MONEY MARKET FUND REFORM SPURS RENEWED INTEREST IN STABLE VALUE

The Case For Stable Value

Matt Kline, *Director*

Client Portfolio Management
Stable Value Analyst

MONEY MARKET FUND REFORM has altered the capital preservation landscape and has led to a renewed interest in stable value from defined contribution plan sponsors who utilize money market mutual funds (or "money market funds"). In this issue of *Stable Value Analyst Insights*, we provide a summary of the key amendments adopted by the U.S. Securities and Exchange Commission (SEC)[1] to the money market fund rules. We also highlight key differences between money market funds and stable value funds. Lastly, we revisit the compelling case for stable value as a defined contribution capital preservation option. The SEC amendments to the money market fund rules did not directly impact stable value. However, we believe the impact of reform on money market funds further strengthens the case for stable value as an optimal principal preservation choice compared to money market funds.

1 Endnote is located on page 7

GALLIARD CAPITAL MANAGEMENT is a wholly owned, independently operated investment management subsidiary of Wells Fargo Bank, N.A. Founded in 1995, Galliard specializes in architecting fixed income and stable value investment solutions for institutions nationwide. A deeply rooted client-centric culture and an in-depth level of expertise in every critical area of the investment solution are the key differentiating characteristics of the firm. Galliard manages more than $85.0 billion in assets for more than 240 institutional clients nationwide.

Government Money Market Funds
Caveat Emptor

Government money market funds were not materially impacted by Money Market Fund Reform, and thus are not required to use a floating NAV, nor are government money market funds subject to the new redemption restrictions. These funds could, however, be indirectly impacted by the new rules. If investors opt to make a significant move into government money market funds, demand for these types of short-term government securities could increase and induce a shift in the demand curve. This could cause price increases, further compressing already low yields, which have historically not kept pace with stable value funds (*Figure 3*).

A Summary of the SEC Money Market Fund Amendments

FIGURE 1 SEC MONEY MARKET FUND AMENDMENTS

Money Market Mutual Funds	Liquidity Gates and Fees (Redemption Restrictions)		$1 or Floating NAV	
	PRE-REFORM	NEW SEC RULE (COMPLIANCE DATE OCT. 2016)	PRE-REFORM	NEW SEC RULE (COMPLIANCE DATE OCT. 2016)
Institutional Prime	No	**Allowed**	$1	**Floating**
Retail Prime	No	**Allowed**	$1	$1
Government	No	No	$1	$1

LIQUIDITY GATES AND FEES (REDEMPTION RESTRICTIONS)

100% liquidity has long been one of the most attractive features of money market funds. The new rules allow fund boards of retail and institutional prime money market funds to restrict withdrawals in certain circumstances by imposing liquidity gates and fees. These redemption restrictions do not apply to government money market funds (*Figure 1*).

STABLE OR FLOATING NET ASSET VALUES (NAV)

The ability to maintain a constant $1.00 NAV has also been a key selling point for money market funds. Under the new rules, institutional prime money market funds must begin using a floating NAV structure. The floating NAVs of institutional prime money market funds will be marked to market out to four decimal places. Government and retail money market funds are not required to adopt a floating NAV structure under the new rules.

Stable Value vs. Money Market: Structure, Performance, Volatility

While the objectives of principal preservation and safety are similar for both money market funds and stable value funds, these two asset classes have different risks, different structures, and the benefits and historical performance of each asset class has also been markedly different. We believe it is useful for plan sponsors to understand some of the key structural differences (*Figure 2*) between stable value and money market mutual funds, given that these are among the most commonly used capital preservation options in defined contribution plans.

