Revamping Retirement Episode 75

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Intro: [00:00:00] Covering the ever-evolving retirement plan landscape to help identify the biggest opportunities for plan sponsors, CAPTRUST presents Revamping Retirement.

Matt Patrick: Hello and welcome to another episode of Revamping Retirement. I am Matt Patrick, and I am co-hosting today with Jennifer Doss. Jennifer, how are you doing?

Jennifer Doss: I am doing great.

Matt Patrick: Couldn't be better. So on today's episode, we are going to be covering capital preservation investments, and we're excited to cover this topic because despite being one of the more highly utilized investments within a defined contribution menu, Capital [00:01:00] preservation options like stable value or money market can sometimes get ignored or hand waved when you're talking about investments that can be a little more volatile.

Matt Patrick: people view them as just, hey, they're short term, fixed income. What could be so exciting there? And I think it leaves you shorthanded where you haven't really gotten in and understand how those products work. and it's certainly an important asset class for a lot of members of the plan, so we're excited to dive into that.

Matt Patrick: Our goal for today is to just provide some general background on how these funds work, and then some considerations for plan sponsors as they look to select and monitor capital preservation options within the plan. I guess one final note we're recording this episode in early April, while there's some significant market volatility going on, so that might find its way into the conversation here and there.

Matt Patrick: So just wanna provide that context depending on. Whenever you're listening to this, just know that's where we are. So with that long preamble, we're gonna welcome in our guest Steve Horner. Steve is a stable value portfolio manager with Franklin Templeton. And, someone we're really excited to talk to on this topic.

Matt Patrick: Steve, welcome to the show.[00:02:00]

Steve Horner: Thanks, Matt and Jennifer. Really glad to be here.

Matt Patrick: Awesome. We're excited to have you. what is your role at Franklin Templeton and why might you be the person we tap to talk about this with us?

Steve Horner: Sure. I've been a portfolio manager at what was Putnam and now Franklin Templeton, on the stable value products Since 2003. so we basically oversee within a team management. Around $18 billion in stable value assets for more than 7,000 clients, combined. myself and my co-head have over 60 years of experience in the industry, 28 for me, so I'm aging myself a little bit here.

Steve Horner: we've been involved from the product area all the way through the management part, including the, insurance part, which obviously plays a big role as well.

Jennifer Doss: Steve, thank you for being here. We really appreciate it. And as Matt mentioned, the markets are a little tumultuous today, so we certainly appreciate you taking time out of the market trading hours. As Matt said, I think it's a area that not a lot of people maybe understand, but it is, anywhere from.

Jennifer Doss: Eight to 15 ish percent of a 401k on average when you look. So [00:03:00] I guess help us just set a baseline. How are stable value funds, maybe different than money market funds, which somebody may be a little bit more familiar with, especially outside of a 401k, or maybe a guaranteed fund,that somebody's looking at.

Steve Horner: Yeah, it's a great question and as you point out it is an option that, does get overlooked sometimes. and, we view it as something that should be as important as any other option, in the plan lineup. 'cause there are significant assets there. So generally there are several flavors of capital preservation that a plan sponsor can choose from.

Steve Horner: You mentioned money market, which everybody is very familiar with. You know, stable NAV reacts to short-term interest rates. and you can transact daily. Most of the stable value options also have a stable NAV, and you can transact daily for the most part. The difference is that the stable value funds offer the ability for the manager to invest longer, in longer term securities.

Steve Horner: That in normal market environments, will have better expected return profile than. a money market will. So that's really the advantage that you

get and the way that, the stable value [00:04:00] funds are permitted to do that. 'cause we're gonna be holding securities that are gonna fluctuate in market value is that we contract with insurers and banks to provide insurance protection called wraps around those assets.

Steve Horner: That basically the function is to guarantee the book value, plus accrued interest up through a certain day on every investment that we hold. As you can imagine, over longer periods of time, you know those returns should aggregate significantly higher than what a money market will provide. So that's the value proposition or what people look at for stable value when they choose it over money market.

