# NEXT GENERATION INVESTMENT STRATEGIES FOR RISK POOLS

DAN SMERECK, MANAGING DIRECTOR







# WHY INVESTMENT MATTERS FOR RISK POOLS?

#### **PURPOSE**

- INVESTMENT INCOME:
  - IS A CORNERSTONE TO THE RISK TRANSFER BUSINESS MODEL, AND MAXIMIZING INVESTMENT INCOME CAN MEAN THE DIFFERENCE BETWEEN REMAINING COMPETITIVE OR LOSING MEMBERS TO AGGRESSIVE PRICING.
- HOW MUCH CAN YOU EXPECT TO EARN?
- HOW MUCH RISK ARE YOU WILLING TO PRUDENTLY TAKE?

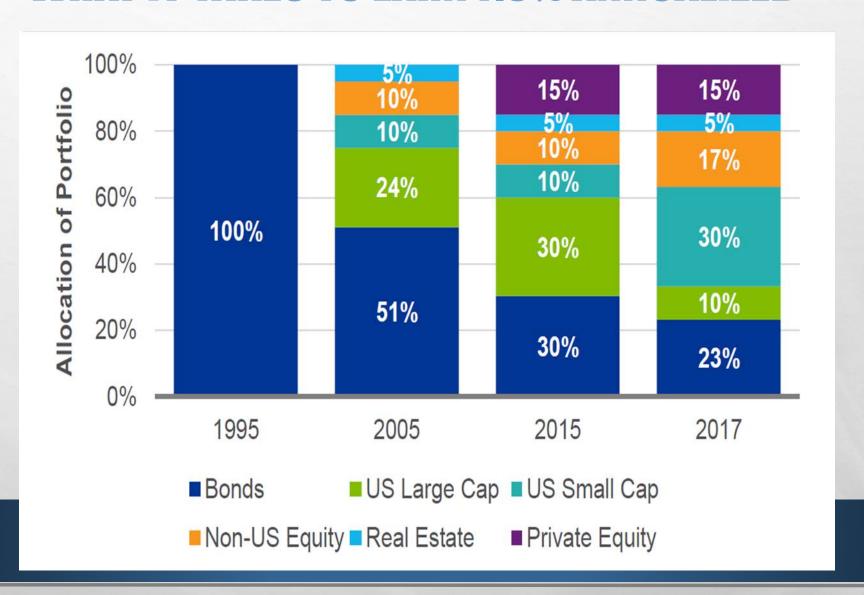
#### **APPROACH**

• INVESTMENT PERFORMANCE OBJECTIVES:

Where do you fall on this objective continuum and why?

