APRIL 24, 2024

AGENDA ITEM 8
INFORMATION ITEM

CALIFORNIA ABLE ACT BOARD

Review of Board Investment Training - Meketa Consulting

Background

The California ABLE Act Board will review and discuss the importance of having an annual investment training provided by Meketa Investment Group, Inc (Meketa). This training and Meketa's regular updates provide protection for Board members by establishing sound and consistent procedures that govern their decision-making. The session planned is intended to:

- Review Key Terms
- Review Policy Statements
    - Investment Policy
    - Monitoring Procedures
- Review Investment Portfolios
    - Assets Allocation and Diversification
    - Building Portfolios

Presenter

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Aysun Kilic, FCA, Consultant/Portfolio Strategist, Meketa Investment Group, Inc.

Attachments

- Attachment #1 – Board Investment Training

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MEKETA

CalABLE Board Investment Training

April 24, 2024

Meketa Investment Group

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A Few Key Terms

What is a Benchmark?

→A benchmark is a standard measure that can be used to analyze the allocation, risk and return of a portfolio or mutual fund.

→In investing, benchmarks typically come in two flavors:

Index	Peer Universe
• Indexes include multiple securities, assets, or other instruments which represent the investable universe for a specific style of investing.	• Provides a fund's comparative standings (or rank) within an appropriate peer group of fund with similar mandates and objectives.
• Provides context in understanding a portfolio's absolute performance.	• Helps gauge the effectiveness of a fund's management team versus similar funds especially in periods when absolute results are outside of historical norms.
• Indexes represent a portfolio of unmanaged securities that represent a designated market segment. – Index providers create and calculate market indices and then license their products. – Each follow their own standardized methodology.	• Peer groups can be broad in nature as well as broken down into segments based on portfolio characteristics. • There are a variety of databases for the institutional and the mutual fund market. – Morningstar and Lipper are top providers for mutual fund peer universes.

→There are benchmarks for every type of investment and strategy.

Active versus Passive Investing

Active Management

→Active management refers to a portfolio management strategy where the manager makes specific investments with the goal of outperforming a benchmark index.

- If Manager A returns 10% and the S&P 500 Index returns 8%, Manager A has outperformed the benchmark index by 2%.

→An active management strategy involves making calculated decisions regarding stocks, sectors, countries, etc.

Passive Management

→Passive management refers to a portfolio management strategy where the manager makes specific investments with the goal of mimicking the structure and performance of a benchmark index.

→Investors may choose passive management because it provides broad market exposure, with minimal operating costs and fees.

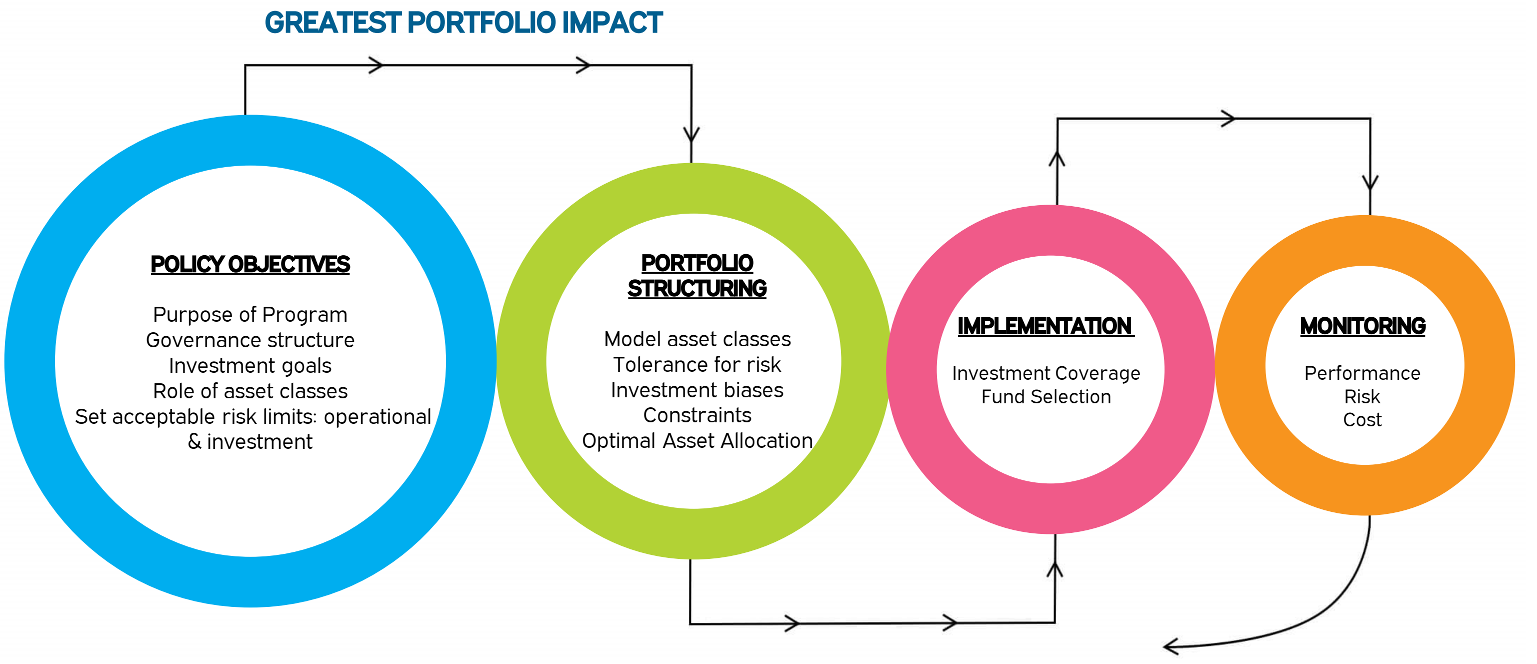
The Framework:

