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Office Hours with CAPTRUST Investment Team | October 2026 (Webinar Recording)

Matt Patrick: Hello, and thank you all for joining us for our Defined Contribution Investment Update. My name is Matt Patrick. I'm a member of the Defined Contribution team here at CAPTRUST, and I'll be your moderator for today's discussion We're gonna cover a few topics today. We're looking at what are the most prevalent investment items that are impacting DC plan menus.

So we're gonna... We'll pop up some of the topics here in a moment. Things we're gonna cover defined contribution investment menu design, and the investment backdrop and how that's influencing that design. Federal Reserve and interest rate environments. We actually got some Federal Reserve news within the last hour or two but we're gonna be covering more change in leadership there, change in approach, and how that could trickle down to your DC plan.

And then a hot topic in the DC space has been private market investments. Hearing a lot of conversation about it from asset managers, from retirement plan providers. So just want to arm you with some information about how those products work, considerations and where our mind is at for that. As we go through our conversation today, our question and answer function is open, so if you think of something along the way, please feel free to drop it in there and we'll get to as many of those as we can.

We're also gonna be recording this video, and we'll be sending this out afterwards if you'd like to view it again, unless we deem it doesn't go well, and then you'll never see it again. That's right. So joining me today for this conversation, I have three members of the CAPTRUST investment team. To my immediate left, Mike Vogelzang, who is CAPTRUST's Chief Investment Officer and head of our investment group.

As we go through the topics, Mike's gonna be covering them from a big picture, macroeconomic perspective. To his left, David Hood is Head of Investment

Manager Research here at CAPTRUST. He's gonna have the opposite, the bottom-up research view, but can also provide some insights on how asset managers are viewing these topics and how they're positioning their portfolios appropriately.

And then to my right, Jim Underwood is Head of Portfolio Management here, and he's gonna bring us home with that lens of portfolio construction and how these topics are influencing us there. So gentlemen, appreciate you all being here. Excited to dive in.

David Hood: Awesome. Yeah. Thanks, Matt.

Matt Patrick: All right, so first thing we're gonna tackle is investment menu design, and one thing we've been talking about a lot internally is a shift in how US equities in particular are being classified from a growth and value perspective.

So Mike, maybe I could throw it to you. What's going on there?

Mike Vogelzang: Yeah. The market action over the last three to five years really, you can even back it up further, has really changed the nature of what we see in the market. We're... Right now we're been focusing recently on this blurred line between growth stocks and value stocks.

And it's important for folks who may not deal with this every day to understand that the, the definition of growth and value is really set by a couple of a couple of sort of vendor providers. R- Russell controls the Russell 1000. That splits into growth and value. The S&P 500, Standard and Poor's controls that growth and value.

And what we've seen is so much change in the individual stocks underlying the index- Concentration we'll talk about in a minute as well, that you... the line between those are actually starting to blur. This past September rebalancing or June rebalancing, I guess it was, in Russell was really complicated, and it really set the tone for us to look at it and say, "What?

This doesn't really make any sense." What this crazy chart here on the right looks like... is actually saying is that this gives you a sense of the migration from growth stocks in orange. So you can look at the top here, Apple, Microsoft, Amazon, Alphabet, and AMD, the chip manufacturer how a bunch of those actually became value stocks.

So Apple and Microsoft are now more value stocks than they are growth stocks. In what universe does that make sense? So we're... and we're seeing things like Caterpillar and Micron Technology and SanDisk, some of these other companies that have been for years valuation sensitive and really deep value cyclical stocks are now in the growth universe.

This is causing all kinds of problems for growth managers and value managers and how they rebalance, and it's driving the point home to us that it, it- there's less I don't wanna say the word less value, but there's less import in how this definition is reached by the committee at Russell.

And so particularly Russell. And we've been honestly beginning to emphasize more of a core structure for US equities. We feel like it captures the essence of both the growth and value, and you lose some of the noise in the transitions back and forth.

Matt Patrick: Makes sense. Jim, from a portfolio construction standpoint, what does that look like?

Jim Underwood: Yeah. When Russell does the rebalancing, the goal is to balance the growth and value exposure, but because you have such large companies out there today you can do that very cleanly. So about 30% of the Russell 1000 index actually sits in both of them, and that's the reason why you see over here th- there's both a blue component of Apple and an orange component of Apple.

That means there's growth exposure of Apple, and there's value. Another challenge is there's about eight billion dollars of assets that benchmark against the Russell Indices. And so that's a major market event every time they rebalance. And so you're starting to see this, significant disruption when it rebalances, and now Russell's about to go to semi-annual instead of an annual frequency, so you're gonna see that multiple times.

And so again, I think those are the challenges that when we start to think about portfolios and start to think about lineups is- We just need to understand that from a growth value perspective, there could be challenges. As Mike said, we are looking at more core mandates as we move forward. And so making sure you have a good understanding of not just what's happening at the high level, but under surface, I think is also very important.

David Hood: Yeah. And I think from a practical standpoint, what how this relates to the plan sponsor is like these asset classes are very robust, so there's a

lot of options in value and growth, but there's a lot of unnecessary trading and rebalancing that's going around. So with some of these core options out there, there's just a lot of depth there, and so participants are not necessarily missing out in terms of the opportunity set.

What's happening is these companies are shifting within, right? And so I think as we look at and point our research to this, is trying to understand how these trends are evolving and especially around just value and growth, but we'll talk about concentration here in a minute on the next slide. But to really provide optimal choices for the participant to really understand what they're owning and not have to kinda chase things around.

