dakota

EPISODE 6:

Positioning for US Plan Sponsors

With Russ Kamp

Robert Morier: Welcome to the Dakota Live! Podcast. I am your host Robert Morier. The goal of this podcast is to help you better know the people behind the decisions. We introduce you to Chief Investment Officers, Manager Research professionals, Senior sales leaders, and other important players in the industry who will help you sell and better understand the investment sales ecosystem. If you're not familiar with Dakota and their Dakota Live! content, please check out dakota.com to learn about their services. This content is provided for informational purposes, and should not be relied upon as recommendations or advice about investing in securities. All investments involve risk and may lose money. Dakota does not guarantee the accuracy of any of the information provided by the speaker, who is not affiliated with Dakota. Not a solicitation, testimonial, or an endorsement by Dakota or its affiliates. Nothing herein is intended to indicate approval, support, or recommendation of the investment advisor or its supervised persons by Dakota. Today's episode is brought to you by Dakota Cocktails. Are you looking to expand your network and connect with other professionals in the investment industry? Look no further than Dakota Cocktails. The premier networking event series for sales professionals, allocators, and more. Our ongoing series of events takes place in cities across the country, providing you with the opportunity to connect with like-minded individuals and build meaningful relationships. At Dakota Cocktails, you'll enjoy delicious drinks, great conversation, and the chance to connect with industry leaders. Whether you're looking to make new contacts, explore potential partnerships, or simply learn from others in the industry, our events are the perfect place to do it. Join us at Dakota Cocktails, and discover the power of meaningful connections. Visit our website at dakota.com/cocktails to learn more and find an event near you. Joining me at the desk today is Dan DiDomenico. Welcome to the show, Dan. Thanks for being here.

Dan DiDomenico: Thank you, Robert. Thanks for having me.

Robert Morier: We really appreciate it. I know it's a very busy time of the year, particularly in your seat here at Dakota. So we appreciate you making the time.

Dan DiDomenico: Busy, but I'm excited to be here.

Robert Morier: Oh, good. Good. Well, before we introduce our guest, I wanted to share more about Dan and his role with Dakota. Dan is the President of Dakota. You've been with the firm since 2008. In his role, he has significant experience raising assets, as well as guiding product development, helping develop the sales strategy for each of Dakota clients. In addition to his leadership responsibilities, Dan is an active member of the investment sales and membership services teams, with primary relationship responsibility for a group of institutional consultants, independent broker dealers, banks and RIAs. Prior to joining Dakota, Dan worked in product management and investor relations for the Hartford and Penn Square Real

Estate Group respectively. And you began your career at Vanguard, where you worked with institutional clients, I believe, for about eight years.

Dan DiDomenico: That's right.

Robert Morier: Oh, great. And last but not least, Dan is a graduate of Villanova University where he graduated with a BS in Finance. So we've got a Fordham grad here too. Are you ready for that? I'm a little concerned. I found this out in pre-taping. I found out that we've got a Fordham grad and we've got a Villanova grad. So so far seems -

Dan DiDomenico: Go Jesuits.

Robert Morier: Yeah. Go Jesuits. Things are OK so far, as it should be coming from Jesuit schools.

Dan DiDomenico: That's right.

Robert Morier: Well, you've been here nearly since the beginning of Dakota. And I know there's been a tremendous amount of growth over the years, and we're sitting in part of that growth now at these studios. As you've seen the changes at Dakota and then the changes in the industry since you started, probably in the height of the financial crisis -

Dan DiDomenico: It was. Yeah. Well, here with Dakota, started in 2008. April of 2008.

Robert Morier: Good timing.