Policy Statements

Program Structure Goals

1. Offer a range of options across the risk spectrum – utilizing high quality funds
2. Diversified options should provide broad based capital market exposure
3. Efficient from a risk-return perspective; meet or exceed the rate of college tuition inflation
4. Identify/remove unintended biases
5. Cost conscious

The Framework



Elements of an Investment Policy Statement

Specifies Program's Guiding Principals

- Defines purpose of the Plan
- Outlines expectations and responsibilities
- Defines decision making processes; guidelines and general instructions for investment management decisions
- Defines the investor
- Blueprint to govern plans objectives and tolerance for risk
- Outlines eligible asset classes and their permissible uses
- Provides a mechanism for evaluation

Evaluating the Program

Approach and Understanding of Investment Design

- → Overall appropriateness of investment options – rational capital markets exposure
- → Review portfolio's effectiveness at generating returns relative to the risks incurred

Due Diligence and Risk Management

- → Overall risk oversight
- → Underlying fund evaluation
- → Asset allocation / risk analysis

Appropriateness of 529 Investment Menu

- → The number and quality of the investment options
- → Broad based capital market exposure
- → Investment biases
- → Reasonableness of cost relative to investment structure

Monitoring Procedures

→The Monitoring Procedures are designed to aid in making the best decisions on behalf of participants.

→Since Programs are mostly comprised of retail mutual funds or exchange traded funds as the underlying components, performance data is easily accessible.

→The key element to developing the Monitoring Procedures is to pre-determine a level of underperformance that is unacceptable.

- To accept actively managed funds is to accept periods of relative underperformance (beyond portfolio management fees).
- It is important to establish a level of underperformance where the fund no longer meets expectations.

→The Monitoring Procedures then provide for predetermined steps to address funds that do not exhibit material improvement.

Manager/Fund Monitoring

The evaluation process should exhibit several key features

→ Objectivity

→ Balance between short-term issues and long-term objectives

→ Biases of client

While the process might be fluid, a systematic documented approach is essential

→ Incorporate quantitative and qualitative aspects of managers/funds' practices

→ Understanding the role of the manager/fund in the Program

→ Clear time period of review

Manager/Fund Monitoring

Quantitative Review

Formulaic criteria focused on

- → Relative performance versus a benchmark/peer group over various time periods

Understand underperformance

- → Is investment style out of favor?
- → What are the biases of the investment strategy?
- → Do the portfolio characteristics reflect its stated investment style?
- → Is the benchmark/peer group an accurate representation of the fund's opportunity set?
- → Is the underperformance consistent with expectations?

