

NEW MEXICO
PUBLIC EMPLOYEES RETIREMENT BOARD
INVESTMENTS COMMITTEE MEETING

May 28, 2015

This meeting of the Public Employees Retirement Board Investments Committee was called to order by Vice Chair Roman Jimenez, 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
Patricia French
Stewart Logan
Louis Martinez

Member(s) Excused:

Roman Jimenez, Vice Chair
Dan Esquibel

Other Board Members Present:

Paula Fisher
Loretta Naranjo Lopez
John Reynolds
Dianna Duran
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
Julian Baca, Deputy CIO
Judy Olson, Executive Assistant
Karen Risku, Deputy General Counsel
Roderick Ventura, Assistant General Counsel
Natalie Cordova, Controller/CFO
Greg Portillos, CIO
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 Plan Manager

Others Present:

Anne Hanik Ortiz, LFC
Jamie Feidler, Cliffwater
Tom Toth, Wilshire
Paul Lium, Nationwide
Walter Schmidt, Rockwood Capital
Tyson Skillings, Rockwood Capital
Stafano Mion, Ardian
Michael Bane, Ardian
Don Wencewicz, AFSCME Retirees
Akio Tagawa, Linea Solutions
Bryce Haws, Linea Solutions
Ronald Merriman, Retiree

2. APPROVAL OF AGENDA

Mr. Logan moved to approve the agenda as published. His motion was seconded by Ms. French and passed by unanimous [4-0] voice vote.

3. APPROVAL OF CONSENT AGENDA

Ms. French moved to approve the consent agenda. Mr. Logan seconded and the consent agenda was unanimously [4-0] approved.

Ms. French stated she read the minutes and found them to be accurate.

4. CURRENT BUSINESS

Chief Investment Officer's Report

1. Investment Performance Summary – April 2015

Jonathan Grabel, Chief Investment Officer, offered that the fund balance ended at \$14.8 billion at the end of April, a new high-water mark. It was a very strong month with the plan up 1.35 percent and up 3.49 percent for the fiscal year. He reminded the Committee that staff-provided numbers are always net of fees and expenses.

Mr. Grabel focused on the importance of evaluating performance beyond returns. He referred to the daily change in the PERA fund balance over the past 209 trading days and noted the numbers were not audited. The median trading day saw a change of about \$29 million; there were more down days; largest single loss in a day was \$136 million; there were 11 days with gains above \$75 million; and the largest single gain was \$154 million. Numbers of this kind are to be expected in the capital market which is dynamic and fluid. PERA's volatility is not

excessive, stated Mr. Grabel. He noted that the new strategic asset allocation better diversifies and reduces risk.

Mr. Grabel said staff was working to develop multi-dimensional, actionable, understandable and concise reports.

Reviewing the month's results, Mr. Grabel noted that domestic equity was up 45 basis points, international equity was up 4.72 percent, core fixed income was down 36 basis points, and fixed income plus was up 1.83 percent. Within PERA's alternatives portfolio, absolute return was up 1 basis point, private equity was up 1.91 percent, real estate was down 96 basis points and within the real estate composite REITs were down 3.86 percent; however, the annualized performance of REITs since inception has been up 10 percent. Real assets were down for the month; however, MLPs were up for the month. He reminded the Committee that PERA wants to use its asset allocation as the risk management tool to minimize drawdowns.

2. Cash Plan Update

Mr. Grabel said the change in the fund balance shows the plans are up \$150 million for the month. The month finished with a little over \$1 billion in cash. He reviewed the overlay program and noted that the actual investments are inclusive of the overlay and compared to the 6 percent in cash the uninvested within that is .4 percent of the PERA funds.

Mr. Grabel identified the sources of cash for April that included redemptions from the portable alpha program and hedge funds. In terms of uses of cash \$40 million was spent in benefits, refunds and manager fees. Capital calls continue to be low and this month they were \$17 million. The cash overlay program was up \$17 million and has been positive since inception.

Mr. Grabel said there is an approximate 10 percent cushion that is not invested in the overlay program.

3. Other Updates

Mr. Grabel noted that he preferred committing to new managers and opening new accounts prior to or following the custody bank transition. He provided the following updates:

- Global High Yield RFI – Recommendation coming forward today
- Multi-Strategy Credit RFP – 29 proposals were received
- Emerging Market Equity – Current manager contract expired and a recommendation is coming forward today
- International Equity Small-Cap RFI – Including the incumbent, 10 managers were invited to bid and those bids are due next week
- Listed Infrastructure RFP – Eleven responses were received – this RFP will help the real asset target get closer to the range within the strategic asset allocation
- 457B Investment Consultant RFP – Nine responses
- Securities Lending – Losses decreased by \$500,000 leaving the unamortized losses at \$3.7 million

Mr. Grabel lauded staff and the Board for their diligence in addressing a very aggressive RFP/RFI schedule.