Matt Patrick: Can I, can I task you with some, Term definition in there. a couple things just to wanna make sure everybody tracks as we go through. so NAVI think was the first one you said. Do you mind explaining what that is?

Steve Horner: Sure, net asset value. basically for a mutual fund, it would be the share price that you trade at. if it's $10 a share or whatever the movement is for money market and for stable value it is generally $1 at all times. It's basically held constant.[00:05:00]

Matt Patrick: Perfect. and then you explained to, I guess just to double down for everybody, if you hear the term again, so the wrap, wrap, provider wrap contract. If you hear wrap, that's the insurance component of these products.

Steve Horner: Exactly right. it basically allows us to hold securities that are going to fluctuate in market value, but not really recognize that daily fluctuation and keep the NAV at a dollar. and we can talk more about how that process works over time and how those fluctuations revert into returns. but basically it does allow you to hold that NEV constant, which is a very attractive thing when participants are looking at capital preservation.

Matt Patrick: Okay, perfect. And then, building off of that, talked about market value, so that would just be like what you could sell the bonds for on the market. But then the book value, which you also mentioned, which I know was tied to that. could you just define book value just so we have that as well?

Steve Horner: Sure. so basically the book value is what is owed to participants on any given day and every day. The fund will credit the participants with a certain amount of interest, like a money market does, [00:06:00] so that they decide to move their money away from the stable value fund into some other option.

Steve Horner: They will get their principle balance from the previous day, which includes all interest they've accrued, plus that day's interest and go forward. It doesn't matter what the underlying value of the market. Bonds are, it's just the book value that is what is owed to participants.

Matt Patrick: Okay. I think good to establish those terms out of the gate since I think they'll pop up throughout, especially as we get into how to think about how to evaluate these products relative to each other. So I appreciate you, running through that. you were getting into it a little bit in terms of the value proposition of stable value relative to money Mark.

Matt Patrick: But I guess just to reiterate in terms of how are stable value funds constructed? and then I guess as a way to launch into how do we think of that relative to the value they can add for money markets?

Steve Horner: Yeah, it's a great question. 'cause there are several flavors, you would call them for plan sponsors to choose from in the stable value space. It's not a generic one size fits all type of product. so there really three different, versions of stable value that a plan sponsor can evaluate. if they choose to [00:07:00] go that route versus money market in their capital preservation piece.

Steve Horner: I'll walk through each of them, but the differences, among the options have to do with transparency, cost and termination provisions, which all I would think from a plan sponsor's perspective are very important things to be aware of. the first flavor is what we call general account stable value.

Steve Horner: What this is, is basically in a direct annuity contract investment. With an insurance company. So the provider will put the assets on the balance sheet of the insurer and become a creditor of that insurer 'cause you basically are giving them the assets of the plan. And in return, the insurer will provide a guaranteed rate of return on that investment for some period of time.

Steve Horner: Generally it's six months, could be a year, could be three months. And then that rate is changed over time. by the insurer, and that's where the transparency piece comes in. There's no way for the plan sponsor to look through and see why they got the return they have now versus, what the markets have been doing.

Steve Horner: [00:08:00] also because this is what would they call, a spread product for the insurer? it is backed by the entire balance sheet of the insurer, which could include a lot of different types of assets, could be equity, it could be high yield, could be emerging markets. the cost that you're actually paying

for that product is never gonna be known because you're not gonna know what the spread that the insurer is getting on the assets that you've given to them.

Steve Horner: and finally the thing that is really difficult with these products is they generally contain or routinely contain exit provisions that are punitive, to the participants. Generally, it's either a market value adjustment to book value, meaning that there's some deficit that the plan sponsor or the participant would have to make up to get out of that product.

Steve Horner: Or if they offer you a book, value payout, it's a very long-term book value payout, generally five years or more, which may force the plan sponsor to be with the insurer longer than they want to. So those can offer some significantly attractive rates because the insurer can set the rate.

