# The Case for Equities

## State Compensation Insurance Fund

14 July 2011

**Representing Wellington Management**

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# Bonds and Equities Serve Different Investment Objectives

**Generate stable yields to match shorter-term liabilities**

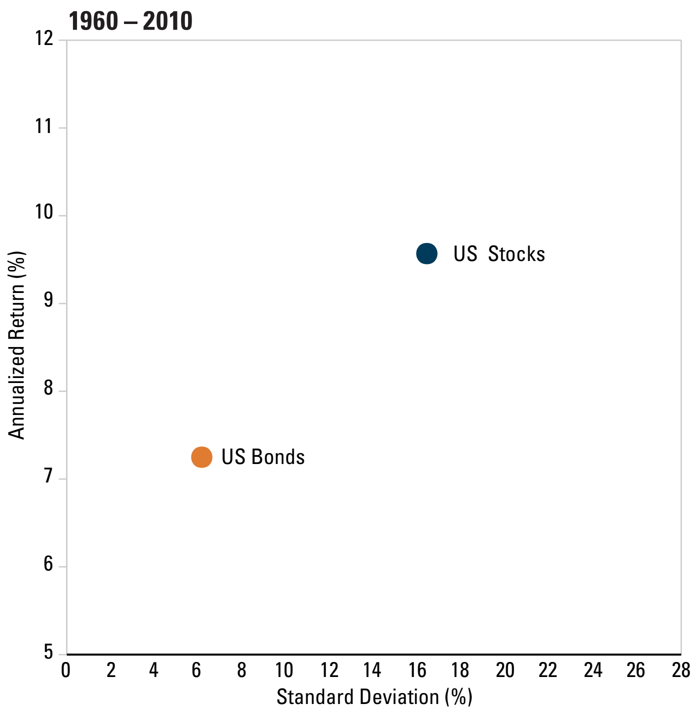
- Government Bonds
- Corporates
- Cash

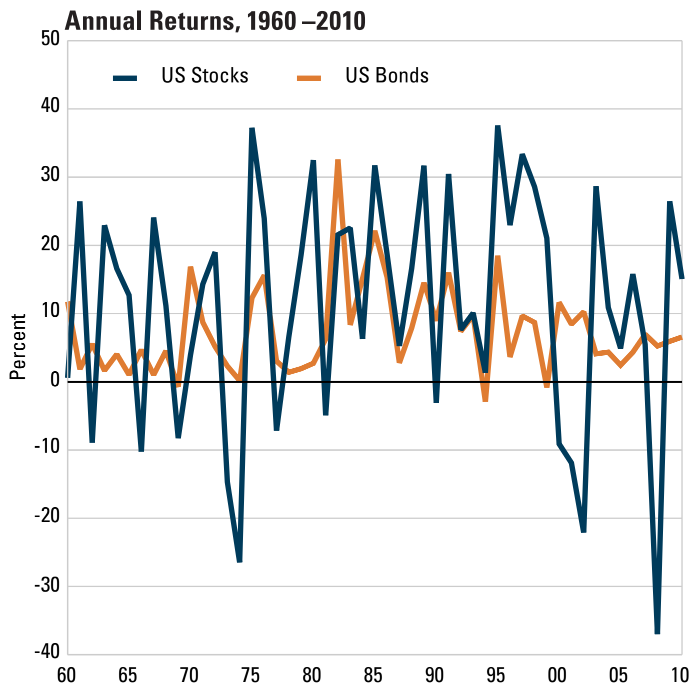
**Generate high-but-variable returns to achieve long-term payout objectives/grow surplus**

- US equities
- Non-US equities
- Emerging markets

**Asset Allocation**

# Stocks Provide Higher Returns with More Volatility (Risk)




US Stocks: S&P 500

US Bonds: 1976 – 2010 Barclays Capital US Aggregate Bond, 1973 – 1975 Barclays Capital US Govt/Credit Bond, 1960 – 1972 Ibbotson US Intermediate Govt Bond



