MARCH 18, 2025

AGENDA ITEM 4
INFORMATION ITEM

CALIFORNIA ABLE ACT BOARD

Review of Fiduciary Investment Training - Meketa Consulting

Background

The California ABLE Act Board will review and discuss the importance of having an annual investment training provided by Meketa Investment Group, Inc (Meketa). This training and Meketa's regular updates provide protection for Board members by establishing sound and consistent procedures that govern their decision-making. The session planned is intended to:

- Review Policy Statements
  - Investment Policy
  - Monitoring Procedures
- Review Key Terms
- Investment Portfolios.
  - Assets Allocation and Diversification
  - Building Portfolios
  - CalABLE Plan Review

Presenter

Kay Ceserani, Principal/Consultant, Meketa Investment Group, Inc.
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Attachments

- Attachment #1 – Fiduciary Investment Training

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CalABLE

March 18, 2025

Board Investment Training

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MEKETA'S ROLE

- We provide a range of services that can be customized to meet our clients needs.
- We are often called upon by many of our clients to assist with several ad-hoc projects – some staff led and some where our role was expanded.

College Savings Services

- Investment Policy, Plan Development & Maintenance
- Recommendations Regarding Breadth & Construction of Investment Options
- Investment Benchmarking
- Glide Path Analysis
- Asset Liability Modeling
- Quarterly Performance Reporting & Market Commentary
- Manager Evaluation, Selection & Monitoring
- Underlying Fund/Manager Fee Review
- Standalone Option Gap Analysis
- Annual Program Manager Analysis
- Fund Coordination
- Board/Staff Education
- Proxy Voting Recommendations
- Participate in Morningstar Annual Review Meetings
- Program Manager Selection & Evaluation

Ad-Hoc Projects[1]

- Determine Default Option
- Matching Grant Structure Review
- State Revenue Forecast Project
- Underlying fund Sustainability Review
- Industry Analysis: FDIC and Stable Value Options
- Industry Analysis: Shift from Age-based to Year-of-Enrollment
- Create Morningstar Interview Presentation Materials
- College Savings Rating Entity Education
- Program Manager Fee Negotiations
- Develop Program Manager RFP
- Participate in College Savings Plan Updates to Legislative Bodies
- Establishment of Investment Beliefs
- ABLE Industry and Program Review

[1] Certain ad-hoc projects may not be included in Meketa's standard fees.

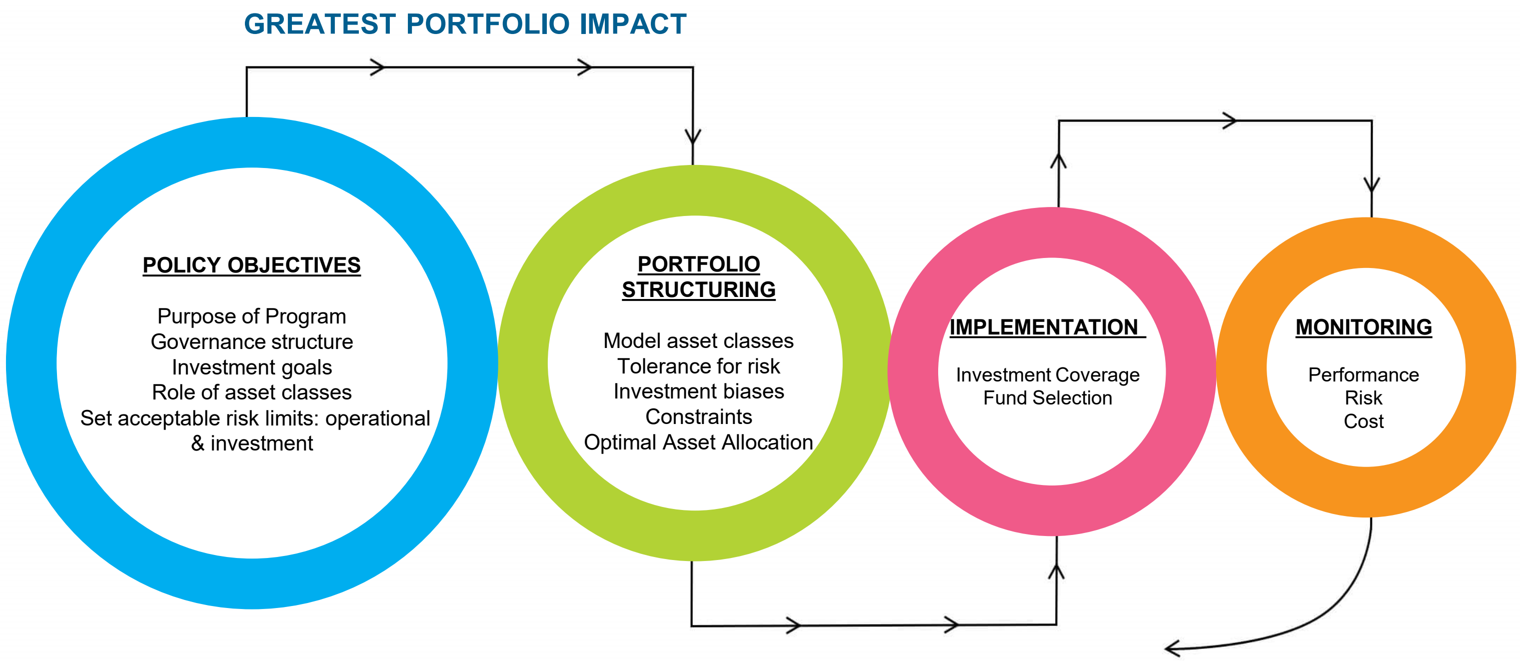
The Framework:

Policy Statements

Plan Structure Goals

1. Offer a range of options across the risk spectrum – utilizing high quality funds
2. Diversified options should provide broad based capital market exposure
3. Efficient from a risk-return perspective; meet or exceed the rate of college tuition inflation
4. Identify/remove unintended biases
5. Cost conscious

THE FRAMEWORK



Evaluating the Program

Approach and Understanding of Investment Design

- Overall appropriateness of investment options – rational capital markets exposure
- Review portfolio's effectiveness at generating returns relative to the risks incurred
- Provides participants the ability to save for short- and long-term needs/goals

Due Diligence and Risk Management

- Overall risk oversight
- Underlying fund evaluation
- Asset allocation / risk analysis

Appropriateness of the ABLE Investment Menu

- The number and quality of the investment options
- Broad based capital market exposure
- Investment biases
- Reasonableness of cost relative to investment structure

Monitoring Procedures

- The Monitoring Procedures are designed to aid in making the best decisions on behalf of participants.
- Since Programs are mostly comprised of retail mutual funds or exchange traded funds as the underlying components, performance data is easily accessible.
- The key element to developing the Monitoring Procedures is to pre-determine a level of underperformance that is unacceptable.
  - To accept actively managed funds is to accept periods of relative underperformance (beyond portfolio management fees).
  - It is important to establish a level of underperformance where the fund no longer meets expectations.
- The Monitoring Procedures then provide for predetermined steps and timeline to address funds that do not exhibit material improvement.

