NEW MEXICO

PUBLIC EMPLOYEES RETIREMENT BOARD

INVESTMENTS COMMITTEE MEETING

June 25, 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.

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
Roman Jimenez, Vice Chair
Patricia French
Stewart Logan
Louis Martinez

Member(s) Excused:
Dan Esquibel

Other Board Members Present:
Paula Fisher
Loretta Naranjo Lopez
John Reynolds
Jackie Kohlasch

Staff Members Present:
Wayne Propst, Executive Director
Claudia Armijo, Assistant General Counsel
Jonathan Grabel, Chief Investment Officer
Greg Trujillo, Deputy Director
Renada Peery-Galon, ASD Director
Julian Baca, Deputy CIO
Judy Olson, Executive Assistant
LeAnne Larrañaga-Ruffy, Portfolio Manager
Joaquin Lujan, Portfolio Manager
Christina Keyes, Portfolio Manager
Jude Perez, Portfolio Manager
Mark Montoya, Financial Analyst
Kristen Varela, Financial Analyst
Karyn Lujan, Deferred Compensation Administrator

Others Present:
Gabriella Zadra, Cliffwater
Tom Toth, Wilshire
Paul Lium, Nationwide
J. Arnell, Charterhouse
Christian Fehling, Charterhouse
Lynsey Register, Charterhouse
Ivan Zinn, Atalaya Partners
Devon Muir, Mercer

2. APPROVAL OF AGENDA

Ms. French moved to approve the agenda as published. Her motion was seconded by Mr. Jimenez and passed by unanimous [5-0] voice vote.

3. APPROVAL OF CONSENT AGENDA

Ms. French moved to approve the consent agenda. Mr. Logan seconded and the consent agenda was unanimously [5-0] approved.

4. CURRENT BUSINESS

Chief Investment Officer's Report

1. Investment Performance Summary – May 2015

Jonathan Grabel, Chief Investment Officer, offered that the fund balance ended at $14.8 billion at the end of May. The investment returns for the month were up 2 basis points although assets were down $41 million during the month. He noted that PERA's asset allocation serves the mission to pay benefits today and into the future. Currently, PERA is $500 million a year cash flow negative in that the benefit payments exceed the contributions. Fiscal year to date, the fund is up 3.5 percent, and although below the actuarial hurdle, PERA has achieved tremendous accomplishments.

Mr. Grabel reminded the Committee that the numbers presented are all net of fees and expenses. He discussed the current focus on when the Feds will raise rates. Rates have moved this month as has the yield curve. He noted that PERA's core fixed income portfolio is up 2.15 percent in this environment and presents opportunity for some of PERA's managers to make money. Rising rates are expected and this provides better economic conditions, a better employment environment and inflation in wages. Higher interest rates, benefits savers, encourages lending with banks and thus stimulates the economy. Core fixed income is expected to be less volatile than other asset categories. Rising rates may impact other asset categories more than fixed income. As the Fed fund rate increases, it gives the Feds more tools to help shape monetary policy going forward.

Mr. Grabel reviewed the returns of asset categories during May and noted that domestic equity was up 1.26 percent and international equity was down 1.23 percent. He reminded the Committee that PERA is investing in terms of decades, and it is important that PERA is prudently diversified. Core fixed income was down 361basis points, and fixed income plus was down 62 basis points. PERA's alternatives portfolio had a strong month; absolute return was up 70 basis points, private equity was up 3.99 percent, real estate was up 6 basis points and real assets were down 1.07 percent.

Mr. Grabel pointed out that PERA's benchmarks are not meant to be marketing materials, but instead a tool to shape important decisions.

2. Cash Plan Update

Mr. Grabel said the month finished with $925 million in cash, and it is expected June will finish with less than $400 million. He said cash planning is exceedingly important and complicated. All but 10 percent of the cash is invested in the overlay program which has enabled staff to better manage cash. He reviewed the sources of cash, mentioning there was $33 million in distributions from private equity firms. In terms of uses, $43 million was spent to pay benefits, refunds and manager fees. Capital calls increased to $46 million, and this may be the first month where capital calls were higher than distributions for private equity. There was $31 million moved to the international equity portfolio as approved within the structure analysis. Fiscal year to date, the cash overlay plan is up $18 million.

The Board members who participated in the open house with Investment staff yesterday agreed that the presentations were excellent.

