

# ABSOLUTE RETURN STRUCTURE REVIEW

EMPLOYEES' RETIREMENT SYSTEM  
OF RHODE ISLAND

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# ABSOLUTE RETURN OVERVIEW

- **As part of the implementation series discussions, we have put together a structure review for the Absolute Return portfolio**
- **The Absolute Return portfolio has a strategic asset allocation target of 6.5%**
  - The allocation resides within the Volatility Protection category (15% target) which is part of the broader Stability sleeve (33% target)
- **Long-term results for the portfolio have been impressive with high-single digit returns (net of fees), low volatility, and a high Sharpe Ratio**
- **There are modest drawbacks to the allocation including a lack of liquidity and high fees**
  - That said, the broader portfolio is very liquid and parts of the portfolio, such as the public equity allocation, are very low cost

# WHAT ARE ABSOLUTE RETURN STRATEGIES?

Absolute return strategies aim to improve long-term risk-adjusted returns of a portfolio by **lowering volatility and correlations**

**Key attributes to consider when allocating to absolute return strategies:**

- ✓ **Low correlation and beta vs. a stock-bond portfolio**
- ✓ **Diversification of risk factors**
- ✓ **Ability to monetize gains during market drawdown**



**Absolute return strategies can vary in key attributes thereby allowing investors to customize portfolio allocation to fit different**

# PORTFOLIO SUMMARY

Total Portfolio Assets (\$millions)	\$11,065
Total Absolute Return Assets (\$million)	\$729
Number of Absolute Return Managers	6
% Actively Managed	100%
Benchmark	HFRI Fund of Funds Index
Expected Return (10-Year)*	5.6%
Expected Risk (Standard Deviation)*	8.6%

## Stated IPS Portfolio Objectives

- Absolute return investments seek to generate performance through active selection of securities and asset classes, with little-to-no consistent bias to broad markets (i.e. beta). Investing in a broad range of securities including equities, fixed income, commodities, currency, and derivatives, absolute return funds serve as diversifiers, seeking returns from active investment decisions, both long and short (i.e. alpha).**

		Current Target	Actual – 4/30/2024
Growth	<b>Global Equity</b>	<b>40.0%</b>	<b>36.7%</b>
	Private Equity	12.5%	17.0%
	Non-Core Real Estate	2.5%	2.3%
	<b>Private Growth</b>	<b>15.0%</b>	<b>19.2%</b>
	<b>TOTAL GROWTH</b>	<b>55.0%</b>	<b>56.0%</b>

Income	Equity Options	2.0%	1.7%
	Liquid Credit	5.0%	4.2%
	CLO Mezz/Equity	2.0%	2.4%
	Private Credit	3.0%	3.2%
	<b>TOTAL INCOME</b>	<b>12.0%</b>	<b>11.4%</b>

Stability	Long Treasuries	5.0%	4.6%
	Systematic Trend	5.0%	4.7%
	<b>CPC</b>	<b>10.0%</b>	<b>9.4%</b>
	Core Real Estate	4.0%	3.3%
	Private Real Assets (ex-RE)	4.0%	4.1%
	<b>Inflation Protection</b>	<b>8.0%</b>	<b>7.4%</b>
	Inv. Grade Fixed (ex-Treas.)	6.5%	5.3%
	<b>Absolute Return</b>	<b>6.5%</b>	<b>7.3%</b>
	Strategic Cash	2.0%	1.7%
	<b>Volatility Protection</b>	<b>15.0%</b>	<b>14.3%</b>
<b>TOTAL STABILITY</b>	<b>33.0%</b>	<b>31.0%</b>	



Assets as of April 30, 2024. \*Expected return and risk based on assumptions from 2023 asset/liability study.

# ABSOLUTE RETURN FRAMEWORK

Objective	Return Seeking	Blend	Diversification
Return Target Range (Net of fees)	Above 7%	Between 5%-7%	Below 5%
Volatility Target	51-65% of Equity Vol.	41-50% Equity Vol.	30-40% of Equity Vol.
Equity Beta	0.45- 0.55	0.36 - 0.44	0.20 - 0.35
Equity Correlation	0.71 - 0.85	0.51 - 0.70	0.35 - 0.50
Downside Market Capture (vs. S&P 500)	61% - 70%	31% - 60%	20% - 30%
Benchmark	HFRI Fund Weighted  Or  Custom mix based on strategy mix	HFRI FOF	HFRI FOF Conservative

The ERSRI Absolute Return portfolio is designed to provide portfolio diversification and low overall risk. The goal of the broader Stability allocation is to earn modest returns over the long term while providing the portfolio with resilience to three acute portfolio risks: extended equity market sell-offs, inflation surges, and asset price volatility spikes.