If they liked these sets of stocks, which went from this index to that, that's very confusing, takes a lot of education. And so I think that's what we're seeing in trying to adjust our research around that concept.

Mike Vogelzang: Th- think about it, we spend a lot of time trying to understand those dynamics.

And if you're a plan participant and you're not in the markets every day you just start to chase your tail. And again we're looking at this across the board for, from our investment profile at CAPTRUST, and trying to understand where the best applications for core app- core might be.

And frankly, we're coming to the conclusion that there's better opportunity set for almost every investor now to stay away from the tails, let the noise subside, and get your exposure in a core environment.

Matt Patrick: So Mike, you alluded to that flipping between value and growth- Yeah ... causing some challenges for managers as they're tracking the metric.

Maybe David, how, what have you encountered in terms of talking to managers, how they're navigating that?

David Hood: I think, th- they're a little bit indifferent, and they should be, because they're trying to stick to a constant investment philosophy and find key metrics and fundamentals out there that have both secular and cyclical attributes.

And sometimes when we get innovative technologies like AI, and we'll talk about some of the concentration, your challenge with some of those long-term views, something that could have been very dormant for a long period of time,

could now become very cyclical in a short amount of time and c- and cause some major disparities, I would say in performance.

It's been a very, I- I say this, it's been a very tough and challenging environment for just active management writ large. This is a very fast-moving market, very dynamic, a lot of changes. I think over long term, certainly I think they've, they, I think they've made up for their fees and whatnot, but in these short periods of time, you're gonna see periods like this.

And I do think that's why, again, we're trying to keep participants invested, and a- again, at the end of the day, they're not taking anything away from them. We're just trying to optimize the delivery of how we would think about delivering that core menu within the space.

Mike Vogelzang: Yeah, there's a number of other things like this that I think play right into this sort of changing nature of the market that we're in.

And the growth value is simply an example. I think large and small is another example. When I was a kid growing up in the business, the small cap universe was about 20% of the total US equity index. Today, it's less than 5%. And so there's, how do we respond to that as investors and putting together lineups for endowments and foundations and defined contribution plans and even wealth clients?

There's so much noise underneath the surface in, in these categorizations that I think they've become counterproductive rather than productive

Matt Patrick: So maybe we've been getting to concentration- Yeah ... itching to get to that. Yeah. I guess maybe ta- you're hitting it there. What's causing that compression and fewer small caps to be present?

Mike Vogelzang: Sure. It's just the dominance of the biggest companies in the market. It's not very complicated. We've seen technology go from roughly 12 or 13% of the S&P 500, I think it was a decade ago, maybe it's a little longer and it's now up to almost 40%. And by the way, that includes some names that have been taken out of technology.

So if you'd start with the original set of names in technology, you could make an argument that tech is now 50% of the market. So what that means is, Apple today, and Microsoft today, and Nvidia today individually are larger than the entire small cap index. So one company is larger from a market cap perspective than the entirety of the Russell 2000.

And so w- we're starting to ask ourselves, why even bother? You're dealing with these little niche-y, tiny companies. And so small cap is another example of that. And that just goes to the concentration on your screen here where, the, the top 10 were, what, 19%.

Now it's, now small and mid cap are 10%. So small cap is even a smaller piece of that.

Jim Underwood: Yeah. A- and, along those same lines is when you start to break that 5 or 10% in mid or small cap into growth and value as well- Yes. ... Now you're starting to see very small fractional weightings into some of these asset classes and they can become more distractions than very valuable to a line-up.

David Hood: Yeah.

Mike Vogelzang: Yeah, go ahead.

David Hood: No, I was gonna say and the thing here, and we'll talk about this la- later in the presentation, is that, there's incredible small cap companies in the US.

Jim Underwood: 100%.

David Hood: But a lot of them are staying private for longer. There's so many opportunities there. We'll talk about how that impacts defined contribution.

But in this space, a lot of our endowment foundation clients are getting their kinda large, liquid, traditional kinda stock portfolio in, in these markets that we've been talked about, but there's an ocean of opportunity outside of that as well. And so again, I think it's not to say that there's not good small cap companies.

There's amazing small cap companies being formed every day in this country, right? It's just how you're accessing them. It's just in different methods, and we'll kinda talk about that, Yeah ... and s- and how that can and can't be done in DC. But, I think perspectively from a long-term basis, there's cer- there's still opportunities there.

Mike Vogelzang: Yeah, there's a th- not to get too existential here on the small cap stuff, but, y- you can make the argument that private equity in today's world has pulled out of the small cap universe all of the interesting technology. And so

small cap is becoming a, of a ghetto, if you will, of smaller, unproductive, not growing as fast collectively and then a whole bunch of unproven technology like biotech where you're getting y- it's just not as institutionally driven a market as it used to be.

That's really the concentration issue. The, the other thing is that portfolios have to be at least aware and own big chunks of these massive companies, right? You've got Nvidia, Microsoft, and Apple, which I think are all north of 6% of the S&P 500 today. So if you don't own those and they go up, you're not gonna keep up with the be- benchmark.

Matt Patrick: So we did get a question on this, and a reminder to if you have questions, submit them, and we'll tackle them. So it mentions, we were talking earlier about consolidation and value and growth, and we were talking about it in the large cap context, but I guess, Jim, where you were going with compression of the small cap.

Similar thought there in terms of a more broad mandate across the market cap spectrum- Yeah ... in terms of your approach?

