

PIMCO DC Dialogue™

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This issue's featured
interview is with

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Keep the baby. Lose the bath water.

In this PIMCO DC Dialogue, we talk with Matt Rice about the evolution of defined contribution plan investment structures. He shares his experience in working with plans of all sizes in establishing custom target-date strategies. Matt discusses some of the operational considerations as well as rebalancing frequency. He also talks about the need for more conservative asset allocation structures and emphasizes the importance of inflation-protection securities in DC plans. Finally, he discusses the entry of alternative securities in DC and predicts we'll see more of the asset types in today's defined benefit plans added to DC plans.



DC Dialogue

DC Dialogue: *DiMeo Schneider has been working with many plan sponsors on structuring DC plans to meet retirement-income needs. Can you share with us some of the types of work you're doing in this area?*

Matt Rice: We work with our plan sponsor clients to help them structure their investment menus including their qualified default investment alternatives. A major trend recently has been toward custom target-date strategies. We saw the trend begin before the qualified default investment alternative (QDIA) provision, and then accelerate afterwards.

Our clients have long struggled with the limitations of off-the-shelf products, the lack of thorough and thoughtful diversification and over-reliance on a single fund family to manage every single asset class in participants' portfolios. Our clients want more flexibility to drive costs down, enhance diversification, and freedom to use best-in-breed underlying managers.

In terms of both beta optimization and alpha maximization, many clients find that custom strategies offer the best of both worlds. Customization gives them the ability to create broader, more optimal asset-allocation strategies with more sensible glide paths. It also allows them to select best-in-breed underlying managers and use both active and passive management where most appropriate.

When they create custom target retirement-date strategies, our clients typically use their underlying core funds or managers within their target retirement-date funds. In addition, most also include other asset classes they don't want to include in the core menu, such as emerging markets, real estate, high-yield bonds, foreign bonds, Treasury Inflation-Protected Securities (TIPS) or commodity futures. The benefit of customization is that you get to use multiple managers from different investment management firms, and you can employ a more thoughtful allocation structure and broader diversification.

We work with many of our 401(k) plan sponsor clients on their defined benefit plans as well. Many have seen the benefits of more sophisticated and thoughtful asset-allocation strategies and understand the benefits of best-in-breed manager selection. Many want to employ models for their 401(k) plans similar to the ones they use for their DB plans. Today, as the DB plan becomes a dying breed, many paternalistic plan sponsors feel that their DC plans deserve more attention than ever.

DCD: *Why would you want to include something in the target-date fund that's not in the core lineup?*

“Customization gives clients the ability to create broader, more optimal asset-allocation strategies with more sensible glide paths.”

Rice: It's difficult to educate participants on more esoteric asset classes such as commodity futures. While a 5- to 10-percent allocation to commodity futures within a portfolio may be appropriate for most participants, you don't necessarily want them to have the flexibility to allocate 100 percent of their portfolios to that asset class. Adding a commodity fund, with no constraint, to a core lineup almost dares participants to jump into it with both feet. The same is true of other, more esoteric investments such as emerging markets, foreign bonds, high-yield bonds or real-estate investment trusts. Too much flexibility to invest in esoteric asset classes, combined with participants' naïve desire to chase performance, can be a dangerous combination.

DCD: ***Does the client still hold those assets in the recordkeeping system? Or, are they off the system?***

Rice: They're in the system, but they don't register as core options on the enrollment form, Internet site, or 800 number. It shows up within a target retirement-date model as an underlying fund. But you can't select the fund if you decide to build your own mix.

DCD: ***Are custom strategies feasible only for large or mega plans?***

Rice: No. We have clients of all sizes with custom strategies; our clients' plans range from \$2.5 billion down to \$20 million on the custom target-retirement side. The real issues are the recordkeeping constraints, as well as whether the sponsor remaps plan assets to the custom target-date funds. By remapping assets, the sponsor creates a larger asset base right off the bat, making more feasible the custom strategy's implicit sunk cost. While there are many strong paternalistic arguments for remapping to target-date strategies, remapping also allows you to cross the asset hump and make the jump to customization. If you add custom target strategies as new investment options and don't map, it can take a long time for assets to find their way to these strategies – even with the best education and communication efforts. Inertia is the most powerful force in the universe, especially for 401(k) participants!