Mr. Grabel reminded the Committee of the BNY Mellon's recent settlement with regulators regarding foreign exchange practices. He noted that last week regulators announced a settlement with five global banks – JP Morgan, Barclays, CitiGroup, RPS and UBS – pleading guilty to criminal charges in that they colluded with respect to manipulating foreign exchange rates. He said this appears to be the end of an era of foreign exchange trading practices. BNY Mellon is a broker not a fiduciary for PERA.

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 \$60 Million to Rockwood X, LP, in the Real Estate Portfolio

[Exhibit 1: Staff recommendation re: Rockwood; Exhibit 2: Cliffwater report, 5/28/15; Exhibit 3: Rockwood report, 5/28/15]

Christina Keyes, Portfolio Manager, said staff was recommending up to \$60 million commitment to Rockwood X, a real estate fund focused on equity and debt investment opportunities in office, retail, hotel, multi-family residential and urban mixed-use properties. The markets are in the US, Canada and the Caribbean. She said PERA has invested in Rockwood Funds VIII and IX and those have done well for the fund.

Walter Schmidt, Rockwood Senior Managing Partner, said the two funds that PERA has invested in have done well and he was pleased to continue a relationship with PERA. The organization continues to be privately held, owned by seven partners and there is a clear deep-rooted fiduciary culture at Rockwood. He reviewed the management committee structure and the deep expertise they have in portfolio and asset management.

Mr. Schmidt provided an overview of Rockwood's view of the US economy, where they find market opportunity, investment strategy and their target return rate of 12 percent to 14 percent net IRR. He noted what Rockwood calls "the great reversal of urban growth" where there is a desire for a more urban lifestyle – mixed-use. The infrastructure of the 1950s and 1960s in the suburbs provided for housing, retail and office jobs and now the mixed-use environment is growing.

Tyson Skillings, Rockwood Portfolio Manager Partner, discussed their investment strategy and how that overlays with the portfolio composition discipline. Target market and key economic drivers exist in live/work/play areas to include 12 to 14 markets including Seattle, Portland, San Francisco/Bay Area, Los Angeles, Orange County, San Diego, Phoenix, Denver, Chicago, Philadelphia, Boston, New York City, Washington, DC, and Miami. These market areas have high barriers to entry, strong knowledge based industries, and strong global influence. He spoke about the demographic trend that they capitalize on within their investment strategy. Fund X will follow the same discipline used in implementation of Funds VIII and IX. The goal

is to assemble a diversified portfolio that will generate a 12 percent to 14 percent net IRR to investments. He discussed how they manage risk across the fund to generate return through a risk spectrum of income in place, income expected within 12 to 24 months and income expected within 24 to 36 months.

A discussion about the greater segmentation of today's millennium population and how it affects retail, food, hotels, etc. ensued. Mr. Skillings noted that retirees along with the millennials are seeking greater diversity of environment. He said Rockwood wants to be part of the real estate that caters to that demand growth.

In response to Rockwood's plan to invest in the Bay Area, Ms. Naranjo Lopez asked whether they considered the fact they were contributing to the gentrification and high property value that prohibits many from living there. Mr. Schmidt said they were greatly concerned and reviewed the zoning practices in terms of affordable housing and transportation. Development requires an investment in affordability.

Noting that short-term rates have been working in Rockwood's favor, if that was to change is the firm positioned to handle that, asked Chair Mayfield. Mr. Schmidt said the firm uses a steep LIBOR curve in their projections and their buffer against interest rate increase in the business plan is to increase the income of the project.

It was mentioned that Ms. Keyes' report was a good complement to Cliffwater's report.

Mr. Logan made a motion to recommend that PERA commit up to \$60 million to Rockwood X, LP, in the real estate portfolio, to be funded according to PERA's Cash Plan, subject to approval of legal documentation by General Counsel. Ms. French seconded and the motion passed by unanimous [4-0] voice vote.

2. Recommendation to Commit up to \$65 million to Ardian Infrastructure IV, LP an Infrastructure Fund in the Real Asset Portfolio [*Exhibit 4: Staff recommendation re: Ardian; Exhibit 2: Cliffwater report, 5/28/15; Exhibit 5: Ardian report, 5/28/15*]

Ms. Keyes said this fund pursues diversified infrastructure opportunities focusing on existing assets and businesses and mature markets throughout Western Europe. The fund target is a net IRR of approximately 10 percent to 13 percent and the manager has strong regional connections throughout Europe. She introduced the Ardian representatives present.