MANAGER/FUND MONITORING

The evaluation process should exhibit several key features

- → Objectivity
- → Balance between short-term issues and long-term objectives

While the process might be fluid, a systematic documented approach is essential

- → Incorporate quantitative and qualitative aspects of managers/funds' practices
- → Understanding the role of the manager/fund in the Program
- → Clear time period of review

Quantitative Review

Formulaic criteria focused on

- Relative performance versus a benchmark/peer group over various time periods

Understand underperformance

- Is investment style out of favor?
- What are the biases of the investment strategy?
- Do the portfolio characteristics reflect its stated investment style?
- Is the benchmark/peer group an accurate representation of the fund's opportunity set?
- Is the underperformance consistent with expectations?

Qualitative Review

Non-performance issues

- Has there been a change in …
  - ☑ People – PM/Analysts
  - ☑ Process
  - ☑ Philosophy
  - ☑ Organizational Structure

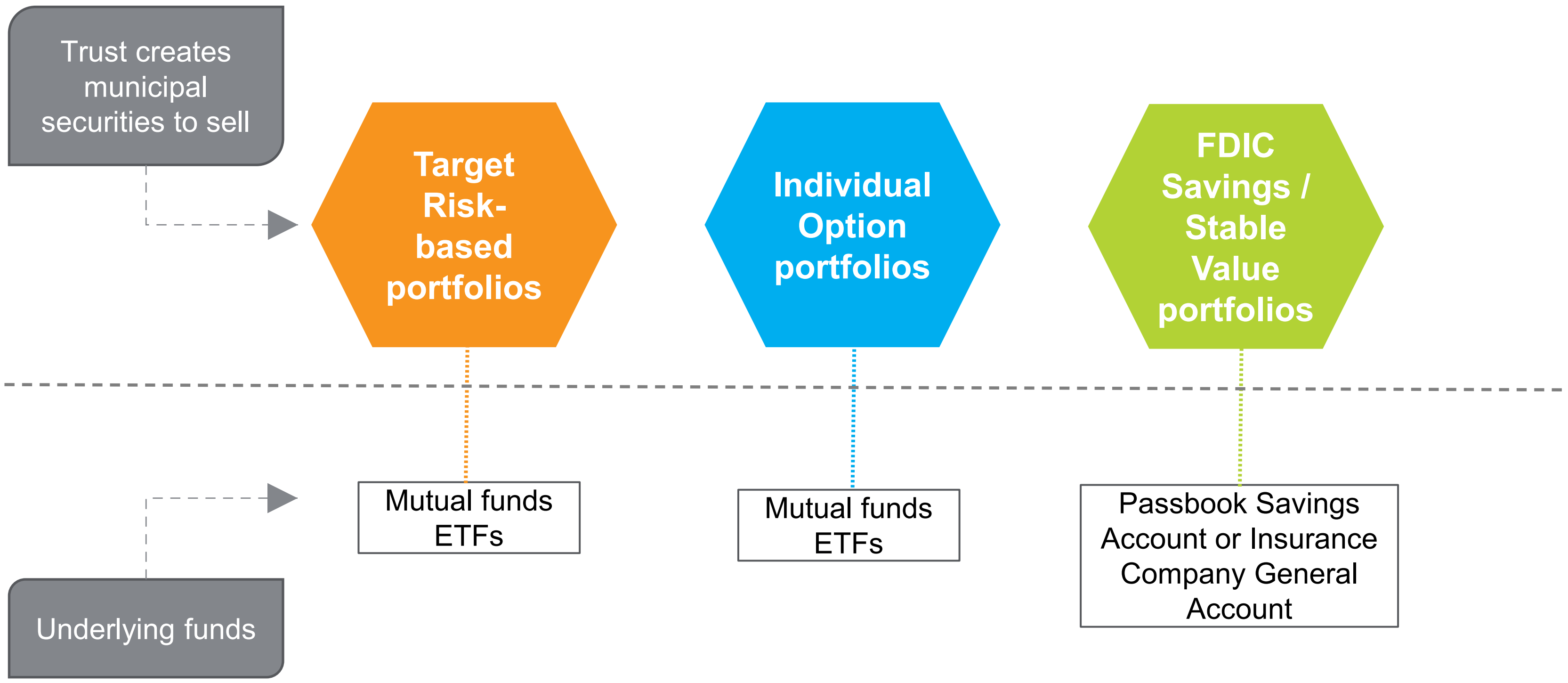
Implications of change/event

- Is the change positive or negative?
- How will it impact the management of the fund?
- How will it impact the firm/team culture?
- Will it be a distraction to the investment process?

ABLE Portfolio Structure

→ ABLE portfolios are municipal securities typically comprised of '40 Act mutual funds.
- A municipal security is a security issued by the government or a governmental agency of a municipality.

→ Both ABLE portfolios (municipal securities) and the underlying funds should be monitored.



A Few Key Terms

What is a Benchmark?

→ A benchmark is a standard measure that can be used to analyze the allocation, risk and return of a portfolio or mutual fund.

→ In investing, benchmarks typically come in two flavors:

Index	Peer Universe
• Indexes include multiple securities, assets, or other instruments which represent the investable universe for a specific style of investing.	• Provides a funds comparative standings (or rank) within an appropriate peer group of fund with similar mandates and objectives.
• Provides context in understanding a portfolio's absolute performance.	• Helps gauge the effectiveness of a fund's management team versus similar funds especially in periods when absolute results are outside of historical norms.
• Indexes represent a portfolio of unmanaged securities that represent a designated market segment. – Index providers create and calculate market indices and then license their products. – Each follow their own standardized methodology.	• Peer groups can be broad in nature as well as broken down into segments based on portfolio characteristics. • There are a variety of databases for the institutional and the mutual fund market. – Morningstar and Lipper are top providers for mutual fund peer universes.

→ There are benchmarks for every type of investment and strategy.

Active versus Passive Investing

Active Management

- Active management refers to a portfolio management strategy where the manager makes specific investments with the goal of outperforming a benchmark index.
  - If Manager A returns 10% and the S&P 500 Index returns 8%, Manager A has outperformed the benchmark index by 2%.
- An active management strategy involves making calculated decisions regarding stocks, sectors, countries, etc.

