DEFERRED COMPENSATION COMMITTEE CALENDAR SHEET
June 5, 2024

To: Deferred Compensation Committee

From: Diane Chui Justen
Deferred Compensation Director

Date: June 5, 2024

Agenda Item: Stable Value Overview and Update

Recommendation:
Discussion item only.

Background:

The SFDCP Stable Value Fund ("SVF") currently holds nearly $950 Million in participant assets as of March 31, 2024, accounting for 18% of Plan total assets under management. SVF has been managed by Galliard Capital Management since 2013 and their current five-year contract with the SFDCP expires on June 30, 2025. As a result, an investment manager search is required, and Callan will be conducting their manager search process.

Staff and Callan will provide an overview of Stable Value, and will also present a proposed timeline outlining the custom search process, with Staff and Deferred Compensation Committee involvement, over the next eight to ten months.

The SFDCP may choose to invoke the twelve-month extension provision in the existing contract with Galliard at any time, which would extend the expiration to June 30, 2026 if needed.

Attachment:
Callan Presentation

June 5, 2024

SFDCP: Stable Value Overview and Manager Search Process

Greg Ungerman, CFA
DC Practice Leader

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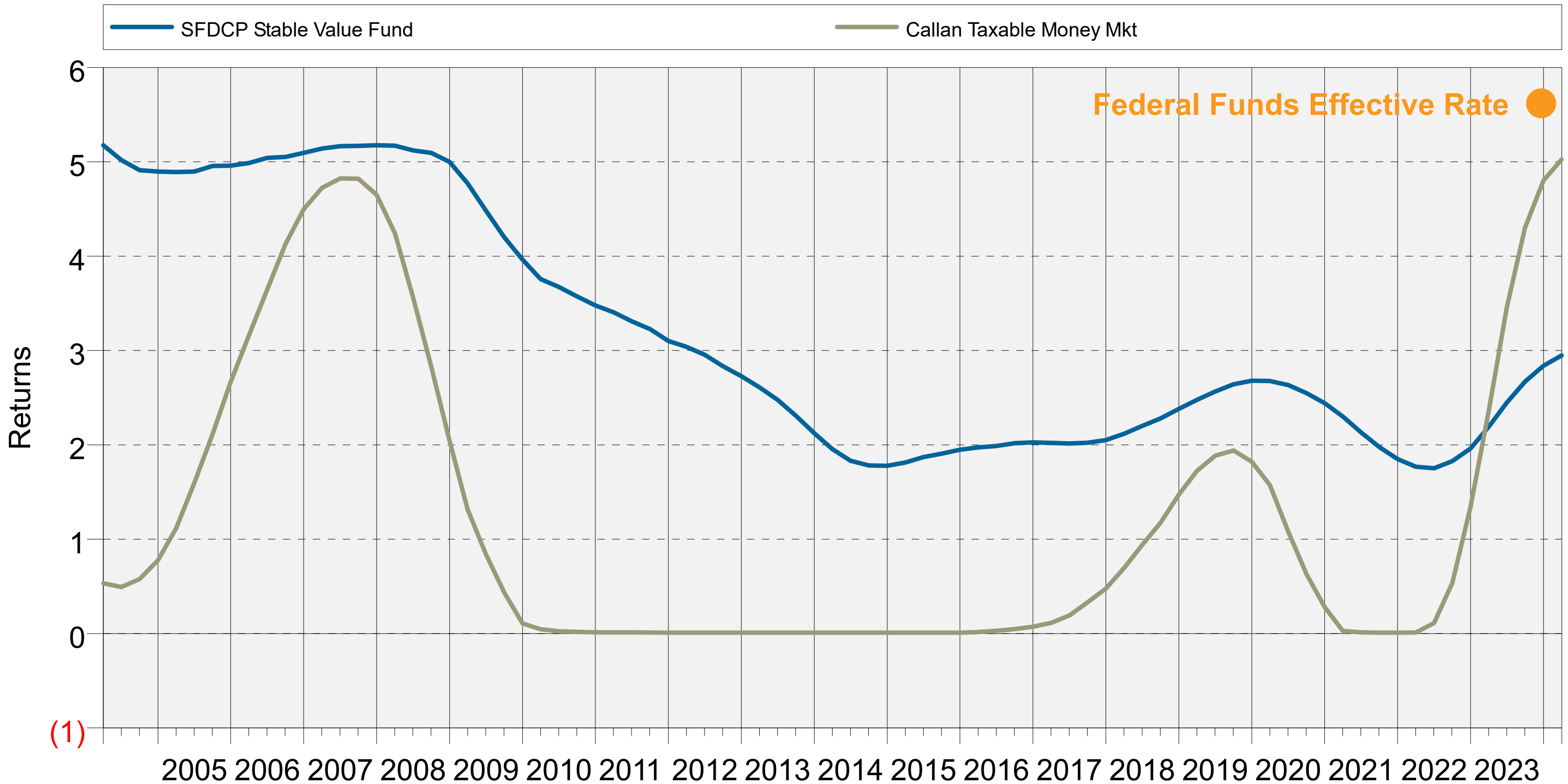
Short Term Interest Rate Spike vs Stable Value