Steve Horner: But there are [00:09:00] significant disadvantages as well to going into that type of product. The second flavor is, what we would call an insurance separate account. Now it's similar to the general accounts, stable value fund or stable value product from the insurer. However, in this case, the assets are not held on the insurer's balance sheet.

Steve Horner: They're held in trust for the plan that invests them. so the plan retains ownership of the market value. Now this gives the plan a little bit more transparency into what the investments are that are backing contract. it also will potentially lower the cost because there is no spread game here for the insurer at this point because the assets deliver what the returns are.

Steve Horner: The one thing I would say though is that the termination provisions of these products are very similar to what you see in the general account space, generally either a market value adjustment or a very long book value payout. So again, a plan might get stuck in that option longer. Than they want to.

Steve Horner: And then the third stable value option is the one that's most common when you're talking about a third party [00:10:00] manager, like a Franklin or Fidelity or a Vanguard. it is a CIT based product, that basically offers you an investment in the same types of securities that you would get in the insurance.

Steve Horner: separately managed account, but more diversified. There's a lot of different issuers represented that provide the wrapper insurance coverage. also there could be a diversification of the types of assets that are able to be used for the investment piece and the cost is gonna be lower.

Steve Horner: Obviously, we know that CITs are one of the lowest cost, vehicles in the 401k industry, so that's gonna play a role as well. But most importantly, all of these products will have some termination provision that will only restrict a plan's ability to leave for up to 12 months. It's called a 12 month put provision.

Steve Horner: So there is a lot more flexibility, if you will, in terms of plans moving between managers in this type of situation. Those are really the main differences and the main flavors that you get, when you're looking at stable value across the board.

Jennifer Doss: Steve, I'm gonna try to draw a parallel for people [00:11:00] because, just a minute ago we did just throw out a lot of terms. and it's very natural for all of us to do, here, and I know a lot of people listening probably know what stable value funds are, but just for people that maybe.

Jennifer Doss: Don't, you talked about a general account throwing out, hey, you might earn a spread, but you don't have transparency into why you're earning it. So I would draw, a similarity between that and a savings account I might have at a bank, So I'm gonna give them my money, they're holding it.

Jennifer Doss: theoretically they're taking that money and they're loaning it out to other people. They're making. A difference on what they're paying me and what they're getting in interest back from another borrower. That's their spread. The difference that they make. So I can think of that in terms of that.

Jennifer Doss: And then in terms of being locked in for a certain amount of time with that,termed provision. I think of that as like a cd. Somebody goes out and buys a three year cd. They understand that money is locked up for three years because somebody is gonna go out and actually buy. See, bonds that mature in three years, and so you have to hold to maturity, to get that full value.

Jennifer Doss: If you terminate [00:12:00] early, sometimes you have to pay penalty. So I think if I'm drawing a similarity between that and what people might deal with in their everyday lives, is that fair?

Steve Horner: Yeah, those are actually really good examples of what we were talking about and things like you said, that people might understand better. the one caveat I would say is that. The termination provisions, can be different based on what the portfolio underlying looks like at the time the plan wants to terminate, so the payout could be shorter or longer if the value of the assets is lower or higher.

Steve Horner: in some cases, and this is in my experience, very rare. A plan can get out of a GA product right away because the market value is higher than book value. But that doesn't happen very often. but to your point, there is some level when you go to terminate, if you terminate a CD early, you pay a penalty,

Steve Horner: This is a similar thing where you might have to pay a penalty if you want to get out of the GA product when market value is lower, the book fight. those are really good examples that are very comparable to what we're talking about.

Matt Patrick: we keep hitting on the, the market value adjustment piece, like you highlighted there. I think just to hammer that part home a little bit. So the book value, which we're [00:13:00] saying you can read through, like that's what you want to get out. So that's what a participant would see in their account is the book value amount.

Matt Patrick: So the example you're giving would be if the bonds are worth less than that and you have to take the adjustment, someone in their capital preservation option would see their capital diminished, which is not what we want.

