MEMORANDUM

TO:	State of Delaware Plans Management Board
FROM:	CAPTRUST
DATE:	November 30, 2021
SUBJECT:	Fidelity Stable Value Investment Option

Background
The State of Delaware Education Savings Plan (529 Plan) currently offers a broad array of investment options for the plan users. Within this array are a collection of static "individual portfolios" which maintain underlying holdings in just one asset class, such as an S&P 500 Index. Fidelity is now planning to make available a new investment option for its 529 plan clients. Beginning in March 2022, Fidelity will offer a stable value fund investment that can be included in the 529 plan lineup as another static individual portfolio.

Discussion
The Fidelity Stable Value Fund is an investment option that seeks principal protection, while offering a steady, predictable return profile that is consistent with a conservative investment vehicle. The Delaware Education Savings Plan currently offers two separate principal preservation options, a money market option and bank deposit option. Given that the Fidelity Stable Value fund would be a third principal protection option in the lineup, if the Plans Management Board decides to add the stable value fund to the plan, the Board should also determine if it will be purely an addition to the investment lineup, or if it will be a replacement to either of the current principal protection options.

With respect to the current options, because the Bank Deposit fund includes FDIC insurance with the underlying holdings, we would not consider this an option for replacement. However, the money market fund would be more redundant if it were to remain in the lineup with the stable value fund, and thus, could be replaced by the stable value fund.

Stable value funds provide the potential to outperform money markets funds over time, and historically have done so. From 12/31/00 to 12/31/20, money market funds increased by 27.88% cumulatively, versus a cumulative gain of 120.06% over the same twenty-year time period for stable value funds[1]. While historic performance is not a guarantee of future returns, the consistent outperformance of stable value, while protecting principal, is compelling.

The underlying investment holdings for these two options are very similar. Stable value funds invest in high quality short and intermediate term bonds, while money market options invest in short-term high quality liquid securities (e.g., government bonds, CDs, commercial paper). While their holdings are similar, the yield on the portfolios differ due to the insurance component of stable value funds. Yield for a stable value fund is based off of fluctuations of the crediting rate (determined by the insurance wrappers in conjunction with the performance of the

[1] Stable Value Investment Association and Fidelity as of 12/31/2020

underlying holdings). Yield of a money market portfolio, on the other hand, is purely based on the fluctuations of short-term interest rates.

The fee structure for these two investments is slightly different but has the same ultimate cost. The total fee for the Fidelity Stable Value fund is 58 bps (30 bps fund + 15 bps wrap + 8 bps program + 5 bps admin). For the current money market fund, the total fee is also 58 bps (38 bps fund + 15 bps program + 5 admin). Given the return profile of stable value, our expectation is that the stable value fund would return net of fees roughly 0.50% - 1.00% yield at inception. This would be higher than current money market rates, which average between 0.00% - 0.25%.

In a market environment where rates are continuously rising, there would also be an increase in the stable value fund crediting rates, though they would be expected to lag the market. These rising rates would negatively impact the market to book ratio for the portfolio; however, participants would still benefit with the increase in yield and the rising crediting rates. In rising rate environments, short-term interest rate movements would benefit money market funds, however, over longer term periods, the stable value fund should return more (given its higher interest rate risk exposure).

The duration for this fund would be targeted between 1.5 to 3.0 years (currently, the portfolio has a duration of 2.97). The portfolio benchmark would be the Bloomberg Barclays 1-3 and 1-5 Government Credit index. The portfolio would be managed by three different managers; Dave Deblase (26 years of experience), Rob Galusza (36 years of experience) and Julian Potenza (17 years of experience).

For liquidity, in the event that the plan decides to remove the stable value fund, the plan must notify Fidelity ahead of time. Fidelity would ensure an orderly liquidation of the assets to protect the remaining investors in the portfolio. During this time, plan participants would still have the ability to buy or sell the portfolio at book value.

Monitoring
If a stable value fund is incorporated into the 529 plan, the Investment Committee will have a responsibility to monitor the investment ongoing, similar to the monitoring of the current investment lineup options. In monitoring the fund, the Investment Committee should consider criteria, including, but not limited to, the following:

- financial strength of the guarantors of the insurance wrappers as determined by a nationally recognized statistical rating organization;
- current interest rates;
- current portfolio yield;
- average holding credit quality;
- current crediting rate;
- contract liquidity provisions
- fund effective duration; and
- current market to book value ratio.

Conclusion
Stable value funds have been gaining popularity within 529 plans over time. In 2017, 11% of programs offered a stable value fund, while by 2021 that percentage increased to 22%. Money market adoption within 529 plans has remained stagnant during this same period, increasing only from 18% to 19%.

Given the information described above, our recommendation is for the Plans Management Board to adopt the Fidelity Stable Value fund as an investment option in the State of Delaware Education Savings plan. Because of the similar objective for this investment and the money market individual portfolio, we do not think it is worth offering both of these options in the plan at the same time. Based on the potential for enhanced performance with a similar risk profile, we would recommend transferring the assets from the current money market individual portfolio to the stable value fund, and then removing the money market option from the plan.