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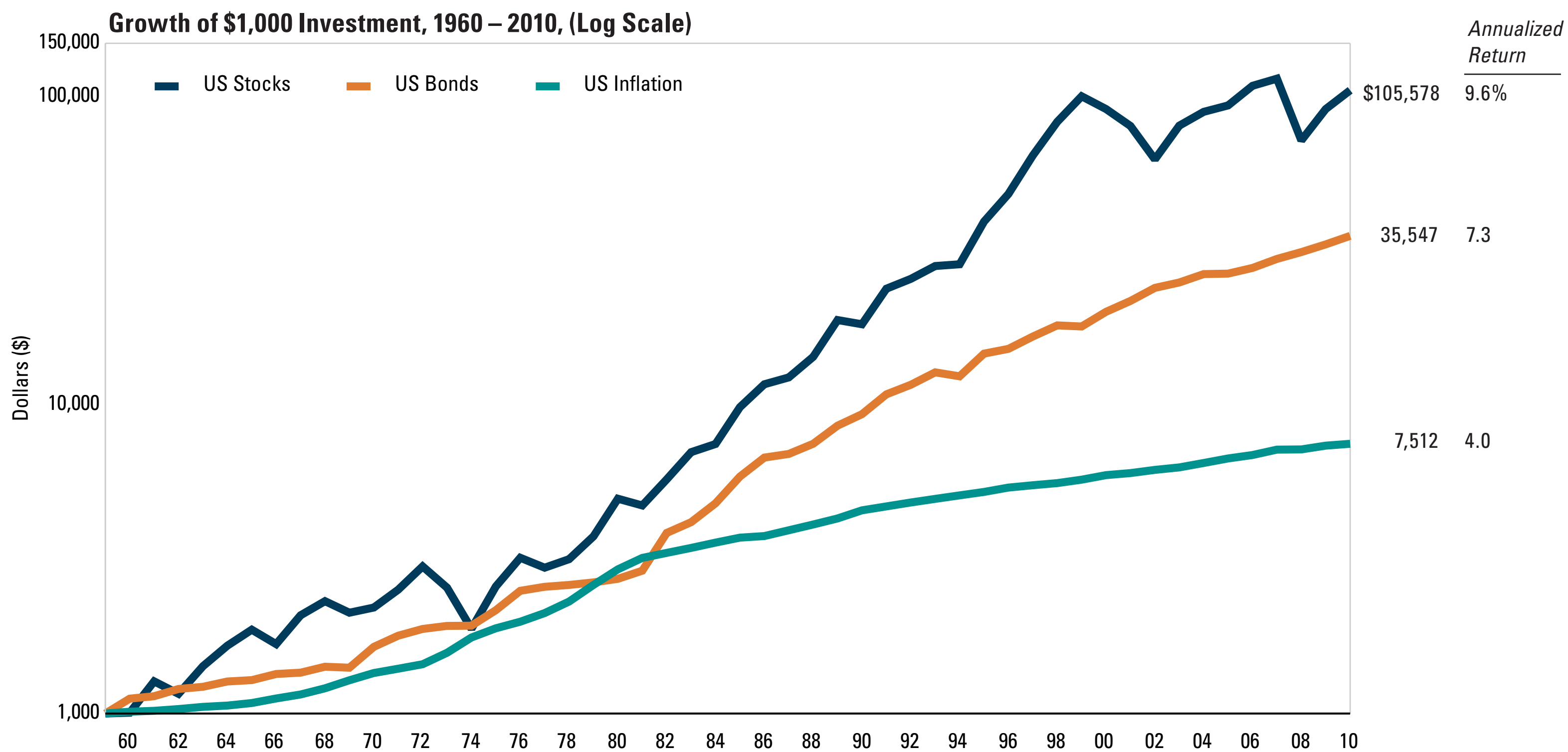
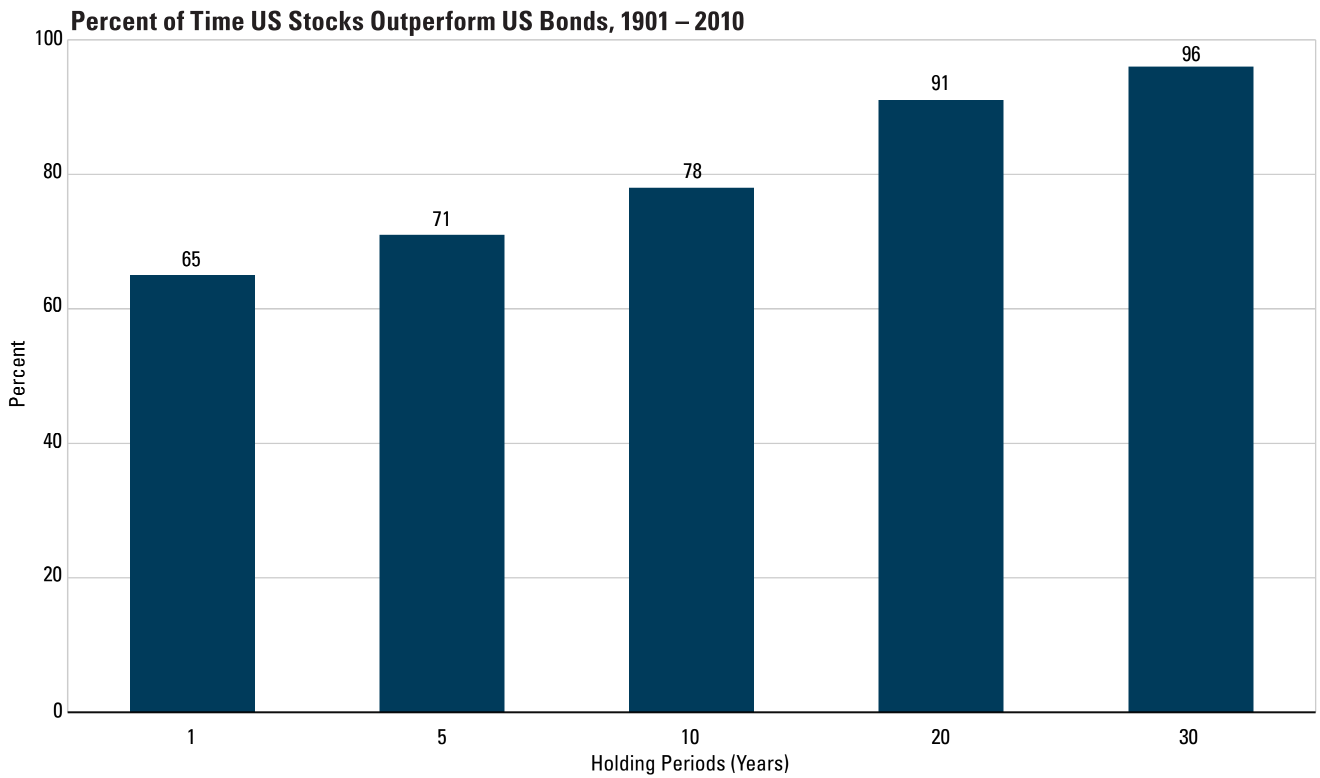
# But Have Provided Much Higher Asset Growth Over the Long Term