3. Other Updates

Mr. Grabel provided the following updates:

- Multi-Strategy Credit RFP – 29 proposals were received and the evaluation committee will meet tomorrow
- International Equity Small-Cap RFI – 10 managers were invited to compete including the incumbent, and the evaluation committee will be eliminating some for the next round of review
- Listed Infrastructure RFP – New mandate with approximately $40 million generated 11 responses, and interviews for the finalists are being planned
- 457b Investment Consultant RFP – Seven responses were received and the evaluation committee will be meeting this afternoon
- Securities Lending – unrealized losses decreased by $400,000 and is down to $3.3 million. A true-update will be reflected in the June report. BNYMellon will provide new reporting on this
- Custody bank transition to BNYMellon occurs next week. PERA is in excellent shape for this, and staff were lauded for their efforts
- Joaquin Lujan was recently quoted in a trade magazine demonstrating the depth of the investment team

Mr. Martinez asked where the $50 million that PERA will receive from the Wells Fargo settlement will go. Mr. Grabel responded that all of PERA's fund money is fungible.

Mr. Grabel announced that Julian Baca was leaving PERA to go to UNM to do economic research. Mr. Baca has been a key contributor to the investment team.

The Board recognized with appreciation Mr. Baca and staff that worked on the BNYMellon transition.

The Board members congratulated Mr. Baca and talked about his responsiveness, professionalism, depth of knowledge and passion within his expertise.

Mr. Baca thanked the Board stating it was an honor to work for them.

Mr. Propst said of Mr. Baca that he is a consummate professional with a good heart.

B. <u>Action Item</u>: 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 $50 Million to Atalaya Special Opportunities Fund VI, LP, in the Private Equity-Credit Portfolio

[*Exhibit 1: Staff recommendation re: Atalaya; Exhibit 2: Cliffwater report, 6/25/15; Exhibit 3: Atalaya report, 5/28/15*]

Mr. Grabel introduced Gabriella Zadra the head of private equity from Cliffwater.

Joaquin Lujan, portfolio manager, said Cliffwater and staff recommend a commitment of up to $50 million to Atalaya Fund VI. He noted that this fund has a five-year end date, and the debt assets through which the strategy will invest are cash paying that de-risk quickly and have a short duration.

Atalaya's founder and CIO, Ivan Zinn, born and raised in Santa Fe said he was particularly flattered and proud to be before the PERA Board. Atalaya is Spanish for watchtower and his favorite hiking trail. He said he had dinner with his family last night and many are PERA members, and he was reminded that, if he should develop a partnership, he had personal accountability.

Mr. Zinn said Atalaya is a credit-focused special opportunities investment firm that is an opportunistic buyer of credit assets, as well as an occasional lender. Atalaya began nine years ago. The bulk of the firm's energy is spent on the smaller end of the investment potential spectrum at the sub-$50 million range, which they find holds more opportunity.

Atalaya focuses on three categories: real estate, financial assets, and corporate. He delineated the composition of the funds over time with the bulk of activities in the real estate and financial asset categories. The shorter term investments creates more frequent cash generation, and that can be recycled or distributed to the investors. Fund VI is expected to have a similar breakdown to Fund V which is 80 percent in real estate and financial assets with a much smaller percentage in corporate investing.

Mr. Zinn provided an example of commercial real estate where Atalaya capitalized on a sale of orphaned assets due to a bank merger. The team checks on all the loans and collateral.

Mr. Zinn said the firm does invest in its funds and will commit at least $7.5 million or 1 percent to Fund VI. He said he and his partners have tens of millions of dollars invested across all their funds.

Mr. Grabel reminded that the private assets in general has lumpy inflows and outflows/ capital calls and distributions. There is a cap of 23 percent of the portfolio for illiquid investments.

Ms. Zadra said Cliffwater conducted diligence on Atalaya during its fourth fund and recommended fund V to a few clients as well as their asset income fund.

Ms. French made a motion to recommend that PERA commit up to $50 million to Atalaya's Special Opportunity Fund VI, LP, subject to legal review by counsel. Mr. Jimenez seconded and the motion passed by unanimous [5-0] voice vote.

2. **Recommendation to Commit up to $70 million to Charterhouse Capital Partners X, LP, in the Private Equity Portfolio**
[*Exhibit 4: Staff recommendation re: Charterhouse; Exhibit 2: Cliffwater report, 6/25/15; Exhibit 5: Charterhouse report, 6/25/15*]

LeAnne Larrañaga-Ruffy, portfolio manager, said Charterhouse, a European buy-out fund, works within PERA strategy, which has 22 percent exposure to Western Europe via four dedicated funds and the remainder through global funds. This recommendation with Charterhouse is a follow-on investment, as PERA is a limited partner within Fund IX and has had a relationship with Charterhouse for six years. She invited the representatives from Charterhouse, noting they came in from London.

