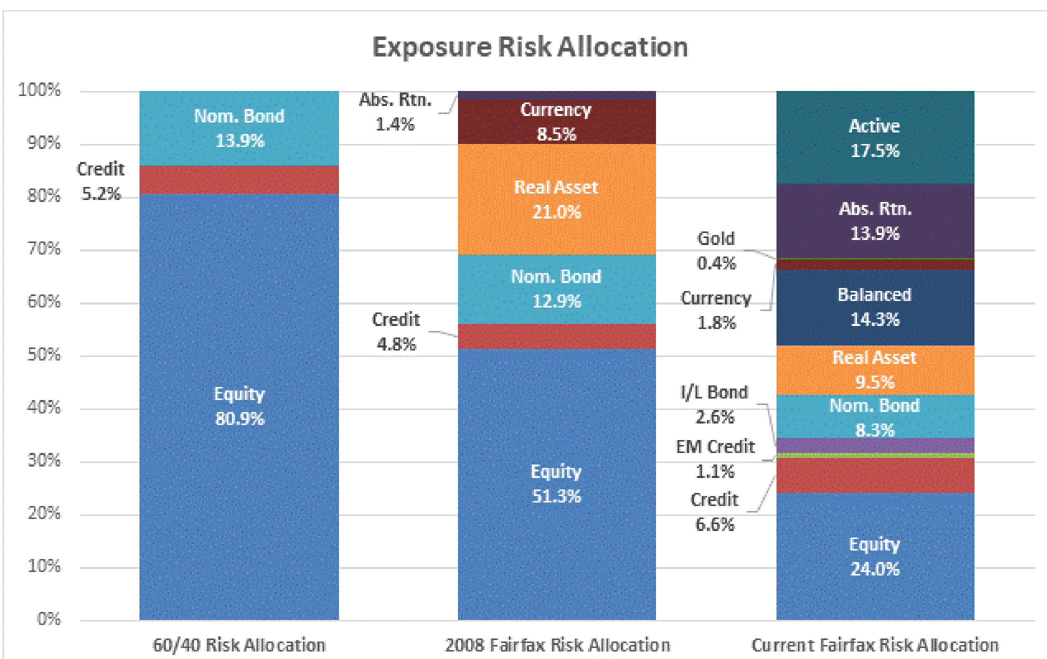
Response to Questions on the Retirement System Review

Request By: Supervisor Cook

Question: Provide a description of the asset allocation approach used in the retirement systems, focusing on changes made since the great recession.

Response: The Boards of Trustees for the Fairfax County Employees' (ERS), Police Officers (PORS), and Uniformed (URS) Retirement Systems have adopted a risk-balanced investment approach to achieving the return objectives of the Systems. The investment philosophy seeks to broadly diversify the investment portfolios' risk exposures, in order to deliver as smooth a return pattern as possible through the course of the business cycle (peak, trough, expansion, contraction) and economic cycle (rising/falling inflation and growth). Maintaining this risk-balance and diversification gives the systems the desired exposure to each segment of the capital markets and provides opportunities to produce the expected returns over various market cycles. Stability of investment returns thus results in less volatility in employer contribution rates.

The three Fairfax County retirement systems, in general, have less equity exposure than both traditional "60/40 balanced" funds and their peers, in favor of greater exposure to other diversifying asset classes. The chart below compares the exposure risk allocation of a "60/40 balanced" fund, the 2008 risk allocation of the Fairfax County retirement systems, and the current risk allocation of the Fairfax County retirement systems. As shown in the chart, the typical 60 percent equity/40 percent fixed income portfolio actually has more than 80% of its risk coming from equity. The Fairfax County portfolios in 2008 were considerably better diversified, though they still had more than 50 percent of their risk coming from equity. Staff has continued to work to improve the diversification of the Fairfax County portfolios since 2008.



The two charts below show diversification based on economic cycle and business cycle. The typical 60 percent equity/40 percent fixed income portfolio is not well diversified by economic cycle or business cycle. While the Fairfax County portfolios in 2008 were better diversified than the typical 60 percent equity/40 percent fixed income portfolio, they had a heavy bias towards a rising growth and expansionary environment. The current Fairfax County portfolios are well-diversified across economic and business cycles. As a result of their greater exposure to other diversifying asset classes, the systems by design give up a little during equity bull markets and gain a little in more volatile markets.