MEKETA
INVESTMENT GROUP

Risk Mitigating Strategies: Universe Analysis

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Risk Mitigating Strategies, or "RMS," is an asset allocation program designed by Meketa Investment Group to provide institutional portfolios with robust diversification benefits and defensive characteristics relative to growth-like asset classes such as equities and credit. RMS programs are designed to have low correlations to equities and traditional assets on average, but especially to have the potential to profit from turbulent markets or equity drawdowns by having low to negative conditional correlations to equities during these times.

RMS programs generally incorporate several of the following asset classes: Long Term Treasuries, Trend Following, Global Macro, Long Volatility, and Alternative Risk Premia. Meketa tailors RMS programs to each investor's objectives and constraints. Meketa favors a portfolio approach when constructing an RMS program, as no single strategy can effectively fulfill all return and risk objectives of the program . Meketa designs these programs after carefully evaluating the specific objectives and constraints of each investor. Since no two institutional investor portfolios are the same, and return objectives and risk constraints can vary among investors, RMS does not have a single specification or "one size fits all" formula.

While we published a white paper in September 2019 that thoroughly explains our approach to RMS, our work with clients' RMS programs dates back to mid-2015. Meketa designed RMS expecting programs to provide defensive characteristics (e.g., downside protection) relative to equity-dominated portfolios during times of crisis while at the same time offering positive expected returns during normal times to mitigate the opportunity cost of reduced holdings of higher expected return asset classes.

Recent performance

During the first quarter of 2020, concerns about the economic impact from COVID-19 resulted in global equities declining by up to 34 percent for both the S&P 500 and MSCI ACWI. With the S&P 500, the sell-off occurred over only 24 days, representing the fastest decline to bear market territory in history. This served as the first true test for the RMS programs implemented by Meketa clients of whether they would perform as designed. What follows is an analysis of those programs.

The universe evaluated includes all clients with whom Meketa works that utilize either an explicit RMS program or a similarly defensive portfolio that is not called RMS but resembles it in design[1]. This currently includes 36 clients, implying a fairly robust sample size. The following charts provide a summary of the universe performance during the first quarter of 2020.

[1] Some Meketa clients have implemented RMS or Crisis Risk Offset (CRO) programs at the asset allocation level (i.e., explicit RMS), while others have structured them as defensive allocations within fixed income, alternatives, or hedge fund allocations (i.e., implicit RMS)

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Figure 1 shows the average and median performance of the RMS universe alongside the returns for US stocks (i.e., the S&P 500), core investment grade bonds (i.e., the Bloomberg Barclays Aggregate), and a naïve 60% stock/40% bond mix. It shows that RMS programs performed as expected, posting solid gains. Specifically, the median RMS strategy gained 6.0% and the average was up 7.5%. These compare favorably to core bonds, which serve as a traditional anchor-to-windward, which produced a 3.1% gain.[2] Clients took advantage of these positive returns and rebalanced toward risk-oriented assets.

[2] We understand that many investors use active management to implement their core bond portfolios. Experience has taught us that many core bond managers accept greater credit risk in their portfolios in pursuit of a higher yield than their benchmark. In addition, many core bond managers had a shorter duration posture than the benchmark at the beginning of 1q20. Unsurprisingly, the average core fixed income fund was up 2.0%, gross of fees, in 1q20 according to eVestment Alliance (data as of 6/1/20).

FIGURE 1
Performance Comparison for 1Q2020

Figure 2 below provides additional perspective regarding the performance of the RMS universe during the first quarter of 2020. In this case, we show the full range of performance, as illustrated by quartile. It shows that the universe had outliers well above and below median, with the difference in returns ranging more than 20%.

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These differences stem largely from program design or class construction. Investors favoring long duration US Treasuries or long volatility strategies produced the higher returns for the first quarter of 2020. Clients favoring alternative risk premia and discretionary global macro fared less well in the environment.

