UCRP and GEP
Quarterly Investment Risk Report
Quarter ending June 2011

Committee on Investments/
Investment Advisory Group
September 14, 2011
Contents

- Asset allocation history
  - What are the fund’s asset exposures?
- Asset allocation current position and risk contributions
  - How do they compare to policy targets?
- Capital markets expectations for return
  - What is the probability the fund will achieve its required return?
  - Is the amount of risk required acceptable?
- Historical Funded Status
- Forecast Funded Status
  - What is the probability the fund will be able to meet future obligations (with and without additional contributions)?
- Historical standard deviation of total returns vs. benchmark
- Historical standard deviation of active return
  - What is fund’s realized volatility?
  - How does it compare with the policy benchmark and risk budgets?
Contents continued

- Systematic vs. residual risk contribution  
- Asset allocation vs. selection risk contribution
  - What are the sources of volatility?
  - What factors drive performance?
    Is the fund adequately diversified?
- Sharpe ratio (total risk)
- Information ratio (active risk)
  - Are risk exposures being rewarded?
  - Historical risk adjusted returns
- Performance Attribution
  - What are the sources of active return?
    - Asset allocation versus security selection
    - Which asset classes contributed or detracted from return?
Risk Metrics for UCRP
Asset Allocation

- Total Risk is largely related to the allocation between equity and bonds
- The portfolio was rebalanced to a neutral weighting between equity and bonds by the end of Q2 2011
Asset Allocation and Risk

*Note:* Exposures and Risk charts below are shown using March 1, 2011 target asset weights. Systematic risk is estimated using long term forecasts [from Mercer Investment Consulting, July 2011], not recent realized volatility.

**(Lower Left)** Asset weights are measured relative to Current Policy. The fund has an overweight in Private equity and underweight in Core Bonds and TIPS.

**(Lower Right)**
- The fund’s forecast total systematic risk (blue bars) is 13.53% annualized standard deviation. It is heavily weighted to US and Non-US developed equity (66% of total).
- Forecast active systematic risk is up slightly at 36 bp. The Private equity overweight accounted for almost 80% of this amount (red bars).
Expected Risk and Return

Forecast risk and return (using Mercer’s July 2011 capital markets assumptions) lies near the constrained efficient frontier; long-term forecast return of the current policy allocation of 7.6%* is close to the actuarially required return of 7.5%.

*Asset Class returns and efficient frontiers are shown in the chart as arithmetic (i.e., average) expected returns.

The projected compound annual return over multi-year horizon is 7.6% for the Current Policy weights.

Forecast volatility of the current policy is 14.0%.
The Pension Fund’s liabilities have been growing steadily (upper left) with University employment, while the assets have grown (and fallen) with the equity markets. The ratio of actives to retirees has recently fallen from 3x to 2x (lower left).

The Funded Ratio (= the ratio of assets to liabilities), is an overall metric of the financial health of a pension plan. This ratio has fluctuated considerably over the past (lower right), and has recently fallen below 100% with the bear market of 2007-09.
Forecast Funded Status

- Contributions were reinstated in 2010 after a pension “holiday” that began in 1990. Annual benefit payments have grown in line with and recently exceeded, Normal Cost over the last decade (upper left).

- The bottom charts show projected funded ratio with planned contributions. On the left is a static forecast assuming a constant 7.5% investment return beginning FY 2012. On the right is a simulation of a variable rate of return. It indicates that the probability of reaching full funding (ratio = 1.0) by 2016 is below 20%. [These projections and simulations are approximations only, developed by Treasurer’s Office, not Segal Co.]
Total risk trend is quite similar to the benchmark; recently Plan volatility has been slightly less than the Budget, but well within ranges. Total volatility has resumed a historically normal range, higher than the mid 2000’s but lower than the 2008-09 crash.

Total Risk budget equals Benchmark risk plus the Active risk budget. The ranges are +/- 20% around the budget.

Risk is measured by standard deviation of monthly total returns; each point or bar shows a 12 month measurement period. All risk calculations done using exponentially declining weights. (This and following charts show risk budgets as if they had been in place during entire historical period.)
The spike in Active Risk in Q1 09 resulted from the underweight in equity as the market fell and then rallied, plus higher equity volatility. Active risk has currently resumed its low level of the mid 2000’s (about 0.50% annualized standard deviation). It is still well below long term expectations for active return, but is well diversified.

The Active risk budget is 3% annualized Tracking Error (adjusted for market volatility), with ranges of +/- 1 pct. point around Budget

Risk is measured by standard deviation of monthly active returns; each point or bar shows a 12 month measurement period. All risk calculations done using exponentially declining weights.
Risk Attribution

(Upper Left) Virtually all of Total Risk is attributed to systematic (market) factors (red bars).

(Lower Right) Normally, the majority of Active Risk is attributed to security selection. When asset allocation transitions are implemented, allocation risk increases. During the market turmoil, the equity over/underweight dominated all other decisions, but for the past 5 quarters residual risk is resuming its normal contribution.

Risk is measured here by variance (standard deviation squared) of monthly returns; each bar shows a 12 month measurement period.