Passive Management

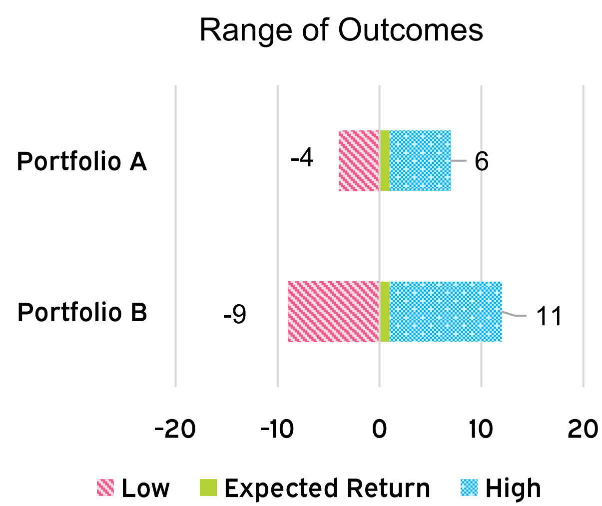
- Passive management refers to a portfolio management strategy where the manager makes specific investments with the goal of mimicking the structure and performance of a benchmark index.
- Investors may choose passive management because it provides broad market exposure, with minimal operating costs and fees.

Standard Deviation: A Measure of Risk

- Standard deviation, is one of the most common measures of risk in investments
- It measures the variability (or volatility) of a dataset
  - Low standard deviation = low volatility
  - High standard deviation = high volatility

For example, if we look at two portfolios:

Portfolio A	Portfolio B
Expected Return = 1% Standard Deviation = 5% Range of Outcomes ± 5%A	Expected Return = 1% Standard Deviation = 10% Range of Outcomes ± 10%



The Line-up:

Investment Portfolios

Investment Menu Considerations

529 Plans

ABLE Plans

The Line Up: Investment Options

Most common choice of 529 participants

→ **Age- / Enrollment-based Options**
- Diversified options that de-risk over the investment horizon

→ **Target Risk (Static) Options**
- Diversified options that do not change over time.

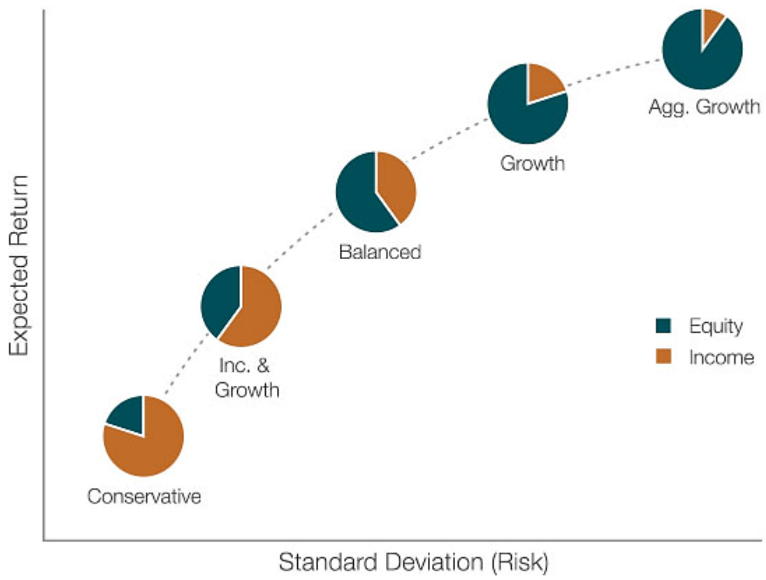
→ **Stand Alone (Individual) Options -- Not common in ABLE Plans**
- Invests in a single fund
- Can be Passive or Active

→ **Capital Preservation Option**
- Protects against decline in yield and loss of capital
  - Money Market
  - Stable Value Fund
  - FDIC

Most common choice of ABLE participants

TARGET RISK PORTFOLIOS

- Asset allocation remains unchanged over time
- Offered in index, active, or blended form
- Allows an investor to target a point along the efficient frontier that aligns with their risk tolerance
- ABLE plans tend to offer 3 to 8 Target Risk Options



What is asset allocation and why is it important?

→ Asset allocation is the process of accepting and managing both risk and opportunity
  - Explicitly, it is the decision of how much to invest in distinct asset classes (stocks, bonds, real estate)
  - Implicitly, it is also the determination of how much and what types of risks you are willing to accept

→ Each asset class exhibits unique risk and return behavior

→ Each asset class interacts differently with other asset classes

→ Combining asset classes allows investors to control more fully the aggregate risk and return of their portfolio
  - Allows investors to create a multi-asset portfolio tailored to a unique set of objectives

→ Likely to have the largest impact of any decision you make

→ The amount you invest in stocks, bonds, real estate, etc., will be a key driver of long-term returns
  - Asset allocation explains more than 90% of the variability of a fund's return over time[1]

[1] Source: Determinants of Portfolio Performance, Brinson, Hood, and Beebower, 1986 "investment policy dominates investment strategy (market timing and security selection), explaining on average 93.6 percent of the variation in total plan returns."

Understanding Asset Allocation

→ Asset allocation is like cooking

→ Putting together a great dish first involves selecting the proper ingredients

- We must understand the characteristics of each individual ingredient and
- We must understand how those ingredients interact with each other

→ Then we need to figure out the right amount of each ingredient to include

- The proper combination should yield an optimal result
- This combination is otherwise known as diversification

→ Primary motive for diversification is to reduce risk

→ Represents the only way to reduce risk without reducing expected returns

→ Investments should be allocated across multiple classes of assets that enhance diversification

→ Since diversification can reduce risk while not reducing expected return:

- Diversification is often said to be the only "free lunch" in investing

Asset Allocation and Diversification

What's the difference?

Asset Allocation	Diversification
The portion, or percentage, of each asset class that an investor has in their portfolio. For example, 60% stocks and 40% bonds.	A risk management practice to reduce the impact of any one investment, by investing in a mix of assets that move up and down under different market conditions.

Different, but related.

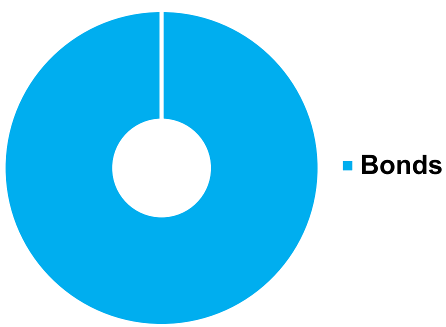
Risk Defined

- Risk is any uncertainty with respect to investments that has the potential to negatively impact financial outcomes.
- The level of risk associated with a particular investment or asset class typically correlates with the level of return the investment might achieve.
  - The rationale behind this relationship is that investors willing to take on risky investments and potentially lose money should be rewarded for their risk.
- Investment Risk cannot be eliminated, but asset allocation and diversification help manage both systemic risk (risk affecting the economy as a whole) and non-systemic risk (risks that affect a small part of the economy, or even a single company).
  - The members assume the investment risk for the CalABLE Program. As such, they are responsible for their own asset allocation and diversification of their Account.