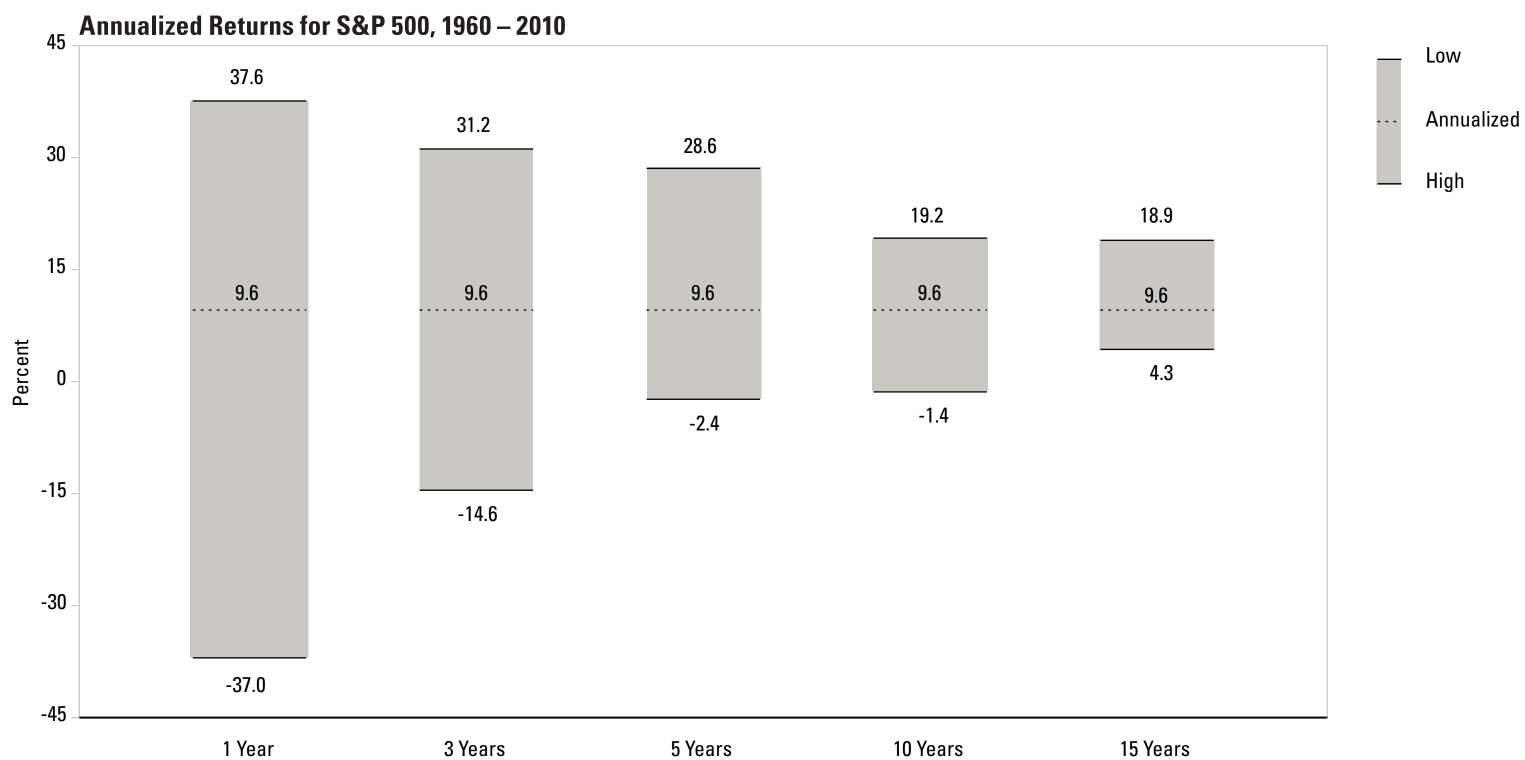

US Stocks: S&P 500
US Bonds: 1976 – 2010 Barclays Capital US Aggregate Bond, 1973 – 1975 Barclays Capital US Govt/Credit Bond, 1960 – 1972 Ibbotson US Intermediate Govt Bond
US Inflation: US CPI

# Time Is an Asset
## Longer Time Horizons Favor Stocks




US Stocks: S&P 500
US Bonds: 1976 – 2010 Barclays Capital US Aggregate Bond, 1973 – 1975 Barclays Capital US Govt/Credit Bond, 1969 – 1972 Citigroup US High Grade Corporate, 1901 – 1968 S&P US High Grade Corporate Bond

