PO Box 7864
Madison WI 53707-7864

Wisconsin College Savings
Program Board

T 608-264-7899
F 608-266-7645
edvest@ost.state.wi.us

College Savings Program Board
Investment Advisory Committee Meeting

State of Wisconsin Department of Administration Building
101 E Wilson Street; Madison, Wisconsin

December 2, 2013 -- 10:00 a.m.

Minutes

I. **Call to Order and Roll Call** at 10:00 a.m. (Ken Johnson, Chair)
Present: Ken Johnson (phone), Bill Oemichen, Rob Kieckhefer, Michael Wolff, Annoesjka West, Paula Smith, Paul Zemsky (phone), Halvard Kvalle (phone), Brian Griggs (phone), Kerry Alexander, Ed Mihallo (phone), and Jim DiUlio

II. **Agenda Approval and Public Posting Report** (Chair, staff) Meeting has been posted properly. <u>Motion by *Oemichen*, second by *Wolff* to approve agenda. Agenda approved by voice vote.</u>

III. **Approval of Committee Meeting Minutes for August 19, 2013** <u>*Motion by Wolff, second by Oemichen to approve the minutes. Carried.*</u>

IV. **Public Presentations** There were none requested. However a letter from a private citizen arrived this morning, addressed to “Dear Meeting Hosts” through the Edvest email box, in response to the public posting of today’s meetings. The writer was commenting on issues that are unrelated to college savings. It was decided to address the message at the meeting of the full Board, and if present allow the person to make a short presentation at the meeting.

V. **Old Business**

A. **Third Quarter 2013 Investment [**Callan Associates] *Annoesjka West* reported that U.S. equities were strong in the third quarter, in spite of government shutdown and debt ceiling impasses. European GDP showed positive numbers for the first time in 18 months, and strengthening currencies and other economic data pushed the developed foreign equities up as well. Domestic bonds were mixed due to taper concerns, but foreign bonds generally outperformed U.S. bonds as interest rates were more stable overseas. The portfolios in the Tomorrow’s Scholar and Edvest plans lagged the benchmarks a bit for the quarter, but absolute returns were very good. The WFA Small Cap Value fund bounced back but is still down for longer periods. With only three full quarters of operation, it is hard to draw conclusions from these results, but no watch list recommendations are warranted at this time. The committee discussed the benchmarks, specifically why passive funds lagged their benchmarks. *West* responded that the difference is the program and/or state fees attached to the portfolio. *Ed Mihallo* explained how a portfolio’s benchmark reflects the blend of the constituent funds, but the benchmarks do not include the effect of fees. Tracking error can influence the relationships sometimes, he added.

B. **Watch List, Recommendations** None at this time.

VI. New Business

A. **Proposed adjustments to asset allocations and underlying funds --** *Johnson* reviewed the process of annual reviews by the committee and approval by the Board. In addition, the discussion at next year's review should also include identifying portfolios with low participation with an eye toward simplifying the selection process.

The ING team for Tomorrow's Scholar was introduced by *Paula Smith*. On the phone is *Paul Zemsky*, CIO of ING US Investment Management's Multi-Asset Strategies team (who presented here last quarter), *Halvard Kvalle* who directs the manager selection team, and *Brian Griggs*, with the portfolio specialist team.

Zemsky then reviewed ING's annual process for the multifund portfolios, keeping the structure consistent, but touching up allocations or managers. For example, their recommendation for the coming year keeps the fixed allocation percentages but internally makes changes to shorten durations. On the bond side, they want to shorten duration without giving up a lot of yield, while with equities the emerging markets can be brought down a bit. Senior bank loans are a new category, with periodic adjustments and currently yielding over 3%. He then went through the grid with changes to the portfolios. Question from *Kieckhefer*, 'are we changing enough?' 'Yes,' *Zemsky* replied, since we are early in the cycle. It's a fair question, and we may do some more next year, while balancing the risk and reward calculation. *West* asked why the 13-14 allocations seem different than the 17 and 18. *Zemsky* said that as we are getting more defensive, some of the portfolios that didn't have short term are getting more. For example, a half-percent defensive position in a young portfolio doesn't have much effect. Based on a number of other researchers, including the Fed, he thinks we are in good shape. *Kvalle* went through the subadvisor changes as well as commenting on current managers. The separate charts and tables show the adjustments. The model ING is using for college cost assumptions is the same simulation that is used in the TIAA-CREF models.