DCD: ***What are the different operational approaches to offering custom strategies?***

Rice: We see two primary approaches for custom strategies: a unitization approach and a model-portfolio approach. The unitization approach requires the record keeper or trust to create commingled funds of underlying funds and managers, and strike daily net asset values for the pools. Larger plans or those that remap assets to create a sufficient base to get established may be attracted to this approach. It also works for record keepers that cannot or choose not to support a model-portfolio approach.

“By remapping assets, the sponsor creates a larger asset base right off the bat, making more feasible the custom strategy’s implicit sunk cost.”



The model portfolio approach resides on the recordkeeping system at the participant level. Model portfolios are simply predetermined allocations to underlying funds. For example, if a participant selects the 2020 model, the system automatically allocates 20 percent of their account to Fund A, 12 percent to Fund B, and so on, based on the model's target allocation. As the 2020 model's target allocation changes over time, the record keeper simply rebalances each participant's account to the new targets.

For smaller plans – those below \$100 or \$50 million – the model portfolio approach may be the only viable option for many sponsors due to the potentially higher cost of the unitization approach.

In our experience, record keepers are less likely to charge additional fees for the model-portfolio structure. The structure may not require the record keeper to strike a daily NAV or manage cash flows in and out of a commingled fund. So the model-portfolio structure can require fewer resources. In the structure, a participant's contributions are allocated simply based on a predetermined, percentage mix, and rebalanced at the participant account level.

So, smaller plans can create cost-effective custom strategies. These strategies aren't limited to the mega-plans, as many sponsors often assume.

“The goal is to meet participants’ real retirement spending needs with a focus on managing left-tail risk over the participants’ investment horizons.”

DCD: ***Do all record keepers support the model-portfolio approach to target strategies?***

Rice: Most, but not all, record keepers support them. You need to talk with your record keeper to determine if they do. More record keepers are developing the capabilities, though some are more reluctant than others to do so. Many times the record keeper is also a mutual-fund company. In that case, it may have incentives to discourage custom strategies because it instead wants to distribute its own proprietary target retirement-date funds.

As record keepers lose clients because they don't offer this service, we'll see the more reluctant record keepers get on board.

DCD: ***What's the primary objective to which you manage as you create custom target asset allocations?***

Rice: The goal is to meet participants' real retirement spending needs with a focus on managing left-tail risk over the participants' investment horizons. The left tail is not simply an investment loss over a finite period. It also can be catastrophic unexpected underperformance, like not keeping pace with Treasury bills or inflation. You might identify an investment strategy that gives you a 60-percent probability of meeting your retirement spending goal, but has

a 20-percent probability of catastrophic underperformance. You might then identify another strategy that gives you a 59-percent probability of meeting your goal but only a 5-percent probability of catastrophically underperforming your goal. You have to weigh those alternatives. Does it make sense to drop from a 60-percent probability down to a 59-percent probability on your median scenario in order to reduce the probability and magnitude of a left-tail event? We think it does.

The objective should be more than maximizing the probability that a median expected outcome meets your replacement goal. You also have to consider the impact of catastrophic underperformance as well. With a broader diversified glide path we can both improve the expected return of the median scenario and thin out the fat left tail.

DCD: *How do you manage left-tail risk or avoid catastrophic underperformance?*

Rice: We create portfolios that blend a broad range of asset classes to reduce expected volatility, without sacrificing expected median returns compared to many first-generation glide paths. These tend to be heavy on the big four asset classes: U.S. cash, U.S. investment-grade intermediate nominal bonds, U.S. equity, and foreign developed equity. All of these are vulnerable to unanticipated inflation. Many people frequently miss the need to manage investment-horizon left-tail risk. Everybody tries to put all their eggs in the basket

