

US Insurers Issue European Medium Term Notes

Ron McHugh, John Hancock Mutual Life

During the last few years, a number of insurance companies have established European Medium Term Note programs and have been issuing off these programs in ever-increasing volume to reach both European and Asian investors. This article briefly discusses the markets into which EMTNs are sold, the structures being used to reach the investors in these markets, why the products are attractive to the issuers and the investors, and what has been issued thus far and by whom. It will also touch on what we can expect to see in the immediate future.

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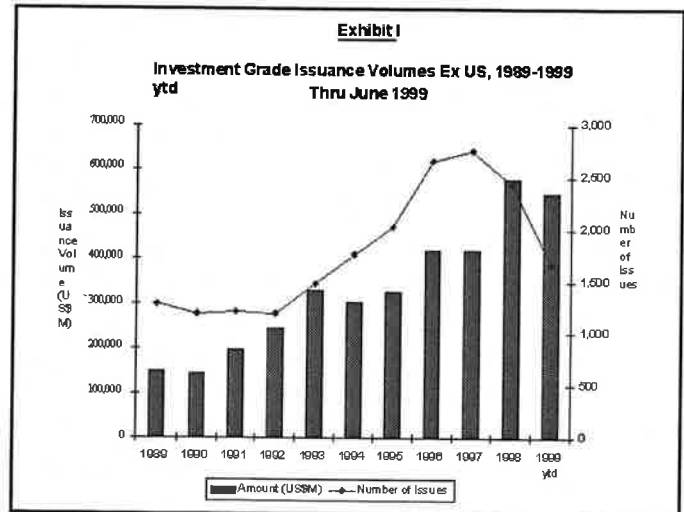
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Yardeni on Stocks: A Bearish View

By Randy Myers



Batten down the hatches. If Deutsche Bank Securities Chief Economist Ed Yardeni is right, the turmoil we've seen in the stock market during the second half of 1999 is only a precursor to bigger declines to come. Yardeni predicts that by March 2000 the Dow Jones Industrial Average could fall 30% from its all-time high of 11,326 set on August 25, a tumble

that would drive the blue-chip indicator down to about 8,000. Yields on 30-year Treasury bonds in this recessionary scenario could drop from the current 6.25% or so to less than 5% and perhaps close to 4%, he says.

Yardeni's concern is that the stock market has been priced "for perpetual perfection," a happy outlook that's just not realistic. Worse, he says, the impending Y2K computer crisis could wreak havoc on the world's economy, sharply disrupting business profits.

Yes, conventional wisdom holds that the threat from the widely publicized Y2K bug, which can prevent older computers from reading year 2000 dates correctly, is vastly overrated. Most companies say they have done or will do the necessary work to correct the problem before the bug can wreak havoc with their computer systems. But Yardeni is skeptical.

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EDITOR'S PERSPECTIVE

Greg Wilensky, Sanford C. Bernstein & Co., Inc.

The SVIA staff and the Stable Times Editorial Board have completed our testing and contingency planning, and our faithful readers will be relieved to know that this final Stable Times of the 1900's is guaranteed to be 100% Y2K compliant. Even Dr. Yardeni, one of the featured speakers from the Association conference and frequent Y2K alarmist, can trust us on this. So if you are concerned about going out on New Year's eve for fear that you will not be able to get back home, feel free to ring in the year 2000 by reading the Stable Times.¹

This issue of Stable Times includes coverage of the recent Association conference as well as articles on other topics from our members. We highlight some of the trends, challenges, and opportunities facing the stable value industry. As Churchill noted, "A pessimist sees the difficulty in every opportunity; an optimist sees the opportunity in every difficulty." Our goal as an industry should be to, not only take advantage of the positive trends, but to convert the challenges or difficulties we face into opportunities to help investors and grow our business.

To help put the future in perspective, we start by highlighting where we are today. Judy Markland, from Landmark Strategies highlights some of the major findings from the Association's third annual survey of investments and investment policies in stable value funds.

Ron McHugh, from John Hancock gives us a timely look at a new opportunity for insurance companies to leverage their existing stable value knowledge base. He details how insurance companies are expanding their long term funding agreement business by tapping the European Medium Term Note market using special purpose vehicles.

We also present team coverage of the Association's annual conference. Randy Myers, a freelance journalist who has written several articles for us in the past, joined us in Washington DC for the entire conference and has contributed pieces on several of the sessions. Randy has done an excellent job of combining information from the different sessions to give a more complete picture of the changing landscape facing the industry. For example, while the declining percentage of assets represented by stable value

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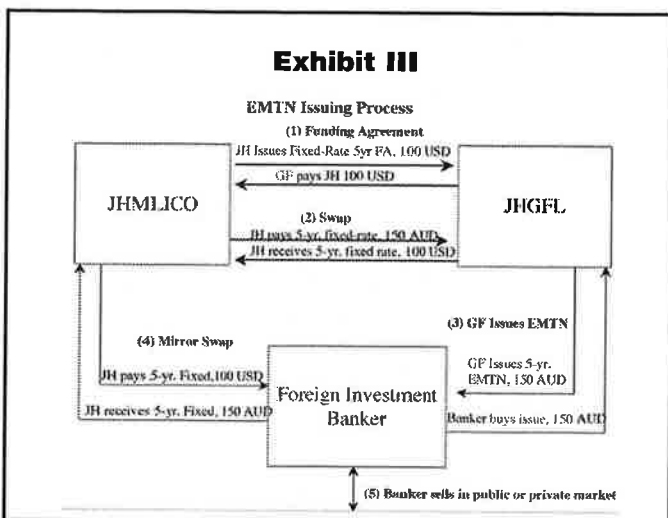
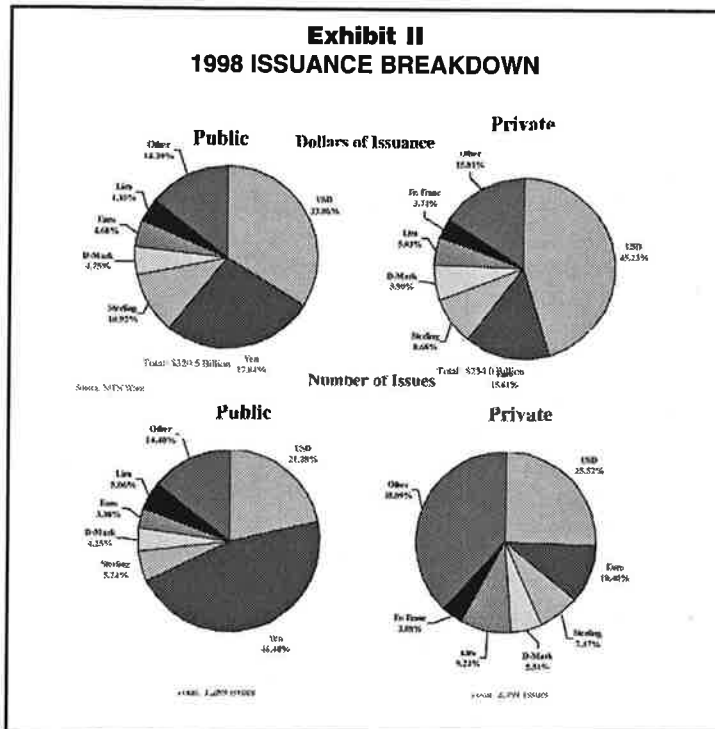
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Background on the EMTN Markets

Exhibit I shows the growth in annual issuance volume of EMTNs from \$148 billion in 1989 to greater than \$550 billion in 1998. Issuers include a variety of borrowers including banks, US and Foreign Corporations, foreign governments, government institutions, and entities with government guarantees, just to name a few.

The EMTN programs established by the US insurance companies are similar in many respects to the programs established by other frequent issuers of EuroBonds. The notes are sold in bearer note form and distributed by investment bankers to banks, asset manager, insurance companies and retail investors. Public deals generally run the gambit of \$100 million to several billion for a single issuance; while private deals are generally \$5 million up to \$100+ million and generally



AUD to 1 USD. Exhibit III shows the steps taken to execute this transaction.

purchased by a single investor. Exhibit II shows a breakdown of 1998 issuance of all EMTNs by dollar amount for both public and private deals as well as by number of issues.