Qualitative Review

Non-performance issues

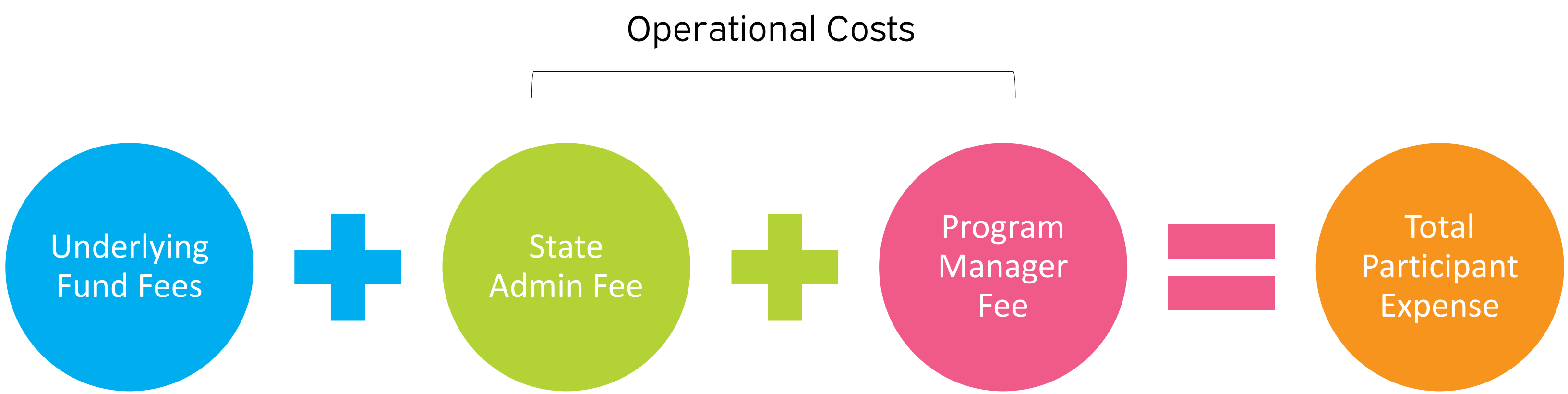
- → Has there been a change in …
  - ☑ People – PM/Analysts
  - ☑ Process
  - ☑ Philosophy
  - ☑ Organizational Structure

Implications of change/event

- → Is the change a positive or negative?
- → How will it impact the management of the fund?
- → How will it impact the firm/team culture?
- → Will it be a distraction to the investment process?

Portfolio Fee Components

→ Portfolios are evaluated based on the Total Participant Expense



The Line-up:

Investment Portfolios

The Line-up

Investment Menu (Somewhat Similar to 401k Plans)

→ **Static Options (Risk-based)**
- Asset allocation remains the same over time

→ **Stand Alone (Individual) Options**
- Invests in a single fund

→ **FDIC Option**
- Savings account

→ **Stable Value Option**
- Protects against decline in yield and loss of capital

Conservative Options

Asset Allocation and Diversification

What's the difference?

Asset Allocation	Diversification
The portion, or percentage, of each asset class that an investor has in their portfolio. For example, 60% stocks and 40% bonds.	A risk management practice to reduce the impact of any one investment, by investing in a mix of assets that move up and down under different market conditions.

Different, but related.

Asset Allocation and Diversification

What is risk? … the possibility that a negative outcome may occur.

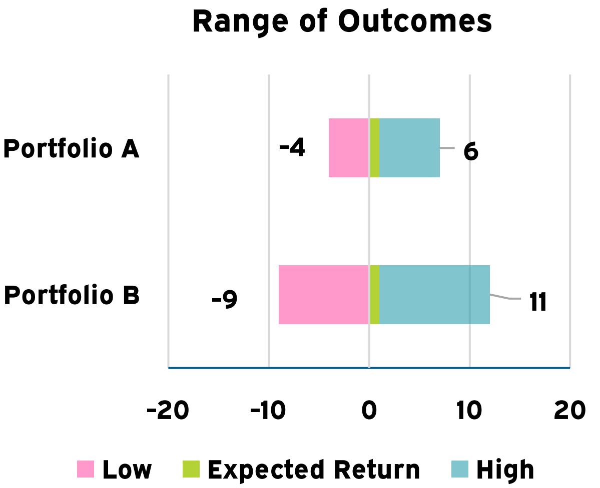
→ Standard deviation, is one of the most common measures of risk in investments

→ It measures the variability (or volatility) of a dataset

- Low standard deviation = low volatility
- High standard deviation = high volatility

For example, if we look at two portfolios:

Portfolio A	Portfolio B
Expected Return = 1% Standard Deviation = 5% Range of Outcomes ± 5%A	Expected Return = 1% Standard Deviation = 10% Range of Outcomes ± 10%



Asset Allocation and Diversification

Asset allocation is one of the most important decision an investor makes

→ Asset allocation decisions dominate the risk and return in investment results

→ Impact of other decisions like manager selection is minimal

→ Awareness of risk embedded in an asset allocation is critical

A properly developed (diversified) asset allocation …

→ Combines risky assets (stocks) with less risky assets (bonds & cash)

