thanks to our Sponsors

*(as of 7/22/2012)*

### Sponsor Exhibitors

- **Euclid Specialty Managers**
  2701 Prosperity Avenue, Suite 220
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  Newtown Square, PA 18940
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  3 Crescent Drive, Suite 400
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  Philadelphia, PA 19112

# Sponsorship Levels

**Sponsor Exhibitor..............................$3,000**

- 2 complimentary registrations
- Recognition in program
- Complimentary exhibit space

**Sponsor..........................................................$2,500**

- 2 complimentary registrations
- Recognition in program

**PAPERS' corporate sponsors provide financial support beyond regular conference registration fees and annual membership dues. Additional sponsorship opportunities for the 2012 PAPERS Fall Workshop are still available by contacting PAPERS Executive Director Jim Perry *(717-651-0792 or perryja1@comcast.net)* today for more details.**

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PAPERS Pennsylvania Association of Public Employee Retirement Systems

# 6th Annual Fall Workshop Agenda

***Wednesday, Sept. 19 – Thursday, Sept. 20, 2012***

Holiday Inn Historic District, Philadelphia, Pennsylvania

## Forging a Future from the Past

## Wednesday, September 19th

**9:00 AM – 5:00 PM** **Conference Registration/Exhibits..................Lobby area outside meeting rooms**

**10:00 AM – 11:30 AM** **PAPERS Board Meeting................................................................ Franklin Room**

**12:00 PM - 1:00 PM** **Opening Luncheon ........................................................................ Hancock Room**
Welcome from Jim Perry, *PAPERS Executive Director*

**All workshop sessions take place in the Franklin Room**

**1:00 PM - 1:45 PM** **Keynote Address..........................................................**(tentatively) William G. Clark
*Senior Vice President & Chief Investment Office*
*Federal Reserve System Office of Employee Benefits*

*Mr. Clark will discuss his role at the Federal Reserve System and share his thoughts on the state of the Economy.*

**1:45 PM - 2:30 PM** **Panel Discussion: *What is your Pension Plan Doing to Educate Trustees?***
Panelists ..............................Timothy Johnson, *Allegheny County Retirement System*
Jeff Clay, *Public School Employees' Retirement System*

*The panelists will discuss why education should be provided to trustees at local pension plans. They will outline what is being done at their plans and how those efforts are being received*.

**2:30 PM - 2:45 PM** **Beverage Break**

**2:45 PM - 3:30 PM** **Protecting yourself from Personal Liability as a Trustee**
Presenter ............................................. Daniel Aronowitz, *Euclid Specialty Managers*

*Dan will discuss things you need to be aware of when acting in a fiduciary capacity as a public pension trustee to minimize your personal liability exposure.*

**3:30 PM - 4:15 PM** **Risks and Rewards in U.S. High Yield Bonds**
Speaker from Penn Capital Management to be announced

**4:15 PM - 5:00 PM** **Investing the Commodities Super Cycle**
Presenter .................................................... Tim Rudderow, *Mt. Lucas Management*

*Mr. Rudderow will discuss commodities and how to invest in the "Commodity Super Cycle".*

**6:00 PM - 8:00 PM** **Reception and Museum Tour at the National Constitution Center**
***525 Arch Street, Independence Mall***
*Sponsored by Kessler Topaz Meltzer & Check*

## Thursday, September 20th

**7:15 AM – 12:00 PM** **Conference Registration/Exhibits.................Lobby area outside meeting rooms**

**7:15 AM - 8:00 AM** **Breakfast.......................................................................... Hancock Room**

**All workshop sessions take place in the Franklin Room**

**8:00 AM - 8:45 AM** **Asset Allocation & Rebalancing**
Moderator....................................................Michael Shone, *Pierce-Park Consulting*
Panelists: To be announced

*This panel will explore asset allocation and rebalancing techniques in light of the current market environment.*

**8:45 AM - 12:00 PM** **PAPERS Manager Challenge**
Moderator...................................Barry M. Gillman, *Brandes Institute Advisory Board*

*This simulation game was created by San Diego-based money manager Brandes Investment Partners LP, whose representatives talk to the teams as they assemble around laptops to compete with other trustees investing a hypothetical $10 million portfolio of assets over a 15-year time span.*

**12:00 pm - 1:30 pm** **Closing Luncheon.......................................................................... Hancock Room**

*As of 7/22/2012; Subject to change*

# Who Should Attend the PAPERS Fall Workshop

- **Pension Fund Staff and Board of Trustees**
- **Public Pension Investment Officers, Portfolio Managers**
- **Investment Consultants, Asset Managers, Banks, Other Pension Service Providers**