EMTN Structure

Suppose John Hancock Mutual Life Insurance Company (JHMLICO) wanted to issue a \$100 million (USD) 5-year fixed rate note in the Australian Market. Assume the exchange rate is 1.5

Although most of the steps take place almost simultaneously, it is perhaps clearer if discussed as a sequence of events. First, JHMLICO issues a 5 year funding agreement to JH Global Funding Limited (JHGFL), a special purpose vehicle specifically created to issue EMTNs. The special purpose vehicle allows JHMLICO to issue a funding agreement as opposed to debt, yet the EMTNs are issued as a note or Eurobond, a structure familiar to investors around the world. In the second step, JHMLICO and JHGFL enter into a swap contract where JHMLICO pays a 5 year fixed rate on a face amount of 150 AUD and receives a 5 year fixed rate on 100 USD. JHGFL then issues the EMTN, which is underwritten by the investment banker. In the fourth step, JHMLICO enters into a swap agreement that mirrors the previous one. Often, the investment banker is the counterparty on the mirror swap as part of the package including the placement mandate for the EMTN issuance. JHMLICO receives a 5 year fixed rate on a face amount of 150 AUD and pays a 5-year fixed rate on 100 USD. Finally, the investment banker sells the notes in the public or private market.

The public EMTNs are listed on one of the European or Asian exchanges. This listing, and the secondary market made by the bankers, provides liquidity for these public EMTN issues. Private trades may or may not be listed on an exchange and the investment bankers do not provide a secondary market.

For the insurer, the balance sheet impact of this transaction would be the same as issuing a GIC in the Stable Value market, with the addition of two offsetting currency swaps. The net proceeds are used to purchase fixed income investments as part of spread lending operations. The Funding Agreement is subject to statutory minimum reserve requirements, cash flow testing, and of kinds of sensitivity analysis just like a GIC. Since the net proceeds are used in matched funding operations, the rating agencies have treated these as operating leverage, like other insurance liabilities, and not as financial leverage (like debt acquired for acquisitions).

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Benefits to Insurers

From the insurer perspective, the EMTN markets provide an excellent fit with existing skill sets, an improvement in the corporate risk profile, a lower cost of funds and an opportunity for growth. Many of the skills that made insurers successful in the Stable Value Market are fully transportable into the EMTN market, such as credit risk management, asset liability management, large contract capabilities, and the ability to analyze complex structures.

The improvement to the corporate risk profile is the result of the ability to more closely match the maturity date of the assets and liabilities. With the EMTNs, the issuers are able to issue large volumes in long dated paper, choosing at any point in time which part of the maturity spectrum of the various markets to target. Eventually, this should alleviate most concerns the rating agencies may have with liquidity ratios and exit strategies.

Lower cost of funds is an outgrowth of flexibility, expansion and diversification of issuance markets. The numbers in Exhibit IV below shows indicative All-In cost of funds over US Dollar LIBOR of EMTN issuance at various currencies and maturities as of March, 1999. The four center columns represent the major currencies of the European markets while the last column represents the best execution available at that maturity in any currency. Exhibit IV is just a snapshot at one point in time. The relative attractiveness of EMTN issuance for a specific currency will change with market conditions. Likewise, market conditions at any point in time will determine the attractiveness of EMTNs relative to domestic issuance (GICs, FA's, etc.).

Benefits to Investors

The primary buyers of EMTN's are banks, insurance companies, asset management groups, corporate and government pension plans and retail investors in Europe and Asia. Common drivers of demand for all these investors are diversification of credit, movement away from sovereign risk, dearth of high quality domestic credits along with high quality investment quality constraints, and a disappearance of currency plays caused by currency union.

Banks are generally the largest buyers of floating rate debt, while investment and pension plans are the largest buyers of long fixed rate debt. Retail participation is generally strong up to the 5-year point, then declines with increasing maturity.

EXHIBIT IV					
<i>All-In Issuance Cost over US Dollar LIBOR</i>					
<u>Maturity</u>	<u>US\$'S</u>	<u>Euro</u>	<u>Sterling</u>	<u>Swiss Franc</u>	<u>Best Execution Curve</u>
3	N/A	N/A	N/A	15	15
5	27	N/A	N/A	19	19
7	27	28	N/A	29	27
10	27	30	32	30	27

The source of the numbers are indications from investment bankers that are based on secondary market trading levels, market conditions, SWAP levels, and feedback from key investors.

Recent Issuance by US Insurers

Exhibit V (on page 5) shows the issuance through September 30, 1999 by US insurers issuing Funding Agreement backed debt into the European and Asian debt markets by currency along with the US dollar equivalent.

Market Impact of the Yankee Invasion

The impact on the European markets caused by these insurers issuing debt in Europe is mixed. The immediate impact issuers have on the market is primarily a function of how well advised they were by their bankers, how they are planning on using the EMTN program and how patient they are with the markets. Some bankers fear the additional supply in these markets will cause spreads to widen. Others feel that more investor attention will be focussed on the sector because it's now big enough to generate interest with the middle market investors.

All bankers feel that a deal that is not well placed with investors or not well priced is bad for the market. The new issuers are particularly susceptible in that if they price a deal too tight, it will subsequently sit on the bankers books, or price a deal too wide, it will generate a higher trading level for all their future issuance.

It's important to remember the size of the markets is measured in trillions while the size of the issuance of the insurers is measured in billions. The impact of a bad deal on the sector is generally short lived, especially for issuers within the sector with well established franchises like SunAmerica and John Hancock, but can stick with the issuers who access the market less frequently.

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Where the larger number of insurers could have a more significant and permanent impact is on private trades where only a couple of insurers were quoting several months ago, now there will be a half-dozen or so. Insurers with high annual issuance plans may drive up the spreads for all issuers.

Recent Developments

There have been two recent developments that will enhance issuance of the FA/GIC backed structures. The first is that the New York Insurance Department recently blessed issuance of 144(a) debt issued to Qualified Institutional Buyers (QIBs) in the U.S. This is expected to expand the investor base into the largest market in the world where many of the issuers have great name recognition. The impact on spreads should be positive from the issuer's perspective.

The second development is that a proposal by the Bank of International Settlement (BIS) on risk capital requirements for banks would reduce the risk capital weighting on AAA and AA rated corporate debt from 100% to 20%. Banks are by a wide margin the largest buyers of debt. The impact of this development on spreads should also be positive, but will take some time to develop.

EMTNs have received positive reviews not only by market participants but also from the rating agencies and other outside constituencies. These developments, along with the expanding market opportunities overseas and an increasing sophistication dealing in these markets, should provide a positive environment for insurers' spread lending operations in the foreseeable future.

Exhibit V**US Insurer FA Issuance to EMTN Market - First 3 Quarters of 1999**

Target Date	Issuer	Maturity	Final Coupon	Currency	Armt mm	Armt US\$m
9/30/99	Monumental Global Funding Ltd.	10/20/04	3-mth Euribor + 0.15%	EUR	500,000	533,650
9/27/99	AIG SunAmerica Institutional Funding II	10/6/03	6.3750	US\$	250,000	250,000
8/25/99	John Hancock Global Funding Ltd.	2/15/06	6.7500	AUD	300,000	189,000
8/25/99	AIG SunAmerica Institutional Funding II	5/26/04	6.5000	STG	100,000	158,000
8/19/99	AIG SunAmerica Institutional Funding II	7/15/05	6.7500	AUD	400,000	255,000
8/17/99	Pacific Life Funding Llc	9/15/05	3.5000	SFR	200,000	131,580
8/12/99	AIG SunAmerica Institutional Funding II	11/25/05	5.0000	EUR	250,000	269,542
7/14/99	Nationwide Financial Services	8/18/04	3.0000	SFR	500,000	316,670
7/14/99	Allstate Life Funding	7/26/04	3-mth Libor + 0.30%	US\$	250,000	250,000
7/9/99	John Hancock Global Funding Ltd.	8/13/09	4.0000	SFR	300,000	190,913
6/23/99	MassMutual Global Funding LLC	7/7/06	7.0000	US\$	300,000	300,000
6/21/99	SunAmerica Institutional Funding	4/27/04	2.0000	SFR	150,000	97,428
6/9/99	Travelers Insurance Co. Institutional Funding Ltd.	6/16/06	4.2500	EUR	250,000	257,626
6/7/99	AIG SunAmerica Institutional Funding	6/2/04	6.2500	US\$	250,000	250,000
6/7/99	John Hancock Global Funding Ltd.	6/22/04	6.5000	US\$	300,000	300,000
6/2/99	John Hancock Global Funding Ltd.	6/6/04	4.3750	US\$	150,000	86,972
5/19/99	AIG SunAmerica Institutional Funding	6/2/04	6.2500	US\$	500,000	500,000
5/6/99	John Hancock Global Funding Ltd.	3/30/09	6.1250	US\$	250,000	250,000
5/5/99	SunAmerica Institutional Funding	5/21/02	3-mth Euribor + 0.05%	EUR	500,000	528,989
4/22/99	SunAmerica Institutional Funding	12/7/09	5.3750	STG	250,000	403,551
4/16/99	Monumental Global Funding Ltd.	7/15/09	4.3750	EUR	250,000	269,426
3/22/99	John Hancock Global Funding Ltd.	2/18/04	2.5000	SFR	150,000	102,585
3/18/99	Jackson National Life Funding LLC	4/6/04	3-mth Libor + 0.20%	US\$	300,000	300,000
3/17/99	John Hancock Global Funding Ltd.	3/30/09	6.1250	US\$	250,000	250,000
3/10/99	SunAmerica Institutional Funding	4/27/04	2.0000	SFR	250,000	170,381
3/3/99	Principal Financial Global Funding LLC	4/7/04	2.2500	SFR	250,000	172,521
2/24/99	Travelers Insurance Co. Institutional Funding Ltd.	3/5/09	4.5000	EUR	300,000	332,853
2/18/99	Pacific Life Funding Llc	12/23/03	2.5000	SFR	100,000	70,651
2/16/99	SunAmerica Institutional Funding	2/16/09	5.7500	US\$	150,000	150,000
2/2/99	SunAmerica Institutional Funding	2/16/09	5.7500	US\$	850,000	850,000
2/1/99	Pacific Life Funding Llc	3/15/07	3.0000	SFR	350,000	246,600
1/22/99	John Hancock Global Funding Ltd.	2/8/06	3.8750	EUR	300,000	347,705
1/12/99	Principal Financial Global Funding LLC	1/22/09	4.5000	EUR	300,000	346,580
1/7/99	John Hancock Global Funding Ltd.	2/18/04	2.5000	SFR	250,000	182,017

