PAPERS

Pennsylvania Association of Public Employee Retirement Systems

PO Box 61543, Harrisburg, PA 17106-1543

Website: ***www.pa-pers.org***

Spring 2014 (Vol. 9, No. 1)

In This Issue

Looking Ahead to More Networking & Educational Opportunities

8th PAPERS Fall Workshop

Sept. 17-18, 2014
(Wednesday-Thursday)
Philadelphia
Wyndham Hotel Historic District

Registration for the Fall Workshop will begin in July, 2014.

Corporate sponsorships for the 2014 PAPERS Fall Workshop are now being accepted. Contact PAPERS Executive Director Jim Perry *(717-651-0792 or perryja1@comcast.net)* today for more details.

PA's Capitol Welcomes PAPERS to Harrisburg

PAPERS

10th Annual Forum

Wednesday, May 28 – Thursday, May 29, 2014
The Harrisburg Hilton Hotel

The conference agenda appears inside on Pages 4-6.

The guaranteed group rate for overnight lodging at the Hilton Hotel will be available only for reservations made on or before 4/27/2014………hurry, time is running out! See page 8.

Conference registrations are due to PAPERS by 5/7/2014. The application is available on-line and also on page 7.

From the PAPERS Executive Director

Spring is on the way! It's time for the snowbirds to migrate north and the time for 2014 PAPERS Spring Forum is fast approaching.

We have put together an interesting educational program that will address some of the issues that are on most of our minds this year. The economic turmoil and liquidity crisis we have experienced is mostly in the rearview mirror. It's time for us all to move forward, knowing that we have done what we could to insure the future – both for our current retirees and all those hard working employees who are looking forward to the day when they can realize their dreams and fly south with the snowbirds as yet another winter approaches.

We hope that you will take this opportunity to join us on May 28th and 29th at the Hilton Hotel in Harrisburg for the 10th Annual PAPERS Forum. A draft agenda is included on pages 4-6 of this newsletter for your review. As you review the agenda, you'll notice that we plan to shed some light on the Detroit Bankruptcy issues and its ramifications for Pennsylvania's public pension plans. We will also cover many other timely topics on investments, legal issues and actuarial science.

Complete the registration form on page 7 right away so you don't miss any of the great educational and networking opportunities at this year's Forum. As a special treat will be having a reception in the Rotunda of the State Capital Building on Wednesday evening, May 28th.

I'll look forward to meeting you there!

Jim Perry

PAPERS Executive Director

Becoming a PAPERS Member is Easy

A current year PAPERS membership is required for attendance at the Spring Forum and/or Fall Workshop and to receive credits in the CPE and/or PPCP programs.

Public employee retirement systems (pension funds) can apply to become Participating Members; each Participating Membership includes one complimentary admission to both the Spring Forum and the Fall Workshop. Corporate providers of service to pension plans can apply to become Associate or Affiliate Members online at **www.pa-pers.org** or by contacting:

PAPERS
PO Box 61543
Harrisburg, PA 17106-1543

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Three PAPERS Membership Categories

- **Participating** ($95) - *Public employee retirement systems (pension funds)*
- **Associate** ($1,000) - *Corporate providers of legal and investment services to pension plans*
- **Affiliate** ($500) - *Corporate providers of other services, exclusive of legal and investment services, to pension funds.*

Corporate (Associate & Affiliate) Members also have the additional opportunity to become sponsors for PAPERS' two annual conferences – the Spring Forum and the Fall Workshop. Sponsors receive recognition in the printed and on-line materials produced for the conferences and also receive priority consideration to provide speakers and/or make presentations.

PPCP Webinars

By: Krista Rogers, PAPERS Board Member & Director of Education

The PPCP has been hosting webinars covering topics such as:

- ***The Value of Values and Their Valuations***
- ***Why Risk Matters***
- ***Securities Litigation Update***

Interest and attendance have been steady and I am looking for presenters for the fall months. The webinars are tentatively scheduled for the third Wednesday of the month and each month except May, June, September and December from 10:30-11:30 a.m. These webinars give members an opportunity to obtain credits toward the PPCP certification as well as gain pertinent information on topic relevant to Public Pension Professionals.

April's webinar was held on the 16th with Chuck Friedlander, F.S.A. presenting ***GASB 67 & 68 – Preparing for Change***.. Chuck is the Director of Actuarial Services with Municipal Finance Partners in Harrisburg, PA.

- July 16th – topic yet to be determined – open presenter slot
- August 20th – topic yet to be determined – presenter Schroder's

The PPCP Program is open to all trustees, mangers and administrative staff as well as service providers who offer services to public pension plans in Pennsylvania. I would encourage all members to look at enrolling in the PPCP and the webinars are a great opportunity to earn credits toward the certification.

Please contact me with any questions on the program or if you have an interest in being a webinar presenter.

