



NEPC, LLC

YOU DEMAND MORE. *So do we.*SM

2013 Investment Manager Webinar

NEPC Research

March 7, 2013

One Main Street, Cambridge, MA 02142 | TEL: 617.374.1300 | FAX: 617.374.1313 | www.nepc.com

CAMBRIDGE | ATLANTA | CHARLOTTE | CHICAGO | DETROIT | LAS VEGAS | SAN FRANCISCO

Today's Speakers



- **Mike Manning, CFA, CAIA**
 - Managing Partner



- **Erik Knutzen, CFA, CAIA**
 - Chief Investment Officer



- **Tim Bruce**
 - Senior Research Consultant

Our Goal

To work constructively with the asset management community to deliver innovative and high quality investment strategies that meet and exceed our clients' objectives.

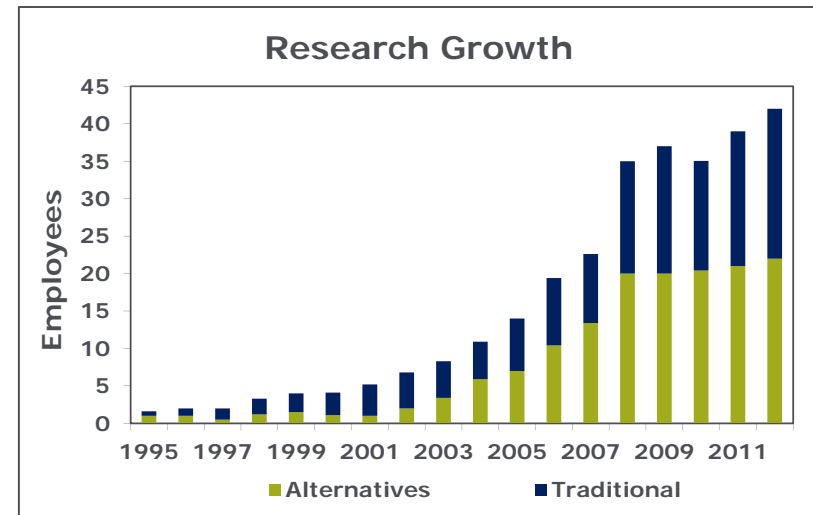
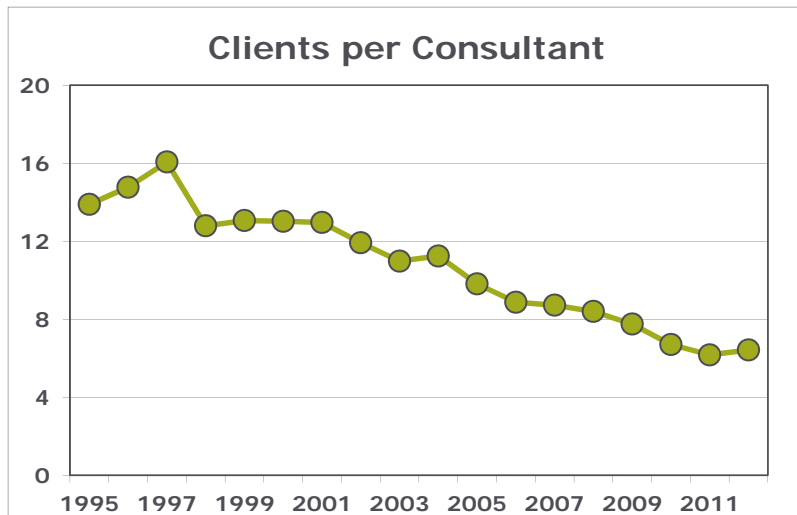
- **Introduction and NEPC Update**
- **Client Perspectives & Market Outlook**
- **Research at NEPC**
- **Investment Manager Searches and Activity**
- **Your Questions**

- **Independent consulting firm since 1986**
 - 100% employee owned, 33 Partners
 - No conflicts
- **Stable, consistent business**
 - Firm stability helps clients and allows us to re-invest in the business

The NEPC Difference

- **Informed innovation**
 - We challenge assumptions to find the best answers
- **Research-driven process**
 - We help clients build the right portfolio for their needs
- **Demonstrated results**
 - Client outperformance in 24 of 27 years
 - Recognized leader in client satisfaction

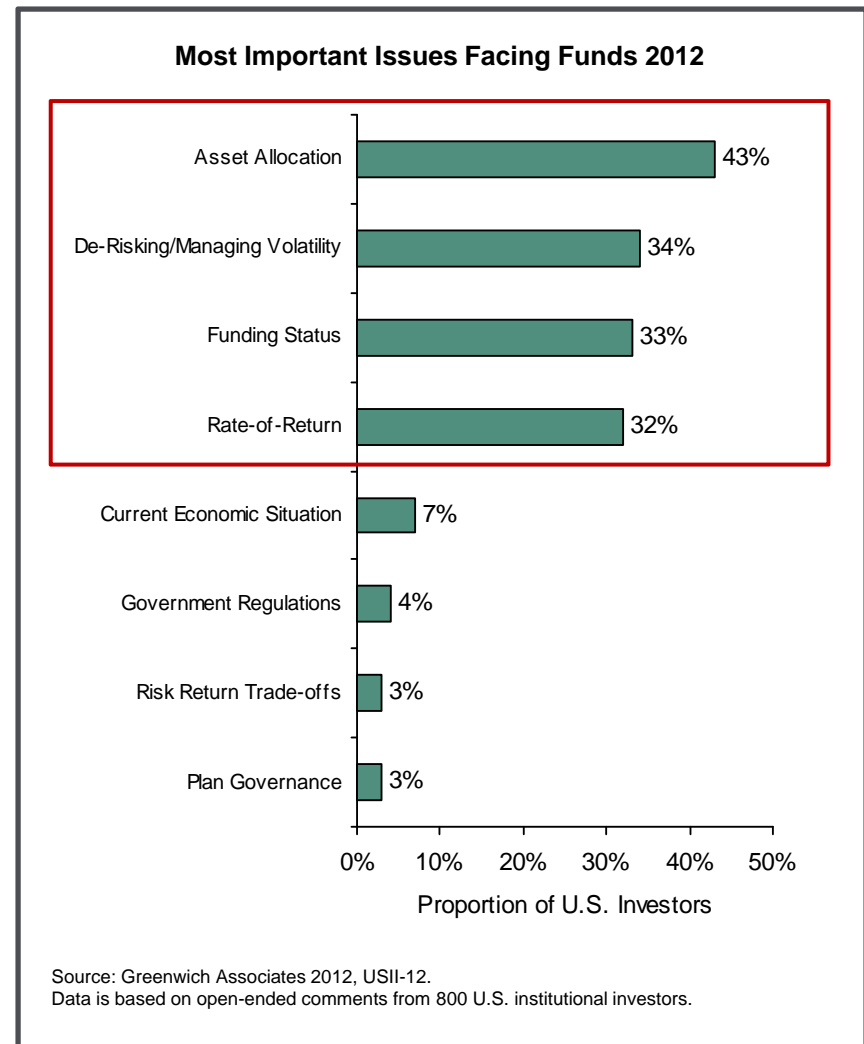
- **NEPC remains the leading independent consulting firm**
 - 311 clients and \$714 billion in assets
 - A destination for investment professionals who want to consult
- **We remain focused on our commitment to clients**
 - Adding consulting staff and services
 - Investing in technology to improve the client experience
 - Offering access to manager meeting notes
 - Continuing to build global research effort
 - Flexible and customized approach to client relationships
 - Advisory and Discretionary service models