→ To meet a return target while minimizing their risk (volatility)

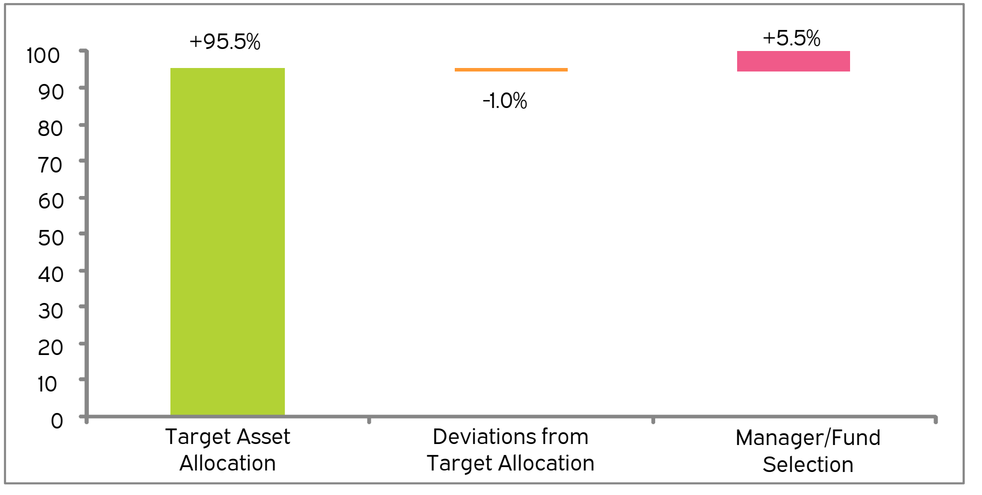
Volatility

How much a portfolio's overall value fluctuates up and down.

Impact of Asset Allocation and Diversification

The **Plan** determines the asset allocation for participants in age-based and static 529 Portfolios.

Investment Portfolio Risk Contribution Example



Asset Allocation and Diversification

Overview of Asset Classes

→ The investable universe is largely composed of just two broad asset classes.

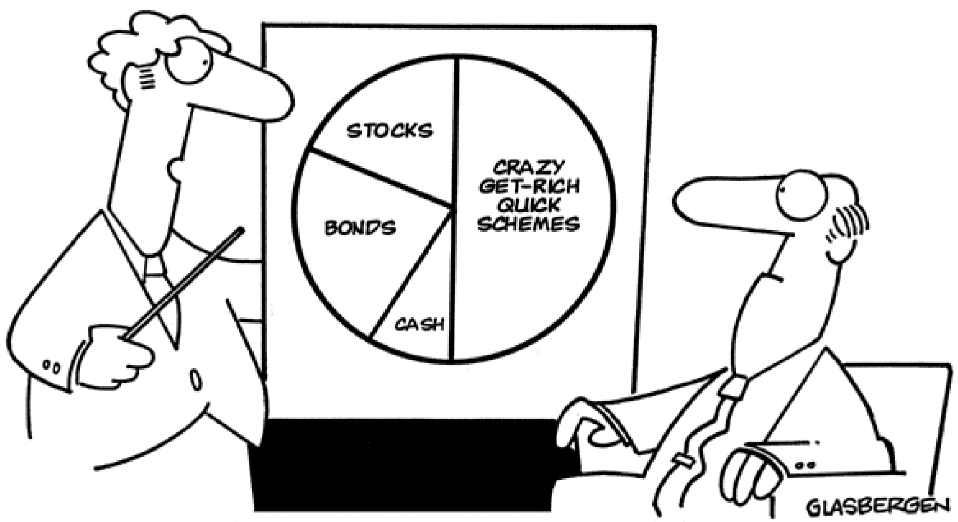
→ Historically, these major asset classes have not moved up and down at the same time.

Equity	Fixed Income	
Stocks	**Bonds**	**Cash Equivalents**
→Ownership in publicly traded companies →Categorized by style, market capitalization, and geography →Role: Growth	→Essentially loans that the investor (lender) makes to an entity (borrowers) →Role: Protection and income generation	→Short term, highly liquid, low risk debt instruments →Role: Capital Preservation

Infrastructure	0.5	0.3
Natural Resources, Energy, Timberland and Agriculture	0.2	0.1
Private Real Estate	10.2	5.4

Asset Allocation and Diversification

→ Why not just invest in the asset classes which have the highest expected long-term returns?



