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College Savings Program Board
Investment Advisory Committee Meeting

State Treasurer's Conference Room
1 S. Pinckney Street, Third Floor
Madison, Wisconsin

September 7, 2010
1:00 p.m.

Minutes

I. Call to Order and Roll Call at 1:05 p.m.(Ken Johnson, Chair)
Present: Johnson, Durcan, Oemichen, Wolff, Schlissel, Sarah Henriksen and Tom Biwer [both Wells Fargo, by phone], Connie Schulz [Sen. Darling's office], Edward Ferko and Michael Fleming [Vanguard Funds], and Jim DiUlio.
Absent: Sheehy

II. Agenda Approval and Public Posting Report (Chair, staff)
Approved by unanimous voice vote

III. Approval of Committee Minutes for May 3, 2010
Accepted and motion by *Wolff*, second by *Durcan* to approve. Carried.

IV. Public Presentations (if requested in advance)

V. Old Business

A. Second Quarter 2010 Investment Performance S*chlissel* began her report by recalling how volatile the markets have been. The losses of the second quarter were corrected by a strong July, but then in August all of it was given back. Domestically, concerns over recession and the BP oil spill were prominent in the second quarter. Jobs are scarce. Internationally, the problems in Greece have affected other countries. Emerging markets held their own, as the best performing class in the second quarter, while interest rates remain at all-time lows with little evidence of change.

That being said, she said that both EdVest and tomorrow's scholar funds have fared well in this environment, with many of them beating their benchmarks and peers.

B. <u>Watch List Update, Review, Recommendations to Board</u> Currently, EAI has no recommendations to change anything on watch list. Regarding the watch list eligibility, no changes are recommended. The committee accepted the recommendation. No action was taken with regard to the Watch List.

C. <u>Presentation on investment tools; selected graphics and other data</u> *Schlissel* then began a brief review of last quarter's fund performance and benchmark numbers, to be followed examples of EAI analytics tools. At the point where money market performance numbers are nearly all zeroes for a year or less. *Henriksen* added that fees are currently suspended on all classes of money market portfolios. *Wolff* and *Schlissel* reported that rating and rule changes are coming in the money market and stable value areas, especially with pensions.

Going through the underlying funds report, *Schlissel* said that this has been a very difficult market to invest through—securities selection has not mattered, stock prices have been punished in spite of higher than expected earnings, the fundamentals have been thrown out the window.

Johnson asked a question regarding Vanguard's Institutional Index placed at the 44 percentile for three year returns. She clarified that the fund is in the broader Large Cap Blend category, but when compared to other index 500 funds, it would rank very high due to low expenses.

Of note are four of the underlying funds in tomorrow's scholar, having outperformed their benchmarks by 200 basis points since inception: Wells Fargo Growth, Riversource Diversified Equity Income, Harbor International, and Wells Fargo Income Plus Bond. In addition, nearly all of the enrollment-based choices in the tomorrow's scholar plan rank well with 529 plan peers.

Schlissel then reviewed some examples from the graphs and charts in the larger reports EAI prepares for both plans. [calendar timing allowed for presentation of the detailed material with the executive summary]

Due to time considerations, *Johnson* suggested that the committee change the agenda to now proceed to the Vanguard Funds presentation, as New Business. All agreed.

VI. New Business

A. FUND MANAGER PRESENTATION
Vanguard Funds; Ed Ferko and Mike Fleming

Chair *Johnson* welcomed Ed Ferko and Mike Fleming of Vanguard Funds, continuing the two year series of Fund Manager Visits with the committee.

Ed Ferko recalled his relationship the Board from late 2003, with Vanguard's initial $50 million of Wisconsin's assets, now at $400 million. Since then, he said, Vanguard now has a dedicated group working with higher education-related products, totaling about $28 billion. Twenty-six 529 plans in 25 states currently use Vanguard funds; in five of those, Vanguard is also the program manager with Upromise.

He related Vanguard's history from Jack Bogle's founding in 1975 to present. The company operates on a model that looks like a cooperative, where the individual funds own the management group. With more than half of assets in of institutional shares, fund expenses are kept low.

Question from *Johnson* regarding Wisconsin's program receiving the most advantageous pricing. Ferko replied that there is one class of lower fees with Institutional Plus shares, effective with $200 million assets, currently at 2.5 basis points—compared to the 5 basis points at $5 million plus. He added that this is by individual fund, not an aggregated balance. Currently, the program's assets in the Institutional Index 500 are about $170 million. As assets near the next point, Vanguard will work out the mechanics with the program manager and staff toward a transition. The committee discussed broader 529 issues with Ferko, including public attitudes toward 529 plans, likelihood that Coverdell limit will permanently revert to old level, and state tax deductions.

Mike Fleming, an investment analyst, then outlined Vanguard's use of outside managers since 1975. Of the 51% of assets not in index funds, 44% those are managed externally. He reviewed the process used to select and evaluate these managers monthly, including deliberate action in case of style drift or ownership changes. Their board is permitted to make changes without shareholder approval.

In response to a question, he said Vanguard has no SEC or other regulatory issues currently or on the horizon.

Fleming then talked about index construction and fair-value pricing, treating all a day's trades in the same manner. The committee asked about strategies to gain a basis point or two. He replied that managers are rated on performance within trading error—not on 'great performance.' Another question about ETFs was answered by relating some other 529s that are using them. Access to institutional ETFs are available at 5 to 9 basis points, but there are also commissions to consider.

He then described some of the details and internal management of the Wellington fund. Going through the process for both the fixed and equity sides of the fund, and portfolio sectors, he answered a few short questions from the committee.

Chair *Johnson* thanked Mike and Ed for their presentation and visit to the committee.

The agenda resumed with the remaining Old Business items:

D. <u>Recent media coverage, Morningstar interviews</u> A story about the Strong Funds settlements with individual investors appeared last weekend in the *Milwaukee Journal Sentinel*. Letters sent out by law offices soliciting clients appears to have generated the interest. *DiUlio* was contacted and quoted regarding the Board's action last year to the separate settlement for the EdVest plan. The story was accurate, however, a number of calls and emails have come into both the Treasurer's Office and at Wells Fargo Funds.

In preparation of Morningstar's review of 529 plans later this year, telephone interviews were conducted last week with Board members, staff and Wells Fargo Funds. Participants shared their experiences.

E. <u>Update on Credit Union outreach and CD portfolio</u> The situation remains much the same as earlier in the summer, on hold with the economy. In the credit union portfolio, currently 62% is in cash.

VII. Future Committee Agenda Discussion Items

VIII. Announcements

The next meeting of the committee will be Tuesday, November 2, at 1:00 p.m.

IX. Adjournment

Motion by Durcan, second by Johnson to adjourn. Meeting adjourned at 3:10 p.m.

> **NOTE:** ***The Committee may recess into closed session, pursuant to the exemptions contained in s. 19.85, Wis. Stats. for deliberation of investment of public funds or other business where competitive reasons are an issue.***