

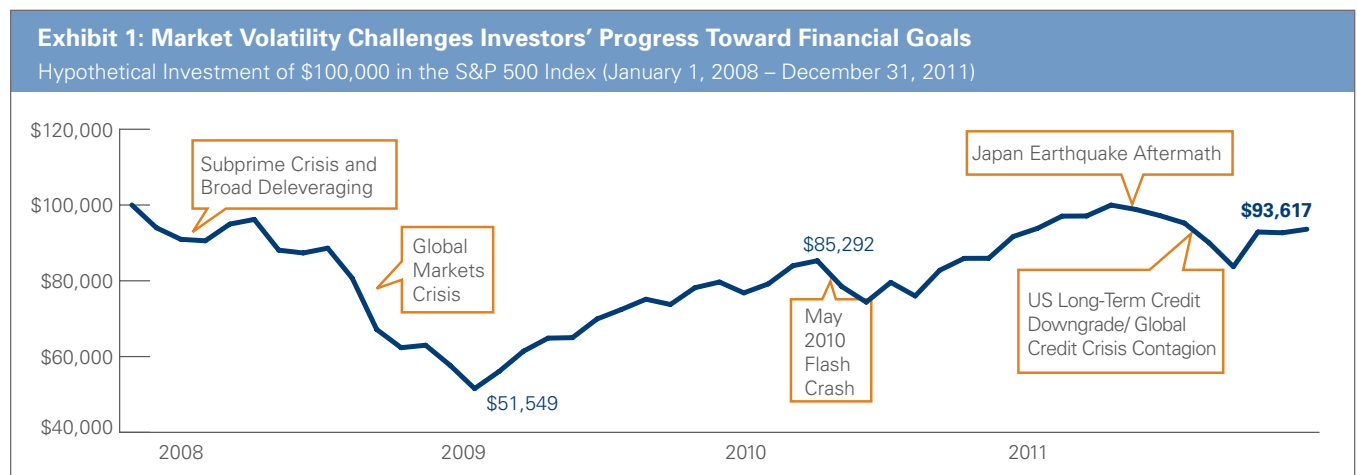
A Thoughtful Approach to Alternatives for Defined Contribution Plans

We believe the world has changed over the past decade, challenging participants' ability to stay on track and achieve their retirement goals

Historically, many participants in defined contribution plans have sought investing success through a balanced asset allocation comprised of roughly 60% developed market equity and 40% US fixed income. This traditional approach was suited to the relatively lower volatility of markets in the last half of the 20th century.

The World Has Changed

Some investors try to time markets like these, potentially getting out at the wrong time out of concern for preserving the value of their savings. In these cases, investors might already have suffered losses and, out of fear, may miss out on market recoveries that follow. Other participants remain inert, not taking advantage of opportunities to construct less volatile portfolios that could offer them long term benefits.



The S&P 500 Index is the Standard & Poor's 500 Composite Index of 500 stocks, an unmanaged index of common stock prices. Indices are unmanaged. The figures for the index reflect the reinvestment of all income or dividends, as applicable, but do not reflect the deduction of any fees or expenses which would reduce returns. Investors cannot invest directly in indices.

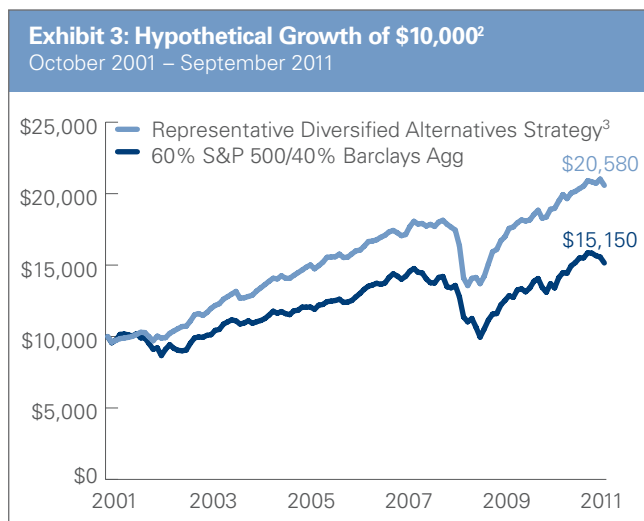
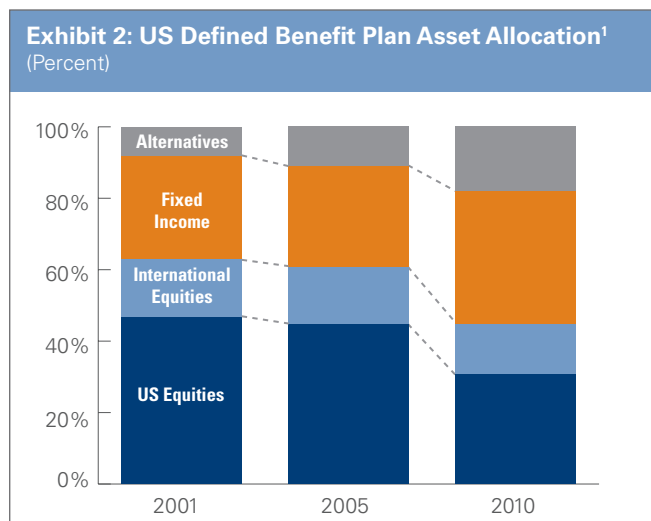
Defined Benefit Plans Have Taken a Different Path