# Why You Should Attend the PAPERS Fall Workshop

- **Learn how other pension fund executives are strategizing for the coming year to deal with the current economic turmoil.**
- **Enjoy a highly interactive and educational program specifically tailored for institutional investors in Pennsylvania.**
- **Meet your peers, hear their firsthand experiences and share your ideas.**
- **Network with asset managers, service providers, consultants and asset managers.**
- **Take advantage of the panelists' presentations provided in the conference hand-out materials.**
- **Analyze various potential innovative investment opportunities available to pension funds.**
- **Earns credits for Continuing Professional Education credits and/or the Certified Public Pension Trustee (CPPT) program.**

# Registration for 6th Annual PAPERS Fall Workshop

**Sept. 19-20, 2012 at The Holiday Inn Historic District**
**400 Arch Street in downtown Philadelphia, PA**

## Conference Registration Deadline - September 1, 2012

**Each individual attending must submit a separate registration form. Please check appropriate category:**

- ❑ **Pension Plan Representatives** – Current (2012) PAPERS Participating Membership required
  - ○ First individual from pension plan – complimentary
  - ○ Each additional individual - $50
- ❑ **Service Provider Representatives** - *Firms providing investment management and legal services*
  Current (2012) PAPERS Associate Membership required
  - ○ Each individual from organization - $400
- ❑ **Service Provider Representatives** - *Firms providing consulting services, exclusive of investment/legal*
  Current (2012) PAPERS Affiliate Membership required
  - ○ Each individual from organization - $200
- ❑ **CorporateSponsors** - Current (2012) PAPERS Membership required + $2,500 sponsorship
  - ○ Two complimentary registrations

**Individual's name** ______________________________________________

**Preferred name for name tag** ______________________________________

**Representing (name of pension plan or company)** ___________________________

**Mailing address** ______________________________________________

**City, State, Zip** ______________________________________________

**Telephone number (______) _____-________ E-mail address** ___________________________

Please indicate all Fall Workshop events that you plan to attend. This information is needed so arrangements for adequate seating & meals can be made.

**Wednesday, Sept. 19, 2012**
- ❑ Afternoon sessions
- ❑ Cocktail reception @ Nat'l Constitution Center
  ____ *Indicate number of additional guests attending reception with you*

**Thursday, Sept. 20, 2012**
- ❑ Breakfast
- ❑ Morning sessions
- ❑ Lunch

___ **Check if interested in CPPT (Certified Public Pension Trustee) Program**

## Full payment of any fees due must be included with this registration.

**You may pay the registration fee either by check or electronically through PayPal.**

1. ***To pay by check.*** Please make check payable to: **PAPERS** and return with this application to: **PAPERS, P.O. Box 61543, Harrisburg, PA 17106-1543**
2. ***To use PayPal.*** Please access the PAPERS website (www.pa-pers.org) and click on "Fall Workshop". Select the appropriate type of registration from the drop down box and follow the directions to have PayPal transfer the applicable fees automatically from your bank account to PAPERS. In addition to PayPal payment, you must also submit this registration form. Your completed conference registration form may either be mailed to: ***PAPERS, PO Box 61543, Harrisburg, PA 17106-1543*** or scanned, saved and e-mailed to: ***douglas.b@verizon.net.***

**The PAPERS Fall Workshop group rate for overnight lodging of $139 double or king plus tax at The Holiday Inn is guaranteed only for reservations made on or before 8/17/2012. To make hotel reservations, call 1-267-765-3383 OR reserve on-line at:**

***http://www.holidayinn.com/hotels/us/en/reservation/roomrate?destination=400+Arch+St+Philadelphia+Pennsylvania+United+States&hotelCode=phlim&groupCode=PAP&execute=basic***

# Kessler Topaz Meltzer Check, LLP &

## the PA Association of Public Employee Retirement Systems

**cordially invite conference attendees and their families for a reception on Wednesday, September 19, 2012 (6-8 p.m.) at the National Constitution Center in Philadelphia, PA during the 6th annual PAPERS Fall Workshop.**


**The Constitution Center** is the only nonpartisan, nonprofit institution devoted to the Constitution, illuminating constitutional ideals and inspiring acts of citizenship. Our 2-hour reception will be in the Delegates' Restaurant located on the main floor of the Center with historic Independence Mall as the backdrop.