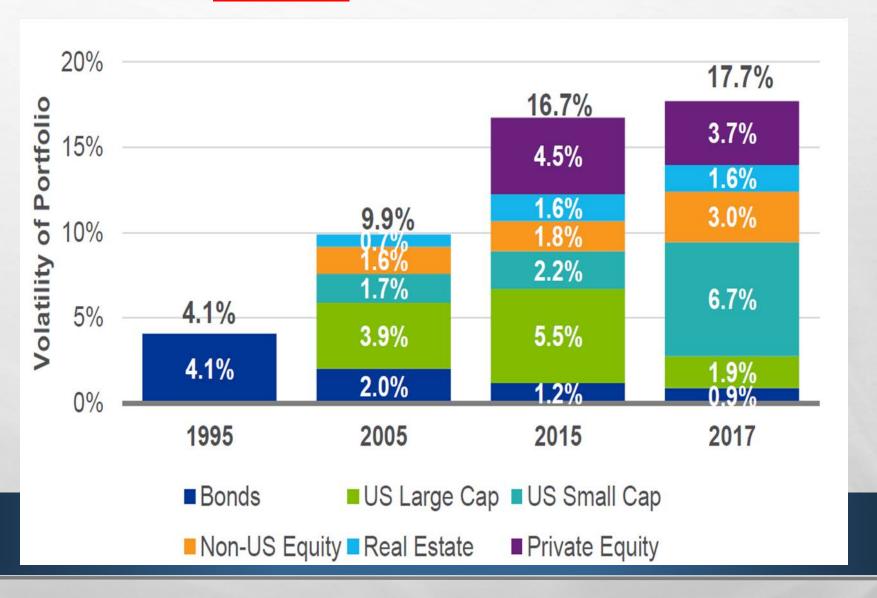


#### **WHAT IT TAKES TO EARN 7.5% ANNUALIZED**



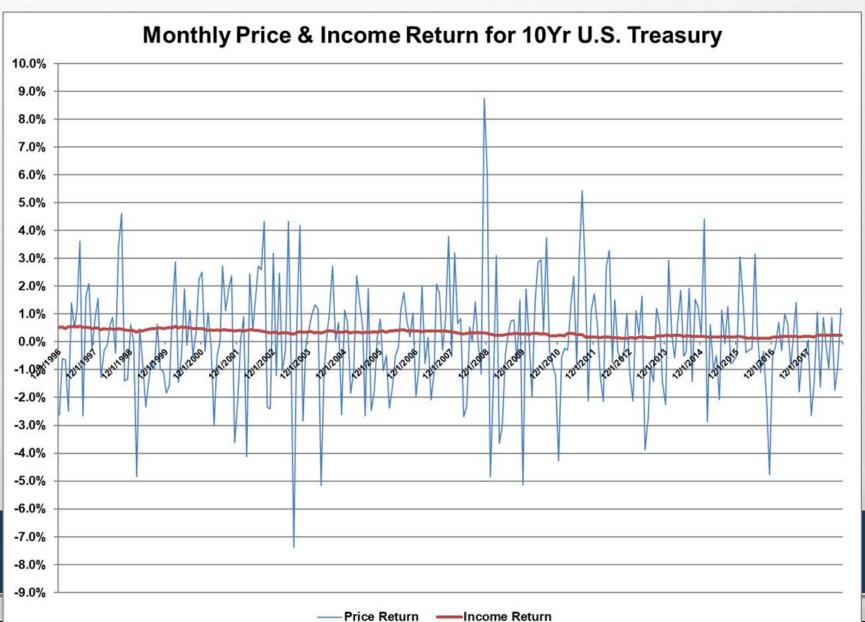
1 2

#### WHAT TO EXPECT TO EARN 7.5% ANNUALIZED



1 2

#### **INCOME VS. PRICE RETURN**



#### **YIELD + PRICE = BOND RETURNS**



#### **REGULATORY REGIMES**

- FLEXIBLE VS. INFLEXIBLE
- REGULATED VS. UNREGULATED
- **OPPORTUNITY COSTS & IMPLICATIONS**

#### FLEXIBLE VS. INFLEXIBLE

#### **INFLEXIBLE**

- U.S. TREASURY BONDS/NOTES
- U.S. AGENCY BONDS
- FDIC INSURED CDS

#### **FLEXIBLE**

- ALL "INFLEXIBLE" ITEMS PLUS:
  - INVESTMENT GRADE CORPORATE BONDS
  - MORTGAGE BONDS
  - ASSET-BACKED BONDS
  - HIGH YIELD BONDS
  - EQUITIES
  - INSURANCE REGULATIONS

#### **ORSA IS COMING FOR YOU...**



**ORSA = "Own Risk & Solvency Assessment" Testing - NAIC** 

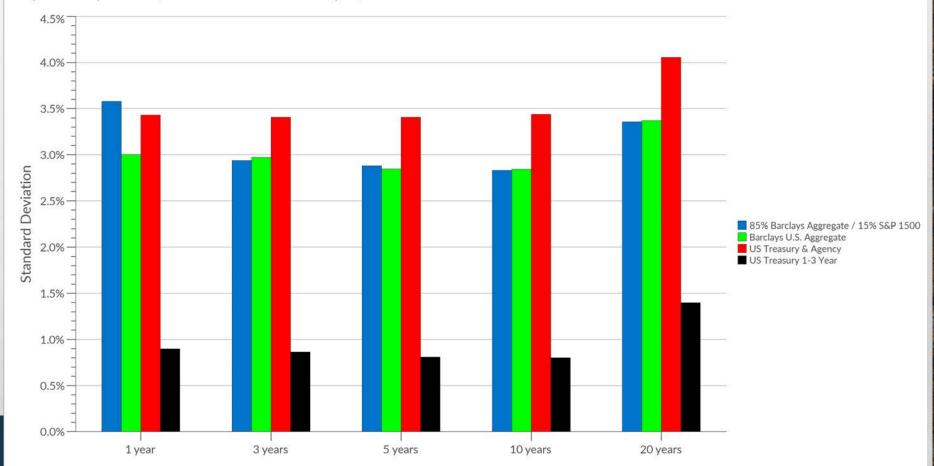
#### **OPPORTUNITY COST - INCOME**

| \$ 50,000,000 Portfolio Size          |                 |    |           |    |            |    |            |    |            |  |
|---------------------------------------|-----------------|----|-----------|----|------------|----|------------|----|------------|--|
| FOI CIOIIO SIZE                       | 1 Year          |    | 3 Years   |    | 5 Year     |    | 10 Year    |    | 20 Year    |  |
| US Treasury 1-3 Year                  | \$<br>1,540,000 | \$ | 1,591,595 | \$ | 2,524,493  | \$ | 5,615,092  | \$ | 37,370,882 |  |
| Barclays U.S. Aggregate               | \$<br>2,645,000 | \$ | 2,904,493 | \$ | 6,763,842  | \$ | 22,043,547 | \$ | 75,525,857 |  |
| Additional Income                     | \$<br>1,105,000 | \$ | 1,312,898 | \$ | 4,239,349  | \$ | 16,428,455 | \$ | 38,154,975 |  |
| 85% Barclays Aggregate / 15% S&P 1500 | \$<br>3,215,000 | \$ | 5,951,673 | \$ | 10,628,195 | \$ | 35,326,303 | \$ | 87,027,421 |  |
| Additional Income                     | \$<br>1,675,000 | \$ | 4,360,078 | \$ | 8,103,703  | \$ | 29,711,211 | \$ | 49,656,539 |  |

#### **OPPORTUNITY COST - VOLATILITY**

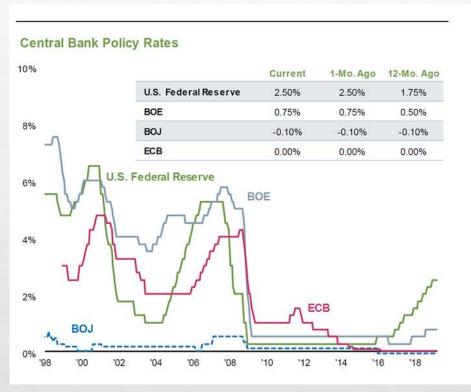
#### Manager vs Benchmark: Standard Deviation