Client Perspectives & Market Outlook

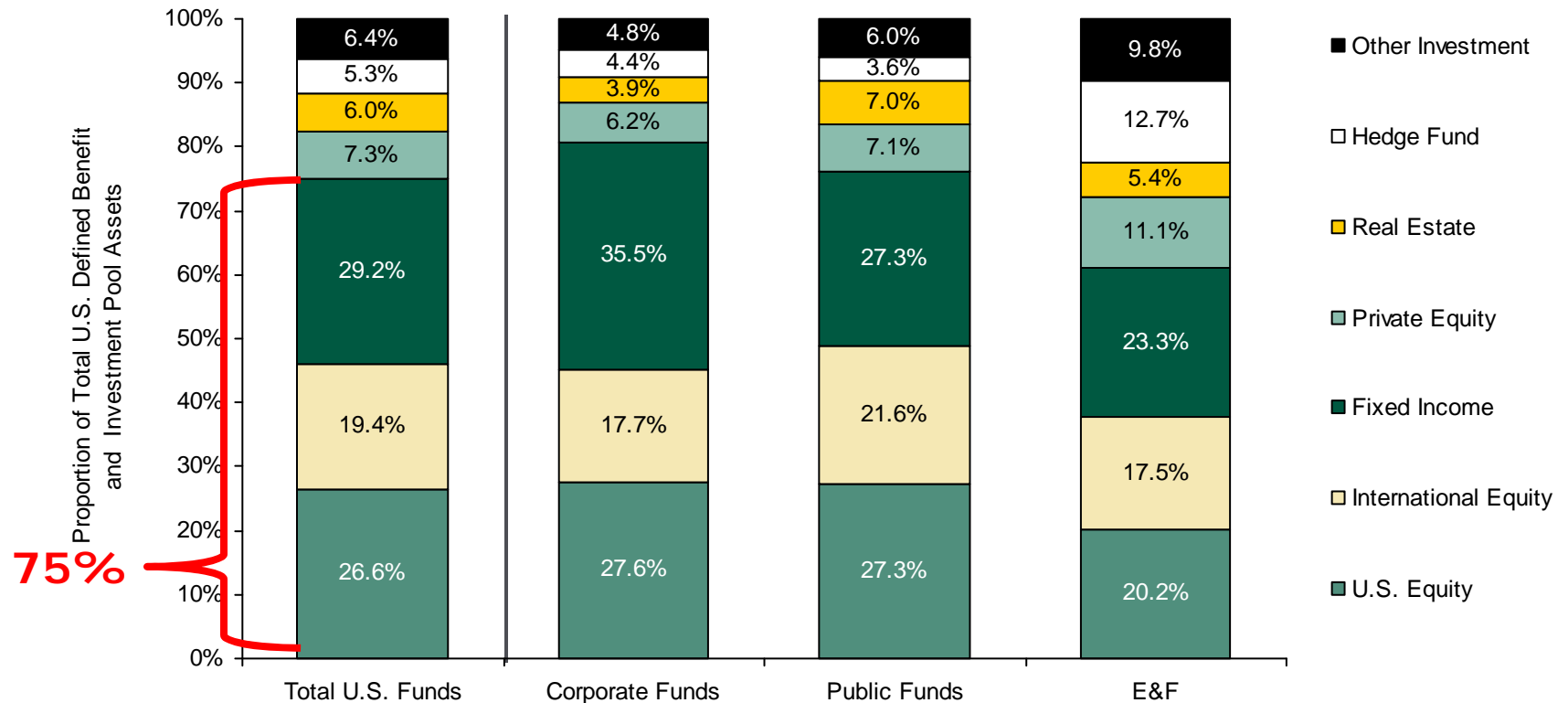


- **Strong 2012 Performance**
 - Average plan up 10.5%
- **Return expectations are down**
 - 7.3%-7.5% on average
- **Funding ratios are below 100%**
 - Corporate @ 81%
 - Public @ 77%
- **Focus is on generating returns and managing volatility**
- **Client plans are increasingly unique**



Asset Allocation Across Client Types

U.S. Investors' Institutional Asset Allocation (DB, Investment Pools, Excluding DC), by Type of Plan



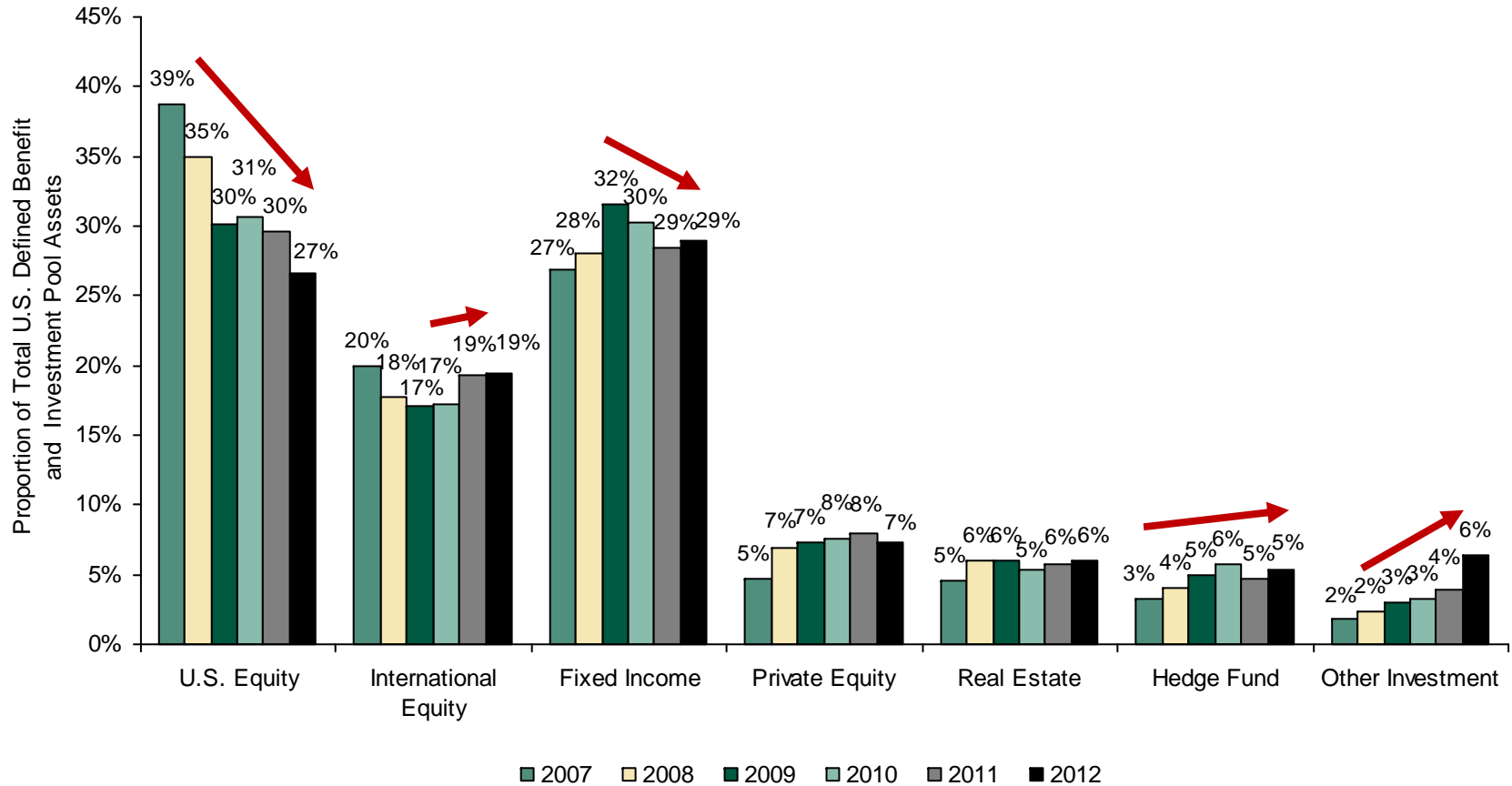
Source: Greenwich Associates 2012, USII-12.

U.S. assets are projected to the 2012 Greenwich Associates universe of 2,357 U.S. institutional investors with \$250 million or more in total assets. Percentages are dollar-weighted.

Results are for institutional assets only: corporate and union fund defined benefit plan assets; public fund defined benefit plan assets; endowment and foundation fund investment pool assets. "Other investment" represent allocations to commodities, money market, and other.

Defined Benefit Asset Trends

U.S. Investors' Institutional Asset Allocation (DB, Investment Pools, Excluding DC)



Source: Greenwich Associates 2012, USII-12.

