September 18, 2019

FROM: Bruce A. Ring, Jr.
Director of Investments

RE: 2018 Annual Program Review

Section 166.450 of the Revised Statutes of Missouri requires the Director of Investments of the State Treasurer's office to annually review the Missouri Higher Education Savings Program ("MOST") and report those findings to the MOST Board ("Board"). The director must review five areas:

- Board administration
- Financial status
- Investment policy
- Participation rate
- Continued viability

Accordingly, I am pleased to report the following from my review for calendar year 2018.

I. Board Administration

Ascensus Government Savings Recordkeeping Services, LLC serves as MOST's program manager, record-keeper, and servicing agent. Together with its affiliates, Ascensus Government Savings has overall responsibility for the day-to-day operations of the plan. Formerly known as Upromise Investments, Ascensus Government Savings assumed responsibility as recordkeeping and servicing agent, for both the Direct and Advisor Plans on June 3, 2006. On February 7, 2011, the Board entered into another contract with Ascensus Government Savings extending through June of 2016. Another RFP for program management services was issued in 2015. On February 8, 2016, a new contract was entered into with Ascensus Government Savings extending the contract service period to June of 2021, under the terms of this contract the Advisor Plan was eliminated and the participants were migrated into the Direct Plan in 2016. In addition, the Board met quarterly during 2018, as required by law.

II. Financial Status

Following is a review of the financial status of our major partners and a summary of the investment performance of the investment options within the MOST plan.

A. Financial Status of MOST Partners

Ascensus Government Savings is part of Ascensus, Inc., the largest independent retirement and college savings services provider in the United States, helping over nine million Americans save for the future. With more than 30 years of experience, the firm partners with financial institutions to offer tailored solutions that meet the needs of financial professionals, employers, and individuals. Ascensus specializes in recordkeeping, administrative, and program management services, supporting over 98,000 retirement plans and 4.5 million 529 savings accounts. It also administers more than 1.5 million IRAs and health savings accounts.

The investment manager for the Direct Plan, The Vanguard Group, Inc., remains a strong franchise. Vanguard is one of the world's largest investment companies, offering about 397 low-cost traditional funds and ETFs. As of June 30, 2018, more than 20 million investors in about 170 countries have entrusted Vanguard with more than $5.1 trillion in global assets under management. Vanguard continues to be a leader in the 529 plan industry, evidenced by over $92 billion in 529 savings and pre-paid tuition plan assets under management. Headquartered in Malvern, Pennsylvania, Vanguard has about 16,600 employees spread across 19 locations worldwide.

B. Performance of MOST Underlying Funds

Overall, 2018 had a mostly negative performance from equity, with a somewhat positive but mixed performance from fixed income, although the overall performance of all portfolios would best be described as negative with only four portfolios returning positive numbers for the year. Equity portfolios showed results ranging from -17.59% to 1.94%, while the fixed income results ranged from -0.25% to +2.76%. Overall, the results show declining performance in most if not all portfolio's from the previous program year. Overall it was a very tough year from an investment perspective.

In 2018, the returns on the underlying funds in the Direct Plan were quite a bit lower than the returns we saw in 2017, with all but four funds showing negative returns. The annual returns ranged from -17.40% in the DFA International Core Equity Portfolio to a high of +2.96 in the Vanguard Total International Bond Index Fund.

Treasurer Fitzpatrick's office is responsible for monitoring the relative performance of each of the underlying investment alternatives versus an established benchmark. This effectively measures the contribution that the investment manager's expertise has on participants' returns. During calendar year 2018, both absolute returns and relative performance were mixed at best. All of the underlying portfolios performed as expected or slightly below benchmark, with no funds underperforming enough to warrant WATCH list status during 2018. While index funds are expected to be at or slightly below benchmark, depending on the extent to which they stray from exact matching of the index, actively-managed funds are expected to exceed those benchmarks. But, with one exception (DFA Global Fixed Income Portfolio), the actively-managed funds generally performed below those benchmarks this year.

To summarize, the investment managers' overall contribution to participants' returns was negative. All passive (index tracking) funds performed satisfactorily, and experienced low-tracking error of returns versus their relevant indices.