Krista B. Rogers
PAPERS Director of Education/Certification Program
234 Gordon Street, Duboistown, PA 17702
Phone: 570-971-2528
E-mail: krista-rogers@comcast.net

PPCP Graduates Receiving "Diplomas" on May 28th at the Forum

- **Dana Descavish**, *Cambria County*
- **James Eckstein**, *Butler County*
- **Melva Vogler**, *PA Public School Retirement*

PAPERS Pennsylvania Association of Public Employee Retirement Systems

10th Annual Spring Forum Program Agenda

Wednesday, May 28 – Thursday, May 29, 2014

The Hilton Hotel, Harrisburg, Pennsylvania

All PAPERS events at the Hilton will be held on the second floor of the hotel

Tuesday, May 27th

6:30 PM – 8:00 PM **Conference Registration................................ Lancaster Room Pre-Function Area**

7:00 PM – 9:00 PM **PAPERS Board Dinner Meeting .... Governor Board Room**

Wednesday, May 28th

7:15 AM - 5:00 PM **Conference Registration/Exhibits................. Lancaster Room Pre-Function Area**

7:30 AM - 8:00 AM **Breakfast.. York Room**

All workshop sessions take place in the Lancaster Room

8:00 AM - 8:30 AM **PAPERS Welcome**.................................. James Perry, *PAPERS Executive Director*
Public Pension Certified Professional Program Overview.......................Krista Rogers
Recognition of CPPT Graduates

8:30 AM – 9:15 AM **Keynote Address**
The Future of Public Pension Plans in PA – Legislative Perspective
Speaker ....Rep. Glenn Grell, *State Representative 87th Legislative District*

Representative Grell of Cumberland County, a member of the PA Public School Employees' Retirement System Board of Directors representing the House Republican Caucus, will discuss what the Legislature is thinking about the future of public plans in Pennsylvania.

9:15 AM –10:00 AM ***Global Economic Overview – Opportunities Amid Uncertainty***
Speaker ....Milton Ezrati, *Lord Abbett*

Milton will make the case that risk assets are still the best bet. This is said less because good news is expected on either the economic or the policy front, but rather because these assets still offer attractive valuations…not as drop-dead gorgeous as last year but still attractive. On that basis, they do not need good news to offer attractive returns, just the absence of bad news.

10:00 AM–10:15 AM **Morning Break... Lancaster Room Pre-Function Area**

10:15 AM-11:00 AM ***Public Funds & ETFs: Thinking Outside the Box***
Moderator..................................Al Neubert, *A.S. Neubert Index Business Consulting*
Panelists .... Reginald M. Browne, *Cantor Fitzgerald*
Robert Trumbull, *State Street Global Advisors*

This session will take a look at the many ways that public funds can and should use exchange-traded funds. It will cover issues such as liquidity and institutional access at low cost as well as the availability of a variety of strategies across asset classes. The session will also be interactive to allow the audience to ask questions of the expert panelists.

Spring Forum Program Agenda *(continued)*

11:00 AM-12:00 PM **Trustee Panel**

Asset Allocation: What is in Your Portfolio/Are You Happy with These Assets?
Moderator...Seth Lynn, *Dahab Associates*
Panelists ....Krista Rogers, *Lycoming County*
Craig Ebersole, *Lancaster County*
Ed Cernic, *Cambria County*
Mark Rupsis, *Chester County*

This session will focus on knowing what assets are in your portfolio and understanding how they make their money. They will also talk about diversification among your various managers and diversification of asset classes.

12:00 PM - 1:00 PM **Lunch .... York Room**

1:00 PM – 1:45 PM ***Current Trends in Real Estate***
Moderator...To be announced
Speakers............................... P.J. Yeatman, *CenterSquare Investment Management*
Bob Zenouzi, *Delaware Investments*

P.J. will provide an update on the outlook for the real estate market. Bob will talk about real estate as a spread business, not a growth business, and his belief that it is possible to achieve excess returns at moderate risk levels in a variety of credit market environments.

1:45 PM – 2:30 PM ***Bank Loans Domestic and International***
Moderator........................ Bob Devine, *Public School Employees' Retirement System*
Speaker .... Joseph P. Lynch, *Neuberger Berman*

Joe will discuss Domestic Bank Loans and explain the many features and opportunities that exist. He will also describe the potential risks of this old asset class with a modern twist.

Speaker ....Julian Colville, *Alcentra*

Julian will talk about how as regulations prompt European banks to reduce the size of their balance sheets and re-allocate them, an opportunity exists for non-bank lenders to generate attractive risk-adjusted returns by lending directly to those banks and companies.