"I'd like you to consider a bold new strategy..."

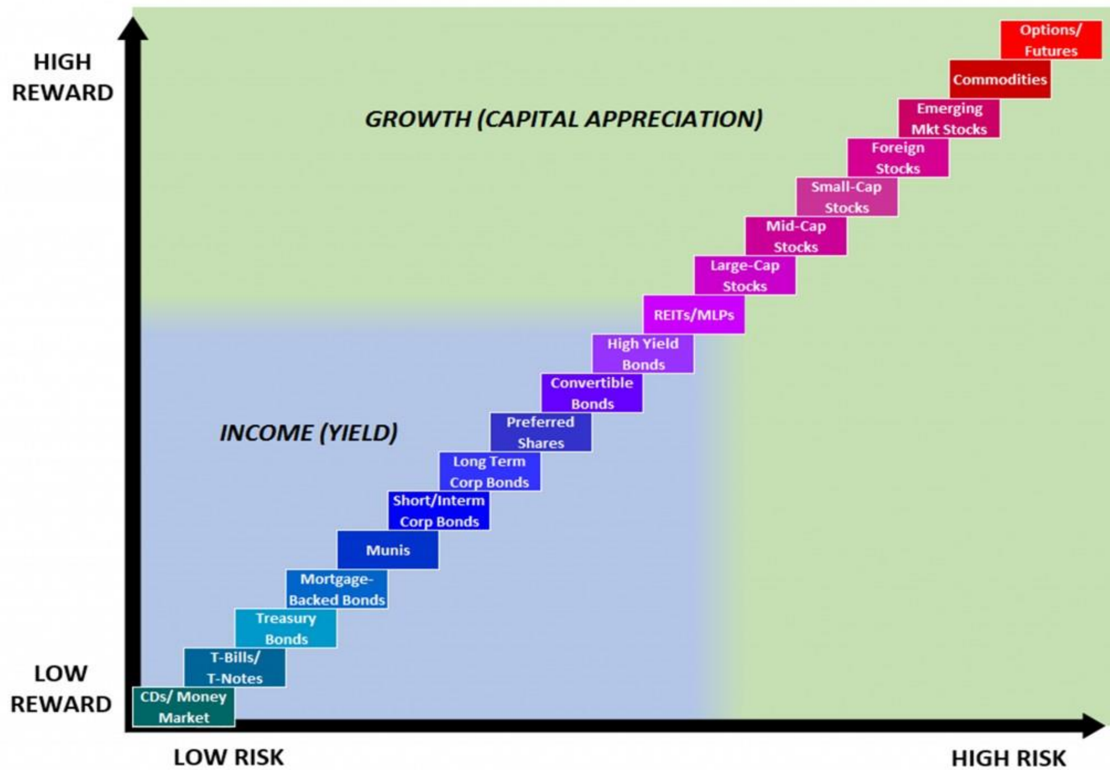
Asset Allocation and Diversification

Risk (Volatility)

→ There exists a tradeoff between volatility and return

→ Historically, stocks have significantly outperformed other asset classes

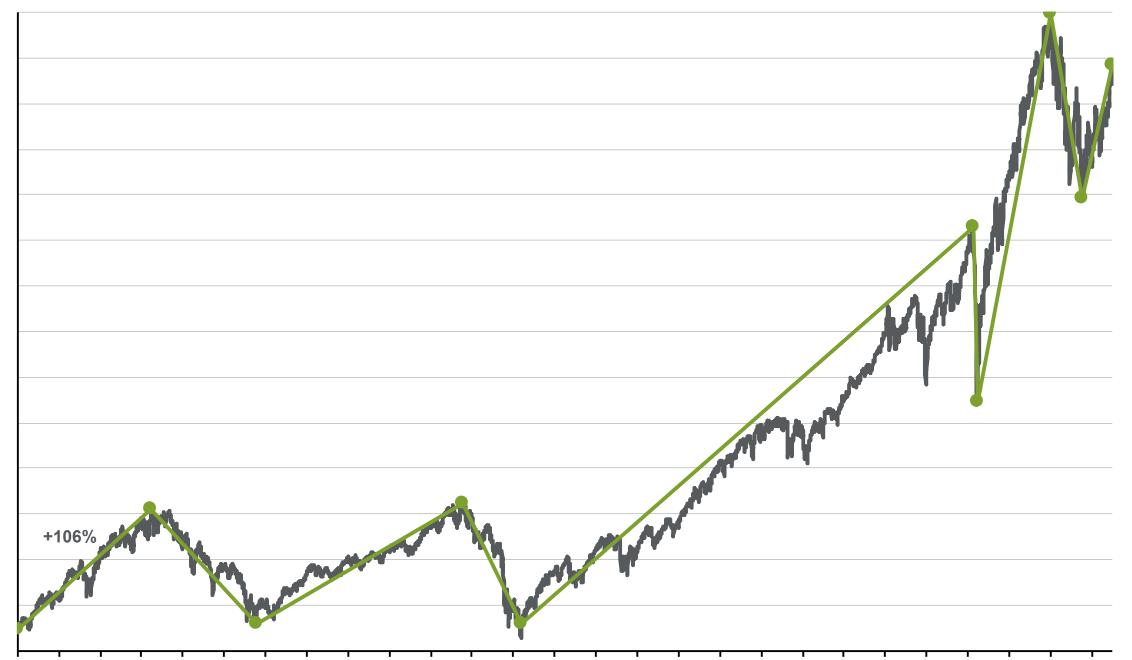
→ But with significantly greater volatility



