

NEW MEXICO
PUBLIC EMPLOYEES RETIREMENT BOARD
INVESTMENTS COMMITTEE MEETING

July 30, 2015

This meeting of the Public Employees Retirement Board Investments Committee was called to order by Chair Dan Mayfield, at approximately 9:00 a.m. on the above-cited date in the PERA Building, 33 Plaza La Prensa, Fabian Chavez Jr. Board Room, Santa Fe, New Mexico.

1. **ROLL CALL:** Following the Pledge of Allegiance, Executive Director Wayne Propst called roll and a quorum was established with the following members present:

Members Present:

Dan Mayfield, Chair
Dan Esquibel
Patricia French
Stewart Logan
Louis Martinez

Member(s) Excused:

Roman Jimenez, Vice Chair

Other Board Members Present:

Loretta Naranjo Lopez
John Reynolds
Jackie Kohlasch

Staff Members Present:

Wayne Propst, Executive Director
Susan Pittard, Chief of Staff-General Counsel
Jonathan Gabel, Chief Investment Officer
Greg Trujillo, Deputy Director
Karen Risku, Deputy General Counsel
Judy Olson, Executive Assistant
LeAnne Larrañaga-Ruffy, Portfolio Manager
Jude Perez, Portfolio Manager
Kristen Varela, Financial Analyst
Karyn Lujan, Deferred Compensation Manager

Others Present:

Tom Toth, Wilshire
Paul Lium, Nationwide
Jamie Feidler, Cliffwater
Davis Fulkerson, Century Capital
Frank Bazos, Century Capital

Barbara Pardo, Retiree
Sally Malavé, OAG
Lisa Gandomenico, OAG
Andrew Trujeque, Retiree
Isaac J. Ortiz, Retiree

2. APPROVAL OF AGENDA

Mr. Logan moved to approve the agenda as published. His motion was seconded by Mr. Esquibel and passed by unanimous [5-0] voice vote.

3. APPROVAL OF CONSENT AGENDA

The Consent Agenda was approved by consensus.

4. CURRENT BUSINESS

Chief Investment Officer's Report

1. Investment Performance Summary – June 2015

Jonathan Grabel, Chief Investment Officer, reviewed the results for June and the end of the fiscal year. The fund balance was \$14.5 billion at the end of June, down 1.5 percent from May. The last two days of the month had strong negative movement. The plan was up 1.87 percent for the fiscal year which is below the actuarial hurdle of 7.75 percent. For the three-year period, the fund is up 10.47 percent and the five-year period is up 10.4 percent. The 10-year period includes the significant draws from the Great Financial Crisis; there is still a positive return of 5.72 percent.

Mr. Grabel discussed economic news in that the government released a Q2 GDP (measure of total economic output) and the result was 2.3 percent annualized which is below the expectation of 2.6 percent. Additionally, the Q1 number was revised from a contraction of .2 percent to a positive .6 percent annualized. Some of the traditional economic measurements may not fully capture the changes in the economy – the shift from durable goods to consumables.

Mr. Grabel reviewed the different sectors noting domestic equity was down 1.64 percent for June but continues to have strong performance for the fiscal year. International equity was down 2.6 percent and down 3.6 percent for the fiscal year. Core fixed income was down 1.1 percent for the month and up 1.03 percent for the fiscal year. Fixed income plus was down over 8 percent for the month and down for the fiscal year. Absolute return was down 79 basis points for the month and up over 3 percent for the fiscal year. Private equity was down marginally for the month, yet it was the winner amongst different strategies for the full fiscal year – up net 17.7 percent. Private equity is PERA's highest fee strategy and had the highest outperformance. He said this highlights the need to be fee aware yet not make decisions solely based upon fees. Real estate was down for the month by 1.76 percent and up for 8.66 percent for the year.

Mr. Grabel said the portfolio is better positioned today with better downside protection than a year ago.