Rolling 1 Year Returns for 20 Years Ended March 31, 2024



- Wrap contracts provide greater return consistency versus money market funds but can trail Money Market funds in periods when rates rise quickly and/or there is an inverted yield curve.
- The SFDCP Stable Value Crediting rate continues to rise and is set to 3.08% for Q2 2024.

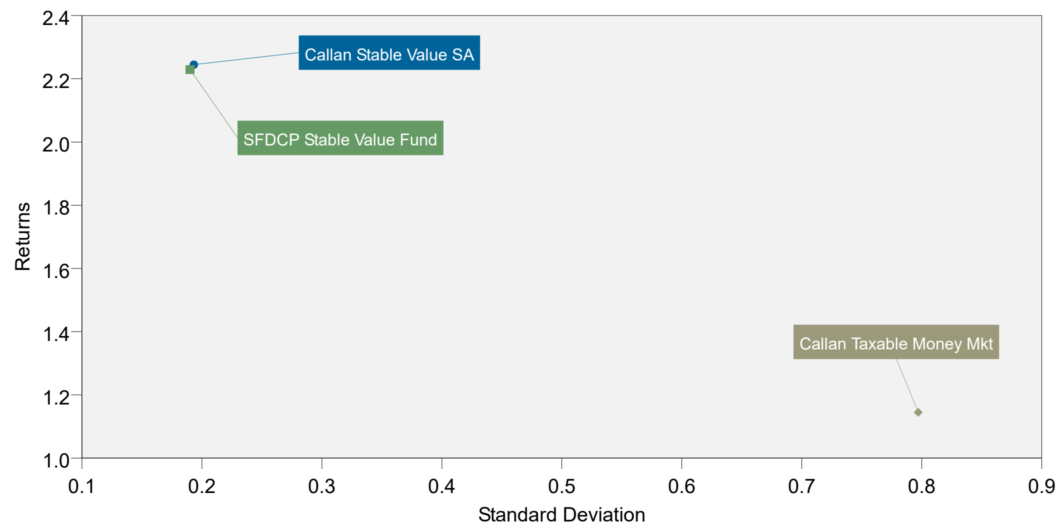
Tier II: Core Options – Capital Preservation