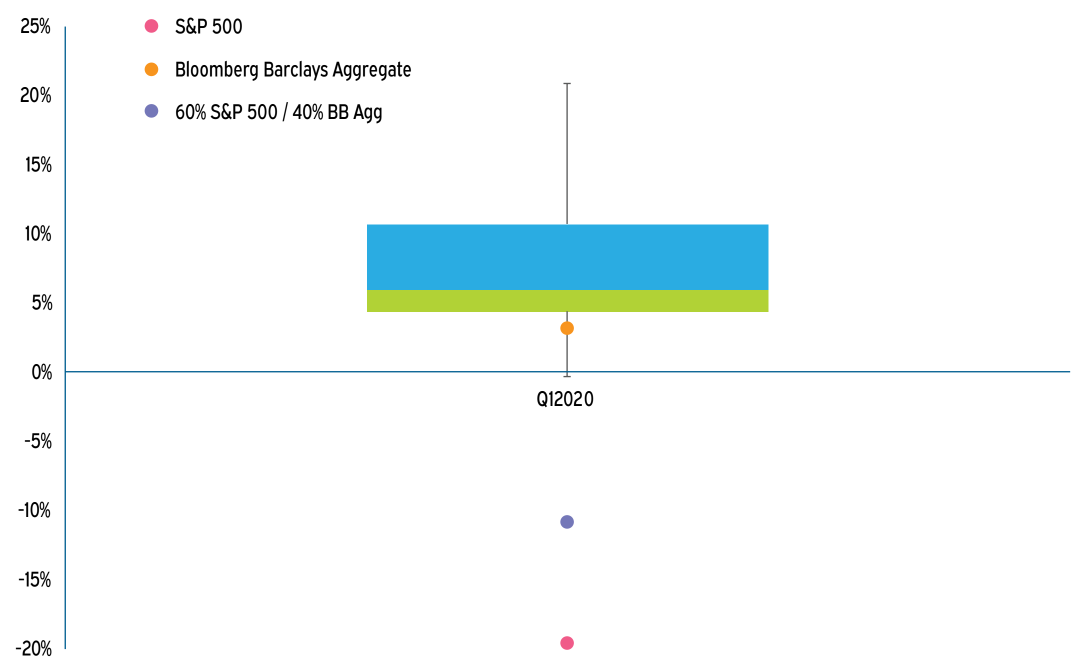

FIGURE 2
Interquartile Performance for 1Q2020

Summary

Global markets presented an extreme challenge to all investors during the first quarter of 2020. It also provided a true test since publishing our white paper in 2019 of whether our clients' RMS portfolios would perform as designed under a period of severe equity stress. RMS programs had a material impact on reducing client drawdowns, allowing them to harvest gains and purchase higher risk assets.

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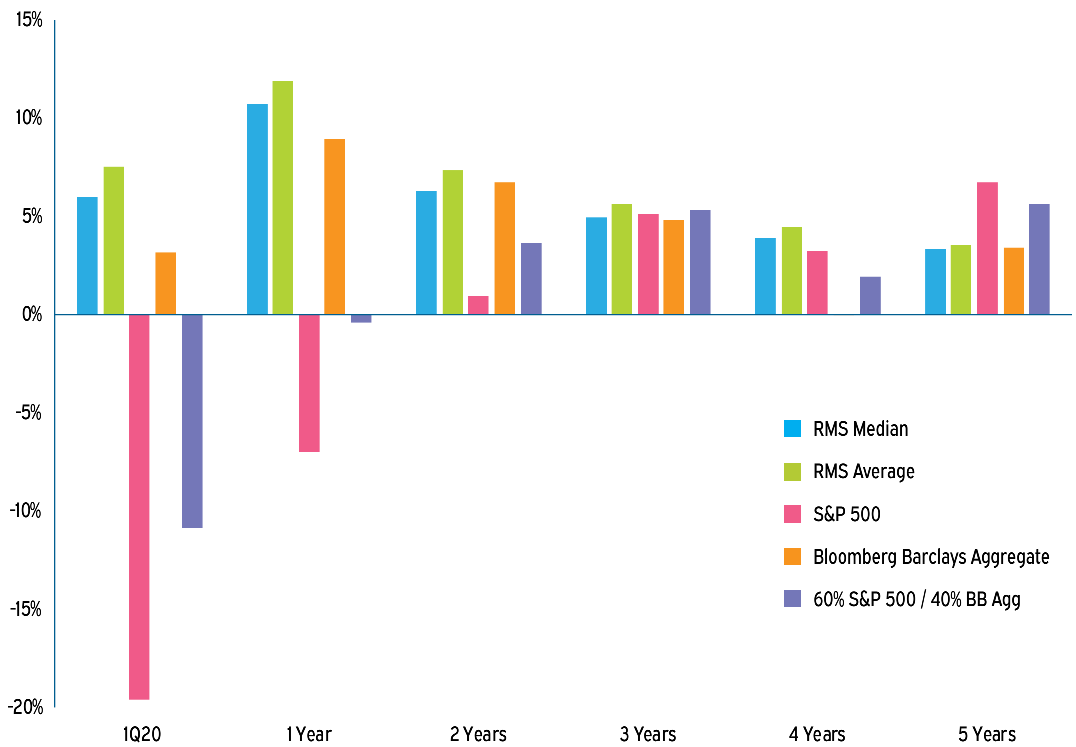
In short, our clients' RMS program behaved as anticipated during the market downturn. The median RMS strategy gained 6.0% and the average was up 7.5% during the first quarter. These returns compare favorably to core bonds, which serve as a traditional anchor-to-windward, which produced a 3.1% gain.