Dan DiDomenico: So right in the face of the great financial crisis. It was good timing, because you learn a lot. And it's during those types of periods that you reflect on now, as we're going through a period of volatility. And now that I'm one of the elder members of the team and have the experience of going through that, I'm able to share with them some of the experiences and how we handled and conducted ourselves then and what we can learn and grow from in this period now. Because they'll remember this one as well as they move on in their careers. But taking a step back, thinking about how Dakota has evolved over the years, we have seen tremendous growth. I've been quite fortunate to have had a very unique and a seat here at the table where I've participated, contributed to, but also just witnessed all this great growth that's come together. But what's really important for me and for Dakota and for all of our members now is that central to what we do, it really has not changed. It's really just how we have delivered those services, how it's expanded in support of asset managers that are looking to grow their businesses and the role that we play in that. That's what's changed the most over the years. And it's grown to this great studio that we have here and being able to deliver content and information to make the life of an investment sales professional easier. We were kidding before we were getting on here, how challenging the industry is. We all know that. It's very challenging. So what is that we can do in our role here at Dakota to make their lives just a little bit easier, a little bit more efficient so they can be more productive. And that's what's evolved and continues to grow. For example now, we have these great Dakota networking events. Because we're just trying to create a community around what it is that we're all trying to accomplish. So from a member standpoint, it's been wildly well received. And just last night, we were in Richmond. And we had a cocktail event. We had great participation across both of the aisles. From one standpoint, it's the investment sales professionals that are coming in to network with one another to talk about what's going on in their lives and on the other side of the aisle, we have allocators that are coming in. Because they want to network as well. They want to know what their peers are doing in the industry. And it cuts across all varieties of allocators as well, from the institutional consulting world, to the pension world, into the wealth management world of RIAs and multifamily offices. So we get a great blend of people coming together at those events.

Robert Morier: Well, you mentioned a lot of different types of investors from public pension plans, consultants, wealth management. How have you seen the temperature of the environment change, as you've been at these events, you're speaking with a lot of different allocators, a lot of different sales professionals. We talk about 2008, but we've just come out of another significant crisis over the last two and a half years now. So how would you diagnose where people are today in terms of the conversations you're having with your prospects and clients?

Dan DiDomenico: Yeah. The lines used to be so clean back in the 2008 time period. We had the institutional world and quite separately, you had the wealth intermediaries. The RIAs, the private banks, the broker dealers. Those lines have blurred. A lot of the conversations that we're having more often than not, there is an institutional consultant that's going to be involved in some capacity or role within the research or the asset allocation decisions. So a lot of the conversations we have between those private clients or institutional, they're not the same anymore. Obviously, the growth of alternatives and the use of alternatives, especially private funds in the wealth intermediary channels, that has and continues to grow. So again, the asset allocation, the implementation of the asset allocation programs, the use of a variety of types of funds from long only equities, fixed income, to non-traditional or alternative strategies, those conversations feel a lot the same between the institutional and the private wealth intermediary channels.

Robert Morier: But you've mentioned one segment, and that's the plan sponsor of public pension plans, Taft-Hartleys. I'm very excited to introduce Russ Kamp to our audience today. Russ is an industry veteran who's been working for over 40 years now with many of these plan sponsors. So thanks for being here today, Russ.

Russell Kamp: Robert, it's my great pleasure. Thank you. And Dan, it's a pleasure to be with you as well.

Dan DiDomenico: Likewise. Thank you.

Robert Morier: Well, we have a lot of questions for you in these 40 minutes. But before we get into our conversation surrounding the plan sponsor market, I want to share a bit more about your background for the audience, if that's OK, for a few minutes. So Russ is the managing director and senior asset manager for Ryan ALM, which he joined in July of 2019. Ryan ALM is an asset liability management firm working with us plan sponsors. Russ has over 40 years, I wrote "nearly" before. So I had to check my math. It's over 40 years of experience in the retirement industry. And then prior to joining Ryan ALM, you were the managing partner for Kamp Consulting Solutions, which I would assume is your own business.

Russell Kamp: It was.

Robert Morier: Kamp with a K. So which was a full retainer asset and liability consulting firm. You are a passionate advocate for pension reform and legislative efforts in Washington DC. Frequently writing and speaking on this subject. We're really excited to hear a lot of your thoughts on that today. And prior to launching your firm, you were a senior vice president and director of asset management for Two Sigma Investments where you helped launch their long only business. Before joining Two Sigma, you were the CEO of Invesco Quantitative Strategies group. They were managing over $30 billion in institutional clients. And you began your career as an analyst for Janney Montgomery Scott's investment management control division. I'm sure some of our listeners remember that name, as well as another name. An asset consulting firm that was later acquired by evaluation associates. If you started your career before 2005, you'll know Evaluation Associates well. Some very wonderful people came out of that firm. Where you were a senior vice president, senior consultant, and partner. So again, thank you for being here. It's wonderful to see you.

Russell Kamp: It's great to see you again, and thank you for the opportunity. I'm really looking forward to it.

Robert Morier: Well, absolutely. Well, Philadelphia welcomes you as well. It's great to be here. Well, I was on your website. You've been publishing thought pieces, white papers for several years to thousands of readers in our industry. Thinking about where we've come since 2008, we're talking about the financial crisis and obviously the more recent events that we've been through. And it's a big question to start. But how would you consider the state of pensions in the US market today?