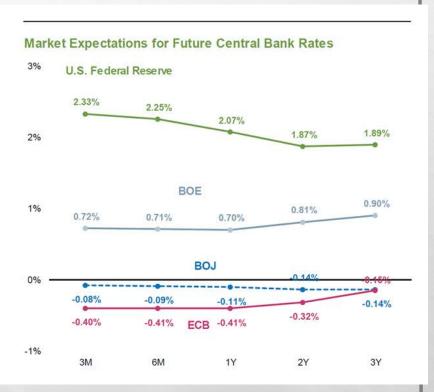
May 1999 - April 2019 (not annualized if less than 1 year)



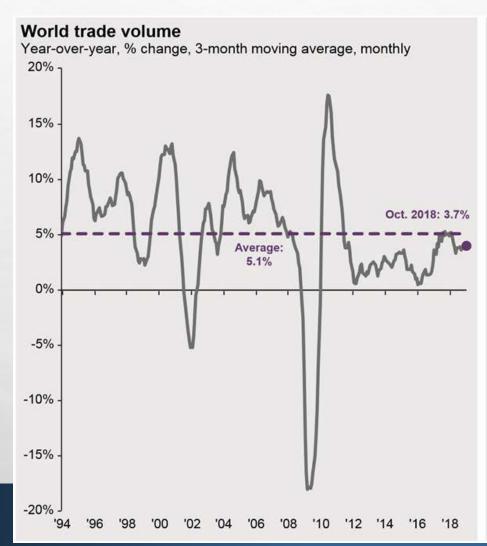
## CAPITAL MARKET CONDITIONS

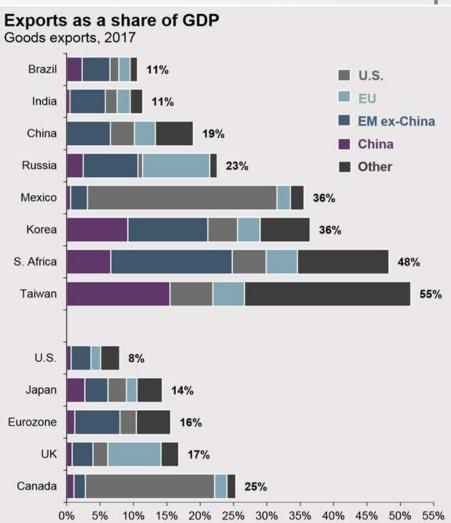
#### **INTEREST RATES**



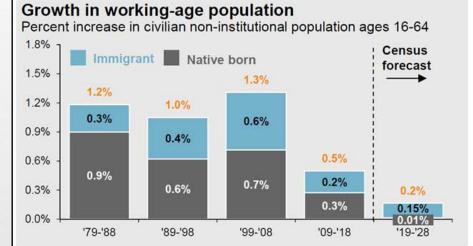


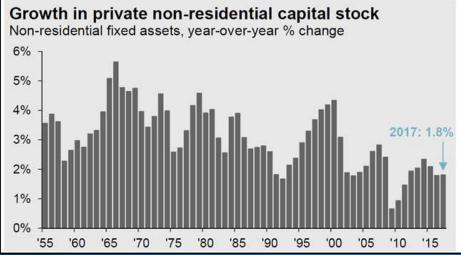
#### TRADE

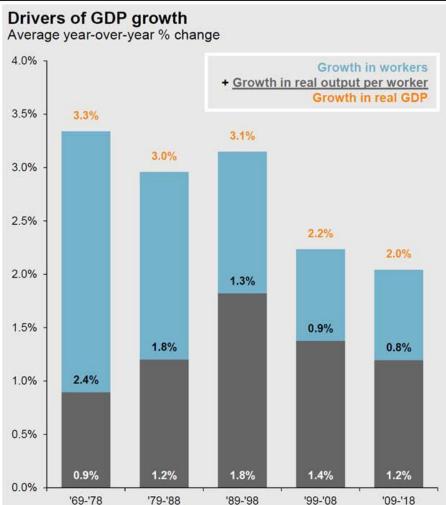




#### **ECONOMIC GROWTH**







## TRENDS TO CONSIDER

#### **INVESTMENTS ARE PEOPLE-DRIVEN**





MID 1960'S TO MID 1980'S MULTI-TASKERS
INDEPENDENT ASSERTIVE OF CYNICAL TEAM PLAYERS
WE CYNICAL TEAM P



#### **HISTORICAL GAME CHANGERS**

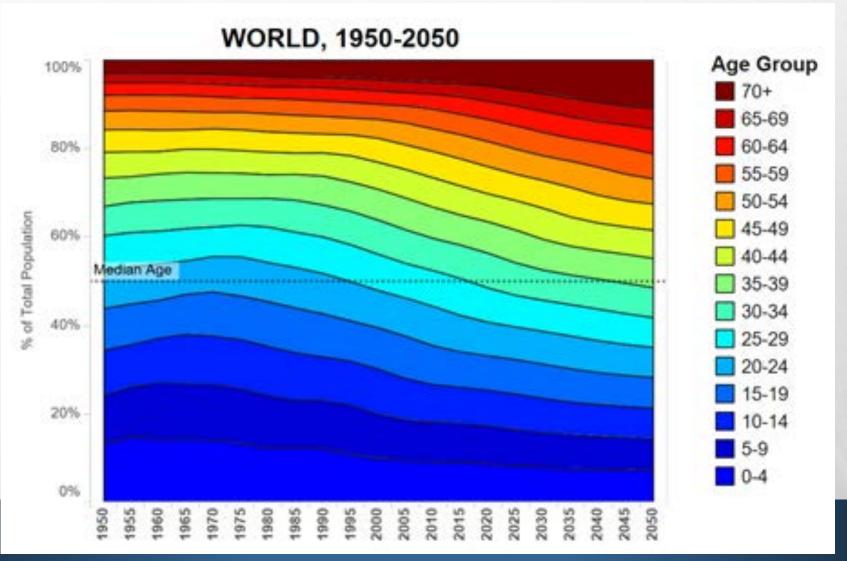
- THE RISE OF MECHANICAL POWER
- 21 THE ADVENT OF ELECTRICITY & COMMUNICATION
- 3) THE DIGITAL AGE & DEVELOPMENT OF MODERN COMPUTING
- 4) NOW BUILDING & EXTENDING THE IMPACT OF DIGITIZATION IN NEW AND/OR UNANTICIPATED WAYS