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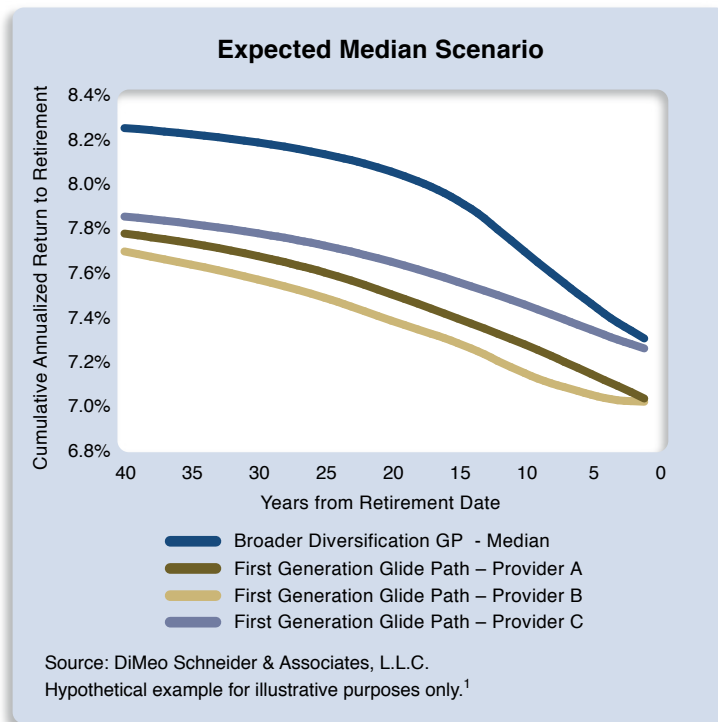


Chart 1

that maximizes the probability of meeting an objective, rather than saying, "If we fall 1-percent short of the objective, we'll probably be okay. However, if we fall, say, 25-percent short of the objective, we could be in serious trouble."

DCD: ***What are the various types of risks you see and how do you bring in different assets and blend them to minimize the risks?***

Rice: If a participant has a long time horizon, he or she is at risk of not generating a sufficient real return to fund retirement spending needs. However, as the retirement date approaches, the participant has to worry about short-term losses and/or the opportunity cost of underperformance that can arise if risk premiums don't deliver excess return in the decade prior to the retirement date.

The risks get more complex as retirement approaches because there's less time to ride out potential negative consequences of risk in hopes that mean reversion occurs. Once retirement hits, you have all sorts of risk. One is that you don't earn a rate of return in retirement that's high enough to fund 20-plus years of living. Another risk is that a participant lives too long and outlives their money. Of course, there are some benefits as well – a longer life. There's also the risk of a large catastrophic short-term decline from which you can't recover. Continuing to spend down a portfolio in the wake of a significant investment loss leads to an accelerated depletion of principal and a very negative cascade effect.

There's no reason ever to seek risk, even if you have 50 years to retirement. It's better to structure a portfolio that has lower variability of returns across the entire spectrum of time horizons. However, diversification only gets you so far. At some point, you need to begin sacrificing expected return in exchange for a lower variability of returns.

Some people think 10 or 20 years is a long time. But it's very possible that any asset class could go through a 10-, 20-, or even 30-year period of significant underperformance relative to its historical risk premium. It'd be a bit easier perhaps if we had 100-year working careers, but we don't.

So it's important to reduce risk across the entire spectrum. It's also important from a behavioral finance standpoint. Someone may have 30 years until retirement and, therefore, allocate heavily to equities. But what happens when that individual goes through a terrible bear market and her portfolio is down 30 percent to 35 percent? Are they going to ride it out?

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There's a risk that this participant gets nervous and bails out on their strategy. We're dealing with human beings, here, not automatons. We're emotional. So we need to think about risk reduction across the board, even when we have a very, very long time horizon to retirement.

DCD: ***What factors influence design when you structure allocations for your clients?***

Rice: There's a lot of discussion about how to incorporate DB plans, as well as about how to incorporate savings rates into the equation. On the DB side our take is a little different than that of many others who assume that if you have a significant DB-plan benefit you can treat it as fixed income, and allocate more to riskier assets like equities. Traditionally, that's how many practitioners view their asset-allocation modeling.

We're not so sure about this. If you have a significant DB-plan benefit coming to you when you retire – you can tolerate more risk in your 401(k), but you don't necessarily need to take it.