Russell Kamp: Well, actually, I think on average, pensions are in good shape today. I mean, we've seen a tremendous rally from the depths of the 2007 to 2009 crisis. Equity markets were historic in terms of producing returns that were outsized. And then we come upon 2022. And it's a troubling environment, but it's not devastating. The problem is the confusion that's created by different accounting standards. If you look at corporate America this year, despite the fact that asset growth has been negative, and quite negative, liability growth has been greater to the downside, because of rising interest rates. Rising interest rates reduce the present value of that future liability. And so funded status has actually improved for corporate America. Unfortunately because multi-employer plans and public pension systems operate under Gatsby, most trustees don't appreciate that fact. Because they're discounting their liabilities at the ROA. And so in this environment they look like it's a devastating situation where things appear to be deteriorating, but in fact, they're not. So why we have two different accounting standards is beyond my ability to comprehend. Obviously, there's a third standard, which is the International Accounting Standards, which has a true mark to market for liabilities. But it's not a devastating year despite the deterioration in asset values.

Robert Morier: And I would think that one of the reasons that people feel like it's always a devastating year because every year I read that it's a devastating year for DB plans. And every year I hear that we need to be creating new product for defined contribution. So as you think about the balance between DC and DB, and really a question for both of you, Dan, from a sales perspective, thinking about the two areas of the market and then Russ, from an advisory perspective. It sounds like there's a lot of education going on just in general. The health of the DB plans versus the availability of DC.

Russell Kamp: I mean, for me, I'm a huge advocate for defined benefit plans. I don't think asking untrained individuals to fund manage and then disperse quote unquote, "a benefit" is making a lot of sense. I just think it's poor policy. Unfortunately, a lot of employees asked for this back in the '80s and '90s. And you get what you ask for sometimes. And it's not necessarily great news. Defined benefit plans should be the backbone of our retirement industry. Defined contribution plans should occupy that supplemental position that they were originally designed for. Within the defined benefit space, we've witnessed a great resignation during COVID. There's been a lot of fluidity in terms of the workforce. If I'm a plan sponsor and I realize that for the first time in over two decades, my pension plan may be producing pension income as opposed to pension expense, maybe it gives me an opportunity to reevaluate the use of defined benefit plans going forward. At one point in time according to the Department of Labor, we had more than 45% of our private workforce covered by a defined benefit plan. Today, it's about 13%. And within that 13%, a big chunk of that, unfortunately, are in frozen and terminated plans. So the thought that we could potentially see a revitalization of defined benefits because now instead of harming those income statements, they may be positively influencing them, let's hope. Because I think, again, that needs to be the backbone of our retirement industry.

Dan DiDomenico: Yeah. Look, I go back to my days at Vanguard. I worked very closely with defined contribution, defined benefit plans. Back then, the new products that were being rolled out were the target date funds. Prior to that, it was the life cycle funds. But you're still putting lot of the onus, a lot of the responsibility on the plan participants. So there's always a lot of education that went around and more often than not, those decisions that were being made, because if you think about the timeline that many of the participants have in those plans, they're not thinking in allocating along those lines. Where the target date funds are supposed to help with those decisions, we plug in, you can allow that glide path then to naturally evolve as you get a little bit older to be more conservative versus having more risk when you're in a younger age. We haven't seen a lot of great products in evolution after that. And I think that's coming because I know Vanguard, I know others are talking about how to incorporate alternatives and private funds into retirement plans. It's going to be tricky. But it's appropriate there. If you think about the timeline and the duration of the time that you're in those plans, matching that with the duration and the term of a private fund, that would cause a potential match there. There is a potential match. I'm just not sure how the liquidity works for people who are transitioning jobs. If we had people operating with more of a lifetime employment mandate or mantra, then maybe it works a little bit better. But my point about defined contribution, though, is I think I'm mostly concerned about the financial wherewithal of the average individual in this country. I just don't think there is a lot of disposable income in this inflationary environment. The pressures are mounting. What is the first thing that goes well? It's the funding of the retirement program. The other problem too is that retirement accounts under DC framework tend to be glorified savings accounts. Somebody goes through a transition with work, they immediately look for bridge loans out of their 401(k). And so again, great as a supplemental form of retirement income as somebody's primary. I just have a real problem with that. And then you mentioned target date funds. I mean, target date funds were designed to protect the participant. Well, it doesn't make sense that in this environment, those closest to retirement have the worst performance relative to those in their 20s. And again, a lot of it has to do with the fact that we've gone through four decades of a declining interest rate environment where a lot of these products were tested with this huge tailwind behind us. Now, unfortunately, we have this headwind blowing like any hurricane that's hit Florida. And a lot of these products now are getting their comeuppance, because they haven't gone through a sustained period of rising interest rates, sustained period of inflation, and fed policy decisions that leave a lot of uncertainty.