Jamie Arnell, Charterhouse partner, sits on the portfolio structure committee, a group of five senior partners who are responsible for the overall monitoring and allocation of capital within the investment strategies. Charterhouse has been based in the UK in London since 1934, is one of the oldest private equity firms in the world and has been doing buy-outs for the last 40 years. The firm only does buy-outs and only does those buy-outs in Western Europe. Charterhouse is a one team/one office structure.

Mr. Arnell said Charterhouse always target deals where they are management's preferred bidder: "We have a management-friendly investment strategy." Nearly half their deals are acquired without an auction process. The partnership approach taken with management does not prevent them from adding value to the companies they invest in.

Mr. Arnell said their performance across the cycles has been good. Since the beginning of 2014 they have realized approximately €4 billion. The firm has been independent since 2001 and owned by the partners. Fund X is targeted as a €3 billion fund.

Christian Fehling, German national partner in the firm, who specializes in the German speaking countries in Europe, said they average 12 transactions for each fund. That is approximately €250 million to €300 million per transaction and can be as high as €500 million. The target returns over a three- to five-year period is to either double or triple the investment. Mr. Fehling reviewed the geography of their investments, noting they only invest in businesses headquartered in Western Europe and are often global business. Recent transactions have been in UK, France, Germany, Italy and Spain. They have a slight preference in asset-light businesses such as business services, as well as financial services, media and healthcare.

Mr. Fehling said Charterhouse focuses on high quality businesses with good growth prospects. They always partner with the existing management. A relationship is built before buying in.

Lynsey Register, Investor Relations Director, said their approach to management is how they create value, with nearly 80 percent of the value created through profit growth.

Mr. Arnell discussed the Charterhouse team, characterizing them as seasoned executives with strong multi-lingual skills with seven nationalities and eight different languages. He likened their headquarters to the Tower of Babel. They have a broad range of partners doing deals in different geographies across Europe. Having one office provides for a cohesive style and quick lines of communications. Ms. Register said that, overlaying that team structure, they also have a number of processes to monitor investments.

A discussion about the pharmaceutical market in Italy where generics are just now gaining an uptake ensued.

In regards to the problems with Fund VIII, Mr. Arnell said there were three issues, Fund VII had spectacular returns and, as a result, there was an element of overconfidence leading to quick investments. In addition, there was a concentration of deal-doing partners, but that has been corrected and broadened out. Thirdly, this was a period of high availability of leverage, and a couple of transactions in VIII had too much leverage without debt appreciation, which was difficult with the downturn of the European economy and in particular the French economy. These team and timing issues have all been resolved and reflected in Fund IX's success.

Mr. Grabel remarked that investing is the easiest business in the world until you lose money. The changes Charterhouse made provides confidence that investments will perform better. He also mentioned that a new database, Top Q, was used by staff in preparation of this recommendation.

Mr. Logan asked about the currency used and Mr. Arnell said all the fund dynamics are done in the Euro. There may be currency fluctuations.

Ms. Jimenez made a motion to recommend that PERA commit up to $70 million to Charterhouse Capital Partners X, LP, in the Private Equity Portfolio, subject to approval of legal documentation by General Counsel. Ms. French seconded and the motion passed by unanimous [5-0] voice vote.

C. Information Item: Deferred Compensation

1. Q3 FY 2015 DC Plan Review

[*Exhibit 6: Nationwide Retirement Solutions Q3 2015 report*]

Karyn Lujan, Deferred Comp Plan Manager, introduced Paul Lium Program Director Nationwide Retirement Solutions (NRS). Mr. Lium said he has enjoyed working with Ms. Lujan. He said that, with Ms. Lujan's partnership, they are better educating the PERA membership that the DC is PERA's plan.

Observing that Nationwide has been PERA's DC manager for years, Ms. French said that she is concerned that many of HR managers in the state do not know this is a PERA plan. Ms. Lujan said staff was developing new material to include PERA's logo on all deferred compensation plan material to better connect to (NRS). She said they would be working to change the culture of what the PERA members think about the DC plan. She said she hoped to improve on the relationship between PERA and human resource managers. It is important to educate the HR managers to make sure the DC enrollment forms are included with the new employee orientation packets.