# Time Is an Asset
## Longer Time Horizons Shrink Distribution of Outcomes



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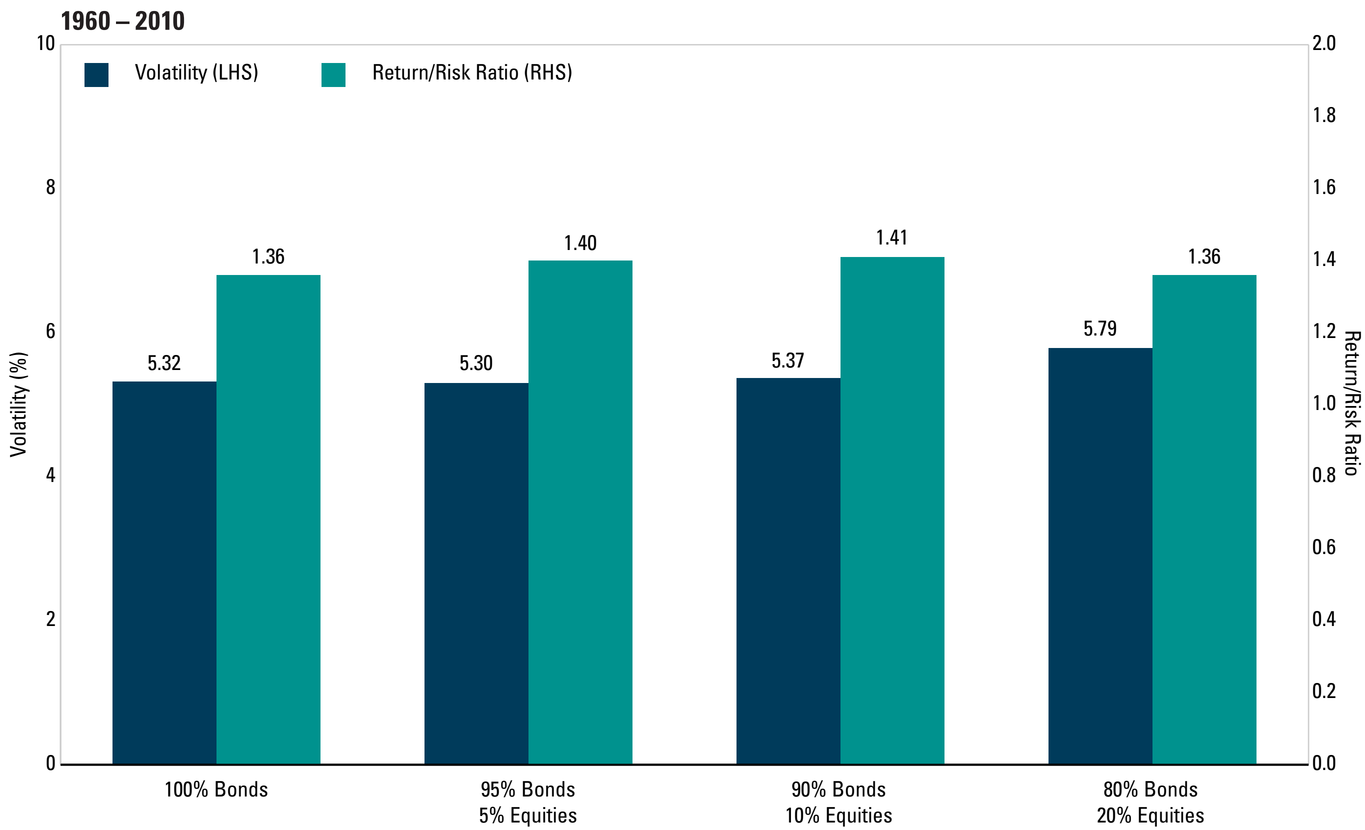
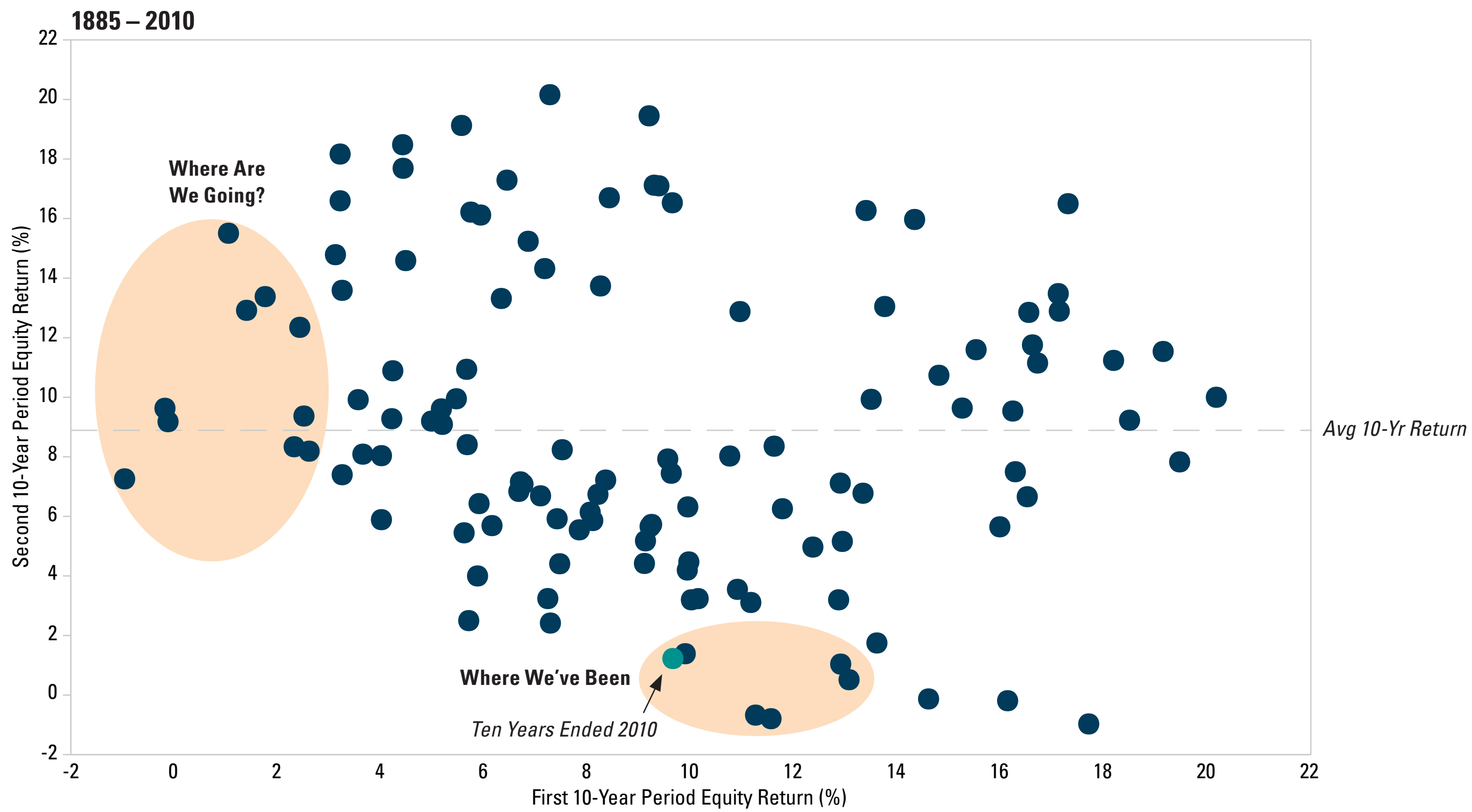
State Compensation Insurance Fund
Investment Committee - July 14, 2011
Open Agenda Item 5 - Portfolio Diversification - The Case for Equities

