What Matters in Stable Value Funds

Stable value funds have long been a fixture in defined contribution plans, with more than $800 billion in assets[1] and a large majority of plans offering them as an investment option. Stable value has evolved beyond being simply a standalone capital preservation option to now serving as a key component in today's model portfolios, target date funds and managed accounts. Here we focus on what is important to consider when you review stable value options for your clients.

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Key Takeaways:

- With stable value there is more than meets the eye, including benefits that we believe are attractive in any economic environment.
- Using a disciplined fiduciary process, consider stable value as a flexible menu option for your clients.
- Talk to Lord Abbett about our approach to stable value and how we can support your needs.

WHAT IS A STABLE VALUE FUND?

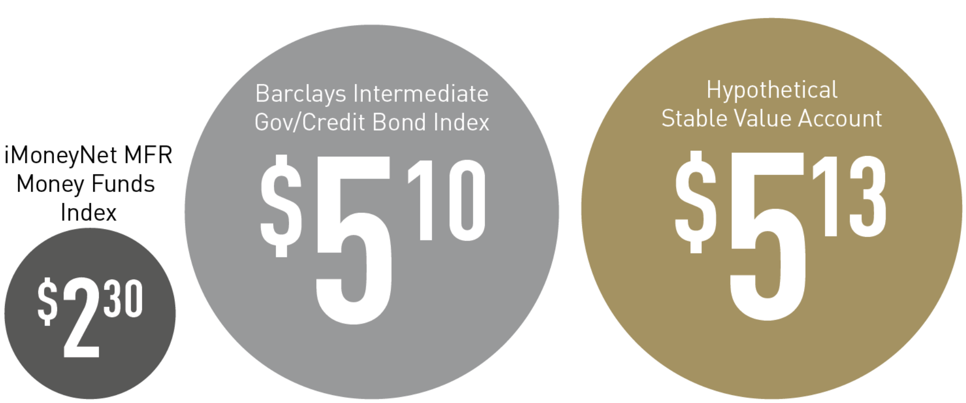
Offered only in defined contribution plans, a stable value fund is an investment vehicle that generally invests in high quality fixed income portfolios through contracts with banks and insurance companies, known as "wraps." These wrap contracts provide participants with a guarantee of principal along with a competitive rate of interest while enabling plan participants to transact at contract value regardless of the market value of the underlying investments. In essence, these contracts smooth the volatility for participants in the fund through the crediting rate.

Stable value has traditionally been known as a low-risk, principal-preservation option on the investment menu. Historically, these options have provided long-term returns similar to intermediate-term bond funds, without the corresponding volatility.

Stable Value Return Outlook

Higher Return Potential Than Money Market & Intermediate Fixed Income

Growth of $1 12/31/1988 to 12/31/2018



Source: Stable Value Investment Association (SVIA). See last page for methodology.[2]

Fast Facts: Stable Value Funds

- **Offered by 75% of DC plans**[3]
- **$814 billion** in assets[4]
- **90%** of advisors surveyed are more likely to recommend stable value over money market.[5]

WHAT ARE THE POTENTIAL BENEFITS OF STABLE VALUE FOR PLAN SPONSORS AND PARTICIPANTS?

A stable value option can be an attractive investment for retirement plan participants within their overall portfolio. With a stable rate of interest and protection of principal, they are considered a substitute for a short or intermediate-term bond fund. Key features of a stable value option include:

Capital preservation

Stability of growth in principal and earned interest

Returns similar to bonds, with less volatility

STABLE VALUE VS. MONEY MARKET OPTIONS – SOME CONSIDERATIONS

Since both options are commonly used to protect participants' principal, it's worth asking the question: What is the difference?

WHAT IS THE PRIMARY DIFFERENCE?

