



SELECTING A PROPER STABLE VALUE BENCHMARK

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Introduction

Stable value funds were first introduced in the 1970s around the same time that 401(k) plans came into existence. These investments were specifically designed for qualified retirement plans, as low risk investments that offered principal preservation and a steady positive return. The first stable value funds consisted of guaranteed investment contracts (GICs) issued by insurance companies. These traditional GICs were fixed-rate paying instruments designed to guarantee original principal invested. Over time, the structure of stable value funds evolved. Today, stable value funds often include a diversified portfolio of fixed income securities wrapped by contracts issued by multiple insurance companies. According to the Stable Value Investment Association (SVIA), whose members include major stable value managers and contract providers (insurance companies), there was approximately \$821 billion in stable value assets at the end of 2016, and nearly half of all defined contribution plans offered some type of stable value fund.¹

One reason stable value funds have become so popular is because the book value accounting treatment afforded to them through their use of insurance contracts buffers participants from fluctuations in the underlying investments. Sector, credit, and yield curve diversification allows these funds to (generally) deliver higher yields than other low volatility investments, such as money market funds. However, this unique structure poses numerous challenges for fiduciaries charged with selecting and monitoring stable value funds. One of these challenges is benchmarking. This white paper examines SageView's considerations for benchmarking stable value funds, particularly commingled/pooled stable value funds.

Challenges in Benchmarking Stable Value Funds

There are three main types of stable value funds available today:

1. Traditional guaranteed investment contract (GICs),
2. Separate account GICs, and
3. Stable value collective investment trusts (CITs), also sometimes referred to as commingled/pooled stable value funds.

Each type of stable value fund has its own unique characteristics, and all face benchmarking challenges. For the purposes of this white paper, we will primarily focus on benchmarking challenges for stable value CITs.

The challenge of stable value fund benchmarking challenge centers around two unique attributes.

1. Accounting methodology. All other investments used by defined contribution retirement plan participants are reported at market value, which is typically the fund price (Net Asset Value, or NAV) established on the open market at the end of the trading day. Stable value funds are permitted to report performance at book value, provided that certain pre-determined criteria are met. Book value is simply defined as the value of initial deposited principal, plus accumulated interest, plus additional deposits, minus withdrawals and expenses. Book value accounting results in "smoothed" performance results that aren't directly comparable to a market value benchmark. Although pooled stable value funds use book value to report performance, plan sponsors should also consider reviewing the portfolio's market value performance, which can be requested directly from the investment manager, or approximated through the changes in the fund's market-to-book value ratio.
2. Principal protection objective. This attribute is philosophical. A primary investment objective for stable value funds is to preserve invested capital, or in other words, to not lose investors' money. If a stable value fund does not lose money, it is fair to say that it has accomplished one of its chief goals, without the need for comparison against a market value-based

¹ https://stablevalue.org/media/misc/Stable_Value_at_a_Glance.pdf



benchmark. That does not mean that market value-based benchmarks are not useful for assessing stable value funds, but just that they should not be the sole determinant of whether a fund is successful, as they might be for other investment categories.

Ideal benchmarks for pooled stable value funds are not available due to the book value accounting structure of these investments. However, despite these challenges, retirement plan consultants must still thoroughly and objectively evaluate all investment options in a plan lineup, including stable value funds. In order to accomplish this task, a reasonable benchmark is necessary.

Definition of a Good Benchmark

From an investment perspective, a benchmark serves as a point of reference for evaluating the performance of a portfolio. The selection of an appropriate benchmark depends on the investment objective and constraints that control the fund manager’s portfolio construction process. A benchmark is generally a collection of various securities that defines a manager’s preferred investment habitat.

Before delving into benchmark selection for pooled stable value funds, let’s review the definition of a good benchmark. According to the CFA Institute, for a benchmark to measure performance effectively, it should possess the following properties, known by the acronym “SAMURAI”²:

- *Specified in advance* – The benchmark is known before the start of an evaluation period.
- *Appropriate* – The benchmark is aligned with the manager’s investment style.
- *Measurable* – The benchmark’s return is easily calculated on a reasonably frequent basis.
- *Unambiguous* – The underlying holdings and their weights are clearly defined; alternatively, the factor exposure should be clear.
- *Reflective of current investment opinions* – The manager has current investment knowledge the benchmark’s constituents.
- *Accountable* – The investment manager should be aware of and accept accountability for the portfolio’s performance relative to the benchmark.
- *Investable* – It is possible to simply own or invest in the benchmark.

Benchmarks Considered

To begin our search for a good benchmark, we reviewed the fact sheets of some popular stable value funds to collect data concerning their benchmark reporting practices. Generally speaking, manager-selected benchmarks vary considerably, but it is common to see two benchmarks being used. Usually, one of the benchmarks is a cash proxy (e.g., the 3-month T-bill), while the other is a short-term market value-based bond benchmark. In several other cases, the Hueler Pooled Fund Universe was listed as a benchmark.