FINRA

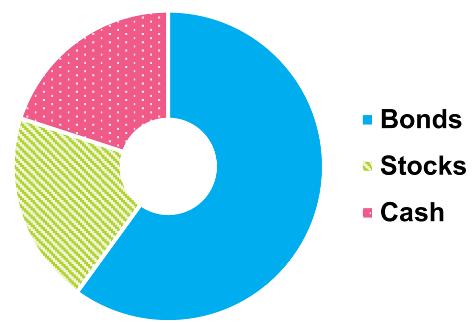
Example: Benefits of Portfolio Diversification

Bond Portfolio



Return:	3.1%
Std Dev:	5.0%

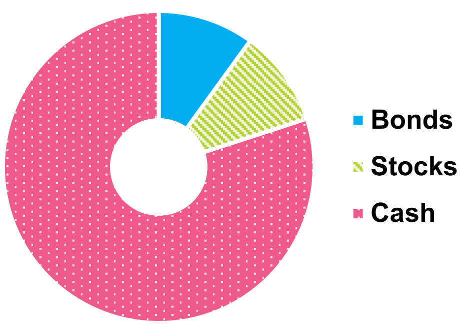
Diversified Portfolio A



Higher return, same risk

Return:	4.3%
Std Dev:	5.0%

Diversified Portfolio B



Lower risk, same return

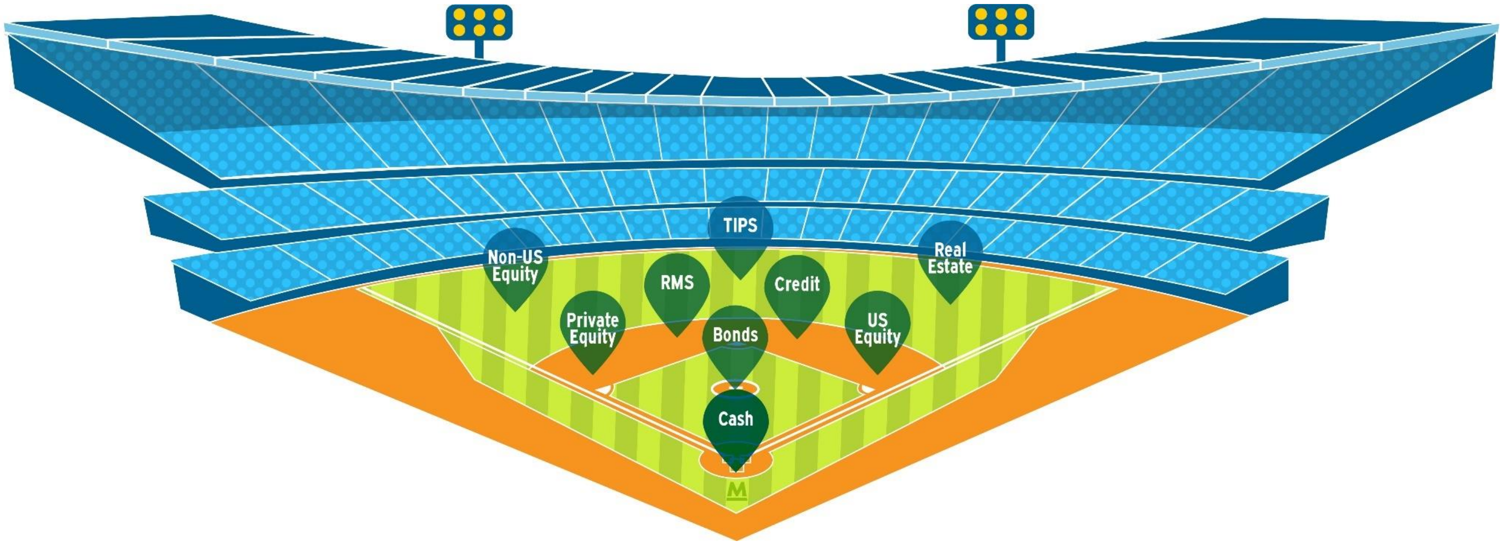
Return:	3.1%
Std Dev:	2.7%

→ By diversifying, investors have the ability to create more efficient portfolios. The addition of multiple asset classes allows for a portfolio with the same risk and higher return or the same return with lower risk.

Note: based on proprietary expected return, standard deviation and correlation inputs.

Each asset class should play a specific role

- To be a successful team, each position plays a different and important role.
- The same concept applies to portfolios: different asset classes should operate together like a well-rounded team.
- Like players on a team, some assets may have “slumps” or “hot streaks”.
- A diversified team protects the portfolio from the volatile swings of individual assets.



Asset Allocation and Diversification

Asset allocation is one of the most important decision an investor makes

- Asset allocation decisions dominate the risk and return in investment results
- Impact of other decisions like manager selection is minimal
- Awareness of risk embedded in an asset allocation is critical

A properly developed (diversified) asset allocation

- Combines risky assets (stocks) with less risky assets (bonds & cash)
- To meet a return target while minimizing their risk (volatility)

Volatility
How much a portfolio's overall value fluctuates up and down.

Overview of Asset Classes

→ The investable universe is largely composed of just two broad asset classes.