2:30 PM – 2:45 PM **Afternoon Break .... Lancaster Room Pre-Function Area**

2:45 PM – 3:45 PM **Alternative Investment Strategies Panel**
Moderator...To be announced
Hedge Funds .... Robert P. Covino, Jr., State Street Global/*SSARIS Advisors*
Private Equity.. Jackie Rantanen, *Hamilton Lane*

What is PE? – Jackie *will talk about the history, performance, cash flows & exposure of the private equity industry. Ms. Rantanen will also discuss how investors can access the asset class. It will be a general presentation touching upon all aspects of the private equity industry.*

3:45 PM – 4:45 PM ***Closing the Courtroom Door on Investors***
Speaker ....Darren Check, *Kessler Topaz Meltzer & Check, LLP*

This session will provide an overview of recent Supreme Court and Circuit Court decisions, pending cases, and corporate actions that are impacting the landscape and future of shareholder litigation. Over the past few years, shareholders' right to seek judicial redress for corporate fraud and resulting investment losses have been severely limited. Recent Supreme Court decisions have made it more difficult for public pension funds to recover for their members.

Spring Forum Program Agenda *(continued)*

6:00 PM – 8:00 PM **Reception/Tour at the Pennsylvania State Capitol Building**

Hosted by the following Platinum Sponsor Associate Member Firms:
Kessler Topaz Meltzer & Check (lead sponsor)
BNY Mellon
Cantor Fitzgerald
Schroders Investment Management
State Street Global Advisors

You are welcome to bring along your family members for this evening with advance reservation. Guides will be available to provide tours of the Capitol during your visit. A gala food/ beverage buffet will be located in the Main Rotunda.

Thursday, May 29th

7:30 AM-12:00 PM **Conference Registration/Exhibits................ Lancaster Room Pre-Function Area**

7:30 AM - 8:00 AM **Breakfast.. Allegheny Room**

All workshop sessions take place in the Lancaster Room

8:00 AM – 8:30 AM ***A Review of an Evening with Ben Bernanke***
Speaker .... Craig Ebersole, *Lancaster County*

8:30 AM - 9:15 AM **Understanding & Implementing Actuarial Assumptions**
Moderator...Krista Rogers, *Lycoming County*
Speaker ....Chuck Friedlander, *Municipal Finance Partners*

9:15 AM–10:00 AM **Outlook for Fixed Income as We Move Through Uncertain Times**
Speaker ....Matt Toms, *Voya Investment Management*

10:00 AM-10:15 AM **Morning Break... Lancaster Room Pre-Function Area**

10:15 AM-12:00 PM **The Implications of the Detroit Bankruptcy on Public Pension Plans in PA**
Moderator... James Allen, *PA Municipal Retirement System*
Panelists:
Attorney..Jennifer Mills, *PSERS/PMRS Legal Division*
Actuary... James E. Holland, *Cheiron*
Bond Manager.............................Sean McShea, *Ryan Labs Asset Management*
Local Plan Trustee ....Michael Hughes, *City of Harrisburg Retirement Systems*

In this session we will focus on the potential impact that the bankruptcy filing in the City of Detroit could have on public plans here in Pennsylvania, as well as around the country.

12:00 PM - 1:00 PM **Closing Luncheon.. Allegheny Room**

As of 4/24/2014 – subject to change

Registration for 10th Annual PAPERS Forum

May 28-29, 2014 at The Hilton Hotel in downtown Harrisburg, PA

Each individual attending must submit a separate registration form.

Conference Registration Deadline - May 7, 2014

Please indicate appropriate category (check one only):

☐ **Pension Plan Representatives** – Current (2014) PAPERS Participating Membership required
- ☐ First individual from pension plan – complimentary
- ☐ Each additional individual - $75

☐ **Service Provider Representatives** - *Firms providing investment management and legal services*
Current (2014) PAPERS Associate Membership required
- ☐ Each individual from organization - $750

☐ **Service Provider Representatives** - *Firms providing consulting services, exclusive of investment/legal*
Current (2014) PAPERS Affiliate Membership required
- ☐ Each individual from organization - $375

☐ **Platinum Sponsors**
Current (2014) PAPERS Membership required
- ☐ Four complimentary registrations
- ☐ Each additional registration - $750

☐ **Gold or Silver Sponsors**
Current (2014) PAPERS Membership required
- ☐ Two complimentary registrations
- ☐ Each additional registration - $750

Individual's name ______________________________

Preferred name for name tag ______________________________

Representing (name of pension plan or company) ______________________________

Mailing address ______________________________

City, State, Zip ______________________________

Telephone number (______) _____-________ **E-mail address** ______________________________

Please indicate all Forum events that you plan to attend (needed seating & meals arrangements):

Wednesday, May 28, 2014
- ☐ Continental breakfast
- ☐ Morning sessions
- ☐ Lunch
- ☐ Afternoon sessions
- ☐ Cocktail reception @ PA State Capitol

Thursday, May 29, 2014
- ☐ Continental breakfast
- ☐ Morning sessions
- ☐ Lunch

☐ **Check if interested in PPCP (Public Pension Certified Professional) Program**

Full payment of any fees due must be included with this registration.