Steve Horner: Yeah, it's, it's, and it's one of those things where because there's obviously specific rules about the plan, making a decision for participants that cost them money. Within erisa, what they'll do is they'll take the long-term payout, which can be five years, 10 years.

Steve Horner: And that's very difficult to explain to a participant too, why you can't move your money to somebody else that you want to have managed over that time. I'm not trying to say these products aren't worthy, stable value products, but everybody needs to go with their eyes open and know exactly what they're buying before you look at an insurance-based product because.

Steve Horner: It's only when people try to get out that they finally realized that maybe there was something that they should have looked at before

Jennifer Doss: Yeah, and I think that's fair. We're starting to see that a lot. Lately with [00:14:00] clients, within our own book is they want to switch record keepers or they're ready to make a change. And that just is another complicating factor of, can I take what I have and can I move it? And a lot of times the answer is no.

Jennifer Doss: And so then you get into all of these variables that, you're talking about today. So you just alluded to as you were talking about the value proposition of these, if I'm to simplify it, are the factors that plan sponsors should consider? Is it that transparency, cost determination, provisions?

Jennifer Doss: are those the major things? Are there other things that plan sponsors should be looking at other than, clearly performance, if there's performance available.

Steve Horner: Yeah. I mean, I think if you're comparing stable value to money market, clearly it's a return proposition, 'cause over longer periods of time in normal market environments, any kind of stable value should outperform money market because of the ability to buy longer securities, which generally have higher coupons and have higher expected returns.

Steve Horner: but in terms of, if you're looking between the options or even just selecting a manager. within stable value, there's obviously a lot of things to look at that. are important when evaluating any [00:15:00] option. the first, and this one might not be as common for other options, but planned demographics are really important.

Steve Horner: looking at stable value, the characteristics are vital to review just because. if the average age of the population is low, they might choose something that might be slightly more aggressive. I hate to use that word in capital preservation space, but because they know people are gonna be invested for a long time, if the average population age is high and you have a lot of retirees Non-participating people in there can move their money out quickly. You might make a different choice there as well. so understanding these factors are always a great beginning point to deciding what type of stable value fund or what type of structure you wanna look at. You already alluded to long-term performance.

Steve Horner: I view stable value like every other 401k option. you wanna select a provider who's shown consistent performance, not just in the last year or two, but over longer periods of time. the dispersion you're gonna see among managers in this space is gonna be tighter than it is in other options, just because I.

Steve Horner: The guidelines are [00:16:00] similar in most cases, and there's not a thousand basis point differences in fixed income where there are in equity funds. but there are still different ways to manage this product and that can

produce different returns over time. So that's something that should be definitely looked at.

Steve Horner: and we've alluded to this a lot. The fund structure is something that, we believe in very strongly at Franklin, because there are different ways to structure a stable value fund. And because it's a fund that is book value based. Cash flow into and out of the fund is very important, and the timing of that cash flow is also very important.

Steve Horner: So understanding how a manager plans to deal with. cashflow, they're not expecting into or out of the fund. it will affect not only current returns, but future returns, which we can talk out about a little bit later. and that can lead to a lot of different outcomes. so knowing the manager's philosophy and how they've structure their fund is very important.

Steve Horner: and the last thing I would say is maybe manager tenure. having a long tenured manager. That's been responsible for most, or preferably all of the [00:17:00] performance evaluation period is definitely preferred because then you know, you're dealing with the team that has actually produced the performance that you're looking at.

Steve Horner: They can walk you through why some years were good, why some years were bad. And even preferably if they've been around a long time like I have, they've gone through a lot of crisis periods, like Y 2K, the financial crisis, covid, even this. Environment we're going through now, which has been quite stressful.

Steve Horner: That should give the plan sponsors some comfort that they can deal with the next crisis, which at some point is eventually bound to happen. the one thing we would caution is that, and this is happening now, and Matt alluded to this a little bit, there are a number of providers out there who are launching new funds in this environment, that already have legacy products.

