Outsourced Chief Investment Officer: A Steady Hand During Periods of Uncertainty

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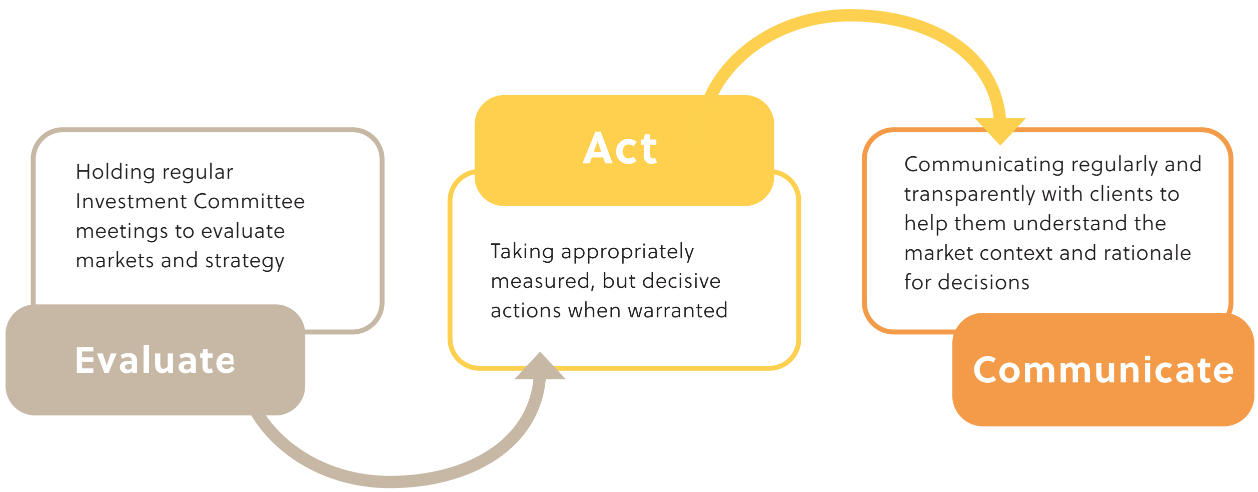
In the first quarter of 2020, world markets were blindsided by two significant events: the global spread of the novel coronavirus (COVID-19) and a steep drop in oil prices caused by disagreements between Saudi Arabia and Russia over levels of supply.

In short, while it may be incredibly hard, if not impossible, to entirely insulate an organization or plan from such turmoil, there are ways to potentially mitigate risk and better navigate choppy waters. For many asset owners, this means trying to schedule ad-hoc board meetings and to gather and disseminate enough information to help the board members to make risk management decisions without sacrificing the returns needed to fund benefits or spending plans all while putting emotions to the side. A daunting task for many.

Enter the Outsourced Chief Investment Officer (OCIO)

An OCIO is the fiduciary responsible for allocating assets and selecting managers within the context of a mutually agreed upon investment policy. One of the primary benefits of hiring an OCIO manager is a more efficient investment decision making process, which is a highly desirable characteristic, particularly during periods of extreme volatility and uncertainty.

The OCIO can facilitate the efficient investment decision-making process by:



How PFM, as an OCIO Provider, is Navigating the Storm

In the beginning of the year, the broader economy and the capital markets were on a generally upward trajectory. However, in roughly mid-February, as the novel coronavirus continued its rapid spread around the globe and disagreements between Saudi Arabia and Russia over supply sparked a massive decline in oil prices, the markets witnessed extreme volatility. Over the course of 22 days, U.S. equities collapsed by roughly 30%.

To provide historical context on the speed of the market decline, the closest modern comparison within the last 50 years was a 38 day period that began on August 25, 1987 and included the infamous "Black Monday." Outside of that, one would have to go back to the Great Depression, where three drawdowns of similar magnitude were witnessed over a five-year period.

As a result of recent market turmoil and to specifically address logistical issues caused by COVID-19, PFM took the following actions:

- In early March, PFM began to implement its Business Continuity Plan, including technology measures to ensure work-from-home capacity to help mitigate the effects of COVID-19.
- PFM's Multi-Asset Class Investment Committee began to meet more frequently on both an ad-hoc and scheduled basis to discuss portfolio positioning and to discuss and analyze changing market conditions.

A timeline of meetings, asset allocation actions and communications through the end of March is below:

Additional Details and Our Thinking Behind Portfolio Allocation Decisions

De-risking of Portfolios on February 28

During February, we actively monitored COVID-19 and its spread. During the week of February 24, we become concerned when the Centers for Disease Control and Prevention (CDC) released a report detailing the outbreak and its potential negative impact. We convened an emergency Investment Committee meeting on February 28, at which we decided to de-risk our portfolios (reducing equities by 20% of the target weight, adding 10% to fixed income and 10% to cash holdings).

Incremental Re-Risking of Portfolios on March 16

By the middle of March, the domestic and international markets had already pulled back over 20%. Based on our view that valuations were favorable towards equities and that the markets had begun to discount the possibility of a recession, we felt that it was an appropriate time to increase risk within the portfolio in a measured approach.

Incremental Re-Risking of Portfolios and Asset Allocation Decision on March 24

By this point, the equity markets had visited 30%+ declines, fully discounting a typical recession. However, the federal government and the Federal Reserve (Fed) began to take aggressive and welcoming actions. Specifically, the Fed unleashed an "unlimited" quantitative easing (QE) program and lawmakers passed legislation to assist businesses and individuals negatively impacted by the pandemic. The backstopping by the Fed and the fiscal stimulus from the government led us to view risk as having been reduced, but not eliminated. As a result, PFM again incrementally increased exposure to equities.

Data Points on Our Radar Screen

Despite the chaos that consumed much of the first quarter, equity markets began to show some signs of life in the latter part of March (major indices posted significant one-day gains on March 24).[1] While we are encouraged by this, we are waiting on several factors before taking further action to get back to target risk, including:

- The number of new novel coronavirus infections to either plateau or decline
- An initial view of company and personal balance sheets
- Increasing investor sentiment
- Economic numbers to bottom out or improve
- An improvement in liquidity within the bond market and credit spreads to decrease from all-time highs

How an OCIO Can Help in Trying Times

During turbulent times, OCIO providers can be a valuable resource as they can enable quicker, more effective decision-making. While board members may be steeped in their enterprise's mission, very few are investment professionals, monitoring the myriad fundamental and technical elements impacting markets on a daily basis. It is in these acute periods of extreme volatility and uncertainty where the OCIO can provide exceptional value by evaluating markets, acting in a measured but decisive manner in the best interest of their clients, and communicating regularly and transparently with clients.

As an OCIO provider, PFM has taken several tangible steps in the first quarter to appropriately position client portfolios based upon prevailing market conditions and risks. We will continue to monitor markets closely and will remain vigilant in our efforts to best serve our clients both during and after these turbulent times.

If you have any further questions, please do not hesitate to reach out to your PFM representative.

1 https://www.cnbc.com/2020/03/24/stock-market-futures-open-to-close-news.html.

To learn more or discuss in greater detail, please contact us:

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