Table 1 – Stable Value Managers Representative Benchmarks

Manager	Benchmark 1	Benchmark 2
Manager A	Barclays 1-5 Yr Gov/Credit > A	n/a
Manager B	Barclays 1-3 Yr Gov/Credit	n/a
Manager C	iMoneyNet All-Taxable Money Market	Barclays 1-3 Gov Bond
Manager D	Hueler Analytics Pooled Fund Universe	Lipper Money Market Funds Index
Manager E	50% Citigroup 3-mo T-bill / 50% Merrill Lynch 1-3 Yr Treasury	Citigroup 3-Mo US T-bill
Manager F	Citigroup 3-Mo US T-bill	n/a

² Maginn, J., Tuttle, D., Pinto, J., and McLeavey, D. “Managing Investment Portfolios: A Dynamic Process.” CFA Institute, Third Edition, 2007.



Next, we took these commonly utilized stable value benchmarks and compared them to other potential benchmarks that we believed might serve as better gauges for evaluating stable value funds. One of these candidates was the Bloomberg Barclays Stable Income Market Index. We provide a brief overview of each benchmark below.

Hueler Pooled Fund Universe – Also known as the Hueler Analytics Stable Value Pooled Fund Comparative Universe, it represents investment strategies of over \$105 billion in stable value assets, representing 15 unique pooled funds. Collectively, these funds have exposure to 8 different traditional GIC issuers and 18 synthetic wrap providers, with synthetic contracts comprising the majority of the assets. Funds in the comparative universe are equally weighted. Separately managed accounts established for large retirement plans are not included in the universe.³ Using strict definitions, the Hueler Pooled Fund Universe is not truly an index, but rather a composite of actual investments. Since the composite constituents use book value (not market value) accounting, so too does the Hueler Pooled Fund Universe report book value performance.

Bloomberg Barclays Stable Income Market Index (SIMI) – This benchmark is a blend of market returns of fixed income securities. The SIMI includes allocations to government, credit and securitized fixed income sectors. The SIMI tends to include the more conservative segments of each fixed income sector and restricts the maturities of the bonds that can be used in order to better match the underlying investments of most stable value funds. The weights to each of the sectors is determined through an iterative process to provide the best possible tradeoff between risk and return. In constructing the SIMI, one of Barclays’ objectives was to create an allocation that would best withstand both of the recent credit crises and periods of rising interest rates. The resulting allocations remain fixed for this index and are shown in Table 2.

Table 2 – SIMI Benchmark Allocations

Index	Weight
Govt/Credit 1-5 Year	65.0%
MBS 15 Year Fixed Rate	25.0%
ABS Credit Cards Aaa	2.5%
ABS Autos Aaa	2.5%
CMS Aa 1-6 Year	5.0%

Barclays 1-3 Year Government/Credit Index – This index incorporates all bonds from the Barclays Treasury Bond Index and the Barclays Agency Bond Index that have maturities between one and three years. Some U.S. corporate bonds, foreign debentures and secured notes are also included.

Citigroup 3 Month US T-bill – This index represents the monthly return equivalents of the yield averages of the last 3-month Treasury bill issues. T-bills are government backed, short-term investments considered to be representative of a risk-free investment.

As previously mentioned, an ideal benchmark solution for a pooled stable value fund does not exist due to the book value accounting structure of these investments. Therefore, selecting a benchmark is an exercise of selecting the best option out of a suboptimal universe. The Hueler Pooled Universe is the option used most frequently by consultants due its book value return structure, which allows for an easy comparison to pooled stable value funds. However, it has several very significant

³ Hueler Analytics.



drawbacks that are becoming increasingly difficult to ignore (see Table 3 of the Appendix for further details).

The 3-month T-bill is probably the most frequently referenced benchmark in stable value managers' product factsheets. It is a simple metric that is very transparent and whose construction makes it well-suited to assess capital preservation investments. It is difficult to argue that this benchmark is appropriate in this context, however, because of the highly disparate duration, sector, and credit profiles that exist between this index and most stable value funds.

The remaining two benchmarks that we considered, the Barclays 1-3 year Gov/Credit Index and the Barclays SIMI, share similar attributes. Ultimately, SageView's Investment Committee selected the Bloomberg Barclays Stable Income Market Index as the preferred benchmark for evaluating stable value funds because it best satisfied the criteria of a good benchmark and was specifically designed for this category. Since SIMI is a market value-based benchmark, certain challenges will continue to exist in using it to assess stable value fund's book-value returns. However, we believe the structure of the SIMI will significantly reduce the severity of the issue, particularly over longer benchmarking periods. One obvious challenge is that the benchmark may show a negative return during a given quarter when interest rates rise. This will present a stark contrast to pooled stable value funds, which should never show negative returns due to their book-value accounting structure. This apparent juxtaposition presents an opportunity to discuss with clients the unique characteristics of stable value funds and the purpose they serve in retirement plans. Furthermore, since book value accounting stabilizes short-term returns but has little to no impact on long-term performance, the performance discrepancy will naturally dissipate over time. A detailed analysis of the pros and cons of each benchmark is shown in Table 3 in the appendix.