Even through these periods of volatility, defined contribution plans remained largely composed of developed market equity and US fixed income, while the composition of global markets has shifted significantly. So called "niche" asset classes like REITs and commodities have gained considerable market depth supported by increased liquidity and standardization. Defined benefit plans, unlike many defined contribution plans, have used these asset classes as alternatives to diversify their levels of US equity exposure (Exhibit 2).

In fact, defined benefit pension plan managers have long recognized that certain non-traditional or "alternative" investments can provide important benefits for managing volatility and the impacts of inflation and even provide additional sources of growth potential. While a wide range of factors can impact how retirement plan assets perform, defined benefit plans have historically outperformed defined contribution plans through some significantly volatile markets.

Of course, the term “alternatives” is broad and can mean different things to different people. In defined benefit plans, it can refer to everything from emerging market equity and debt to commodities. It’s a diverse set of asset classes that in many cases do not correlate with those traditionally found in many plans’ investment menus. These types of exposures could be useful to plan sponsors seeking ways to help their employees build portfolios that can potentially have lower relative volatility in volatile markets.

Plan Participants Need a Thoughtful Approach



¹ Source: Greenwich Associates. ² Source: Goldman Sachs Asset Management. ³ TIPS: Barclays Capital Inflation-Protected Notes Index (20%); Commodities: Dow Jones UBS Commodity Index 3 Month Forward (5%); Global Real Estate: Dow Jones Global Select Real Estate Securities Index (5%); Emerging Markets Equity: MSCI Emerging Markets Index (5%); Emerging Markets Debt: JPM EMBI Global Composite Index (15%); High Yield: Barclays Capital Very Liquid High Yield Bond Index (15%); Bank Loans: Credit Suisse Leveraged Loan Index (15%); Hedge Fund Replication: Goldman Sachs Absolute Return Tracker Index (20%). Source: GSAM/Bloomberg. Past performance does not guarantee future results. Returns are gross returns and do not reflect the deduction of investment fees or transaction costs, which would reduce returns shown.

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We believe thoughtful inclusion of these non-correlative asset classes in a defined contribution plan menu could potentially help participants better manage volatility, counter the impacts of inflation and provide new sources of return potential when traditional stock and bond markets underperform. The key for plan sponsors is making the right asset classes available without making an already crowded plan investment menu even more crowded. The illustration below (Exhibit 3) looks at how bundling some of these non-traditional assets could provide broader diversification in a way that plan sponsors are comfortable making available in a plan lineup.

This example compares the performance of a hypothetical initial \$10,000 investment over 10 years in a hypothetical bundle of alternative asset classes, called the “Representative Diversified Alternatives” strategy, with the performance of the same investment in a proxy for a traditional participant 401(k) portfolio (i.e. a 60% S&P 500/ 40% Barclays Aggregate).

This measurement of compounded return, gross of fees, is meant to illustrate how a more diversified approach might benefit a participants’ retirement savings over the 10-year time period. Diversification, of course, doesn’t eliminate risk entirely or guarantee a profit and there are always risks when it comes to investing. The example isn’t a representation of any actual participant asset allocation and does not imply that an investor would be likely to achieve performance similar to what’s shown. However, it may be a starting point for understanding the role alternatives can play in a retirement portfolio.

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