FIGURE 2 STABLE VALUE VS. MONEY MARKET FUNDS: STRUCTURAL DIFFERENCES

	Stable Value	Money Market Mutual Funds[1] (Compliance Date: October 2016)
NAV Structure	Stable value funds can have either a floating or a stable NAV. Unlike money market funds, stable value funds seek principal preservation benefits through the use of investment contracts. Investment contracts are used as a vehicle that seeks to protect plan participants from experiencing principal losses.	Institutional prime money market funds are required to use a floating NAV. Retail and government money market funds may continue to use a stable NAV structure. Money market funds seek principal preservation benefits by investing in eligible money market securities. Money market funds are not permitted to use the investment contracts used in stable value investing to protect participants from experiencing principal losses.
Liquidity Fees and Redemption Gates	Participants may withdraw assets from their stable value option at contract value (principal plus accrued interest) regardless of financial market conditions. Some transfer restrictions may apply when competing funds are in the plan.	For retail and institutional prime money market funds, mutual fund boards may impose liquidity fees and redemption gates in certain environments to mitigate the risk of a run on the fund. The new liquidity fees and gates were designed to help mutual fund boards slow redemptions during periods of financial stress. Therefore, the fees and gates could prevent participants from accessing their assets during times when they are needed most.
Investments Utilized	Stable value strategies typically invest in a diversified portfolio of short and intermediate duration fixed income securities (i.e., bonds) coupled with stable value investment contracts which seek to provide a smooth income pattern and protect participants from experiencing principal losses.	Money market funds invest solely in short duration securities as defined in SEC Rule 2a-7. These include securities such as government securities, certificates of deposit, commercial paper and other highly liquid short-term securities.

1 Endnote is located on page 7

Stable Value has provided a rate of return that has outpaced money markets and inflation over the last 20 years.[2,3]

PERFORMANCE DIFFERENCES BETWEEN STABLE VALUE AND MONEY MARKET MUTUAL FUNDS

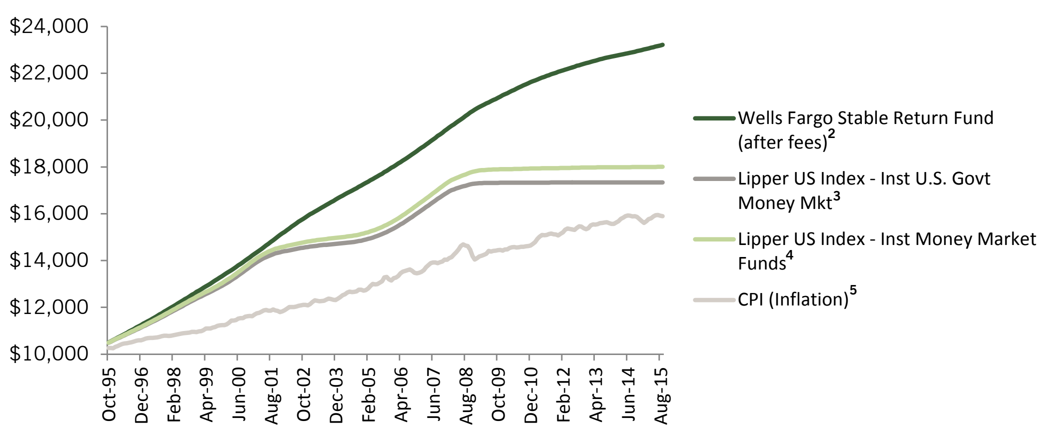
FIGURE 3 STABLE VALUE VS. MONEY MARKET FUNDS AND INFLATION ANNUALIZED RETURNS AS OF 9/30/2015

	Annualized Returns				
As of 9/30/2015	1 Year	3 Year	5 Year	10 Year	20 Year
Wells Fargo Stable Return Fund (before inv. mgmt. fees)[2]	1.69%	1.69%	1.97%	3.11%	4.48%
Lipper US Index - Inst U.S. Govt Money Mkt[3]	0.07%	0.07%	0.09%	1.49%	2.70%
Lipper US Index - Inst Money Market Funds[4]	0.01%	0.01%	0.02%	1.32%	2.52%
CPI (Inflation)[5]	(0.31%)	0.84%	1.67%	1.79%	2.21%
Wells Fargo Stable Return Fund (after maximum fees)[2]	1.26%	1.28%	1.56%	2.70%	4.07%

The Wells Fargo Stable Return Fund (the "Fund") is a collective trust fund for which Wells Fargo Bank, N.A. ("Wells Fargo") is investment manager and trustee. Galliard Capital Management, a wholly-owned subsidiary of Wells Fargo, serves as advisor to the Fund. Amounts designated as being "before investment management fees" include all income, realized and unrealized capital gains and losses (for calendar year and annualized performance) and all annual fund operating expenses. Amounts designated as being "after maximum fees" are the "before investment management fees" amounts less the maximum 0.40% fee which may be charged by Galliard for management of each client's account. See endnotes for details on net of fees calculations.