# Adding Incremental Equity Exposure to a Bond Portfolio Has Minimal Impact on Volatility and Increases Return/Risk Ratio




Equities: S&P 500
Bonds: 1976 – 2010 Barclays Capital US Aggregate Bond, 1973 – 1975 Barclays Capital US Govt/Credit Bond, 1960 – 1972 Ibbotson US Intermediate Govt Bond

# Miserable Decades Tend To Be Followed by Normal Decades




Sources: Cowles Commission, S&P, MSCI



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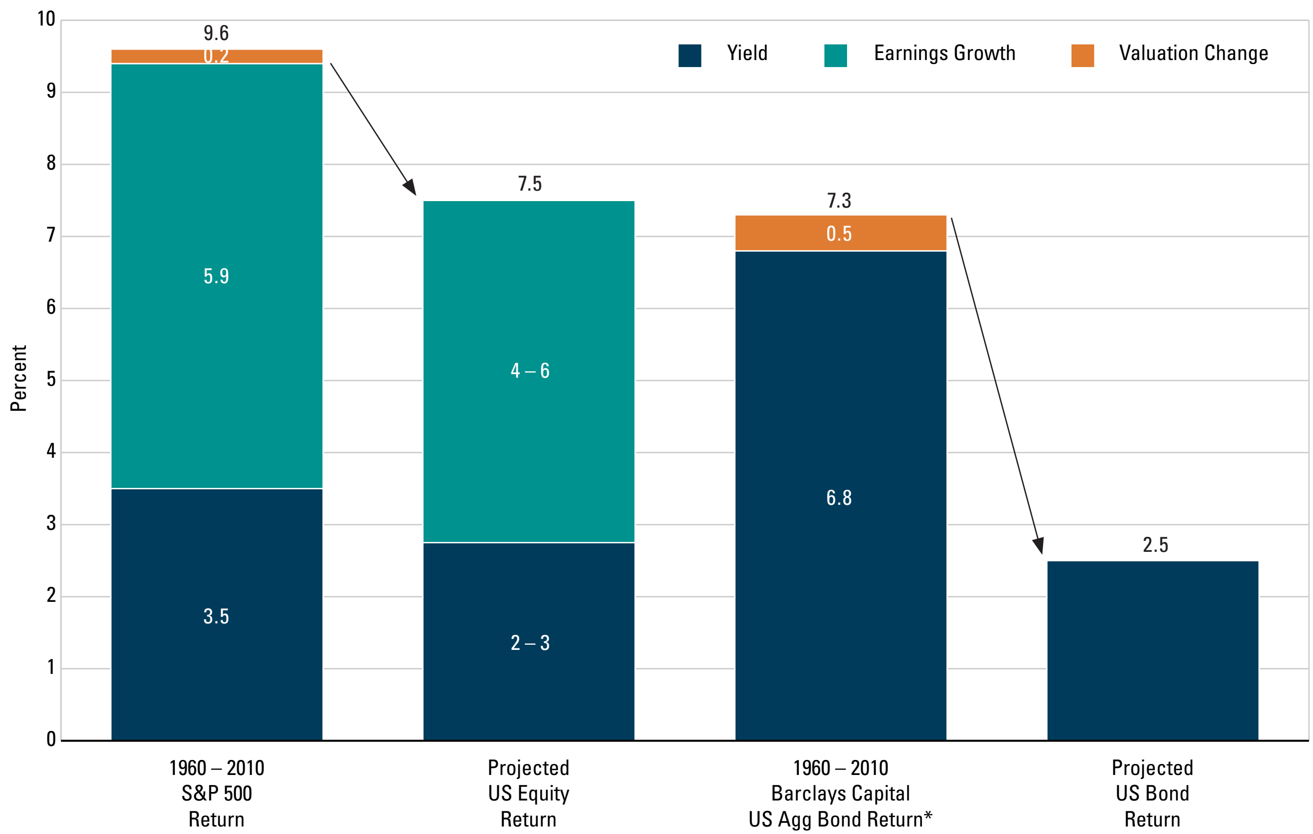
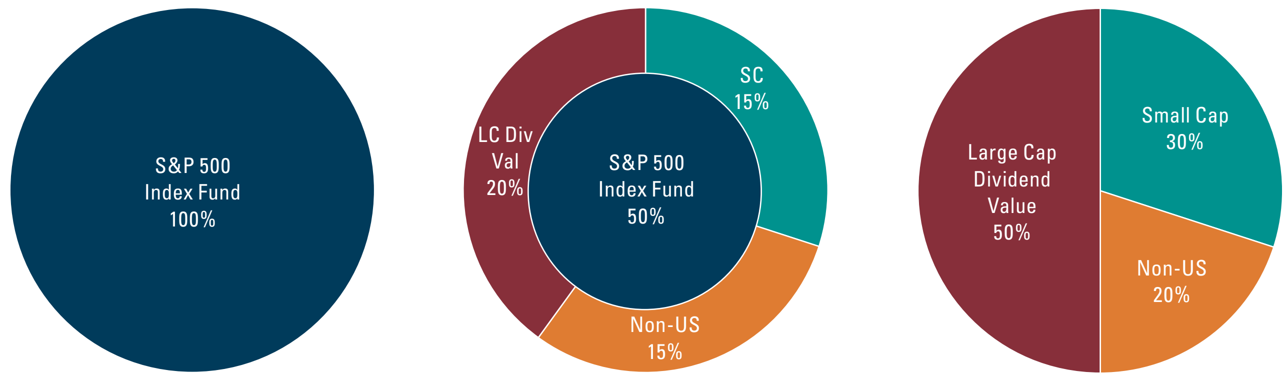
# Lower Expected Returns For Both Stocks and Bonds Going Forward