During the reception, feel free to visit "Headed to the White House" an exhibit that features the excitement and pageantry of America's presidential election process from the campaign trail to inauguration. With this interactive exhibit you can practice your public speaking, experience the role of a campaign manager, reporter or candidate and sit behind the desk in the exhibit's Oval Office as the new commander-in-chief.

*(more details on page 8)*

# Please join us for a reception hosted in a crown jewel of Philadelphia's Independence Mall.


**DATE:** **Wednesday, September 19, 2012**

**TIME:** **6 p.m. to 8 p.m.**

**LOCATION:** **National Constitution Center**
**Independence Mall**
**525 Arch Street**
**Philadelphia, PA 19106**
*(one block from the conference at The Holiday Inn)*

**RSVP:** **By September 1, 2012**
*Indicate acceptance on Fall Workshop registration*

**Why not make bring along the family and/or spend a few extra days in historic Philadelphia before or after the PAPERS Fall Workshop?** There are so many things to do and see with a great many within walking distance of the Workshop hotel location. Check out all that the "City of Brotherly Love" has to offer at: www.philadelphiausa.travel. Explore this website to find some great deals and discount coupons for various attractions. The Independence Visitors Center at 6th & Market Streets is a short easy walk from the hotel and features a free orientation movie, brochures, displays and much more about Philadelphia.

# 6th Annual PAPERS Fall Workshop

## *September 19-20, 2012*

**If you're interested in overnight lodging for the Fall Workshop**

## The Holiday Inn Historic District

*400 Arch Street, Philadelphia, PA*

Conference Rate: $139/double or king + tax

*Conference Rate Guaranteed only through August 17, 2012*

For Reservations:

**CALL** 1-267-765-3383 OR **RESERVE ON-LINE** at:

***http://www.holidayinn.com/hotels/us/en/reservation/roomrate?destination=400+Arch+St+Philadelphia+Pennsylvania+United+States&hotelCode=phlim&groupCode=PAP&execute=basic***

## Driving Directions to the Holiday Inn Historic District

**I-95 Traveling North from Philadelphia International Airport**

Follow I-95 North to Exit 22 (Exit is marked 676 West, Independence Hall and Callowhill Street). Follow the Callowhill Street Exit. Proceed two (2) lights to 4th Street and turn left. We are just past the third traffic light on the right hand side.

- **Shuttle Service from the Airport:** Lady Liberty can be picked up at the luggage claim area and then for return trip to the airport, the hotel bellmen can assist with arranging pick up times. The cost is $10 per person each way. Their phone number is 215-724-8888.
- **Public Transportation from the Airport:** SEPTA does have options available to get here. From the airport, they would take the R1 Airport Line from Terminal EF to Market East station. At Market East, they will transfer to the Market Frankford Blue Line East Bound. From this, they get off at 5th street and walk the two blocks to the hotel. The fare for this is $8.25.
- **Taxi Service from the Airport:** The flat taxi rate from the airport to the hotel is $28.50.

**Traveling from the New Jersey Turnpike**

Take Exit 4 off of the turnpike. Take Route 73 North to Route 38 West to Route 30 West. Once you are on Route 30 West, follow the signs to the Ben Franklin Bridge. When you are crossing the bridge, stay in your right hand lane. At the bottom of the bridge, take the first right hand turn. It is a very sharp turn, about 180 degrees. (You will end up being on a cobble stone road) Go to the stop sign at the bottom of the ramp and turn right. This street is 4th Street. Our driveway is just past the second light on the right hand side.

**Traveling from the Pennsylvania Turnpike**

Follow 76 East to Exit 38, which will be marked Central Philadelphia, 676 East. This exit is on the left-hand side. You are currently Vine Street Expressway. Follow this to 8th Street exit and turn right. The next light that your come to is Race Street. Turn left onto Race Street. Follow Race Street for four traffic lights and turn right onto 4th Street. We are just past the first traffic light, on the right hand side.

**Traveling from New York on I-95 South**

Exit off of I-95 South at Exit 22 the Route 76, Vine Street, Center City Exit. At the bottom of the ramp, stay to your left, this will take you onto 2nd Street. Take 2nd Street for two traffic lights and turn right. The street that you are turning onto is Arch Street. Take Arch Street for two, (2), blocks and turn left. The street that your turning onto 4th Street. We are the first driveway on your right hand side.

*At the PAPERS Fall Workshop*

# Brandes Institute Manager Challenge

Manager Challenge, a simulation game scheduled for the PAPERS Fall Workshop, will teach important lessons about selecting money managers and overseeing a portfolio.