Asset Allocation and Diversification

Potential volatility of risky assets: US equities fall ≈50% 2x in the last 20 years

S&P 500 Price Index

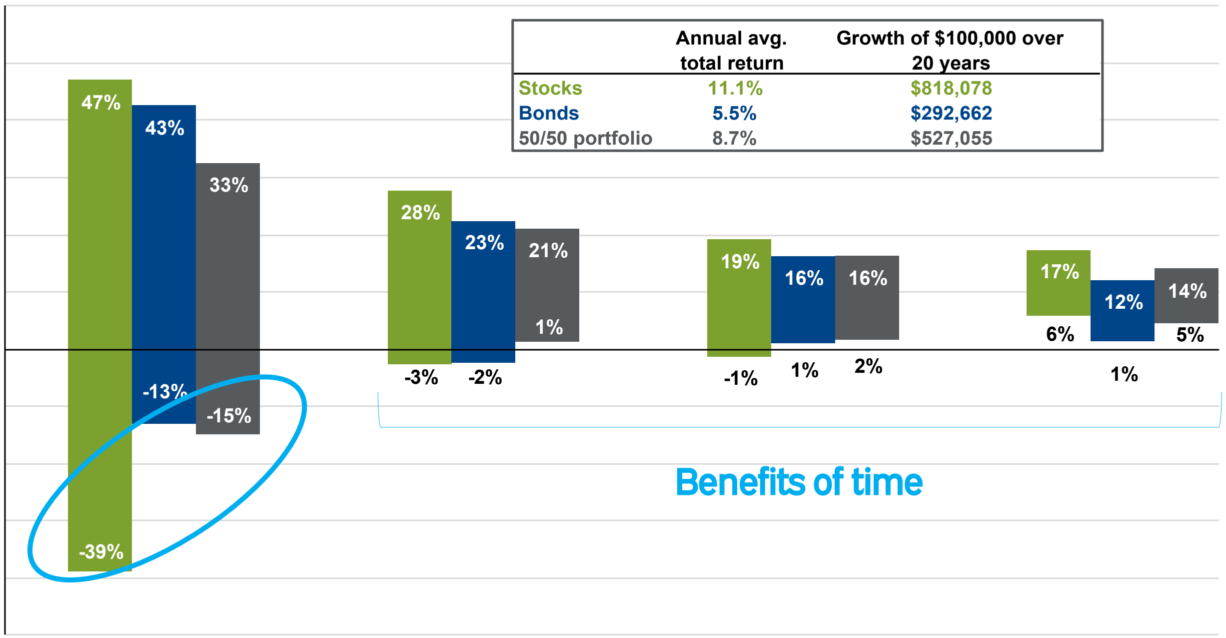


Source: Compustat, FactSet, Federal Reserve, Refinitiv Datastream, Standard & Poor's, J.P. Morgan Asset Management.
Dividend yield is calculated as consensus estimates of dividends for the next 12 months, divided by most recent price, as provided by Compustat. Forward price-to-earnings ratio is a bottom-up calculation based on IBES estimates and FactSet estimates since January 2022. Returns are cumulative and based on S&P 500 Index price movement only, and do not include the reinvestment of dividends. Past performance is not indicative of future returns.
Guide to the Markets – U.S. Data are as of June 30, 2023.