Target date for ING's adjustments will be in January, following notice in the December statements. The proposed Edvest changes are likely to take place in about 90 days, due to other considerations at TIAA-CREF

Discussion then moved to *West's* assessment of the proposal. She said that other state 529 clients are considering or have made these changes with floating rate securities, global allocation, and shorter durations, particularly with active management. She added that while there are differences of opinion on when interest rates will rise, it may be wise to not get too far ahead and overreact. *Mihallo* said that Tomorrow's Scholar comes with an advisor for the client, when needed, adding that the Edvest proposal takes a more aggressive approach because it doesn't have that resource.

In response to *Johnson's* question, *West* said she is comfortable with this proposal. *DiUlio* agreed, mentioning that advisors are a key part of the product and 529 provides tools to compensate, such as changing how new dollars are invested. The chance that Congress will allow multiple direction changes could happen again, as it did before during financial stress. *Johnson* added that during the course of the year, we should be measuring our decisions, for guidance next time.

<u>Motion by *Wolff*, second by *Oemichen* to recommend ING's proposed portfolio adjustment for Tomorrow's Scholar. Carried, all ayes.</u>

Ed Mihallo then presented the TIAA-CREF Edvest proposal. He said it should come as no surprise that their proposal looks very much like ING's since they both have come to the same conclusions. New to the Edvest plan will be funds from Templeton and T Rowe Price to fill distinct niches, in keeping with the open architecture format, and added to the older age portfolios. Since these are active funds being added to passive portfolios, there is a trade-off, adding about 1.5 bps to weighted expenses but with the benefit of the added classes. In response to a question from *Johnson*, he said on a risk-adjusted basis the portfolios should do better, even with less indexing.

West then provided analysis of anticipated changes to the Edvest plan, prepared a few weeks ago and coming to the similar results. She discussed the characteristics of the added investment classes. As with the earlier presentation, she said she is comfortable with the proposal, and likes the added funds.

Johnson asked how the trade-offs we discussed will be communicated to the participants. Something to the effect that we are responding to interest rates. *DiUlio* responded that it would be nice to include a letter to accompany the disclosure and that he will work with both teams to include it with the official communications.

Kieckhefer asked *West* if there were any bottlenecks on the horizon with a rapid change in interest rates, stable value for example. She responded that perhaps high yield and bank loan markets have limited capacity.

<u>Motion by *Oemichen*, second by *Kieckhefer* to recommend TIAA-CREF's proposed adjustment for Edvest. Carried, all ayes.</u>

B. **Due diligence meetings with TIAA-CREF portfolio managers –** *DiUlio* reported that he met with many of T-C's managers at their New York offices on October 16-17, along with state of Oregon, doing round robin meeting. Annoesjka West joined us along with Ed Mihallo. Three things stood out: the depth of their high yield bond team—they are in an advantageous position with research resources. Also the social responsibility team is very diligent with their benchmarking and activism. We do not have many assets in that portfolio yet, but the performance will attract interest. The third thing that was impressive was the overnight process that captures thousands of bits of information with their investments and condenses it to a three-page flash report. We will do it again, and would recommend the experience for Board members. *West* added that the process is a good practice for any state or plan.

C. **2013 Morningstar ratings, other evaluators –** We were ranked neutral for both plans, *DiUlio* said, and it's a bit frustrating considering all the work with the upgrades. A team will be meeting in the coming months to better prepare to tell our story to Morningstar. Other state administrators have shared the same concerns. Our plans will be eligible for Saving for College tracking in January, with a year's performance experience.

D. **Update on Edvest Bank CD portfolio** Currently we have $7.5 of the 26 million in the portfolio placed in certificates. The total number has stayed constant since the October 2012 conversion. However, the Principal Plus option has grown from $43 million to $66 million during that same period—where else are you going to get 1.25 yield? added Mihallo. The placement level will be watched.

VII. Discussion Items for Future Committee Meetings –

Johnson suggested some focus on interest rate environment, perhaps during midyear. *Kieckhefer* said more information on that subject the better. *DiUlio* added that the high yield team at TIAA-CREF could also be interesting.

VIII. Announcements The next meeting will be February 17.

IX. Adjournment

Motion by *Wolff* second by *Oemichen* to adjourn. Carried. The meeting was adjourned at 12:05 p.m.