It all boils down to this: are you really trying to optimize for the median scenario? Or would you rather reduce the magnitude of the catastrophic scenario? It's a philosophical difference we have with a lot of practitioners. So we don't necessarily regard a very large DB-plan benefit as license to structure the DC portfolio more aggressively.

More important, you have to think about the type of company you have. What are the savings rates? Are they high? Are they low? How much have people accumulated? What's the turnover? In this day and age, many companies have very high turnover, which means some participants may only be in a plan for a few years at a time. Then they head off to another company, which means they're likely to roll out of the plan. You can only hope they roll their money into their new company's 401(k) or an IRA and that they don't cash out. We have to consider a lot of these types of things. However, it's very challenging to factor these considerations into actionable portfolio construction ideas.

DCD: ***Is there much variation in glide path from employer to employer, based on demographics, savings, and these other factors?***

Rice: There are similarities, but also some differences. Part of it has to do with the nature of the organization, how sophisticated it is. For instance, some plan sponsors are comfortable with all the asset classes we suggest, including the more esoteric, and others aren't, or prefer to place constraints on certain asset types. Generally, the fewer the asset-class constraints, the longer you can delay or slow the roll down of the glide path.

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DCD: *Looking at a typical DC plan, what are some of the primary asset classes that are missing if you want to create optimal diversification?*

Rice: There are many, including TIPS, high-yield bonds, foreign bonds, emerging-market equities, real estate, commodity futures and even energy infrastructure master limited partnerships. These are the types of asset classes that many endowments, foundations and other institutional investors have incorporated into their portfolios for decades. These asset classes also have a place in DC plans. Frequently the problem is that plan sponsors don't want to offer all these additional asset classes in their DC plans because it's challenging enough to explain to participants the difference between a stock and a bond.

“TIPS, high-yield bonds, foreign bonds, emerging-market equities, real estate, commodity futures and even energy infrastructure MLPs all have a place in DC plans.”

To overcome this communication challenge, you can blend these asset classes or diversifiers within the core investment options or simply within the custom target strategies. By blending them into a broader strategy, it's easier to manage the risk to each participant because the participant can't over-allocate to any individual asset class.

DCD: *Tell us more about real estate and energy master limited partnerships (MLPs).*

Rice: Typically in a 401(k) plan, you add real estate through REITs because daily valuation is essential in the modern 401(k) plan. Private real estate can be problematic as a result of less frequent valuation. That typically limits clients to REITs.

Energy MLPs provide access to energy infrastructure. The MLP space largely is composed of midstream energy assets like oil and gas pipelines. They tend to have fairly low commodity price exposure and historically have generated high yields with relatively stable growth. They also have exhibited fairly low correlation both to equity and fixed-income markets. This is a relatively new asset class in its current form; it's not one with which many are familiar. In fact, currently there are no mutual-fund products available today for this type of exposure, given certain regulatory and tax constraints. However, there are ways to access the asset class through closed-end funds or other structures. This asset type fits best in a unitized custom target strategy rather than as a standalone core option in a plan. You have to invest very carefully and consider certain liquidity and tax issues. All the current ways to access the asset class have drawbacks, but not enough to ignore the asset class altogether.

DCD: *Would you consider these different asset classes to be alternatives?*

Rice: Yes. Practitioners have many different definitions for what constitutes ‘alternative’ versus ‘traditional’ investments. There’s no concrete, objective delineation between the two. But most would consider TIPS, high-yield bonds, foreign bonds, emerging markets, real estate, commodity futures and energy infrastructure MLPs as being alternative asset classes – particularly in the context of a 401(k) plan but perhaps not in an endowment or foundation.

DCD: *When we think of alternatives, we think of hedge strategies, absolute-return strategies, private equity, and other less liquid securities. In the future will any of these types of securities find their way into plans?*

Rice: Hedge funds and private equity are not valued daily. For illiquid assets to find their way into a 401(k) plan, you either need to throw out the daily valuation construct that we’ve all gotten used to, use stale pricing, or devise artificial liquidity, which might include maintaining a fairly high cash position mixed with the illiquid securities. Some in the marketplace create artificial liquidity. However, providing liquidity where none really exists can create problems. For example, if you ever need to liquidate an investment all at once, it could create some significant issues ranging from a major headache to litigation.