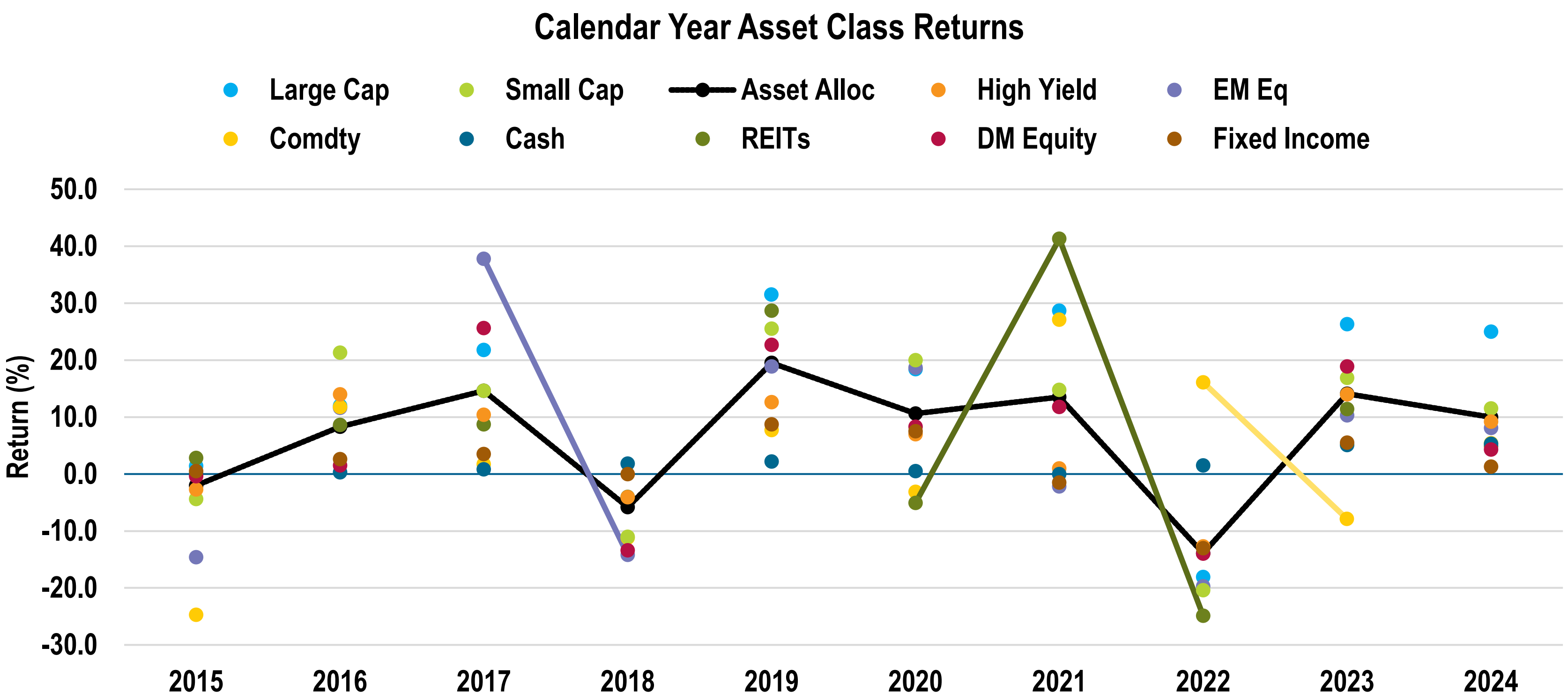
→ Historically, these major asset classes have not moved up and down at the same time.

Equity	Fixed Income	
Stocks	**Bonds**	**Cash Equivalents**
• Ownership in publicly traded companies • Categorized by style, market capitalization, and geography • Role: Growth	• Essentially loans that the investor (lender) makes to an entity (borrowers) • Role: Protection and income generation	• Short term, highly liquid, low risk debt instruments • Role: Capital Preservation

RISK (VOLATILITY)

- There exists a tradeoff between volatility and return
- Historically, stocks have significantly outperformed other asset classes
- But with significantly greater volatility

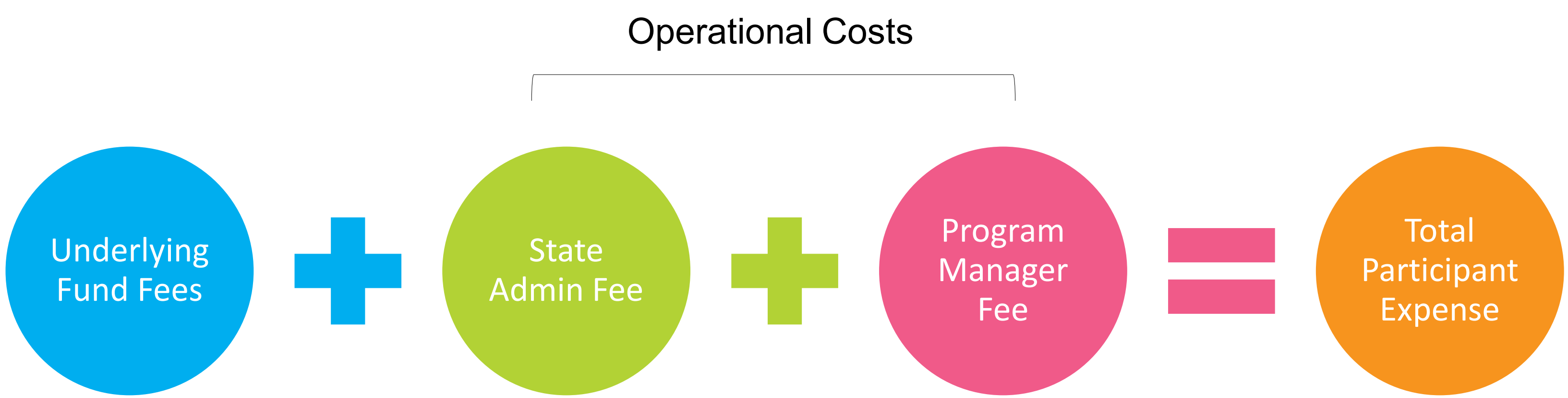
RETURNS FOR DIFFERENT ASSET CLASSES



Source: Bloomberg, FactSet, MSCI, NAREIT, Russell, Standard & Poor's, J.P. Morgan Asset Management. *Guide to the Markets – U.S.* Data are as of December 31, 2024. Large cap: S&P 500, Small cap: Russell 2000, EM Equity: MSCI EME, DM Equity: MSCI EAFE, Comdty: Bloomberg Commodity Index, High Yield: Bloomberg Global HY Index, Fixed Income: Bloomberg U.S. Aggregate, REITs: NAREIT Equity REIT Index, Cash: Bloomberg 1-3m Treasury. The "Asset Allocation" portfolio assumes the following weights: 25% in the S&P 500, 10% in the Russell 2000, 15% in the MSCI EAFE, 5% in the MSCI EME, 25% in the Bloomberg U.S. Aggregate, 5% in the Bloomberg 1-3m Treasury, 5% in the Bloomberg Global High Yield Index, 5% in the Bloomberg Commodity Index and 5% in the NAREIT Equity REIT Index. Balanced portfolio assumes annual rebalancing. Annualized (Ann.) return and volatility (Vol.) represents period from 12/31/2009 to 12/31/2024. Please see disclosure page at end for index definitions. All data represents total return for stated period. The "Asset Allocation" portfolio is for illustrative purposes only. Past performance is not indicative of future returns.

Portfolio Fee Components

→ Portfolios are evaluated based on the Total Participant Expense.