Observations

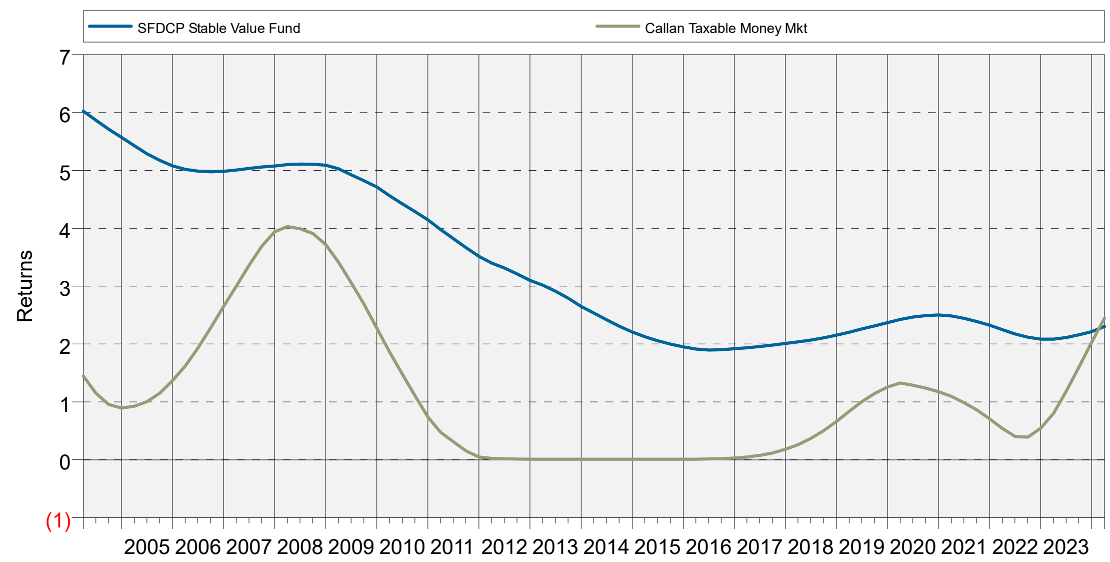
- Within Capital Preservation, SFDCP offers:
  - **Active**: SFDCP Stable Value Fund (18% of assets)
- The underlying fund of the SFDCP Stable Value Fund white label structure is the Galliard Stable Value strategy.
- Stable value funds have historically offered a higher yield than money market funds.
- Although stable value funds have offered a returns premium, they typically carry additional considerations:
  - **Wrap contracts**: Add costs to the structure and may result in investment restrictions for the investment managers of the stable value assets.
  - **Performance**: The crediting rate often decreases in a rising interest rate environment due to the longer duration of the underlying portfolio.
  - **Equity wash provisions**: This doesn't currently apply to the SFDCP since you don't offer a money market fund.

Observation: Callan supports the Plan's offering of a stable value option within capital preservation.