Robert Morier: Well, you mentioned rising inflation. A rising inflationary environment as well as rising interest rates. NEPC did a study recently where they pulled about 44 plan sponsors talking about what they see are the biggest risks over the next few years. Those were two out of the three. The third was declining corporate profit margins.

Dan DiDomenico: Well, that comes next.

Robert Morier: It does. It does. It's a domino effect for sure. So anything else that you think we should be looking out for. I mean, those are, obviously, very significant challenges that plan sponsors and the pension market is going to face over the next few years. I was surprised that geopolitical risk didn't come up on that list as well. But it seems like, obviously, the domestic challenges that we're facing today seem to be at the top of mind.

Russell Kamp: Well, I definitely agree with you. I think there should be concern about what's happening with Russia and the Ukraine and the impact that has on food and fuel and a number of other chemicals that are vital to our own production capability. But let's look domestically. I mean, one of my greatest concerns is what's transpiring in the Mississippi River. The river recently has begun to rise again. But we were at historic lows in terms of the ability to transport goods to the Port of New Orleans. Barges had to be operating at less than full capacity, which increases expenses and contributes to that inflation. I mean, we have COVID still. Whether you're looking at 0 tolerance in China or even here in the States. I mean, it impacts production. And so when you have so much demand for goods and services because of all the stimulus that's been provided to the average American and we still have pretty significant savings, that excess demand needs to be met with production. If it doesn't, then that's where you get that spiraling inflation. We have an unemployment rate right now at about 3.6, 3.7 historically low. When we last had inflation nearing double digits in interest rates above 10%, you had unemployment close to 10%. In this inflationary environment, I find it difficult to believe that a Fed funds range of 3.75 to 4 is going to tamp down economic activity when you have full employment and you still have pretty significant savings relative to where we were pre-COVID.

Robert Morier: Dan, how about on your side? Just in terms of questions, concerns that your clients have. I would assume they cover a lot of the same, but any patterns emerging from your perspective and how would you address those patterns as you're thinking about more of a consultative sale?

Dan DiDomenico: Yeah. So not surprising. But the more defensive strategies that we work with, they are much more in favor and far more topical. They come up a lot more in these types of periods. Right? I mean, we work with an equity income strategy that during that great equity bull market, especially on the growth side, the conversations around why would you own something that has downside protection, what is downside protection? Why do we need that? So all of this re-emerges. Right? So within our conversations, it's about how can you generate differentiated returns that aren't highly correlated to the equity markets? What role do you play in that portfolio? We're, obviously, now talking a lot more around private credit and certainly with higher rates. How can you generate a return stream from credit that isn't, maybe, exposed to corporate America? Where maybe we haven't seen the spread quite blow out in fixed income. Obviously, it's been a challenging year for fixed income as well. But now thinking about duration risk. When do I put on duration risk? Where can I look to generate those higher levels of income and yield but from different places? And so that's where a lot of our conversations right now are centered. But look, we still have a lot of exposure to growth and to equity. That's a big part of our business. So it's having those conversations around, look, here's what you own. I think that, sometimes, people get away from that. We look at the daily volatility in some of these strategies. And some of the selling pressures that we've seen certainly have been indiscriminate. Part of it's been due to those macro factors, part of it's also been these companies that are going through transition or about to go through that earnings reset that everyone is expecting. So they're starting to price that in. So it's giving people understanding here's what you own. Here's the quality of the portfolio. And look, when that risk on trade comes back, you never know when that pivot occurs. But it's just giving more information and communicating and being transparent around these portfolios. That's the role that we play in the conversation.

Robert Morier: A good point. When I reached out to Russ prior to coming on board, I asked him some talking points. What are you thinking about? He wrote bonds are back. I'm glad you wrote something more than. That but you did mention that bonds are back. So as you're thinking about this interest rate environment, you're thinking about fixed income. A lot of our audience are in the fixed income business either on the sales or portfolio management side. Where are you seeing opportunities in terms of fixed income, and how should people be thinking about some of these strategies that Dan had just mentioned?

