NEW MEXICO

PUBLIC EMPLOYEES RETIREMENT BOARD

INVESTMENTS COMMITTEE MEETING

November 19, 2015

This meeting of the Public Employees Retirement Board Investments Committee was called to order by Chair Dan Mayfield, at approximately 9:20 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
Paula Fisher

Staff Present:
Wayne Propst, Executive Director
Susan Pittard, Chief of Staff/General Counsel
Jonathan Grabel, Chief Investment Officer
Greg Trujillo, Deputy Director
Danna Valdez, Executive Assistant
Karen Risku, Deputy General Counsel
Renada Peery-Galon, ASD Director
Jude Perez, Deputy CIO
LeAnne Larrañaga-Ruffy, Portfolio Manager
Mark Montoya, Financial Analyst
Kristen Varela, Portfolio Manager
Emily Lopez, Financial Specialist

Others Present:
Jamie Feidler, Cliffwater
Tom Toth, Wilshire
Robert Merriman
Judy Olson, PERA Retiree
J. Maxon, SJFD
T. Hughes, PERA
Matthew O'Connor, Carlyle Power Partners
Charles Kaye, Warburg Pincus
Gregory Baecher, Warburg Pincus

2. APPROVAL OF AGENDA

The agenda was accepted by consensus.

3. APPROVAL OF CONSENT AGENDA

Mr. Logan moved to approve the consent agenda. Ms. French seconded and that motion passed by unanimous [5-0] voice vote.

4. CURRENT BUSINESS

Chief Investment Officer's Report

1. Investment Performance Summary – October 2015

Jonathan Grabel, Chief Investment Officer, said the PERA Fund finished October with a balance of $14.2 billion. For the month the fund was up 3.68 percent and the balance was up $470 million. He characterized the month as "very strong with a stellar performance" with the fund down 1.09 percent fiscal year to date.

In regard to the costs of terrorism on an investment portfolio, Mr. Grabel noted that first and foremost the human tragedy must be recognized. He said staff, with the assistance of consultants and managers, analyzed three reactive options following an event similar to what occurred in Paris: 1) Retreat by selling everything and hold cash; 2) Employ tactical/opportunistic/behavioral investing. Both of these options use market timing which is not a prudent strategy. A third option, and the only viable choice, is to focus on PERA's mission – the strategic asset allocation and implementation of that with consistent revisits in a methodical and data driven manner. That is the only option, stressed Mr. Grabel.

Mr. Grabel thanked his investment team for their work in getting the numbers prepared for today's meeting.

For the month, domestic equity was up 7.68 percent and international equities were up 7.03 percent. Of the $470 million the fund is up, over $400 million is derived from public equities; 85 percent of the fund's gains are from 48 percent of the fund's assets. Mr. Grabel reminded the Committee that exposure to public equities was greatly reduced last year when the new strategic asset allocation was adopted. He noted that last month, 83 percent of the fund's losses were from 48 percent of the assets evidencing that public equities are the largest contributor to PERA's gains and losses.

Core fixed income was up 8 basis points, fixed income plus was up 1.6 percent for the month. The absolute return was down 1.82 percent and the impact of that on the portfolio is less material as the allocation is trending down. Private equity was down 11 basis points for the month. For the past 12 months, private equity, PERA's best performing category was up 17.7 percent, Fee-wise, private equity is the most expensive asset category and yet it has the best performance. Real estate was up 3.44 percent for the month and real assets were up 1.74 percent.

2. Cash Plan Update

Mr. Grabel said the fund balance increased by $470 million during October. The month ended with $424 million in cash, all of which is invested through the overlay. He reviewed the sources of cash for the month with $100 million from core fixed income, $35 million from private asset distributions, $74 million from hedge fund redemptions and $15 million from a transfer from residual accounts from the former custody bank. Uses of cash during October included a net outflow of $46 million for benefits, refunds and manager fees and $24 million for capital calls for private assets. He noted the net decrease in private assets.