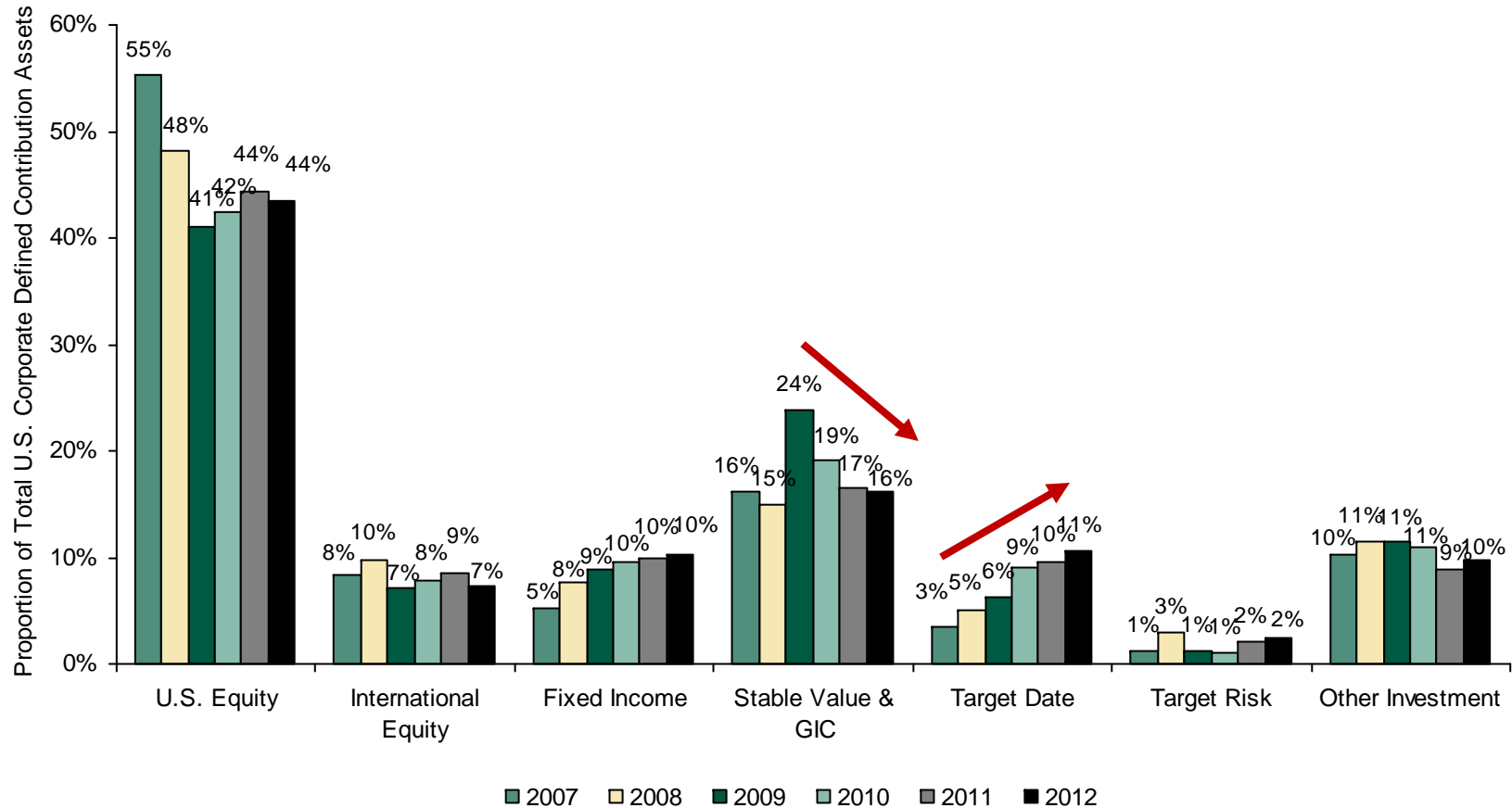
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Defined Contribution Asset Trends

U.S. Investors' Defined Contribution Asset Allocation



Source: Greenwich Associates 2012, USII-12.

U.S. assets are projected to the 2012 Greenwich Associates universe of 2,357 U.S. institutional investors with \$250 million or more in total assets. Percentages are dollar-weighted.

Results are for corporate, union, and public fund (2012 only) defined contribution assets. "Other investment" represent allocations to REITS, money market, balanced, commodities, and other.



- **Recognize that current global deleveraging is a multi-year event**
- **If appropriate, increase portfolio risk – and expected return**
- **Continue to increase emerging markets exposure**
- **Use active strategies to enhance returns**
- **“Buy Low” in segments of illiquid and less liquid assets**
 - Structured securities offer attractive expected returns

- **Strong 2012 market returns lead to subdued expectations**
 - Without a fundamental shift in underlying economic drivers, favorable recent performance “robs from the future” and lowers 5-7 year outlook across markets
 - Markets have rallied based on policy announcements more than economic results
 - Policy accommodation could provide further tailwind to markets in near-term
 - Valuation expansion is unlikely to be a large driver on its own as few markets look cheap
- **Potential for macro shock is elevated in the near term**
 - Stimulative monetary policy in developed world creates a deceptively calm backdrop
 - US fiscal cliff, European misstep, China slow down, or Middle East conflict could send shocks across markets
- **Global growth outlook remains constrained as developed world lacks political will to truly address debt burden**
 - Pressure for fiscal tightening (European austerity, US fiscal cliff) could neutralize benefits of monetary stimulus
 - Structural debt issues plus ancillary effects of money printing will extend deleveraging
- **Seeds of inflation planted but not yet watered**
 - Money printing has led to asset price inflation instead of inflation in the real economy
 - Monetary easing creates long-term inflation threat, but muted credit growth limits near-term inflation pressure

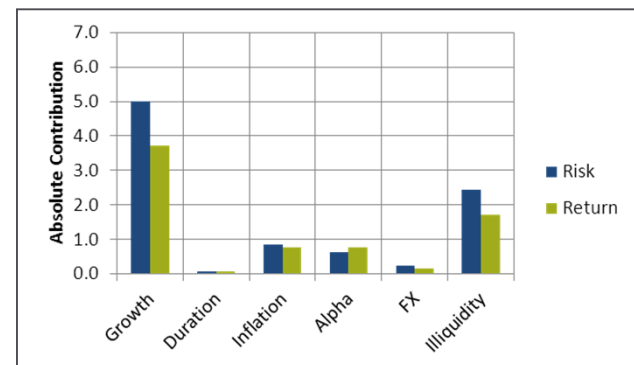
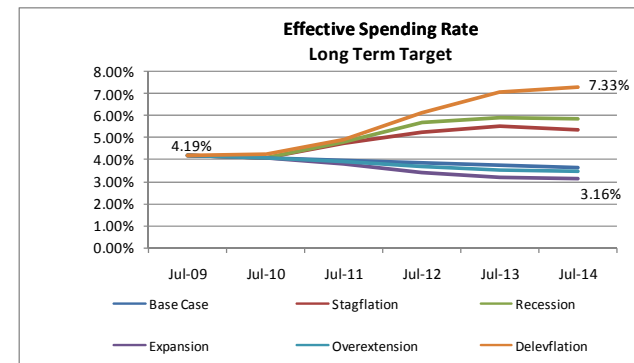
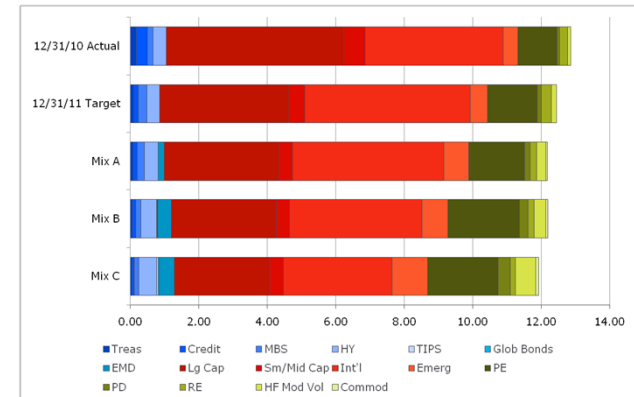
- **Focus on strategic allocations in a time with few tactical opportunities**
 - Confirm your policy objectives and investment goals
 - Avoid stretching for higher returns through increased risk
 - Be prepared to act if opportunities do present themselves
- **Position for a continuation of macro-driven themes**
 - Examine existing managers' capabilities
 - Add to global asset allocation and top-down active strategies
 - Use flexible active managers to implement allocations to policy-driven markets
 - Non-US equities have attractive valuations, but return premium reflects downside risk
 - Credit markets have recovered but liquidity has fallen, making market dynamics less stable
- **Use Risk Parity as a stable foundation of a diversified program**
 - Reconsider what constitutes a “core” investment in this environment
 - No longer just stocks and bonds
 - Risk Parity can be used as a liquid placeholder while tactical opportunities are limited
- **Continue building allocations in emerging markets and real assets**
 - Developing countries consistently demonstrate superior fundamentals to G7 markets
 - Most investors remain vulnerable to higher inflation, with limited real assets exposure
- **Allocate to less liquid strategies with patience**
 - Distressed assets thesis is compelling but current opportunities are limited
 - Strategies providing capital to markets that have traditionally relied on banks are appealing with high income and relatively shorter time horizons
 - Significant system stress remains in real estate market but conditions have improved

Research at NEPC



Asset Allocation at NEPC – A Progressive Approach

- **Mean-Variance analysis is a useful but limited tool for asset allocation**
 - Relies on static/unrealistic assumptions
- **We use multiple models to develop more robust asset allocation solutions**
 - Risk budgeting
 - Scenario analysis
 - Liquidity analysis
 - Alpha risk budgeting
 - Factor Analysis
- **We embrace innovation in asset allocation**
 - Continuously work to develop new models to analyze and stress test current and potential allocations
- **We incorporate dynamic components to our process**
 - Market-driven assumptions
 - Opportunistic component
 - Delegating assets to flexible strategies such as global tactical asset allocation



Dynamic Implementation – NEPC’s Advice Drives Client Actions

2005

- Continue diversification
- **Consider Hedge Funds, Real Return and Global Asset Allocation**

2007

- Mixed signals in market
- Strong returns, low volatility may breed complacency

2009

- Position for opportunities
- Assess total risk in program
 - Evaluate liquidity needs
- Dollar a secular bear