Michael Bane, Ardian, Head of US Investor Relations, reviewed Ardian's beginnings in the industry and today there are 360 employees across 10 global offices. The company is privately held and majority owned by the employees. Ardian is very present in Europe which is important to their strategy. He identified the arena in which Ardian manages \$50 billion. Ardian began investing in infrastructure in 2005 with the first fund launched in 2006 and is one of the most experienced managers in the market and certainly in Europe.

Mr. Bane emphasized that Ardian is committed to being a responsible investor. The team is very disciplined with an approach toward long-term transparent partnership.

Stefano Mion, Ardian Managing Director, said the managing team speaks five languages and represents nine nationalities which is crucial in investing in Europe. Their investments are diversified over 20 investments in seven countries over six sectors. He noted that diversification serves as a good form of risk management within Ardian's long-term strategy. In the first two generations of investments Ardian was able to return more than 50 percent of the cash deployed mainly through dividends.

Mr. Mion reviewed Ardian's investment strategy noting infrastructure cannot be replaced very easily whether that is a utility, airports, roads, etc. Returns in infrastructure are linked to inflation and over the long term that provides protection from inflation. They expect to own the asset for a long term to generate maximum dividends.

Mr. Mion discussed the micro-economic environment in Europe starting with quantitative easing which led to a decrease in government rates. Over the past year, Ardian refinanced a large number of assets within the portfolio to take advantage of the low rates and locking in low rates for the long term. Inflation is currently down in Europe and he said Ardian was able to create recurring profits in a zero growth market.

Chair Mayfield asked whether the US dollar was at any risk when investing in Europe. Mr. Grabel stated that the materiality of the investment is not of the magnitude in the context of the entire PERA fund. He noted that the dollar is strong and that is to the fund's benefit and a positive to the returns. Betting on the movement of currencies is very difficult to do because of the multitude of factors and externalities.

Mr. Feidler said investing in a European based market is a form of diversification within the portfolio.

Mr. Bane said between 40 percent and 50 percent of the LPs in the IV fund are expected to be non-Euro denominated investing limiting partners. Typically they do not hedge at the level of the commitment. He noted that the European market is more mature and there is access to different types of assets particularly in the transportation segment.

Mr. Mion said there are signs that the GDP is coming back to growth in the Euro Zone providing an upside for the assets and portfolio and entering into a good, stable regulatory environment.

Ardian's three funds have shown consistency in returns, strategy, IRRs and dividends. Diversification in the fund reduces risk and Mr. Mion reviewed the diversification of Fund III highlighting the balance between transport assets, utility assets, and renewable energy assets. He discussed the strong correlation to inflation; as inflation goes up revenues will go up and it will create an asset protection.

Assets have been deployed for Fund IV: roads in Portugal and airports in Italy.

Mr. Mion confirmed that along with Ardian's investment professionals and executive team the employees all have a stake in the fund.

Mr. Logan made a motion to recommend that PERA commit up to \$65 million to Ardian Infrastructure Fund IV, to be funded according to PERA's Cash Plan, subject to approval of legal documentation by General Counsel. Ms. French seconded and the motion passed by unanimous [4-0] voice vote.

C. Information Item:

1. Deferred Compensation EZ Enrollment (Short Form)

Karyn Lujan, Deferred Comp Plan Manager, said this new, one-page enrollment form is for the lifecycle portfolio plan which simplifies choosing investment options and is member friendly. Following enrollment the member receives a welcome kit in the mail with full plan details.

Mr. Grabel noted that the existing agreement will exist along with the new EZ enrollment agreement.

Paul Lium, Nationwide, said during the orientation meeting the long form is fairly intimidating.

Ms. Lujan said marketing information explains each of the lifecycle portfolios.

2. Updated Deferred Compensation Participant Agreement Long Form

Ms. Lujan said the form has been updated and is more user friendly. She said unnecessary fields have been removed. The participant has the option to receive electronic/email quarterly statements.

Once the forms are re-reviewed by Nationwide's compliance department the website will be updated with the new forms in a couple of weeks.

3. Q3 FY15 Performance Update
[Exhibit 6: Wilshire, Numbers in Context; Exhibit 7: Q3 FY15 Investment Performance Review]

Tom Toth, Wilshire, discussed the quarterly economic overview and said it is expected that the environment has low returns. Inflation expectations are muted and up slightly from last quarter but below the Federal Reserve's target of 2 percent.

Mr. Reynolds recommended a session on asset class return assumptions be scheduled at the Board Retreat.

Mr. Toth summarized Wilshire's findings from their regular funding study reports. Ninety-two state retirement systems are used for a comparison of funding information. While pension liabilities grew so did assets.

The expectations for GDP growth for 2015 have been moderated to the 2.5 percent to 2.75 percent range. The unemployment rate continues to improve. Inflation statistics will have a meaningful impact on the Federal Reserve decision regarding interest rates. The lower the inflation number comes in the more room there is to err on the side of growth.