Projections based on Wellington Management five-year capital market expectations
*1976 – 2010 Barclays Capital Capital US Agg Bond, 1973 – 1975 Barclays Capital US Govt/Credit Bond, 1970 – 1972 Ibbotson Intm Govt Bond

# Potential Equity Structures

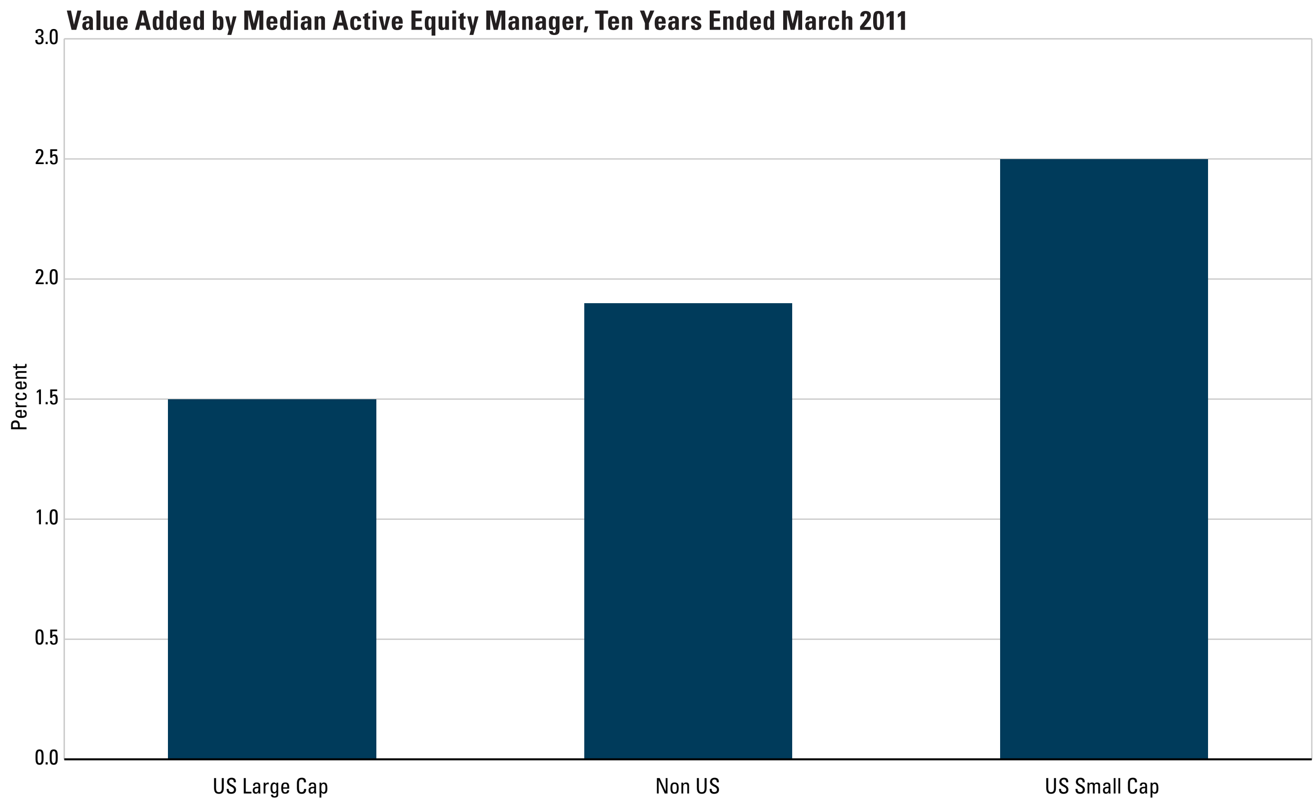
Passive | Passive + Active | Active




| | Passive | Passive + Active | Active |
|---|---|---|---|
| Current Yield | 2.0% | 2.2% | 2.3% |
| Projected 5-Year Net Total Return* | 7.4 | 7.8 | 8.1 |
| Projected 5-Year Volatility (Std Dev) | 16.0 | 16.7 | 17.5 |
| Expected Turnover | 10% | 52% | 89% |
| Estimated Fees | 10 bps | 70 bps | 140 bps |

*Returns are net of estimated management fees
All figures annualized
Projections based on Wellington Management capital market five-year expectations. Actual results may differ significantly from projections,
See Asset Allocation Strategies Group Disclosure