Appendix

TABLE 1
RMS Universe Composition by Historical Period

	1Q2020	1 Year	2 Year	3 Year	4 Year	5 Year
Number of Clients	36	36	26	18	17	12
Client Type						
Corporate	4	4	2	2	1	1
Endowment & Foundation	14	14	10	8	8	4
Multi-Employer	8	8	5	4	4	3
Public	10	10	9	4	4	4

FIGURE 3
Trailing Period Performance as of March 31, 2020



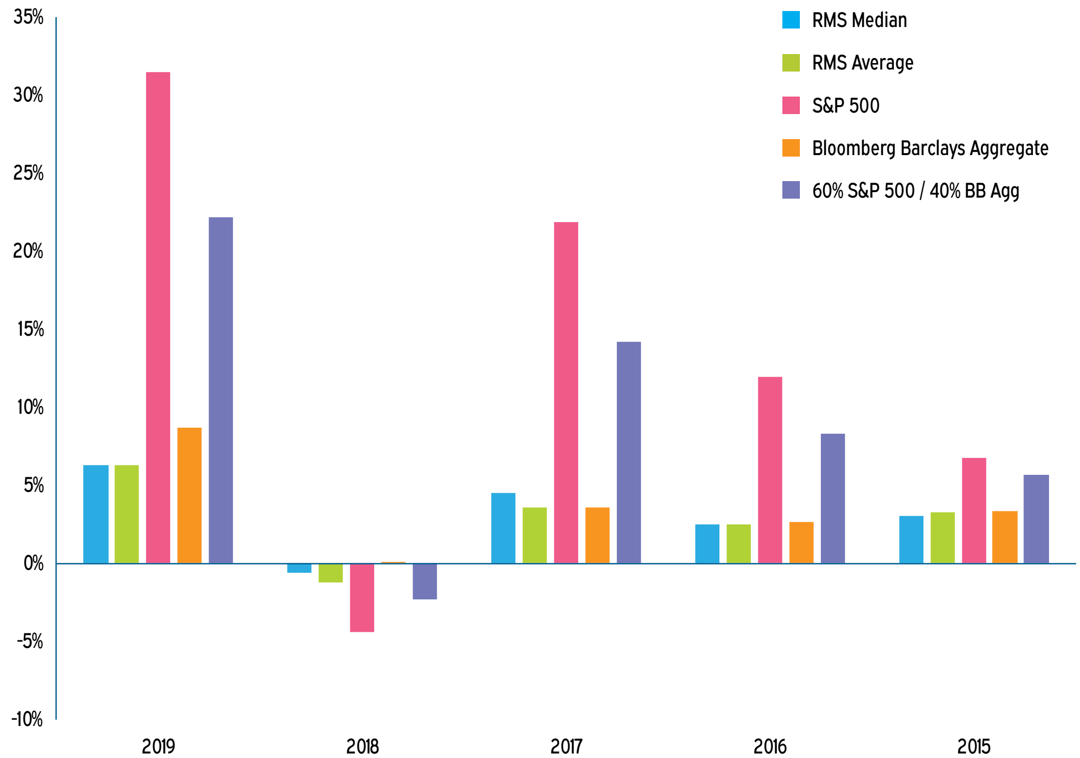


FIGURE 4
Calendar Year Performance

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The description herein of RMS and the targeted characteristics of this strategy and investments is based on current expectations and should not be considered definitive or a guarantee that the approaches, strategies, and investment portfolio will, in fact, possess these characteristics. In addition, the description herein of a Meketa risk management strategy is based on current expectations and should not be considered definitive or a guarantee that such strategy will reduce all risk. These descriptions are based on information available as of the date of preparation of this document, and the description may change over time. The RMS strategy is unique for each client and there is no guarantee that the strategy will benefit any client account. Past performance of these strategies is not necessarily indicative of future results. There is the possibility of loss and all investment involves risk including the loss of principal.