Mr. Toth discussed the importance of understanding and accepting the volatility of floating exchange rates.

Reviewing PERA's fund performance, Mr. Toth said the larger components – global equity, core fixed income – are largely in line with the targets, international equities are close to the target and slightly overweight for core fixed income. The underweights are in the less liquid asset classes which he attributed to the type of sub- investments within liquid assets. He reviewed the total fund performance in terms of long-term, one-, three- and five-year returns and reminded the Committee of recognizing risk within the equation. He noted that PERA's Sharpe ratio for the portfolio is higher than that of the index thus the risk adjusted measure of return is superior to that of the policy index. He identified the drivers of the return over the one-, three- and five-year periods are positive excess returns from domestic equity, absolute return portfolio and core fixed income.

4. Fund Rebalance Update

As of May 14, 2015 the PERA fund had approximately \$940 million in cash of which the vast majority is invested through the overlay account based upon a pro-rata allocation of PERA's strategic asset allocation stripping out the illiquid assets. Cash invested in the overlay program has 29 percent in the domestic equity, 37 percent in international equity and 34 percent in core fixed income. The intention of the program is that it provides a good perpetual shorter term vehicle. He noted that that situation is not unique to PERA.

Staff deems it prudent to invest a significant majority, \$940 million, to rebalance about \$645 million in accordance with the policy bands in the strategic asset allocation. Mr. Grabel referred to the cash rebalance methodology by pro-rata asset category and allocation of cash based upon Board approved managers and their percentages.

Mr. Grabel said all of these actions are compliant with PERA's Investment Policy Statement and none of the upper limits of the strategic asset allocation will be breached. Wilshire and Cliffwater have been advised of this methodology. He pointed out that the actual numbers will vary based upon total fund balance and the relative value of respective managers within each asset category.

Mr. Grabel said rebalancing as a policy and procedure is an important discussion that may occur at the retreat.

Mr. Reynolds said he'd like to discuss the difference between cash and the overlay versus rebalancing that cash into the various asset categories. Mr. Grabel said that would be part of the conversation of moving from a synthetic investment to a physical security.

5. Custody Bank Update

Deputy CIO Julian Baca said he along with Mark Montoya and Kristin Varela have been focused on the custody transition to make sure it is as smooth as possible. Mr. Baca said this is a team effort across the investment staff.

Mr. Baca reviewed the process that is guided by a detailed implementation plan and timeline. He identified the topics covered which include the assistance of PERA personnel within legal, IT, and accounting. He discussed the weekly staff calls with BNYM, the calls between BNYM and JP Morgan to accomplish the transition, staff trainings, and the fact that the transition is on track for July 1, 2015. There may be some lags which are typical for big transitions.

Responding to Chair Mayfield's question, Mr. Baca said there may be delays in the first month's reporting which is typical. He anticipated full reporting within a few months. In regard to the level of service from JP Morgan, the outgoing custody bank, Mr. Baca said it is fairly typical of a conversion of this nature.

Mr. Grabel said JP Morgan is compliant and working with PERA, however, they have been terminated and that can strain a relationship. He said PERA is candidly dependent upon JP Morgan and he pointed out that PERA was not getting an A+ for effort to begin with from them which is what precipitated the change.

Mark Montoya, Analyst, reviewed the different areas/modules that staff, BNYM and JP Morgan have been focusing on during the process. The process includes opening global markets which ensures that PERA's investment managers are able to perform seamlessly. He discussed that all of PERA's performance data will be transferred to BNYM.

Ms. French thanked staff for the tremendous effort they have expended on this project.

Kristin Varela, Analyst, demonstrated some of the new reports and improvement PERA will gain with BNYM. There will be better control of data, better checks and balances, more independent capabilities, more granular fee data and a more efficient finalization of monthly performance data. There will be greater efficiencies in hedge fund data and closing accounting will occur five days earlier than the current process. She outlined the comprehensive report packages BNYM will provide which include an improved general ledger reporting which is very important to PERA. She said the improved risk reporting capabilities will provide access to greater portfolio analysis.

Overall, BNYM will provide timelier, more accurate, robust reporting that will improve PERA's self-reliance, all at a lower fee, stated Ms. Varela.

Staff was lauded for their excellent work.

5. **OTHER BUSINESS**

None was presented.

6. **ADJOURNMENT**

Having completed the agenda, and with no further business to come before this Committee, Ms. French moved to adjourn. Mr. Logan seconded and Chair Mayfield declared this meeting adjourned at 11:50 a.m.

Approved by:

 6/25/15

Dan Mayfield, Chair
Investments Committee

ATTEST:



Wayne Propst, Executive Director

Attached Exhibits:

- Exhibit 1: Staff recommendation re: Rockwood*
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