CLIENT CASE STUDY

Equity structure realignment

Rebuilding the equity portfolio and manager lineup for a multi-billion-dollar hospital system

Organization

A premier U.S. not-for-profit hospital system with a multi-billion-dollar long-term investment pool and a recently modernized asset allocation and IPS framework.

Challenge

Following asset allocation work, the finance staff (Staff) and the Investment Committee (IC) turned their attention to the equity program, which had evolved piecemeal over many years. Our joint review surfaced several concerns:

- **Unintended regional and style tilts.** The equity portfolio was meaningfully overweight U.S. equities—particularly U.S. small/mid cap—and underweight non-U.S. developed markets, relative to a global market-cap framework. Factor analysis revealed sizable style tilts (for example, value and smaller-cap exposures) that were not explicitly tied to the client's investment beliefs.
- **Complex manager roster.** Multiple active managers with overlapping mandates produced concentrated factor bets and higher tracking error than the client's risk tolerance, while some strategies carried only moderate or "review"-level ratings from Russell's manager research team.
- **Need for better risk insight.** Committee members wanted a more intuitive understanding of where equity active risk was coming from—how much from stock-specific skill versus broad factor exposures, and how much each manager contributed.
- **Fee efficiency.** The client was keen to reduce overall implementation costs across public markets without sacrificing manager quality, building on early success renegotiating fees in fixed income.

The client wanted a partner who could both design a best-practice equity structure and act as an extension of staff in manager evaluation, risk analytics, and implementation.

A piecemeal equity lineup left the portfolio overweight U.S. small/mid cap, underweight non-U.S. equities and running more tracking error than the client's risk tolerance.

Solution

1. Clarifying equity investment beliefs

We facilitated workshops with the Staff and the Investment Committee to help them articulate a concise set of equity beliefs: the role of equities as the primary growth engine, desired balance between U.S. and non-U.S. exposure, views on small-cap and factor tilts, and the appropriate mix of active and passive management.

These beliefs informed a revised policy benchmark, moving toward a global market-cap orientation with a modest allocation to emerging markets and clear expectations for how much active risk the Committee was willing to budget.

2. Diagnosing the existing structure with multi-manager risk analytics

Using Russell Investments' proprietary multi-manager risk framework, we decomposed the equity portfolio's active risk into stock-specific and factor components, identified the top contributors to tracking error, and examined manager-level contributions to key exposures (such as size, value, volatility, and sector and regional bets).

The analysis showed that:

- Total forecast tracking error was elevated relative to the client's tolerance, with a large share coming from style and regional factors rather than stock selection.
- Several managers with overlapping styles were compounding similar factor bets, limiting the diversification benefits of a multi-manager structure.

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3. Designing a new equity structure aligned with beliefs

Guided by this analysis, we proposed a new strategic equity structure that:

- Aligns regional exposures with a global developed/emerging markets benchmark framework, reducing unintended home-country bias.
- Reduces the overweight to U.S. small/mid cap and rebalances exposure toward non-U.S. and global mandates, more closely mirroring global market-cap weights.
- Targets a lower, more intentional level of tracking error at the total equity level, with a greater share of active risk expected to come from stock-specific opportunities and market segments with greater odds of active management success, rather than broad factor bets.

4. Rebuilding the manager lineup

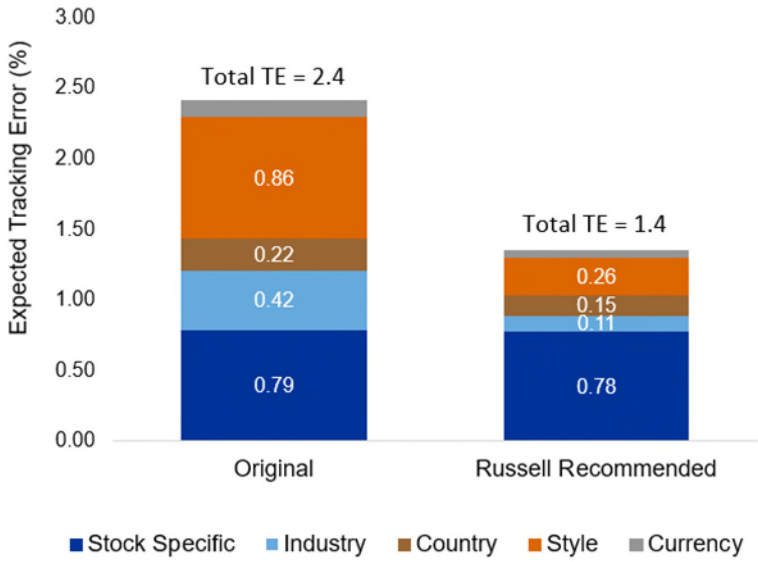
Working within the updated structure, we recommended a series of manager changes:

