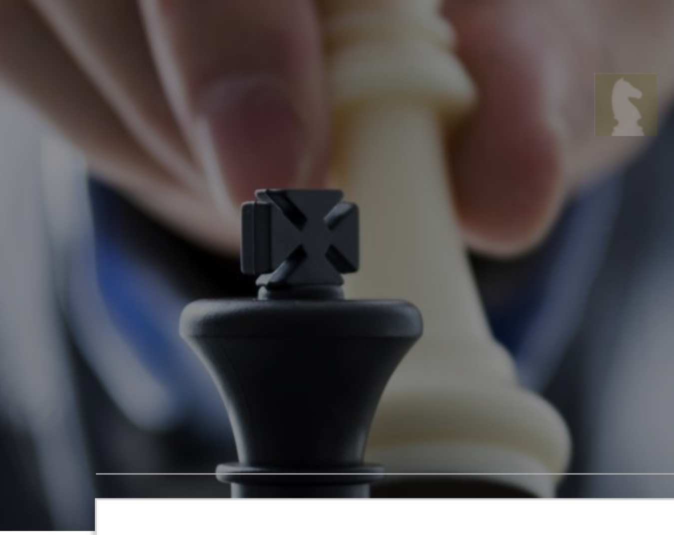

Education: Key Investment Terms

A curated glossary of essential terms and concepts for staff and Board/Committee members.

STRATEGIC ASSET ALLIANCE
THE INSURANCE INVESTMENT SPECIALIST

Most Common Asset Classes for Insurance Companies & Risk Pools

Investment-Grade Fixed Income:
Fixed income is a type of investment debt security *(aka bond)* that pays investors fixed interest payments until its maturity date, when the principal investment amount is repaid.

Bonds are evaluated by rating agencies on the probability that the issuer will repay its debt. Any issuer or bond with an investment-grade rating are considered highly likely to repay debt by the maturity date.

Investment-Grade Ratings:
S&P: “BBB-” and Above
Moody’s: “Baa3” and Above
NAIC: Bonds Rated 1 to 2

Risk Assets:
Risk assets are any investment outside of investment-grade fixed income. This includes High-Yield Bonds, Common Stock (or Equities) and Preferred Stock, as well as certain Long-Term Schedule Ba Investments.

Risk assets provide greater potential returns, but with greater risk of loss.

Alternatives:
Alternative assets are any investment outside of stocks and bonds, such as hedge funds or private equity.

Fixed Income: Terminology

Asset-Backed Securities (ABS):
An asset-backed security is a bond made up of illiquid assets (excluding mortgages) that have been packaged and sold to investors.

This includes assets such as car loans, student loans, leases, credit card debt, royalties, etc.

Should the bond default, the pooled assets can be seized and sold in order to ensure repayment to investors.

Fixed Income: Terminology (Continued)

Cash & Cash Equivalents (CCE):

Cash & Cash Equivalents refer to any assets that are cash or can be immediately exchanged for cash. Cash equivalents are liquid assets and typically have a Maturity date of 3-months (or less). As they typically maintain their dollar value, there is much flexibility when it comes to transactional decision-making.

Cash Equivalents:
Money Market Funds (MMF)
Short-Term Investment Funds (STIF)
U.S. Treasury Bills (T-Bills)

Certificate of Deposit (CD):

A certificate of deposit is a financial product sold by banks and credit unions offering an interest rate premium on a lump-sum deposit that remains untouched for a defined period. An insurer or risk pool may consider a CD as they typically offer fixed, predictable returns.

Collateralized Debt Obligation (CDO):

A collateralized debt obligation, which are made up of bonds, is a type of asset-backed security with a complex structure intended for institutional investors, such as insurance companies and risk pools.

A CDO ‘derives’ its value from other underlying assets. The assets in a CDO are pooled together and then split into pieces known as ‘tranches’, which are bonds of varying investment-grades.

Collateralized Bond Obligation (CBO):

A collateralized bond obligation, which is a subset of CDOs, is an investment-grade bond that derives its value from a variety of junk bonds. Since the pool of bonds within a CBO include several types of credit quality bonds, they offer enough diversification to be considered “investment grade.” Like CDOs, CBOs are separated into tiers (aka tranches), with each tier offering different levels of risk and compensation.