3. Other Updates

Mr. Grabel reviewed the following:

- Kristen Varela has been promoted to Portfolio Manager
- The listed infrastructure RFP will be revisited and reissued
- PERA SmartSave/457B rebranding is underway with a mailing to all active members

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 $65 Million to Carlyle Power Partners II, LP

[*Exhibit 1: Staff recommendation re: Carlyle; Exhibit 2: Cliffwater report re: Carlyle; Exhibit 3: Carlyle Report*]

Jude Perez, Deputy CIO, reminded the Committee that PERA's real asset portfolio has a target of 7 percent and the portfolio is currently at 3.1 percent with a market value of approximately $440 million. The portfolio is heavily weighted to North America and upstream energy. Carlyle is a power generation fund that is downstream and staff and Cliffwater find this area very interesting for the fund.

Mr. Perez said PERA has been researching Carlyle Power Partners for well over a year and Cliffwater's research history is even longer. Jamie Feidler, Cliffwater, stated they have a multi-year relationship with Carlyle.

Managing Director and Co-head of Carlyle Power Partners, Matthew O'Connor, provided an overview of the firm and Fund II. Carlyle has over $188 billion in managing assets under four operating segments: corporate private equity, real assets, global market strategies and investment solutions. There is $40 billion in the real assets segment which Power Partners falls under.

Mr. O'Connor said there are 10 dedicated investment professionals in Power Partners and this is their second fund in which they will raise $1.5 billion. They will target private equity-type returns. He emphasized they are not a utility nor will they be buying utilities. Power Partners invests the unregulated side of power which is about 40 percent of the US power generation landscape. The power is not sold to end customers. Their expertise is in the US with a focus on New England, mid-Atlantic, southeast and California. He provided an example of a business they purchased and retained the personnel, technical capabilities, and assets. That platform was used as their day-to-day operational portfolio company to run their power plants and use the engineering expertise they acquired with the business to add value and expand. The goal is to use that operational expertise to drive improvements and earnings at the Power Partner plants to be sold as a more valuable asset to the next buyer.

Mr. Martinez said the operational risk seemed to be the greatest. Mr. O'Connor said the team includes a dedicated engineering department with construction management, civil, electrical and mechanical and combustion turbine engineers. Further, they have a 20-person repair and maintenance crew.

Mr. O'Connor indicated that their focus is fossil fuel, however, there are two solar plants in the portfolio which he characterized as challenged in terms of returns. Returns from the renewable space are sub 10 percent.

Identifying himself from an "energy county," Mr. Logan asked about Caryle's relationship with Cogentrix. Mr. O'Connor said Cogentrix works for the benefit of the LPs but Carlyle controls the day-to-day operation. They work solely for Carlyle. Origination and sourcing of transactions comes from Carlyle's New York team and Cogentrix is part of the due diligence team.

Mr. O'Connor noted that this summer for the first time in the history of the US more power was generated from natural gas than coal.

In regard to carbon credits, Mr. O'Connor said renewables generate carbon credits and at this point they do not have a need for those credits. In the future, they may look to do that.

Mr. Esquibel moved to approve the recommendation to allocate up to $65 million to Carlyle Power Partners II, LP, an infrastructure power generation real estate fund, Power Partners II will invest in approximately 20 or more power assets in North America over five years through eight to twelve transactions subject to legal review. Ms. French seconded and the motion passed by unanimous [5-0] voice vote.

2. **Recommendation to Commit up to $85 Million to Warburg Pincus Private Equity XII, LP**
[*Exhibit 4: Staff recommendation re: Warburg Pincus; Exhibit 2: Cliffwater report re: Warburg Pincus; Exhibit 5: Warburg Pincus Report*]

LeAnne Larrañaga-Ruffy, Portfolio Manager, said staff is recommending a commitment of up $85 million to Warburg Pincus, a global growth fund in the private equity portfolio. This fund will focus on growth oriented investment opportunities on a global basis. She said the fund will provide stage, sector and global diversification.

Charles Kaye, Warburg Pincus Co-CEO, said he has been with the firm for 30 years and it is one of the oldest and largest private equity firms in the world. The firm is owed and run by its 70 partners and 180 investing professionals that constitute the firm.

Greg Baecher, Warburg Pincus Principal, referred to the strong absolute returns; a 25.5 percent gross IRR, 17.6 percent IRR since inception and 11 mature/completed funds. He said they have consistent high returns and discussed how their strategy mitigates risk.