Jim Underwood: Bo- both across mid and small cap and growth and value. So instead of having four potential line items in the, in, or vehicles in a lineup, then you may only have one, and it's gonna be able...

One, it'll attract more assets. Two, it eliminates this friction between what's growth and what's value, and hopefully it becomes a, a more meaningful allocation in, in, from a weighting perspective. And hopefully, again, we think there's some op- opportunities there. I'm not saying that the, the pure s- nine, nine style box approach is broken.

It certainly works. Just understand that there are some challenges that you need to be thoughtful of as you, you build the lineup that might put you might put together for that

Mike Vogelzang: allocation. The, the old phrase in the DC business, right? Too many choices is no choice at all.

That's right. And so if you have, just in the US equity market, you have, have six style boxes, growth, value, and then nine if you put core in there those nine become paralyzing for people who aren't in it every day. And so w- we're saying that the noise between the left and right, between the growth and value, and

even b- some way between small and, or sm- mid-cap, as we call it, and large cap is just becoming louder and louder.

Let's just simplify and make sure people get the exposures that they need so that we're not, again, chasing your tail where you're putting all your money in one particular style box that happens to be left behind, and then you've lost generational kind of money.

Matt Patrick: Yeah. And I think can't emphasize enough the couple times you've mentioned, Mike, around like if you're not in it every day, it's gonna be really challenging to keep up with this and why, why present that challenge to members that are investing in the plan? Super hard. Super hard.

Mike Vogelzang: Absolutely. Yeah.

Matt Patrick: Maybe like quickly we can hit, woven in there, we haven't maybe addressed it head-on, but artificial intelligence obviously very influential in terms of those big names coming up. Mike, how do you think of that from a broad- Yeah ... broad market perspective? And then David, be curious your thoughts on how are managers navigating that.

Mike Vogelzang: Yeah. It i- it is, I think by the CFA charter we're obligated to mention artificial intelligence- Yeah ... in any investment context- that's right ... we talk about today. Let's check

Matt Patrick: that off.

Mike Vogelzang: Yeah. We're good with that. No it's become the biggest conversation topic.

Artificial intelligence slash, data warehouse construction slash technology and productivity enhancement are the issues of the day. And there's a million opinions. Right now we're at a bit of a fraught place because what's happening is that most of the AI development costs have been paid for previously, have been paid for with cash flow out of these companies, and today that cash flow is now used up and they're starting to borrow, and investors are getting a little worried about that.

We've seen the AI trade weaken a bit. I, I... it just dominates the conversation. Y- it's on the Fed's mind. We'll talk about that in a minute. It's on every portfolio's manager's mind. It's honestly behind this growth value noise that we're seeing. It's driving that.

So there's sort of no place to hide in, in the markets and, it feels like a massive generational opportunity, and it probably is, but that doesn't mean that every investment will make sense going forward. Absolutely. So you gotta be really careful, really thoughtful about how you implement this sort of big change in the markets because it can get overdone.

Matt Patrick: Yeah. Maybe David, back to something so Mike referenced earlier, like- There's such big chunks of the index. You have to own a lot to participate or you're gonna be out of step with where the index is. How do managers navigate that, particularly if their views- Yeah ... maybe conflict with that approach and that's the risk for them?

David Hood: I- it's tough. We're talking about concentration risk, which can lead to massive wealth creation, but all of these managers have some kind of risk framework, and they're trying to size positions and keep this. So I would just broadly say managers have been trying to keep up with this because it is like a generation...

If you look at the CapEx spend of this industry versus others in history, it's just absolutely massive. And what I think is super interesting is that not only on the equity side, but I think some of the real story here around the AI trade is what's happening in fixed income, right? The issuance and what's that having, the impact on rates.

We'll talk about the Fed as we pivot here to the fixed income side in general. But a lot of people are focused on the equity side. I think what's happening, at least until the next time we talk, is gonna ha- the fixed income markets in terms of how AI's funding some of this investment, and CapEx spend is gonna be where a lot of the action is, to be honest.

Jim Underwood: And just to finish that thought is, and we've had lots of conversations about this within our investment committee, there's really two equity markets today.

Mike Vogelzang: Yeah.

Jim Underwood: There's the equity markets associated with artificial intelligence, and then there's the equity markets of more old economy companies.

And I think it, to think about it a different way, it's the, the artificial intelligence companies aren't terribly impacted by rising interest rates. The old economy

stocks are absolutely impacted by rising interest rates, and you're starting to see market dispersion pretty significantly just along that one spectrum.

David Hood: Yeah. Yeah. But, or up until the past couple weeks when they have been started to be impacted by interest rate rises.

Jim Underwood: On- only those that didn't have cash flow.

David Hood: Yeah, that's right.

Mike Vogelzang: The Neo Clouds, as they're called. That's exactly. Where they're just, they're building their businesses based on borrowing.

Suddenly, when they were f- three and a half, 4% interest rates, now all of a sudden they're five and more, and the spread that they have to pay to, over those Treasury rates is going higher. So yeah, they're, some of those folks are gonna be under real real pressure going forward.

Yeah. Interesting question came up here. With the market consolidating, why not just focus on the major key averages? I think that's exactly what we're talking about, right? The S&P 500 as a core investment strategy is really important for us to remain focused on. But historically, our industry has done either a good or bad job, depending on your perspective, breaking those down into pieces- Yeah

into components. And what we're saying is that those components, the growth and the value component of the S&P 500 or the Russell 1000 are really really being challenged in a significant way by the concentration in the market. That's really the issue. So we agree with you.