## The Case for Active Management




Source: Mercer Performance Analytics, annualized US$ returns, gross of fees

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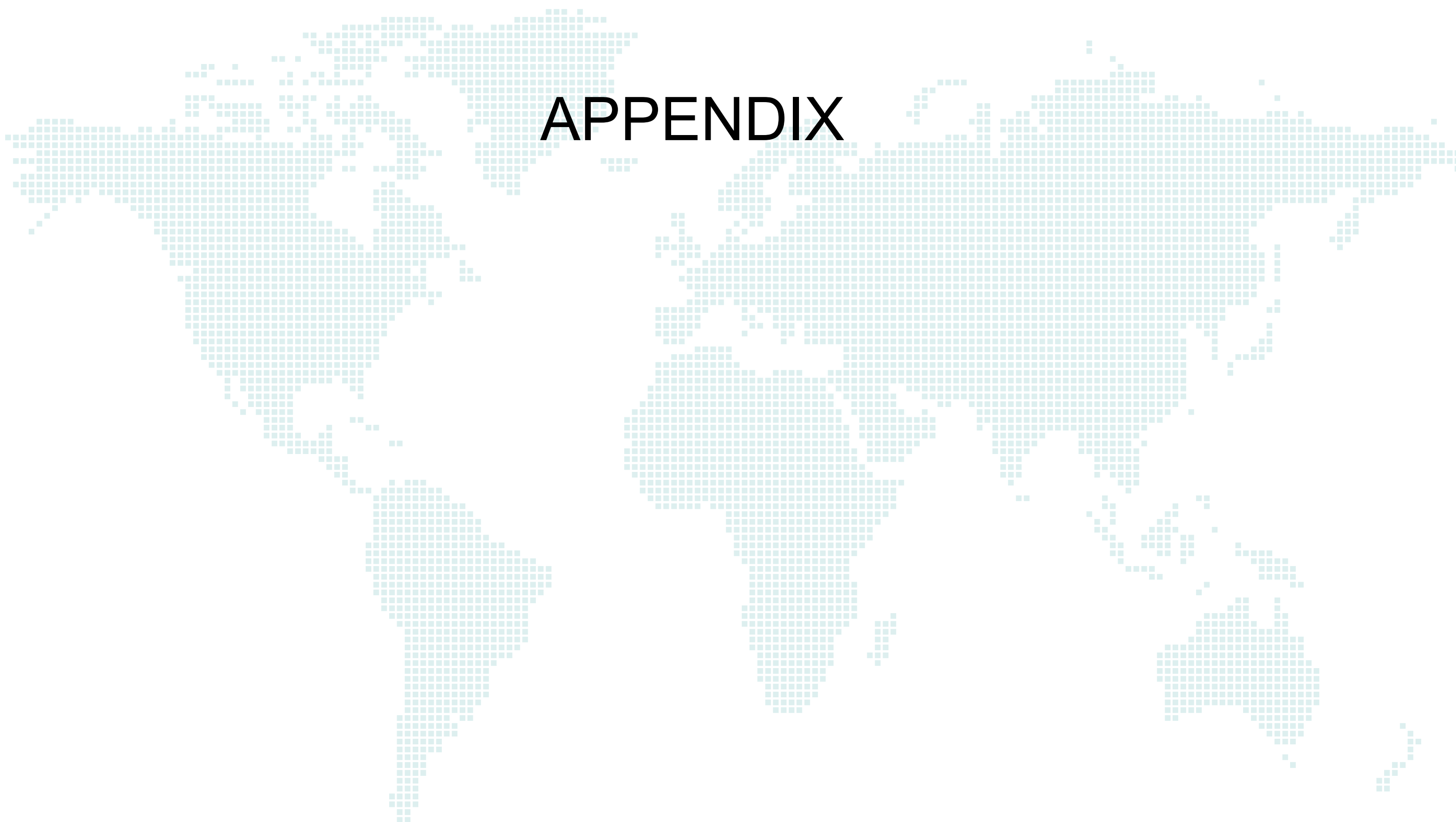
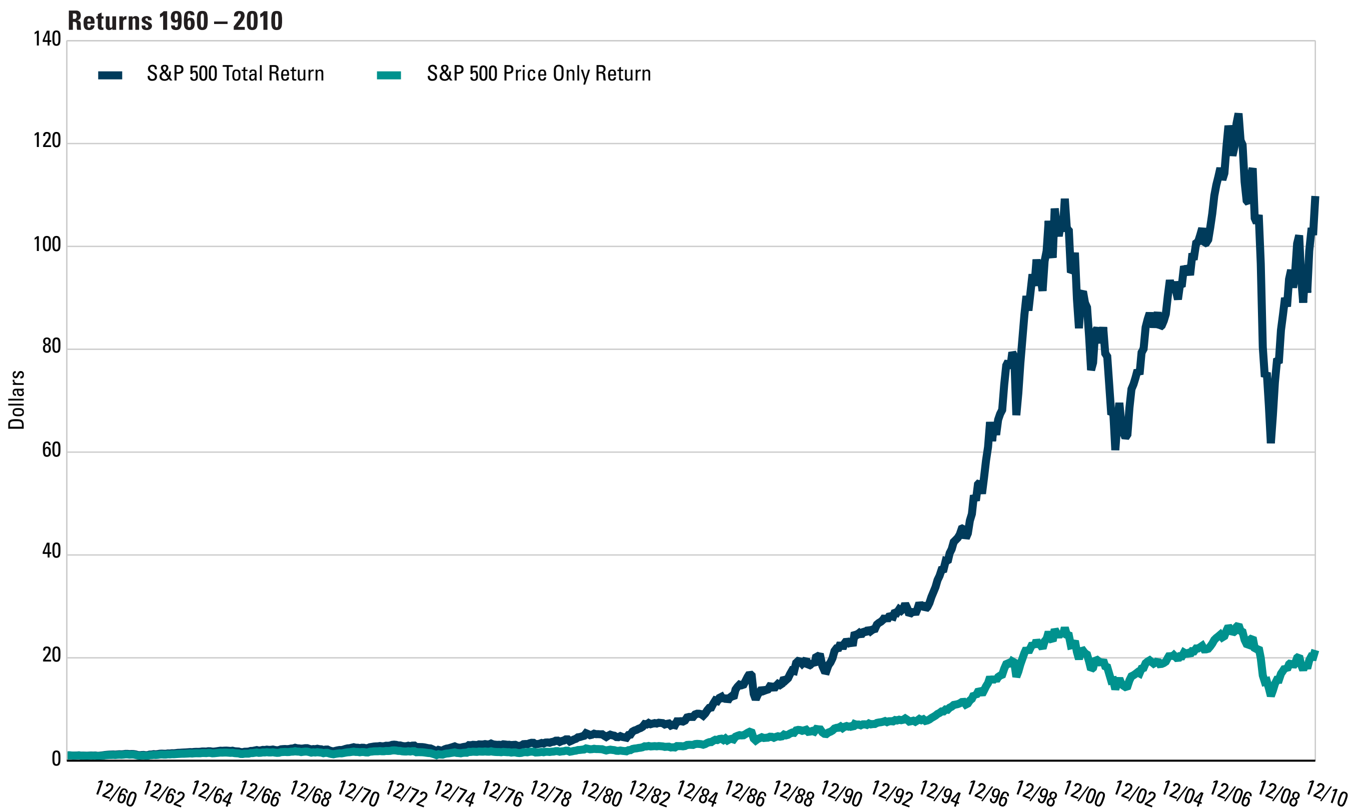
# APPENDIX