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Yardeni on Stocks: A Bearish View

"Let's look at these assurances," Yardeni told his audience during an October 13 luncheon address to the SVIA 1999 National Forum in Washington, D.C. "Almost all of them are based on self-reporting. As economists and investors, we need data. Imagine going to a company's 10-Q filing with the SEC, and, instead of providing an earnings report, the company just said, 'We did better. Trust us.' Never before (Y2K) have we as humans so trusted others we are depending upon."

In a poll of businesses that he conducted in June, Yardeni added, only 16% of the respondents said they would need this year's fourth-quarter to complete their Y2K remedial work. But when he conducted the same poll in September, 43% of the respondents said they would need the fourth quarter to complete their work, suggesting that schedules were slipping dangerously. Also, 20% said they were still waiting for mission-critical, Y2K-compliant programs from third-party software vendors.

How would Y2K failures impact the economy? In part by disrupting the global supply chain and sabotaging corporate productivity. While many U.S. companies have been working on the Y2K problem for years, Yardeni says, efforts in some other countries have lagged far behind. For example, he says, Venezuela, Mexico and Italy didn't start addressing Y2K until this year.

Among the companies that would be hit hardest by a disruption in the global supply chain would be those that depend on just-in-time manufacturing techniques, including the influential auto manufacturing sector.

Despite this gloomy short-term scenario, Yardeni was quick to remind his listeners that he is actually optimistic about the stock market for the long term.

"My prediction is 15,000 for the Dow by the year 2005," Yardeni said. "That might not sound like much with the Dow where it is now, at about 10,500, but it sounds very good compared to Dow 8,000.

"I'm wildly bullish about the long-term," Yardeni concluded. "I just think there are going to be some buying opportunities along the way."

EDITOR'S PERSPECTIVE

Editor's Perspective continued from page 2

funds creates a challenge for the stable value industry, the continued growth in defined contribution assets and the rapid growth of the number of people over 50 (the segment of the market that highly values the safety and predictability of stable value) can create significant domestic opportunities for the stable value industry.

Randy also covers budding opportunities for stable value around the world as the defined contribution model from the US spreads to Europe and Asia. In addition, several articles discuss the burgeoning fields of investment advice (both inside and outside the defined contribution market) and asset allocation modeling. This recent trend is poised to create both challenges and opportunities for our industry.

Wendy Cupps from PIMCO provides a review of the conference session on stable value mutual funds aimed at the rapidly growing IRA sector, a sector that, until recently, was closed to stable value. Dan Libby, AKA "the hardest working man in stable value", from IBM covers the action at the Performance Measurement update. The task force hopes that by "de-mystifying stable value to the professional investment community at large, [we can foster] the widespread use of stable value where appropriate and lend a greater sense of credibility to the asset class as a whole."

You will get all of this and our regular updates on stable value performance and a return of the Stable Times crossword puzzle. So sit back and enjoy the final Stable Times of the year, but heed the counsel of the great philosopher, Milton Berle: "if opportunity doesn't knock, build a door."

Financial Engines: Providing Investor Advice Via the Web *By Randy Myers*

For many plan sponsors, it's become the new frontier: offering investment advice to participants in their defined contribution plans. The question, of course, is how to offer it effectively and affordably.

Conveniently, a Nobel laureate has come up with some answers.

In 1990, Stanford University professor Bill Sharpe won the Nobel Prize in economics. Today, while still teaching at Stanford, he serves as chairman of Financial Engines, an Internet-based company he co-founded that provides investment advice to individual investors over the Web.

Financial Engines has attracted considerable notice, and some early customers, for two fairly obvious reasons. First, it carries the imprimatur of a Nobel laureate, assuaging the fears of plan sponsor that they will be offering bum advice to their employees. Second, the economics of the Internet make it affordable. It's also easy to use.

In an address to the SVIA National Forum in Washington, D.C. in October, Sharpe shared some of the secrets behind Financial Engines early success.

"Individuals care about outcomes," Sharpe said. "They have three questions on their mind. Will I have enough money when I retire? What specific investments should I make? And what should I do when markets change?"

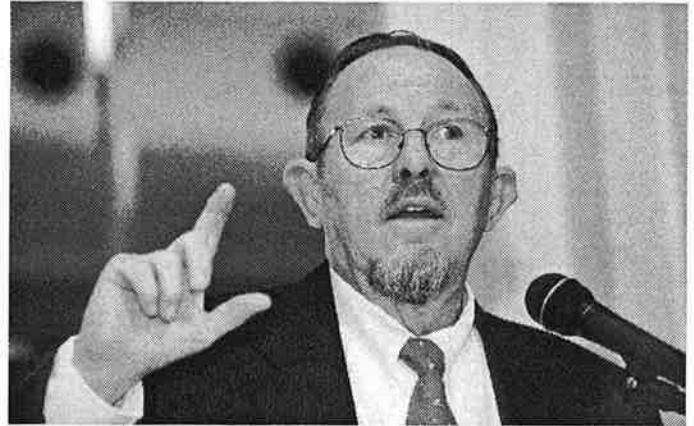
Financial Engines answers those questions, he said, when investors log onto its Web site and enter a few details about their life and finances, such as their age, sex, income, current investment holdings, and savings rate. Moments after that data has been entered (for anybody with their account statements in front of them, the job won't take more than five minutes or so), the site lets them know how likely it is that their current investment program will meet their financial needs in retirement.

To get to the answer, Sharpe explains, Financial Engines runs a sophisticated Monte Carlo analysis of the investor's inputs, generating thousands of potential outcomes based on the funds in which the person is invested, the volatility of those funds, their historical performance and their costs.

If that were all Financial Engines did, it would be providing a valuable service. But the service also goes on to let investors perform a variety of "what if" analyses by changing the variables they've entered into the program—how much they're investing, how long they plan to work, their retirement goals and their tolerance for risk—to come up with the best possible investment portfolio for the level of risk they're willing to assume. Then, the program recommends specific funds for the investor, and indicates what percentage of their portfolio should be allocated to each fund.

Financial Engines' Web site, www.financialengines.com, is accessible to the public, and much of what it makes available to registered participants in 401(k) plans is also available free to anybody who visits. At this time, Financial Engines' does not include or recognize Stable Value in its asset allocation models. The free service doesn't include what-if analysis or specific fund recommendations, but individuals can buy that service.

"What we're seeking to do is to help the average investor with terribly important, and even life-threatening, issues," Sharpe said. "The question is whether we can bring sophisticated investment analysis to the individual at low cost, quickly, and in terms they can understand. I would say we have the technology to make that possible."



Changing Demographics Should Help Stable Value Industry

By Randy Myers



The American population is getting older, and that's good news for the stable value industry-or so says Mark Goldstein, an internationally recognized authority in the field of aging and its implications for the workforce and marketplace.