All target metrics are net of fees and over a broad market cycle.

# FRAMEWORK COMPARISON TO ERSRI PORTFOLIO

Objective	Diversification	ERSRI Absolute Return
Target Return / Actual Return (net of fees)	Below 5%	8.8% (annualized)
Volatility Target / Actual	30-40% of Equity Vol.	17% of Equity Vol.
Equity Beta	0.20 - 0.35	0.07
Equity Correlation	0.35 - 0.50	0.39
Downside Market Capture (vs. S&P 500)	20% - 30%	<0%
Benchmark	HFRI FOF Conservative	HFRI Fund of Funds Index

- Since inception, the ERSRI Absolute Return Portfolio has met its diversification objective
- The portfolio exhibits a low level of volatility and low correlation to equity markets
- The portfolio has also generated a very strong return which has been an added benefit

ERSRI return and risk statistics are actual portfolio results since inception (2017) through March 31, 2024. Beta and correlation measured against S&P 500 Information for the "Diversification" structure is based on target metrics net of fees and over a broad market cycle.



# HISTORICAL PERFORMANCE

## Trailing Period Performance as of March 31, 2024 (Annualized, Net of Fees)

	ERSRI Absolute Return	HFRI Fund of Funds Index	S&P 500	Bloomberg Aggregate	60/40 Portfolio	3 Month Treasury Bills
1 Year	10.45	9.68	29.88	1.70	14.27	5.24
3 Year	9.25	2.88	11.49	-2.46	3.27	2.58
5 Year	9.60	5.00	15.05	0.36	6.89	2.02
7 Year	N/A	4.37	14.09	1.06	6.75	1.90
10 Year	N/A	3.59	12.96	1.54	6.00	1.38

## Calendar Year Performance (Net of Fees)

	ERSRI Absolute Return	HFRI Fund of Funds Index	S&P 500	Bloomberg Aggregate	60/40 Portfolio	3 Month Treasury Bills
2023	8.52	6.07	26.29	5.53	15.37	5.01
2022	9.80	-5.31	-18.11	-13.01	-16.02	1.46
2021	9.35	6.17	28.71	-1.54	10.20	0.05
2020	10.93	10.88	18.40	7.51	13.49	0.67
2019	8.91	8.39	31.49	8.72	19.41	2.28
2018	4.47	-4.02	-4.38	0.01	-5.52	1.87
2017	N/A	7.77	21.83	3.54	15.41	0.86
2016	N/A	0.51	11.96	2.65	5.92	0.33
2015	N/A	-0.27	1.38	0.55	-0.98	0.05
2014	N/A	3.37	13.69	5.97	4.96	0.03



Performance is net of fees and annualized for periods greater than 1 year. 60% / 40% Benchmark is MSCI ACWI and Bloomberg Aggregate.

# RISK STATISTICS

## Standard Deviation (Annualized)

	ERSRI Absolute Return	HFRI Fund of Funds Index	S&P 500	Bloomberg Aggregate	60/40 Portfolio	3 Month Treasury Bills
3 Year	1.59	4.11	17.35	7.14	12.13	0.66
5 Year	3.14	5.99	18.21	6.08	11.99	0.59
7 Year	N/A	5.51	16.73	5.36	10.79	0.51
10 Year	N/A	4.97	15.09	4.76	9.71	0.48

## Sharpe Ratio

	ERSRI Absolute Return	HFRI Fund of Funds Index	S&P 500	Bloomberg Aggregate	60/40 Portfolio	3 Month Treasury Bills
3 Year	4.20	0.07	0.51	-0.71	0.06	N/A
5 Year	2.41	0.50	0.72	-0.27	0.41	N/A
7 Year	N/A	0.45	0.73	-0.16	0.45	N/A
10 Year	N/A	0.44	0.77	0.03	0.48	N/A

## Additional Risk Statistics

	ERSRI Absolute Return	HFRI Fund of Funds Index	S&P 500	Bloomberg Aggregate	60/40 Portfolio	3 Month Treasury Bills
Beta to S&P 500	0.07	0.25	1.00	0.16	0.63	0.00
Beta to Aggregate	-0.04	0.31	1.43	1.00	1.29	0.01
Best Month	2.67	6.85	12.82	4.53	7.79	0.66
Worst Month	-3.84	-7.63	-16.79	-4.32	-12.83	-0.01
% Positive Months	89%	65%	66%	63%	63%	96%

Statistics based on monthly, net of fee returns. 65% / 35% Benchmark is MSCI ACWI and Bloomberg Multiverse.  
Beta based on last 5 years. % Positive months since inception of fund. Up/down market capture since April 2018 – March 2024.





