Morley
CAPITAL MANAGEMENT

Ask Morley

What is **stable value?**

A unique retirement planning tool

Stable value funds are designed to preserve capital and earn returns similar to short duration bonds with risk similar to money market funds.

What we'll discuss

What makes stable value unique?

The importance of stable value investing

A closer look at stable value

A brief history on stable value

Stable value originated in the late 1970s as a conservative investment option for retirement plans. Originally, fund holdings were predominantly Guaranteed Investment Contracts (GICs). GICs are typically issued and backed by the general account of the large insurance companies. They typically have a stated rate of return for a stated period of time and allow for book value payments to plan participants. Throughout the years, in an effort to mitigate risk and a desire to track interest rates more closely, stable value managers began managing bond portfolios in-house and buying independent stable value investment contracts, also known as wrap contracts, to maintain participants' ability to transact at book value instead of purchasing GICs. Today, stable value funds are predominantly invested in wrap contracts with bonds as the underlying assets of such contracts while GICs represent a much smaller portion of overall funds.

What makes stable value unique?

Stable value is only available to participants in a qualified savings plan. It is designed to provide participants the ability to transact at book value while earning returns similar to short duration bonds. Book value is the value of an investment plus earned interest minus withdrawals. Participants transact at book value by the stable value fund's use of stable value investment contacts (wraps).

Wrap contracts are designed to protect a participant's capital investment. They are essentially a pledge by the financial institutions issuing the contracts to pay participant withdrawals at book value in certain circumstances. This pledge is provided in exchange for a fee. While wrap contracts do not insure the value of a fund and are not insurance against fund losses, they are designed to provide capital preservation by amortizing the gains and losses of the underlying bonds over time through the crediting rate.

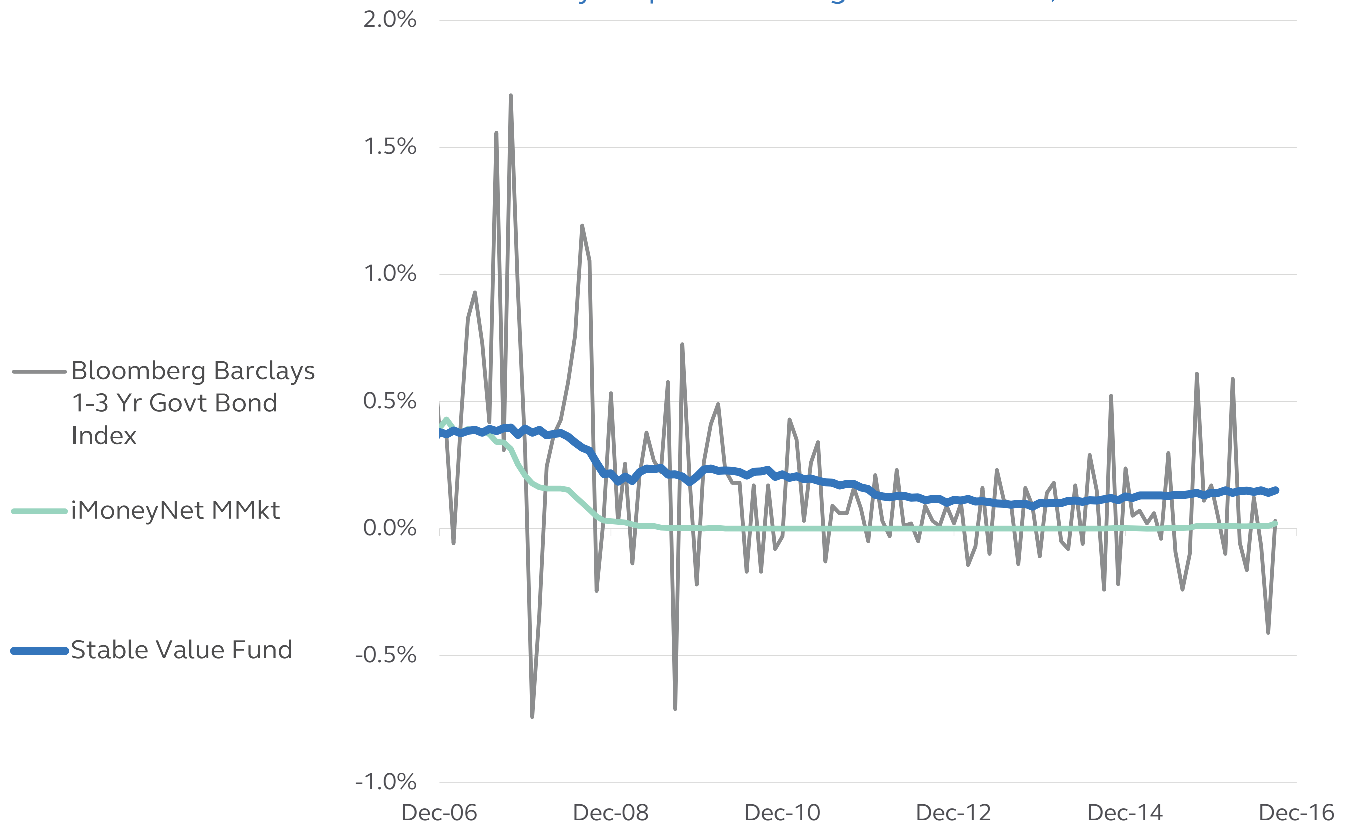
The crediting rate is calculated based on the characteristics of the underlying bonds, specifically, the yield to maturity, the ratio of market to book value, and the aggregate duration of the bonds. The duration is the period over which the market to book value ratio is amortized.