2. Cash Plan Update

Mr. Grabel said the fund balance was down \$262 million. The month finished with a little over \$407 million in cash. He reviewed the uses of cash for the month noting \$43 million went out of the fund to pay benefits, refunds, and manager fees, and \$38 million for capital call. A little over half a billion was rebalanced from the synthetic securities in the overlay to the physical securities with the managers approved by the Board during June. In addition, \$11 million was used to fund the impaired assets in the securities lending portfolio. The other side of that journal entry is the reduction in liability.

Mr. Grabel said the sources of cash during June included \$59 million from PE distributions and hedge fund redemptions and \$25 million from the Wachovia settlement. He reviewed the cash overlay/buffer cash plan which was down \$8 million for the month and for the fiscal year it was up in excess of \$10 million.

3. Other Updates

Mr. Grabel referred to the SPIVA S&P Dow Jones Indices scorecard and noted the domestic equity managers' performance versus the benchmark. He referred to the five-year numbers and of the managers in that period's top quartile then rolling forward to today; only .28 percent of the 703 managers are still in the top quartile. This demonstrates active management versus passive management and more efficient asset categories. In July 2014, 56 percent of PERA's portfolio was indexed versus today where over 68 percent of the equity portfolio is indexed. He said the Board is taking appropriate action based on data.

B. Action Item: Alternative Asset Recommendation for Approval, to be Funded According to the Cash Plan and Subject to Legal Review by General Counsel

1. Recommendation to Commit up to \$30 Million to Century Focused Fund IV, LP in the Private Equity Portfolio

[Exhibit 1: Staff recommendation re: Century; Exhibit 2: Cliffwater report, 7/30/15; Exhibit 3: Century Report]

LeAnne Larrañaga-Ruffey, portfolio manager, said Cliffwater and staff recommend a commitment of up to \$30 million to Century Focus Fund IV, a financial services buy-out fund for the private equity portfolio. The portfolio currently has 15 percent exposure to financial services. Century is dedicated to financial services and will focus on insurance, banking, asset management and specialty finance. The fund will complement the current private equity portfolio.

Davis Fulkerson, Century Capital Management, said their investment strategy is within the lower-middle market buyout and growth equity investing in the financial services marketplace. The real emphasis is on the service and distribution businesses to support those

broader industries. He discussed the great potential for return at companies in the lower middle market stage and said their specialized knowledge is beneficial. Their concentration on services and distribution investments is particularly appealing in the market.

A concrete example is a company in the employee benefit space, stated Mr. Fulkerson. What this company does is sells voluntary benefit products – gaps in coverage of healthcare plans. A great deal of education is required to the employees and Century saw an opportunity in that. Century has tangible things within their network that are useful to the finance sector.

Frank Bazos, Century Capital Management, referred to the company's defined and reputable process. He said they take a very research-driven approach to identifying areas of investing. He described the process from meeting to identify areas to research and what can Century bring to companies in that area. The team discusses whether they want to invest in that area and if so they identify every private company in that area. Annually Century makes 4,000 cold calls to company owners, visits over 100 companies, and develops relationships. That is their strategy

Mr. Bazos said 80 percent of the investments made come through that process of calling and visiting. Another part of their strategy is geared toward investment bankers.

Mr. Fulkerson referred to one company, Priority Care Solutions, which provides assistance to workers injured in the worker's compensation market. Century brought that company through their direct and advisory relationship several clients who could bring \$10 million to \$20 million individually from their companies to help grow Priority Care Solutions. Century provides tangible results to create value that companies join with Century to help grow their company.

Mr. Fulkerson said there is competition in Century's field, however, not with the strong focus on finance. Mr. Bazos said they tend to look for profitable and growing companies.

Mr. Esquibel asked about inherent risks in this investment. Mr. Grabel said whenever capital is committed for a 10-year period there is a risk. The only way to get the capital back, once committed, is at a very steep discount. Other risks relate to leveraging, the sector, and stability of the culture/people of the firm.

There is an immediate halt to investment activities if more than two of the general partners leaves the firm, stated Mr. Bazos. What follows is a process with the limited partners taking control. Mr. Fulkerson said Century's volatility has been extremely low. We have pursued a cautious strategy, stated Mr. Fulkerson. Mr. Bazos said Century uses very little debt or leverage in their investments.

