



HOOKER & HOLCOMBE COMPANIES



Focus:
The Future of
Long-term
Expected
Pension Returns

2013 PERAC EMERGING ISSUES FORUM

SEPTEMBER 12, 2013

PRESENTED BY:

Evan W. Woollacott, Jr. – FCA, MAAA, EA

Rodger K. Metzger – CFA[®], AIF[®]





Agenda

A Look at
the Issue

Actuarial
Perspective

Investment
“Solutions”
?



Looking Back

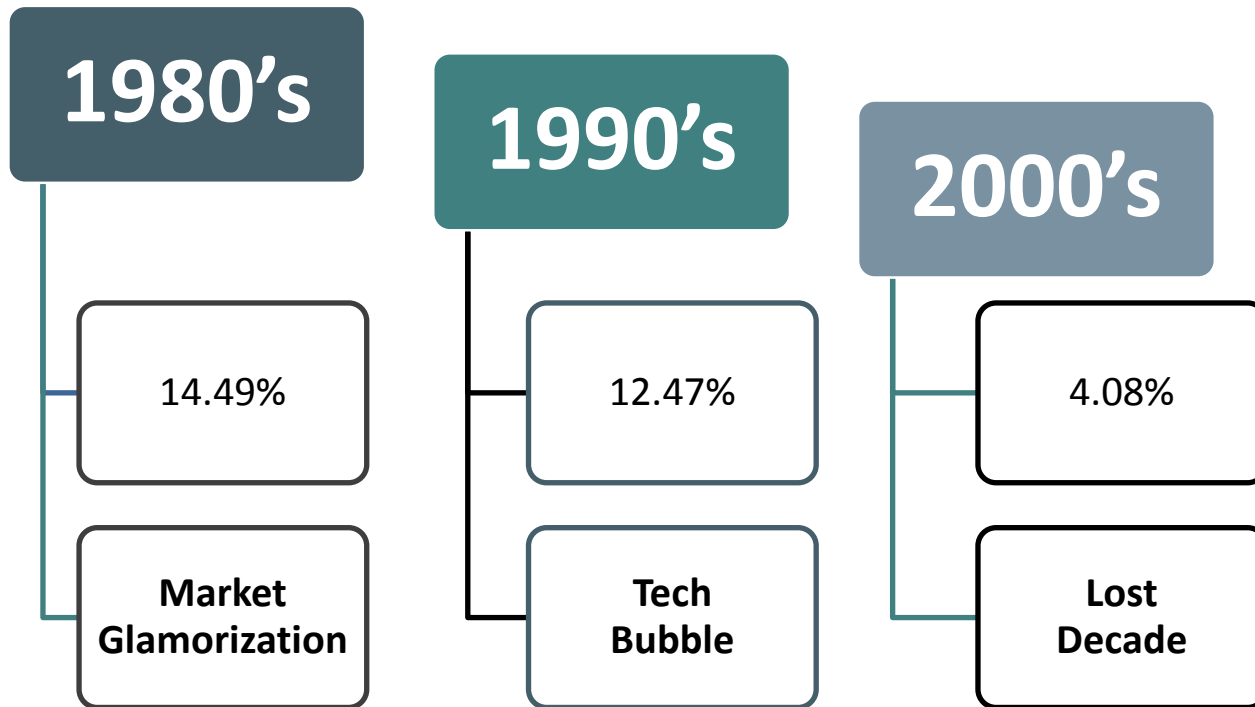
60/40 Portfolio

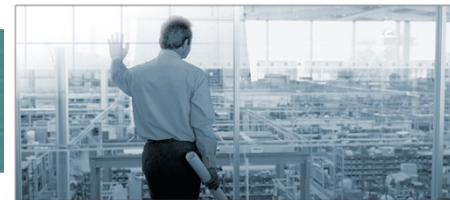
- Domestic Equities (S&P 500) - 45%
 - International Equities (MSCI EAFE) - 15%
 - Domestic Bonds (Barclay's Agg.) - 40%
-
- Quarterly Rebalanced



Historical Investment Returns

60/40 Portfolio





HHIA Capital Market

**Assumptions
2011**

(20-year Time Horizon)