Steve Horner: and I'm not saying there's anything wrong with that, but. Why they're doing that is because the new environment has a higher rate structure than what the legacy environment was. So they're able to offer a rate now that we can't compete with because we have legacy investments that have, in this case, losses that [00:18:00] have to be amortized over.

Steve Horner: What I would caution is that if the strategy is the same from those managers. The plant sponsors should expect over longer periods of time that the returns are gonna look like their legacy products. So I would just

caution not to be enamored with the one rate that's out there today. Look at the long-term performance and make sure that's appropriate for what you're trying to accomplish.

Matt Patrick: I'm sure a lot of plan sponsors can relate to that and, 'cause we've seen a lot of these offered through,occasionally it's a new CIT that's launched, but most of these would be through a separate account, stable value offering where they're like, Hey, we can give you a plan specific rate.

Matt Patrick: It funds that a, equal, book value and market value and the rate is. Two or 3% higher than what you're getting on the fund that you're in now. So to your point, Steve, feels very appealing. Like it's a similar structured product. it looks so much better day one here.

Matt Patrick: But if we're talking about that type of separate account, I know you talked about insurance separate accounts earlier. any of the factors that you mentioned in terms of monitoring, more important or different when you're looking at a [00:19:00] separate account versus a CIT that mixes more plans in there.

Steve Horner: A couple things to consider though, is that. Versus the CIT size is important for a separate account in terms of strategy. the cis are all, a billion dollars plus. They have, huge economies of scale and their structure is already established. So to start a brand new fund, depending upon the strategy that the manager has, you could be looking at a minimum as low as 25 million or even higher in some cases.

Steve Horner: new separate accounts generally only work for larger plans that have, large amount of stable value assets to deploy. so that's one thing to consider. Also, cost, there might be additional costs to set up a separate account. With your record keeper or with the manager, then the CIT investment, which is already on every platform that is out there.

Steve Horner: So obviously those costs can be small, they could be large, but it's definitely something you wanna factor into the equation there. and again, we'll go back to the same thing. you wanna make sure the strategy is the same. or you're comfortable with the manager. And they're gonna use the same strategy that you're comfortable [00:20:00] with in, the separately managed account.

Steve Horner: Now, there are some abilities to potentially change some things because it is for that specific plan. So that can be an advantage if, the plan

sponsor wants to do something slightly different than what you've done in the past. There are, flexibility advantages there. and again, this goes back to what I talked about with cashflow.

Steve Horner: The liquidity philosophy of a manager is something that we believe to be very important. how do you handle those inflows and outflows? Do you have a specific facility in your product? That deals with liquidity or are you basically just going to buy and sell securities as money comes in and out?

Steve Horner: because as I pointed out, as a book value product, those flows are important. Those flows matter. and so making sure that you understand the philosophy around the liquidity for each manager is also very important.

Jennifer Doss: Gotcha. and maybe just to clarify, based on at least my own experience, I, I think when you talk about having a larger amount of assets, typically we're seeing somewhere between 75 million and a hundred million [00:21:00] and investible stable value assets. So again, you're talking about a much larger plan potentially if that's about, eight to 15% of the total plan.

Jennifer Doss: To keep that in mind for people that are listening. you mentioned at the very beginning, Steve, you threw in that under normal market conditions and. Normal market conditions, stable value funds should outperform something like a money market because they are investing in longer term rates. And I'll go back to the example I gave earlier where, at my bank I can actually get a 12 month CD right now with a higher rate than I can get a five year cd.

Jennifer Doss: And that probably doesn't make a lot of sense to a lot of people. but is that the normal market environment you're talking about, or can you relate that to stable value discussion.

Steve Horner: Yeah, it's a great question because, the last few years have been extremely challenging, for a lot of reasons in stable value. And one of them is what you just pointed out, is that the yield curve has been inverted for most of the last three years. So basically what that means is that short term returns on three month paper, [00:22:00] six month paper, 12 month paper.