- Money market mutual funds are fairly straightforward. They invest in very short-term, high-quality securities, and are designed to provide maximum liquidity. Their income depends on the current interest rate environment.
- Stable value funds are more nuanced:
  - They invest in high-quality short- to intermediate-term fixed income investments.
  - Unlike money market funds, the value of these investments can fluctuate significantly; that's why stable value funds purchase insurance wrappers to smooth out market fluctuations, enabling the use of "book-value" rather than market value accounting.
  - These investments typically provide higher returns than money market funds, providing participants with a guaranteed interest rate, a feature that continues to draw investors.

HOW POPULAR IS ONE OR THE OTHER?

MetLife's 2017 Stable Value Survey[4] found that stable value was more prevalent than money market as a capital preservation option:

- 83% of plan sponsors surveyed offered stable value
- 46% of plan sponsors offer stable value only but not money market funds
- 36% offer both stable value and money market funds

THE STABLE VALUE LANDSCAPE – WHAT ARE THE EXPERTS SAYING?

Stable value funds have long been a mainstay in defined contribution plans for good reason: they can offer the attractive benefits of principal preservation, volatility smoothing and a steady competitive interest rate. Experts say that stable value has evolved to accommodate the emerging needs of plan sponsors in constructing a diversified investment menu.

"It's important that advisors take the time to understand today's stable value options and be able to articulate their value proposition to their plan sponsor clients, and ultimately, to participants. This is especially critical in an era where we are focused on retirement outcomes," says Rob Barnett, Group Vice President, Product Leader at Wilmington Trust. "There are benefits advisors may be unaware of."[6]

Karl Tourville, Founding Managing Partner and President of Galliard Capital Management, says the stable value industry has adapted and thrived through many changing environments, and he suggested that now it may be in its "golden age."[7]

KEY INGREDIENT IN BOTH OFF-THE-SHELF AND CUSTOM TARGET DATE OPTIONS

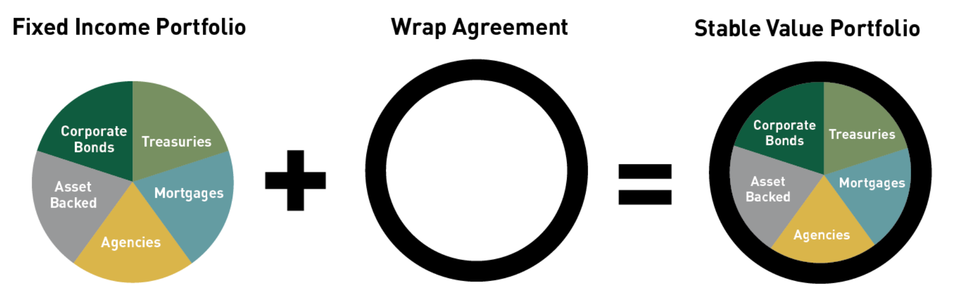
Warren Howe, National Sales Director, Stable Value Markets at MetLife, believes there are good reasons for stable value's continued longevity and strength. "A key trend we are seeing is stable value's growing inclusion in options such as target date funds, both off the shelf and custom target date funds, as well as model portfolios," he says. "We see custom target date funds among larger plans that are interested in leveraging stable value and the other investment options from their core menu and creating a custom glide path that better fits the needs of their employee demographics. It becomes even more important as participants near retirement that the glide paths utilize an option such as stable value to preserve and protect their savings."

When constructing custom options, Howe sees three contributors to stable value's strength: "One, it's less expensive, because you are leveraging the scale of the assets from the core investment options and not adding additional funds and the associated asset management and recordkeeping costs . Two, a plan sponsor has already done the due diligence to select the most appropriate investment options for their participants, so these options are already thoroughly vetted. And three, unlike with an "off the shelf" target date option, with a custom option, a plan sponsor retains the flexibility to replace a manager if they are unhappy with any component of the structure or its performance.[8]

LOOKING UNDER THE HOOD – THE MOVING PARTS OF STABLE VALUE FUNDS

Stable value options have distinct structures, features and risks. To properly evaluate a stable value fund, advisors should understand how they are structured and what influences their performance. The chart below illustrates how a stable value fund is constructed.