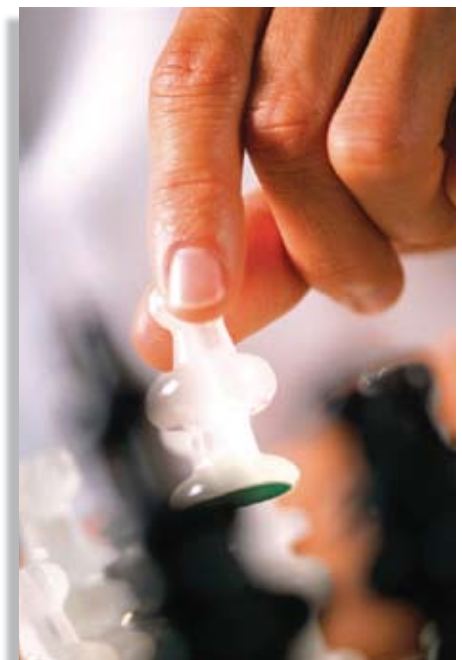
On the hedge-fund side, there are potential ways to do it within a daily environment. You can go to a hedge-fund manager – maybe a long-short manager – and get them to run a separate account for your plan. At this stage with our clients, it’s fairly unlikely that we’ll add hedge funds or other illiquid securities within the 401(k) plans any time soon. Down the road, however, it’s not completely outside the realm of possibility.

In the meantime, there are many other liquid asset classes, which practitioners aren’t using enough, that can provide valuable portfolio diversification. For instance, many haven’t yet added TIPS, high-yield bonds, foreign bonds, emerging markets, REITs, commodities, or other asset classes that can provide lower-cost esoteric beta exposures and increase the diversification benefits to participants.

DCD: *How might the glide path change after someone turns 65 and retires?*

Rice: These discussions are interesting. Should a glide path remain the same at age 65? Once you turn 65, do you hit a certain static risk budget or does it stay dynamic? Should the path continue to grow more conservative over time?

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To answer these questions, you have to start assuming a lot of things about participants. For example, you can't assume that all participants will maintain the same strategies or even stay in the plan when they turn 65. It's likely that many, if not most, will leave the plan when they retire. You have to deal with that reality.

It's important to manage the portfolio effectively up to the 65th birthday, put it in a position so that if it does change to a different strategy or roll out of the plan, it's not the end of the world. You don't want the retiree getting hit by a portfolio that may be down significantly from its peak just at the time of transition. While there's perhaps little academic support to this concern, there are pragmatic ones. At this point one should have a broadly diversified portfolio with a low risk posture, including inflation-protection securities.

"We allocate portfolio assets to inflation-protection securities along the entire glide path – not necessarily for the same reason."

DCD: ***What do you do to protect participants against inflation, and at what point does inflation protection become important?***

Rice: We allocate portfolio assets to inflation-protection securities along the entire glide path – not necessarily for the same reason. Early on with more aggressive portfolios, we view TIPS as a tremendous diversifier to equities. When we look at periods of time when equity markets struggle typically, TIPS frequently perform better than nominal bonds. TIPS also should do particularly well in periods of unanticipated rising inflation.

Foreign bonds, particularly unhedged currencies, also can be a tremendous diversifier. Many of our clients with meaningful allocations to foreign bonds saw this during the first quarter of 2008 when the S&P 500 Index was down about 9.5 percent and foreign unhedged bonds were up 10.9 percent. During many periods when the U.S. equity market has sold off dramatically, foreign unhedged bonds frequently do well because the dollar often suffers when riskier U.S. assets deflate. Another good example occurred in 2002, when the S&P 500 sold off by about 22 percent and foreign unhedged bonds were up about 22 percent. The year 2002 was the type of year most portfolios needed a 'low-correlation hero.' Many relatively low-correlation financial assets tend to rise in correlation during periods of stress. During periods of stress, foreign unhedged bonds appear to be one of those rare financial assets that seem to have falling correlations to U.S. risky assets.