Mr. Kaye focused on the firm's growth deep industry expertise and geographic presence. Mr. Baecher discussed the firm's strong commitment to no fees which makes Warburg Pincus and LPs aligned with the same incentives.

Mr. Esquibel expressed concern that Warburg Pincus would be making investments in companies PERA was already invested in with another manager. Mr. Grabel said there are occasions where managers work together but that is a minority of the time and there may be high yield bond managers and/or credit managers that may own some of the credit but these investments are not like buying a stock.

Mr. Esquibel moved to recommend approval of a commitment in the amount of up to $85 million to Warburg Pincus Private Equity XII, LP, a multi-sector fund focused on global growth private equity fund subject to legal review. Ms. French seconded and the motion passed by unanimous voice vote.

C. **<u>Information Item:</u> Q1 FY16 Performance Review**
[*Exhibit 6: Wilshire, Numbers in Context*]

Tom Toth, Wilshire Consulting, reviewed the asset class assumptions for 2015 and noted the increase in expected return from global equities is up by 50 basis points since the beginning of the year. As the expected return for equities has gone up the expected return for core fixed income actually went down through the 3rd quarter by five basis points. In contrast the fixed income plus sectors expected returns went up materially. The greatest return in expected return is from master limited partnerships (MLPs) they have sold off materially in sympathy with oil prices.

Mr. Toth mentioned that inflation remained flat over the past 12 months while the unemployment rate continues to come down.

He discussed the divergence within emerging markets and noted that the performance has lagged that of equity markets both international and domestic. Emerging market economies with a high reliance on foreign capital are at a greater risk due to the risk of that capital flight. Emerging market economies with a high reliance on commodity and fuel exports have also been subject to volatility. An active approach to managing emerging market equities is prudent.

Referring to MLPs, Mr. Toth said they have experienced a major swing in terms of valuations. The third quarter was the worst seen for MLP pricing since the global financial crisis. MLPs have moved in concert with oil prices but not to the same magnitude.

Mr. Toth reviewed risk statistics noting the movement of the fund relative to the market and while the beta was above one it was moderated over this one-year time frame. Over the past three years the beta has been 1.07 percent. Risk adjusted returns are negative because the portfolio was down.

D. Information Item: Domestic Equity Portfolio Review

Ms. Larrañaga-Ruffy reminded the Committee that in September 2014, the Board approved the recommendation by staff and Wilshire to restructure the domestic equity allocations to eliminate the small-cap growth bias and reduce domestic equity exposure from 29 percent to 21 percent. The transition was completed in March 2015 and eliminated three managers and increased passive exposure. With these modifications came a fee savings of approximately $3 million. The portable alpha program is still being transitioned and by the end of December 2015 the initial portable alpha program is anticipated to be redeemed. Beginning, January 2016, the AQR (Applied Quantitative Research) alphaport should be fully implemented at 12.4 percent of the domestic equity portfolio.

Mr. Toth reviewed the style map which outlined the positioning of the domestic equity portfolio in two dimensions – style of the portfolio value vs. growth, and the size of the portfolio large cap vs. small cap. The changes made to the portfolio were done to move it closer to the market as a whole which serves as a risk mitigation exercise.

Mr. Toth noted the tracking error for the portfolio is below 1 percent at .95 percent. The predicted beta, its sensitivity to market moves is also below 1 percent at .93 percent.

Mr. Toth said there were no recommendations for changes to the domestic equity portfolio.

Ms. French requested the inclusion of fee information within Wilshire's reports.

5. OTHER BUSINESS

Kristen Varela was congratulated on her promotion and Mr. Grabel was thanked for his service.

6. ADJOURNMENT

Having completed the agenda, and with no further business to come before this Committee, Chair Mayfield declared this meeting adjourned at 11:05 a.m.

Approved by:

Dan Mayfield, Chair
Investments Committee

ATTEST:

Wayne Propst, Executive Director

Attached Exhibits:
Exhibit 1: Staff recommendation re: Carlyle
Exhibit 2: Cliffwater Report
Exhibit 3: Carlyle Report
Exhibit 4: Staff recommendation re: Warburg Pincus
Exhibit 5: Warburg Pincus Report
Exhibit 6: Wilshire, Numbers in Context