The importance of stable value investing

Stable value is designed to provide capital preservation and relatively stable returns. Capital preservation means participants should expect to maintain all of their initial investment. A stable value fund's objective is not only to preserve capital, but also to provide a positive rate of return with limited rate fluctuation relative to other investment options.

When comparing stable value to other investment options, one may find that stable value has provided returns similar to short term bond funds when measured over a full market cycle. Unlike short term bond funds, stable value seeks to provide price stability which a bond fund does not typically enjoy. If a participant's risk tolerance is limited, then an investment that is designed to provide a relatively stable positive rate of return may be appealing. Stable value is designed to earn income rather than experience the ups and downs of owning a bond fund.

The goal of stable value is to preserve capital and provide a modest level of income over time.



Past performance is not a guarantee of future results. Returns assume reinvestment of income and do not reflect the impact of fees and expenses. Returns for periods less than one year are not annualized. The Stable Value Investment Association Model Stable Value Account represents the performance of the Barclays Intermediate Government Corporate Bond Index with a hypothetical wrap contract and is used to demonstrate the performance of a hypothetical stable value fund. The iMoneyNet All-Taxable Money Market Fund Index measures the equally weighted returns of the largest taxable money market funds. The Barclays 1-3 Year Government Bond Index measures the returns of investment grade, fixed-rate dollar-denominated bonds publicly issued by the U.S. Government, with a maturity of over 1 year but less than 3 years.