Asset Allocation and Diversification

Over time, US equities produce the best returns but exhibit largest variation in returns

Range of stock, bond and blended total returns
Annual total returns, 1950-2022



Source: Bloomberg, FactSet, Federal Reserve, Robert Shiller, Strategas/Ibbotson, J.P. Morgan Asset Management.
Returns shown are based on calendar year returns from 1950 to 2021. Stocks represent the S&P 500 Shiller Composite and Bonds represent Strategas/Ibbotson for periods from 1950 to 2010 and Bloomberg Aggregate thereafter. Growth of $100,000 is based on annual average total returns from 1950 to 2022.
Guide to the Markets – U.S. Data are as of June 30, 2023.

Returns for Different Asset Classes

																2008 - 2022	
2008	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**YTD**	**Ann.**	**Vol.**
Fixed Income 5.2%	EM Equity 79.0%	REITs 27.9%	REITs 8.3%	REITs 19.7%	Small Cap 38.8%	REITs 28.0%	REITs 2.8%	Small Cap 21.3%	EM Equity 37.8%	Cash 1.8%	Large Cap 31.5%	Small Cap 20.0%	REITs 41.3%	Comdty. 16.1%	Large Cap 16.9%	Large Cap 8.8%	REITs 23.4%
Cash 1.8%	High Yield 59.4%	Small Cap 26.9%	Fixed Income 7.8%	High Yield 19.6%	Large Cap 32.4%	Large Cap 13.7%	Large Cap 1.4%	High Yield 14.3%	DM Equity 25.6%	Fixed Income 0.0%	REITs 28.7%	EM Equity 18.7%	Large Cap 28.7%	Cash 1.5%	DM Equity 12.1%	Small Cap 7.2%	Small Cap 23.2%
Asset Alloc. -25.4%	DM Equity 32.5%	EM Equity 19.2%	High Yield 3.1%	EM Equity 18.6%	DM Equity 23.3%	Fixed Income 6.0%	Fixed Income 0.5%	Large Cap 12.0%	Large Cap 21.8%	REITs -4.0%	Small Cap 25.5%	Large Cap 18.4%	Comdty. 27.1%	High Yield -12.7%	Small Cap 8.1%	REITs 6.6%	EM Equity 23.0%
High Yield -26.9%	REITs 28.0%	Comdty. 16.8%	Large Cap 2.1%	DM Equity 17.9%	Asset Alloc. 14.9%	Asset Alloc. 5.2%	Cash 0.0%	Comdty. 11.8%	Small Cap 14.6%	High Yield -4.1%	DM Equity 22.7%	Asset Alloc. 10.6%	Small Cap 14.8%	Fixed Income -13.0%	Asset Alloc. 7.8%	Asset Alloc. 6.1%	Comdty. 20.2%
Small Cap -33.8%	Small Cap 27.2%	Large Cap 15.1%	Cash 0.1%	Small Cap 16.3%	High Yield 7.3%	Small Cap 4.9%	DM Equity -0.4%	EM Equity 11.6%	Asset Alloc. 14.6%	Large Cap -4.4%	Asset Alloc. 19.5%	DM Equity 8.3%	Asset Alloc. 13.5%	Asset Alloc. -13.9%	High Yield 5.2%	High Yield 5.4%	DM Equity 20.0%
Comdty. -35.6%	Large Cap 26.5%	High Yield 14.8%	Asset Alloc. -0.7%	Large Cap 16.0%	REITs 2.9%	Cash 0.0%	Asset Alloc. -2.0%	REITs 8.6%	High Yield 10.4%	Asset Alloc. -5.8%	EM Equity 18.9%	Fixed Income 7.5%	DM Equity 11.8%	DM Equity -14.0%	EM Equity 5.1%	Fixed Income 2.7%	Large Cap 17.7%
Large Cap -37.0%	Asset Alloc. 25.0%	Asset Alloc. 13.3%	Small Cap -4.2%	Asset Alloc. 12.2%	Cash 0.0%	High Yield 0.0%	High Yield -2.7%	Asset Alloc. 8.3%	REITs 8.7%	Small Cap -11.0%	High Yield 12.6%	High Yield 7.0%	High Yield 1.0%	Large Cap -18.1%	REITs 3.0%	DM Equity 2.3%	High Yield 13.0%
REITs -37.7%	Comdty. 18.9%	DM Equity 8.2%	DM Equity -11.7%	Fixed Income 4.2%	Fixed Income -2.0%	EM Equity -1.8%	Small Cap -4.4%	Fixed Income 2.6%	Fixed Income 3.5%	Comdty. -11.2%	Fixed Income 8.7%	Cash 0.5%	Cash 0.0%	EM Equity -19.7%	Cash 2.3%	EM Equity 1.0%	Asset Alloc. 12.4%
DM Equity -43.1%	Fixed Income 5.9%	Fixed Income 6.5%	Comdty. -13.3%	Cash 0.1%	EM Equity -2.3%	DM Equity -4.5%	EM Equity -14.6%	DM Equity 1.5%	Comdty. 1.7%	DM Equity -13.4%	Comdty. 7.7%	Comdty. -3.1%	Fixed Income -1.5%	Small Cap -20.4%	Fixed Income 2.1%	Cash 0.6%	Fixed Income 4.2%
EM Equity -53.2%	Cash 0.1%	Cash 0.1%	EM Equity 18.2%	Comdty. -1.1%	Comdty. -9.5%	Comdty. -17.0%	Comdty. -24.7%	Cash 0.3%	Cash 0.8%	EM Equity 14.2%	Cash 2.2%	REITs -5.1%	EM Equity -2.2%	REITs -24.9%	Comdty. -7.8%	Comdty. -2.6%	Cash 0.4%