It makes some sense to focus on the major averages.

Matt Patrick: And I think thinking about it in the context of a DC menu design, normally you're gonna have, you'll have some sort of allocation option, a target date, a managed account, something that they're gonna default people into- Sure, yeah ... that gives them a mix of stocks and bonds.

Typically, you're gonna have a passive suite of funds in there, and we would certainly say no changes there. But a lot of the consolidation we're talking about and simplification of the menu is in that active management space- Sure ... where traditionally there's been value and growth styles, and we're simplifying there.

So I think if you're an investor or you have participants that are interested in investing in a more passive, just I wanna track the major indexes way that's gonna be there, that's available, and we would- Yeah ... c- certainly continue to endorse that. Sure.

Jim Underwood: I'm here to represent the portfolio management team.

And so I have to look down before I look up. And as a result, this question is one that I think about all the time. And I do look at the underlying concentration of the broad indices, and I think a lot of those companies, especially the mega-cap companies, have a common return driver. And if artificial intelligence theme doesn't play out the way the market's expecting, that's the main reason why you would want to look different.

Mike Vogelzang: Yeah. Yeah.

Jim Underwood: Absolutely.

Mike Vogelzang: Interestingly, it's actually not too hard to look different today.

Jim Underwood: It's

Mike Vogelzang: not. There, there aren't very many opportunities, but the places that do look different are readily available. Let me just give you one statistic which I find fascinating. We've been tracking over the last number of years the number of stocks that have and I don't mean to get into the weeds, but I'm gonna get a little bit.

Stocks that have negative betas. That is, if the market goes up 10%, a stock with a beta of one goes up 10% approximately as well, right? So if the market falls 10% the stock with a beta of one falls 10% as well. So it moves together, right? Today, 30% of the S&P 500- Has a negative beta. That is, if the market moves down, those stocks will move up.

That is unheard of. We've never seen this level of that before, and f- again, 30% of the stocks as of June 30 had a negative, I think it was six or nine-month beta calculation, which is just nuts. So it means that while the market's been going up while Microsoft and Broadcom and Nvidia have been going through the roof, there's a whole other class of stocks that have been going down.

That's the unusual piece of this market, and that's what we're seeing with this growth in value, that's what we're seeing with concentration, that's what we're seeing with technology's dominance. It's all connected. It's all connected.

Matt Patrick: All connected and all unprecedented historically.

Mike Vogelzang: Yeah. So- It's a very unusual place.

Matt Patrick: All right, I'm gonna put a bow on this one. Are those, they're gonna, they're gonna turn the lights off on us while we're on our- ... our first topic, but good discussion there. We've mentioned the Federal Reserve a couple times. We're gonna jump to that section of our conversation. The Federal Reserve actually made an announcement this afternoon, leaving rates unchanged, but that does not align necessarily with the news we got last month.

Maybe a shi- we have a shift in leadership, shift in approach. So we'll get into that if we jump to our next slide here, just talking about the rate environment. Mike, maybe start- ... us off with new regime. What are we seeing?

Mike Vogelzang: Yeah. I think that's the that's a really important thing for investors to understand.

Since 1996, when Al- Alan Greenspan was in the Federal Reserve chair seat we've become more and more transparent with the Fed's activities. There was a joke a few years ago that the only way they could be more transparent is if they let CNBC into the Federal Open Market-

Committee meetings. I don't think that's gonna happen but it was the direction of becoming more transparent, telling everybody what they were going to do, giving direction as to where we were going. And Kevin Warsh is saying, "No thank you. No mas. No bueno. This isn't what we're doing.

We're not going here. We're gonna pull back the other direction." So he is much more reticent to share information about what's happening, what he, how he views the market. This is this... he's trying to be less interventionist, and I I... you can think it's a good thing or a bad thing, it doesn't really matter, he's gonna be this way.

But it is an important change, and I th- I think where it's really gonna matter is when we have a significant market correction.

David Hood: Yeah.

Mike Vogelzang: For the last 30-plus years, we've had what's generally been known as the Federal Reserve put. That is, if the market falls or we get a panic in markets, the economy weakens, think COVID, think the global financial crisis, et cetera, that the Federal Reserve will be there to flood the system with cash, reflate the stock market, and so you'll never really lo- have a long-term permanent loss in your capital.

That's what they've been doing. We don't know how Kevin Warsh is gonna react. We're not gonna know until the next big downdraft whether he's gonna step in and help the market out, or he's not going to exercise the Warsh put, if you will. So that's, to me, the biggest change in what's going on. He's just being less forward guidance, as the slide says, less market intervention just simply being quieter.

And I think the markets are digesting some of that. It's part of the reason why we've seen some higher rates.

David Hood: Yeah.

Jim Underwood: The right side of the page to me is a perfect reflection of less guidance. The right side of the page the blue numbers show what most people used to refer to as the dot plot, and that would be the expectation that the different Fed members would have for interest rates going forward.

The orange line shows what the market's implied expectation is. And the numbers aren't terribly important. The dispersion and how they're diverging are, is what's most important because ultimately that's going to have to reconcile, and that reconciliation is going to be a source of market volatility.

If the market moves down, that's gonna be actually a positive for the market. If the F- FOMC ultimately makes some adjustments to their dot plot, that's likely gonna raise the mar- market volatility. So to me, it's all about that, that gap that's widening between what the market expects, and it's all driven because there's just less transparency of what that forward guidance is gonna look like.