Risk & Return for 10 Years Ended March 31, 2024

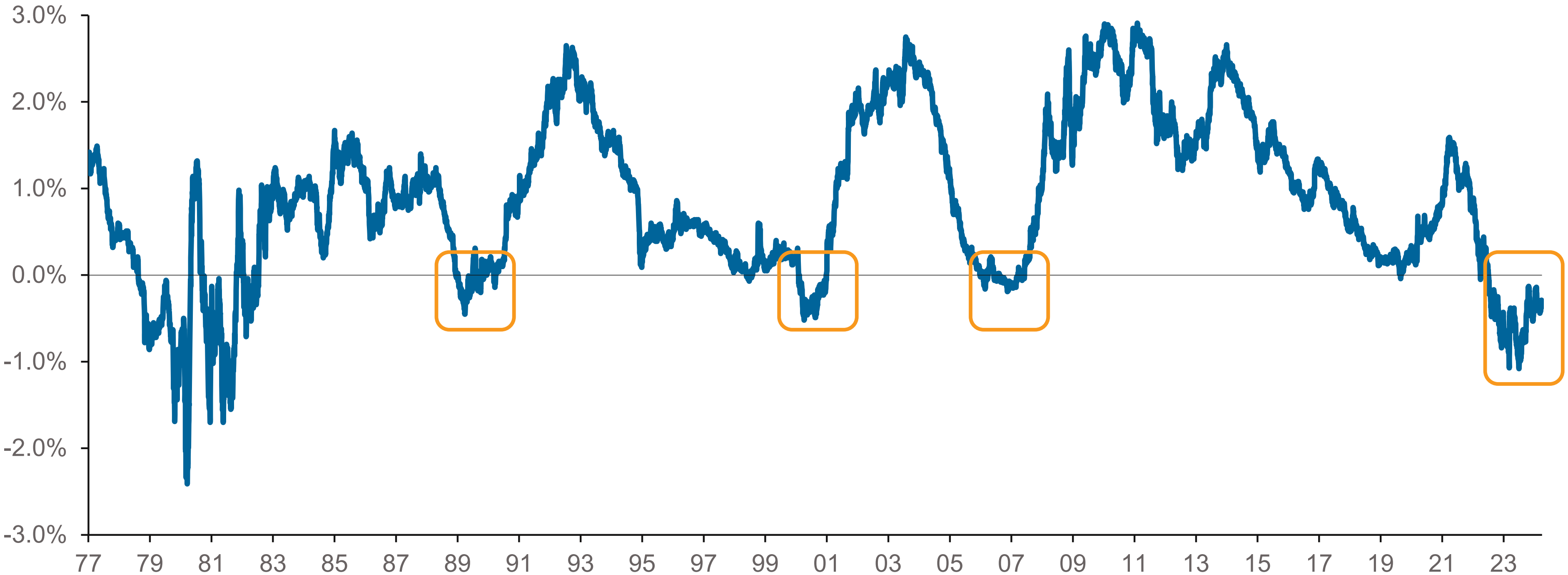


Rolling 3 Year Returns for 20 Years Ended March 31, 2024



Bond Market Has Been Expecting a Recession Since July 2022

10-Year Treasury vs. 2-Year Treasury Spread



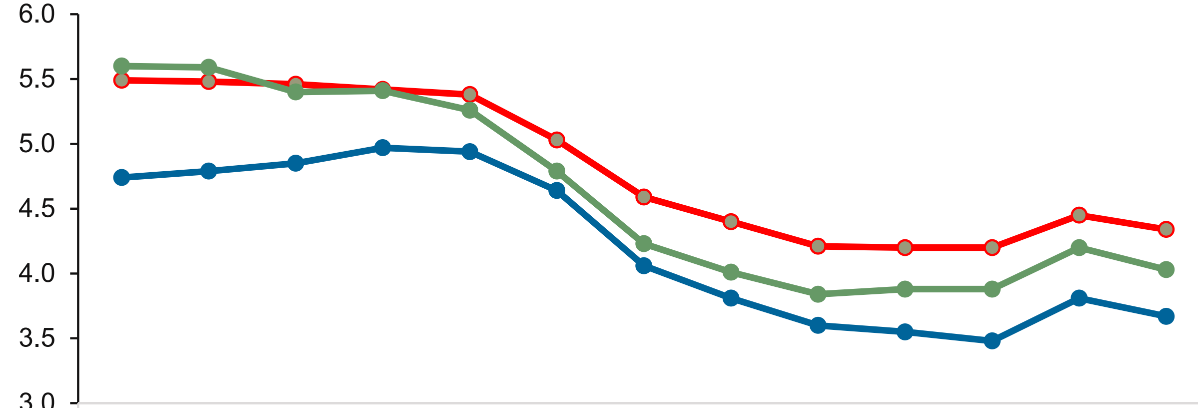
- Inversion in the 10-year to 2-year Treasury yields does not always forecast a recession, but most recessions are preceded by a yield curve inversion.
- Yield curve inversion means investors expect a recession will occur and interest rates will be cut, and therefore increase their demand for securities with longer duration with higher potential for capital gain when rates fall.
- Bond investors beginning to anticipate “higher for longer” rate regime?
- Inversion started in July 2022, bottomed at -1.08% in July 2023, and ended March 2024 at -0.39%.

Source: Federal Reserve Bank of St. Louis

Fixed Income Themes

Yield curve is inverted but flattening

U.S. Treasury Yield Curve (%)



	1 Mo	2 Mo	3 Mo	4 Mo	6 Mo	1 Yr	2 Yr	3 Yr	5 Yr	7 Yr	10 Yr	20 Yr	30 Yr
3/31/2024	5.49	5.48	5.46	5.42	5.38	5.03	4.59	4.40	4.21	4.20	4.20	4.45	4.34
12/31/2023	5.60	5.59	5.40	5.41	5.26	4.79	4.23	4.01	3.84	3.88	3.88	4.20	4.03
3/31/2023	4.74	4.79	4.85	4.97	4.94	4.64	4.06	3.81	3.60	3.55	3.48	3.81	3.67

Minimal change to the shape of the curve

- The yield curve flattened modestly in 1Q as rates in the short end remained relatively stable, while they rose in the intermediate and long end.
- The curve remains inverted despite the increases, with the 2s/10s at -39 bps, a slight decline from the end of 2023.