Source: Bloomberg, FactSet, MSCI, NAREIT, Russell, Standard & Poor's, J.P. Morgan Asset Management.
Large cap: S&P 500, Small cap: Russell 2000, EM Equity: MSCI EME, DM Equity: MSCI EAFE, Comdty: Bloomberg Commodity Index, High Yield: Bloomberg Global HY Index, Fixed Income: Bloomberg US Aggregate, REITs: NAREIT Equity REIT Index, Cash: Bloomberg 1-3m Treasury. The "Asset Allocation" portfolio assumes the following weights: 25% in the S&P 500, 10% in the Russell 2000, 15% in the MSCI EAFE, 5% in the MSCI EME, 25% in the Bloomberg US Aggregate, 5% in the Bloomberg 1-3m Treasury, 5% in the Bloomberg Global High Yield Index, 5% in the Bloomberg Commodity Index and 5% in the NAREIT Equity REIT Index. Balanced portfolio assumes annual rebalancing. Annualized (Ann.) return and volatility (Vol.) represents period from 12/31/2007 to 12/31/2022. Please see disclosure page at end for index definitions. All data represents total return for stated period. The "Asset Allocation" portfolio is for illustrative purposes only. Past performance is not indicative of future returns.
Guide to the Markets – U.S. Data are as of June 30, 2023.

Asset Allocation and Diversification

Diversification

→Combining risky assets (stocks) with relatively safe assets (bonds), the investor achieves diversification

→Diversification happens when assets don't move directly together

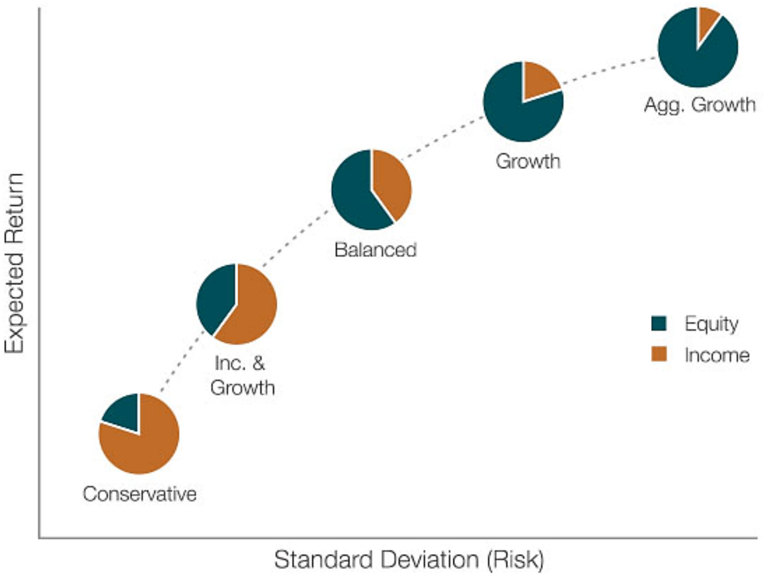
- By holding assets that are not highly correlated, the overall portfolio exhibits less risk (volatility) than the individual risky assets

→ Since diversification can reduce risk while not reducing expected return, diversification is often said to be **the only "free lunch" in investing**

Building Portfolios

Target Risk Portfolios

- → Asset allocation remains unchanged over time
- → Offered in index, active, or blended form
- → Allows an investor to target a point along the efficient frontier that aligns with their risk tolerance



Questions?