You may pay the registration fee either by check or electronically through PayPal.

1. ***To pay by check.*** Please make check payable to: **PAPERS** and return with this application to: **PAPERS, P.O. Box 61543, Harrisburg, PA 17106-1543**
2. ***To use PayPal.*** Please access the PAPERS website (www.pa-pers.org) and click on "Spring Forum". Select the appropriate type of registration from the drop down box and follow the directions to have PayPal transfer the applicable fees automatically from your bank account to PAPERS. In addition to PayPal payment, you must also submit this registration form. Your completed conference registration form may either be mailed to: ***PAPERS, PO Box 61543, Harrisburg, PA 17106-1543*** or scanned, saved and e-mailed to: ***douglas.b@verizon.net.***

The PAPERS Forum group rate for overnight lodging of $128 plus tax at The Harrisburg Hilton is guaranteed only for reservations made on or before 4/27/2014.

2014 PAPERS Forum

Directions/Hotel Information

The 2014 PAPERS Forum returns to the Harrisburg Hilton on Market Square in downtown Harrisburg. The hotel is conveniently located at One North Second Street just steps away from Harrisburg's "Restaurant Row".

From New York/New Jersey
Take the George Washington Bridge to I-80 West, take 287 South to I-78 West to I-81 South, Exit 66. Take Front Street south approximately 5.5 miles to Market Street. Turn left onto Market Street; the hotel entrance is one block on the left just after crossing Second St.

From Philadelphia
Take PA Turnpike 76 West, get off at Exit 247, take I-283 North to I-83 south to Exit 43 (Second Street-Capitol complex). At the fourth traffic light, turn right onto Market Street and the hotel entrance is on the left.

From Baltimore/Washington
Take I-83 North to Exit 43 (Second Street-Capitol complex). At the fourth traffic light, turn right onto Market Street and the hotel entrance is on the left.

From Pittsburgh
Take PA Turnpike 76 to Exit 242, Take I-83 north to Exit 43 (Second Street-Capitol complex). At the fourth traffic light, turn right onto Market Street and the hotel entrance is on the left.

Parking - To access the Walnut Street Parking Garage connected to the hotel, travel on Market Street just past the hotel, turn left onto Court Street and follow the signs to enter the garage.

If you're interested in overnight lodging for the Forum

Harrisburg Hilton Hotel

One North Second Street (Market Square), Harrisburg, PA

Single or double rate - $128/night plus tax

The 10th annual PAPERS Forum will begin with breakfast on Wednesday, May 28, 2014 and continue through early afternoon on Thursday, May 29, 2014. PAPERS has arranged a special room rate for attendees at the Forum who desire overnight lodging on May 27th and/or 28th. **The group rate of $124 per night can only be guaranteed if reservations are made on or before April 27, 2014.**

To make room reservations on-line, log onto:
http://www.hilton.com/en/hi/groups/personalized/M/MDTHHHF-PAPERS-20140527/index.jhtml

To make room reservations by phone, please call Harrisburg Hilton at **717-233-6000** or toll-free **1-800-HILTONS** and ask for group code **PAPERS**.

For more information (driving maps, parking information and hotel details), click on www.Harrisburg.Hilton.com.

Special Thanks to our 2014 Forum Sponsors

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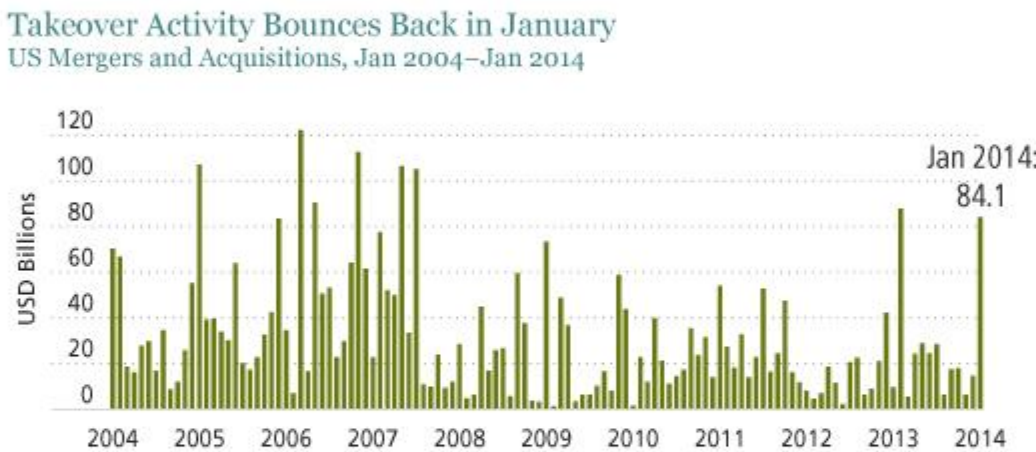
Investing in an M&A Boom

By James T. Tierney, Jr., Head of Concentrated US Growth at AllianceBernstein

Equity markets got off to a rough start in 2014, but a resurgence of corporate dealmaking has given investors reason to cheer. With executives' confidence increasing, and companies sitting on a mountain of cash, we think that the stage has been set for a sustained recovery of US takeover activity.