Stable Value has historically outperformed both government and prime money market funds by 150 to 200 basis points (bps) annually with less volatility (lower standard deviation,) while providing the daily liquidity that participants expect from their capital preservation option. In addition to consistently outperforming money market funds, stable value returns have outpaced inflation. This has not always been the case for money market funds, which calls into question their value as a true capital preservation option.

FIGURE 4 STABLE VALUE OUTPERFORMS MONEY MARKET FUNDS: GROWTH OF $10,000 OVER 20 YEARS[6]



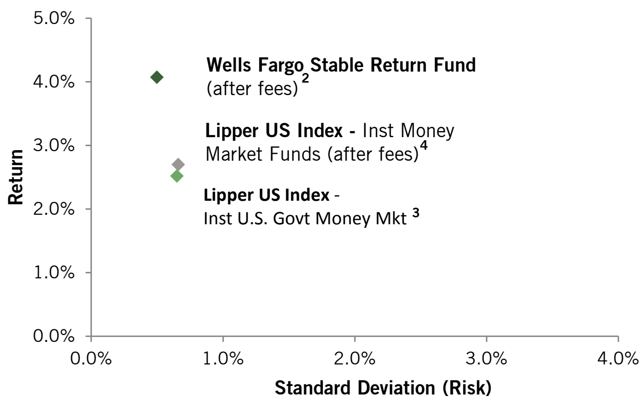
1, 2, 3, 4 Endnotes are located on page 7

VOLATILITY DIFFERENCES BETWEEN STABLE VALUE AND MONEY MARKET MUTUAL FUNDS

Both stable value and money market funds are considered to be low volatility conservative investment options that are designed to insulate plan participants from return volatility associated with market behavior. The manner in which a stable value portfolio achieves low volatility is quite different from money market funds. Money market funds typically invest in very short duration government securities, certificates of deposit, commercial paper of companies, or other highly liquid and high quality securities which help achieve a low volatility profile. Stable value funds utilize investment contracts which enable stable value managers to invest in short-to-intermediate fixed income securities while insulating plan participants from the volatility of those securities. The investment contract issuer guarantees a crediting rate no lower than 0% (thus providing principal protection). Money market funds do not utilize investment contracts. Investment contracts are unique to stable value and have served as a powerful financial tool for dampening volatility. Over a 20 year period ending September 30, 2015, stable value returns experienced higher returns and less volatility (lower standard deviation) than money market funds.

Stable value returns have had less volatility (lower standard deviation) than money market funds over the long-term. (*Figure 5*)

FIGURE 5 STABLE VALUE: HIGHER RETURNS, LESS RISK AS OF 9/30/2015[1,2]



Risk/Return	Annualized	
	20 Yr Return	**20 Yr Std. Dev.**
Wells Fargo Stable Return Fund (after fees)[2]	4.07%	0.50%
Lipper US Index - Inst. U.S. Government Money Market[3]	2.52%	0.65%
Lipper US Index - Inst. Money Market Funds[4]	2.70%	0.66%

Galliard believes the new Money Market Fund Reform makes an even more compelling case for stable value as an optimal principal preservation solution for defined contribution plans.

The Case for Stable Value

The fundamental argument for why stable value is an optimal principal preservation option for defined contribution plans remains the same. Galliard believes the new Money Market Fund Reform rules only serve to strengthen the compelling relative value argument in favor of stable value over money market funds.