A Closer Look at Stable Value: How They Work



Fixed Income Portfolio
- Underlying assets invested in major sectors of fixed income market.
- Primarily invested in high quality fixed income securities with an overall portfolio average credit quality typically AA or higher.

Wrap Agreement
- Typically issued by a bank or insurance company.
- Permits participants to transact at book value.
- Smooths market volatility through the crediting rate.

Stable Value Portfolio
- Stable share price.
- Typical returns have historically been higher than money market options over full market cycles.

WHAT TO BE AWARE OF AS A FIDUCIARY

From a retirement plan fiduciary standpoint, it's critical to frequently review all the options on the plan menu and ensure that participants have access to a good variety of prudent investment options. Often that means including stable value among the choices.

As you perform your due diligence on available stable value options for your clients, it's important to have a good understanding of how these products are constructed and use a thorough, documented process for evaluating them. While stable value funds may not be as transparent as money market funds, their components can be explained and understood. Plan fiduciaries should review, among other things, the investment manager, performance history, and the underlying investment portfolio in order to evaluate risk, duration, sector allocation, and other significant data.

Because their structure includes insurance "wrappers," this can pose a challenge to evaluate the different wrap contracts. The benefit provided by the wrap contract(s), however, is the distinguishing characteristic of a stable value solution. That's why it's important that appropriate due diligence review includes the fund guarantee providers.

Another consideration is the structure of the stable value offering being utilized. Two commonly used structures are insurance company general account solutions and pooled stable value collective investment trusts. Each features a wrap contract with one or more guarantors that provides principal preservation, benefit responsiveness and a guaranteed interest rate. There are two main differences, however:

- **General account** – The interest rate is determined by the insurance company and the return is backed by the assets of the insurer's general account.
- **Pooled Fund** – The interest rate is determined based upon a clearly defined crediting rate formula and the return is supported by assets held in an external trust.

A pooled structure offers more transparency and clarity, with visibility to the underlying assets you can monitor and evaluate.

How Lord Abbett may differ from others in the marketplace:

- A deep expertise in stable value
- Strength of our strategic design, credit orientation, and quantitative research

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LORD ABBETT'S APPROACH TO STABLE VALUE SOLUTIONS

With our commitment and deep expertise in this area, we can walk you through the fiduciary considerations and help you assemble a diversified menu that includes a strong stable value option for your clients. We can provide a thoroughly vetted recommendation that helps you recommend the right option, with the right performance and the right attributes for your client, one that solves for their specific employee audience and retirement readiness needs.

With the strength of our enterprise, people, and systems, and our methodical approach to risk management, Lord Abbett offers strategies that complement stable value managers and other sub- advisors – with an emphasis on short and intermediate duration. At Lord Abbett, we intuitively understand the unique purpose of stable value and how to operate within its particular guidelines, including how to manage within the more conservative oriented investment guidelines desired by plan sponsors as they work with wrap providers and stable value managers.

WHEN LOOKING AT INVESTMENT MANAGERS ... FOCUS ON WHAT MATTERS

What to look for	Lord Abbett emphasizes
▪ Those that emphasize compliance and risk management throughout process	✔
▪ Downside management for retirement plan participants	✔
▪ Mandate for capital preservation	✔
▪ Finding marginal yields where appropriate, within constraints and guidelines	✔

See how Lord Abbett can help

Ask your Lord Abbett Relationship Manager about how we can assist you in evaluating stable value products that best meet the needs of your retirement plan clients. Together, we can put all the resources and solutions of Lord Abbett and your firm to work for your client.

For more information, contact us at **888-522-2388**.

[1]Stable Value Investment Association, Quarterly Characteristics Survey Q2 2017.