Systematic Risk is associated with benchmark exposures; residual risk is associated with non benchmark decisions (security selection).
Risk Adjusted Return: Total

Sharpe Ratio (risk adjusted total return) trend has been quite similar to the benchmark for the past 5 years. The 12 month return on risky assets is positive since 2009 but with typical volatility.

Sharpe ratio is “excess” return (total return less risk-free rate) divided by total risk; each point or bar shows a 12 month measurement period. All risk calculations done using exponentially declining weights.
Information ratio (risk adjusted active return) is the result of both asset weighting decisions and active performance. It is higher when the returns are positive and more consistent (less volatile). The Info. ratio has been positive for the past 5 quarters; from the graph below, active returns for the past 8 quarters have been small but positive.

Information ratio is active return (total return less benchmark) divided by active risk; each point shows a 12 month measurement period. The Significance level is the probability that results are due to skill, with 50% being a neutral measure. All risk calculations done using exponentially declining weights.
Performance Attribution

Active Return for the Quarter was +0.36% (Fund return of 1.48% vs. policy benchmark of 1.12%).

[BELOW] Asset allocation decisions (blue bars) added 0.01% (equity overweight and core bond underweight). Security selection decisions (red bars) added 0.35% (primarily Absolute Returns and non-US public equity).
Risk Metrics for GEP
Asset Allocation

- Total Risk is largely related to the allocation between equity and bonds
- The portfolio was rebalanced to a neutral weighting between equity and bonds by the end of Q2 2011
Asset Allocation and Risk

**Note:** Exposures and Risk charts below are shown using March 1, 2011 target asset weights. Systematic risk is estimated using long term forecasts [from Mercer Investment Consulting, July 2011], not recent realized volatility.

(Lower Left) Asset weights are measured relative to Current Policy. The fund is overweight in Private equity, and Cash, and underweight in Core Bonds and TIPS.

(Lower Right) The fund’s forecast total systematic risk (blue bars) is 14.28% annualized standard deviation. It is evenly balanced among US equity, Non US developed equity, and Absolute Return (71% of total). Forecast active systematic risk is up slightly at 26 bp. The Private equity overweight accounted for almost 70% of active risk (red bars).
Expected Risk and Return

Forecast risk and return (using Mercer’s July 2011 capital markets assumptions) lies near the constrained efficient frontier; forecast return of the current policy mix of 8.2%* is close to the nominal return needed to maintain a constant real payout per student (estimated at 8.5%).

* Asset Class returns and Efficient frontiers are shown in the chart as arithmetic (average) expected returns.

The projected compound annual return over multi year horizon is 8.2% for the Current Policy weights.

Forecast volatility is 14.1%.
Risk Measures: Total

Total risk trend has been quite similar to the benchmark; GEP volatility is quite close to its Budget. Total volatility has resumed a historically normal range, higher than the mid 2000’s but lower than the 2008-09 crash.

Total Risk budget equals Benchmark risk plus the Active risk budget. The ranges are +/- 20% around the budget.

Risk is measured by standard deviation of monthly total returns; each point or bar shows a 12 month measurement period. All risk calculations done using exponentially declining weights. (Charts show risk budgets as if they had been in place during entire historical period.)
The spike in Active Risk in Q1 09 resulted from the underweight in equity as the market fell and then rallied, plus higher equity volatility.

Active risk has resumed its low level of the mid 2000's (about 1.0%), but is still well below long-term expectations for active return, and is well diversified.

The Active risk budget is 3.0% annualized Tracking Error (adj. for market volatility), with ranges of +/- 1 pct. point around Budget

Risk is measured by standard deviation of monthly active returns; each point or bar shows a 12 month measurement period. All risk calculations done using exponentially declining weights.
Risk Attribution

(Upper Left) Virtually all of Total Risk is attributed to systematic (market) factors (red bars).

(Lower Right) Normally, the majority of Active Risk is attributed to security selection. When asset allocation transitions are implemented, allocation risk tends to dominate. In late 2009, the equity overweight dominated all other active decisions. For the past 14 months, residual risk has resumed its normal contribution level.

Risk is measured here by variance (standard deviation squared) of monthly returns; each bar shows a 12 month measurement period. Systematic risk is associated with benchmark exposures; residual risk is associated with non-benchmark decisions (security selection).
Sharpe Ratio (risk adjusted total return) trend has been quite similar to the benchmark for the past 5 years. The 12 month return on risky assets is positive since 2009 but with typical volatility.

Sharpe ratio is “excess” return (total return less risk-free rate) divided by total risk; each point or bar shows a 12 month measurement period. All risk calculations done using exponentially declining weights.
Information ratio (risk adjusted active return) is the result of both asset weighting decisions and active equity and bond performance. It is higher when the returns are more consistent (less volatile). The information ratio has been positive for the past 5 quarters; active return has been small but on average, positive in the past 8 quarters.

Information ratio is active return (total return less benchmark) divided by active risk; each point shows a 12 month measurement period. The Significance level is the probability that results are due to skill, with 50% being a neutral measure. All risk calculations done using exponentially declining weights.
Active Return for the Quarter was +0.90% (Fund return of 1.24% vs. policy benchmark of 0.34%).

[BELOW] Asset allocation decisions (blue bars) added 0.02%. Security selection decisions (red bars) added 0.89% (virtually all from Absolute Returns).