



Passive vs. Active and Internal vs. External Investing

The investment management world of today can be divided into two broad categories of management style, each reflecting a fundamentally different belief system regarding how modern capital markets behave. These two schools of thought are generally referred to as passive and active management.

The State Board of Administration utilizes a mix of active and passive investment strategies. The SBA employs an active investment strategy where the probability of being paid for assuming the increased cost and risk of active investing is greatest, and where there is the greatest possibility of out-performing a market index. Conversely, where there is the least likelihood to out-perform market indices, the SBA finds it more sensible to passively invest (mirror the indices for those markets) and save management costs associated with active investing. One of the SBA's historical strengths has been operating at very low cost. The SBA's size and significant proportion of passive investments are among contributors to SBA's cost advantage.

Passive Investing

Passive managers attempt to construct their portfolios to closely approximate the performance of well-recognized market indices such as the Standard & Poor's 500 index (large U.S. companies), Russell 2000 index (small U.S. companies) or Morgan Stanley EAFE index (large international companies). Passive investing typically has the lowest management costs. Additional savings can be realized when these portfolios are managed in-house.

Active Investing

Active managers build a stock portfolio utilizing a wide variety of strategies for identifying companies believed to offer above-average prospects, i.e. those that can "beat the market." Regardless of the approach, all active managers share a common thread: they buy and sell securities selectively based on their evaluation of future events. Active investing, because of research and time requirements tends to be more costly. Many institutions will contract with outside managers due to the expertise needed to be successful with active investing. This will add to the overall cost associated with active investing.

FRS DEFINED BENEFIT TOTAL FUND ASSET CLASS ALLOCATION

Data Through December 31, 2018

	Active as % of Asset Class	Passive as % of Asset Class	Internal as % of Asset Class	External as % of Asset Class	As % of Total Fund
Total Fund	65.5%	34.5%	44.7%	55.3%	100.0%
Cash	91.0%	9.0%	100.0%	0.0%	1.3%
Fixed Income	54.6%	45.4%	66.4%	33.6%	20.1%
Global Equity	51.9%	48.1%	45.3%	54.7%	52.6%
Private Equity	100.0%	0.0%	1.2%	98.8%	7.5%
Real Estate	100.0%	0.0%	63.3%	36.7%	9.7%
Strategic Investments	100.0%	0.0%	1.1%	98.9%	8.9%