III. Investment Policy

In mid-2007, the Board adopted a formal investment policy governing program investment. The policy establishes objectives for structuring the investment options; formulates policies for selecting appropriate investment managers and the use of specific investment vehicles; and establishes an investment-performance process for underlying funds in the Plan. The policy is an important statement by the Board in terms of defining its fiduciary responsibilities and standards for Treasurer Schmitt's office staff and MOST partners.

Since its adoption, the policy has been amended twice. In 2008, the Board modified the policy to allow the Director of Investments, rather than the Board, to place a fund on, or release it from, the "WATCH" status.

In August 2011, the Board made several modifications to the policy. The Board lengthened a fund's formal review period—specifically, up three consecutive quarters from two—when looking at benchmark performance evaluation for the Watch List. When determining a fund's Watch List eligibility and quarterly performance, the Board also added "Beta" and "Alpha" measures to a review process. Finally, the Board eliminated the "value of active management" measurement criteria.

In June 2016, a new Investment Policy was adopted by the Board when the Advisor Plan participants were merged into the Direct Plan and the Advisor Plan was eliminated.

In 2017, the Board reviewed the investment policy.

IV. Participation Rate

The following is an examination of the participation rate of the MOST programs. By examining the participation rate for the program, we can attempt to gauge the relative success the program has had in reaching the state's residents and encouraging them to increase 529 savings—the original goal of the IRS section authorizing these programs. The relative success or failure of states' various 529 programs rests on many different factors including the effectiveness of marketing efforts, availability of a state tax deduction, demographic and economic conditions, cost structure and the abilities, and resources of states' partners to attract and retain assets. However, one facet that has remained a constant is the competition for assets among states' program managers, which remains fierce.

A. Growth of Plan in 2018

The MOST Plan experienced growth in accounts but not assets during the year. The lack of asset growth in 2018 is due to poor investment returns primarily driven by a severe downturn of the market in December, 2018.. The positive change in number of accounts is primarily the result of plan marketing, the new ability to use 529 assets to pay for K-12 tuition expenses, and popularity of the program.

Plan assets went down by a rate of 3.74% as compared to a 14% growth rate in 2018, ending the year at approximately $2.893 billion as compared to year-end 2017 at $3.006 billion.
Contributions outpaced withdrawals in the plan. Total contributions for 2018 were at $356M, up almost $70M from 2017. Total withdrawals for 2018 were at $329M, up $73.7M from last year.

The number of accounts increased 6% in 2018 to 167,380 as compared to 157,634 in 2017. The vast majority of accounts are Missouri residents which account for almost 88% of account ownership.

B. Comparison of MOST Participation to National Trends

Nationally, assets in 529 Plans on average have grown significantly over the past decade. However, last year the significant negative market action in December created an environment where most 529 Plans experienced a dip in assets under management (despite strong contributions last year). The Missouri's MOST Plan's 2018 results were consistent with its peers.

For 2018, MOST assets were reduced by -3.75% which was comparable to most Direct Plans in 2018. This was attributable to the aforementioned market action in December of 2018, and to a lesser extent, plan net cash flow. When compared to our peer plan group, MOST has performed well over the past 5 periods showing a 7.92% compound growth rate, outperforming 4 of our six peer group members.

V. Continued Viability

The MOST 529 Plan remains a viable 529 savings program. In Ascensus Government Savings' 10½-years of program management, we have experienced strong trends in asset and account growth despite the market turmoil that plagued much of this period. We also saw an upswing in the number of new beneficiaries enrolled in the plan, which shows growth of new customers.

Throughout the economic downturn and subsequent recovery, the Plan's performance has been resilient. The fact that participants weren't required to make non-qualified withdrawals on a large scale during this period is promising. As a result, the majority of participants should have experienced full recovery of their 529 savings account balances and some asset growth. The economic environment has been quite good for the past two or three years and should remain so for the coming months although fears of a recession have been surfacing.

In an effort to further strengthen our future performance, the Board decided to restructure the glidepaths in the plan to provide a smoother transition through the years and lessen some of the risks associated with transitioning from 1 age group to the next. The addition of DFA funds has enhanced our program offerings and should improve our overall plan.

Additionally, with the addition of K-12 participation in the plan, we saw a new significant driver of new accounts and withdrawals during 2018. This will most likely trend higher in future years as the availability of this option becomes more widely understood.

Missouri's MOST 529 Plan remains not only viable, but well positioned for growth as one of the premiere plans in the country.