2011

- Examine portfolio structure
- Reduce US equity exposure
- Continue building Em Mkts (EQ & FI)
- **Consider unconstrained FI strategies (Multi-Sector)**
- Illiquid strategies remain attractive

2006

- Relax constraints
- Liability Driven Investing

2008

- Reduce equity exposure
- Position for volatility
- **Credit Opps (April)**

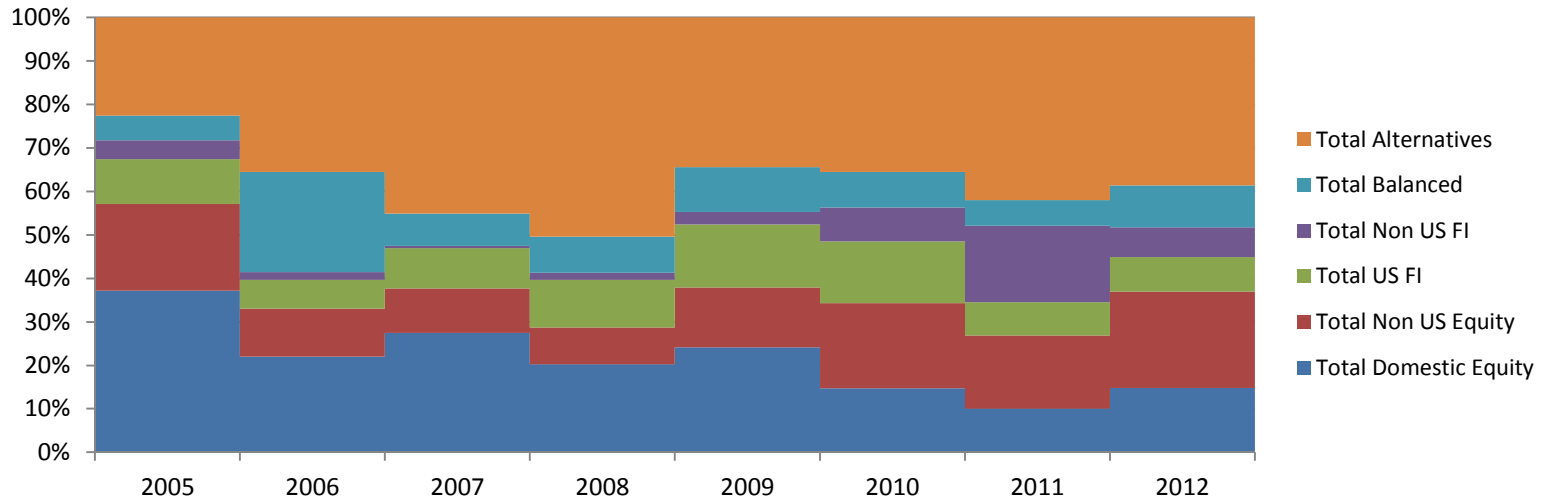
2010

- **Increase exposure to Emerging Markets**
- Build allocation to Real Assets
- Consider illiquid opportunities
- Reevaluate the role of Fixed Income

2012

- **Increasing risk, as appropriate**
- **Allocate to emerging markets, particularly small cap stocks and local currency bonds**
- **Credit appears attractive on a risk-adjusted basis**

Number of Searches by Asset Type (in Percent)



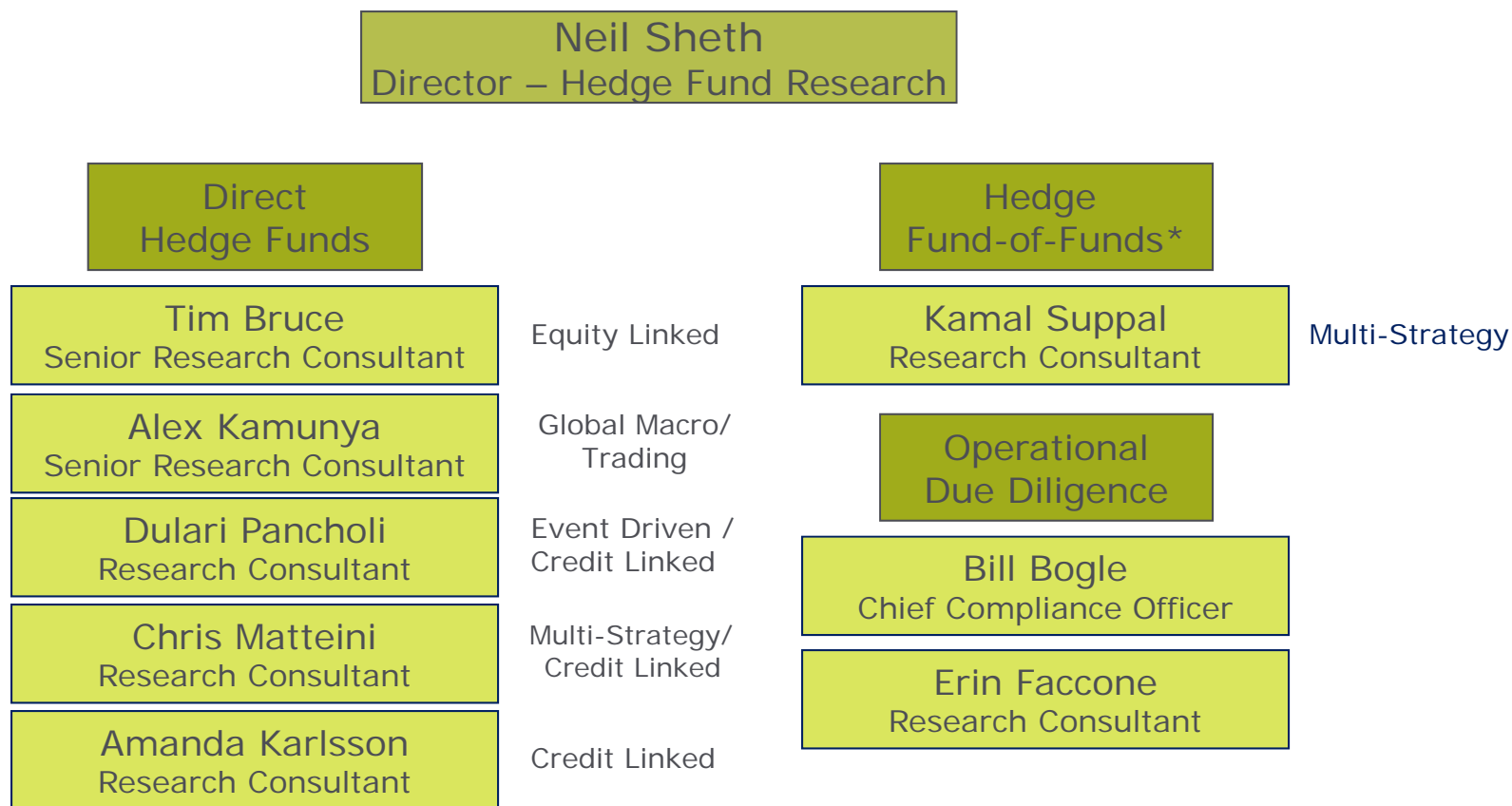
- **NEPC Manager Research**
 - Dedicated Research group supplemented by consulting teams
 - Rate more than 1,200 investment strategies across asset categories
 - Performed more than 2,400 manager meetings in 2012, 250+ in manager offices
 - \$16.0 billion placed in 556 searches in 2012
- **Traditional Research**
 - 12 person team
 - 42 Preferred Lists
 - US, Non-US, Emerging Markets Equity
 - Global, Credit, Emerging Market Fixed Income
 - Commodities, Inflation-Linked, Global Asset Allocation, Risk Parity
 - 300+ Preferred strategies
- **Hedge Funds**
 - \$25.1B in assets under advisement
 - 15 person team
 - 8 Preferred Lists with 60+ Preferred strategies
 - Equity-Linked, Credit, Event-Driven, Global Macro, Multi-Strategy, Fund-of-Funds
- **Private Markets**
 - \$29.3B in committed and invested assets under advisement
 - 12 person team
 - 15 investment categories covered
 - Private Equity, Private Debt, Real Estate, Real Assets
 - ~50 strategies underwritten per year
 - More than 875 total partnerships tracked

Traditional Research – Investment Category Leaders

Tim McCusker Director – Traditional Research	Multi-Asset Class Research
Donna Szeto Senior Research Consultant	US Large Cap Equities
Steve Gargano Senior Research Consultant	US Small/Mid Cap Equities
Jeff Markarian Senior Research Consultant	International Equities, Liquid Real Assets
Phillip Nelson Research Consultant	GAA, Risk Parity, Global Fixed Income, TIPS, LDI Strategies
Seth Bancroft Research Analyst	Fixed Income – Core, Global Credit, Emerging Markets and Opportunistic