Russell Kamp: Well, first of all, I'm excited that bonds are back. As an asset liability manager, bonds are really the framework for taking risk off the portfolio through defacement strategies. And we as an industry have seen just a tremendous migration to alternatives over the last several years. And I don't argue with that. I think that there are great opportunities in that space. But what you need is time. Right? So one of the greatest investment tenants is time. A time horizon that can be extended and not disrupted because of market dislocations. And so what we propose from an asset allocation framework is get rid of this concept that all the eggs need to be in one basket focused on the return on asset assumption. Bifurcate your assets. Create a liquidity bucket and then have a growth bucket. The liquidity bucket is used to meet near-term benefits and expenses. It's the retired lives liability that you know is fixed, right? And then all of your alternatives now can just grow unencumbered to meet those future liabilities. The thought of having this tremendous migration without a liquidity policy doesn't make sense to me. You know, Guinness Asset Management out of the UK did a study back in 2014. And fortunately, they updated it recently in 2020. And what they have shown is that going back to 1940 and over a 10-year periods of time, 47% of the return to the S&P 500 comes from dividends and dividends reinvested. If you extend that out to 20-year horizons, it's 57% of the total return comes from dividends and dividends reinvested. But what do we do as plan sponsors? Every month, we sweep cash wherever we can find it. Whether it's interest income from the fixed income managers, dividend income from equities or distributions from your alternatives. Well, what they're doing is they're damaging that long term return. I think it was Buffett who said that the compound interest is the eighth wonder of the world. Well, we've mitigated that by the practices of just sweeping cash. If you constructed a defeased bond portfolio in this environment, first and foremost, you're defeasing future liabilities, which are not interest rate sensitive. So you get rid of the greatest risk to bonds, particularly in this environment. Second, you've just extended the investing horizon now for all of those alternative assets to grow. And now you're allowing higher returning assets to actually get that compounding from the reinvestment of those dividends. There's just so much going on by just thinking outside the box a little bit and coming up with a solution with regard to asset allocation. I look at our current asset allocation practices as nothing more than riding a roller coaster up and down. If you remember after Sandy, when the roller coaster at Seaside Heights ended up in the Atlantic Ocean, I mean, that's what I look at as our asset allocation practice. We ride it up, we write it down, we write it up, and eventually we get all wet when it falls into the ocean. And we got to get off that roller coaster. I mean, that's the biggest problem.

Robert Morier: Well, what's that education process like? Introducing alternatives into an asset allocation model, as you're speaking with trustees, as you're speaking to your own clients, Dan, we were talking about private credit to start this conversation. What's that education process like? Because it's ever evolving. There's always new product. There's always some niche strategy or vehicle that comes out to help mitigate some of these challenges that you just described. So how do how do you see that education process and how do you see your clients receiving it?

Dan DiDomenico: Yeah. From our seat, I always say that we have the benefit of articulating and trying to bring to life the complementary role, a strategy that we represent can play set against the current exposures within an asset allocation and a plan that's already been put into place. I think your seat is much more challenging. It's making those asset allocations in decisions, right? And when to allocate. So from our perspective, when I'm in the conversation, talking about private credit or talking about any of our long only equity strategies, we're playing that role of just trying to bring to life the performance patterns. What they should expect in different market environments knowing that these are tools. Ultimately, at the end of the day, what we're bringing to the table, they're the ingredients for the cake that is being made from a plan sponsor standpoint. So I always feel like we have that benefit of being able to sit back and just say, look. I can't say that all of our portfolios are going to perform in every given market environment - there's a lot of consistency to this. So we're fortunate to have great managers that understand their role they do perform when they're supposed to perform. But making sure that we're connecting the right end allocator, the long term more strategic allocator, to understand what are those market environments in which they should perform. We always say that the harder job is Russ giving the advice and the guidance around creating those asset allocation programs. Because that is challenging in these kinds of environments.