Here's a scene from a recent conference of pension-fund trustees in New York City: With a deadline fast approaching, a roomful of participants are rechecking computer screens and flipping through pages of data to wrap up some key investment decisions.

- *Take more risk or less?*
- *Should they include newer "alternative" investments?*
- *Which portfolio managers should they select for each asset class?*

If the trustees do a terrible job, they've been warned, "there's a very real chance you'll lose your job." Fortunately, the trustees also know this: It's all a game.

The players were part of teams of about five people each are competing to make the best investment decisions and produce the best returns, on paper. The object is for these pension-fund trustees, many of whom have primary jobs that aren't in finance, to learn more about smart investing practices—and self-defeating behaviors—without costing anyone real cash.

The exercise highlights some of the same challenges and pitfalls facing individuals who spread their money among mutual funds.

## What is the Manager Challenge?

The Manager Challenge is a web-based, investment strategy simulation. It provides a competitive and fun environment in which participants can sharpen their skills in manager selection and monitoring—while learning valuable real world lessons.

## Why compete in the Manager Challenge?

In a business known for its competitive personalities, you can test your skills against your peers to see how you stack up. Invest a couple of hours of your time in the Manager Challenge, and you can gain experience over the Challenge's simulated 15-year time span.

## How does the Manager Challenge work?

Individuals or teams allocate assets among products offered by fictitious investment managers in an attempt to:

- Increase portfolio value
- Manage career risks
- Exceed liability and policy targets

The Manager Challenge has a 15-year timeframe, divided into five periods of three years. Each period brings new developments—performance fluctuations, product closures, personnel turnover among select managers, and mergers or acquisitions. Teams can fire existing managers, hire new ones and adjust asset allocations. The winning team achieves the highest portfolio value at the close of the final period, after adjusting for the value of career points retained.

The simulation was created by San Diego-based money manager Brandes Investment Partners LP, whose representatives talk to the teams as they assemble around laptops, ready to invest a hypothetical $10 million. The reps try to prepare the players, coaching them on what approaches the game will—and won't—reward.

Brandes offers this educational competition at various conferences and seminars for institutional investors and consultants who select investment managers.

## To read about coverage on the Manager Challenge that appeared in the Wall Street Journal:

http://online.wsj.com/article/SB10001424052702304203604577394431579048676.html

# Multi-Asset Class Portfolios: Keeping Things Flexible

Wai Lee, PhD, Neuberger Berman
Chief Investment Officer and
Director of Research – Quantitative
Investment Group

**After an extended period of market turbulence, macroeconomic dislocations and increased cross-asset class correlations, the investment community is increasingly looking past traditional "one-size-fits-all" asset allocation strategies to find solutions that may be effective in an increasingly variable environment. In our view, it makes sense to approach asset allocation flexibly, with the investor's choices depending on a variety of factors. Below, we provide a few ideas to consider as we move into 2012.**

## TURBULENT LANDSCAPE, NEW QUESTIONS

There is no doubt that the past few years have been challenging for investors. From increased market volatility to historical trend deviations to myriad macro-level events that have impacted market and asset price behavior in often extreme ways, investors have been left to question long-held assumptions underlying various asset allocation methodologies as well as their own approaches. The environment has shifted to one in which constructing multi-asset class portfolios that can deliver on investment objectives over a period of several years seems infinitely more complicated than just a few years ago. In fact, 2011 punctuated this perhaps most distinctly, as the third quarter of the year saw many markets post their worst quarter since early in the financial crisis, only to be followed by a month that was one of the best for certain equity markets since the 1970s.

How should investors handle these extremes and how can they effectively build portfolios to weather such storms and changing conditions? As investors have asked such questions, this has highlighted many of the assumptions that led them to more "traditional" asset allocation methodologies in the first place. For institutions, for example, typical plan restrictions might prohibit the use of leverage or shorting of securities—yet, at the same time, have a required return, which has led long-term allocations to relatively risky assets such as equities. Over time, the portfolio mix of 60% equities and 40% fixed income (or slight variations thereof) emerged as "typical" because it was thought to have a good chance of meeting the required return. This was despite the known concentration in equity risk resulting from the mismatch between equity and fixed income risks in such a portfolio. (Note that, in and of itself, equity can be interpreted as a leveraged investment, as the stock market includes companies that have issued debt as part of their financing.)