Steve Horner: have been higher than longer term returns. which is not the normal environment. Generally a yield curve. If you think about it intuitively, if you're willing to lend your money to somebody for six months, they're gonna give you a specific return. If you're gonna willing to lend it to 'em for three years, you should get more for that,

Steve Horner: 'cause you're locking up your money for longer. That's what the normal yield curve does. The longer you go out, generally, the more that you're going to be paid to lend money to whoever you're lending it to. What's happened is that we've gone through a period of time where, if you recall, coming out of the Covid crisis rates were close to zero,

Steve Horner: and been there for a long time. the Federal Reserve. Was late in deciding that they had to raise interest rates to try to contain inflation. So they raised them very rapidly over a period of, I wanna say 14 months. Rates went from zero to over 5%. And when they do that, it's a short term rate.

Steve Horner: They're raising three month rates, they're raising six month rates, they're not raising 30 year rates or 10 year rates. So you've [00:23:00] effectively have a period of time where the short end of the curve is now. Yielding more than the long end, which is not the normal environment, and that makes it very difficult for a stable value manager to outperform.

Steve Horner: a money market fund or a CD as you point out, because we don't react that quickly to those rate changes, our portfolio turns over much more slowly than a money market does. The average maturity of a money market somewhere between 45 and 60 days for stable value, you're looking at two and a half to three and a half years,

Steve Horner: So we don't mature assets as quickly. so stable value is underperformed money market significantly for the last three years, which is the first time it's ever happened in the history. of the industry. And this goes back to the late 1970s when this product was actually introduced. so that's been a very, challenging environment to be in.

Steve Horner: Secondly, along with the rate rise, and this is something that generally doesn't happen either. I. Stock markets and risk assets have gone crazy. they've gone almost straight up, except for the last two weeks that we've witnessed,a pairing back due to some of the administration policies that have been [00:24:00] announced.

Steve Horner: So participants smartly have decided that they wanna move back into something that's riskier because we saw tremendous flow during covid and during the economic outflow of that in, because people were worried about. The economy. They were worried about their job, they were worried about their investments, but that part had changed.

Steve Horner: So basically starting in late 2022, all the way through January of 25, you would say we've seen outflow of stable value almost every month. Consistent outflow. and roughly, if you look at the CIT stable value universe, back in September of 22 versus now, the size is 20% lower. That's the kind of outflow that these funds have seen over that period of time, which again, is unprecedented in the history of the industry. So with those two things together,a lot of the losses that you got from their interest rate rise in some cases, managers had to sell securities at lower than par, To fund those outflows for participants. What that has [00:25:00] caused is. These losses are now embedded in some manager's portfolios who didn't have a liquidity philosophy that they dealt with to handle these withdrawals that are affecting current crediting rates and will affect future crediting rates.

Steve Horner: That's why I talk about liquidity philosophy being important. If a manager is prepared to handle inflow and outflow, they might not have to sell securities to handle outflow, right? They might already have something in place. If they're not, then they might have to sell securities. They don't wanna sell.

Steve Horner: inside of those, parts of the product that have variability to interest rates. this is something that's gonna continue for a number of years going forward, and this is something we talked about before. any change in the market value of the bonds is amortized over the entire duration of the fund.

Steve Horner: So we're talking two and a half to three and a half years. That's what allows you to hold that NAV constant because you don't have to experience those up and downs that a bond fund would in any given day. But what that also means is that legacy losses [00:26:00] will continue to affect future returns in the future, which obviously is going to make some stable value funds.

Steve Horner: underperform money market for the future going forward for some period of time, that doesn't mean, however, the long-term value proposition is dead. what I would think as a plan sponsor is that I wanna buy an option for every part of my, lineup.

Steve Horner: That is a very long-term option. Five years, seven years, 10 years. I don't wanna have to change that if I don't have to. Over those time periods, stable value still outperforms money market, So that's what we've been trying to tell clients. look, this is a very anomalous environment. It's going to change.