# GLOBAL HARD TRENDS

#### HARD TRENDS - GLOBAL

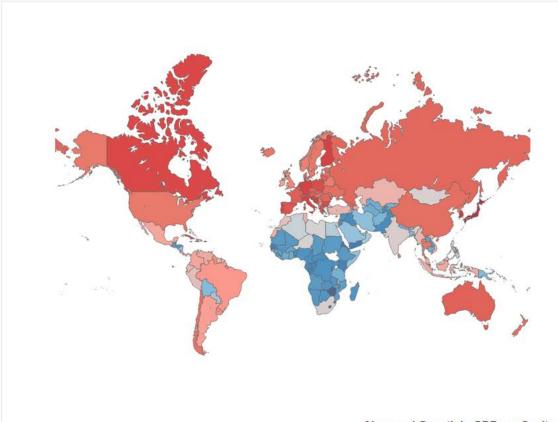
# 1) DEMOGRAPHIC 2) GOVERNMENT REGULATION 3) TECHNOLOGY

#### **GLOBAL HARD TREND #1 - DEMOGRAPHIC**



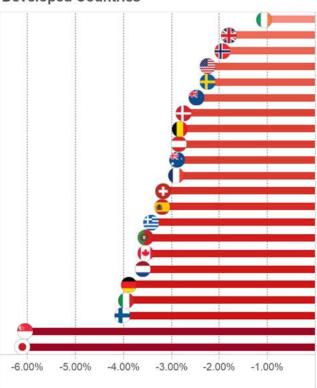
#### GLOBAL HARD TREND #1 - GDP IMPACT

#### **How Demographics Affect GDP Growth Around the World**



Select Year: 2025

#### **Developed Countries**



Abnormal Growth in GDP per Capita

Source: Research Affiliates, LLC, based on data from the United Nations, Penn World Table and Global Financial Data.



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# GLOBAL HARD TREND #2 – GOVERNMENT REGULATION

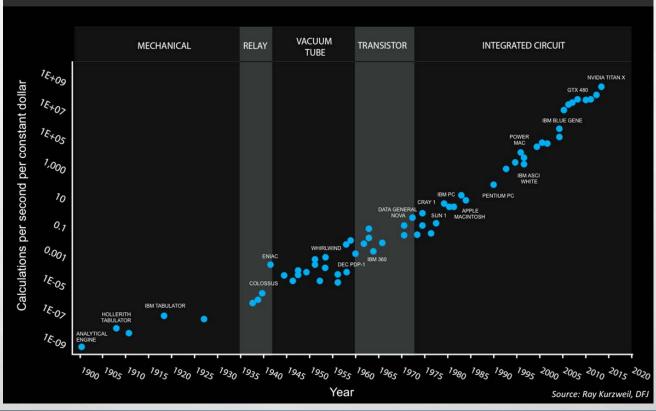
1) RENEWABLE ENERGY USE INCREASING
2) CYBER-CRIME POLICY EVOLUTION
3) ACCELERATING USE OF HIGH SPEED DATA
ANALYTICS FOR AUDITING & COMPLIANCE

#### **GLOBAL HARD TREND #3 - TECHNOLOGY**

- 11 INCREASING USE OF MOBILE APPLICATIONS
  21 INCREASING USE OF CLOUD & VIRTUALIZATION SERVICES
- 3) INCREASING USE OF NETWORKED SENSORS & MACHINES