For fixed-income allocations in glide paths that are 15-plus years from retirement, we tend to have very little in nominal bonds. We do have allocations to TIPS and some foreign bonds, as well as a healthy chunk in commodity futures.

Commodity futures can be a good diversifier, long term. When stocks fall 10 percent, commodity futures are frequently positive and can dampen some of the volatility. As you approach retirement it's essential to have a portfolio that hedges your liabilities. In this case, DB and DC plans are different because, in a DB plan, you usually express the liability in nominal terms. With a DB plan, you don't care as much about inflation because you manage to a nominal liability target.

On the other hand, in a DC plan you do care. In a DC plan, participants' liabilities are real, or after inflation. Retiree assets need to keep up with inflation as much as possible. That's why you need to have asset classes that do better during stretches of unanticipated inflation, in addition to traditional asset classes. These include commodity futures, TIPS and, frequently, foreign bonds that have exposure to foreign currencies.

DCD: ***Does real estate protect against inflation as well?***

Rice: Real estate can be a better inflation hedge than stocks, but I wouldn't call it a great inflation protector. There are very few terrific inflation protectors. You can only hope to find some assets that aren't terrible inflation hedgers. Perhaps the purest inflation protector is TIPS. But as government issues, you also get a lower expected return. One of the asset classes with the highest correlation to the consumer price index is cash; however, real returns frequently are negative so that isn't a terrific solution either. Real estate doesn't provide the same inflation protection you get from TIPS or commodity futures, but you get a little more inflation protection than from pure equity. Assuming that rising rents accompany higher overall inflation, real estate can be a solid inflation hedge. However, higher inflation usually accompanies higher interest rates and discount rates, which causes the present value of future rents to fall. Real estate is a mixed bag at least, whereas many other financial assets are just plain bad inflation hedges.

Equities aren't a great inflation protector because when you get periods of rising inflation, you frequently get periods of rising interest rates, higher discount rates, which usually means contracting P/E ratios. If you go through a decade of unanticipated rising inflation like we had in the 1970s, it's typically not a great period for equities. Participants approaching or in retirement absolutely need more inflation protection. Regardless of time horizon, some inflation protection is wise in any portfolio.

*“In a DC plan,
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DCD: *What do you think of the typical target-date glide path compared to the approach you suggest?*

Rice: We suggest a broader array of assets than we typically see in packaged products. Also, we tend to have more inflation protection than the first-generation glide paths. Because we have broader diversification to lower-correlation assets, we're also able to start rolling down the glide path much later than other more traditional methodologies. This allows you stay longer in a higher-expected-return portfolio, dramatically lowering the long-term opportunity costs of moving too rapidly into a lower-expected-return mix. However, you can only delay this roll down if you lower volatility across short, intermediate- and longer-term time horizons.

DCD: *What's the best approach for rebalancing a custom asset mix back to its target allocations?*

Rice: We use our own proprietary rebalancing algorithm, the Portfolio Engineer™, for our clients' custom target-date funds that have unitized structures. For clients with a model portfolio structure, in which it's onerous to track every participant's underlying allocation, we suggest semiannual rebalancing back to targets.

Our research shows that monthly and quarterly rebalancing is too much. Many asset classes don't follow the perfect random walk and