Steve Horner: The Fed is thinking about starting to cut rates more. So that could actually change the dichotomy a little bit, but be prepared that still for some period in the future, we might have to see returns that are lower than money market for a while.

Matt Patrick: I was gonna, do some more, term definition. we haven't, defined crediting rate yet that would be just the rate that's delivered to investors in the stable value fund.

Matt Patrick: Any, anything else you'd add to that, Steve?

Steve Horner: Yeah, it's not [00:27:00] exactly equivalent, but it's similar to the money market seven day yield. That's effectively, if you look at a given credit rate for a day and you divide it by 365, that's what the investor will get for that day.

Steve Horner: And the rate will be annualized to show you what the current rate is on the fund.

Matt Patrick: And then I wanted to dig in some,we're talking about it in the current context, which I think is good because one of the most frequent plan sponsor questions that we've gotten over the last few years, in the capital preservation space is just the money market relative to stable value.

Matt Patrick: So I appreciate you going into detail and defining the background. I think that'll be really helpful. I guess just more broadly speaking, This would be a quickly rising interest rate environment that we went through. And that's the backdrop for what you just explained could you walk through what the expected performance of stable value relative to others would be, and, slower rising environments, falling rate environments.

Matt Patrick: just give the flip side of what we've gone through recently.

Steve Horner: Sure. so basically if you think about it intuitively, because returns in stable value are lagged,effectively what we've experienced in the past is going to affect your return in the [00:28:00] future. what would logically mean is that in the short term, stable value will outperform just a random bond fund that's not wrapped with that insurance protection.

Steve Horner: when rates go up quickly, stable value will outperform because they're not gonna have to amortize all those losses very quickly. Conversely, if

rates go down quickly and there's a lot of gains, stable value's gonna underperform a bond fund. Now, money market's different,

Steve Horner: Because money markets react immediately to rate changes. if the fed raises rates or cuts rates by 25. Literally you get the entire 25 within two days on most money markets 'cause they're turning over their portfolio that quickly. Whereas stable value funds take a while for securities to mature or money to come in that you invest in a new rate.

Steve Horner: So it's gonna be a lot slower. in a normal environment where rates are kind of range bound or they move or change slowly, you would expect stable value to perform in line with bond funds. And in fact, that's really an important point that you brought up, Matt. What a plan sponsor should actually, assume is that a stable value fund over say [00:29:00] 5, 7, 10 years, should perform very closely to an intermediate bond fund, minus the cost of the insurance.

Steve Horner: That's really what this does. It's the same return. Pattern, it's just the return pattern is smoothed over time instead of volatile quarter to quarter. So that's the kind of returns that a plan sponsor should expect in a stable value fund over longer periods of time. so here's a great example of what we're talking about.

Steve Horner: During 2022 when interest rates rose dramatically because the fed was hiking rates. Most bond funds had negative returns,in that period of time, stable value returns, were positive. So for example, the Barclays one to five government credit index, which is a very common index that is used for stable value, returned minus 5.5% in 2022. The average stable value fund returned positive 1.85%. So that's the example of when rates go up quickly. Stable value's gonna do very well relative to, a bond fund. The other way around it would look [00:30:00] different. it would look like they lag significantly. I.

Matt Patrick: That's good context and I like that. presenting the flip side with money markets, the relation between stable value and money market is the inverse of stable value relative to the bond market. I think important context there for why,we've seen a lot of plan sponsors happy, there's not a lot of chasing returns, at least from what we've seen this is the promise of the stability that's there.

Matt Patrick: it tracks interest rates, but it tracks them slower. And, while there can be some headlines like, money market is outperforming stable value by a

significant margin now, this is exactly what we. Would want it to do in this context. There was a violent movement, but those that have been invested have been steady and have been steadily creeping up, which is what they're designed to do.

Matt Patrick: So I appreciate you providing that context.