# Value Equity Income
## The Power of Dividends and Compounding




Source: Wellington Management







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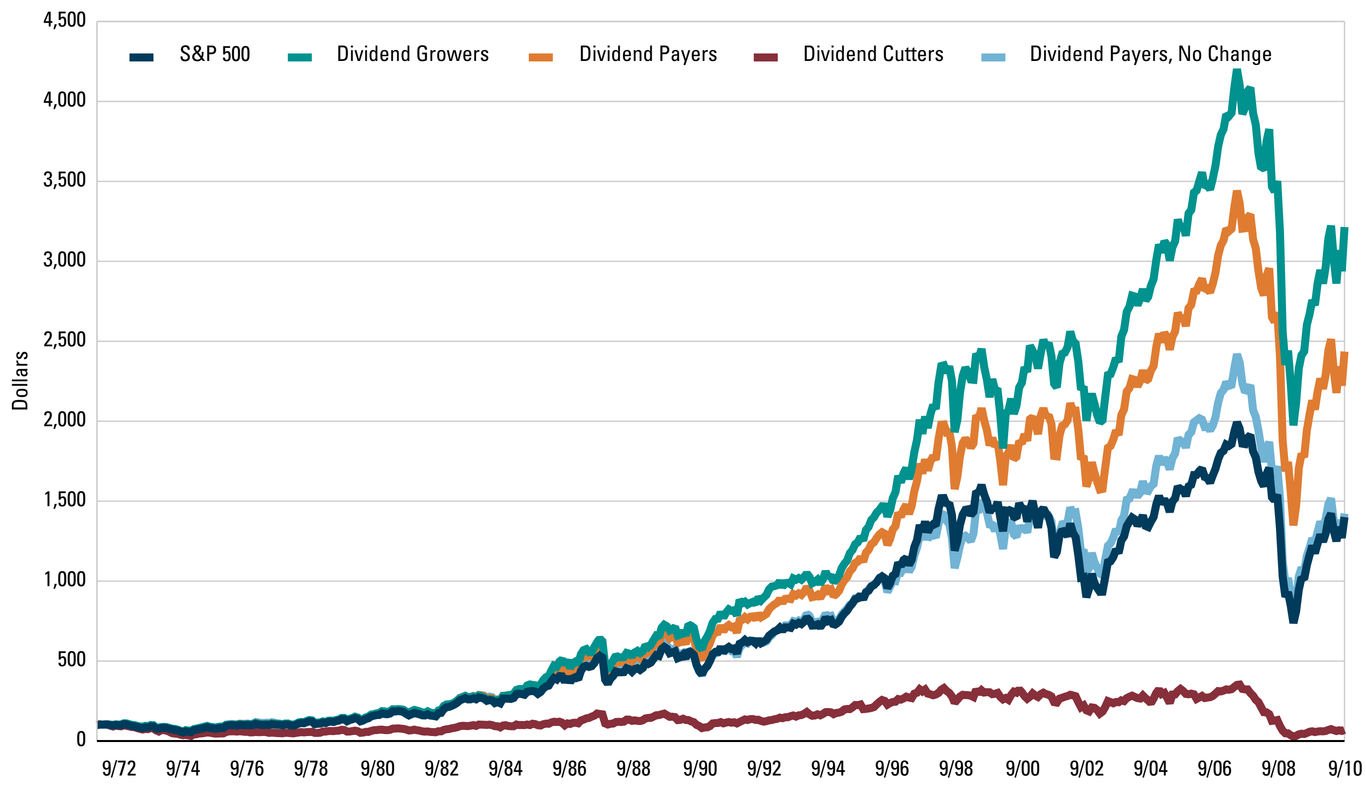
# Dividend Growth
## Capital Allocation Matters




Source: Ned Davis Research
Market Weighted Total Return Indexes
January 1972 = US$100







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## Equity Exposure
## Setting Appropriate Limits/Targets

*Risk Management and ALM Framework Perspective*

Define equity exposure as a percentage of surplus

Typical range: 20 – 40%

*Investment Policy Statement and Regulatory Reporting Perspective*

Define equity exposure as a percentage of admitted assets

Typical range: 5 – 10%

# Asset Allocation Strategies Group Disclosure

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