The Board of Trustees of the West Virginia College and Jumpstart Savings Programs

Investment Committee Meeting Minutes

315 70th Street, SE – 2nd Floor Conference Room
Microsoft TEAMS Optional

December 6, 2023

The Investment Committee Meeting of the Board of Trustees of the West Virginia College and Jumpstart Savings Programs was called to order on Wednesday, December 6, 2023 at 9:01 am. A silent roll call was taken, and a quorum was established. The following members were present: Mr. Chris Heller, Chair and Mr. Patrick Smith. There is one vacancy on the committee.

The following consultants were present: Mr. Chris Morvant; Mr. James Glendon; Ms. Allison Mortensen; and Ms. Lianna Peto representing Hartford Funds; and Mr. Tim Fitzgerald representing NEPC, LLC.

The following WVSTO staff members attended: Mr. Steve Bohman; Ms. Gina Joynes; Ms. Amy Willard; Ms. Lindsay Marchio; Ms. Amy Hamilton; Mr. Greg Curry; Mr. Karl Shanholtzer; and Ms. Elizabeth Liston.

The agenda consisted of the following:
Call to Order – Silent Roll Call

I. Consideration of the Minutes of the March 22, 2023 Meeting
II. Update on Annual Due Diligence Review of Hartford Funds
III. Morningstar 2023 Results
IV. Consideration of Proxy Statement for the Hartford Growth Opportunities Fund
V. Annual Review of Investment Committee Charter
VI. Other Business

Adjournment

Agenda Item I.

The Chair indicated the first order of business on the agenda was the approval of the minutes from the Investment Committee meeting on March 22, 2023. The minutes were previously circulated with the Board packet. Patrick Smith moved to accept the minutes as presented and the motion was seconded by the Chair, Chris Heller. There being no discussion, the members were polled, and the motion carried.

Agenda Item II.

The Chair indicated the next order of business on the agenda was the update on the annual due diligence review of Hartford Funds. The Chair recognized Tim Fitzgerald of NEPC. Mr. Fitzgerald began with a handout summarizing what NEPC is doing regarding annual due diligence meetings, as it is an important fiduciary responsibility. The meetings were all virtual this year allowing them to be spaced out and cover a variety of topics.

Mr. Fitzgerald noted some of the discussion topics when holding a due diligence session regarding an investment option. The topics include changes in the fund manager, secession planning, having a well-defined philosophy and approach, risk metrics, understanding the most and least favorable environments to know when a fund should perform well, changes in assets under management, and any performance issues.

He concluded by noting that the final due diligence sessions for 2023 will wrap up later today with a presentation on Stable Value and a marketing discussion. He concluded by advising at the next meeting you will be able to see a summary memo of the 2023 due diligence meetings.

Mr. Chris Morvant, Hartford Funds, added the annual meetings allow them the option to do deep dives, not just on investment topics, but cross- functional topics like customer service and operations, and cyber security.

Agenda Item III.

The Chair indicated the next order of business on the agenda was the Morningstar 2023 results. The Chair recognized Amy Willard, Assistant Treasurer, to give the presentation.

Ms. Willard advised that Morningstar released their national ratings of fifty-four 529 plans on November 2, 2023. Of the three plans under the SMART529 umbrella, only the Hartford SMART529 plan has sufficient assets to be rated by Morningstar. Morningstar bases their ratings of 529 plans on four primary pillars – People, Process, Parent and Price.

The Hartford SMART529, which is an Advisor-sold plan, maintained a neutral rating overall, but did receive an upgrade in the Parent Pillar rating. In 2022, the Parent Pillar was rated as Average, but in 2023 the Parent Pillar received an Above Average rating. The analyst, who was new to the plan for this year, stated the following in the official write-up:

> West Virginia State Treasurer's Office provides significant oversight, leading to an upgrade in the Parent rating to Above Average from Average. Multiple layers of oversight include a board of trustees and an investment committee of qualified professionals with relevant expertise. They vet every proposal in a multi-step review process supported by feedback and analysis from an internal investment advisor and external consultant.

Ms. Willard noted that we are very excited to receive this upgrade in the Parent pillar as it recognizes the hard work of the Board to help oversee the program. She personally thanked everyone on her team and NEPC who helped with the Parent aspect of the Morningstar RFI and oral presentation. Ms. Willard also thanked Hartford Funds, as they are responsible for pulling together most of the materials for the other three pillars as well as their own oral presentation to Morningstar.

As for those other three pillars that contribute to the overall rating, Ms. Willard noted the plan maintained the Above Average rating in the People pillar and the Process pillar. In the price pillar, the Hartford SMART529 plan is still rated as high although the write-up notes that it is "one of the more affordable advisor-sold plans."

Ms. Willard pointed out there are only three medal-rated advisor-sold plans. One advisor-sold plan is rated Silver and two are rated Bronze. Of the 34-total medal-rated plans, 31 of them, or 91%, are direct-sold plans that perform better in the Price pillar based on the inherent nature of a direct versus advisor-sold plan.