Stable value has a 40-plus year track record of successfully weathering challenging economic environments and varying interest rate and yield curve climates—all while delivering on its primary objective of principal preservation. The Financial Crisis during late 2008 and early 2009 highlighted stable value's ability to perform during unprecedented turbulence. While not entirely immune to market stresses, the stable value asset class has repeatedly delivered steady returns and safety of principal during times when plan participants needed it most.

CONCLUSION

The compliance date for plan sponsors to implement the new Money Market Fund Reform rules is set for October, 2016. Implementation of the new rules will introduce more administrative complexities for plan fiduciaries. This has prompted many plan sponsors to review their current conservative investment options and determine which option is most suitable for plan participants. Given the compelling investment case in favor of stable value, we believe plan sponsors currently using any type of money market option in defined contribution plans may want to consider stable value as a more attractive principal preservation choice.

THE CASE FOR STABLE VALUE

Stable value is an optimal principal preservation option in any market environment.

- Stable value has consistently outperformed inflation
- Stable value has historically outperformed money market funds
- The Financial Crisis during late 2008 and early 2009 highlighted stable value's ability to perform during unprecedented turbulence.

[1] For more details on the SEC Money Market Fund Reform rules, visit http://www.sec.gov/rules/final/2014/33-9616.pdf

[2] The Wells Fargo Stable Return Fund (the "Fund") is a collective trust fund for which Wells Fargo Bank, N.A. ("Wells Fargo") is investment manager and trustee. Galliard Capital Management, a wholly-owned subsidiary of Wells Fargo, serves as advisor to the Fund. Amounts designated as being "before investment management fees" include all income, realized and unrealized capital gains and losses (for calendar year and annualized performance) and all annual fund operating expenses. Wells Fargo Stable Value Fund W is 100% invested in the Wells Fargo Stable Return Fund G. While the Wells Fargo Stable Return Fund G has been in existence since 1985, Fund W has only been available with the applicable trustee fee of 3 bps since 2/2/15. In order to illustrate historical performance of the Fund, Fund W's returns have been linked with the historical returns of Wells Fargo Stable Return Fund G and the resulting amount is reported as performance before investment management fees. Amounts designated as being "after maximum fees" are the "before investment management fees" amounts less the maximum 0.40% fee which may be charged by Galliard for management of each client's account. Returns may have been impacted by the effect of compounding and have been rounded to the nearest basis point. Fees which may be charged to each client for investment management are described in Galliard Capital Management's Form ADV Part 2 and on page 2 of this fund fact sheet. Returns for periods less than one year are not annualized.

[3] The **Lipper US Index – Inst U.S. Gov't Money Mkt** is an average of funds that invest principally in financial instruments issued or guaranteed by the U.S. Government, its agencies, or its instrumentalities, with dollar weighted average maturities of less than 90 days. These funds are eligible to keep a constant net asset value. The total return of the Lipper Average does not include the effect of sales charges. You cannot invest directly in a Lipper Average.

[4] The **Lipper US Index – Inst Money Market Funds** is the average of the 30 largest funds in the Lipper Money Market Funds Category. These funds invest in high quality financial instruments rated in top two grades with dollar-weighted average maturities of less than 90 days. These funds are subject to the floating NAV requirements. You cannot invest directly in a Lipper Average.

[5] CPI (Inflation) data is represented by the US BLS CPI All Urban NSA 1982-1984. Source: Morningstar. Figures for 2015 are based on Morningstar estimates.

[6] The growth of $10,000 shown in Figure 3 is a hypothetical illustration based on the growth of returns of the Wells Fargo Stable Value Fund W, the Lipper US Index – Inst U.S. Govt Money Mkt, and the CPI All Urban data from the Bureau of Labor Statistics from October 1995 through September 2015.

FOR MORE INFORMATION CONTACT:

For other Stable Value Analyst Insights publications, please contact your Galliard relationship manager or email Galliard at the following address:

Galliard Client Service

Galliardclientservice@Galliard.com

You can also visit the Galliard website at www.Galliard.com

Galliard Capital Management, Inc.
800 LaSalle Avenue, Suite 1100
Minneapolis, MN 55402
www.Galliard.com (800) 717-1617

ARCHITECTS OF INVESTMENT SOLUTIONS