

Deferred Compensation Plan INVESTMENTS COMMITTEE REPORT 14-02

Date: August 28, 2014
 To: Investments Committee
 From: Staff
 Subject: Deferred Compensation Plan Investment Manager
 Search: Small-Cap Growth & Small-Cap Value Equity

Board of Deferred
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Recommendation:

That the Investments Committee review initial results for the Small-Cap Growth and Small-Cap Value Equity mutual fund search and identify finalist funds for additional assessment.

Background:

At its February 18, 2014 meeting, the Board adopted revisions to the Plan’s Investment Policy Statement incorporating the option for a mutual funds search process for filling certain investment manager mandates as approved by the Board. The Board further approved recommendations for moving forward with a search schedule for the Plan’s various investment options as recommended by staff. At its March 18, 2014 meeting, the Board also reviewed the search criteria for each asset category as recommended by staff and Mercer Investments, the Plan’s investments consultant.

Discussion:

Currently, the Plan offers one small-cap investment fund option within its core investment menu. This option is currently managed by State Street and is 100% passively managed. The estimated mandate size is \$100 million.

The Board had previously determined that the Plan would move towards adopting a Plan-branded fund for the small-cap investment option, with allocations to other strategies beyond a fully passively managed fund. As indicated for the DCP Small-Cap Fund investment option profile, included within the Plan’s Investment Policy (see excerpt below), the branded fund would be allocated to 34% passive, 33% growth, and 33% value.

Option	DCP US Small Cap Stock Fund
Objectives	<ul style="list-style-type: none"> ▪ High total return ▪ Diversification within the mid/small cap equity market segment
Primary Investments	Domestic stocks with market capitalizations that are similar to those of stocks found in Russell 2000 Index. The total portfolio should exhibit characteristics representative of a core equity investment style, including price/earnings and price/book ratios similar to with the Russell 2000 Index.
Source of Return	<ul style="list-style-type: none"> ▪ Dividend income ▪ Capital appreciation/depreciation
Expected Return	Very High
Expected Risk	Very High
Portfolio structure	34% passive manager/33% growth manager/33% value manager

To further the Plan towards offering a newly branded small-cap fund within its investment lineup, Mercer has completed the investment manager search for the Small-Cap Growth and Value Equity categories. The full analysis for each asset category is attached for the Committee's review.

The following criteria were used to screen for viable Small-Cap Growth and Small-Cap Value Equity managers:

- Mutual fund vehicle open to new investors and compatible with Great-West platform
- Strategy track record of 3 years or longer (specific vehicle may be shorter)
- Investment style consistent with the small cap growth or value style including appropriate categorization in the database with the stated benchmark of the strategy representative of the style
- Minimum assets under management in strategy of \$400 million
- Maximum assets under management in strategy of \$12 billion
- Investment expense ratio equal to or less than 1.35%

Based on the above criteria, 14 viable Small-Cap Growth funds were identified that are offered by the following providers:

1. American Century Investment Management
2. Baron Capital
3. Brown Investment Advisory & Trust Company
4. Century Capital Management
5. Eagle Asset Management
6. Emerald Advisers
7. The Hartford Mutual Funds (HartfordSCG)
8. The Hartford Mutual Funds (HartfordSmCo)
9. Janus Capital Management
10. Kalmar Investments
11. Morgan Stanley Investment Management (MSIM)
12. Principal Financial Group
13. RS Investments
14. Waddell & Reed Asset Management Group (Ivy)

Eleven (11) viable Small-Cap Value Equity funds were also identified that are offered by the following providers:

1. American Beacon Advisors
2. ClearBridge Investments
3. Delaware Investments
4. Dimensional Fund Advisors (DFA)

5. Dreman Value Management
6. Federated Investors
7. Harbor Capital Advisors
8. Phocas Financial Corporation
9. Principal Financial Group
10. Robeco Investment Management
11. William Blair & Company

Mercer assessed these funds and evaluated them based on major categories of long-term performance, team depth, personnel turnover, portfolio construction, business management, strategy assets, and expense ratio. A summary and detail of these rankings are included in the attached Mercer reports: on page 11 of the Small-Cap Growth analysis and on page 10 of the Small-Cap Value Equity analysis.

In reviewing the summaries, staff found that it would be helpful to provide the Committee with a tool for simplifying Mercer’s assessments into bands of general relative standing, which allows the Committee to, in a broad way, compare the results of staff’s consolidation of the review results with Mercer’s independent fund ratings (which involve a separate analytic process and are provided in Mercer’s report as supplementary information only). The following tables provide the Committee with a summary of these bands, but they are not intended to be interpreted by the Committee as a formal scoring of the funds.

SMALL-CAP GROWTH

Firm	Evaluation Category Banding (based on staff’s consolidation of evaluation category results)	Independent Mercer Fund Rating (not included in evaluation categories)
HartfordSCG	Band A	average
Eagle	Band B	average
HartfordSmCo	Band C	excellent
Principal	Band C	average
MSIM	Band D	excellent
Ivy	Band D	average
Brown	Band D	average
Kalmar	Band D	average
Emerald	Band E	average
Janus	Band E	average
RS	Band F	average
Baron	Band G	average

Firm	Evaluation Category Banding (based on staff's consolidation of evaluation category results)	Independent Mercer Fund Rating (not included in evaluation categories)
AmCentury	Band H	average
Century	Band I	average

SMALL-CAP VALUE EQUITY

Firm	Evaluation Category Banding (based on staff's consolidation of evaluation category results)	Independent Mercer Fund Rating (not included in evaluation categories)
WBlair	Band A	excellent
Federated	Band B	average
Phocas	Band C	excellent
AmBeacon	Band D	excellent
DFA	Band D	excellent
Harbor	Band D	excellent
ClearBridge	Band E	average
RobecoBP	Band F	excellent
Delaware	Band G	average
Principal	Band H	average
Dreman	Band I	average

Upon review of the general search criteria and the broad qualifications of the identified providers, staff recommends that the Committee identify finalist funds for additional assessment.

Submitted by: _____
Esther Chang

Approved by: _____
Steven Montagna