In the overall universe of 54 plans there were 10 plan upgrades (8 direct and 2 advisor-sold) and 7 plan downgrades (6 direct and 1 advisor-sold). The net number of silver-rated plans increased by 3, the net number of bronze rated plans decreased by 3, and the total number of Gold, Neutral, or Negative-rated plans remained the same. 63% of the 54 rated plans received medals in 2023, which is the same as the previous year.

Ms. Willard concluded by advising that improving our Morningstar rating is always a goal, our advisor-sold plan is the one being rated and will always present an uphill battle due to how fees are evaluated, and the size of our plan compared to other advisor sold-plans in larger states. Hartford Funds will likely have more to share with regards to the Morningstar ratings process as part of their Program Manager update to the full board.

Mr. Heller asked how far away the direct-sold plan is in terms of assets to be rated. Ms. Willard responded that we believe Morningstar uses $1 billion in assets under management as the threshold. Our SMART529 WV Direct is at approximately $400 million in assets and SMART529 Select is at approximately $600 million, so both plans are a good bit away from being rated.

Agenda Item IV.

The Chair indicated the next item on the agenda was the consideration of Proxy Statement for the Hartford Growth Opportunities Fund (HGOF). The Chair recognized Karl Shanholtzer, WVSTO Internal Consultant, to give the presentation.

Mr. Shanholtzer advised the HGOF is seeking shareholder approval to change from a diversified to a non-diversified fund. The HGOF is benchmarked to the Russell 3000 Growth Index which is a large-cap growth index. The Russell 3000 growth index tracks stocks of the Russell 3000 index that meet the growth criteria. As of June 30, 2023, the index is composed of approximately 1,533 stocks.

Mr. Shanholtzer stated the index returns have been driven by just a few large-cap growth stocks. The Magnificent Seven make up approximately 39.25% of the Russell 3000 Growth Index as of June 30, 2023, and through November 30, 2023, the index total return has been 33.64% YTD, with the Magnificent Seven combined return approximately 105% YTD over the same period. He said the concentration of returns in a limited number of stocks presents a challenge to portfolio managers – they cannot take positions at the benchmark weight in more than a couple of the top performers and their ability to overweight top performers is limited.

Mr. Shanholtzer added this issue is not limited to HGOF. T Rowe Price, Fidelity and Vanguard have all sought, and received, approval from shareholders to change to a non-diversified status for certain large-cap growth funds. He added AKF Consulting reviewed the fund line-ups of seven other 529 plans (4 advisor-sold and 3 direct sold across five different states) to determine whether the plans had any similar funds that had changed classification – Alaska's direct-sold and advisor-sold plans included the T Rowe Price Blue Chip Growth Fund which changed classification in 2021. No other plans in the group that were identified as having large cap growth funds changed classification.

Mr. Shanholtzer advised the Investment Policy Statement does not appear to prohibit use of a non-diversified fund, but cautions that the Investment Policy Statement says the following: "...the Program Managers shall invest only in a prudent manner in which risk and return are given proper consideration and fund risk is controlled."

Mr. Shanholtzer continued with the risks of non-diversified funds. Non-diversified funds may have higher volatility as compared to diversified funds due to having higher concentrations in a fewer individual stocks and smaller positions in more issuers. Non-diversified funds can also experience sub-par performance if an overweight position experiences an unexpected decline. The Sequoia Fund (SEQX) had a substantial allocation to Valeant Pharmaceuticals (up to 36% at one point) – the stock lost 90% of its value resulting in a 50% decline in fund value. Baron Partners Fund (BPTIX) a substantial allocation to Tesla contributed to a dismal 2022 – (42.41%) versus Russell Mid-Cap Growth Index return of (26.72%). Mr. Shanholtzer added that non-diversified funds may perform worse than a diversified fund in a negative market environment.

Mr. Shanholtzer concluded that the September 30, 2023 balance in advisor sold plan was just under $124 million which represents approximately 7.39% of The Hartford SMART529 - $68 million as a standalone investment option and $56 million as part of the age-based plan.

Mr. Morvant of Hartford Funds made the request to add some additional thoughts. He feels the proposed change to the HGOF is being motivated by evolving market conditions which makes growth opportunities difficult. The HGOF is actively managed, and its current diversified status is limiting ability to perform to expectations. Mr. Morvant stated their independent mutual fund board of trustees, which represent shareholders, unanimously voted to approve this change. He added that about 30% large cap growth funds, within the Morningstar universe are now non-diversified. He also wanted to point out that moving to a non-diversified classification doesn't mean no diversification, as there are still internal risk guidelines associated with the fund, one of those being the maximum active weight position over the benchmark is 3%. He advised that the SEC said they are no longer enforcing definitions for passive funds who track index back in 2019. An actively managed fund provides flexibility to react to the market. Mr. Morvant added as an advisor-sold plan financial advisors will be watching over the plan and its assets. There is no expectation of significant wholesale changes if approved. Mr. Morvant concluded by advising there is a special shareholder meeting next week requiring 50% of voting shares to get a quorum and 67% must approve for the proposal to pass. If no quorum is established, the meeting would be adjourned to reschedule for a later date.