Asset Class

Inflation

Return

3.00%

Fixed Income

Short Term

4.00%

Intermediate Govt

5.50%

Intermediate Corp

6.25%

MBS/ABS

6.25%

High Yield

7.50%

International Fixed

6.50%

Equities

US Large Cap

8.50%

US Mid/Small Cap

9.75%

International Developed

9.25%

Emerging Markets

10.50%

Other

Real Estate

8.00%

Commodities

10.60%

Alternative Investments

8.25%



Return Using HHIA Capital Market Assumptions

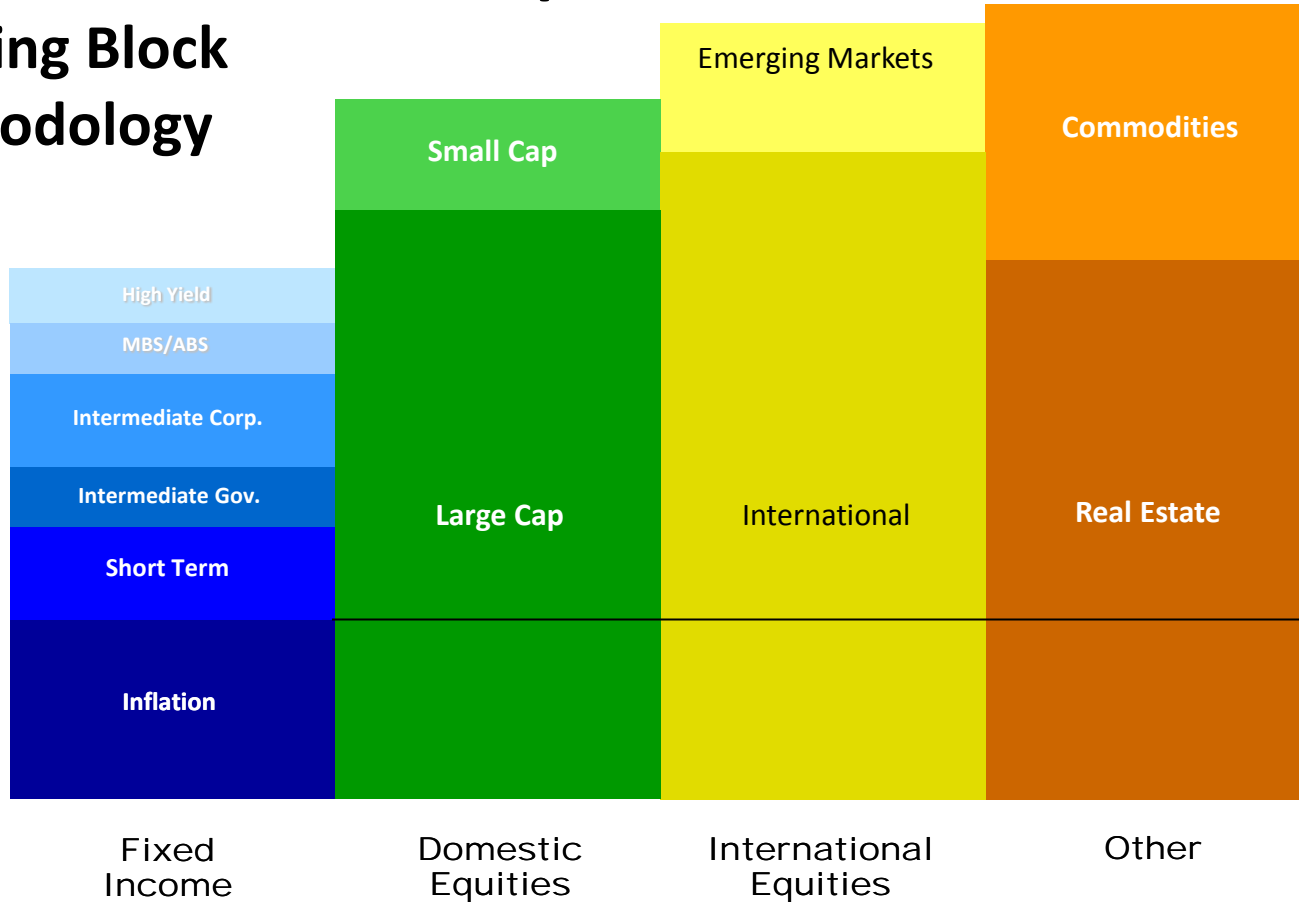
	Portfolio Weight	Expected Return	Weighted Return
Large Cap	45%	8.50%	3.83%
Int'l Developed	15%	9.25%	1.39%
Core Fixed *	40%	5.88%	2.35%
Sum			7.56%