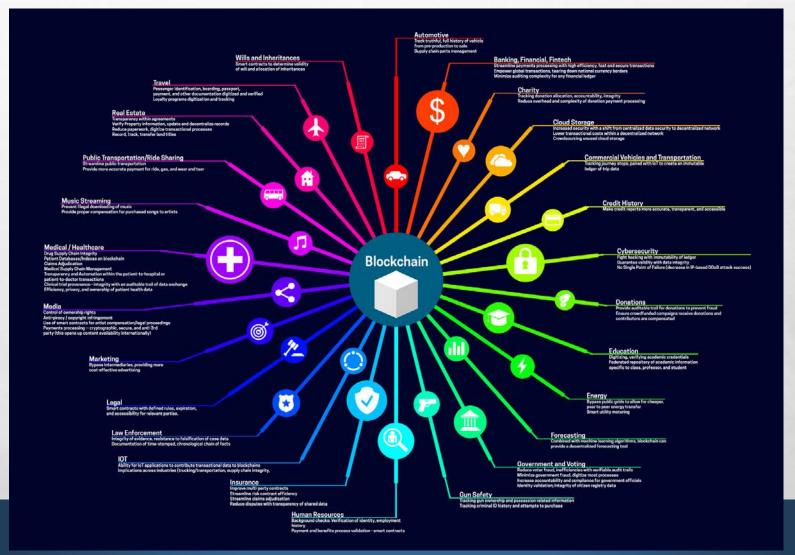
#### **TECHNOLOGY HARD TREND - FOCUS**

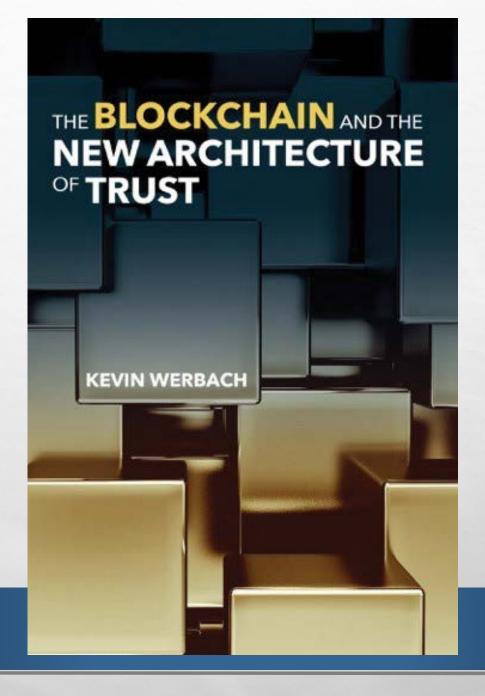




- PROCESSINGPOWER
- DIGITAL STORAGE
- BANDWIDTH

#### **BLOCKCHAIN INNOVATION**





### **GOVERNMENTAL RISK POOLING**

HARD TRENDS

#### HARD TRENDS - RISK POOLS

- AGING WORKFORCE KNOWLEDGE/WISDOM TRANSFER
- INCREASED RESPONSIBILITIES OF LOCAL GOVERNMENT
  - CREATIVE COVERAGE & RISK MANAGEMENT SOLUTIONS
- INCREASED USE OF TECHNOLOGY WILL EMPOWER RISK POOLS
- COLLABORATION WILL CONTINUE & ACCELERATE

## **CAPITAL MARKETS**

HARD TRENDS

#### HARD TRENDS - CAPITAL MARKETS

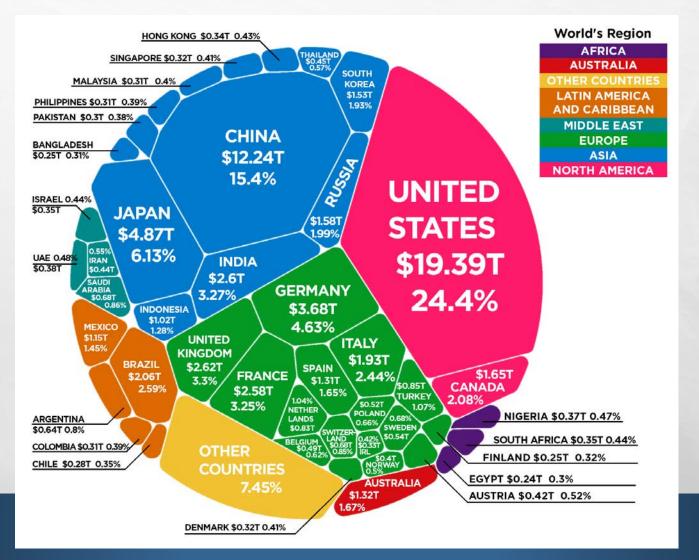
1) GLOBALIZATION CONTINUES
2) TECHNOLOGY INNOVATION CONTINUES
TO AUGMENT & DISRUPT MARKETS
3) WORLD FINANCIAL LEVERAGE
INCREASING

## Slowbalisation

The future of global commerce

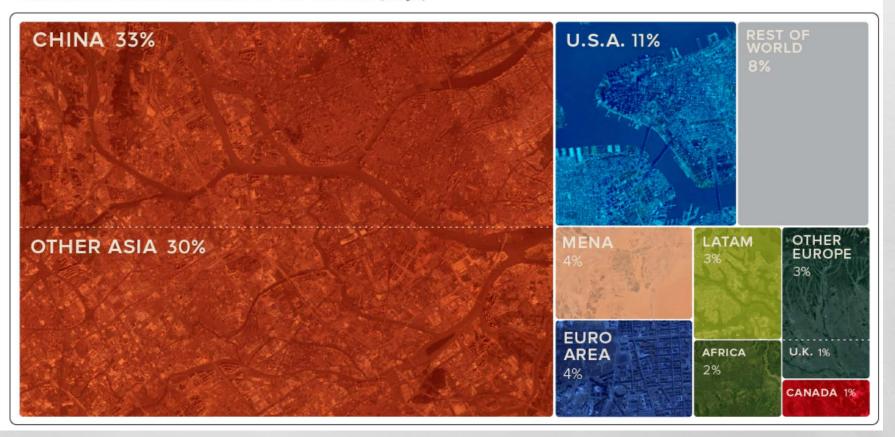


#### **WORLD ECONOMY - \$80 TRILLION**



#### **GLOBAL GDP GROWTH 2019**

PERCENTAGE SHARE OF GLOBAL GDP PPP GROWTH (2019F)



# GLOBAL FLOWS – TRADE, FINANCE, & DATA



# **GLOBALIZATION: THEN VS. NOW**



Source: McKinsey Global Institute

oliever in everyone st when self-taught.

#### WikiScholar Abook? I can find all the info I need online for free these ways are much

# THE DEATH OF EXPERTISE

AGenfus IRL
 Is that really how you spell expertice?

AnAmPatri According to my u little reason to ass

The Campaign Against Established Knowledge and Why it Matters

DrMom\_312 This title just sounds like yet another elitist appeal to authority.