Jennifer Doss: And I also think, like you said, if you've been in the industry long enough, when you go through some of these crises and the fed drops rates to zero, those can be very prolonged periods, We just came out of one not too long ago. And so those are instances where, Again, you've got this stable value fund that's being a workhorse, Just steadily marching along within [00:31:00] your portfolio. might go down a little, might go up a little, but it's not too variable, Depending upon the environment, a lot of these volatility that you might see in the market or the bond market or whatever it is, masked

Jennifer Doss: underneath the portfolio

Steve Horner: It's, yeah. The only time where you saw drastic changes in crediting rates, say quarter to quarter was, in 2008 with a great financial crisis. the bond market had, over a thousand, maybe in some cases, 2000 basis points of underperformance during that crisis in a very short period of time.

Steve Horner: From when Lehman, went to fall to December of that year. so you saw credit rates move from say 3%, three and a half percent in the fourth quarter of 2008 to maybe 1.5%, but that's still a small amount relative to what other funds experienced. and the best part about stable value is that when the situation turned around, rates caught up very quickly.

Steve Horner: So the credit rate was only at that low 1.5% for a very short period of time So even if you sold out of your stable value fund, you didn't lose anything because you still had positive returns if you sold out of that bond fund in the [00:32:00] fourth quarter and you missed the run back up in the first quarter.

Steve Horner: that's a huge, what we call a whipsaw in the industry. You didn't wanna do that. So to your point, I'm the first to admit that stable value is not gonna get anybody to retirement, right? It's not something you should put a hundred percent of your assets in, especially if you're a younger individual.

Steve Horner: But it does serve as a great anchor and a place where you can take respite. From those types of markets, even markets that we're experiencing

today, when things are volatile and you know you're gonna get a positive return, no matter what happens in the markets.

Jennifer Doss: Well, Steve, considering all the comments today,I don't know that you may ever retire yourself. but I'm gonna ask you anyway, sowe ask all of our guests, Steve, what does retirement mean to you? and it might not mean a full retirement, right? It could mean lots of different things, but what does retirement mean to you?

Steve Horner: It's a great question and it's something that I have to start thinking about a little bit. 'cause I'm not, 25 anymore. I can't say I haven't thought about it at all, but I'm not anywhere near, making the decision to do So that's one good thing. I would say,it's a lot of things.

Steve Horner: [00:33:00] More time with family and experiences with people that I care about. those are the things that are really important in life. things aren't important. Experiences are important, so having the time to plan things like that out, like some travel trips with people that you care about, that's something that we're gonna do.

Steve Horner: I. I do also feel like, I need to spend more time in charitable pursuits, not just, from the economic side, but from the time side, giving time away to people that are less fortunate for whatever reason. it's something that I haven't done a ton of in my career and I'd like to do some of that in retirement.

Steve Horner: and also enjoying your time. Your time on this Earth is limited. Nobody really knows exactly when your time is up. working forever is not a good idea. no one ever said on their, gravestone that they wish they spent more time at work.

Steve Horner: balancing the benefits and the joys that you get from work with what you are going to, get after, work is something that, is very important. I think those are the things that I would pursue, if and when I do choose to call it a day.

Jennifer Doss: That's great. Franklin Templeton just breed the sigh of relief, but.

Steve Horner: That's very.

Matt Patrick: They're like, he doesn't have a concrete plane yet, so [00:34:00] that's good. That's gotta be a good sign. He's sticking around.

Steve Horner: My manager listens to this. No concrete.

Jennifer Doss: Yeah.

Jennifer Doss: All right. Steve, we really appreciate it. Thanks for taking us through. I know it's a lot of terminology and we stopped you a good number of times and tried to clarify and it's things that just roll off the top of your tongue and frankly roll off the, tip of Matt and i's tongue too every day.

Jennifer Doss: we're trying to make the complex simple here, so hopefully we've accomplished that and we appreciate your help doing it. And,we hope to have you, back again someday.

Steve Horner: My pleasure, anytime. Thank you.

Jennifer Doss: Absolutely, and thanks for all of our listeners. please subscribe wherever you podcast and we will see.

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Nancy: This [00:35:00] presentation does not contain legal, investment, or tax advice.