Total Traditional Research team of 12 professionals

Hedge Fund Research – Investment Category Leaders



Total Hedge Fund Team of 15 professionals

* Single strategy hedge fund-of-funds covered by Direct Analysts

Private Markets Research – Investment Category Leaders



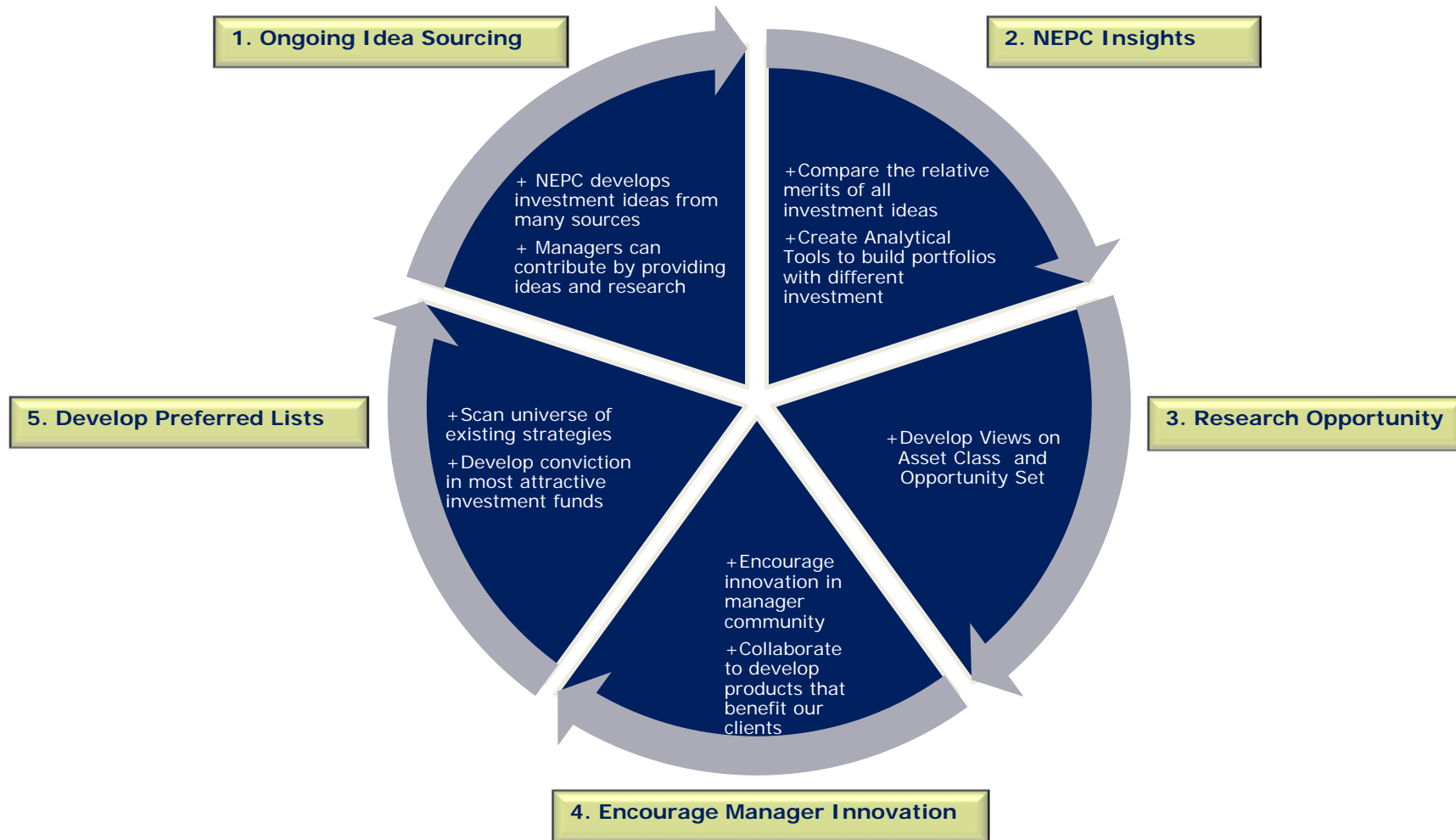
Total Private Markets team of 12 professionals

The NEPC Research Process:

- We are going to provide an overview of how we develop investment ideas and select managers
- We are going to highlight the similarities and differences between the traditional research process and alternatives

Overview of the Research Process

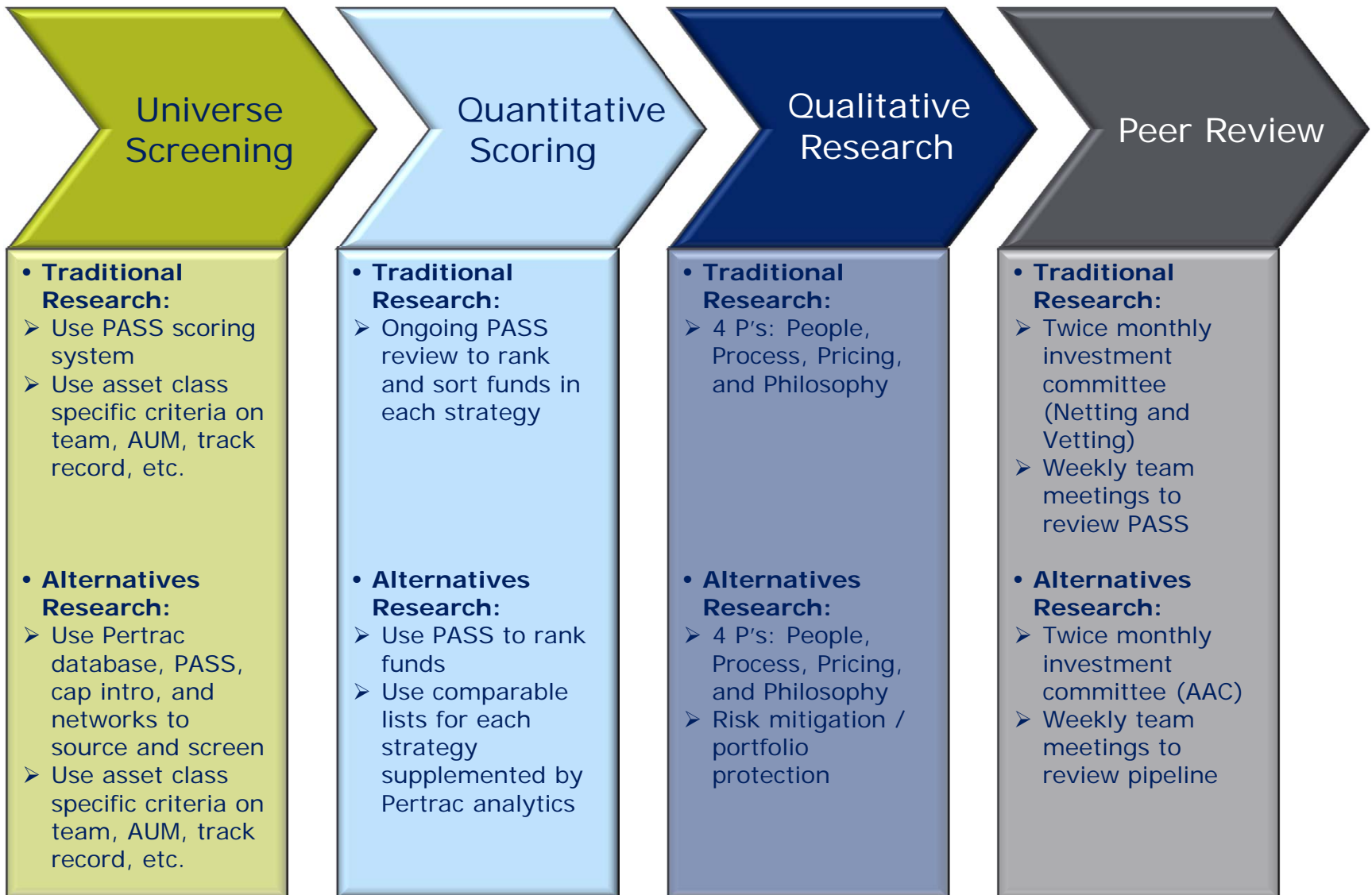
❖ How NEPC develops investment ideas:





Key Manager Criteria:

- “Have you done it?” - Consistent alpha at appropriate risk levels
- “Why can you keep doing it?” - Defensible investment thesis
- “Who is going to do it?” – Solid & stable organization structure