TOM NICHOLS

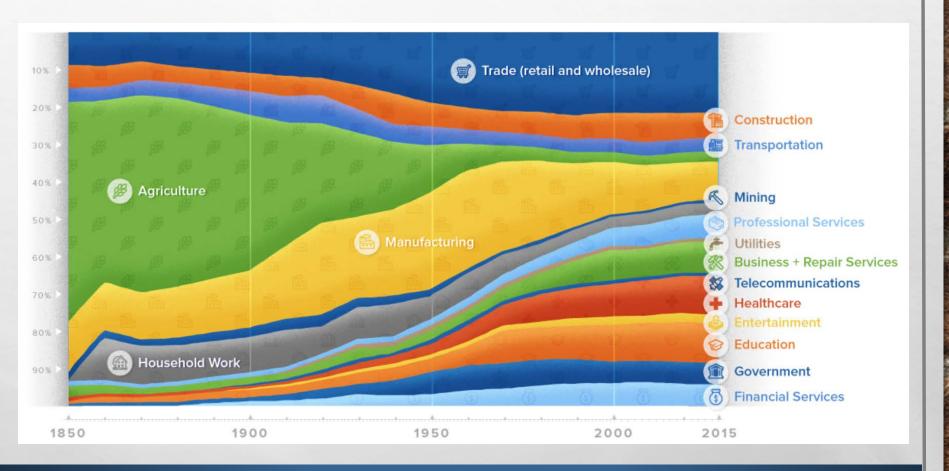
And why do we care what this so called "expert" has to say???

WebSurfBum ok out this great call video from

# GLOBALIZATION KNOWLEDGE, THE NEWS CYCLE &

**EXPERTISE** 

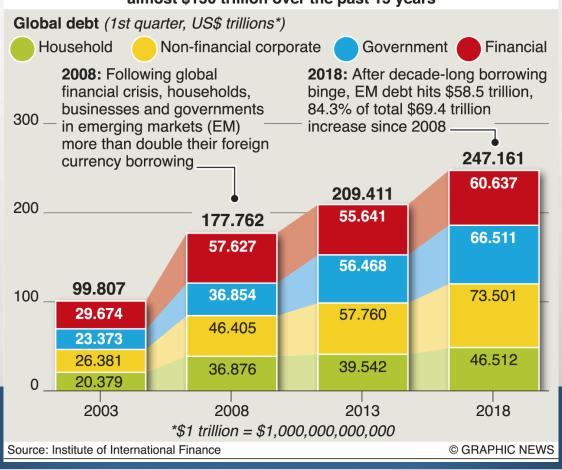
#### 150 YEARS OF US EMPLOYMENT - BY SECTOR



## **GLOBAL DEBT**

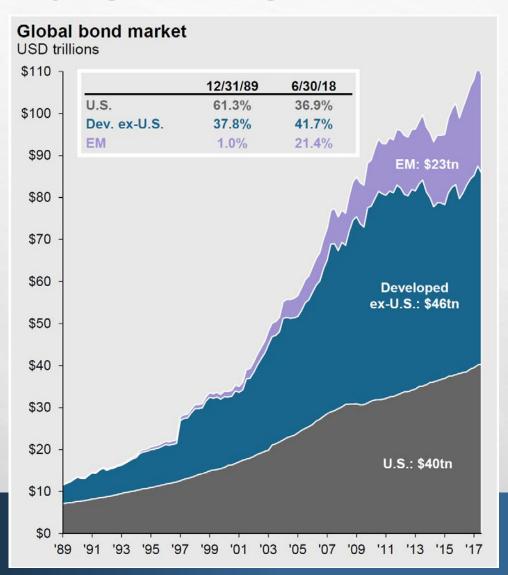
#### World debt hits record \$247 trillion

Global debt rose to a record \$247 trillion in the year to the end of March, piling pressure on emerging markets. World debt has surged almost \$150 trillion over the past 15 years