Speaking at the SVIA 1999 National Forum in Washington, D.C., Goldstein explained that as people get older they usually adopt more conservative investment strategies. Because stable value funds are uniquely conservative-they guarantee an investor's principal yet generate better long-term returns than money market funds-they're a natural fit for America's aging population.

To make the most of this opportunity, Goldstein said, companies must understand the demographic trends influencing the marketplace, as well as the psyche of older Americans, including how they buy goods and services.

The great graying of America can be explained by two factors, Goldstein said. The first, and most frequently documented, is the impact of the baby boomer generation-the record 76 million infants born in the post-war era from 1946 through 1964. Those boomers are now turning 50 at the rate of 10,000 per day. The second is what Goldstein calls the "longevity revolution." Advances in medicine, hygiene and technology

have added 30 years to the average human life over the past century, a feat which Goldstein says may go down as the greatest accomplishment of our time. Combine these two factors, and it turns out that two-thirds of all the senior citizens who have ever lived are alive today. And, the senior segment of the U.S. population is continuing to grow at three times the rate of any other.

The vast wave of baby boomers passing 50, Goldstein said, have clearly identifiable buying patterns. "They are concerned more with quality than price," he said. "They want to save time and effort. They are convenience driven. They want honest facts and information from sellers, not persuasion. They want consistency between the seller's promise and what the seller actually delivers. They want relationships versus transactions. They want interactive ways to get information. And they respond best to what might be called 'seller restraint.'"

Goldstein said many boomers feel too busy to think about tomorrow, and are searching for balance in their life. Many would prefer more time than more money.

"Baby boomers have created a boom in every industry they've passed through over the course of their lives," concluded Goldstein, who, when he's not on the lecture circuit, serves as North American training director for Age Wave Communications, a marketing communications firm. "Now, 80 million boomers are focusing their energy on investing in their own retirement. I suggest you take this ball and run with it."

Working Longer for Less: Why Education for Retirement Investors is Crucial

By Randy Myers



Twenty-five years from now, warns Dallas Salisbury, American workers can expect to retire later than they do now yet still face a greater chance of outliving their assets.

Salisbury, president and chief executive officer of the Employee Benefits Research Institute, a Washington, D.C.-based think tank, told the SVIA 1999 National Forum that several trends point toward this less-than-rosy retirement picture for the nation's baby boomers. They include ever-lengthening life expectancy rates for U.S. citizens, the ongoing shift from defined benefit to defined contribution pension plans in corporate America, and the reluctance or inability of many people to participate fully in the defined contribution plans available to them.

"In another 10 years, money in IRAs and Keogh accounts could equal all of the money in defined benefit and defined contribution plans combined," Salisbury told his audience. "This is a fundamental change in where retirement assets are sitting."



Still, he said, too few working Americans have absorbed the importance of investing for their own retirement. In one recent survey, for example, 22% of federal workers said they didn't participate in their retirement savings plan. In another, 80% of private-sector workers said they don't expect to get as much money as they should from Social Security-yet 75% said it would be their primary source of income in retirement. Worse yet, many incorrectly believe that their Social Security benefit will be at least twice as large as the actual amount.

Salisbury is no Chicken Little. He doesn't expect the Social Security system to go broke. But he does see it evolving into a floor for retirement income for many Americans, rather than the primary source of retirement income. And that means plan sponsors must do a better job of educating their work force about the need to save for retirement, and even offer them advice on how to do it.

David Wray, president of the Profit-Sharing/401(k) Council of America, believes it will happen.

"We will see investment advice becoming an important part of the education effort," Wray said in his address to the SVIA 1999 National Forum. "And that advice will not only be about how to handle asset allocation, but also about the importance of investing in the first place. I think that full-service financial planning will be a typical employee benefit within 10 years."

Wray said that in some cases advice may be offered electronically through Internet-based financial advisory firms as Financial Engines and the 401k Forum, which are already making investment advice available to participants in defined contribution plans where the employers have funded the cost. In other cases, the advice may be dispensed in annual face-to-face meetings between individual employees and financial planners.

Cindy Hounsell, executive director of the Women's Institute for a Secure Retirement, noted that investment education and retirement planning are particularly important for women, 80% of whom die single thanks to the longer life expectancy that women enjoy when compared to men.

"The segment of the population that will be growing the most in the near future is what some have called the 'old old,' or those who are 85 years old and older," Hounsell said. "That's why, when I hear women talking about saving for a college education for their children, I advise them to think first about saving for their retirement. Their kids will go to school; there are scholarships available. There are no scholarships for retirement."

SVIA Investment & Policy Survey Highlights

Judy Markland, Landmark Strategies

The Association's third annual survey of stable value investments and investment policies covers more than 97,000 plans with assets of \$214.5 billion as of year-end 1998. Responding firms reported stable value asset growth of 10.1% for the year. At 6.35% compared to the previous year's 6.63%, yields credited on the portfolios continue to show good stability and rates well above those available on other DC asset classes offering principal safety and liquidity.

As in previous years, data for the survey was compiled for funds of four different manager types: individual funds managed externally, individual funds managed in-house (typically jumbo funds), commingled funds in bank and investment company pools, and commingled funds in life company full-service plans (invested in general or separate accounts of the life company). This format not only expedites data collection but allows comparisons of investment management styles across various segments of the industry.

Comparison by Type of Stable Value Fund, 12/31/98

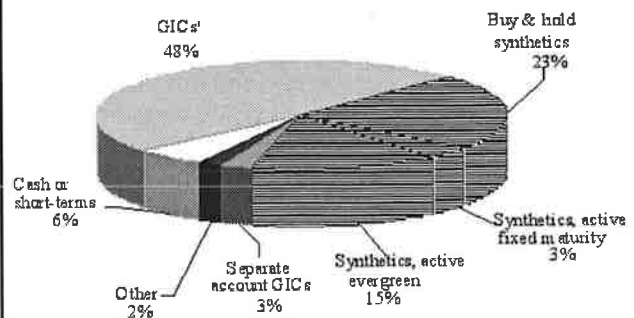
	Individually Managed			Commingled	
	Total	External Mgmt.	In-house Mgmt.	Bank and Invest	Life Co. Full
SV assets (billion)	\$214.5	\$106.3	\$19.0	\$40.7a	\$48.5
Average fund size (million)	\$1.8	\$254.9	\$1,055.7	\$3.6	\$0.5
SV assets as % of plan assets	19.5%	14.8%	27.8%	N/A	26.5%
Blended rate (net, %)	6.35%	6.41%	6.74%	6.22%	6.21%
Modified duration (yrs.)	2.8	2.3	3.2	2.4	3.7
Credit quality ^b	3.2	2.7	3.4	3.0	4.5 ^c

^aDC assets only. ^bwhere 1=govts. and agencies, 2=AAA, 3=AA+, etc. ^cissuer quality

The following are some of the 1999 survey's key findings for the asset class:

- Overall credit quality for stable value funds is AA+.
- Average fund sizes in the survey ranged from \$1.1 billion for the jumbo funds managed in-house to \$0.5 million for life company full service Stable value funds. Stable value is well represented in all size segments of the DC market.
- Stable value funds were 19.5% of plan assets at year-end 1998, compared to 21.0% the previous year. Stable value funds were 14.8%, 27.8% and 26.5% respectively for externally managed, internally managed and life company full service segments.
- General account GICs constituted 48 % of the fund portfolios, with synthetics at 41 % and separate account GICs 3 % .
- Externally managed individual funds have 12.1 stable value issuers on average, while in-house funds have 13.4 and pools 20.4.
- Non-participating contracts comprised 35.2% of stable value fund portfolios at year-end 1998; fully 49.4% of the investments in stable value portfolios participate in gains and losses from changes in asset values and net participant withdrawals. These gains and losses are smoothed over time to ensure the fund's principal stability.
- New investment volume for stable value portfolios totaled \$46 billion during 1998. With a lower level of market interest rates during the year, yields on stable value placements fell to 6.13% from 6.55% in 1997.

12/31/98 Stable Value Fund Portfolio Composition



¹ including general account full service products

Performance Measurement Task Force Update

K. Daniel Libby, IBM Retirement Funds

Representatives from the SVIA Performance Measurement Task Force held a panel discussion at the annual conference sponsored by the Association. Participating in the panel discussion were this author and Paul Donahue from PRIMCO as co-chairs of the Task Force along with Kelley Fairbank from Frank Russell who serves on the committee as well.

Coinciding with the Task Force's Phase II, the purpose of this presentation was to allow the community the opportunity to review the direction of the Task Force once again and to foster public debate. I will attempt to summarize here briefly. However, recognizing that I am at risk of doing injustice to any of the presentations as they were given in full, I request the indulgence of my co-presenters at the outset for any license I may inadvertently take with their presentations.