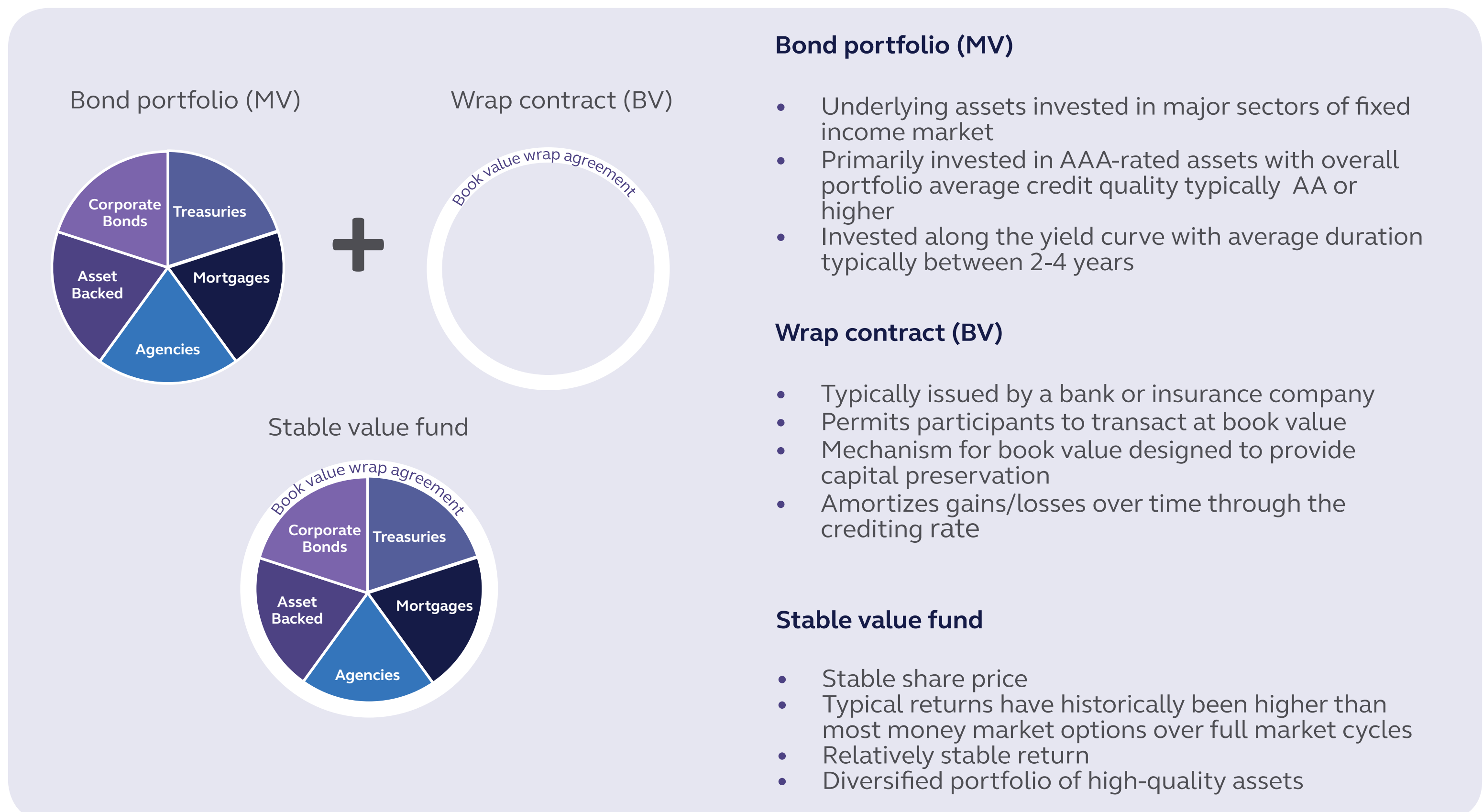
A closer look at stable value

To achieve the objective of capital preservation and relatively stable returns, stable value is typically focused on five primary factors:

Investment strategy
Investment management
Fixed income sector diversification
Credit quality
Wrap issuer diversification

Many funds incorporate a number of investment strategies positioned at different points along the yield curve, a line that plots interest rates of bonds with equal credit quality but differing maturity dates. Some stable value funds employ a blend of complementary strategies, managers and styles seeking to add value to the fund's overall performance and improve the consistency of returns over time.

Typically, a stable value fund is comprised of well-diversified, high credit quality securities and wrap issuers with the majority of assets having a credit quality of AAA, as provided by an independent credit rating agency. The primary sectors typically found in stable value funds are government, corporate, mortgage-backed and asset backed bonds. Bonds are then wrapped by third party institutions and provide participant withdrawals at book value in certain circumstances.



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Important considerations

Stable Value Benefits

Capital Preservation
Stable value funds are designed to preserve a participant's capital investment.

Relatively Stable Returns
Investment contracts allow a fund to amortize gains and losses over time through the crediting rate, thereby reducing the impact of short term market volatility.

Who Can Invest in Stable Value?

Stable value funds are only available within an employer-sponsored defined contribution or retirement savings plan, including but not limited to, 401(k), Profit Sharing, and Governmental 457 Plans through separately managed accounts or Collective Investment Trusts (CIT).

Stable value is not available to retail investors. This means that a retail investor cannot invest in a stable value fund through an investment broker or adviser.

A Word on Risk

While stable value is generally considered a conservative investment option, stable value assets carry potential risks. Risks include, but are not limited to:

Interest Rate Risk How the movement of interest rates over time affects the market value of the bonds that underlie the wrap contracts thereby affecting the rate of return on the stable value fund. All else being equal, an increase in interest rates causes a decline in bond prices and a decrease in interest rates will cause bond prices to rise. Typically, a stable value fund rate of return will track the direction of interest rate movements with a lag.

Credit Risk The risk that an issuer of a bond will be unable to meet its obligation to the stable value fund.

Investment Contract Risk The risk that an issuer of an investment contract will be unable to meet its obligation under the contract to the stable value fund. Additionally, the accounting standards predicating the structure of stable value funds may be subject to review and revision by regulatory entities.

For more information regarding the risks associated with a stable value fund please refer to the disclosure document or other governing documents for the applicable stable value fund.

Have other questions about stable value? Contact us or visit us at www.morley.com.

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