CalABLE Plan Review

Investment Options

	FDIC Savings/ Checking	Bank	Target Risk	Individual	Money Market/ LGIP	Fund Families
ABLE Alliance	1	Fifth Third	6	---	---	Vanguard, BlackRock, Schwab, American Funds, Sallie Mae
STABLE	1	Fifth Third	4	---	---	Vanguard
ABLE Collaboration (AL, HI, OR)	1	BNY Mellon	3	---	---	Vanguard
ABLE Collaboration (WA)	1	BNY Mellon	3	---	---	Vanguard, DFA
ABLE Collaboration (MD)	1	BNY Mellon	4	---	---	Vanguard, DFA
CA	1	BNY Mellon[1]	7	---	---	Fidelity, Schwab, Vanguard
CO	1	Fifth Third	6	---	---	Vanguard, BlackRock, Schwab, American Funds, Sallie Mae
FL	1	BNY Mellon	3	3	1	Vanguard, BlackRock, Florida PRIME (LGIP)
LA	---	---	4	7	1	Vanguard
MA	---	---	8	---	1	Fidelity
ME	1	Bangor Savings Bank	---	---	---	---
NE	2	S - NexBank[2] C - Fifth Third	3	---	---	Vanguard
NY	2	S - Sallie Mae C -Fifth Third	4	---	---	Vanguard, Sallie Mae
TN	---	---	---	14	1	Vanguard, DoubleLine, PRIMECAP, Western Asset
TX	1	Bank of the West	4	---	---	Vanguard, PIMCO, Eaton Vance
VA – ABLE Now	---	---	3	---	1	Vanguard, Fidelity
VA – ABLE America	---	---	6	---	1	American Funds

1 Shifted from TIAA Bank to BNY Mellon August 21, 2023.
2 Shifted from First National Bank of Omaha to NexBank June 16, 2023.

Scorecard

	CalABLE	Minimum	Average	Maximum	Finding
Options					
# of Fund Families	3	1	**2.9**	5	Above Average
# of Options	8	1	**6.2**	15	Above Average
# or Target Risk Options	7	0	**4.6**	8	Above Average
Fees					
Qtrly Maintenance Fee	$7.50	$0.00	**$6.80**	$10.50	Above Average
Administration Fees (bps)	38.0	0.0	**20.5**	40.0	Above Average
Target Risk Avg. Underlying Fund Fees (bps)	4.4	2.0	**9.8**	67.0	Below Average
Target Risk Avg. Total Fees (bps)	42.4	11.0	**33.9**	84.0	Above Average

→ CalABLE's investment menu provides participants with more choices than the average plan.

→ Portfolios are constructed utilizing low-cost funds from several fund families.

→ Administrative costs are on the high end as the plan doesn't benefit from the same scale the partner state programs do.

CalABLE Plan Investment Menu

→ **8 Options**

- FDIC Bank Safe
- Seven (7) Target Risk Options
  - Income Portfolio
  - Conservative Portfolio (20% Equity)
  - Income and Growth Portfolio (40% Equity)
  - Balanced Portfolio (50% Equity)
  - Conservative Growth Portfolio (60% Equity)
  - Moderate Portfolio (80% Equity)
  - Growth Portfolio (100% Equity)

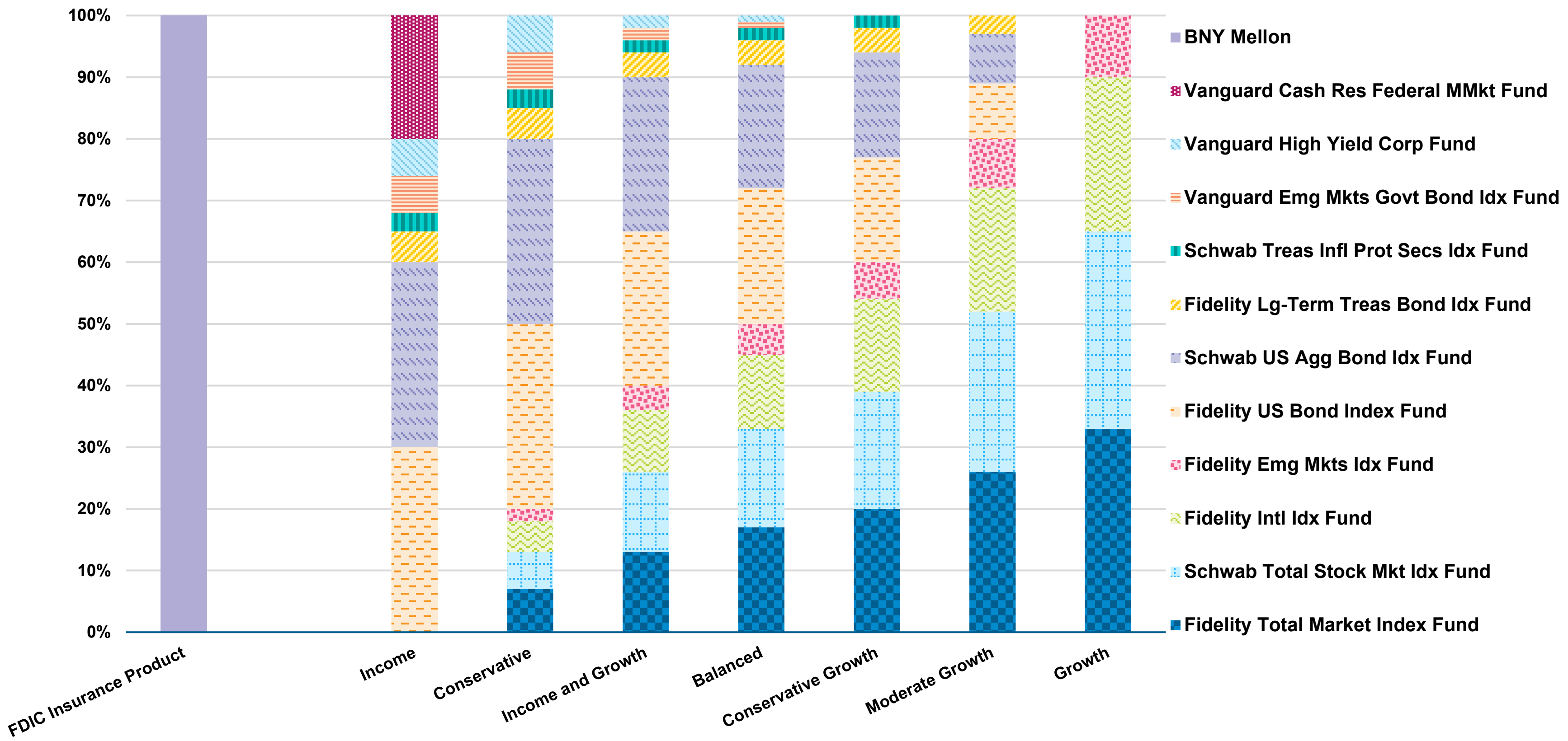
→ **The Target Risk Options utilize the following underlying investments**