Leading off, Kelley Fairbank gave an overview of fiduciary obligations and how performance standards are integral to meeting those obligations. The focus of her discussion paralleled the practices common in Defined Benefit markets with those in Defined Contribution markets. It is evident that all too often a different standard is applied even though there is no legal justification for such.

As presented, the importance of performance measurement cannot be overstated. It allows for the application of many standard tools that are common in other asset classes. Performance measurement gives the manager the information needed to confirm or modify his or her process; it also assists clients in determining how much value a manager is able to contribute, why and in which markets. What is clear is that there already exists a well-tested mechanism for calculating performance that can be readily applied to Stable Value with only minor adjustments and/or clarifications.

Picking up from where Kelley left off, Paul reviewed the rationale behind the efforts that the Task Force is undertaking and addressed the areas that pose special consideration for Stable Value funds.

As presented, it is important to keep in mind that the true audience for a total return market- (fair-) value performance measurement is plan sponsors and consultants. The intention is to provide a measure that would allow a client to ascertain, over shorter time periods, ex post, what have been the drivers of performance for a manager and when have those drivers been adding value. These are examples of performance-based analysis that have been available for some time to clients for other asset classes.

The purpose, in part, is to assist in de-mystifying stable value to the professional investment community at large and even in some small way to the lay community as well. This would assist greatly in fostering the widespread use of stable value where appropriate and lend a greater sense of credibility to the asset class as a whole.

The purpose is not to seek to have investors discontinue the use of book value performance measures. They alone remain the only appropriate measures for reporting to participants. Furthermore, book value measures will continue to form the basis for asset allocation decision making on the part of participants. Further, crediting rates will continue to be disclosed as an Additional Disclosure under the proposed Performance Measurement Standards.

Several areas that are to be covered in the Performance Measurement Standards represent areas that pose special considerations for Stable Value funds. Paul's presentation touched on each of these briefly with the intent of raising the awareness of the community as the final document continues to be drafted. Each of these areas has been, in turn, the culprit in holding up the committee in lengthy exchange; and the committee is optimistic that the final wording on each point is rapidly reaching a consensus.

Firstly, integral to any Performance Measurement Standard for Stable Value funds shall be the treatment of GICs. Since the standard is an economic value-based standard and GICs do not have observable secondary market prices, the "economic" pricing of GICs will be a challenge that each manager is faced with at the outset. The Task Force has considered, at length, many alternative formulations, i.e., "how to" sections, that would direct the managers in deriving an economic valuation for GICs. There is a concern that any specific formulation would almost certainly be incomplete. A likely resolution to this quandary may be to have the document simply discuss the overriding precepts that should govern the calculation of economic valuation for GICs.

Performance Measurement continued on next page

Performance Measurement continued from previous page

Secondly, at the center of the controversy surrounding economic valuation of Stable Value funds has been the handling of the benefit responsive insurance that is a unique and integral part, either explicitly or implicitly, of these assets. The Task Force has engaged in considerable debate over various methods to either rigorously value or account for the "put option" that gives rise to Stable Value. Here again, a likely resolution seems to be gaining consensus. Inasmuch as the impact of cashflows, either on a "par" or "non-par" basis, are to be removed from the calculation of performance, the cost of purchasing this insurance will be disclosed and added back to gross up performance.

Thirdly, the creation of performance composites may require some special considerations in the Stable Value market. This arises from the dual facts that GICs are often mandated by client policies and total-rate-of-return performance benchmark indices do not exist for GICs. Debate continues as how to craft a document that marries the competing objectives of including only homogenous investment strategies within a composite and limiting the number of composites. A subgroup within the Task Force has been identified to craft this consensus.

Fourthly, because Stable Value management has been ongoing for many years some consideration may need to be directed toward transition or crossover issues in implementing a Standard in the Stable Value market. While no consensus has arisen, one possible resolution may be to announce some crossover date, such as January 2001, for the creation of these measures at each investment manager.

Lastly, due in part to the unique nature of Stable Value, certain Additional Disclosures are under consideration. These include credit quality, duration, market-to-book ratios, crediting rates, cashflow histories and par/non-par coverage ratios. Again, a subgroup within the Task Force has been identified to finalize this portion of the document.

" Performance measurement gives the manager the information needed to confirm or modify his or her process; it also assists clients in determining how much value a manager is able to contribute, why and in which markets. "

As the final presenter, this author discussed the implementation of performance measurement standards for Stable Value funds at IBM. The first portion of this presentation reviewed some of the thinking behind this topic and related topics at that plan sponsor. This review included the rationale behind performance measurement for Stable Value funds, strategic allocation for these funds, implementation of a performance measurement standard for these funds and considering the efficiency of GICs. As shown in the presentation, each of these discussions reviewed prior articles from the presenter in *Stable Times*. In addition, the presenter covered the actual performance of the IBM Stable Value Fund, which is expected to be in compliance with the Standard when published.

At the conclusion, time remained for questions from the audience. Clearly a small minority of members remained strongly opposed to implementing an economic value-based performance standard for Stable Value. In response, the presenters noted that these Standards arose to meet a demand from some segments of the community. Yet, they are intended only as guidance and in the end are, of course, optional for each manager to implement.

Mark Your Calendar!

The SVIA 2000 National Forum
is scheduled for
October 10-12, 2000
at the
Monarch Hotel in Washington, DC.

Got Ideas?

Stable Times needs your input —
so if you would like to contribute an article or
just have suggestions, please let us know.
You can contact SVIA at
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Ideas for the first issue of the new millennium
are appreciated before February 1.

Taking Stable Value Global

By Randy Myers

Japan would seem like an ideal candidate for stable value products. Its \$2 trillion pension market is the largest outside the U.S., and its rapidly aging population has a conservative investment culture, said Sandy Chotai, global asset consultant with Towers Perrin, at the SVIA 1999 National Forum in Washington, D.C. Next year, new provisions in Japan's tax code will allow employers to introduce defined contribution plans patterned on the 401(k) model in the U.S. And finally, sponsors of new DC plans will be required to offer at least one low-risk investment option featuring a principal guarantee.

Other international opportunities would seem to abound as well. In continental Europe, defined contribution plans are becoming increasingly popular, especially in Switzerland, Denmark, Spain, Italy and France, where, again, investors tend to be conservative, with a risk profile far more suited to investing in stable value than the risk profile of the typical U.S. investor. DC plans are also growing in popularity in Australia. And in Hong Kong, a new DC system is being introduced in 2000 that will require plan sponsors to offer at least one "capital preservation product."

"I think we will see increasing demand for stable value investment options as the DC model takes root around the world," observed Larry Zimpleman, senior vice president, global expansion, for the Principal Financial Group.

Yet the U.S. stable value industry faces considerable hurdles in transferring their products and know-how to the international marketplace. For starters, the very existence of stable value products depends on having the flexibility to account for participant balances at book value—and in Japan, as in most of continental Europe, that flexibility doesn't currently exist, said Paul J. Donahue, director of product development for PRIMCO Capital Management. Getting approval to do it would likely require government sanctions, he said, which in turn would require the patient work of experts, especially in Japan.

Why? Unlike their counterparts in the U.S., Japanese accountants play little role in setting accounting standards. Instead, that responsibility is held by the Business Accounting Deliberation Council, a division of the Ministry of Finance. And when pensions are at issue, the Ministries of Health and Welfare, Industry and Trade, and Labor can also be involved. Combine Japan's cultural preference for consensus and its general conservatism with the possibility of involving multiple government entities to approve accounting changes, and the stable value industry faces significant barriers to innovation in Japan, Donahue said.

Donahue also noted that the yield curve in Japan is highly compressed right now, which suggests that stable value products invested in intermediate-term fixed-income securities—the usual approach in the U.S.—likely would not offer returns sufficient to attract Japanese investors. In addition, he said, the cost of the wrap contracts needed to guarantee principal in Japanese stable value funds is likely to be significantly higher, at least initially, than it is in the U.S., since issuers will need to recover their development costs and because they have no experience base from which to develop a pricing model. Again, this would lessen the appeal of stable value products.

In the U.K., the stable value industry also finds itself confronted with a compressed yield curve, but a less restrictive regulatory environment. British accountants have considerable flexibility, and often look to American best practice where no precedents exist, Donahue said. On the other hand, U.K. investors tend to be much more aggressive than their counterparts in continental Europe, a negative for anybody hoping to market a stable value product there.

Despite these challenges, Donahue—whose own firm has been exploring opportunities in the U.K., Japan and Hong Kong—stressed that stable value products should appeal to many investors outside the U.S., particularly since their risk-reward tradeoff is superior to money market funds and many intermediate-term bond funds as well.

