

# Our Stable Value Diverse Manager Strategy Solution

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## Diversity, Equity & Inclusion Takes Center Stage

Diversity, equity and inclusion (DEI) has become an increasingly discussed issue both in broader societal terms and in the world of finance. In fact, according to a recent study by McKinsey & Co. titled Diversity Wins: How Inclusion Matters (May 2020), the business case for inclusion and diversity (I&D) is stronger than ever. And, going forward, we believe that the national discussion around this topic will likely accelerate and that this could have a myriad of implications for the broader investment community, specifically in the stable value space within which PFM Asset Management (PFMAM) operates.

## DEI is Very Important to PFMAM

Though we maintain a national footprint, we have also always placed a heavy emphasis on being an active member of the communities in which we operate. To that end, diversity and inclusion have been a focus and an integral part of our culture for many years. We proactively seek out and welcome professionals that reflect our clients' broad diversity and the communities that we have the privilege and opportunity to serve.

PFMAM has also actively partnered with minority- and women-owned managers in its fixed-income and multi-asset class businesses since 2000. We believe that our history sets us apart from other investment managers who may not have prioritized diversity, equity and inclusion as purposefully in the past.

## Stable Value Has Historically Been Lacking on the Diversity Front

As with defined benefit plans, the use of diverse investment managers within defined contribution plans and, specifically, stable value funds has been historically lacking. In our experience working with plan sponsors, we see minimal evidence of allocations to minority managers. Note that specific to stable value, there is little in the way of public information regarding particular allocations or managers. However, based upon past underwriting, discussions with market participants and publicly available information on the top 25 defined contribution plans with stable value options, we have concluded the following:

- ▶ **401(k) Plans** — No diverse investment managers or fixed income sub-advisors were identified within corporate stable value funds.
- ▶ **457(b) Plans** — Minimal use of diverse fixed income sub-advisors within very large public stable value funds only.

When hired, it has been exclusively at the direction of the plan sponsor and limited to three to four firms in total, typically with minimal effort expended by the parties involved.

In fact, what we have found has been perhaps an expediency approach and an effort to more or less “check the box.” Specifically, our market intelligence indicates that of the 10 largest plans with stable value options (totaling approximately \$73 billion), only three currently utilize a minority- or women-owned investment manager as a sub-advisor. The allocation was never greater than 13% in total.



Almost universally, public defined contribution plan sponsors have delegated management of their stable value funds to their stable value investment manager or their insurance company plan record keeper (which offer either general account or separate account solutions). In the case of the investment manager community, these firms employ approaches that have been in place for 20 to 30 years and hiring diverse managers has generally not been part of their process. Some managers will not hire any external managers, while others have been assuming more management internally in an effort to reduce fees. For the insurance companies, which are the primary recordkeepers of 457 plans, in-house control of the “stable value” assets has been a primary source of profitability, thus, precluding their usage of diverse managers.

## Our Solution

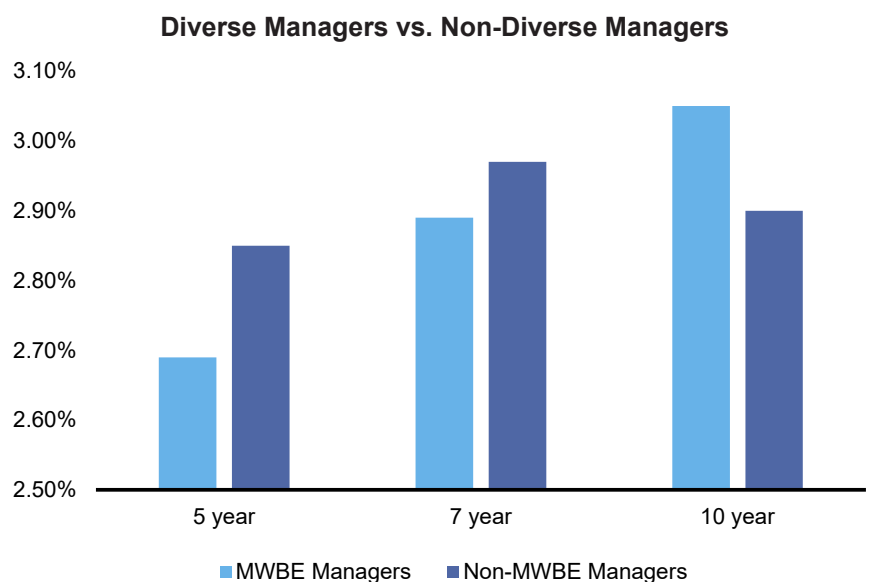
In 2019, PFMAM blended its knowledge of stable value with its knowledge of public entities and investment managers to develop a solution aimed at promoting DEI within stable value funds. Our solution blends an internal quality and conservative fixed-income management approach with diverse fixed-income firms. For whatever reason, these firms have traditionally not received serious consideration from the investment consulting community outside of the public funds arena.

Leveraging our fixed-income manager research team, we performed a comprehensive analysis of the minority- and women- owned business enterprise (MWBE) fixed-income manager universe to identify firms that complement PFMAM’s management philosophy. The result was the approval of Garcia Hamilton & Associates, LM Capital, Longfellow Investment Management, Ramirez Asset Management and Xponance. Our solution is structured as separate accounts that may either accommodate an entire fund or be incorporated as a sleeve within a larger fund. PFMAM assumes the role of fiduciary and structure manager for the sleeve.

