HEALTH SYSTEM 100®
LEADERSHIP CONFERENCE

In Cooperation With:
Russell Investments

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# Top Five Investment Questions Health Systems Should Be Asking

Over the past decade, hospitals and healthcare systems have benefited from declining interest rates, which have made it attractive to fund capital expenditures with debt. At the same time, strong stock market performance has often helped generate returns on long-term operating assets that were higher than borrowing costs.

But now, rougher seas lie ahead. Hospitals and healthcare systems are on the verge of a new economic reality.

Political uncertainty dominates the 2017 outlook as markets adjust to the new realities of Brexit and President Trump. The search for returns is not going to get any easier against a backdrop of record high U.S. equity prices, narrow credit spreads and low bond yields. We expect more fiscal stimulus, more inflation pressures, a more hawkish Fed and the likelihood of two rate increases in 2017. Hospitals and healthcare systems need to account for potentially higher borrowing costs and lower investment returns as they also consider the impact of what a changing political and policy landscape means to them.

**With this environment in mind, we've created a list of the top five investment questions health systems should be asking.**

## 1 Does the asset allocation strategy for each of your investment pools support the financial strategy of the entire enterprise?

Right now, non-profit healthcare systems are grappling with significant industry changes, such as the changing payer mix, infrastructure investments for electronic medical records and mergers and acquisitions. This often leaves very little time for busy CFOs to focus on their investment pools. Today's markets are volatile, and we may be late in the recovery cycle, which means now is not the time to put your investments on autopilot. We recommend looking at your aggregate risk exposures, as well as the exposures within each individual investment pool. This will help ensure that all of your investments are aligned with your organization's needs, and allow you to diversify risk and return sources across your investment program, as well as to better ensure that the investment strategy for each pool is appropriate for its objectives.

## 2 What is your exposure to interest rate risk?

Rising interest rates impact your pension plan liabilities, the cost of debt and the returns earned on any long-term investments. If your pension plan is underfunded, rising rates may help improve funded status; even though asset values (especially fixed-income assets) tend to fall in a rising rate environment,liability values tend to fall faster. In addition, the cost of debt issuance may rise, increasing the overall cost of borrowing for capital improvements or merger and acquisition activity. Keep in mind, too, that for funded status to improve, it's not enough for rates to rise; rates need to rise more than the market has already priced in – that's why, historically, a bet on rising rates has been a losing bet more often than a winning one.

## 3 Do you have an extreme home country bias in your equity portfolio?

Although U.S. equity markets have done incredibly well for the past few years, U.S. equities are relatively expensive, and we anticipate their profit growth to be, at best, in the mid-single digits in 2017. We believe now is the time for investors to begin to add geographic diversity to their portfolios in search of returns. Both Japan and Europe currently have better value, less political uncertainty and central banks that are likely to continue with supportive policies. Emerging markets are a bit more nuanced, as valuation across these economies remains attractive. However, they really need robust global growth without an aggressive Fed or strong U.S. dollar to do well. When shifting to a more market-neutral allocation within an equity portfolio, keep in mind the impact of currency on those shifts. We recommend considering separating the country allocation decision from the currency allocation decision.

## 4 Are there return sources missing from your investment mix?

Because of the nature of your investment pools, most non-profit healthcare systems are conservatively invested. There is a heavy reliance on liability matching fixed income in pension plans, and a significant allocation to low risk, liquid assets in operating and insurance pools. In this volatile return environment, we believe a diverse array of return sources is needed to continue to meet return objectives while minimizing risk. Consider taking a close look at your asset mix in 2017 to see if there are additional return sources that could help improve the risk adjusted returns of your portfolio.

## 5 Does your investment policy statement and portfolio implementation structure allow for dynamic management?

The combination of low expected long term returns with market volatility means that we're encouraging investors to find a way to use that volatility in their favor. Investors can do this by incorporating investment strategies that may offer incremental returns, not taking uncompensated risks and ensuring that the investment portfolio is implemented efficiently. Taking advantage of volatility means that your investment policy statement (IPS), investment committee and service providers should be aligned with this effort. 2017 is a great time to have those conversations, to adjust your governing documents to allow for dynamic management and to ensure your team has the right skills and resources to implement your portfolio effectively.

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**For More Information**
If you'd like more information about how Russell Investments can help you strategically position your investment program in 2017, we'd love to have a conversation with you.

Available Now: The Healthcare Fiduciary's Handbook: A simple, illustrative guide with practical advice and planning tools. Request your free copy at Russellinvestments.com/handbooks.

For more information call us at 866-739-7979 or visit Russellinvestments.com/healthcare.

**About Health System 100**
Health System 100 is an annual gathering of C-level executives and select VPs from large regional systems. Combining a deep focus on health systems' future with a concentrated group of forward-thinking leaders, Health System 100 will tackle what the future holds, what leading-edge providers' strategy should be, and what practical steps you should take now.

The inaugural annual leadership conference will be held October 15-18, 2017 at The Ritz-Carlton Amelia Island in Florida. For more information, please visit www.healthsystem100.com.