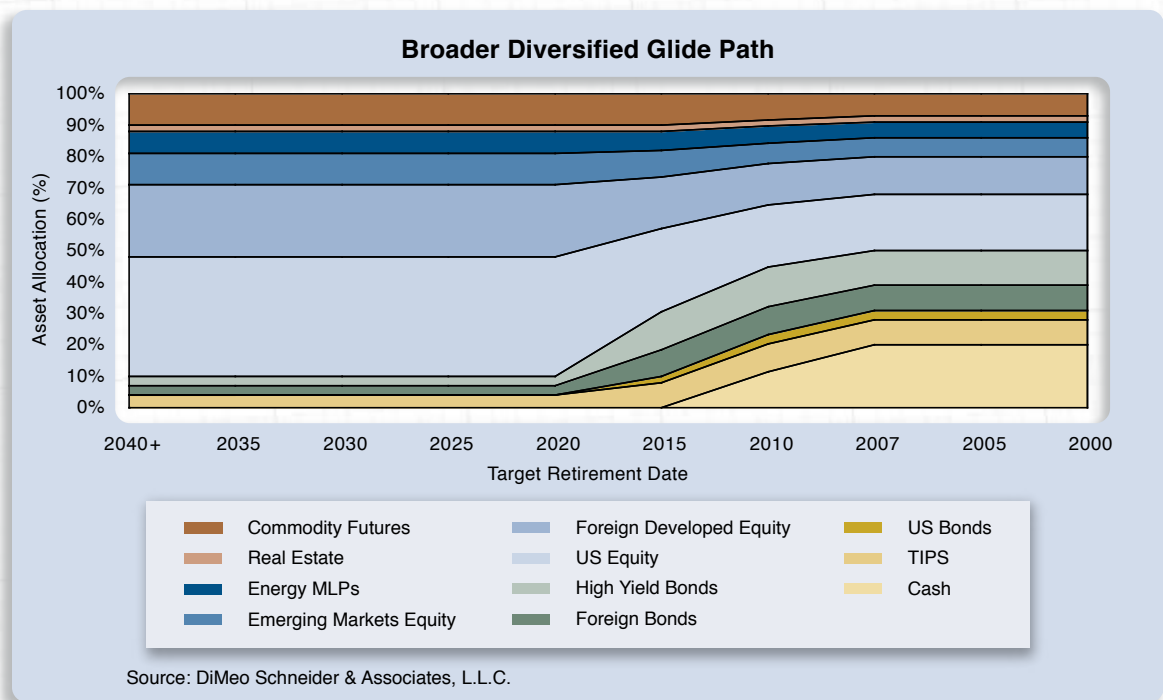


Chart 2

tend to trend a bit. So by rebalancing too quickly, we might catch falling knives and pull back from running asset classes too early. Rebalancing quarterly frequently is too often, and doing it annually typically isn't enough. Semiannual tends to work well and that's what many of our clients do.

DCD: *What about the timing of the glide-path roll down, for instance shifting to a more conservative allocation?*

Rice: A glide path can roll down every day, every quarter, every six months, every year, and so on. We typically suggest our clients use a glide path that rolls down to the new target once a year. We found there's not much benefit to more frequent roll downs, in terms of changing the allocation during the course of the year.

From an administrative standpoint, it's also cleaner to do it less frequently. As long as you don't give up anything, it's typically a good idea to err on the side of simplicity. So there's rebalancing back to targets and there's rebalancing to the next year's glide path – and these are two independent discussions. Less frequent – semiannual for rebalancing to the targets, and annual for rebalancing to next year's asset allocation – is most effective for us. What's important is to determine ahead of time your once-a-year period.

DCD: *Does seasonality affect when to schedule the rebalance – for example, trade in October or trade at the beginning of the year?*

Rice: The little trends we hear about – the October or January effects – exist because they're simply the way the markets happened to unfold in the recent past. In hindsight, it may have been beneficial to rebalance during specific periods. However, I don't think we have a large enough sampling to draw meaningful conclusions that these historical instances will repeat themselves. Another several hundred years of data showing seasonal effects might persuade us, but that data doesn't exist yet.

DCD: *When you advise clients about putting participants on the right path to retirement, what do you say that participants should do?*

Rice: First – before we discuss any investment strategies – we talk about how to get participants to increase their savings rates. Some practitioners emphasize every investment product's or methodology's value-added detail rather than emphasize the savings rate. Boosting the savings rate is the low-hanging fruit and is a major prerequisite to funding retirement successfully.

Aside from discussions about investment products, if you look at the difference between a 5-percent savings rate and a 7-percent savings rate over the course of someone's life, it's massive. You could be in a very mediocre product, but if you have a 7-percent saving rate, you could be far better off than the person who's in a great product but only has a 5-percent saving rate.

“Boosting the savings rate is the low-hanging fruit and is a major prerequisite to funding retirement successfully.”

Sponsors can encourage more saving through education, but there are other more effective strategies like automatic enrollment or automatic annual increases to deferral rates. If you don't have high enough savings rates, the investment strategy really doesn't matter. Warren Buffet could show up at your house every month to give you his best investment ideas, but if you don't save it's not going to get you far.