There followed discussion regarding investment initiatives, geographic areas of investments basically limited to the US, and the importance of a proven successful management team. It was mentioned that Ontario Teachers' Pension is one of their largest investors.

Ms. French moved to recommend a commitment of \$30 million to Century Focused Fund

IV, LP, a private equity partnership focused on investments in financial services companies to be funded according to the PERA's Cash Plan, subject to approval of legal documentation by General Counsel. Mr. Logan seconded and the motion passed by unanimous voice vote.

C. Information Item: FY15 Investment Perspectives

Mr. Grabel said overall FY15 was a challenging year. The natural governor of investments is the capital markets. The healthcare sector continues to outperform, up 23 percent for the year. In terms of losers, it is the energy index which is down over 20 percent for the year and continues to have a difficult time. The takeaway is that prudent diversification is the best long-term strategy.

Mr. Grabel said strategic allocation is one of the most important components to investing and PERA has made significant progress implementing the updated strategic asset allocation approved April 2014. The fund now has better diversification. Approximately 75 percent of the fund has been repositioned this fiscal year by the Board. The vast majority of the portfolio is within its target bands in accordance with the strategic asset allocations.

Alternative assets are less efficient and take much longer to achieve targets, stated Mr. Grabel. Within that portfolio there have been strong accomplishments. He discussed the significant legwork required to make recommendations – it takes years to build a pipeline to bring things forward.

Mr. Grabel noted that the Board approved its first two separate accounts for funds of one for the alternatives portfolio – 57 Stars and AQR.

The transition of custody banks was a tremendous effort. PERA successfully transitioned over 3,700 domestic securities, 3,800 global securities, over 220 wire transfers between various countries and the old custody account involving over 42 different currencies. 79 different accounts were opened, and BNY Mellon opened 158 accounts to transition the assets.

What little is left in the outstanding transition issues is a real testament to the hard work of the team. "It's remarkable," stated Mr. Grabel. Regarding securities lending, the entire book was transition. It has been implemented and is live at BNY Mellon with no impaired assets to report.

Mr. Grabel said staff continues to have daily calls with JP Morgan and BNY Mellon. He hoped to close all JP Morgan accounts by month-end.

Mr. Grabel discussed the Board completed fee study and offered that the study increases transparency for the membership. The study identified pro forma fee savings in excess of \$10 million. The decisions were made not to reduce fees but to better position the portfolio.

In terms of RFPs/RFIs, Mr. Grabel started with new mandates: High Yield, Emerging

Market Debt, Multi-Strategy Credit and Listed Infrastructure. Existing mandates include: Portable Alpha, International Equity Small Cap, Emerging Market Equity and 457(b) consultant.

The 457(b) accomplishments include: 18,000 participants, assets in excess of \$500 million, enrollment has been improved and made easier, initiated participation with HR managers and plan rebranding to increase awareness and clarify the plan.

Mr. Grabel said every decision PERA makes is interrelated to every other decision made. He said PERA has the right technology and mindset to recognize that it's the whole portfolio; it's the mandate that should drive every decision that is made. Human capital in PERA's investment division is the focus. Time has been well used enhancing collaboration amongst the investment team.

The cash overlay program, initiated September 2014, has provided a gain of \$10.3 million. PERA is embracing new technology that will provide tremendous benefits. Mr. Grabel noted that PERA was getting much better information for less money.

5. **OTHER BUSINESS**

None was presented.

6. **ADJOURNMENT**

Having completed the agenda, and with no further business to come before this Committee, Chair Mayfield declared this meeting adjourned at 10:38 a.m.

Approved by:



Dan Mayfield, Chair
Investments Committee

ATTEST:


Wayne Propst, Executive Director

Attached Exhibits:

Exhibit 1: Staff recommendation re: Century

Exhibit 2: Cliffwater re: Century

Exhibit 3: Century report