January was a great month for M&A. US companies announced deals worth $84.1 billion, marking the second-highest month of activity in more than six years (*Display 1*). And the reawakening of M&A has continued in February with Actavis announcing today that it agreed to buy Forest Laboratories for $25 billion, after last week's $45 billion deal between Comcast and Time Warner Cable. While it's too soon to say that a new trend has begun, several signs point to a better environment for M&A this year.



Through January 30, 2014
Includes deals announced between US-based acquirers and US-based target companies
Source: Cornerstone Macro and FactSet

Upbeat Executives Pay in Cash

Most recent deals are being funded with cash rather than with stock. When a company levers its balance sheet for a take-over, management is providing an implicit vote of confidence in the underlying economy. And optimism on the economy combined with historically low interest rates creates fertile ground for deals.

CEOs of US companies also have plenty of cash to spend. At the end of the third quarter, US nonfinancial companies had record cash holdings of $1.9 trillion, according to Federal Reserve data. What's more, M&A involving private firms might be more attractive for some companies than share buybacks, particularly after last year's stock market rally resulted in inflated share prices.

Beware of Megadeals

Corporate earnings should support this trend. We expect US corporate profits to grow by about 6% to 7% annually over the next five years, and selective acquisitions can help bolster revenue and earnings growth. Of course, there are many challenges to successful integration after a deal is done. That's why we prefer smaller deals that augment a company's current business over mega-takeovers that are difficult to integrate.

Take Amphenol, a US technology company that announced its purchase of GE's Advanced Sensors business for $318 million in November. The deal provides a nice incremental revenue boost and gives the company a foothold in the growing sensor market. In our view, this is a good example of a manageable acquisition with a solid strategic rationale.

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Investing in an M&A Boom

(Continued from Page 10)

Takeovers Support Profit Margins

M&A can also help dispel some concerns about US earnings. Bears argue that record high profit margins are unsustainable. We disagree. Increased takeover activity allows companies to unlock labor synergies to cut costs and sustain margins (*Display 2*). So, an accelerated pace of M&A should enhance the ability of companies to maintain profitability, in our view. While this might not be good news for employment, it's likely to buoy corporate earnings, which should be supportive of equity prices.

Through September 30, 2013
**Nonfinancial companies; after-tax corporate profit per unit of gross value added*
Source: Haver Analytics, US Bureau of Economic Analysis, US Bureau of Labor Statistics and AllianceBernstein

Investing in M&A

Is there a way to invest for acquisitions? In reality, it's not so simple. Many takeover candidates are difficult to pinpoint and tend to be underperforming businesses that aren't very attractive unless they're acquired.

What about the buyers? Acquirers usually face investor skepticism, which often hurts their stock. But in recent months, shares of buyers have actually risen after deals have been announced. Earlier this month, shares of Entegris jumped 11% on the day that the company announced its acquisition of ATMI for $1.15 billion in a deal combining two semiconductor suppliers. In December, shares of Sysco jumped nearly 10% on the day it announced its takeover of US Foods for $3.5 billion.

This suggests that investors are beginning to see the logic of intelligent takeovers by companies flush with cash. So, investing in companies with robust organic growth that are capable of making selective acquisitions could be a rewarding strategy in a new M&A boom.

The views expressed herein do not constitute research, investment advice or trade recommendations and do not necessarily represent the views of all AllianceBernstein portfolio-management teams.

Does the U.S. Federal Reserve Have Us on a Collision Course?

By: Paul Grillo, Senior Vice President, Co-Chief Investment Officer – Total Return Fixed Income Strategy - Delaware Investments

Paul Grillo is a member of the firm's taxable fixed income portfolio management team with primary responsibility for portfolio construction and strategic asset allocation. He is also a member of the firm's asset allocation committee, which is responsible for building and managing multi-asset class portfolios. He joined Delaware Investments in 1992 as a mortgage-backed and asset-backed securities analyst, assuming portfolio management responsibilities in the mid-1990s. Grillo serves as co-lead portfolio manager for the firm's Diversified Income products and has been influential in the growth and distribution of the firm's multisector strategies. Prior to joining Delaware Investments, Grillo was a mortgage strategist and trader at Dreyfus Corporation. He also worked as a mortgage strategist and portfolio manager at Chemical Investment Group and as a financial analyst at Chemical Bank. Grillo holds a bachelor's degree in business management from North Carolina State University and an MBA with a concentration in finance from Pace University.