## FOCUS ON ALTERNATIVE APPROACHES

More recently, the investment community's focus has shifted to developing alternative approaches to asset allocation and multi-asset class portfolios. As part of this, assumptions relating to leverage and shorting are being reevaluated, questions are being posed regarding the meaning of "strategic" and "tactical" with respect to asset allocation, and the role of forecasting returns and assumptions about risk are all being reevaluated. Risk parity, for example, has moved into the spotlight. And while some of the buzz around this approach to asset allocation is likely just that, we do believe it serves an important role in certain portfolios. So, where will the dust settle in 2012 and how should investors think about asset allocation?

Although it is common to define asset allocation in strict terms of "strategic" and "tactical" (with time horizons such as three to five years for strategic, or significantly less than this for tactical), we believe this one-size-fits-all approach actually fits very few investors' objectives successfully. For instance, the process of rebalancing a portfolio periodically back to a strategic 60/40 mix may require trading more frequently than a three- to five-year investment horizon. How this process is designed and whether these trades should be considered tactical are up for debate. We think it is more useful for investors to consider the degree of uncertainty associated with their particular time horizons, and to adjust their investment approach and diversify accordingly.

To be sure, "diversification" is one of the most basic terms in investing, but its meaning and application are not always clear. Based on our extensive research, we believe that investors should diversify to the degree they are uncertain about something. In other words, if you had perfect forecasting ability, there would be no need to diversify at all—you could simply invest in the assets that would do well and avoid the others. On the other hand, where you do not have perfect forecasting ability or you have conditions—such as extended time horizons—that make you less certain about your expectations, then it makes sense to adopt an approach that does not rely so heavily on these forecasts as inputs.

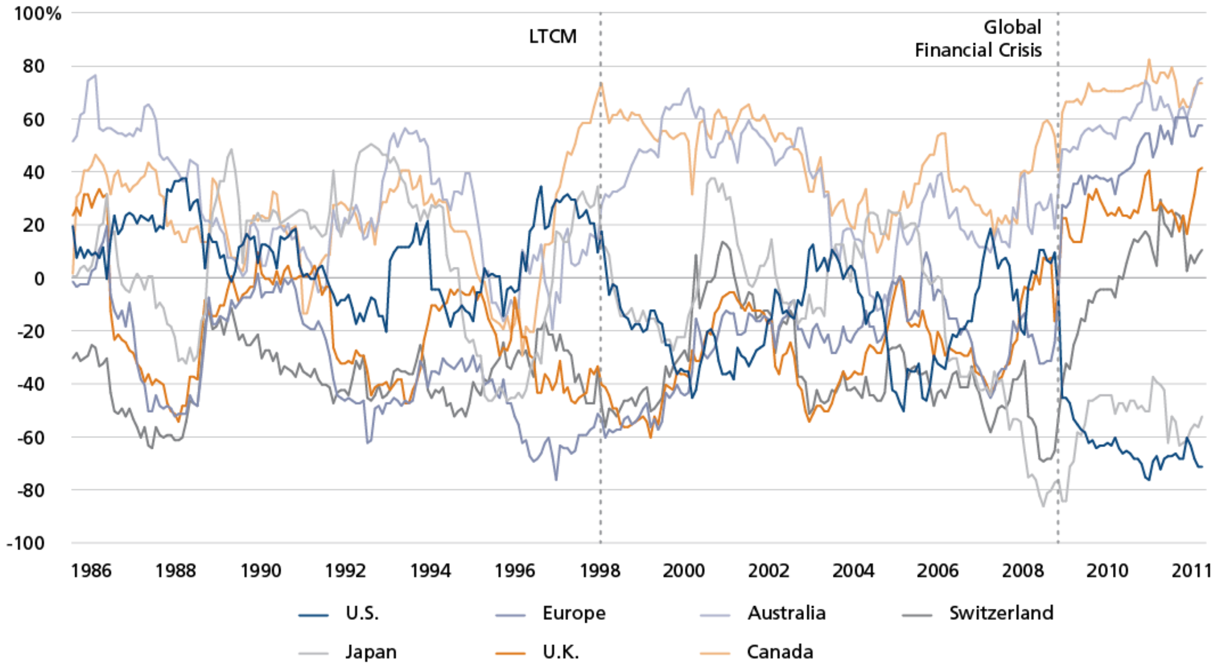
In the context of asset allocation, this is what we believe separates tactical from strategic asset allocation decisions and is a guide that we believe investors should consider utilizing more extensively. Although there is a high degree of uncertainty in forecasting far into the future, our research has shown that, over longer investment horizons, risk-adjusted rewards of risky assets are more comparable to than they are in the shorter term.