- Provides broad based capital market exposure to equities and fixed income
  - Fidelity Total Market Index – FSKAX (1.5 bps)
  - Schwab Total Market Index – SWTSX (3.0 bps)
  - Fidelity International Index – FSPSX (3.5 bps)
  - Fidelity Emg Mkts Index – FPADX (7.5 bps)
  - Fidelity US Bond Index – FXNAX (2.5 bps)
  - Schwab US Agg Bond Index – SWAGX (4.0 bps)
  - Fidelity Long Term Treas Bond Index – FNBGX (3.0 bps)
  - Schwab Treasury Infl Prot Secs Index – SWRSX (5.0 bps)
  - Vanguard Emg Mkts Got Bond Index – VEGBX (40.0 bps)
  - Vanguard High Yield Corporate – VWEAX (12.0 bps)
  - Vanguard Cash Reserves Fed MMkt – VWRXX (10.0 bps)

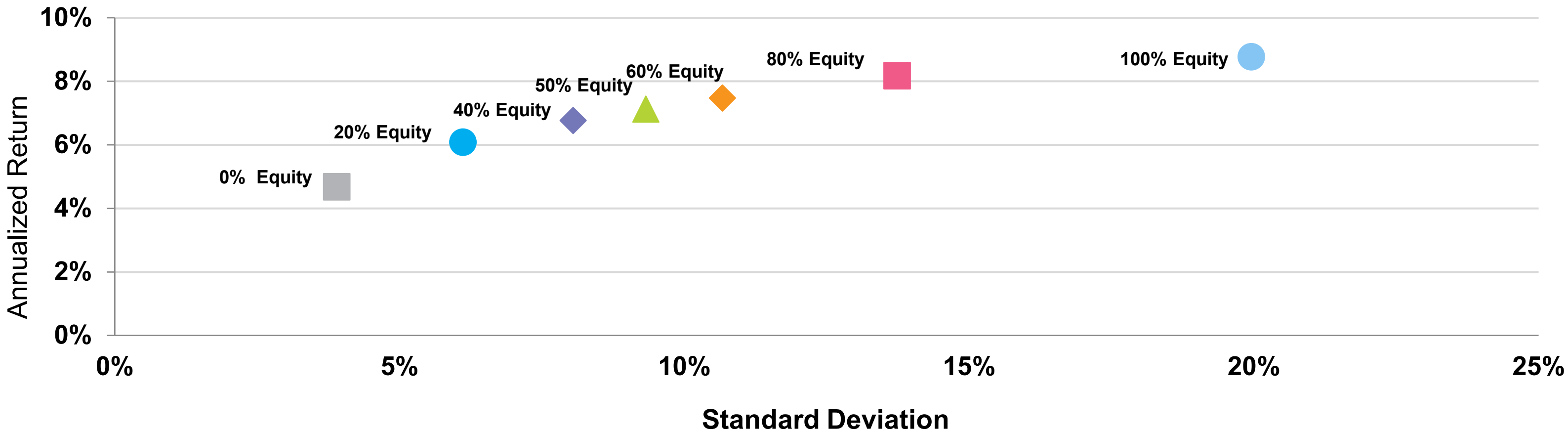
Schwab funds have been collapsed into the Fidelity counterpart.

Allocation by Provider or Underlying Fund

- Predominately passively managed
- Underlying funds split amongst three fund families



20 Year Expected Risk/Return



	Income	Conservative	Income and Growth	Balanced	Conservative Growth	Moderate Growth	Growth
5 Percentile Return	6.11%	8.33%	9.74%	10.57%	11.42%	13.24%	15.00%
25 Percentile Return	5.26%	6.98%	7.96%	8.51%	9.06%	10.19%	11.24%
Expected Return	4.67%	6.07%	6.76%	7.12%	7.47%	8.17%	8.76%
75 Percentile Return	4.08%	5.14%	5.54%	5.71%	5.86%	6.10%	6.21%
95 Percentile Return	3.24%	3.84%	3.84%	3.74%	3.62%	3.25%	2.74%
Expected Standard Deviation	3.90%	6.12%	8.05%	9.33%	10.67%	13.74%	16.96%
Probability of Exceeding 5% Hurdle	35.1%	78.2%	83.7%	84.7%	85.2%	85.2%	84.4%
Probability of Exceeding 3% Hurdle	97.3%	98.9%	98.3%	97.8%	97.2%	95.8%	94.2%
Median Sharpe Ratio*	0.56	0.58	0.53	0.49	0.47	0.41	0.37
Expected Worst Year	-1.6%	-3.5%	-5.7%	-7.1%	-8.6%	-12.0%	-15.5%

*The **Sharpe Ratio** is used to characterize how well the return of the portfolio compensates for the risk taken. The higher the portfolio's Sharpe Ratio, the better the portfolio's returns have been relative to the risk it has taken on. Sharpe Ratio = (Portfolio Return – Risk Free Return) / Standard Deviation.

Questions?

Appendix

ELEMENTS OF AN INVESTMENT POLICY STATEMENT

→ An investment policy statement includes sections to address:

- Purpose and scope.
- Definition of duties (roles and responsibilities).
- Broad objectives.
- Investment Menu framework.
- Permitted program investments.
- Excluded investments.
- Objectives and parameters of specific portfolios.
- Sets forth operational guidelines and rules for monitoring and reviewing the portfolios and underlying funds.
- Outlasts the longevity of the current administration and other involved parties.

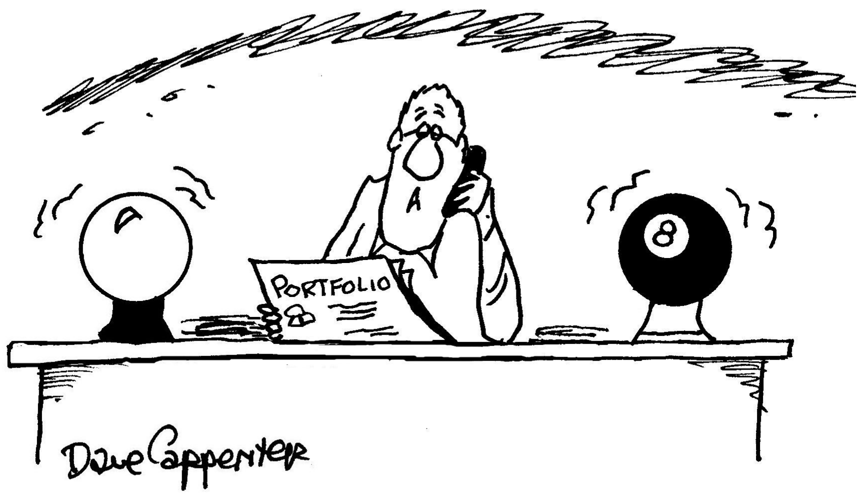
A clearly articulated investment policy statement is central to communicating a Board's governance structure and investment decision making practices.

→ Dynamic process.

- Identified weaknesses and gaps between actual and best practices and between expectations and reality.
- Resulting in a document that is easily understood and requires somewhat infrequent changes.

Specifies Plan's Guiding Principles

ECONOMINIC INDICATORS



"The crystal ball says to buy and the 8-Ball says to sell."