SUMMARY:

Monetary policy continues influencing securities markets. Along the way, it is creating friction and the potential for market confusion. As we start 2014, the markets are grappling with a policy that is transitioning from quantitative easing (QE) measures to one of forward guidance.

Why are the words "collision course" in the title of this commentary? Because of two issues related to Fed policy: (1) A growing chorus of Fed officials are concerned about financial conditions and the propensity of QE measures to create new bubbles, and (2) The Fed has given guidance about how much influence the labor markets will wield over the fed funds rate, and it has defined a threshold for keeping rates low.

Paul Grillo, Co-CIO of Total Return Fixed Income Strategy at Delaware Investments, discusses several scenarios that could play out.

Mr. Grillo's full article is posted in the PAPERS e-library at: www.pap-pers.org.

The Case for Investment Grade Convertible Securities

Richard J. Turgeon, Victory Capital Management

SUMMARY:

In an environment of rising interest rates, investors seek protection using fixed income alternatives to enhance a portfolio's risk-adjusted performance. Often overlooked within portfolio construction are convertible securities. Convertible securities provide investors several advantages over a portfolio of traditional stocks and bonds.

- First, the addition of convertible securities to a mix of stocks and bonds lowers the overall volatility of a portfolio. The fact that the return profile of convertibles is unique is a plus for investors wishing to diversify their holdings into an uncorrelated asset class.
- Second, convertibles provide investors an opportunity to participate in upside gains in equity markets while providing downside support in a falling equity market through bond floor and yield.
- Third, convertibles attract fixed income investors who are concerned about the risk of rising interest rates or increased credit spreads. While rising rates can diminish the value of a convertible's fixed income component, rates that rise in connection with improving equity performance tend to have less of a performance impact.

Mr. Turgeon's full article is posted in the PAPERS e-library at: www.pap-pers.org.

Hedge Fund Performance in a Rising Interest Rate Environment

By: Neuberger Berman Alternative Investment Management Team

***David Kupperman, PhD**, Managing Director, joined the firm in 2011. David is co-head of NBAIM and a member of the Investment Committee and also serves as the Head of Liquid Strategies on the NB Alternative Investment Management Team. Prior to joining, David was a partner and member of the investment committee at Alternative Investment Management, LLC. Prior, David worked as a Managing Director and member of the Executive Committee of Paloma Partners Management Company, a multi-strategy hedge fund focused on relative value trading strategies. Prior to Paloma, David worked at The Carlyle Group, one of the world's largest alternative investment managers. At Carlyle, he most recently served as the Principal of Product and Business Development, reporting directly to the firm's co-founder. Prior to Carlyle, David was a Vice President in both the Private Equity and Portfolio Strategy Groups at Goldman, Sachs & Co. In his role in portfolio strategy, he authored papers on asset allocation and helped develop Goldman's quantitative asset allocation framework for high net worth investors. Additionally, he worked with individual ultra-high net worth clients in establishing their asset allocations and investment strategies. While in the private equity group, he worked on secondary private equity, fund-of-funds, fund performance analysis, and the structuring of alternative investment programs for Goldman clients. He currently serves as a member of the Executive Committee of the Investment Management Division of the UJA Federation of New York. David holds a M.A. and a Ph.D. in Physics from The Johns Hopkins University and a B.A. and a M.E. from Cornell University.*

***Jeff Majit, CFA**, Managing Director, joined the Firm in 2000. Jeff is co-head of NBAIM and a member of the Investment Committee and also serves as the Head of Event Driven & Relative Value Strategy Research on the NB Alternative Investment Management Team. Prior to joining the team in 2002, Jeff worked in Investment Banking for Lehman Brothers' Global Power and Project Finance group where he worked on M&A advisories as well as capital markets financings. Jeff graduated Phi Beta Kappa from Amherst College, earning a BA with concentrations in Economics and Asian Languages & Civilizations. Jeff holds the designation of Chartered Financial Analyst.*

The rising interest rate environment through the second and third quarters of 2013 was particularly painful for long-only fixed income investors with long duration portfolios, and is likely only a glimpse of what is to come. On May 2, 2013 the 10-year Treasury yield reached its year-to-date low of 1.63% and, in just six short weeks, the yield increased by 60%, hitting 2.61% on June 25, 2013. The 2013 year-to-date high of 2.98% was hit 10 weeks later on September 5, 2013.

Given the Federal Reserve's stated intention to begin normalizing interest rate policy over the coming years and the consequent likelihood that interest rates continue to rise across the yield curve, we believe that the upcoming period will be challenging for fixed income investing. As such, investors have already begun to reassess their fixed income allocations and explore additional investment options that mimic the diversification and volatility reduction historically associated with bonds without the associated duration risk. For many, hedge fund investments are helping to fill the void left by declining fixed income exposure.