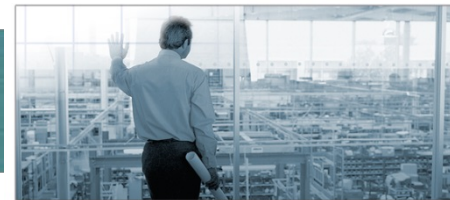
*Blended Return Assumption



Capital Market Assumptions

Building Block Methodology





“Building Block” Challenges

MARKET INSIGHTS Interest Rates and Inflation

Fixed Income



Source: Federal Reserve, BLS, J.P. Morgan Asset Management.
 Real 10-year Treasury yields are calculated as the daily Treasury yield less year-over-year core inflation for that month except for June 2013, where real yields are calculated by subtracting out May 2013 year-over-year core inflation. All returns above reflect annualized total returns, which include reinvestment of dividends. Corporate bond returns are based on a composite index of investment grade bond performance.
 Data are as of 6/30/13.



“Building Block” Challenges United States Equities

- **Demographic Shifts**
- **Reduced % of Global Patents**
- **Increasing % of Consumer Income to Transfer Payments**



Connecticut Cities and Towns

Compared to



Massachusetts Cities and Towns



Mass Compared to CT

Interest Assumption	CT	MA
4.00%	1	0
5.43%	1	0
5.50%	1	0
6.00%	3	0
6.25%	2	0
6.50%	8	0
6.75%	2	0
7.00%	31	0
7.25%	14	0
7.50%	62	4
7.60%	2	0
7.63%	0	1
7.75%	29	13
7.88%	0	6
7.95%	0	1
8.00%	44	68
8.13%	0	1
8.25%	10	11
8.50%	4	0
Total	214	105

Interest Assumption (Grouped)	CT	MA
4.00% - 4.49%	1	0
4.50% - 4.99%	0	0
5.00% - 5.49%	1	0
5.50% - 5.99%	1	0
6.00% - 6.49%	5	0
6.50% - 6.99%	10	0
7.00% - 7.49%	45	0
7.50% - 7.99%	93	25
8.00% - 8.49%	54	80
8.50% - 8.99%	4	0
9.00% +	0	0
Total	214	105

Funded Ratio (Grouped)	CT	MA
0% - 9%	6	0
10% - 19%	3	0
20% - 29%	2	1
30% - 39%	3	2
40% - 49%	10	22
50% - 59%	27	22
60% - 69%	35	33
70% - 79%	42	17
80% - 89%	50	7
90% - 99%	22	0
100% - 149%	12	1
150% - 199%	1	0
200% - 249%	1	0
250% +	0	0
Total	214	105

	CT	MA
Average Interest Assumption	7.49%	7.97%
Liability Weighted Interest Assumption	7.88%	8.14%
Average Funded Ratio	73.4%	61.5%
Liability Weighted Funded Ratio	77.3%	63.4%
* Normalized Liability Weighted Funded Ratio	74.1%	59.0%

(Based upon 7.5% interest, 12 year duration)

Note:
CT count of 214 is Plans, not number of towns, Massachusetts using May data



Connecticut State Plans

	Actuarial Assets	Market Assets	Actuarial Accrued Liability	Actuarial Value Funded Ratio	Market Value Funded Ratio	Interest Assumption
Connecticut Municipal Employees Retirement System (MERS)	\$ 1,828,762,443	\$ 1,683,441,549	\$ 2,150,812,895	85.03%	78.27%	8.00%
Connecticut State Teachers' Retirement System (TRB)	\$ 13,734,831,000	\$ 13,473,656,000	\$ 24,862,228,000	55.24%	54.19%	8.50%
Connecticut State Employees Retirement System (SERS)	\$ 9,744,985,549	\$ 8,468,479,084	\$ 23,018,751,734	42.33%	36.79%	8.00%

In CT, there is a choice between adopting your own plan or joining the Municipal Employees Retirement System (MERS).