Sources: ICE, Treasury

The Fed's 'Dot Plot'

Federal Open Market Committee (FOMC) participants' assessments of appropriate monetary policy

- Median year-end in 2024 = 4.6% (unchanged from December meeting)
- "Longer run" up 10 basis points to 2.6%
- Dispersion of views widens in 2025 and 2026 but narrows over longer run.
- Market expects more cuts next year based on CME FedWatch as of April. Fed Funds expectations for end of 2024:
  - *18% expect 4.50% to 4.75%*
  - *35% expect 4.75% to 5.00%*
  - *32% expect 5.00% to 5.25%*

Source: Federal Reserve (One participant did not submit longer-run projections for the Federal Funds rate.)

How Stable Value Works

Stable value funds invest in bonds with longer duration and credit risk, resulting in higher yields, while wrap contracts smooth daily changes in bond prices

Stable value managers invest in a diversified portfolio of **high-quality, intermediate duration** fixed income securities. These securities may include:

- Treasuries, U.S. agencies, agency mortgage-backed securities, corporate bonds, asset-backed securities, commercial mortgage-backed securities

Wrap contracts, issued by insurance companies and banks, allow for book value accounting:

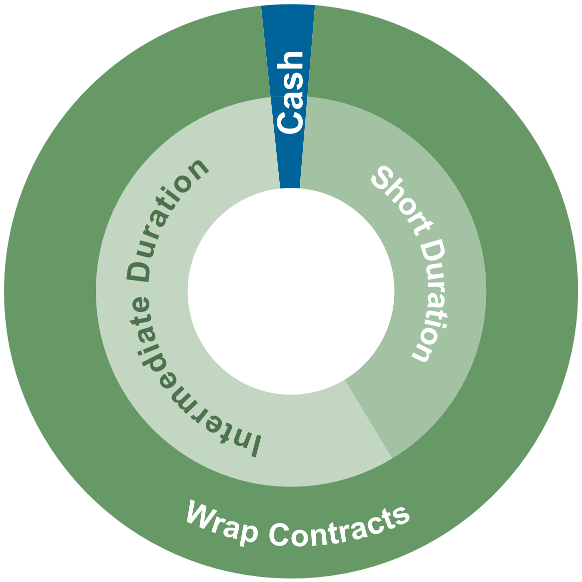
- A stable $1.00 net asset value (NAV)
- Daily participant contributions and withdrawals
- Requires adherence to strict guidelines around sector, quality, and duration

Participants earn a **crediting rate,** not to fall below 0%, which is reset quarterly

- Accrued interest paid out periodically (i.e., monthly)
- Market value gains or losses are amortized over the duration of the portfolio (i.e., 2-4 years)
- Calculated based on the market value, book value, yield-to-maturity and duration of the underlying assets.

Assets not covered by a wrap contract are usually held in **short-term money market** instruments.

Common Structure



Benchmark Duration Range

2.0 to 4.0 years depending on vehicle type and investment guidelines

Stable Value Upcoming Search Summary

Background Summary:

- Galliard manages the SFDCP Stable Value Fund, which was $947 million or 18% of Plan assets on 3/31/24.
- Galliard was hired in 2014 and their agreement with the SFDCP expires on June 30, 2025. They have a five year term.
- Callan is proposing to use the same search process from the 2020 Stable Value search.
- The following slide outlines the proposed process and a rough timeline to conclude during the first quarter to allow time for contracting and legal review.

Please Note: The proposed Timeline is subject to DCC meeting dates and Board agenda availability

Callan Manager Search Process and Proposed Timeline

Custom Search for SFDCP's Stable Value Mandate

August/September 2024

- Develop profile specifically for SFDCP
- Establish criteria for qualification

October 2024

- Screen out strategies that do not meet minimum criteria such as having at least $5 billion in separate account assets under management
- Conference call with Callan research and SFDCP Staff to discuss firms screened out
- Narrow list to 8-12 firms for the Callan Manager Search Committee
- Peer review process to ensure quality, comprised of senior consultants
- SFDCP Staff participates on Callan Manager Search Committee call
- Callan Committee to narrow list to 3 candidates for SFDCP Staff Interviews through a qualitative and quantitative assessment

November/December 2024

- Reviewed the 3 candidates with SFDCP Staff
- DCC to Interview Finalist candidates
- Staff to provide formal recommendation at subsequent DCC meeting

February 2025

- ***The DCC makes recommendation to the Full Board***
- ***Negotiate terms, review agreements with legal by the June 30th contract expiration date***

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