Since 2000, hedge funds have posted strong performance during periods of rising rates in part due to their ability to short, hold cash, allocate among different asset classes and move across different sub-strategies. Such environments have the potential to create attractive opportunities for specific types of managers:

Fundamental Equity Long/Short. Higher interest rates generally mean that hedge funds receive higher rebates on their short positions. This environment also indirectly exposes the disparity among companies with varying financing structures, margins and business models, leading to higher dispersion among stocks. Consequently, fundamental hedge fund managers find these to be fertile stock-picking conditions.

(Continued on Page 14)

Hedge Fund Performance in a Rising Interest Rate Environment
(Continued from Page 13)

Credit Arbitrage. These managers can find interesting relative value opportunities as rates rise. For example, a fund could invest in floating rate bank loans and hedge their credit exposure with duration-sensitive fixed rate corporate bonds. This position has a net negative duration and benefits directly as rates rise. Additionally, rising interest rates are associated with rising costs for corporates with floating rate debt financing. Identifying the companies that will struggle to refinance this expensive cost of capital, as a short investment, or those that can refinance this debt as a long investment, also leads to fundamental credit selection decisions.

Event-Driven. Merger arbitrage returns consist of the risk-free rate and a spread (or risk premium) above this rate. The risk premium provides compensation for risks associated with regulatory approvals, the ability to secure deal financing, shareholder approvals and the timing of a deal closing. As interest rates rise, both the risk-free rate and the risk premium typically increase as well.

CTA and Macro. CTA strategies have historically maintained a long position in government bonds, believing that they offer protection in a risk-off market. However, more recently, low interest rates have made it difficult to trade with a long bond bias. If interest rates continue to rise, CTAs may begin to short government bonds, increasing their correlation to risky assets. CTA strategies have historically had limited success in rising interest rate environments. Global macro funds have also had difficulty (although to a lesser extent) in rising rate environments.

The potential for hedge funds to protect capital and often benefit from rising rates makes them an attractive complement to traditional allocations for a variety of investors. While the exact timing of a potential rise in interest rates is uncertain, and will depend on economic growth, among other things, we believe that investors should look more closely at hedge funds as part of their overall asset allocation.

Halliburton and the Basics of Showing Reliance in Securities Litigation

By: Andrew D. Abramowitz
Spector Roseman Kodroff & Willis, P.C.

The ability of investors such as public pension funds to recover against corporate fraudsters is currently facing a significant hurdle in the form of a legal battle before the nation's highest court. In the case of *Halliburton v. Erica P. John Fund, Inc.*, Houston-based oil giant Halliburton is asking the Supreme Court to do away with a fundamental tenet of securities litigation known as the fraud-on-the-market presumption – and the impact could be far-reaching.

Fraud-on-the-market, which the high court adopted in 1988 in the case of *Basic, Inc. v. Levinson*, speaks to the reliance element in a securities fraud claim. It presumes that well-developed securities markets are efficient and thus the price of a stock reflects all available material information, both positive and negative. This presumption alleviates the responsibility of the investor plaintiff to demonstrate that he or she specifically relied on the defendant company's public statements when bringing a claim. Fraud-on-the-market, in effect, supplants a showing of reliance since it is assumed that the information upon which an investor would rely is already reflected in the stock price.

Halliburton is asking the Court to abandon the fraud-on-the-market presumption applied at the class certification stage, or, alternatively, to allow a defendant at the class certification stage to offer evidence showing that an alleged misrepresentation did not affect the stock price – an opportunity that defendants otherwise do not have until summary judgment or trial. The challenge rests on a number of grounds, including the idea that the "efficient market" premise underlying *Basic* is not valid. Halliburton has also argued that *Basic* is at odds with more recent Supreme Court decisions and also with legislation enacted since the 1988 decision, including the Private Securities Litigation Reform Act. Halliburton also contends that the fraud-on-the-market doctrine should be scrapped because it has proved difficult for lower courts to apply.

The Supreme Court's holding in *Halliburton* will likely have serious implications for investors attempting to bring class actions under the federal securities laws. If the Court abandons *Basic* altogether, many believe that it would be virtually impossible to certify a securities fraud class action, as each plaintiff would have to demonstrate its own individual reliance on a defendant's alleged misstatements. Such individual questions would predominate over questions common to the class, and thus bar class certification.

Some legal analysts have pointed out that for institutional investors, whose sophisticated investment strategies may be based on factors unrelated to what a company says on a day-to-day basis, proving reliance on particular statements may become impossible.