David Hood: Yeah, and I think one of the, the kind of tangible implications for plan sponsors, because stable value assets are still fairly considerable in, in the marketplace, is that, y- I think you, you still have short-term competition between crediting rates and money market will continue to come under scrutiny.

Those rates made up material ground over the past two years. But if the market's right here and is pricing a little bit more tightening, so higher rates, there's still

gonna be a lot of questions around that. And so through cycles, obviously, we've seen stable value provide a very positive experience for participants, provide positive total outcomes, but we've ended that kind of short-term cycle that we were with that steep hiking in rates from a couple years ago.

And again, this path leads to potential, again, that competition cutting under-- coming under scrutiny. I think from the health of the business standpoint, what's really super interesting when we look at it, certainly flows were challenged in that kind of '23, '24 time period for the-- just the business itself.

We've seen flows be volatile, but fairly net neutral, just given while there is a very strong economy out there and a lot of these companies are driving earnings, there's still a lot of risk aversion in terms of participant behavior and kind of flight quality, so which is very healthy. And as we'll talk on the next slide in terms of what rates have actually done in the market, if you look at longer term rates while market of book has is taken a hit a little bit here and while crediting rates are still, like, trending over three, all-in yields at this point, whether it's stable value, we could talk about core fixed income, yields to maturity are trend-trending considerably higher just given the massive shift higher in volatility and rates that we've seen.

That in core menu in terms of volatility in your bond per-performance, and then also just thoughts in, in trying to navigate and think long term about kind of stable value in that role.

Matt Patrick: Yeah, I think that's helpful to touch on just 'cause money market versus stable value is a, it's a pretty constant comparison that you see just as your two capital-- main capital preservation options in the defined contribution market.

Very easy to compare to each other. I think just to emphasize what David's saying everything has actually been performing exactly how they're supposed to. Money market responds very quickly. Stable value responds slower over time. But again, rates going higher means crediting rates flow through and go higher over time too, so they are a benefit to the ultimate yield that investors are getting at the end of the day.

So David, you referenced, yeah, this slide here talking about the, the treasury. Maybe you wanna talk through what does this look like and what are you taking from it?

David Hood: It's just a lot of volatility. It's been a lot of two steps forward, two steps back within fixed income. Again, mentioned stable value.

We're seeing yield to maturities and yields in the 4.5, 5% range. The three-year treasury is up at close to 5%. So you're seeing tremendous value across the curve. You haven't needed that diversification this year, which has been good 'cause equity markets have been so strong. But as a starting point in a high quality, kinda like traditional long-only fixed income portfolio that you'd see in a core lineup, depending on the type of strategy that you're investing in, which is just like a typical defined contribution strategy, you're looking at yields now like the 5, 6, 7, and 8% ranges.

So it's a great starting point right now, and again, most of the defined contribution of these plans are really built for accumulation, so that fixed income component is really meant for diversification and to allow you to kinda glide between stocks and bonds as you kinda age through the plan. But, I think overall, th- we've seen obviously a big move in rates.

We'll talk maybe on the next slide and don't wanna get there too fast, in terms of how we got there, but, I think this, this is obviously has been a, a pretty massive shift higher in rates.

Mike Vogelzang: Yeah, for me it's interesting because it goes back to 2006, so you're talking about a 20-year cycle of going from 5% on the yield of the...

This is the 10-year treasury we're talking about, where it went down to, almost zero, 1.5%, 1% after COVID, and now we're back to sort of standard rates. What it means for investors is that bonds are actually doing what bonds are supposed to do- ... and that is provide some cushion. So you can get interest rates now to move up or down and you're actually gonna have a positive return in most of your bond investments.

And that's a, that's an unusual change. There's a lot of folks in the investment business who started after 2010- Who don't, who have never experienced bond rates at 5%. When I got started the old piece of shoe leather I am, rates were 10 or 12%. In fact, they were high as 15, 16% in the early '80s.

And so those rates were, outrageously high. And as, as those basically a f- 35-year drop in rates to almost zero, now we're just normalizing again. Psychologically, it's really amazing to see what's happened.

Matt Patrick: I think that's a, that's good context 'cause I do feel like you hear a lot of conversation around like rates are high.

Yeah. But yeah, to your point, if you extended that X-axis, like, all the way to the left- ... you're like, we're still pretty low historically.

Mike Vogelzang: You ain't seen nothing yet. No that's really,

Jim Underwood: that's very different. But the whole reason why we keep emphasizing the yield is that's a pretty good approximation of what you should earn out of your bond portfolio over the next five to seven years.

For 20 years, we were sa- saying bonds are likely gonna deliver somewhere between 2 to 4%. Now we feel pretty confident we can say bonds are likely gonna deliver 5 to 6% over the next five to seven years. Could have some additional volatility near term, but ultimately, that starting yield is probably the best indicator of what you should expect out of that bond portfolio going forward.

So as Mike mentioned, it does provide you a much bigger cushion to absorb market volatility if the equity portfolios go through market volatility.

Mike Vogelzang: Yeah but not only that, right? It also provides competition for equities.

Jim Underwood: Absolutely.

Mike Vogelzang: And the classic definition is, of course, is as interest rates rise, stocks should, all things being equal, they never are, but all things being equal, stocks should fall in value.

And so what we're seeing here is with this higher 10-year Treasury yield the pressure is really on the stock market to continue to do well through earnings, which we've seen. But if we get a slowdown in earnings expectations I think, this, and higher rates particularly, we may see a little more pressure on the equity market.