# KEY TAKEAWAYS

- **Results for the ERSRI Absolute Return portfolio has been impressive**
  - Strong total returns (~9% annualized since inception)
  - Low absolute volatility (~2.5% annualized since inception)
  - Low equity beta (0.07 beta to S&P 500 since inception)
- **While the primary objective of the asset class is to provide stability of returns and portfolio diversification, the portfolio has also delivered very strong total returns**
- **The asset class is less liquid than other parts of the portfolio, but as demonstrated earlier this year, we believe there is ample liquidity in the overall portfolio to meet ongoing cash needs**

# APPENDIX



# IMPLEMENTATION TOPICS

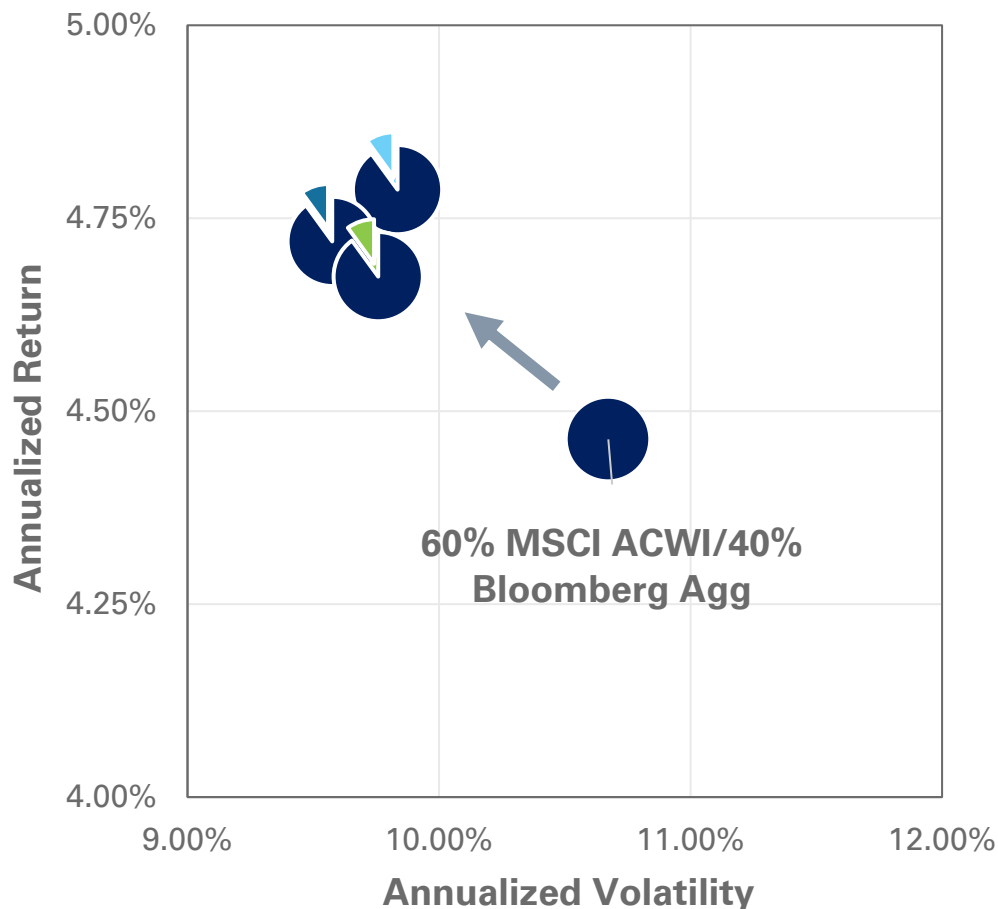
Portfolio Category	Current Approach	Topics	
Growth	<ul style="list-style-type: none"> <li>• Passively managed global equity with regional weights similar to the MSCI ACWI Index</li> <li>• Actively managed private equity</li> <li>• Actively managed non-core real estate</li> </ul>	<ul style="list-style-type: none"> <li>• Review active/passive decision with public equity</li> <li>• Review the role of factor investing</li> <li>• Review regional and market cap allocations within public equity</li> <li>• Pacing plan analysis for private market exposure</li> <li>• Liquidity planning and guardrails for private markets</li> </ul>	<ul style="list-style-type: none"> <li>✓</li> <li>✓</li> </ul>
Income	<ul style="list-style-type: none"> <li>• Actively managed “traditional” income exposure (high yield, convertible bonds)</li> <li>• Actively managed “non-traditional” income exposure (equity options, CLO equity)</li> <li>• Actively managed private credit</li> </ul>	<ul style="list-style-type: none"> <li>• Revisit the mix of “traditional” income assets</li> <li>• Discuss implementation of non-traditional income assets in today’s higher yield environment</li> <li>• Pacing plan analysis for private credit exposure (to be combined with other private assets)</li> </ul>	<ul style="list-style-type: none"> <li>✓</li> </ul>
Stability	<ul style="list-style-type: none"> <li>• Three sub-categories, primarily actively managed</li> <li>• <b>Crisis Protection:</b> Long Treasuries and Systematic Trend</li> <li>• <b>Inflation Protection:</b> Core Real Estate and Private Real Assets</li> <li>• <b>Volatility Protection:</b> IG Fixed Income, Absolute Return, and Cash</li> </ul>	<ul style="list-style-type: none"> <li>• Deep dive on each of the sub-categories to revisit the goals, objectives, and mix of underlying assets</li> <li>• Pacing plan analysis for private real assets exposure (to be combined with other private assets)</li> </ul>	<ul style="list-style-type: none"> <li>✓</li> </ul>