Source: Cartoonstock.com

GDP Construction Spending

Retail Sales Wage Growth

PPI Consumer Spending

Home Building

New Jobs Unemployment

Consumer Savings CPI

Inflation Home Sales

Industrial Production

Manufacturing Demand

PCE Interest Rates

TOP US ECONOMIC INDICATORS

1 | GDP

- Provides the overall value of the goods and services that the economy produces
- Indicates if the economy is growing or slowing

2 | Unemployment

- Measures the percentage of the nations labor force that is unemployed
- High unemployment leads to lower consumer spending and economic output

3 | Inflation

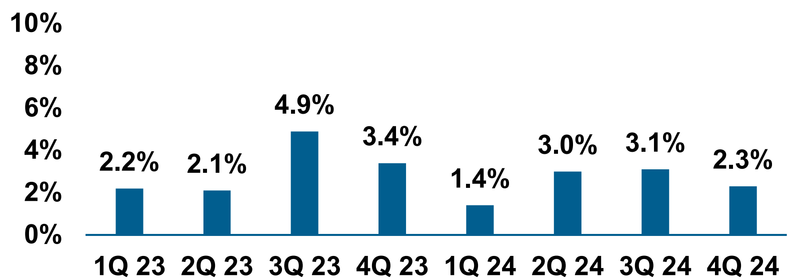
- Measures the change in the price of goods and services in the economy
- CPI (Consumer Price Index) is the mot commonly used inflation index

4 | Interest Rates

- Cost of borrowing money set by the Feder Reserve
- Lower rates encourage spending and investment, which can boost GDP and reduce unemployment

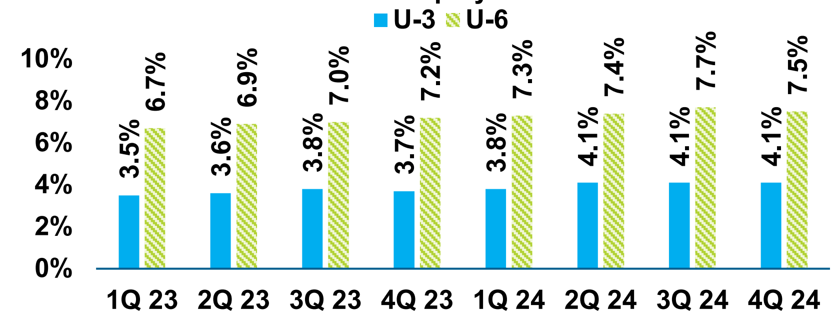
Economic and Market Update

Quarterly Real GDP (Annualized)



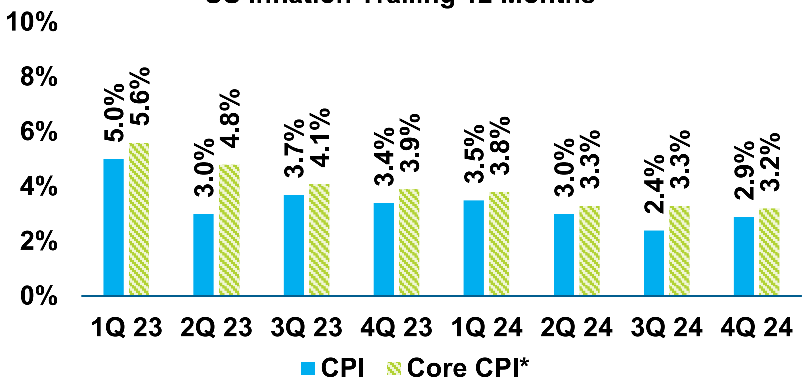
Source: Bureau of Economics Analysis. Data as of Q4 2024 represents the "Advance" estimate. The Q4 and Year 2024 "Second Estimate" will be released February 27, 2025.

US Unemployment



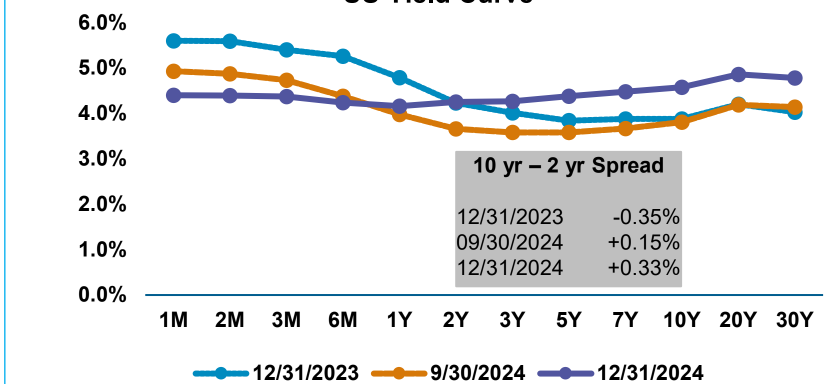
Source: Bureau of Labor Statistics. Data as of December 31, 2024. Seasonally adjusted.
U-3 = Total US unemployed, as a percent of the civilian labor forces (official unemployment rate).
U-6 = Total unemployed, plus all persons marginally attached to the labor force, plus total employed part time for economic reasons, as a percent of the civilian labor force plus all persons marginally attached to the labor force

US Inflation Trailing 12 Months



Source: Bureau of Labor Statistics. Data is non-seasonally adjusted CPI, which may be volatile in the short-term. Data as December 31, 2024.
* Core CPI excludes Food and Energy.

US Yield Curve



Source: US Department of the Treasury.

Investable Universe

- ABLE Plans are limited to public markets
- Representing approximately 90% of the investable universe
- Equity and Fixed Income asset classes can be broken into numerous sub-asset classes
- Each sub-class has its own inherent risk and return potential

Asset Class
US Equity
Non-US Equity (Developed)
Non-US Equity (Emerging)
Public Real Estate Equity
Commodities
US Bonds
Bank Loans
Non-US Bonds (Developed)
Emerging Markets Bonds
Inflation-Linked Bonds
Money Market/Cash Equivalents
Private/Illiquid Markets
Private Equity
Private Debt
Infrastructure
Natural Resources, Energy, Timberland and Agriculture
Private Real Estate
Hedge Funds
Total

Fee Considerations

→ Fiduciaries, when selecting and monitoring service providers and plan investments, have a duty to act prudently and solely in interest of the plan's participants and beneficiaries.

- They must ensure that arrangements with their service providers are "reasonable," and that only "reasonable" compensation is paid for services.

→ There is no one right answer on what is appropriate, but it is prudent for fiduciaries to have a repeatable, documented process for evaluating plan-related fees.

→ Best Practices:

- Implement a transparent and equitable fee structure.
- Minimize fees and expenses where possible.
- Unbundle the recordkeeping fees from the investment management fees (remove revenue share).
- Benchmark fees periodically.

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