Collateralized Loan Obligation (CLO):

A collateralized loan obligation, which is a subset of CDOs, is a security that derives its value from a pool of debt. Typically, the loans pooled together are corporate loans that have a low credit rating or leveraged buyouts made by a private equity firm.

Investors receive scheduled debt payments from the underlying loans, as they are assuming most of the default risk. A CLO manager handles the packaged loans within their various tranches; actively buying and selling loans in order to purchase new debt.

Commercial Mortgage-Backed Securities (CMBS):

Commercial mortgage-backed securities are bonds that derive its value from mortgages on commercial properties. Loans packaged within CMBS are typically for office buildings, hotels, malls, factories, etc.

Like CDOs, CMBS are separated into tranches offering different levels of risk and compensation. As terms on commercial mortgages are generally fixed, CMBS can potentially offer less risk that other asset-backed securities.

Fixed Income: Terminology (Continued)

Corporate Bond:
A corporate bond is a debt security issued by a U.S. corporation that pays investors fixed interest payments until its maturity date. U.S. corporations sell these debt securities to gain necessary capital, while investors receive interest payments at a fixed or variable rate.

Non-Agency Collateralized Mortgage Obligation (CMO):
Non-Agency CMOs are a type of mortgage-backed security issued by private institution, such as an investment bank. Typically, these mortgages are for residential properties.

Municipal Bond (aka 'Muni Bonds' or 'Muni'):
Municipal Bonds are taxable or tax-exempt securities issued by a U.S. state, county, locality, or municipality. Local governments issue these securities to help finance capital expenditures, such as schools, hospitals, transportation, construction, etc. Most muni bonds are exempt from federal taxes, and many are exempt from state or local taxes.

Insurers and risk pools may utilize mini bonds for their tax advantages, lower default rates (compared to corporate bonds), and relative liquidity.

U.S. Agency Bonds:
U.S. Agency Bonds are securities issued by any federal agency or government sponsored entity other than the U.S. Treasury.

U.S. Agency Collateralized Mortgage Obligations:
U.S. Agency CMOs are a type of mortgage-backed security issued by a Federal Agency, such as the Government National Mortgage Association (aka Ginnie Mae), Federal National Mortgage Association (aka Fannie Mae), or Federal Home Loan Mortgage Corporation (aka Freddie Mack).

U.S. Agency Mortgage-Backed Securities:
U.S. Agency MBS are issued by a federal agency, such as the Government National Mortgage Association (aka Ginnie Mae), Federal National Mortgage Association (aka Fannie Mae), or Federal Home Loan Mortgage Corporation (aka Freddie Mack).

U.S. Treasury Bonds (T-Bonds):
Treasury bonds are fixed income securities issued by the U.S. Department of Treasury that have maturities of 10 years or more.

As Treasury Bonds are backed by the U.S. Government, they are essentially risk-free investments as taxes and revenue can always be raised to ensure payment on the interest and principal.

Types of Treasuries:
Treasury Bonds
Treasury Bills
Treasury Notes
Treasury Inflation-Protected Securities

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STRATEGIC ASSET ALLIANCE
THE INSURANCE INVESTMENT SPECIALIST

Most Common Risk Asset Classes for Insurers & Risk Pools

High-Yield Bonds:
High-Yield bonds are below investment-grade and carry a higher risk of default; however, these bonds pay a higher yield than investment-grade bonds.

Below Investment-Grade Ratings:
S&P: Below "BBB-"
Moody's: Below "Baa3"
NAIC: Bonds Rated 3 to 6

Common Stock (or Equities):
Common stocks are securities that represent ownership in a corporation, with the value of the stock being tied to corporate growth/stock market. Common stocks typically offer greater returns than bonds, but carry higher risk of loss, as well as return volatility.

Preferred Stock:
Similar to common stock, however the value is tied to interest rates and not the state of the stock market. Unlike common stock, preferred shareholders have no voice in the future of the company.