Bloomberg Barclays Stable Income Market Index

We conclude our paper by providing retirement plan committees more detail behind this index and hopefully a better understanding of this benchmark. The Bloomberg Barclays SIMI was launched in October 2010, but it reports performance back to July 1999 due to the extended history of its underlying benchmark components.

The index was initially co-created by JPMorgan and Barclays to serve as a market value-based performance benchmark for the bond portion of a pooled stable value fund. JPMorgan established the initial index specifications and Barclays developed a quantitative optimization tool used to determine sector weights. Some of the goals of the optimization included protection against downside risk (to mimic book value performance over the long run) and long-term, risk adjusted performance that is more closely aligned with the crediting rate objectives of most stable value funds.

The index is a blend of low-risk bond sectors (government, credit and securitized) that are underlying components of the Bloomberg Barclays U.S. Aggregate Bond Index, but which focus on shorter durations. A more detailed comparison of the various attributes and characteristics of the SIMI versus the other benchmarks is shown in Table 4 in the appendix.

Appendix



Table 3 – Summary of Pros and Cons of Various Benchmarks

Index	Pros	Cons
Hueler Pooled Fund Universe	<ul style="list-style-type: none"> ▪ Reports book value returns which allows for “apples-to-apples” comparison with stable value funds, which typically don’t report market value performance 	<ul style="list-style-type: none"> ▪ Not an index in the true sense of the word, but rather just a universe of existing products ▪ Reports returns that are gross of management fees (net of wrap fees), limiting its usefulness as a comparison tool ▪ Subject to survivorship bias – there were 25 stable value funds in the index prior to 2008 and currently there are just 16 ▪ Does not presently include the Fidelity MIP, which is a significant stable value fund in the industry, with roughly \$25 billion in assets ▪ Represents less than half of the stable value universe (based on assets)
Barclays Stable Income Market Index	<ul style="list-style-type: none"> ▪ Utilizes fixed income securities that are similar to those used by stable value funds from a credit and duration perspective ▪ Specifically designed with consideration for stable value management ▪ Highly transparent and meets many of the key properties for a proper benchmark 	<ul style="list-style-type: none"> ▪ Market value nature of the index doesn’t allow for an “apples-to-apples” comparison ▪ Stable Value managers generally don’t manage to, follow, or utilize this benchmark
Barclays 1-3 year Gov/Credit Index	<ul style="list-style-type: none"> ▪ Provides a good match for stable value funds in terms of target duration ▪ Highly transparent and meets many of the key properties for a proper benchmark 	<ul style="list-style-type: none"> ▪ Market value nature of the index doesn’t allow for an “apples-to-apples” comparison ▪ Stable value managers generally don’t manage to, follow, or utilize this benchmark ▪ Has no exposure to mortgages, which have been a key investment for stable value funds
Citigroup 3-Month US T-bill	<ul style="list-style-type: none"> ▪ Simple metric that is a widely accepted cash proxy ▪ Highly transparent and meets many of the key properties for a proper benchmark 	<ul style="list-style-type: none"> ▪ Inappropriate for use as a stable value benchmark because it does not reflect the funds’ style of investment (stable value funds have much longer durations and take on greater credit risk) ▪ Market value nature of the index doesn’t allow for “apples-to-apples” comparison, although this issue is minimized by the short duration of the securities used



*Table 4 – Index Characteristics Comparison
Data as of December 31, 2017*

Quality Allocations			
	Hueler	SIMI	Barclays 1-3 Yr Gov/Credit
U.S. Treasury	19.7%		
U.S. Gov Agency	13.2%		
AAA	25.6%	81.1%	72.3%
AA	16.9%	3.5%	5.5%
A	16.6%	7.3%	10.3%
BBB	11.7%	7.8%	10.2%
Below BBB	0.1%	0.4%	0.4%
Not Rated	5.6%		1.2%

Major Sector Allocations			
	Hueler	SIMI	Barclays 1-3 Yr Gov/Credit
U.S. Treasury	18.3%	39.0%	59.5%
U.S. Gov Agency	3.9%	4.9%	10.1%
Other Gov	0.0%	0.9%	5.7%
Corporates	31.2%	17.7%	23.1%
Mortgages	21.3%	29.8%	0.0%
ABS	11.3%	5.0%	0.0%
Cash	7.3%	0.0%	0.0%
Other	6.8%	2.6%	0.0%



IMPORTANT DISCLOSURES:

SageView Investment Committee understands that each plan sponsor has unique needs and goals, and its actions and timing of its actions may differ depending on circumstances specific to the plan sponsor.

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