Russell Kamp: Yeah. It's challenging, because we've been doing the exact same thing for the last 4 to 5 decades. I mean, I got into the business in 1981. And at that point in time, we had, basically, a bank trust department running a balanced portfolio. And that was perceived to not be appropriate. And so we broke apart that model and started to bring in specialists. And now where are we today? We're going back to an OCIO model where you have one manager who now is responsible for the allocation of those assets. So I'm not sure that going full circle has really been beneficial. It's still the same thing. It's a singular focus on the return on asset assumption. If that's not achieved, then, obviously, the contributions into that plan have to go up. I mean, I can give you a situation that's just incredible. In 1999, the average public pension system was well-funded. It was about 120% to 125% funded. It was unfortunately, at that point in time that interest rates dipped below the return on asset assumption. And so it was perceived that bonds were going to be an anchor to windward. And so we started to migrate significant assets to first equities. And then we went through 2000 to 2002. And then we went through 2007 to 2009. And that just proved with a 2% return for the S&P for that decade, that wasn't a strategy that was to be employed. And then we migrated tremendous assets over to alternatives. And it will be left to be seen exactly what's happening under the surface right now, because they're not marked to market. We don't necessarily know what's happening. And plus with regard to private debt, we've not been through an economic crisis with this asset class. It'll be interesting if things deteriorate, if the Fed is aggressive, continues to be aggressive and rates rise, what it does to corporate America if corporate profits begin to deteriorate, their ability to fund that debt they've taken on. So it will be an interesting challenge over the next couple of years. The strategy that I'm espousing right now buys time for all of that effort to work its way through. There's no reason to be forcing a liquidity in an environment where natural liquidity dries up. We've seen that in every environment. You think you have an uncorrelated portfolio, and then everything correlates to one. Right? And so what we look at is creating a situation where you have a sleep well at night strategy. Where you don't have to worry about what's happening on a day-to-day basis. Because each and every month for the next 5, 10, 20 years, whatever, is taken care of because you've defeased these fixed income assets to meet those specific liabilities. And now everything else that you have can just grow. Sometimes it'll grow well, sometimes it'll perform poorly. But at least you're not going to be forcing liquidity at the bottom of those market cycles.

Robert Morier: Well, every time I feel like we have it somewhat figured out, new legislation is introduced, new regulations are deployed. And we have to figure it out all again. So as you think about the legislative changes that have been going on over the last couple of years, the regulatory environment, what have the conversations been like with plan sponsors in that regard? And how should asset managers be thinking about some of those legislative changes that have been employed over the last couple of years?

Russell Kamp: Well, you have a huge opportunity. Many times when we talk about legislative changes, we kind of sit back and say, oh, my goodness. Can you believe what our government's done again. But in this particular case, you had an attempt on the part of multi-employer plans to put forward the Butch Lewis Act back in 2018. It got passed the House in 2019 but was never taken up by the Senate. Biden comes in as president, and Congress creates RPA. He signs it into legislation in March of 2021. And now you have roughly 350 multi-employer plans who are going through an application process with the PBGC to receive grants of what's called special fund financial assistance. This is an incredible opportunity for that segment of our defined benefit universe to actually dramatically improve their funded status. And so there are priority groups 1 through 6 and then there are a host of others that are going to be able to file after the priority group 6 files next year. And so from an asset standpoint, it's going to help fixed income managers primarily, because the assets need to remain segregated. So if you receive a special financial assistance grant, that money is used to meet benefits and expenses. It has to be invested 67% in investment grade bonds, and the remainder can be invested in return-seeking assets. Now, initially when the ruling came out by the PBGC in their interim final rules, it was 100% investment grade. It did not say that the bonds needed to be used to defease the liabilities so that in this total return environment, unfortunately anybody receiving assets earlier in the year will have seen some damage to that portfolio because we know the ag was down over 15% through October. Rates have come down recently, so bond performance has improved. But still, it's been a painful year. The return-seeking assets need to be kept in once a year in that 33%-67% ratio. So it's about $90 million that's being injected into the multi-employer space for investment management organizations to take advantage of that. Now, I say the SFA will mostly benefit those that are going to be implementing high quality fixed income strategies. But if done successfully, the legacy assets in those pension plans can now be managed much more aggressively. Because they're no longer a source of liquidity, at least for that period of time when benefits and expenses are being paid out of the SFA bucket. So those assets are up for grabs. They don't have to be wed. The asset-consulting community doesn't have to be wed to their current structure. They can migrate a significant percentage of those assets into the alternative space, whether we're talking about private equity, private debt, whether we're talking about infrastructure which, obviously, for employer plans is a huge opportunity. They want to be able to create jobs. Well, infrastructure, high quality paying jobs, right? So real estate, infrastructure, timber, agriculture. Whatever you feel like you want to invest in, now you have the opportunity because now you have a runway that extends beyond 10, 12, 15 years in many cases. So it's a great opportunity within multi-employer plans. Unfortunately with regard to corporate America, the PBGC, it's painful because of PBGC premiums to maintain a lot of these plans. And so that's been one of the things that I think has damaged the use of defined benefit plans. But as we talked about before, with funded status improving, with pension income being created as opposed to pension expense, perhaps now we have an opportunity for the investment community to really rally around and support a defined benefit plans and become the advocates that they should have been all along in trying to preserve these critically important vehicles.