Jim Underwood: Yeah that 5% Treasury yield has- When you think of it as a real return, which I know nobody really understands, effectively the return over what you, we expect inflation to be over the next 10 years is about 2.5%. That 2.5% real yield by the 10-year Treasury's as high as I've seen it in a long time.

Mike Vogelzang: Long time.

David Hood: Yeah, Jim, that, that's a that's a really important point. I think as we talk to our managers, this has been almost a real yield story. Yep. This is not... and that is something that we haven't seen. And typically that does at some point spill over to risk markets. Hasn't here.

There's a lot of- Yeah ... natural tailwinds. But that real yield component is big, which means you're taking home what you're earning- ... versus losing that to inflation, yeah.

Mike Vogelzang: Yeah, really important.

Matt Patrick: Jim, could I throw a question your way- Yeah ... that came in? So talking about some of the uncertainty, I think we were talking about in the first section, now we're talking about different Fed approach here.

The question was more around building in a cash position or cash reserves into your portfolio, given some market uncertainty. How do you think about that?

Jim Underwood: Look, rarely do you see a yield reset like we've experienced over the last, call it nine months without an equity market correction.

As, as Mike mentioned, typically those interest rates ultimately get factored into e- earnings expectations, which brings stock markets down.

So we haven't seen that. I think it's a great time to rebalance portfolios. I think it's a great time to revisit liquidity buckets, make sure that you've got the right amount of liquidity on the sideline to withstand just about any kind of market volatility we would see, and more importantly, while you're waiting and keeping that, that excess liquidity in something, you're getting paid 4% to 5% returns on that portfolio.

So it's, I think, a win-win-win.

Mike Vogelzang: Yeah, I... The, the other way to think about cash is how much of your equity portfolio should you be trimming. If you've been invested for a while, you've made a lot of money, right? Market's up- Yep ... I don't know, whatever the

Jim Underwood: total- Almost doubled in the last four hun- four years

Mike Vogelzang: four years. It's crazy, right? It's almost doubled. And if you started at a 60% level and you haven't rebalanced, you're probably at mid-70s now. So how much cash do you wanna have? Maybe take that back down a little bit and redeploy in bonds at a 5 or 6 or 7%, depending what you're buying.

That's a pretty good trade-off. You're keeping your expected return, to Jim's point, in your portfolio at a pretty high level with a little lower volatility, which is the whole game. That's what we're trying to play.

Matt Patrick: All right, we've previewed this next slide about the reason for the- Yeah

for the rate hike up here. So maybe Mike, throw it to you- Yeah ... just to tackle this.

Mike Vogelzang: Sure. There's a couple- these are really two slides here. The left-hand side is, is- talks about why we think rates have surged and moved up so much and then, and, the right side is maybe some of that as well, but also a little bit of a forecast.

I- so on the left side economic growth that we're seeing, and by the way, the economy is practically booming. People have really lousy sentiment. But, and there's reasons for that, but the economy itself is just absolutely crushing it. And so that's driving up the demand for capital. You see it best in the demand for new infrastructure around AI and so on.

And that resilient economic growth is driving higher interest rates, right? That by itself will do that. By the way, we can't get rid of this 2% inflation target that the Fed has. And Kevin Warsh is insistent that he's gonna get to 2%, so he's, that- that's going to be a higher interest rate environment just to get there.

It- the, the other thing is competition, right? So we all know the federal government never seen a dollar that they don't like to borrow, right? Ever.

Jim Underwood: Or spend twice.

Mike Vogelzang: Or spend it twice or p- you know, whatever. And so that, the federal debt just keeps ballooning. Now we're seeing corporate debt for the AI build-out start to balloon as well.

And and by the way, both of those almost are these, what we consider to be non-economic borrowers. They're gonna borrow no matter what. They're, they...

if Oracle is building a data warehouse, they don't care if they have to pay 6%, 8%, or 10%. They're gonna build the data warehouse. And so they're just gonna borrow no matter what.

And so that- that's what we're seeing, these, these non-economic actors coming in and we all know the federal government's certainly that way. It- we just think that the potential in the future is gonna be a bias toward higher rates, just given all these, these factors.

Jim Underwood: Yeah, I w- what I would add is to your f- Initial point, and that is the economy is booming, and it's booming because of what you said l- last, and that is most of the economic activity is related to this big massive build-out by the capital by the AI build-out, it...

which are not price sensitive, so they really don't care what interest rates are doing. And then the other driver of the economy right now is baby boomers. They're sitting on $94 trillion balance sheets, and they're starting to spend those down. And so every time the Federal Reserve raises short-term interest rates, they give everybody high fives because their interest income is substantially higher than their interest expense, which is actually providing some support for the economy.

So when you put those two together, even though we've seen rates starting to tick higher that means that the, the market and the economy can withstand it and actually benefit from it because it's just not impacting what's driving the economy right now.

David Hood: Yeah, and I think again, the impact at the participant or plan sponsor level is, like, when you looked at, fixed income portfolios, it may be a little confusing in the third and fourth quarter especially 'cause you're seeing stock prices maybe go down and bond prices go up and not be that...

We've had a couple of questions that talk about, the hedging ability of bonds and whatnot. And where you're... when you're dealing with that framework of this three-headed monster, you've got government deficits, you've got inflation, and AI issuance. They're all putting pressure, at least in the near term, on some of those characteristics and fundamentals that tend to hold over time.