Although the Supreme Court has not yet decided *Halliburton*, based on questions posed during oral argument, it seems unlikely that *Basic* will be rejected outright. Even so, many commentators have suggested that concern over the economic theory underlying the fraud-on-the-market presumption and may cause the Court to adopt a compromise allowing defendants to rebut the fraud-on-the-market presumption at the class certification stage with evidence. Such a decision would certainly make for a more challenging legal landscape, for investors would know at the outset that they would likely incur the costs of presenting expert evidence to counter defendants' evidence earlier in the proceedings than ordinarily expected. The end result could be that fewer securities class actions as a whole are filed, as the added costs would likely deter many weaker actions. The number of stronger cases, however, would probably not be impacted by such a ruling, because securities plaintiffs anticipate spending money on expert evidence anyway, just at a later procedural stage.

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Regardless, the *Halliburton* decision is one that institutional investors – including the public pension world – will be awaiting with bated breath.

Let's Get Real About Inflation

By: ***Jon Ruff*** *(pictured) and* ***Greg Wilensky*** *of AllianceBernstein*

For the US and other developed economies right now, it's "all quiet on the inflation front." Perhaps too quiet. That's why we believe it's time to get real about inflation and the investing opportunities that may well develop in the next several years.

In 2013, falling global inflation expectations and weaker emerging-market growth forecasts caused a hefty decline in most real-asset investments—natural resource stocks, commodity futures and real estate stocks. As real assets underperformed stocks, inflation-indexed bonds such as Treasury Inflation-Protected Securities (TIPS) underperformed their nominal Treasury counterparts.

Both real assets and TIPS are relatively inexpensive today. That, however, may not be enough incentive to buy them now, since collective market expectations see little chance for rising inflation in the near term. Some may argue that deflation or disinflation has a greater likelihood. But with all the monetary easing of the past few years, the scrappy resilience of the global economic recovery and developed-world central banks looking for some economic heat, isn't there even the chance of inflation?

We think it's wise to be prepared, which is why we see real assets and TIPS as appealing opportunities now—and always. After all, asset classes have a way of shifting from winner to loser (and back again) more quickly than expected, and these asset classes could move extremely quickly if inflation expectations increase.

If you compare historical annual returns for a balanced basket of commodity and real estate investments with the S&P 500 over the past four decades, you'll see some extraordinary shifts in over- and underperformance. Let's look at 1975–1976 and 1997–1998—two time periods when real assets got pummeled as they did last year (*display below*). The story in 1975 was that inflation collapsed nearly five percentage points (from 12.0% to 7.4%), causing these inflation-sensitive assets to underperform. In 1998, the spotlight was on the extraordinary tech boom, and old-economy businesses like real estate and commodities were just about the most out-of-favor sectors around.

Past performance does not guarantee future results.
January 1, 1972 through December 31, 2013
This is a hypothetical example and is not representative of any AllianceBernstein product. An investor cannot invest directly in an index or average and they do not include sales charges or operating expenses associated with an investment in a mutual fund, which would reduce total returns.
The index comprises of 50% commodities represented by S&P GSCI Total Return in USD and 50% real estate represented by the FTSE NAREIT Equity REITs Total Return in USD.
US Consumer Price Index (CPI) represented by US urban consumers' seasonally adjusted CPI.
Source: Bloomberg, Dow Jones, FTSE, S&P and AllianceBernstein

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Let’s Get Real About Inflation

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After each of those periods, real assets posted strong rebounds for the following three- and five-year periods—in conjunction with economic recoveries and the end of declining inflation rates.

What about TIPS versus Treasuries? TIPS underperformed last year as US and global inflation expectations fell. Today the breakeven inflation rate on 10-year TIPS is about 2.2%. If inflation exceeds that breakeven rate over the next 10 years, then investors would be better off owning TIPS. For some historical perspective, the inflation rate has averaged roughly 2.4% over the last 10 years and 2.6% over the last 20 years. So, the current 2.2% breakeven looks attractive.

Will we get rising inflation this year? Next year? Maybe, maybe not. But when inflation does eventually pick up, it could potentially cause a good deal of harm to traditional portfolios of stocks and bonds, both of which underperform during times of rising inflation. Therefore, we think investors would be wise to include an allocation to real assets and TIPS that can protect their portfolios from the negative impacts of inflation.

While TIPS provide appropriate inflation protection for investors’ fixed-income allocation, they don’t have enough inflation sensitivity to protect investors’ stock allocation. That’s a job for real assets. Therefore, we feel it makes sense for investors to add a combination of TIPS and real assets to their retirement portfolios. An additional benefit of blending these asset classes together is that the combination will be less volatile than using real assets alone.

In any case, we feel that inflation-sensitive assets should probably not dominate a portfolio. They should play a modest, complementary role that helps the longtime purchasing power of a portfolio fend off inflation’s ill effects.

Jon Ruff is Lead Portfolio Manager and Director of Research for Real Asset Strategies and Greg Wilensky is a Director of US Multi-Sector Fixed Income at AllianceBernstein.

The views expressed herein do not constitute research, investment advice or trade recommendations and do not necessarily represent the views of all AllianceBernstein portfolio-management teams.