Bank Loans:
Bank Loans are comprised of corporate debt issued by below-investment-grade borrowers; commonly known as leveraged loans or senior loans. They are typically issued by large, well-recognized financial institutions and are used for refinancing, recapitalization, acquisitions, and other general corporate operations.

Other, Particular Long-Term Schedule Ba Investments:
Schedule Ba investments constitute several "other" investments types, but includes risk assets utilized by insurers and risk pools. These assets are more yield-oriented, but come with greater risk of loss, volatility & liquidity risk.

Schedule Ba Risk Assets:
Collateralized Loans
Bank Loans
Developed and Emerging Markets
Real Estate
Sovereign/Global Bonds

Investment Management: Key Terminology

Active Management:
A "Buy and Sell" strategy. Securities are directly bought and sold to makeup the investment portfolio. Trades are conducted constantly to outperform a benchmark.

For more information, please visit www.saai.com

Investment Management: Terminology (Continued)

Annualized Return:
The annualized return is the geometric mean of the returns with respect to one year.

Barbell Strategy:
Concentrating the maturities or cash flows of a portfolio in a combination of short maturities and long maturities, while underweighting intermediate maturities, relative to a more laddered maturity distribution or benchmark.

Basis Point (Bps):
A unit that is equal to 1/100th of 1% (or 0.01%) and is used to denote the change in a financial instrument.

Book Value:
The value at which an asset is carried on a balance sheet, before market value fluctuations. Typically equals the cost of the security plus or minus the unamortized premiums and discounts

Book Yield:
This is the expected return over a fixed income security's expected life based on its cost. It incorporates both coupon income and accretion or amortization of premiums or discounts. When book yield is multiplied by book value, it represents a close approximation as to actual income to be earned over the near term.

Discount Rate:
A discount is the excess of the face value of a fixed income security over the amount paid for the security, excluding purchased interest. Discount rate is the interest rate used in discounted cash flow analysis to determine the present value of future cash flows.

Effective Maturity:
The weighted average amount of time it takes to get your principal (not interest) back. On a bullet (non-callable) security, effective maturity equals nominal maturity. On a callable security, effective maturity could be either the call date or the maturity date, depending on whether the security is trading at a premium or a discount to its call price.

Excess Return
A security's return minus the return of a comparable risk-free security. For most U.S. fixed income sectors, it is a security's return less the return of a comparable duration Treasury security.

Exchange Traded Fund (ETF):
Securities that closely resemble index funds but can be bought and sold during the day just like common stocks. These investment vehicles allow investors a convenient way to purchase a broad basket of securities in a single transaction. Essentially, ETFs offer the convenience of a stock along with the diversification of a mutual fund.

Investment Management: Terminology (Continued)

Investment Income:
For fixed-income securities, the components of investment income include income coming from coupon payments plus or minus the change in accrued interest from the beginning to the end of the period plus or minus the amortization or accretion of the cost basis to par value (this would equate to the change in book value) of the security.

Market Value:
Often referred to as “fair value”, these are indicative of the price at which the securities could be sold in an active market. Most prices are obtained from a third-party pricing vendor. These prices do not represent actual ‘bids’ for individual securities but provide a close approximation of the true sales proceeds which could be generated if the portfolio were liquidated as of the date of the report.

Market Yield:
Yield to maturity (sometimes called “market yield” or simply “yield”) is the rate of return if a security is held to maturity based on its current market price.

Mutual Funds:
An investment vehicle that enables individual investors to pool their money together and benefit from key advantages not normally available to smaller investors. These include: professional day-to-day investment management, greater diversification, easy access to global financial markets and 'wholesale’ discounts and interest rates.

Passive Management:
A “Buy and Hold” Strategy. Securities are held for longer periods, minimizing trading. The portfolio is structured to match a certain benchmark over the long-term.

Private Placements:
A private placement is a capital raising event that involves the sale of securities to a relatively small number of select investors (can be debt and/or equity). Investors involved in private placements can include large banks, mutual funds, insurance companies and pension funds.

Spread:
Normally used to describe the incremental yield of a security over a comparable maturity or reference Treasury, in basis points. Calculations vary by asset class.