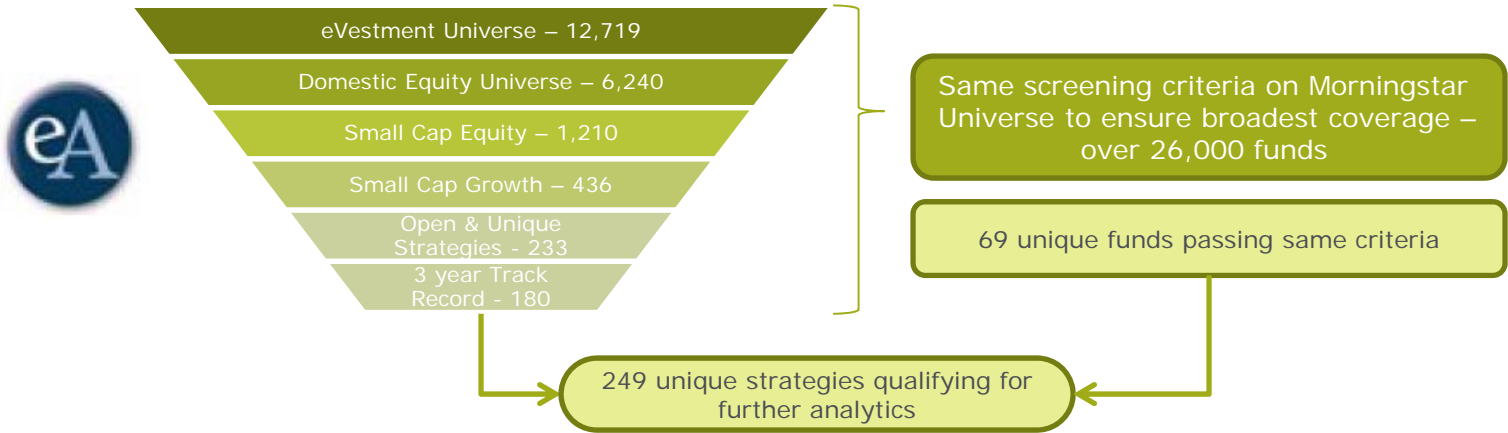




- **Traditional:**
 - eVestment Alliance and Morningstar screened to capture comprehensive universe of strategies in each asset class and investment style
 - Minimum criteria used to focus research
 - Track record
 - Assets under management
- **Alternatives:**
 - Pertrac, HFR, eVestment, and proprietary database to capture fund returns for each hedge fund strategy
 - Minimum criteria used to focus research
 - Track record
 - Assets under management
- **Criteria adjusted for each asset class based on competitive landscape**

Universe Screening – Casting a Broad Net

Here is an Example: Small Cap Growth



Quantitative Scoring – PASS Analytics

- **Traditional and Alternatives:**
- **Proprietary PASS tool (Performance Analytics Statistical Software) used to systematize quantitative analysis**
- **This software isolates net-of-fees alpha, removing market/index performance**
 - Attractive strategies will have consistent net-of-fees performance at reasonable levels of active risk (tracking error)
- **Each strategy scored on variety of excess return statistics**
 - Rolling metrics used to minimize end-point sensitivity
 - Statistical significance of alpha
 - Rolling alpha greater than certain hurdles
 - Upside/Downside Capture
 - Information Ratio
 - NEPC Score on quality of investment thesis and firm stability
- **Scoring channels Research focus to strategies demonstrating ability to deliver excess returns over long term**



NEPC Traditional Research - SMALL CAP CORE - NETTING 07/15/10

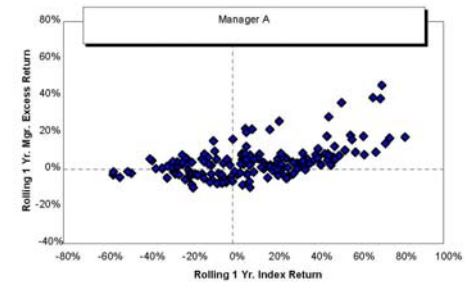
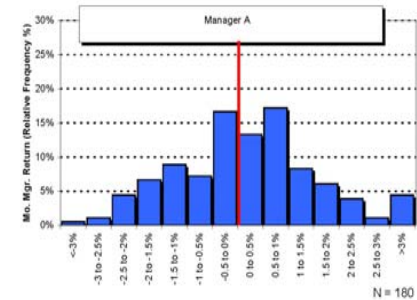
	EVALUATION CRITERIA - DATA								TOTAL SCORE
	CONTRARIAN INDICATOR	ROLLING 3 YR. R.T.R. - % > 0	ROLLING 3 YR. R.T.R. - % > X%	AVG. 3 YR. INFORMATION RATIO	IR + SORT LENGTH OF RECORD	UPSIDE MKT CAPTURE	DOWNSIDE MKT CAPTURE	FIRM/TEAM STRUCTURE/STABILITY	
Assigned Weights	5%	5%	10%	15%	20%	5%	10%	30%	
Managers									
1 Manager 1	0.04	86%	58%	0.63	1.92	86%	72%	5	86
2 Manager 2	0.18	82%	67%	0.58	2.40	125%	100%	5	85
3 Manager 3	0.03	92%	79%	0.73	1.52	93%	79%	5	85
4 Manager 4	(0.02)	77%	65%	0.57	2.31	98%	81%	5	84
5 Manager 5	0.12	88%	68%	0.87	2.82	91%	72%	3	73
6 Manager 6	(0.03)	81%	24%	0.42	2.16	104%	96%	5	73
7 Manager 7	0.34	###	100%	1.14	1.89	100%	70%	2	70
8 Manager 8	0.05	89%	61%	0.87	2.27	104%	89%	3	70
9 Manager 9	0.20	97%	89%	0.71	2.51	100%	70%	2	70
10 Manager 10	0.33	82%	75%	0.95	3.16	106%	78%	2	70
. . .									
172 Manager 172	(0.05)	20%	8%	(0.60)	(1.25)	93%	99%	3	21
173 Manager 173	(0.02)	0%	0%	(0.69)	(1.23)	87%	96%	3	20
174 Manager 174	(0.10)	31%	2%	(0.53)	(1.81)	87%	98%	3	19
175 Manager 175	(0.04)	18%	0%	(0.91)	(2.00)	95%	107%	3	18



- **Traditional and Alternatives:**
- **Deep, qualitative research to identify investment thesis**
 - Strategies scoring well in PASS
 - Strategies identified previously by research team and reasons for poor scoring are well understood
- **An investment thesis is the identification and articulation of a manager’s “competitive edge”**
 - A set of beliefs regarding the security pricing mechanism and what it is about that mechanism which affords the opportunity to add value
 - A set of beliefs about the manager’s competitive advantage in exploiting these opportunities
 - A thesis about how these beliefs can be exploited to generate alpha
- **A belief in a strategy’s investment thesis is forward-looking and leads to a view on the ability to generate future outperformance**
 - Differentiating true investment skill from “noise”
- **Through meetings with lead portfolio manager, investment team and further quantitative analysis, we develop views on each strategy’s key characteristics**
 - Organization/People
 - Investment Philosophy
 - Investment Process
 - Performance Expectations

- Traditional**

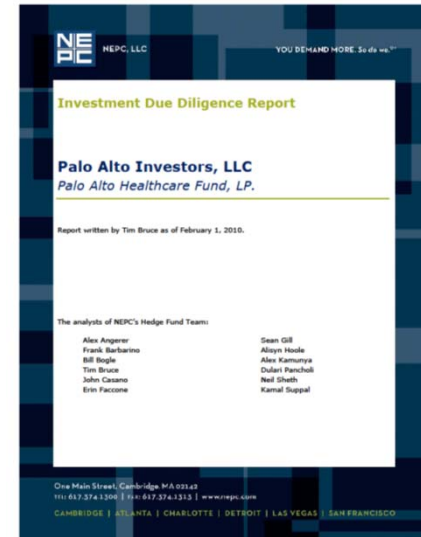
- Rigorous peer through weekly team meetings
- Asset Class Advisory Groups serve as sounding board during research process
 - Potential application of different strategies
 - Provide direction and ideas for new research or new product from managers
- Final proposed list of preferred strategies presented to Due Diligence Committee (Netting and Vetting Committee)
 - Comprised of senior consulting and research professionals
- Comprehensive materials presented along with qualitative review from Research staff
 - Materials cover firm, process, NEPC investment thesis, detailed net-of-fees alpha analytics

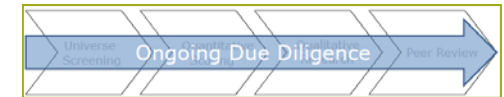




- **Alternatives**

- Rigorous peer through weekly team meetings
- Asset Class Advisory Groups serve as sounding board during research process
 - Potential application of different strategies
 - Provide direction and ideas for new research or new product from managers
- Final proposed list of preferred strategies presented to Due Diligence Committee (Alternative Assets Committee)
 - Comprised of senior consulting and research professionals
- Comprehensive materials presented along with qualitative review from Research staff
 - Materials cover firm, process, NEPC investment thesis, detailed net-of-fees alpha analytics
- Operational Due Diligence review by separate NEPC team





