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Wisconsin College Savings Program Board

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College Savings Program Board Investment Advisory Committee Meeting

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

May 19, 2014 -- 10:00 a.m.

Minutes

- I. Call to Order and Roll Call** at 10:00 a.m. (Ken Johnson, Chair)
Present: Ken Johnson, Rob Kieckhefer, Michael Wolff, Annoesjka West, Dan Morris, Kerry Alexander, Catherine Burdick, Paula Smith, Jim DiUlio, guest Alex Tesensky, and on the phone Pamela Pan, Jimmy Veneruso, Lori Schausten.
- II. Agenda Approval and Public Posting Report** (Chair, staff) Meeting has been posted properly. Motion by Wolff, second by Kieckhefer to approve agenda. Approved by voice vote.
- III. Approval of Committee Meeting Minutes for February 24, 2014** Production problems have caused a delay; all outstanding minutes will be ready for the next meeting.
- IV. Public Presentations:** Dan Morris, TIAA-CREF Global Investment Strategist

Morris opened his remarks on the macro outlook by saying federal tapering/QE should not be a great worry as some have said; things should work out. Most of the GDP underperformance is a result of cutbacks in government spending and weak consumer spending, likely to slowly come back. He's forecasting 2.2% GDP for the rest of the year. Housing starts are improving, but still 40% below the 2000 level. U.S. inflation has been generally flat over the past ten years. In retrospect, easy credit caused a bubble in Europe and will limit recovery. Japan, he said, was one of the few developed economies that is relatively cheap now. Growth forecasts have fallen in emerging markets, and they are not immune to the larger forces of globalization as in the developed countries. Shadow banking in China is hard to follow, but he thinks it is not more than 10 percent of the total credit in the economy.

While equities are currently at fair value, valuation does not indicate direction. He thinks that earnings growth will be in the high single digits in the U.S., and also good in Europe. Emerging markets will underperform U.S. equities as the dollar strengthens. The real yields on fixed income are below averages, but higher coupons could offer protection as interest rates rise, he said. In summary, he feels the U.S. economic outlook is reasonably good, in comparison to other parts of the world, maybe to 3% by year-end. Equities will be flat through tapering, with some acceleration later in the year—with some market uncertainty. And interest rates will eventually return to a more normal mode.

V. Old Business

- A. **First Quarter 2014 Investment Review** [Callan Associates] *Annoesjka West* agreed with Morris' economic report, adding that consumer spending was affected by the harsh winter weather. Discretionary spending was the worst performing sector in the first quarter, while utilities did the best. It is reflected in some the managers who were overweight in discretionary. She then reviewed the quarter's performance for each of the broad equity and fixed classes.

Moving onto the plans, Tomorrow's Scholar is now a solid \$1.5 billion, up about \$20 million from the previous quarter. About 85% of the plan's money is going into the asset allocation options. Looking at the age-based portfolios, all slightly lagged behind their benchmark for the quarter; the conservative options did better. Over the five quarters since transition, most portfolios were behind their benchmark but it is also too short a time to judge active management. She then reviewed the underlying funds.

Discussion regarding the active equity managers was followed with a suggestion from *Johnson* to invite a Voya equity strategist to a future meeting. *Paula Smith* offered to make arrangements.

The Edvest plan only has about 62% in asset allocation options, while the balanced portfolio is the largest of the individual options. Total assets now are just over \$2 billion. The active static-based portfolios have only attracted about 2.5% of the total so far, but were new with the 2012 transition. Overall, the age-based allocations have lagged the respective Callan 529 peer groups. When asked why, *West* said it was partially due to construction of the glidepaths. At a future meeting she plans to report on how the Wisconsin glidepaths compare with other 529s. *Kerry Alexander* commented on the nine steps in the path now used by TIAA-CREF.

Due to the time remaining, the Committee jumped ahead to the Fee Analysis report.

VI. New Business

- A. **Wisconsin 529 Fee Analysis** Callan's *Jimmy Veneruso* presented their group's analysis of Wisconsin's program fees. The peer group includes 88 plans, the entire universe of participant and advisor directed plans. Benchmarks were matched to fees for: account origination, account maintenance, program management, the state, and investment management. Some discussion took place regarding investment management fees vs. the peer group medians. Some Wisconsin plan portfolios were higher than median, however when the low management fees were added, they come in lower than median overall. *Veneruso* mentioned that scale has correlation with fees and outside ratings; for example, Morningstar's Gold-rated plans have larger AUM than Silver, then Bronze. He concluded that as plans grow, fee reductions should be part of the conversations. *Johnson* asked the plan managers for a formal comment to Callan's fee study for the Committee's next meeting.

Back to Old Business:

- B. **Watch List, Recommendations** At the last meeting, there were some questions of the then recent management changes at the top level of PIMCO Funds. News since then has been mixed. *West* said that *Callan* met with their management in March for an update. While the company has a history of greater macroeconomic bets than others, their recent investment choices may turn out well.

She reported that their retail mutual fund outflows were far larger than institutional money. For example, the retail Total Return fund now holds \$232 billion; outflows in 2013 were \$42B and \$7.6B in 1Q2014. But compared to the separate accounts (mostly institutional) now holding \$425B, only \$1.7B flowed out in 2013 and \$3B in 1Q2014. All large asset bond funds experienced similar outflows in 2013. Joining PIMCO in the 18-21% range were American Funds, JP Morgan, DoubleLine, and Loomis, while Fidelity and Vanguard were at 13%. A concern would be if *Bill Gross* leaves through retirement, but the company has a deep bench.

Kieckhefer asked how long it would take to move participants away from PIMCO if needed. *Alexander* and *Smith* said that with required disclosure it would take a few months. *Smith* said *Voya* will be talking with PIMCO again next week, and there is a wide stable of investment managers that are available.

Johnson said that the financial press has speculated on events, especially watching to see if other staff leaves. *Lori Shausten* reported that some of TIAA-CREF's retirement plan clients holding PIMCO have also expressed concerns, and have placed them on watch status. She added that all the PIMCO co-CIOs also manage money, so there is confidence that a number of them could step up in the event *Gross* leaves.

Wolff asked about the timing of a *Gross* departure. *West* thought that is would likely be announced a year in advance.

Motion by *Kieckhefer*, second by *Wolff* to recommend to the Board that PIMCO funds in both plans be placed on the Watch List for circumstance related to management, and that alternatives be ready if needed. Motion carried.

Johnson thanked those present and on the phone for their research and comments.

Due to the hour, the remaining agenda items will be taken up at a later date.

VII. Discussion Items for Future Committee Meetings

VIII. Announcements The next meeting will be August 18.

IX. Adjournment Motion by *Wolff*, second by *Johnson* to adjourn at 11:52 a.m. Carried.