# ABSOLUTE RETURN STRATEGY TYPES

	GLOBAL MACRO	FUND OF HEDGE FUNDS	MULTI-STRATEGY/ MULTI-PM	EVENT-DRIVEN
Reasons to Invest	<ul style="list-style-type: none"> <li>▪ Diversification</li> <li>▪ Tactical opportunities</li> <li>▪ Attractive liquidity terms</li> </ul>	<ul style="list-style-type: none"> <li>▪ Broad hedge fund exposure</li> </ul>	<ul style="list-style-type: none"> <li>▪ Strong risk adjusted returns</li> <li>▪ Low market correlation</li> </ul>	<ul style="list-style-type: none"> <li>▪ Idiosyncratic risk/return exposure</li> <li>▪ Flexible mandates</li> </ul>
Reasons not to invest?	<ul style="list-style-type: none"> <li>▪ Complexity</li> <li>▪ High fees</li> </ul>	<ul style="list-style-type: none"> <li>▪ Low return expectation</li> <li>▪ High fees</li> </ul>	<ul style="list-style-type: none"> <li>▪ High fees and poor liquidity</li> <li>▪ Organizational Complexity</li> </ul>	<ul style="list-style-type: none"> <li>▪ Directional</li> <li>▪ Sometimes cyclical</li> </ul>
Risks	<ul style="list-style-type: none"> <li>▪ Key person</li> <li>▪ Leverage</li> </ul>	<ul style="list-style-type: none"> <li>▪ Over-diversification</li> </ul>	<ul style="list-style-type: none"> <li>▪ Transparency</li> <li>▪ Leverage</li> </ul>	<ul style="list-style-type: none"> <li>▪ Opportunity Cost</li> <li>▪ Relatively Illiquid</li> </ul>
Other Considerations	<ul style="list-style-type: none"> <li>▪ High fee strategies</li> <li>▪ Consider blending systematic and discretionary</li> </ul>	<ul style="list-style-type: none"> <li>▪ Opportunity cost risk, not nimble as direct multi-strategy</li> </ul>	<ul style="list-style-type: none"> <li>▪ Netting cost risk</li> </ul>	<ul style="list-style-type: none"> <li>▪ Emphasis on managers that can perform during both benign and turbulent periods</li> </ul>

# PORTFOLIO DIVERSIFICATION

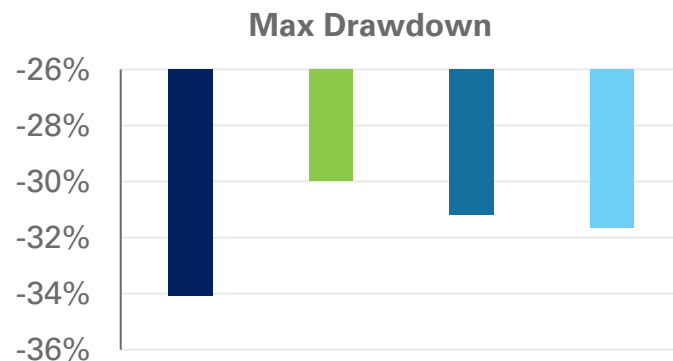
## IMPACT OF A 10% ALLOCATION TO PORTFOLIO RISK/RETURN



	10% Allocation To:	Sharpe Ratio
	Pure Diversification	0.40
	Diversification Tilt	0.39
	Diversification with Return Seeking Tilt	0.39

VS

	60% MSCI ACWI/40% Bloomberg Agg	0.33
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Data is from 1/2008 – 9/30/2023



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