[2]Stable Value Investment Association. The hypothetical stable value account is a "wrapped" fund using Barclays Intermediate Gov/Credit Index as underlying fixed income investments and a rate reset formula of CR = (1+Y)*(MV/BV)^(1/D) - wrap fees – 1. The data calculation rules are as follows: (1) The "Start Date" for each of the three models is December 31, 1988. (2) All return calculations are "gross" before any investment management and stable value wrap fees. (3) iMoneyNet monthly money market returns are converted from 30 day returns to exact days before being used in monthly returns; as a result, an actual month's iMoneyNet return used in these calculations may vary slightly from posted iMoneyNet index publications for months with more or fewer days than 30. (4) Barclays Intermediate G/C Index returns are used to derive market value performance of a bond portfolio over time. These returns are used in the bond fund illustrations, and are also used as the underlying investments of the Hypothetical Stable Value account. (5) No positive or negative cash flow are assumed for any of the three illustrations. The model results illustrate "growth of a dollar" returns. (6) Using the initial 12/31/1988 Intermediate G/C Index yield as the starting stable value gross crediting rate, a "book value" balance as of 1/31/1989 is determined from the initial investment of $1 by adding 31 days of interest based on the annualized crediting rate. (7) Using the actual Intermediate G/C Index gross market value return for January 1989, a "market value" balance is determined as of 1/31/1989 from that initial $1 investment by adding the Index market value returns to the initial $1 investment. (8) The resulting 1/31/1989 "market-to-book" ratio, plus the actual 1/31/1989 Intermediate G/C Index yield and duration are utilized to compute the crediting rate for February 1989. (9) Such February 1989 crediting rate is used to calculate the ending February 1989 book value balance. The actual February 1989 Intermediate G/C Index gross return is used to create the ending February 1989 market value balance. (10) Subsequent months' book or market value balance are determined by increasing prior months' respective balances by the next month's book or market value returns. (11) Subsequent months' crediting rates are created serially in the same fashion as described above. (12) The "Hypothetical Stable Value" account crediting reset rates noted above are calculated using a standard Stable value industry crediting rate reset formula by Invesco Advisers, Inc. using an internal proprietary system or spreadsheet. (13) Crediting rates are reset each month. (14) An Excel spreadsheet is used to perform all of the return calculations and determinations of standard deviations of returns.

[3]"Ten Important Facts About 401(k) Plans," ICI, September 2018 and BrightScope Defined Contribution Plan Database.

[4]Stable Value Investment Association, Quarterly Characteristics Survey Q2 2017. The study included interviews with 241 plan sponsors, 10 DC plan advisors and 19 stable value fund providers.

[5]2017 Stable Value Study, MetLife. The study included interviews with 241 plan sponsors, 10 DC plan advisors and 19 stable value fund providers.

[6]Interview with Rob Barnett, Wilmington Trust, April 4, 2019.

[7]Myers, Randy, "Challenges and Opportunities: The Outlook for Stable Value, 2017 SVIA Spring Seminar, Stable Value Investment Association.

[8]Interview with Warren Howe, MetLife, March 22, 2019.

This article may contain assumptions that are "forward-looking statements," which are based on certain assumptions of future events. Actual events are difficult to predict and may differ from those assumed. There can be no assurance that forward-looking statements will materialize or that actual returns or results will not be materially different from those described here.

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A Note about Risk: The value of investments in fixed-income securities will change as interest rates fluctuate and in response to market movements. Generally, when interest rates rise, the prices of debt securities fall, and when interest rates fall, prices generally rise. The value of investments in equity securities will fluctuate in response to general economic conditions and to changes in the prospects of particular companies and/or sectors in the economy.

Statements concerning financial market trends are based on current market conditions, which will fluctuate. All investments involve risks, including the loss of principal invested.

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Glossary

The **crediting rate** is the interest rate of an insurance policy's investment contract.

Money market funds invest in highly liquid securities and seek to maintain a stable net asset value.

A **target date fund** is a mutual fund that allocates assets based on an intended retirement year. As investors get closer to their target retirement date, the fund's investments shift from more aggressive to more conservative securities.

An **intermediate-term bond fund** invests in fixed-income securities that mature in the medium term, often between 3 and 10 years.