Mr. Lium reviewed the enrollment activities, current assets, total participation, increase in contributions, reinstatements, loan activity, etc. He noted that they now have the ability to send out a "blast" email. A new easy enrollment form has been created and will speed up enrollment. NRS is starting phone availability on Saturdays. He noted that the second quarter in the calendar year tends to be the strongest, industry-wise, for contributions.

2. Q3 FY 2015 DC Investment Review

[*Exhibit 7: Mercer – Q3 2015 DC Investment Review*]

Devon Muir, Mercer, reviewed a schematic of the investment options: managed allocations/lifecycle portfolios, passively managed low-cost funds, actively managed and the extended choice with additional diversifiers. No changes were being recommended by Mercer and the performances have been positive especially international equity, mid-cap options, and bonds.

The lifecycle portfolios continue to grow with more than 20 percent of assets, and Mr. Muir expected that trend to continue with the easy enrollment form. The stable value fund represents the largest holding at 26 percent of the assets. Quarter over quarter, assets increased about $8 million and investments gains were $9.3 million for the quarter.

In terms of the cost to the participants, Mr. Muir said the costs are below those of the midpoint of the institutionally priced-universe, with fund net expenses approximately 42 basis points. He reviewed the returns to the various assets groups and noted that the New Mexico

Stable Value Fund generated 40 basis points over the quarter. The active equity options are performing very well.

Mr. Grabel said the plan is well positioned and the RFP process is a good opportunity for the evaluation committee, and Board as a whole, to reflect upon the investment structure of the plan.

D. <u>Informational Item</u>: Annual Private Equity Program Review
[*Exhibit 2: Cliffwater report*]

Ms. Zahra said this market has rewarded the strong performers, and limited partners have a lot of capital to invest. She concurred with Mr. Grabel's earlier point that this market has been distributing capital back to investors at a faster rate than they are able to reinvest.

Ms. French asked whether Cliffwater is recommending emerging minority-owned managers. Ms. Zahra said they have recommended a fair number of those managers and guestimated it was 15 percent to 20 percent of Cliffwater's approved managers. She said those managers may not be in PERA's portfolio, and would provide that broader list to the IC and staff.

Ms. Zahra said there has been a healthy level of investment activity fueled by managers putting capital to work. In terms of pricing and leverage, it is much the same in the US and Europe, with purchase prices inching up and robust leverage available. Many of PERA's managers are benefitting from the increased liquidity in the market.

Ms. Zahra reviewed the IPO activity stating 2014 was the best market for venture firms since 2000. Cliffwater's outlook by asset class was reviewed and funds were recommended.

In response to Mr. Logan's question about investing in Europe, Ms. Zahra said what makes Cliffwater cautious is that there is still a lot of private equity capital to be invested with US-based firms with significant Europe practices. When there is a lot of private capital in a smaller universe it pushes up prices. Fundamentally, a lot of European companies are not strong growers. Cliffwater favors the mid-market and smaller more regional industry-focused firms within Europe.

Mr. Grabel added that the best private equity investors are contrarian by nature.

Reviewing PERA's PE portfolio, Ms. Zahra noted that PERA has made $1.207 billion in private equity commitments spread across vintage years. Buy-outs are the largest exposure because there are so many different categories within that category. As a cyclical category, Cliffwater expects distressed debt to ramp down.

She noted that in this liquid market, some of PERA's managers have taken that opportunity to sell, and she reviewed examples of that. PERA's commitments are on pace for the year, and even from one year to the other.

Ms. Zahra provided a review of the PE portfolio, noting it has 11.95 percent net IRR since inception thus exceeding its 9.88 percent benchmark IRR. The firms with poor performance include TPG Asia, Nordic, Providence, KRG and Lincolnhsire. The distressed and buyout firms have performed well. A vintage year summary was provided with comments on the partnerships.

5. OTHER BUSINESS

None was presented.

6. ADJOURNMENT

Having completed the agenda, and with no further business to come before this Committee, Mr. Jimenez moved to adjourn. Mr. Logan seconded and Chair Mayfield declared this meeting adjourned at 11:35 a.m.

Approved by:

Dan Mayfield, Chair
Investments Committee

ATTEST:

Wayne Propst, Executive Director

Attached Exhibits:
Exhibit 1: Staff recommendation re: Atalaya
Exhibit 2: Cliffwater report, 6/25/15
Exhibit 3: Atalaya report, 5/28/15
Exhibit 4: Staff recommendation re: Charterhouse
Exhibit 5: Charterhouse report,6/25/15
Exhibit 6: Nationwide Retirement Solutions Q3 2015 report
Exhibit 7: Mercer – Q3 2015 DC Investment Review