Existing and Proposed Policy Targets

Adding additional asset classes – Hedge Funds and MAC Strategies

Asset Class	Policy Target	Optimal Mixes Mix 1	Mix 2	Add 5% HF	Mix 3	Mix 3B	Mix 4	Mix 5
U.S. Large Cap Equity	25%	20%	24%	25%	28%	29%	32%	36%
U.S. Small Cap Equity	7%	5%	6%	7%	7%	7%	8%	9%
Non-U.S. Equity	24%	16%	20%	24%	23%	25%	27%	30%
U.S. Fixed Income	35%	47%	37%	30%	27%	25%	17%	7%
Real Estate	9%	7%	8%	9%	10%	9%	11%	13%
Hedge Funds	0%	5%	5%	5%	5%	5%	5%	5%
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
Expected Return	**6.07%**	**5.40%**	**5.84%**	**6.16%**	**6.26%**	**6.36%**	**6.64%**	**7.00%**
Expected Real Return	**3.82%**	**3.15%**	**3.59%**	**3.91%**	**4.01%**	**4.11%**	**4.39%**	**4.75%**
Expected Standard Deviation	**11.08%**	**8.46%**	**10.13%**	**11.44%**	**11.84%**	**12.31%**	**13.58%**	**15.34%**
Total Return-Seeking (%)	**65%**	**48%**	**58%**	**65%**	**68%**	**70%**	**78%**	**88%**
Total Fixed Income (%)	**35%**	**47%**	**37%**	**30%**	**27%**	**25%**	**17%**	**7%**
% Illiquid	**9%**	**7%**	**8%**	**9%**	**10%**	**9%**	**11%**	**13%**

- 5% hedge fund exposure funded pro rata from both equity and fixed income (Mixes 1-5)
  - Modest improvement in efficiency – return per unit of risk
- Mix 2B adds a 5% allocation to hedge funds to the current target, funded solely from fixed income, which goes from 35% to 30%
  - Increases both return and risk
- Mix 3B adds a 5% allocation to hedge funds, funded from fixed income, and shifts another 5% from fixed income to equity, reducing fixed income from 35% to 25%
  - Greater increase in both return and risk than Mix 2B
- In both Mix 2B and Mix 3B, we suggest the CMT Fund consider the addition of long-biased MAC strategies (5%) within the large cap US equity allocation, similar to those employed within the ATF, to provide diversification in the larger allocation to equity and potential for a differentiated source of alpha

Summary
Recommendations

● The appropriate asset allocation will attempt to balance the dual objectives of maintaining or increasing real spending while maintaining or growing the real (inflation-protected) value of the Trust over the projection period.

● In the absence of gas royalty inflows:

- A 5% of MV spending level may be difficult to sustain in the long run – spending policy is effectively greater than the real investment return for even the most aggressive asset mixes.

● Under the current projection of gas royalty inflows:

- Royalties are insufficient to offset the spending generated by the 5% of MV spending level even for the more aggressive asset mixes; the CMT will need to retain substantial exposure to growth assets to help offset a decline in the real value of the corpus.

- Pursuit of return to meet the current spending policy will result in more variability of spending from year to year.

● **In order for the CMT Fund to Maintain Real Market Value and Real Spending Objectives, we recommend:**

- Adopt a more aggressive asset allocation policy – reducing fixed income exposure by up to 10%

- Consider further diversifying the asset mix by adding **Absolute Return/Hedge Fund and MAC** strategies to mitigate market risk stemming from equity exposure, and to enhance return relative to fixed income.

- Consider moving to either Mix 2B or Mix 3B which will have a greater probability of generating purchasing power protection while balancing against the worsening of the worse case. Our preference is for the CMT to move to Mix 3B.

- Consider reducing the current spending policy by 50 basis points from 5% to 4.5% to increase the probability of maintaining the corpus.