Source: Institute of International Finance

# **GLOBAL BOND MARKET**

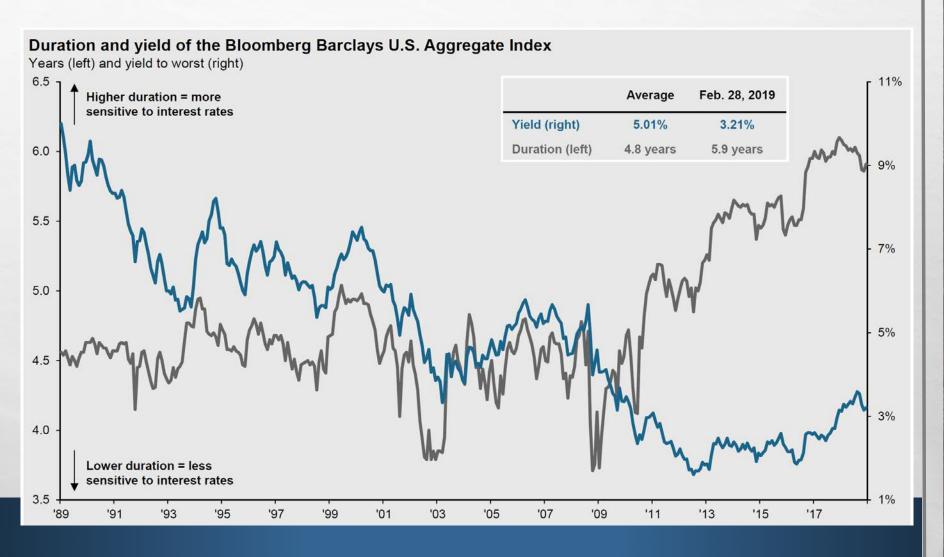


\$109 TRILLION

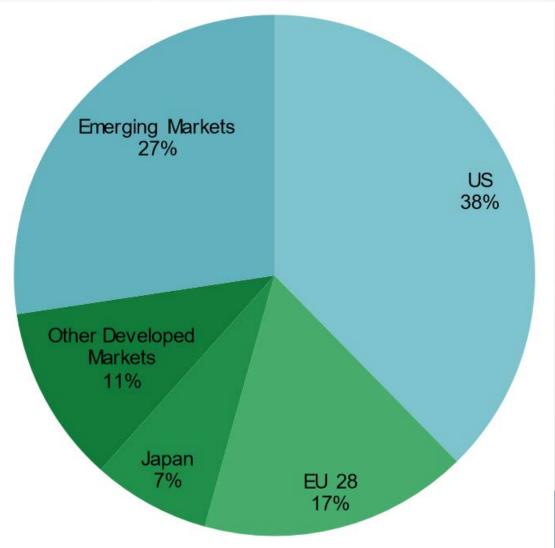
LARGEST INVESTMENT
 EXPOSURE FOR RISK POOLS

Source: J.P. Morgan Asset Management

## **U.S. BOND MARKET**



# **GLOBAL EQUITY MARKET**



# \$85 TRILLION

Source: World Federation of Exchanges, SIFMA

# INVESTMENT MANAGEMENT

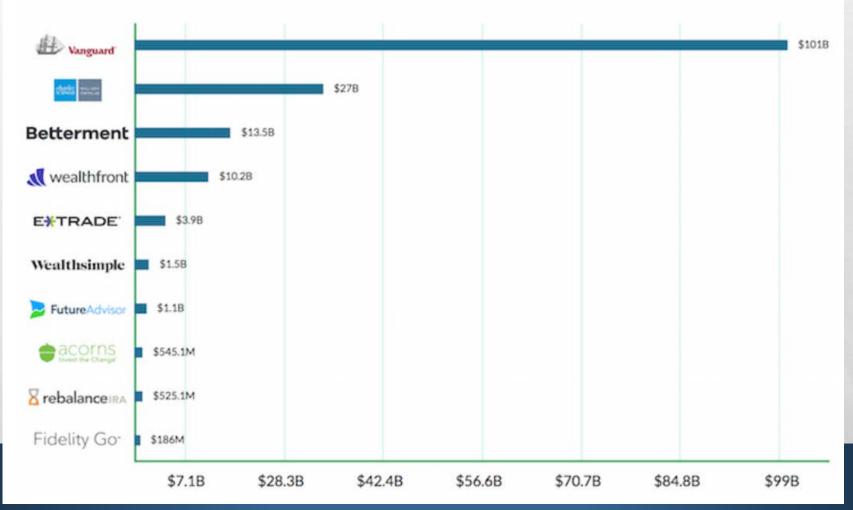
HARD TRENDS

#### HARD TRENDS — INVESTMENT MANAGEMENT

- 1 ROBO-ADVISOR & ARTIFICIAL INTELLIGENCE
- 2 RISE OF PASSIVE INVESTING & FALLING FEES
- 3 LOOKING BEYOND CONVENTIONAL INVESTMENT OPPORTUNITIES (I.E. ESG, ALTERNATIVES...)
- 4 EVOLUTION OF ADVICE/EDUCATION/SERVICE MODEL
- **5** LOWER EXPECTED RETURNS...