- **Traditional and Alternatives:**
- **Centralized Due Diligence Committee meets bi-weekly throughout the year to evaluate recent events & potential issues**
 - Investment professional departure
 - Change in firm ownership structure
 - Litigation
 - Changes to original strategy mandate
 - Subtle long-term issues – questions of change in a firm’s approach or commitment to particular business lines
- **Defined due diligence status at firm and strategy level to supplement strategy ratings**
 - Maintained and reviewed regularly by Due Diligence Committee
- **For all events requiring client action, a 48-hour letter from NEPC’s Research outlining our opinion and suggested action delivered directly to clients**
- **Annual review of all strategies in client portfolios through NEPC Research or Consulting teams**

Manager Search Activity



Searches Conducted in 2012

Total Searches & Reviews 556

Searches by Asset Class

Large Cap Equity	31
Sm/Mid Cap & Mid Cap Equity	22
Small Cap Equity	21
All Cap Equity	6
Fixed Income	26
High Yield Bonds	11
International Equity/Global Equity/Emerging	120
Global Bonds/Emerging Market Debt	37
LDI	6
<i>GAA/TAA (includes LifeCycle)</i>	<i>52</i>
<i>Hedge Funds</i>	<i>63</i>
<i>Private Equity</i>	<i>110</i>
<i>Real Estate</i>	<i>38</i>
<i>Commodities</i>	<i>13</i>

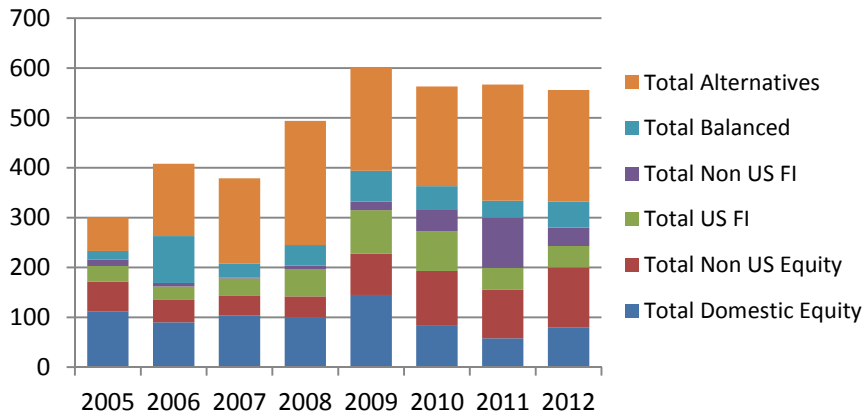


50% of all searches were for non-traditional managers and strategies

Total Search Assets \$16.0 billion

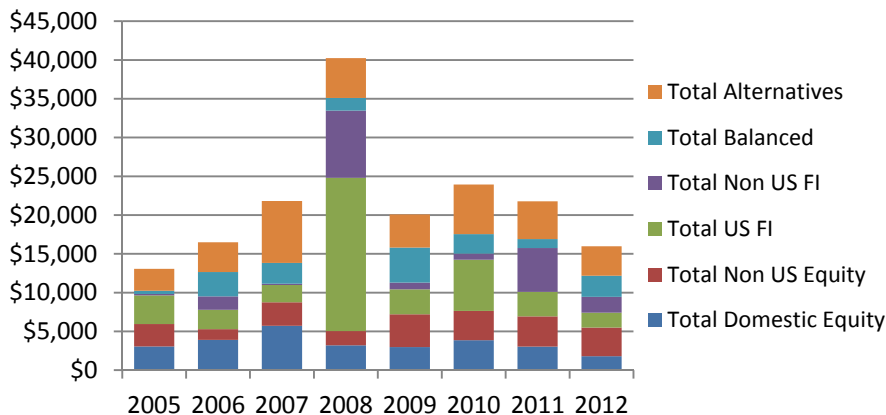
NEPC Historical Search Activity

Total Number of Searches



- **556 Total Searches in 2012**
 - Search activity spread across asset classes
 - Much of the activity is to broaden diversification or pursue specific opportunities

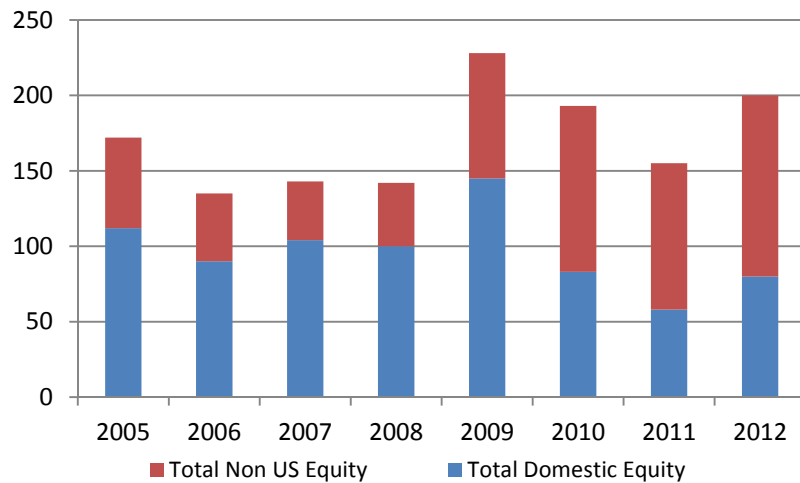
Total Assets Placed in Searches (in millions)



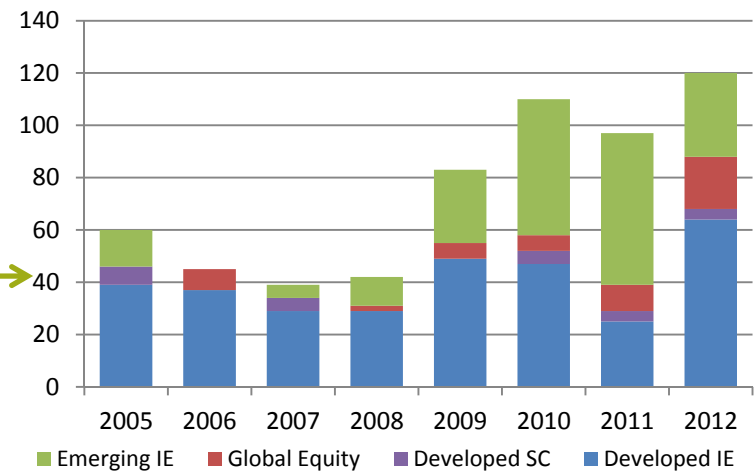
- **\$16 billion in searches in 2012**
- **2008 Fixed Income asset flows a result of market dynamics**
 - Addition of credit opportunities
 - LDI within Corporate clients

Thesis: Developed Market De-Leveraging and Emerging Markets Growth

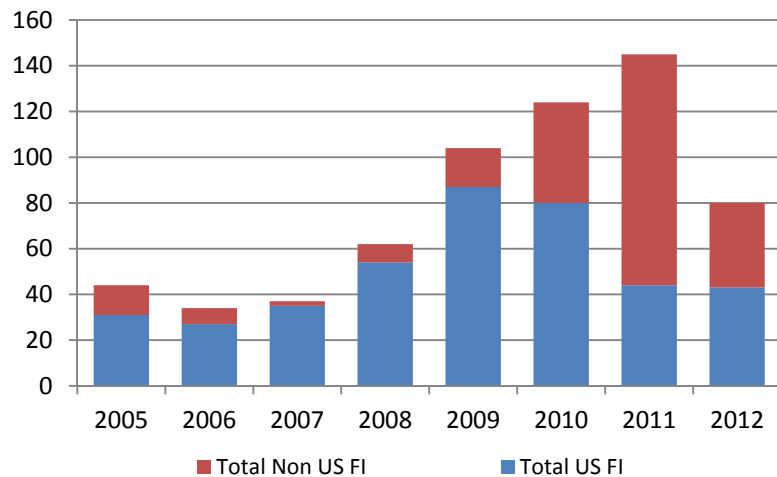
Number of Searches in Equity



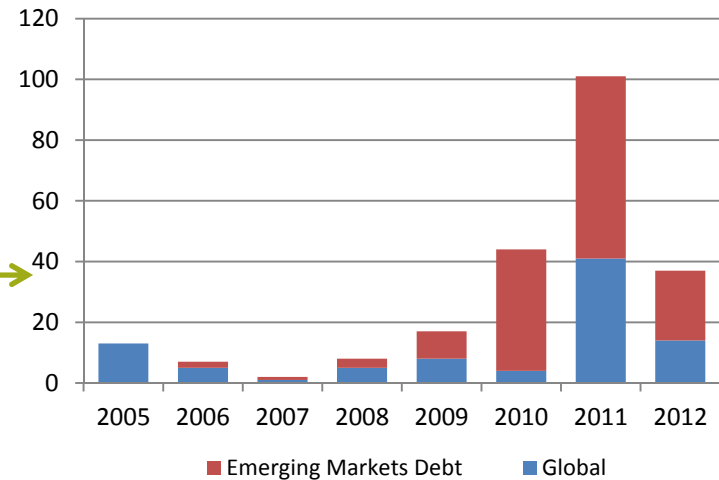
Number of Non US Equity Searches by Asset Class