Robert Morier: So it sounds like the legislation is going to provide the benefit of time?

Russell Kamp: This particular strategy, RPA, if they use that bucket to diffuse liabilities, then they absolutely have bought time. If you're using total return, fixed income strategies that are harmed by changes in the interest rate environment, maybe not as much. But in any case, you're still going to have time for the legacy assets if they were to restructure those portfolios and rely a little bit more on that time frame.

Robert Morier: While this is all happening just legislatively, there have been, I guess you could say a little bit of a ping-pong match as it pertains to ESG. Environmental social and governance integration into public pension and plan sponsor assets. One administration says you don't have to look at it this closely, another administration says you do. So it's turned very political in a lot of ways. But it's something that's very important to the clients that listen to this program, whether you're a corporate pension plan an endowment foundation or a public pension plan, and asset managers have been incorporating and integrating ESG at a breakneck speed over the last few years. So as you see it from your seat working with plan sponsors and thinking about the legislative changes that have happened over the last few years, as it pertains to the US Department of Labor announcing these, they're always called final rules, which I find ironic.

Dan DiDomenico: But they get up to final, final, final rules.

Robert Morier: Final squared. So I would love to hear your thoughts. And Dan, I would I'd love to hear from you too just how clients are asking those questions around ESG and sustainability. It is still the topic that--

Dan DiDomenico: Comes up all the time.

Robert Morier: All the time.

Dan DiDomenico: I'm sure it does. And I think it's going to be an input and it will continue to be an input into a decision making framework. But I'm not really sure that we've come up with a way to truly evaluate the value added from some of these metrics. And until we can, it's going to be very difficult to differentiate one firm from another firm in terms of their ability to actually add value through these decision frameworks. So great that we're paying more attention to ESG issues. Difficult to evaluate the value added from those. Will it be an input? Absolutely. Will plan sponsors, particularly public pension systems continue to look at that, and endowments and foundations? Certainly. But until we get the appropriate metrics in place to measure the value added, I'm not really sure how one differentiates one firm from another,

Russell Kamp: Yeah. And like I said, it comes up in all of our conversations. It's now incorporated into every single DDQ, RFP. It's what's your approach on ESG. And this is across all investment strategies, from value to growth to the alternative side. That metric, that understanding of how it is incorporated into an investment process, we're already there. Now, to your point around what's the impact, right? What's the actual impact that these strategies and how it's being implemented. What kind of positive impact is actually having? And is it the intended impact? So that's where we are now. A lot of our conversations as well when think about new products or solutions. Nobody wants to give up performance. Right? You can't sacrifice a fiduciary.

Robert Morier: You're not supposed to.

Dan DiDomenico: You're not supposed to sacrifice performance. So it's that delicate balance between we want to have a positive impact, we want to be ESG, but at the same time, we have an obligation. We have a fiduciary responsibility to perform and have the best vehicles out there. So I think there's going to be a lot more to come. We're in constant conversations with either our members or potential investment partners that we can bring to the markets to understand, well, what is their solution? What separates them? How are they differentiated? And so there's a lot of interesting conversations going on right now. I don't think the asset flow has quite turned that corner. And I think that's the next leg to the as there's more products as there are strategies that can perform. And that you can measure and show. The impact that they're having. That's where you're going to see a lot more. That opportunity set is really going to expand when we see that all come together.

Russell Kamp: Yeah. I mean, I would love to see an investment manager put together a product, which would be considered their standard product. And then put together a competing ESG product and be able to measure that on a day-to-day basis to see if that framework actually adds value. It's difficult to compare one manager to another. But you have to have a baseline for what that manager would have done without overlaying ESG on top of it. I mean, going back to my days at Invesco, we were asked to slice and dice the universe all the time. If we were working with the Sisters of Mercy out of Detroit, well, we couldn't have a certain segment of our population. The Irish government didn't want to have ammunition. No tobacco, no South Africa. I mean, we've been doing this for years and years. And years and depending on the magnitude of that slice, we were able to tell clients, well, this is how you impact your alpha generating and your risk. And the more you actually trim the universe, the more volatility you're going to create. Because you have more tracking error. So I mean, there are going to be ways to do this. I haven't seen that today. And so I'm a little sanguine actually about the true value added from this effort. I think personally, there are so many other things we need to do to secure the defined benefit plan that the plan participant would appreciate than worrying about some of these things.