DCD: ***Do you believe we need guarantee products such as annuities in DC plans?***

Rice: Many clients talk about annuities, but very few actually pull the trigger to offer them. They continue to evaluate whether and how to provide such products. The minimum-withdrawal products get a little less discussion than annuities. Some of the problems with guaranteed minimum-withdrawal products are complexity in the structures and the higher fees with which many plan sponsors aren't comfortable. However, more clients discuss the immediate-deferred annuity side in helping participants obtain institutionally priced traditional annuities. Plan sponsors tend to be more interested in discussing competitively priced traditional annuities at retirement rather than minimum-withdrawal vehicles, although they've been slow to act on either.

“DC plans will continue to evolve to look more and more like DB plans.”

DCD: ***How will DC plans look in the future?***

Rice: DC plans will continue to evolve to look more and more like DB plans. Take a typical plan sponsor with a DB plan, then look at the assets in their 401(k) investment menu or in the target retirement-date strategies in their 401(k) plan.

We'll ask, "Would you choose those DC investments for your DB plan?" And they'll think much more about the asset-allocation strategies, whether they're custom or off the shelf. They'll also emphasize more institutional rather than retail investment products. They'll add more diversification, including alternative investments. They'll also use a blend of active and passive management as we do today in both DB and DC plans. We'll also see more custom target-date strategies and other creative solutions.

Hopefully, we take what works in DB plans and combine that with what works in DC plans – and get the best of both worlds.

DCD: ***We'll see both active and passive management? What about fee concerns?***

Rice: The challenge is for plan sponsors to identify the areas where active management makes the most sense, then use an active manager there. They also need to identify other places where passive management gives them the highest probability of success. Managing

fees is important, and they need to look at what they get for what they pay. Active management can more than pay for itself, but often doesn't. Some asset classes have more compelling alpha stories than others.

DCD: *We'll also see more customization?*

Rice: Yes. We all talk about the great technology boom and 401(k) recordkeeping technology is getting better every year. People have invested a lot in technology. Just over a decade ago, daily recordkeeping was pretty cutting edge. Now, we can do many other things cost effectively like custom target retirement-date strategies. We'll have more room to customize within a 401(k) plan and a lot more demand for it across all plan sizes. A beneficial byproduct of the custom target-date structure is that it allows a plan sponsor to evolve its thought process over time. Once you select a product off the shelf and put it in the plan, you're stuck with it until you get rid of it. When you add a custom target retirement-date strategy, if your thinking changes over time you can make changes without much trouble. Your custom target retirement-date structures can evolve so you're not forced to throw out the baby with the bath water.

DCD: *Thank you, Matt.*

Rice: My pleasure.

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For more information on DiMeo Schneider, please go to www.dimeoschneider.com or call 800.392.9998.

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greater risk than higher-rated securities. Inflation-linked bonds (ILBs) issued by a government are fixed-income securities whose principal value is periodically adjusted according to the rate of inflation; ILBs decline in value when real interest rates rise. Treasury Inflation-Protected Securities (TIPS) are ILBs issued by the U.S. Government. Real Estate Investment Trusts (REITs) are subject to risk, such as poor performance by the manager, adverse changes to tax laws or failure to qualify for tax-free pass-through of income. Commodities contain heightened risk including market, political, regulatory, and natural conditions, and may not be suitable for all investors. Derivatives and commodity-linked derivatives may involve certain costs and risks such as liquidity, interest rate, market, credit, management and the risk that a position could not be closed when most advantageous. Investing in derivatives could lose more than the amount invested. Diversification does not ensure against loss.

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PIMCO DC Dialogue is prepared and distributed by the PIMCO DC Practice. Based in Newport Beach, this practice is dedicated to promoting effective DC plan design and innovative retirement solutions. Our team is pleased to support our clients and broader community by sharing ideas and developments in DC plans in the hopes of fostering a more secure financial future for employees of corporations, not-for-profits, governments, and other organizations.

If you have questions about PIMCO DC Dialogue or a topic you'd like to discuss, please contact your PIMCO representative or email us at pimcodcpractice@pimco.com. We're interested in your ideas and feedback!



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