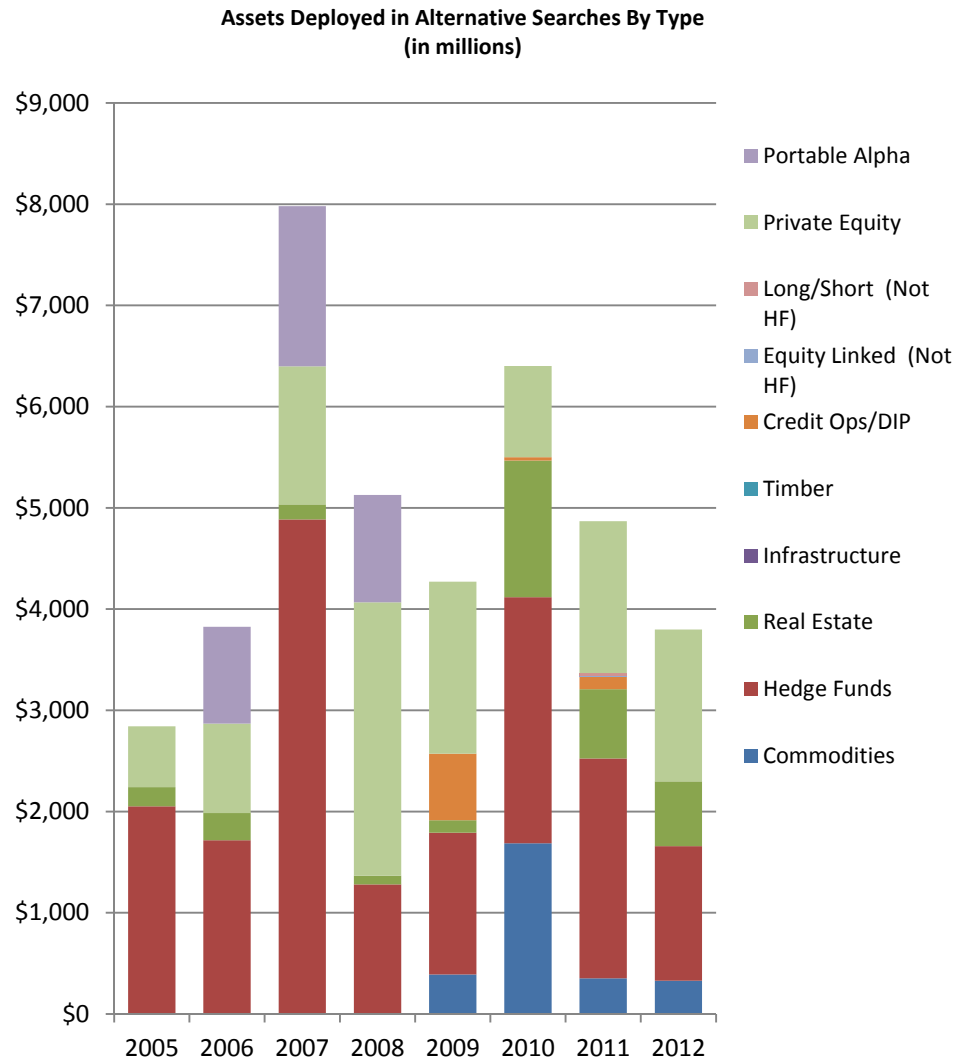
Number of Searches in Fixed Income



Number of Non US/Global Fixed Income Searches by Asset Class



Alternative Search Activity



- **Recent focus areas:**

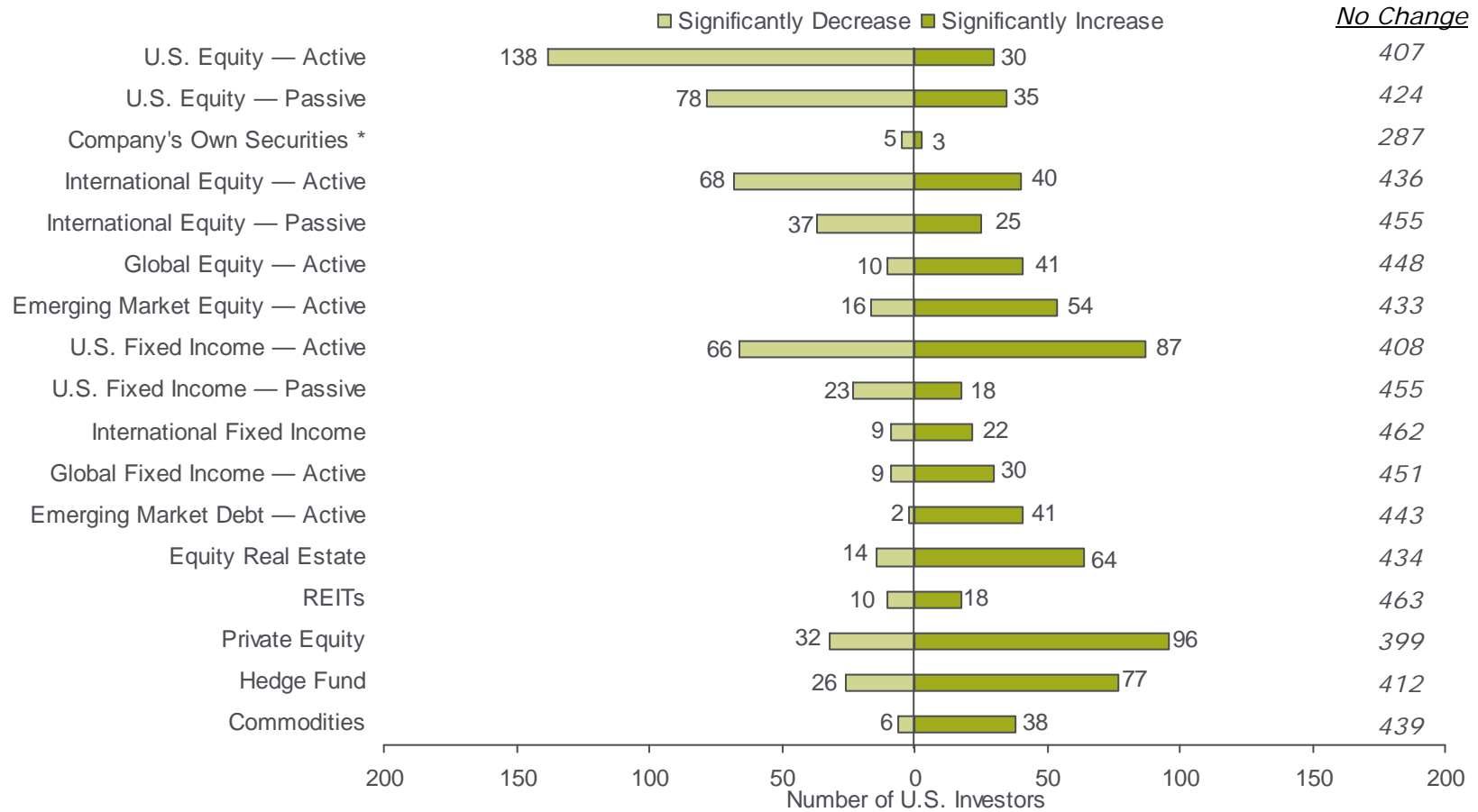
- European Distressed
- Secondaries
- Growth and Small/Mid Buyouts
- Emerging Markets Private Equity
- Global Macro Hedge Funds
- Credit Hedge Funds
- Direct Lending
- Energy

- **Less emphasis on:**

- Large Buyouts
- Venture Capital
- Core Real Estate

Industry Data – Clients Expect Recent Asset Shifts to Continue

U.S. Investors' 3-Year Institutional Asset Allocation Expectations



* Company's Own Securities asked of Corporate funds only.

Source: Greenwich Associates 2012 Survey

Final Thoughts



- **Stay on top of our views**
 - Available at www.nepc.com
- **Bring your best ideas forward**
 - “Best in Class” products
 - Products consistent with identified market opportunities
 - Innovative strategies
- **Focus on Quality not Quantity**
 - A few meetings on the right products and strategies will be much more productive for both sides than meetings for the sake of meetings
- **Be willing to take “No” for an answer**
 - Engage constructively with our Research team-members, be patient with the timing of our Preferred strategy assessment process, and accept our feedback graciously
 - We cannot accept every meeting request we receive and deliver high quality research for our clients

What Managers Should Expect from NEPC

- **Information about client needs and search activity**
- **Our views on the market and our key messages to clients**
- **Our framework for evaluating managers**
- **Responsiveness to meeting requests**
- **Candid feedback**

Your Questions