I guess what has been encouraging over the past couple weeks is that when AI or some of those more thematic I would say names within that basket kind of catch a cold, the bond market has appreciated in price, so- yeah ... so that, that's

been you've seen a little bit more of those traditional kind of like relationships between stocks, bonds come back into play.

Probably over the long term that happens, but in the near term, you, there's certainly areas for volatility.

Mike Vogelzang: It wasn't very long ago, in 2022, when rates went from one and a half to four or whatever it did that bond prices got absolutely crushed And stock prices got hurt. It was the worst sort of double whammy that we've seen.

I remember we wrote ul- extensively about how you lost, almost double digits in the bond market, and you lost 15 or 18% of the stock market in 2022. So that was really difficult. What that's allowed us to do is reset bond yields higher. So now we're not gonna... We don't think we'll have that again at least n- not nearly to that extent.

Jim Underwood: But the point about whether bonds are going to be the diversifier that they've historically been I think this is where it's very important for us to make sure portfolios and lineups incorporate the kind of bond portfolios that we think have the option to deliver both some excess return as well as that diversification profile.

Matt Patrick: Yeah.

Jim Underwood: Because I do have some concerns that the corporate bond market is gonna get more and more heavily tied to what I worried about earlier, and that is artificial intelligence. Because a lot of the new bonds that are hitting the market, they're gonna be aligned with the same theme that's gonna be driving equity markets.

And so you might see some of those movements- ... be a little bit more correlated.

Mike Vogelzang: Yeah. There, there are not many parts of the economy that don't have exposure to AI.

Jim Underwood: And that's something I think as a portfolio manager and as our manager due- due diligence group, we need to understand, are we going to get both the return optun- opportunity in bonds as well as make sure they continue to have the diversifying characteristics that, that we've seen historically.

Mike Vogelzang: To wrap up this question about the inverse hedging of stocks and bonds, right? We haven't seen it since 2022 just because sto- bonds started at such low yields. So when rates went from one and a half to four bonds didn't have that starting cushion, and as a result had really big drawdowns, negative returns in bonds, and stocks did as well because they were reacting to higher interest rates.

We think that starting at five, six, seven percent in the bond market will now provide that inverse relationship again. If stocks fall, we'd expect to see bonds rally. You can make some money, so you're starting to get that diversification benefit out of the bond portfolio again. An

Matt Patrick: important piece of that return to normal- from a interest rate environment perspective.

Mike Vogelzang: 100%. 100%. Absolutely. Yep.

Matt Patrick: All right. We're going to, we're going to jump to our last topic which again is, we mentioned is one that's coming up more in the defined contribution space. Not a lot of history here. Yeah. Still not that accessible broadly, but we see the momentum's coming, the conversation's picking up, and that is private market investments.

So something you may have heard about, you're probably going to hear about if you haven't from a plan sponsor perspective. So maybe Mike, start us off with what are the private markets? How are they differ, and maybe- Yeah ... we can get into it.

Mike Vogelzang: The big difference is, of course, is private markets aren't liquid, right?

You can't sell your, you can't sell your growth fund tomorrow for cash. You're stuck with it for a long period of time. And that extends to private real estate, private credit. So think of the bond market, but with private securities, that illiquid securities, and then of course private equity and pri- and venture capital and so on.

There's been a big let's just say a lot of noise around the next area for investment in private assets, and that is the defined contribution space. We would encourage our clients to watch carefully there's sort of two aspects to this. In the individual defined contribution lineup for a plan participant, we don't think there's really any place for private investments, right?

It just doesn't make sense per, for an individual. In some of the target date vehicles that are out there, we think actually they actually act more like pension plans, and those may be a good place for a very thoughtful investment oversight to include some private investments. Okay? So number one.

Number two, we still don't think that we're at a level from a fiduciary perspective where the quality of those private assets are good, and two, the price of those private investments are where they need to be. So while we see conceptually that some of these target date funds might make some sense for privates, we just don't think that they're there from a fiduciary perspective.

And a number of us in the industry feel this way. So until we see better pricing and better options for investing we're just... we're gonna keep watching.

Matt Patrick: I think that distinction is important because you can run just a, analysis from an investment perspective solely- Yeah ... and see the value for some of these strategies or some of these approaches.

But when you put it in the lens of participant friendly, what are the considerations, costs, liquidity, like you mentioned, like-

Mike Vogelzang: 100%.

Matt Patrick: It, it steps the complexity up a few levels- ... and we need to be thoughtful around

Mike Vogelzang: that. Complexity and potential negative outcomes. Absolutely. That's the real problem.

David- Yeah. David runs all of our due diligence for alternatives at the firm, and so ve- he's in a good seat to be able to comment on some of what we're seeing in the DC space particularly.

David Hood: Yeah, I think it just requires a lot of investment research, some due diligence. We need a durable regulatory framework.

We have to have that fiduciary clarity. But we also need, once we start getting... once we get past that, we've started to see steps made there, really define like participant plan sponsor use cases for how this is gonna achieve over... 'cause a lot of these things aren't exactly like the private markets equivalent that we're investing in within our endowment and foundation business.

And then after that, we wanna see, really robust and live track records so that we can start to understand how these things are gonna r- react. Especially like, how is this, how defensible is this gonna be in a time of market stress, both from a liquidity standpoint- Sure ... and also from a valuation one, which is to Mike's point here.

And then the econ- the, the economics have to work out, right? We need to be able to deliver this at scale for these plan participants and not be completely cost prohibitive in terms of how we're delivering that. I think those things are all very important. And then not only that, but you've got other issues that are just defined contribution specific, like Portability.