*(continued on page 12)*

# Multi-Asset Class Portfolios: Keeping Things Flexible *(continued from page 11)*

**FINANCIAL CRISIS SHOCKED CORRELATIONS**

**Rolling Two-Year Correlation of Stock Market and Currency Returns Within a Given Region**




Source: Bloomberg, Neuberger Berman Quantitative Investment Group.

Given that insight, we believe a portfolio constructed one another using a risk-balanced approach—or one that selects assets based on their expected contribution to the portfolio's risk, rather than one that is constructed based on return forecasts—may be more robust over time. Moreover, if investors are able to relax certain guidelines, such as those around the use of leverage, a leveraged risk parity portfolio with equal contributions to risk from all assets may be able to generate returns on par with traditional 60/40 type portfolios, but at a lower volatility and with less tail risk. With the compounding effect in the investor's favor, lower risk over time could mean higher returns. Given the uncertainties we face going into 2012, such an approach may make even more sense to consider.

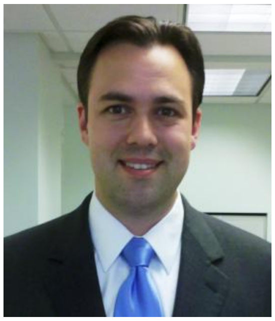
For similar reasons, we believe that shorter-term tactical asset allocation also remains essential to achieving investment success. Such an approach factors in shorter-term return forecasts, including analysis of market trends and interrelationships among asset prices. In the period since the financial crisis of the late 2000s, we have witnessed some of the most dramatic shifts in these relationships in over a decade. For example, both within and across asset categories including stocks, bonds and currencies, correlations are at historically extreme levels. Our research has shown that, increasingly, investor risk appetite—whether in a "risk on" or a "risk off" period—is driving these correlations. As such, we believe the success of a shorter-term asset allocation approach is determined in part by the ability to assess, and effectively manage, these interrelationships.

## LOOKING AHEAD

Putting it all together and looking ahead to 2012, we believe that investors will remain highly focused on asset allocation. Whether one believes that it accounts for a small or large part of long-term portfolio return, in our view asset allocation should not be dictated by passive, possibly antiquated, assumptions. Factors ranging from the time horizon, to both short-term and long-term asset price and market behavior, to, of course, the investor's own ability to assess and manage
all of these dynamics will be important considerations for multi-asset class allocation in 2012 and beyond.



**Wai Lee,** PhD, Managing Director, joined Neuberger Berman in 2004. Wai is the Chief Investment Officer and Director of Research for the Quantitative Investment group with overall responsibility for the quantitative investment function. He is a member of the firm's Investment Risk Committee and Asset Allocation Committee. Previously, he was the head of the Quantitative Engineering group at Credit Suisse Asset Management (CSAM), responsible for the application of quantitative research across various products and strategies. Wai holds a BS (with honors) in Mechanical Engineering from the University of Hong Kong and MBA and PhD degrees in Finance from Drexel University.



## The Risk of Inflation for Public Pension Plans

***Ryan Lennie, CFA****, is a Senior Consulting Analyst with Gallagher Fiduciary Advisors, LLC. He consults with a number of the firm's clients and is responsible for conducting investment manager research and implementing the firm's due diligence processes, focusing primarily on alternative investments.*

Investors have been acutely aware of the threat of inflation since the financial crisis, but that threat has not yet resulted in higher consumer prices. Recorded inflation has actually remained well below its long-term average since the crisis took hold in late 2008, averaging only 2.6% per year. Despite the benign recent history, a significant inflationary threat remains.

Historical periods of elevated inflation have typically followed policy errors by either national Government or by central bankers. The current economic climate is rife with the opportunities for flawed policies that could ultimately trigger a bout of unwanted inflation. Governments around the world have been accumulating substantial debt burdens in recent decades. The end result of that process is unfolding in southern Europe now, but the U.S. could face a similar future if it does not gain control over the Federal budget. The most common remedy for excessive sovereign debt has involved the offending country inflating their way out of the problem by printing more money. Among central bankers, the inflationary threat has typically increased after they take steps to inject more money into the economy. The common theme is simple: if the growth of money actively in use for a given economy outstrips the growth in goods and services, prices are likely to rise.

Public pension plans face a relatively unique inflationary risk. Unlike an endowment or foundation, which is concerned about maintaining purchasing power, a public pension plan faces the potential of benefit payments rising along with the overall cost of living. Plans that are currently struggling with their funded status cannot afford to see benefit payments rise in a significant way without a corresponding increase in assets. As a result, public plans should be considering how they can protect their assets from inflationary threats. Hedging strategies do not necessarily need to be implemented immediately, since current trends suggest the short-term inflationary risk remains limited, but prudent plan sponsors should be exploring the potential of different investment strategies before an inflationary crisis arises.