Total Return:
As opposed to income return, which is an accounting-based calculation, total return is an economic-based calculation. For securities with no interim cash flows, total return is the difference between the ending and beginning market value.

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STRATEGIC ASSET ALLIANCE
THE INSURANCE INVESTMENT SPECIALIST

Long-Term Capital Market Assumptions

Capital Market Assumptions *(sample on the right)* are projected outlooks for various asset classes; typically providing 10- to 15-year risk and return projections. These assumptions are developed by industry-standard, third-party financial institutions.

These assumptions are often referenced when discussing asset allocation, manager performance, economic outlook, etc. Below is a list of definitions for the asset class categories that assumptions are commonly developed for.

Asset Class	2023 Forecast (Annualized)		*Correlation to US Agg.*
	Pre-Tax Return	*Risk*	
Fixed Income			
U.S. Aggregate	4.60%	4.09%	1.00
U.S. Short Gov/Credit	3.60%	1.63%	0.82
U.S. Int. Treasury	3.60%	3.18%	0.83
U.S. Municipal	3.70%	3.79%	0.69
U.S. Inv. Grade Corp	5.50%	7.02%	0.81
U.S. TIPS	4.30%	5.57%	0.72
Equity & Alternatives			
U.S. High Yield	6.80%	8.53%	0.36
U.S. Leveraged Loans	6.20%	7.98%	0.02
U.S. Large Cap	7.90%	16.13%	0.19
U.S. Mid Cap	8.00%	18.04%	0.19
U.S. Small Cap	8.10%	20.37%	0.14
EAFE	9.80%	17.40%	0.22
EM Equity	10.10%	20.65%	0.22

Long-Term Capital Market Assumptions – Asset Class Definitions

US Aggregate:
The broad-based sector measures the investment grade, US dollar denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS and CMBS (agency and non-agency). The average duration is around 6.25 years.

US Short Gov/Credit:
The broad based sector tracks 1-5 year government and credit securities, which are investment grade, and include fixed-rate treasuries, government-related and corporate securities. The average duration is around 2.60 years.

US Int Treasury:
US Intermediate Treasuries measures nominal debt issued by the US Treasury with maturities of 1 to 10 years of maturity.

US Municipal:
Represents tax-exempt securities issued by a U.S. state, county, locality, or municipality. Local governments issue these securities to help finance capital expenditures, such as schools, hospitals, transportation, construction, etc.

Long-Term Capital Market Assumptions – Asset Class Definitions (Continued)

US Inv Grade Corp:
US Investment grade Corporates are issued by a U.S. corporation that pays investors fixed interest payments until its maturity date. U.S. corporations sell these debt securities to gain necessary capital, while investors receive interest payments at a fixed or variable rate.

US TIPS:
U.S. Treasury notes and bonds that have a fixed coupon rate and mature on a fixed date. However, the coupon payments and underlying principal are automatically increased to compensate for inflation as measured by the Consumer Price Index (CPI).

US High Yield:
US bonds rated lower than investment grade on their date of issue and called speculative grade bonds, or colloquially as "junk" bonds. The rating is BB+ and lower. These bonds have a higher risk of default or other adverse credit events, but typically pay higher yields than better quality bonds in order to make them attractive to investors.

US Leveraged Loans:
Bank loans which are corporate debt issued by below-investment grade borrowers. Companies undertake loans for recapitalizations, acquisitions and refinancing. Coupon income from floating-rate loans resets regularly (typically 40-60 days average) to maintain a fixed spread over a variable base rate (SOFR, LIBOR). Loans are often referred to as “senior and secured” and carry the highest priority of claims in an issuer’s capital structure, secured by specific collateral.

US Large Cap:
US equity stock in US corporations with market capitalizations above $10B.

US Mid Cap:
US equity stock in US corporations with market capitalizations between $2B-$10B.

US Small Cap:
US equity stock in US corporations with market capitalizations less than $2B.

EAFE:
International equity stock in large and midsize companies across other developed countries. Europe, Australasia, and the Far East are represented.

EM Equity:
Emerging markets equity are corporations within countries and regions that are undergoing economic transitions. China is often included as well.