"Pension assets outside the U.S. are growing rapidly, and there is a major shift from defined benefit to defined contribution plans," agreed Chotai. "As participants become more sophisticated, we should see increased investment options in those defined contribution plans, and that should present an opportunity for the stable value industry."

To best take advantage of those opportunities, Donahue suggested that U.S. financial institutions partner with local companies in those international markets. Chotai noted that a number of alliances have already been formed in anticipation of tackling the DC market in Japan, including Travelers/Nikko, Prudential/Mitsui, Nippon Life/Putnam, and Sumitomo Life/Templeton.

"Going it alone in establishing stable value options abroad is unlikely to be profitable," Donahue said. "Resident affiliates know the rules of the game, not only economic, which Americans are quick to pick up, but also social. When the required expertise must be purchased for stable value alone, it is likely to come at too high a price. With affiliates, access to expertise at working the regulatory levers is available at little or no direct cost."

Stable Value: The Best-Kept Secret in 401(k) Plans?

By Randy Myers



Are stable value funds the best-kept secret in the 401(k) market? By one measure, they're still wildly popular, accounting for \$182 billion of plan assets at the end of 1998, up 53% from 1992, according to Spectrum Group, a research firm in Windsor, Connecticut.

By other measures, though, stable value funds are drifting off the radar screen. In 1992, stable value assets accounted for 29% of total 401(k) assets, according to Spectrum. By the end of last year, they accounted for just 16%. And while plan participants were directing nearly 13% of their new 401(k) contributions into stable value investments as recently as 1994, they channeled only 5.7% to stable value in 1998.

Part of the problem, explains Wayne Gates, general director of John Hancock Financial Services, has been the extraordinary performance of the equity markets over the past several years. With the S&P 500 posting compound annual return of 30.5% from 1995 through 1998, it's been hard to get people excited about stable value returns in the neighborhood of 6.8%, Gates told listeners at the SVIA 1999 National Forum. The disparity in returns has been

especially problematic because that's where the media and investment education programs are most tightly focused.

But other factors are contributing to the declining prominence of stable value investments, Gates said. They include the industry's narrow marketing focus on 401(k) plans that already have stable value options, almost to the complete exclusion of potential new customers; the product's status as a purely institutional offering, at least until the very recent introduction of a few stable value mutual funds for the IRA market; and a general lack of recognition of stable value funds in many financial planning models. Finally, Gates said, the segment of the market where stable value plans have received the warmest welcome—large companies—has accounted for much less of the new job growth over the past decade than have small companies, whose newer plans are less likely to include stable value options.

Eric Kirsch, managing director and chief investment officer of the Structured Fixed Income Investment Group at Deutsche Asset Management, adds that stable value's unique characteristics have also contributed to its low profile. Personal finance reporters for consumer publications "don't have a clue about stable value," he lamented, and, because stable value funds can't comply with the performance reporting standards of the Association for Investment Management and Research, they're even glossed over by some investment professionals.

"We're non-standard," Kirsch said flatly. "We're not in the mainstream."

Which isn't to say that the industry should tuck its tail and slink away. While there isn't much that can be done about matching the stock market's recent returns, almost all of the other factors weighing against the stable value industry can be addressed and mitigated, said George Baumann, president of PRIMCO Capital Management Inc. Joining Gates and Kirsch at the SVIA 1999 National Forum, Baumann exhorted the audience to:

- Continue to drive home the message that stable value funds are the best low-risk investment option, offering investors a chance to accumulate the maximum amount of wealth in the low-risk sector of the investment arena.
- Develop a standardized performance measurement system for stable value products.
- Maximize the use of the Stable Value Investment Association to promote stable value investments, either by raising membership fees to allow the hiring of more staff or by convincing the membership itself to become more involved in the effort.
- Court the media. "Nothing is more important," Baumann said, "than getting good articles out there that are well written and not 'tainted' by pushing one product over another. The value of public relations is unbelievable."
- Communicate to, and educate, financial planners, on the virtues of stable value products.
- Export stable value products to the international market. "We have a built-in client base in the form of multinational companies

Best Kept Secret continued on next page

Best Kept Secret continued from previous page

with stable value funds that are waiting to include stable value in their overseas retirement plans," Baumann said.

- Refrain from getting overly aggressive when structuring stable value products, particularly in terms of how they are invested. "Pushing the envelope is different than being innovative," Baumann warned. "Bad events have repercussions for all of us."
- Continue to develop stable value products for the retail market, which he said represents "a big way to attract and retain dollars."
- Be persistent. "Some plan sponsors refuse to believe our story," Baumann said. "But we truly do offer the best returns in the low-risk quadrant" of the investment arena.

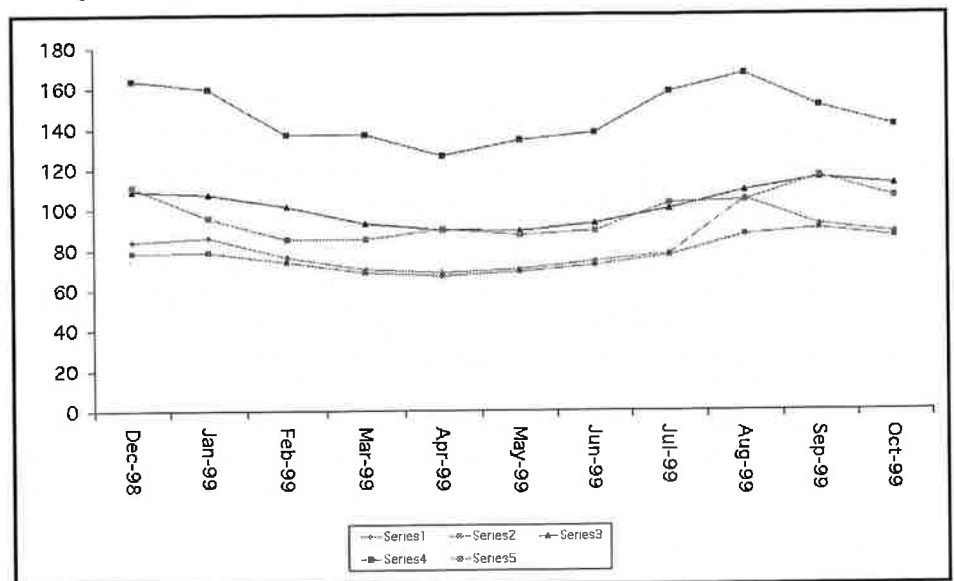
Despite the challenges that face the stable value industry, Kirsch added that the industry also enjoys real growth opportunities, particularly in the small-plan defined contribution market, which today is dominated by mutual fund companies, and in the IRA market.

"By the year 2000, IRA assets should be larger than the assets in either the defined-benefit or the defined-contribution markets," Kirsch said. "With stable value products now available for the IRA market, we have a tremendous opportunity to grow with it."

Tracking Stable Value Yield Spreads

Karl Tourville, Galliard Capital Management

Interest rates moved modestly higher in the third quarter as market participants continued to fret over concerns of stronger economic growth, the prospects for inflation and the direction of Federal Reserve monetary policy. The Federal Reserve has moved to tighten monetary policy and continues a bias towards raising short-term interest rates to cool economic activity and preempt inflationary pressures. As such, longer term interest rates have risen in a fairly dramatic fashion this year, over 1.25 percentage points, which is the second highest rate of increase ever in interest rates in a yearly period. (1994 still holds the record) Further plaguing bond investors this year has been continued widening of risk premiums, especially in the corporate sector. This phenomena began over one year ago in reaction to liquidity concerns in the market tied the hedge fund related financial crisis. Adding to the record widening of risk premiums last fall has been a surge of corporate issuance in the last several months combined with a decreasing appetite for holding inventories of bonds by Wall Street. This supply/demand squeeze has pressured risk premiums in a market already experiencing liquidity concerns.



Hard Sell: Attracting Financial Advisors to Stable Value Funds

By Randy Myers

It is easy to imagine that financial planners are eager to steer some of their clients' assets into stable value mutual funds now that they are available for the IRA market. After all, a huge chunk of IRA assets represent rollovers from 401(k) plans, where stable value funds are already popular with many investors. And when the stock market fluctuates wildly, as it has this year, any investment that can promise consistently positive returns has inherent appeal.

“ This is a very new thing for financial planners, who are inundated with new products every day. Being able to cut through the clutter is very important to them. ”

Ultimately, all of these factors bode well for the success of stable value mutual funds. But as one financial planner explained to listeners at the SVIA 1999 National Forum, it isn't likely that the financial planners, who influence the decisions of many IRA investors, will jump onto the stable value bandwagon overnight.