The simplest way to hedge inflationary risk is to buy U.S. Treasury Inflation-Protected Securities (TIPS) since the bond principal value is directly adjusted for changes in the Consumer Price Index (CPI). Unfortunately, TIPS are among the least attractive options in the current marketplace. TIPS with maturities of up to 15 years have negative real (inflation-adjusted) yields, which means the buyer is guaranteed to underperform inflation if the securities are held to maturity (TIPS returns, if held to maturity, are the real yield plus the change in the CPI). Public plans, therefore, should consider additional investment options. Real assets, including commodities and real estate, can provide indirect protection against inflation. Real assets should be particularly effective if inflation spikes unexpectedly. Equities can also provide long-term protection, but they can dramatically underperform over shorter periods. There is no perfect solution for all plans, but sponsors that recognize the looming threat will be better prepared to take action if it does materialize.

# Protect Your Investment:

## *How to Know if a Securities Settlement is in Your Fund's Best Interest*

**By: Scott M. Tucker, Esq. and
Tiffany J. Cramer, Esq.
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As trustees of a public pension fund, how can you ensure the terms of a potential securities settlement are in the fund's best interest? When the fund has a substantial stake as a shareholder in a company subject to a settlement, or has suffered substantial monetary damages from wrongdoing addressed by a settlement, the fund may have a monetary interest in having its securities counsel review the settlement terms, advise what the settlement means for the fund, and review its available options.

Evaluating the fairness of a settlement boils down to weighing the strengths of the claims asserted in the underlying action, the potential amount of damages, and the likelihood of recovery after trial versus the value of the consideration obtained by the settlement. Trustees should institute a process and have securities counsel available to evaluate a settlement. An effective process includes reviewing the public court filings in the underlying action, including the allegations in the complaint, any briefing and expert reports, news, public filings with the Securities and Exchange Commission, and filings in any actions brought by the Securities and Exchange Commission, Department of Justice or any other governmental agencies.

Likewise, as a fiduciary to a pension fund, it is important to know and consider whether a class action settlement includes an opt-out class versus a non-opt-out class. While a non-opt-out class causes a fund to be bound by the terms of any approved settlement, an opt-out class gives the fund the option to remove itself from the settlement and, if it chooses, proceed with litigation on its own behalf, or with other shareholders who opted-out, in an effort to obtain a better result for the fund. Opting-out from a settlement may also be necessary to preserve a fund's rights and claims in a separate but related litigation. The factors that determine whether the fund should opt-out of a settlement should be discussed with the fund's securities counsel and may include the size of the fund's loss, the merits of the case, the stage of the case when it settled or the percentage of the fund's damages recovered by the settlement.

Once the benefits of a settlement have been weighed against the claims and damages asserted in the litigation, the fund must determine whether to participate in, opt-out if permitted, or object to the settlement. When the benefits of a settlement appear insufficient to release the claims, objecting can encourage the parties in the underlying action to amend the terms of the settlement or persuade the Court to reject the settlement and allow the case to proceed to trial. In aid of any objection, trustees should consider requesting discovery materials produced in the action, which would provide the information available to the counsel which settled the underlying action.

Protecting a public pension fund's investments requires a trustee to confirm a settlement is in the fund's best interest before accepting its terms. The considerations and discussions mentioned above can guide a trustee in evaluating the merits of a proposed settlement.

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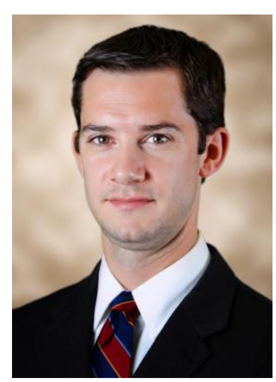

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# The Benefits of Avoiding High Volatility Small Cap Stocks

By: Stephen Rich and Joseph Gaffoglio, Mutual of America Capital Management Corporation

**For this article, we define volatility as the standard deviation of historical returns.*

*<u>Note on Small Cap Risk</u>: Stocks of small capitalization companies have less liquidity than those of larger, established companies and are generally subject to greater price volatility and risk than the overall stock market. Investments in small capitalization stocks may not be appropriate or suitable for all investors.*

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Public pension plans throughout the U.S. face an unprecedented environment where budget deficits and increased market volatility has raised a series of policy challenges for many investment committees. Additionally, correlations across asset classes have increased, making it more difficult for investors to gain diversification benefits within their portfolio. These events have had a material impact on investment policy and performance. In response, many plan sponsors are seeking ways that investment strategies can mitigate the potential adverse consequences of these uncertain times. The goal is to generate consistent investment performance that can help meet future pension obligations.