## It Can Improve Your Diversification Profile

One of the often-heard criticisms or concerns is that incorporating diverse managers may have some adverse impact on performance. However, we believe that line of thinking merely represents an excuse or justifies hiring the big, well-known firms. It is also perhaps an easy way out in the sense that it requires minimal effort and is easily defensible from a fiduciary standpoint. However, it unfortunately disincentivizes plan sponsors from digging deeper to find managers that may be competitive with those industry giants.

As evidence that including MWBE firms is indeed a worthwhile effort for a stable value fund, we performed an analysis of both MWBE managers and non-MWBE managers, with the assistance of Investment Metrics LLC. The results are shown in the chart to the right.



Source: Investment Metrics. Median Annualized Returns as of September 30, 2021.

The criteria used in the selection process is as follows:

- ▶ Over \$1 billion in fixed income assets.
- ▶ 10+ years of composite performance history.
- ▶ Intermediate duration portfolios only.
- ▶ Portfolios subject to “AA” minimum average quality; and
- ▶ No large out-of-benchmark or non-benchmark like positions.

While not conclusive and subject to a more in-depth quantitative analysis and debate, a potentially compelling case is that hiring MWBE managers does not hurt and may actually enhance long-term fund performance. Moreover, when adjusted to a book value return basis, we believe the case for hiring MWBE managers is strengthened even further via the amortization of any alpha via the crediting rate formula.

## Final Thoughts

PFMAM is a market leader in stable value and fixed income management, combined with a rock-solid commitment to DEI. As such, it is only natural that as a firm, we have assumed a market leadership posture by devising a solution that brings greater diversity to defined contribution plans. The vehicle (stable value) doesn’t require access to a recordkeeping platform, and sub-advisors can be (and are) utilized. And, in a stable value market that has seen minimal innovation and change over the past 20 to 30 years, our Stable Value Diverse Manager Strategy represents a real change from the status quo with the goal of bringing the market more in line with broader societal changes.

To learn more or discuss in greater detail, please contact us:

**Steve Schaefer, CFA**  
 Director  
[schaefer@pfmam.com](mailto:schaefer@pfmam.com)

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## Sub-Advisor Disclaimers

### Garcia Hamilton & Associates (GH&A)

*Garcia Hamilton & Associates is a fixed income investment management firm based in Houston, TX. The firm is 100% employee-owned (nine partners), including approximately 91% minority/female ownership, and certified as an MWBE firm.*

*GH&A is an investment management firm registered under the Investment Advisers Act of 1940. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.*

### LM Capital Group, LLC

*LM Capital Group was founded by Luis Maizel and John Chalker to provide fixed income investment management services to investors. The firm is an employee-owned minority business — with consistent senior management — servicing public funds, corporations, and foundations.*

*LM Capital Group, LLC is an SEC Registered Investment Advisor based in San Diego, CA. The firm specializes in active fixed income management for Institutions and High Net Worth individuals. SEC registration does not imply a certain level of skill or training. Information presented is not intended as a solicitation or offer with respect to the purchase or sale of any security or other financial instrument or any investment advisory services.*

### Longfellow Investment Management Co., LLC (LIM)

*Longfellow Investment Management Co., LLC (LIM) is an independent, 100% employee-owned investment management firm and a certified Women's Business Enterprise.*

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### Ramirez Asset Management, Inc. (RAM)

*Ramirez Asset Management, Inc. (RAM), founded in 2002, specializes in fixed income asset management and provides investment advisory services to institutional investors. RAM is a certified minority owned business enterprise (MBE), headquartered in New York City with offices in Chicago, Illinois and San Juan, Puerto Rico; we are an affiliate of Samuel A. Ramirez & Company, Inc., one of the oldest Hispanic-owned full service investment firms in the United States.*

*Ramirez Asset Management, Inc. is a registered investment adviser with the SEC under the Investment Advisers Act of 1940. SEC registration does not constitute an endorsement by the SEC nor does it indicate any level of skill or expertise. RAM believes that any information or data provided has been obtained from sources thought to be reliable, but we do not guarantee the accuracy or completeness of the information. Such information may reflect current market conditions at the time of production; however, it is subject to change without notice and should not be relied upon for anything other than illustrative purposes.*

### Xponance, Inc.

*Xponance is a woman-and diverse-owned asset manager headquartered in Philadelphia, PA. The Xponance Yield Advantage Fixed income assets are headed by Charles Curry, Senior Portfolio Manager. The firm is 100% employee-owned.*

*On August 31, 2018, FIS Group, Inc. (FIS Group) acquired Piedmont Investment Advisors, Inc.'s (PIA) predecessor, Piedmont Investment Advisors, LLC. Xponance®, Inc. (Xponance®) is an independent, registered investment adviser and is the successor registrant under the Investment Advisers Act of 1940 (the "Advisers Act") to both FIS Group and its wholly-owned subsidiary, PIA. Pursuant to a corporate rebranding and consolidation strategy, Xponance® was established effective April 1, 2020, to leverage the long histories of its predecessor entities in providing customized investment management products to institutional clients. FIS Group (through its former subsidiaries, Fiduciary Investment Solutions, Inc. and FIS Funds Management, Inc.) managed assets since 1996 and PIA (through its former affiliate Piedmont Investment Advisors, LLC) began managing assets in 2000. The firm maintains a complete list of composite descriptions, which is available upon request.*