- **Global and non-U.S. equity**: Expand from a single global manager to a diversified group of complementary global and non-U.S. strategies (value, growth, and core), each with strong research ratings.
- **U.S. large cap:** Move to a balanced blend of low-cost passive exposure and a select group of high conviction active managers, using our risk framework to ensure each manager's risk contribution is aligned with conviction and role.
- **U.S. small/mid cap:** Rationalize the roster by terminating lower-rated or overlapping strategies and reallocating to a smaller number of high quality, style diversified managers.

The resulting target structure modestly improves the expected net-of-fee return while reducing total equity tracking error and increasing the proportion of risk attributable to stock selection. These changes have in practice made the equity program considerably more effective and efficient, ensuring risks taken are of high conviction and aligned with the client's investment beliefs.

The combined impact of aligning structure with beliefs and manager changes, can be seen in the below illustrative exhibits showing total forecasted tracking error for the original structure vs. the recommended structure. Exhibit 1 shows the reduction in the total forecasted tracking error from 2.4% to 1.4%. In addition, the exhibit shows that in the recommended portfolio structure, most of that tracking error comes from stock specific risk (shown in dark blue), with approximately 56% of active risk (0.78%/1.4%) coming from stock specific risk in the recommended structure (compared to only 33% in the original structure).

Exhibit 1: Tracking Error forecast, and its components, before and after



Multi-manager risk analytics cut forecast total equity tracking error from 2.4% to 1.4% and shifted the majority of active risk to stock-specific opportunities.

5. Implementation and governance enhancements

To execute the new structure efficiently, we recommended using an implementation platform that centralizes trading, rebalancing, and manager transitions across a multi-manager equity program. The platform's scale and centralized implementation can reduce trading costs, streamline manager changes, and support manager fee negotiations.

In parallel, we embedded the new equity structure into the client's IPS, updating:

- Equity asset class benchmarks and target ranges.
- Active-risk guidelines at both segment and total-equity levels.
- Appendices describing manager evaluation, rating categories, and oversight processes, ensuring that governance keeps pace with the more sophisticated portfolio.

6. A "bonus" win: fixed-income fee savings and future equity fee work

As the equity work progressed, Russell Investments negotiated new fee schedules with the client's core public fixed income managers, delivering meaningful annual fee savings for the client.

Looking ahead, as the client implements the full equity manager search and transitions into the new structure, we plan to apply the same disciplined, research-driven selection and negotiation process to seek additional fee reductions in public equity mandates as well, further improving net returns.

Results

More intentional equity risk. The new structure better aligns regional, size, and style exposures with the client's stated beliefs and risk appetite, with a greater share of active risk driven by stock selection rather than unintended factor bets.

Stronger manager lineup and governance. A clarified manager roster, underpinned by Russell's global research and risk analytics, gives the Staff and Committee greater confidence that each manager serves a distinct role and that risk contributions are understood and monitored.

Cost savings and scalability. Early, tangible fee savings in fixed income, combined with centralized implementation and future equity fee work, provide clear economic benefits alongside structural and governance improvements.

Extension of staff. By combining strategic advice, risk analytics, manager research, and implementation support, Russell Investments effectively acts as an extension of the client's investment office—freeing the finance leadership and staff to focus on broader strategic priorities while maintaining strong oversight of the investment program.

The redesigned equity program delivers more intentional risk, a stronger manager roster and clear fee savings, with Russell Investments acting as an extension of the investment office.

Where to next?

Call Russell Investments at 800-426-8506
or visit russellinvestments.com

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This case study represents a unique situation faced by hospital system seeking a best practice equity portfolio and manager lineup that matched their goals. Case studies are problem-solving stories. We select a situation that is indicative of problems clients in this category are facing. The recommendations described do not represent a standard strategy or set of recommendations made for all advisory clients with similar issues. Each client has unique requirements, challenges, and constraints, and our advisory solutions are tailored to each client's specific needs. Every client's situation, experience and needs are different, and Russell Investments does not imply that the solution herein is appropriate for any other client.

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