How is a record keeper gonna, are we gonna ha- handle and transition these things? And the communication of how this is being done. Like, how does the plan sponsor or plan participant understand how this is moving along for them, and what the trade-offs are, and how they... So there's like a multi-pronged approach.

From our standpoint from a research one, we have the universe covered. We have a lot of clients that, we take a fiduciary first approach to finding the best of the best within private markets and are ready to go. But there's this, these extra layers of complication that whereas really is devil in the details to understand can we deliver?

And for us, it's always kind of client, participant, plan sponsor backward as a fiduciary to make sure that we are, delivering and they are getting the best possible outcome or experience, or we're increasing the probability of that happening over the life cycle of them investing in this plan.

Matt Patrick: Yeah. I think it's great context, like the fiduciary framework, like being nonexistent right now, where you're like some of these are... They're challenges that we've addressed in a lot of other, like portability framework for how we are gonna evaluate and discuss, like what is prudent in terms of evaluation.

It's all the Wild West as it relates to private markets right now. We're just not in a spot to, that. It really is. So I think that like approach of it's not never, but right now we're not seeing it built out enough to address it.

Mike Vogelzang: Color us skeptical, color us patient.

Correct. Where there's, these aren't going away. There's no urgency to make investments. You don't have to keep up with anybody here. Your portfolios, the markets are doing just fine. Let's let these develop and mature and let somebody else get the bruises that are gonna come.

Jim Underwood: Yeah, I think we've all seen the statistics about, the difference between the top quartile large cap manager and a bottom quartile large cap manager may be 50 basis points.

The difference between a top quartile private equity manager and a bottom quartile private equity manager may be 20%. And I would argue that gap gets even wider if you don't have the underlying structure to support a program in private investments, which is where all the education, I think, needs to come from before it becomes a a, a tool in our toolbox for any of our defined contribution plans.

Matt Patrick: That's perfect. Yeah. Great context. So we'll wrap that one up. Last call, if anybody has questions they wanna drop in there, we'll we'll address address those before we wrap up. I guess one that came in how do we think about if the AI trade does fizzle out, like, how do we think about that from a from a tracking perspective?

Yeah. And where would we pivot portfolios in that regard? Yeah.

Mike Vogelzang: It's, it requires some advanced thinking, right? So not... Don't wait for it to happen. It's the, there are a handful of places and they're very clear 'cause they're the places that haven't moved up with the rest of the market.

It's really just go find the stuff that hasn't participated, and you'll find the things that won't go down when AI goes down. There's a lot of talk about are we in a bubble or not. We don't believe we're in a bubble. We just think we're in a period of heightened investment. Back when railroads were being built in this country railroads added tremendously to the productivity of the United States.

They allowed westward travel, which really was unheard of at the time. That doesn't, that didn't stop massive land speculation from going on around railroads, and so as a result, you had these massive booms, you had these massive busts in land around railroads. And but that didn't take away from the productivity enhancement.

The, the most recent one, of course, was the 1990s when the internet was built out and all the fiber cabling was built and laid out across the world. We overdid

that. It was too big. It got too much. And yeah, people lost a lot, but that productivity enhancement that was generated from those was really important.

We think AI's in the same boat. We're gonna overdo it. Some of these data warehouses that are being built with borrowed money are gonna cause a problem at some stage. So it makes some sense to, to pare back some of your winners to, even if it hurts, right? You like to see how smart you are by saying, "I bought something 10, 10X ago."

Pare that back, put some in bonds, find some things that are gonna not participate unless the stock market falls, and then some of these things might actually go up. So you just gotta look a little bit. But there are places, there are pockets in the market where you can hide.

Jim Underwood: I would add the I, I would ask the person that asked the question, what do you mean by fizzling out?

Because if you mean that the, the companies that are investing heavily in building out the infrastructure aren't going to generate a profit the margins they need to support that, I would argue the beneficiary of that is gonna be the rest of the market.

Mike Vogelzang: Yeah.

Jim Underwood: Because that means all the other companies out there, there's value in artificial intelligence.

There's tremendous value in artificial intelligence, and maybe all the other companies will be able to access that value at lower prices. And to me, that, that benefit accrues to the rest of the, to the economy. And so it's almost like it... Who's going to ultimately win? Are the big mega cap companies gonna be able to extract enough value to justify the, the, the big investments that they've made?

If so, the market keeps going up, and then leadership probably doesn't change very much. If the answer is no, the market's likely gonna broaden out, and all of those companies can now access art- the value of artificial intelligence at much lower prices.

Mike Vogelzang: It's it's the promise of the future for us, right?

Whether we can grow our economy so fast that we outgrow this debt, can we s- can we survive some of the potential social unrest that comes from displacement in jobs and how people get paid and all the rest of the things that people are talking about with AI. If we can h- if we can survive that we think we can get through to a, a really interesting, prosperous future.

But we're probably gonna have some bumps to get through.

Matt Patrick: As there always are, right?

Mike Vogelzang: There always are. There always are with big, huge investment cycles like this one.

Matt Patrick: All right. We hit all of our topics. I think we hit all of the questions, so a big thank you to Jim and Mike and David for participating with me today, and a big thank you to you all.

We certainly appreciate you all entrusting your retirement plan with CAPTRUST, and we appreciate you taking some time out of your day to, to join us for this. So thank you all. I hope you have a great rest of the day, and take care.

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