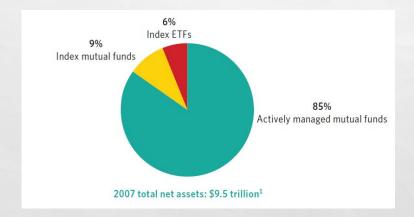
## **ROBO-ADVISORS**



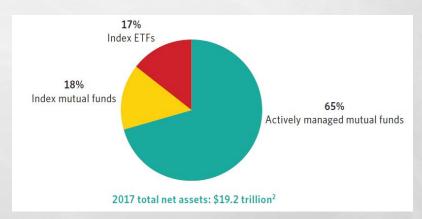


# **PASSIVE INVESTING**

2007



2017



#### THE WORLD AS 100 PEOPLE - ESG INVESTING?



# IMPLICATIONS FOR RISK POOLS

## **RETURNS – TIME HORIZON**

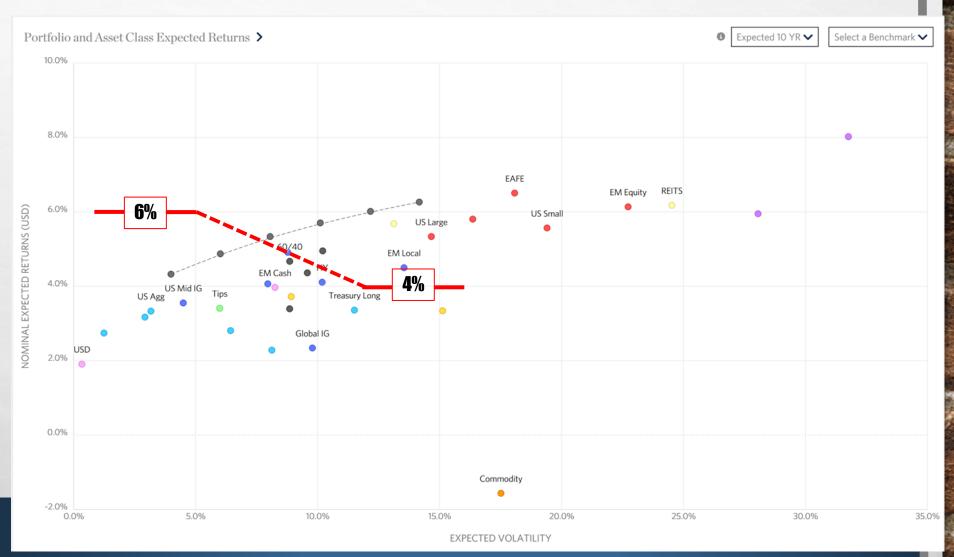
#### 1972-2018

- 100% US STOCKS +10.40%
- 100% US FIXED INCOME +5.80%
- **50% / 50% +8.47%**

#### 2000-2018

- 100% US STOCKS +6.11%
- 100% US FIXED INCOME +4.64%
- 50% / 50% +**5.88**

# **RETURN/RISK EXPECTATIONS**

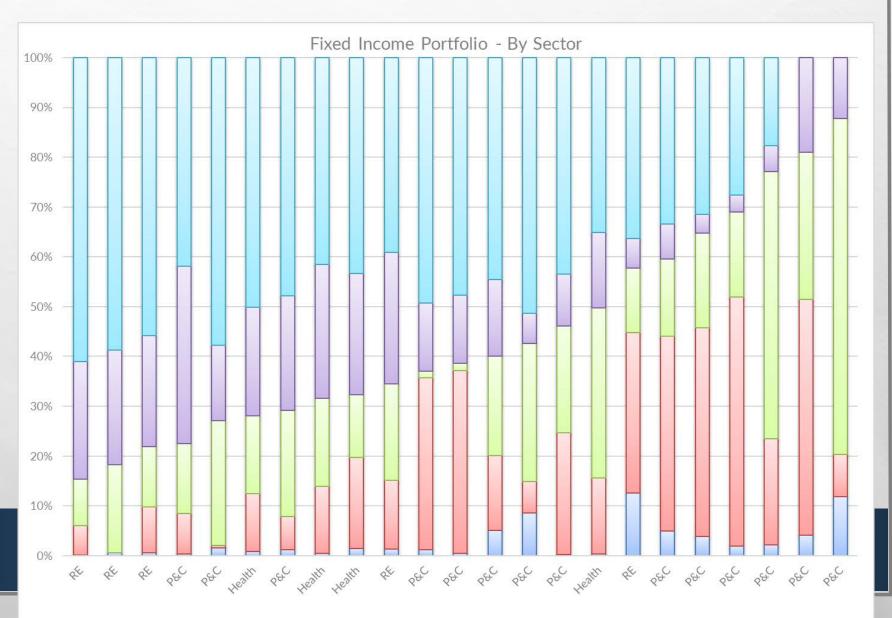


# **SAA RISK POOL CLIENTS**

#### Risk Asset Allocation - % of Total Portfolio



#### SAA RISK POOL CLIENTS – FIXED INCOME

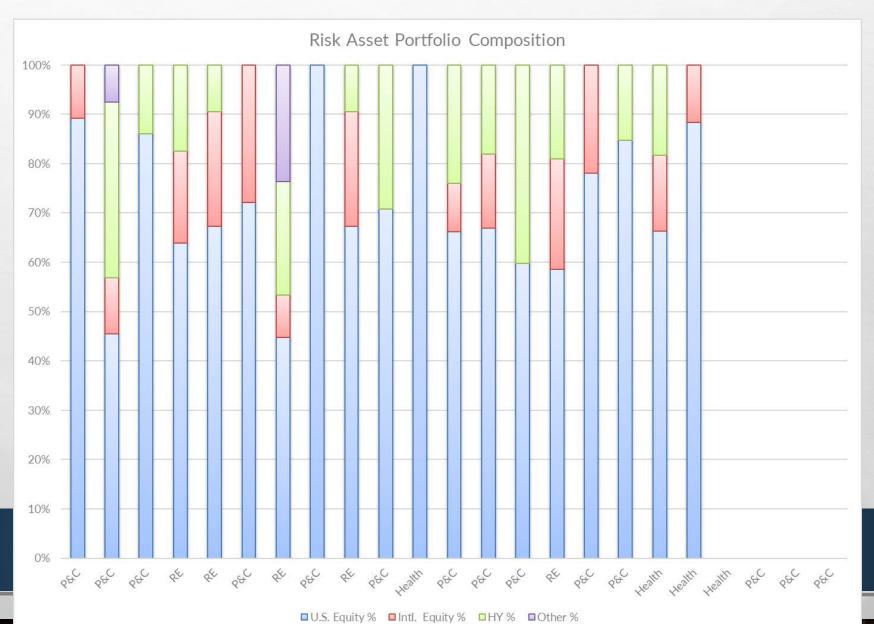


□ Agency MBS (%) □ ABS/CMBS (%)

■ Corporate & Municipals (%)

■UST & US Agency (%)

### SAA RISK POOL CLIENTS – RISK ASSETS



# NOW WHAT?

# **CONSIDERATIONS**

- HOW IS YOUR INVESTMENT PROCESS ADDRESSING THESE TRENDS?
  - ASSET ALLOCATION
  - ENTERPRISE RISK MANAGEMENT MODELING VS. CULTURE
  - BOARD/STAFF EDUCATION
    - (DATA VS. INFORMATION VS. KNOWLEDGE)
  - INVESTMENT POLICY FLEXIBILITY

# **CONSIDERATIONS #2**

- HOW IS YOUR INVESTMENT PROCESS ADDRESSING THESE TRENDS?
  - STAFFING
    - INTERNAL
    - INVESTMENT MANAGER(S)
    - INVESTMENT ADVISORS
  - INVESTMENT MANAGER TECHNOLOGY PLATFORM & FLEXIBILITY
  - INVESTMENT ACCOUNTING & REPORTING

# THANK YOU

**QUESTION & ANSWER** 