Other Actuarial Assumptions

- Do an Experience Study First
- Salary Increase
 - Recommend Graded Scale
- Example of Graded Scale:

(Age Based)

Age 25	6.5%
Age 35	5.0%
Age 45	4.0%
Age 50+	3.0%

- PERAC Uses Service Based with 4% - 4.75% Ultimate Rate



Other Actuarial Assumptions

- Retirement Rates
- Trends Show Employees Retiring Later
- Mortality Improvement Needs to be Factored



Case Study

	Prior Assumptions	New Assumptions
Interest	8%	7.25%
Mortality	1983 Group Annuity Mortality	RP-2000 Mortality projected to the valuation date
Mortality Improvement	None	Projected to the date of decrement
Salary Increase	4%	5% grading to 3%



Case Study (cont.)

	Prior Assumptions	New Assumptions	
Retirement	Earlier of Age 65, or age plus service equals 85, but not earlier than 55	<u>Age</u>	<u>Rate</u>
		55	10%
		56 – 59	5%
		60 – 61	10%
		62	15%
		63	10%
		64	5%
		65	20%
		66	10%
		67	15%
		68	5%
		69	15%
		70	100%



Case Study (cont.)

- Result

	<u>Recommended Contribution</u>	<u>Funded %</u>
Before	\$4,104,000	93%
After	\$3,817,000	94%

- Please note, changes in assumptions do not always produce lower recommended contributions. The only reason this worked was due to the retirement assumption change.



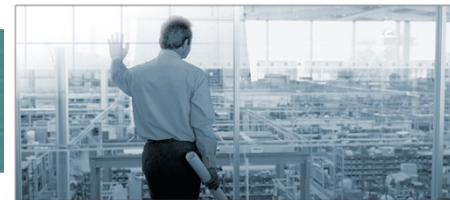
**Pension
Investment
Ideas**

“Solutions”?



Investment “Solutions”?

1. Reduce Behavioral Reliance on Domestic Equities
2. Rebalancing Strategies:
 - Calendar vs. Drift Rebalancing
 - Increase Return or Reduce Standard Deviation?
 - 25-75 Basis Points Per Annum



Investment “Solutions”?

3. Non-Traditional Bond Strategies

4. Tactical Trading

- Extreme Treasury Overvaluation/High Yield
- European Recovery
- EM Macro Struggles
- Beta Adjustments in Fund Selection
- MLP, Floating Rate Securities



Investment “Solutions”?

5. Alternatives vs. Traditional Investments

- Traditional – Asset Class Primary Return Driver
- Alternative – Manager Primary Return Driver
 - Top Quartile Mgrs. Show Persistence
- Alternative Strategy, **not** Asset Class



Disclosures

Hooker & Holcombe Investment Advisors, Inc (HHIA) is wholly owned by Hooker & Holcombe, Inc. located at 65 LaSalle Road, West Hartford, CT 06107 and is an SEC Registered Investment Advisor providing institutional investment advice to corporations and municipalities throughout the Northeast.

The content contained in this presentation is (1) informational only and should not be construed as investment advice; (2) obtained from sources deemed to be reliable but is not warranted by HHIA to be accurate, complete, or timely. HHIA does not accept liability for any losses, direct or indirect, sustained in connection with the use of this content.

Investment advice should be based on an individual's specific factors and circumstances. HHIA recommends that you consult with a qualified investment advisor for guidance regarding your particular situation on appropriate investment strategies for your portfolio.

Fixed income and equity investments are subject to a variety of risk factors and investors should be aware of such factors prior to investing. Diversification does not guarantee positive investment returns and does not eliminate the risk of loss. Past performance is not indicative of comparable future results.



Questions