Long-Term Capital Market Assumptions – Asset Class Definitions (Continued)

Convertible Bond:
A convertible bond or convertible note or convertible debt (or a convertible debenture if it has a maturity of greater than 10 years) is a type of bond that the holder can convert into a specified number of shares of common stock in the issuing company or cash of equal value.

US REITs:
Real estate investment trusts allow access to large-scale, income producing real estate or related assets. Unlike other real estate companies, a REIT does not develop real estate properties to resell them. Instead, a REIT buys and develops properties primarily to operate them as part of its own investment portfolio. These may include office buildings, shopping malls, apartments, hotels, resorts, self-storage facilities, warehouses, etc.

Private Equity:
An equity investment in which the equity is not freely tradable on a public market. Investments tend to be less liquid and long term in nature. In a simplified sense, a company is bought, changed, and re-sold. Value-creation activities can include financing an acquisition, going from public company to private to implement a long-term strategy, restructuring a company's balance sheet, etc.

Global Core Infrastructure:
Infrastructure activities involving the development, ownership, management and/or maintenance of structures or networks, used for the processing or moving goods, services, information/data, people, energy or necessities from one location to another.

Direct Lending:
Loans made from private lenders to companies while avoiding intermediaries such as investment banks and brokers. Companies commonly seek these direct loans to finance buyouts, acquisitions, or growth opportunities. Typically, it is structured as a floating rate interest payment, senior secured on the capital structure, and backed by covenants. Private lenders typically control more influence over the process.

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STRATEGIC ASSET ALLIANCE

Manager Performance: Fixed Income Levers

Duration:
Duration is an approximation that measures the interest rate risk of the security or portfolio.

The higher than number, the more risk from movement in rates

Example: if a security or portfolio has a duration of 10 years, a 1% increase in rates will instantly result in a 10% decrease in the market value. However, longer duration typically means higher yield.

Yield Curve:
Yield Curve is related to duration but focuses on how a portfolio's maturities are structured across the yield curve from short maturities *(i.e. 3 months, 1 year)* to long maturities *(i.e. 30 years)*.

Different structures provide benefits in terms of additional yield or better return potential if rates rise or fall on that specific part of the curve.

Sector Selection:
Managers who use this lever allocate more assets than the benchmark does to sectors that they like and less assets to the sectors they do not like.

If they are correct, this will help them outperform the benchmark. If they are wrong, they may underperform.

Convexity:
Convexity shows the relationship between a bond prices and yield. Duration is used to forecast the change in market value as a result of interest rate changes. But it is an estimate.

Convexity makes the estimate more accurate for bonds that have uncertain cash flows like mortgage-backed securities (MBS).

Example: a manager may improve convexity by buying less MBS than the benchmark. However, this usually comes at a cost: less yield.

Manager Performance: Fixed Income Levers (Continued)

Credit Quality:
Some managers make an explicit "bet" on quality levels of the bonds they hold. Lower credit quality bonds typically pay higher yields to compensate for the additional credit risk (i.e. the risk that an organization won't get its money back at the maturity date). Some think that overall rating categories of bonds are over or undervalued and then structure their portfolios to take advantage of this.

Example: If they think BBB" rated securities offer good value, they may own more of these than the benchmark.

Liquidity:
Liquidity has become a more important factor over the past several years as yields have fallen. Some managers will trade liquidity, or ease/cost of trading a security, for yield/total return. In general, more liquid bonds trade at a lower yield than less liquid bonds of the same type. By owning less liquid securities, managers can boost yield/income. However, if they unexpectedly need to liquidate these securities, this strategy can backfire.

Security Selection:
Related to sector selection, security selection is typically used by "bottom-up" fixed income managers. A "bottom-up" fixed income manager looks for specific bonds they like or don't like and will then buy more or less of them than are contained in the benchmark. They may do this if the bond has better yield or structural/credit characteristics, which will help the bond outperform.

Structure:
Some managers purchase bonds that have unique aspects that might not be understood by the market and thus the bonds yield more and may not be as liquid. In many cases this is related to liquidity. For managers who understand these structures, this can be a great way to add value