“There are a number of roadblocks to acceptance in the financial planner community, beginning with the uniqueness of the product,” said Greg Curry, a certified public accountant, certified financial

analyst, and president of Pillar Financial Advisors. “This is a very new thing for financial planners, who are inundated with new products every day. Being able to cut through the clutter is very important to them.”

Curry also noted that financial advisors assume a risk when they introduce any new product to their clients, should that product fail to perform to expectations. Yet they assume almost no risk by not introducing stable value funds, he said, since, for now, most of their clients don't know about them anyway.

Given that most financial planners aren't familiar with stable value funds either, Curry warned that the sponsors of these funds have a hefty educational effort ahead of them. “Financial advisors like to know the inner workings of the products they sell, and right now, they don't have a clue (about how stable value funds work),” Curry said. “This means that the wholesalers and sales people working for fund sponsors will not only have to know this information, but also will have to be able to explain it.”

Even if fund sponsors work their way past these roadblocks, Curry warned that financial planners will still want satisfactory answers to a couple of daunting questions before they are inclined to sell stable value funds. Most important: How and where will they get access to the funds, and what trading restrictions will be placed on the funds? If the primary broker-dealer an advisor works through doesn't have access to stable value funds, most advisors won't seek them out on their own, Curry said. As for trading restrictions, he said, financial planners hate them.

“The restrictions we're used to are restrictions that say something like, ‘You must stay in this fund for X months or you'll pay a fee,’” Curry said. “That's easy. I can understand that. But if you tack on something else that planners have to explain to their clients, such as ‘if this interest-rate trigger is met, you'd can't pull your money out of your stable value fund when you want to,’ they're going to balk. Rate-spread triggers are a difficult hurdle for advisors to overcome.”

To date, all of the stable value mutual funds that have been introduced for the IRA market feature trading restrictions that kick in if interest rates spike sharply higher. Under such a scenario, the yields on money market funds would spike up, too, prompting many IRA investors to swap assets out of stable value funds and into money market funds or other higher-yielding securities. The restrictions are designed to prevent that from happening, since it would mean that the funds would have to liquidate their assets at the worst possible time, harming investors who stayed in the fund.

“The education of advisors about the use and appeal of stable value funds is going to be difficult,” Curry concluded. “But in the industry's favor, we did some of this work when other synthetic investments first started to appear years ago.”

Asset Allocation: Age Matters

By Randy Myers

How much more conservative are older investors than younger investors? Dramatically so, according to Eileen Leonardi, Fidelity vice president and group leader for managed income.

Speaking to the 1999 SVIA National Forum in Washington, D.C., Leonardi reported that among the 5.9 million participants in 401(k) accounts which are custodied with Fidelity Investments, those participants 65 and older have 30% of their assets allocated to stable value funds, while 20 year olds have only 5% allocated to stable value.

Given that the American population is aging—a phenomenon outlined at the Forum by demographics expert Mark Goldstein—this asset allocation bias should work in favor of the stable value industry for many years to come. Other statistics compiled by Leonardi suggest that it might already be happening:

- While net transfers into and out of stable value funds in Fidelity managed 401(k) plans were negative from 1994 through 1997, they turned positive in 1998 and 1999.
- The rate of new contributions to stable value plans fell steadily from 1995 through 1998, but that figure has turned up so far this year.



401(k) Investors React Quickly to Market Volatility

By Randy Myers

While most participants in 401(k) plans trade very little -- fewer than 1% make transactions in any given month, according to Greg Ellis, a senior vice president with Morley Capital -- those who do trade tend to do so frequently, and, when the financial markets turn volatility.

According to data compiled by Hewitt Associates in surveying 1.4 million 401(k) account records, 83% of the transfers of money that were made during the month of October 1998 went into stable value funds, Ellis told the SVIA 1999 National Forum. October 1998 was, of course, a month in which 401(k) investors were getting statements reflecting the bad news that the average domestic stock mutual fund had produced a loss of 15% in the just-completed third quarter.

After watching the market regain much of its third-quarter loss during the month of October, 401(k) investors did an about face: 66% of all transfers that month went into large-cap equity funds. Of all money transferred out of existing investment options, 59% was taken from stable value funds.

By the end of the year, investors appeared to be nervous once again about the market's gyrations. In the transfers made during the month of December, Ellis said, 91% of the money went into stable value funds.

Asset Allocation Models: Still Searching for Stable Value

By Randy Myers

Imagine running for political office without having your name on the ballot. That's how many providers of stable value products feel as they compete with mutual fund companies for investor dollars.

The problem lies with the asset allocation models that fund companies, brokerage houses and other financial services firms are making available, with increasing frequency, to individual investors. The models are designed to help investors decide how to divvy up their money among the major asset classes depending upon their risk and return objectives. But most of the models don't treat stable value products as a distinct asset class; instead, they lump them together with bond funds. As a result, the models are incapable of recommending that investors allocate any of their money specifically to the stable value sector.

That's a troubling notion to the stable value industry, which notes with pride that stable value products produce returns that are comparable to intermediate-term bond funds, but, thanks to their principal guarantee, expose investors to less risk.

Nonetheless, several speakers at the SVIA 1999 National Forum cited numerous hurdles to having stable value funds recognized as a distinct asset class, most notably the paucity of historical performance data for the sector. Although stable value products have been around since the late 1970s, when guaranteed investment contracts became popular, the current crop of stable value products, which includes synthetic GICs, are best represented by benchmarks that go back only about 10 years, said Lori Lucas, an investment consultant with Hewitt Associates. By comparison, data on stocks, bonds and cash are readily available going back more than 70 years.

"Because we've had a very benign interest-rate environment, the existing data for stable value tends to exhibit very low standard deviation (volatility) and high returns," explained Lucas. "So that makes stable value look very attractive versus a bond benchmark such as the Lehman Brothers Aggregate index. Put that data into an (asset allocation) optimization model, and you end up with almost nothing (of your fixed-income allocation) in bonds, and everything in stable value."

To create more diversified portfolios, plan sponsors who've tried to model stable value funds typically use a proxy, such as Treasury bills, even though, in that case, they know the returns will be lower, Lucas said.

Scott Lummer, chief investment officer for the 401(k) Forum, an Internet-based education resource for 401(k) investors, said that in addition to the problem of finding historical data, his firm doesn't treat stable value as a unique asset class for three other reasons: the inconsistency in the average maturity of stable value fund holdings, which he indicated range from one year to seven years; inconsistency in the type of securities in which stable value funds are invested; and the similarity of most stable value funds to short-term bond funds.

Lummer said that when considering whether to recommend a stable value fund to 401(k) participants, his firm looks at the historical real returns of that specific fund. His firm also considers the maturity and credit risk of the securities held in the fund; the credit risk associated with the wrapper (the financial institution guaranteeing the principal and accumulated interest of the fund and the ability of participants to make withdrawals and transfers at book value); and the exit provisions of the fund, such as withdrawal limits and equity wash rules.

"Frankly, I don't know why you want to be your own asset class," Lummer told his listeners at the National Forum. "Over the past 10 years, stable value has done very well without that distinction."

Paul Lohrey, a stable value portfolio manager for Vanguard Group, the nation's second-largest mutual fund company and an administrator of 401(k) plans for corporate clients, expressed a similar sentiment. Based on investor behavior, he said, recognizing stable value as a separate asset class is simply "beside the point."



SVIA Board Changes

Although SVIA's voting members were faced with a very difficult choice—selecting five individuals from a field of 26 great candidates, the choice was made. Karen Chong-Wuff, Dupont; Wendy Cupps, PIMCO; Ben D'Angelo, Bell Atlantic; Wayne Gates, John Hancock; and Susan Graef, Vanguard have been elected to serve three year terms beginning January 1, 2000. Congratulations to Karen, Ben, Wendy, Wayne and Susan!

The five new members will be filling positions vacated by retiring members: Kelli Hueler, Hueler Companies; John Milberg, Pacific Life; Klaus Shigley, John Hancock; Al Turco, Pepe & Hazard; and Michael Wyatt, Dupont. Although these five are retiring from the Board, you can look forward to their continued participation and leadership

Stable Value Mutual Funds for IRA Investors

Wendy Cupps, PIMCO

Of the \$2 trillion currently invested in mutual funds, the IRA market attracts approximately 50% - and that percentage is growing. However the percent of IRA assets invested in stable value remains very close to 0%. The question many stable value providers are asking themselves today is whether we should try to capture this market potential. "Why wouldn't we?" answered Rob McCormish, speaking at the SVIA 1999 National Forum. His firm, Certus Asset Advisors is one of several firms that may launch a stable value fund for IRA investors.