Mr. Fitzgerald asked about the SMART529 assets in perspective to the whole fund and Mr. Morvant indicated the SMART529 plan owns about 3% of the shares in the overall fund. Mr. Morvant responded if you hire an active manager, you must allow them the flexibility to perform. Mr. Fitzgerald asked how to deal with the flip side of run-off. Mr. Morvant stated they have an Equity Research Team that provides oversight. Ms. Lianna Peto, Head of the Equity Research Team, stated her team is comfortable with the change as it will allow the managers to appropriately express their convictions in order to try to beat benchmark and peers. The maximum 3% single weight position of the benchmark and the maximum 7% productive tracking risk for the fund at portfolio levels are just a couple of the internal guidelines in place. Ms. Peto also stated they do not anticipate the overall number of holdings in the fund to change.

Mr. Fitzgerald advised of the need to be mindful of fiduciary obligation and asked if there have been any other fund Proxy Statements. Ms. Willard stated the WVSTO team doesn't ever recall one. Mr. Morvant said they are very rare for Hartford Funds too. Mr. Fitzgerald noted that other firms haven't been able to reach a quorum for similar Proxy Statements.

Ms. Allison Mortensen, Hartford Funds, advised of a couple points regarding asset allocation. The tracking error to benchmark could go down if the change is approved, adding that if this was an index, it wouldn't be an issue. She stated that from an asset allocation standpoint, she likes that the portfolio managers can invest more. From the standalone perspective, it is good to have an option in every space. She stated that if she were forced to replace the fund, she would probably replace it with a passive index fund or a different manager who may go through this same process. She pointed out that Sequoia was over 30% in value and Hartford Funds' and Wellington's would never go that high.

Mr. James Glendon, Hartford Funds, advised that he is not worried about a run-off of the Magnificent 7. He added that Hartford has deep experience with the growth opportunities and under no circumstances would he expect Steve Mortimer, the manager of the fund, to go crazy. He typically uses smaller names in the fund. In fact, as of right now he has a 0% weight in Apple and Apple has a 12% position in the benchmark.

Mr. Bohman asked about the performance of this specific fund. Mr. Shanholtzer quoted performance in terms of the peer group. For the trailing one-year, the fund ranked 41st, for the trailing three-year, the fund ranked 90th, for the trailing five-year, the fund ranked 70th, and for the trailing ten-year, the fund ranked 38th.

Mr. Heller questioned Mr. Bohman what his preference regarding the risk. Mr. Bohman stated he doesn't want to accept the risk. Mr. Shanholtzer and Mr. Heller both agreed.

The Chair moved that the Investment Committee recommend that the Board vote "No" on the Proxy Statement. Patrick Smith seconded the motion. Hearing no discussion, the Chair polled the members and the motion carried.

The Chair moved that the Investment Committee recommend to the full Board that the Hartford Growth Opportunities Fund be placed on the Watch List if the shareholders approve the measure to make the fund a non-diversified fund. Patrick Smith seconded the motion. The Chair called for discussion. Mr. Shanholtzer noted that if the fund became non-diversified, he would be comfortable with the fund as a standalone option but had concerns about it being in the age-based portfolios. Mr. Fitzgerald agreed with Mr. Shanholtzer. The Chair polled the members and the motion carried.

Agenda Item V.

The Chair indicated the next agenda item was the annual review of the Investment Committee Charter. Annually, the Investment Committee is charged with assessing the adequacy of the Investment Committee Charter and requesting Board approval of any necessary changes. After reviewing the Investment Committee Charter language, Board staff had no recommended changes to the current Investment Committee Charter. The Chair asked if any other members had concerns or changes, and none were heard. The Chair noted that one of the requirements listed in the Investment Committee is an annual confirmation that the responsibilities outlined in the charter have been carried out. After careful review of the charter language, the Chair moved to confirm that the responsibilities outlined in the charter have been carried out for the fiscal year ended June 30, 2023. Patrick Smith seconded the motion. There being no discussion, the Chair polled the members and the motion carried.

Agenda Item VI.

The Chair indicated the next meeting of the Investment Committee will be called as needed and announced in accordance with the Open Meetings Act. There being no further business to come before the Committee, the Chair made a motion to adjourn. Patrick Smith seconded the motion. There being no discussion, the Chair polled the members and the motion carried.

The Chair declared the meeting adjourned at 9:58 a.m.

Prepared by Elizabeth Liston
Committee Approval Date: 3/20/2024

Submitted by:

Chris Heller, Chair
Investment Committee