Robert Morier: Well, whatever you do, make sure you write down your policies and you follow them to the letter, otherwise, talking about regulatory risk, some asset managers out there have seen what happens when you don't follow those policies as it pertains to ESG. So I think it's going to continue to be a topic for many years to come and obviously as Dan had mentioned it is part of our DDQ and RFP process now. So it is the future. We've been spending a lot of time in the US market for good reason, but a lot of our audience and some of our clients and the allocators who tune in are thinking about non-US markets. They're thinking about non-US distribution strategies, they're thinking about international equities, and non-US fixed income. And it wouldn't be a pension crisis if the UK wasn't involved. Our cousins overseas. So how have you been seeing that play out, and what does that mean from an asset allocation perspective in that market relative to the US?

Russell Kamp: Well, the first thing I would say is that the US performance within the equities have dwarfed that of our non-US neighbors. I mean, equity performance outside of the United States has been dismal for appears to be a decade at this point in time. Strength of the dollar has not helped that situation at all. And I think just from a tactical standpoint, it might make sense to begin to shift assets from the US overseas just because of the dramatic under-performance. That's just kind of a top line throw out. With regard to the UK, we had a pension crisis that unfolded in late September and early October. That almost brought down the entire pension marketplace. You know, I mentioned to you before that UK pension systems as well as other entities outside the US operate under ISSB standards. And so that's a mark to market. Well, funded status based on mark to market was really poor in the UK. And as a result, they were looking to improve their funded status through liability-driven investing strategies, most notably, duration strategies. Highly leveraged duration strategies as much as 7 times. I mean, just an incredible to think about that. That these strategies were leveraged to that extent. What was transpiring in the UK that really exacerbated this problem. Similar to the US, you had rising inflation. The UK's inflation scenario is worse than that of the US at this point in time. So Bank of England is raising rates, long gilts are rising. Unfortunately, that's putting pressure on those derivatives that they had engaged in. Those swaps and so as rates were rising more collateral was being called. Well, the only way to build that collateral bucket was to sell gilts. And so you had this virtuous circle where plan sponsors were selling gilts, raising interest rates, and more demand for more collateral was being called. If the Bank of England didn't step in, there would have been a real crisis. Now, I'm not saying that we're through that, we're through the worst part of it, but a lot of those plans were harmed. And a lot of people thought that derivative strategies for duration made perfect sense. But again, I get back to my point I made earlier. Unless you're my age and in the business 41 years, you did not see a bear market in bonds. You did not see double digit interest rates. You didn't see the impact of inflation. And so I think a lot of us have just become complacent that rates were going to be low forever. And that the Fed was always going to be there to step in. Whether it was the Fed or the Bank of England, in this particular case, that during periods of uncertainty, of dislocation, that they were there as the savior, the last resort to step in, provide liquidity. And I think that environment's gone. And it'll be interesting to see what transpires next. So I think when we're talking with plan sponsors, we need to remind them of that fact. That you had four decades of a tailwind. Now you have a headwind. And things that you thought made sense in that previous environment may not make sense. And so let's come up with structures, with thought processes that are going to take-- actually be used appropriately, I think, over the next decade as opposed to what's transpired over the previous four decades.

Robert Morier: Thanks, Russ. Well, Russ, we hope we get many more years of your industry expertise, thoughts, and opinions. We really appreciate it. This has been a wonderful conversation. Dan, thanks so much for joining us as well.

Dan DiDomenico: Thank you, Robert.

Robert Morier: For your insights, they were also equally interesting. So we appreciate you being here in Philadelphia. We appreciate you being here in the Dakota studios. If you want to learn more about Russ and Ryan ALM, please visit their website at www.ryanalm.com. Additionally, you can find a wealth of plan sponsor insights and observations on Russ's blog at www.kampconsultingblog.com.

That's Kamp with a K. You can find this episode and past episodes on our website at www.dakota.com or your favorite podcast platform. We are also available on YouTube, if you prefer to watch rather than listen. And again, Russ, thanks for joining us today on the Dakota Live Podcast. Dan, thanks for being here. I wish you both happy holidays and safe travels ahead.