Consider this: if a portfolio experiences a negative (10%) annual return, a return of slightly more than 11% would be needed the following year just to get the plan's asset level back to its original base. Having recently experienced volatility like this, plan fiduciaries may want to think about the implementation of a low volatility* investment strategy. Here, the investment committee makes subtle changes to the Plan's investment strategy to help improve risk-adjusted performance. This approach would attempt to limit downside performance, preserving precious capital, while contributing to lower overall risk at the plan level. The compounding effect can, in turn, moderate the need for higher future returns. By limiting the potential for severe drawdowns, a higher asset base can be maintained to help the plan recover from periodic losses in less time.

Lowering volatility is not a new investment concept. In virtually all cases, these types of strategies seek to benefit from by utilizing methodologies that systematically minimize standard deviation or beta. Interestingly, evidence reveals that the benefits sought by volatility constrained portfolios differ greatly by asset class. One of the most promising asset classes for that may generate the benefits sought by lowering volatility may be U.S. small capitalization equities. In the table below, we compare the five-year rolling annualized standard deviation for three major asset classes: Fixed Income, as measured by the Barclays Capital U.S. Aggregate Bond Index; U.S. Large Cap Stocks, as measured by the S&P 500® Index; and U.S. Small Cap stocks, as measured by the Russell 2000® Index. As you can see, volatility is higher in every time period for small cap equities than the volatility of large cap equities or fixed income. With this in mind, the challenge is for plan sponsors to select small cap managers who can operate with lower levels of volatility without sacrificing the attractive return potential that U.S. small cap equities provide.

| ROLLING 5-YEAR ANNUALIZED STANDARD DEVIATION | | | |
|---|---|---|---|
| For the Period Ending: | Barclays Capital Aggregate Bond Index | S&P 500® Index | Russell 2000® Index |
| Dec-11 | 3.57 | 18.73 | 24.27 |
| Dec-10 | 3.62 | 17.67 | 22.92 |
| Dec-09 | 3.67 | 15.91 | 21.17 |
| Dec-08 | 3.79 | 12.75 | 17.95 |
| Dec-07 | 3.56 | 8.54 | 14.32 |
| Dec-06 | 3.78 | 12.30 | 17.02 |
| Dec-05 | 3.97 | 14.82 | 18.98 |
| Dec-04 | 3.93 | 16.21 | 21.70 |

*(continued on page 16)*

## The Benefits of Avoiding High Volatility Small Cap Stocks *(continued from page 15)*

In creating a low volatility portfolio in the small cap universe, understanding the volatility of individual stocks is a critical ingredient since volatility not only indicates risk potential but also seems to be a good indicator of potential performance. Indeed, when dissecting the Russell 2000® Index constituent stocks by volatility, the most volatile cohort exhibits persistent below benchmark performance. Interestingly, when a similar analysis is applied to the S&P 500® Index constituents, there is much less dispersion of returns among different volatility cohorts. An approach that combines a well diversified small cap portfolio with the avoidance of the most volatile cohort of small cap securities provides the benefits of lower risk and enhanced potential return. Moreover, lowering volatility in your small cap allocation can have the added benefit of reducing overall portfolio risk and possibly enhancing investment returns.

For many plan sponsors the concept of a low volatility investment strategy is counterintuitive to traditional modern portfolio theory (MPT), which emphasizes that investment risk is linearly correlated with investment return. However, 40 years of historical research reveals that MPT does not hold at the small capitalization security level, and investors are not compensated for exposure to the most volatile stocks. This phenomenon may be explained by either: 1) behavioral finance, where representativeness bias and investor overconfidence can impact this investment anomaly; and 2) that the use of a fixed benchmark mandate discourages investing in lower-risk stocks, which in turn would cause an inefficiency in the market.

Going forward, investor actions cannot be predicted. However, we believe that by following a sensible investment process, a low volatility small cap investment strategy can be implemented that is capable of generating much lower risk while enhancing small cap returns over time.


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**About Mutual of America Capital Management Corporation**

Mutual of America Capital Management Corporation (“Capital Management”), established in 1993, is a registered investment adviser under the Investment Advisers Act of 1940. Capital Management is an indirect subsidiary of Mutual of America Life Insurance Company. Capital Management manages a variety of investment strategies, including small cap strategies, for institutional clients.