GALLIARD
Capital Management, Inc.
ARCHITECTS OF INVESTMENT SOLUTIONS

SOME THOUGHTS ON STABLE VALUE PORTFOLIO MANAGEMENT IN THE CURRENT MARKET

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With the recent volatility in the markets and the increased uptick in participant flows into stable value products, we wanted to take a moment to offer a few thoughts on some themes in the current market and their impacts on stable value portfolios. There will likely be more unsettled times to come and we will continue to navigate our portfolios accordingly. In the meantime, we continue to work to provide the consistency that you have come to expect from Galliard-managed stable value portfolios. Our stable value portfolios continue to be managed consistent with their investment objectives of seeking to provide preservation of capital, relatively stable returns, and liquidity for benefit responsive plan or participant withdrawals

Comparison to the 2008 financial crisis

We have been asked by a number of people if we can draw any comparisons between the current environment and the depths of the 2008 financial crisis. These past few weeks, we have experienced similar cash flow dynamics compared to Q4 2008 and other prior market dislocations. As we have seen previously, defined contribution plan participants in general are seeking safety from the market volatility and losses they are experiencing in their plans' riskier investments. If history is any indication, the majority of participants that reallocate to stable value during times of crisis tend to be hesitant to again take on risk in the short-term. As a result, we are cautiously reinvesting the in-flows we have received in our stable value portfolios to maintain our strategy.

While the severity of the current crisis is reminiscent of the financial crisis in 2008, the drivers differ. The 2008 crisis was largely the result of an overheated asset class (housing), fraudulent underwriting and an over leveraged financial system. The financial system appears to be on firmer footing this time around; however, additional monetary and fiscal stimulus will likely be needed to provide necessary liquidity to households and businesses alike. The size of the stimulus needed and the ultimate impact is uncertain. Liquidity in most sectors is difficult and has been changing day-to-day.

Our portfolios are generally well positioned for this type of risk-off scenario, given our high quality and shorter spread duration biases. We are taking a wait-and-see approach for now, but remain open to opportunistic trading to take advantage of spread widening. We will continue to monitor accounts and the markets to adapt as necessary, but continue to focus on the implementation of our time-tested investment strategy to deliver the principal preservation and consistency that our clients and their plan participants expect from Galliard-managed stable value portfolios.

Negative rates and the impact on stable value strategies

We have also received a number of inquiries regarding the potential impact of negative interest rates on the stable value strategies we manage. Stable value portfolios have certain characteristics and strategic flexibility that should help to mitigate the short term impacts if negative interest rates were to develop in the US fixed income markets:

1. Galliard's stable value portfolios employ stable value investment contracts that provide for a minimum crediting rate of 0%, regardless of the yield of the underlying portfolio assets. Currently, contract providers continue to actively issue stable value contracts and given no indication thus far of any expected change in their commitment to continue providing capacity for additional investments.
2. Due to the sharp decline in interest rates, all Galliard-managed stable value accounts had strong, positive market to book value (MV/BV) ratios as of the end of February 2020, which support contract crediting rates as those gains are amortized to investors. If interest rates were to decline further (even into negative territory), those gains within the stable value contracts should improve (increase) and, thus, continue to support positive stable value crediting rates over the intermediate term.
3. The underlying fixed income portfolios employed in Galliard accounts maintain an intermediate duration profile and emphasize quality and diversification across issuer and sector within the U.S. investment grade bond market. Even if short term US Treasury rates continue to move towards zero or even negative, we anticipate our broadly diversified portfolios will continue to maintain a yield advantage that, at least for the foreseeable future, will continue to provide positive underlying yields for our stable value portfolios.

The longer term implications of an extended near zero or negative interest rate environment are more complex and uncertain and will impact all facets of stable value portfolio management, in addition to the broader impacts on principal preservation investments and retirement savings programs generally. This continues to be an area of focus internally at Galliard and within the stable value industry at large, and we will be happy to update you should evolving market conditions impact our long-term strategy.

In closing, at Galliard, we understand that your stable value option is often the most conservative investment made available to your plan participants, and the participant in-flows we've seen over the last few weeks are daily reminders that participants rely on stable value as a safe haven during times of uncertainty. Our philosophy and process for stable value management were built on this understanding and we have consistently delivered on these objectives for almost 25 years. We appreciate your continued confidence in Galliard and are focused on continuing to provide safety and stability to our investors as the current market environment evolves.

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