"People are living longer, and this means they have to invest their money longer. And in later years, they tend to want to be conservative with their investments. Stable value is the best low volatility, conservative investment option there is," McCormish explained. The new mutual funds designed for IRA investors hope to capture this sizable market potential, concluded McCormish.

Laura Dagan, from Dwight Asset Management Company, spoke about their mutual fund - the Dwight Capital Preservation Portfolio. She explained that though it was complicated and time consuming to set up, they made the decision to launch their fund based on demographic reasons." The boomers fueled the 401(k) market," she explained, "they are getting close to retirement and will want to roll their 401(k) assets into to IRA's." Dagan commented that participants are taking lump sum distributions totaling approximately \$288 Billion per year, with 41% being redirected to IRA investments, with nearly half of those investments in mutual funds. The percentage increases to 88% for plan participants with balances of \$100,000 or more. "So there is substantial opportunity here" noted Dagan.

"Designing the mutual fund was tricky" Dagan explained. Synthetic GICs and a liquidity buffer are used because the SEC prohibits illiquid investments such as GICs. The fund's Board of Directors and auditors must approve the valuation of the wrapper. The wrap providers have no real history to look at when determining the risks inherent in these funds. And evaluating distribution channels is extremely important to the success of the fund.

The structure of stable value mutual funds varies by provider. They typically invest in investment grade issues with some funds allowing a limited allocation to B and BB issues. Most allow for the use of options, futures, and swaps, with some permitting limited currency and equity exposures. The duration of most funds is typically 2 - 2.5 years, and expenses are generally capped at 95 - 125 bps. Wrap fees average 20 bps, and a 2-3% redemption fee is common to protect the wrapper from participant arbitrage opportunities with competing funds. In some cases this redemption charge exists all the time, while for some funds it may be waived for specified types of withdrawals or market circumstances.

Referencing the Aesop fable - The Goose that Laid the Golden Egg, Steven Butters, from CDC Capital, offered a wrapper's perspective on these funds. In this scenario, the golden egg is represented by the \$90 billion currently invested in money market mutual funds in the IRA market. "Stable value funds have the potential to attract this flow. While the investment manager is the farmer and the participants are the farmer's children, the wrapper doesn't want to be the goose." He reiterated that wrappers have little real data to look at in ascertaining risks. There is no equity wash or 12 month put feature to protect them . . . so the triggers become very important, said Butters.

He also feels that it is important that the investment management strategies employed in these funds are consistent with the "moral" of the story. As a wrapper, he wants to feel comfortable that the managers understand the implications that their duration positions and new contributions will have, that they are conservative in their search for yield, and have experience with stable value investing. Butters cautioned that wrapper capacity could be an issue for these funds in the future as the current roster of providers may not be willing to take on large flows if these funds take-off.

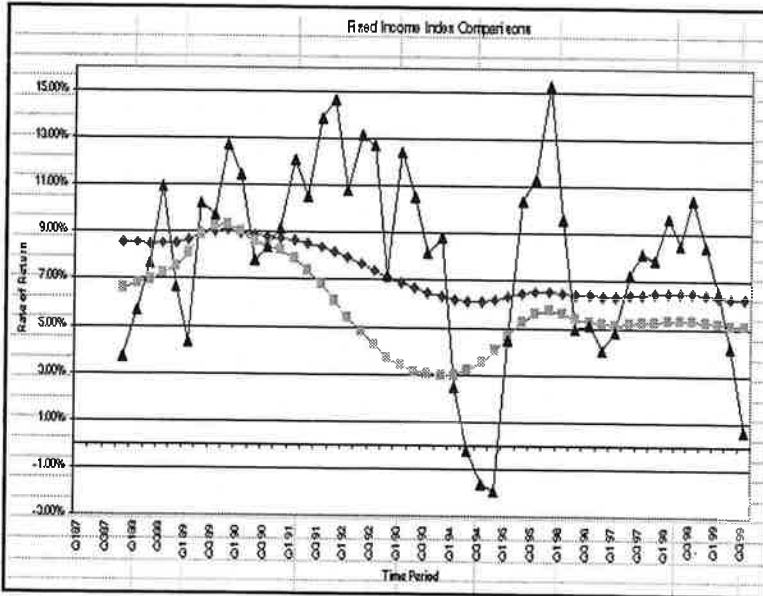
Given the number of stable value mutual fund registrations, it is clear that several providers agree with the panelists' views that stable value mutual funds may attract significant IRA assets. But there are still others who have decided to take a "wait and see" attitude . . . waiting for the retail investor to "Show me the money!"

"Stable Value—Better than Ever"

Janet Jasin Quarberg, Hueler Companies

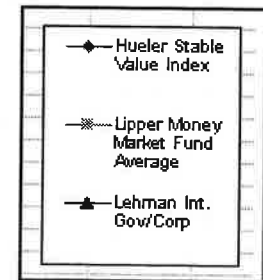
The performance of the Hueler Stable Value Index continues to surpass that of both the Lipper Money Market Average and the Lehman Int. Gov/Corp Index on a one and three year basis. Stable value has outperformed Money Markets by more than 100 basis points annually over the past one, three and five year periods. Bonds have had a difficult year, reporting a .63% one year return compared to Stable Value's 6.22% more than a 5.50% difference.

Volatility gap for the indices continues to widen. Over the past five years, the standard deviation for the Money Market and Stable Value Indices are almost exactly the same, hovering at 11 and 18 basis points respectively. While for the same time period, the Lehman Intermediate Gov/Corp shows significant volatility at 435 basis points.



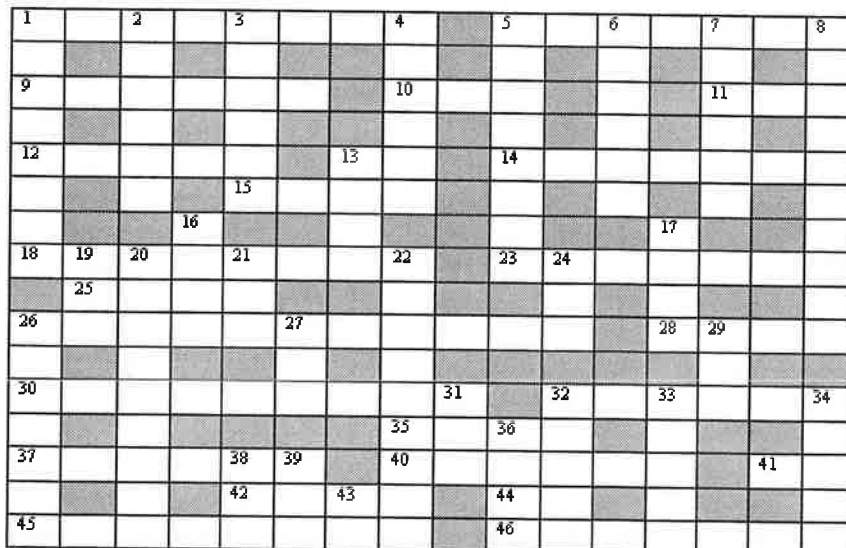
As of 9/30/99	Hueler Stable Value Index	Lipper Money Market Average*	Lehman Intermediate Gov/Corp
1 Year Return	6.22%	5.12%	0.63%
3 Year Return	6.38%	5.22%	6.33%
5 Year Return	6.39%	5.31%	7.08%
5 Yr Standard Deviation	0.11%	0.18%	4.33%

*The Lipper MM returns have been grossed up by an average Lipper fee of 18 bps.



Stable Value Crossword Puzzle

Allen Fen, Fen Associates



Across

- Assign
- Above Par
- Take for granted
- Western State (abbrev.)
- Animal enclosure
- Earning rate
- Pronoun
- Giving to church
- Zippy's exclamation
- Satisfied
- Dylan biographer
- Marine animal
- DC Investor
- French we
- Excess
- Fruit snack
- Tex-mex treat
- Spanish queen
- Spanish tea
- choice, decision
- cost

Down

- statement of findings
- shine
- provoking laughter
- shun
- the science of government
- hatred
- damage, lessen
- faithful to one
- Statistic
- decree
- Japanese noodle
- Actuarial designation
- bring to a close
- Heavyweight champ
- Mining and drilling write-off
- Natural disaster bonds (abbrev.)
- Mortgage structure
- rent
- bank rate
- Mexican T-bill
- Approximate (abbrev.)
- Hawaiian wreath
- Western state (abbrev.)