

NEW MEXICO
PUBLIC EMPLOYEES RETIREMENT ASSOCIATION
SMARTSAVE
COMMITTEE MEETING

August 9, 2016

This fifth meeting of the Public Employees Retirement Board SmartSave Committee was called to order by Chair John Reynolds at approximately 10:30 a.m. on the above-cited date in the PERA Building, Senator Fabian Chavez, Jr. Board Room, 33 Plaza La Prensa, Santa Fe, New Mexico.

Executive Director Wayne Propst called roll and a quorum was established as follows:

Members Present:

John Reynolds, Chair
Jackie Kohlasch, Vice Chair
Dan Mayfield
Loretta Naranjo Lopez

Member(s) Excused:

Tim Eichenberg
Brad Winter

Other Member(s) Present:

Patty French
Dan Esquibel
James Maxon
Paula Fisher
John Melia
Cathy Townes

Staff Present:

Wayne Propst, Executive Director
Susan Pittard, Chief of Staff-General Counsel
Jon Grabel, Chief Investment Officer
Greg Trujillo, Deputy Director/Chief Information Officer
Karen Risku, Deputy General Counsel
Dana David, Assistant General Counsel
Reneda Peery-Galon, ASAD Director
Jude Perez, Deputy CIO
Greg Portillos, Chief Information Officer
Natalie Cordova, Chief Financial Officer

Karyn Lujan, Deferred Compensation Plan Manager
LeAnne Larrañaga-Ruffy, Director of Equity
Kristin Varela, Portfolio Manager
Emily Lopez, Financial Specialist
Christine Ortega, Portfolio Manager
Mark Montoya, Investments Division
Lalleh Dayeny, Investments Division

Others Present:

Paul Lium, Nationwide
Paul Cowie, Meketa
Ted Benedict, Meketa

2. APPROVAL OF AGENDA

Ms. Naranjo Lopez moved to approve the agenda as presented. Her motion was seconded by Mr. Mayfield and passed by unanimous [4-0] voice vote.

3. APPROVAL OF CONSENT AGENDA

Chair Reynolds indicated he reviewed the minutes of the July meeting and found them accurate.

Mr. Mayfield moved approval. Ms. Naranjo Lopez seconded and that motion passed by unanimous [4-0] voice vote.

4. CURRENT BUSINESS

A. Revised Asset Allocation of LifeCycle Portfolios to include a High Yield Bond Fund [Exhibit 1: PERA Staff Memo & Meketa Report]

Karyn Lujan, Deferred Compensation (DC) Plan Manager, said this action item is a follow-up to the July 12 presentation on how a high yield bond fund implementation can benefit the PERA Smart Save Plan's lifecycle portfolios. Staff and Meketa recommend the committee approve a revised asset allocation to include the high yield bond fund within the fixed income allocation of the SmartSave lifecycle portfolio.

SmartSave currently offers nine portfolio options with 52 percent of the participants invested in a lifecycle portfolio. The LifeCycle portfolio was introduced to the fund in 2005 along with various fund allocations, asset classes and strategies.

Ms. Lujan said the addition of the high yield fund could potentially increase returns, and improve the Sharpe Ratio. It is aligned with PERA's philosophy in asset allocation and diversification. The portfolio will remain conservatively positioned in equity compared to the target date fund peer universe.

Paul Cowie, Meketa, reviewed PERA's allocation compared to that of its peers

based on a Morningstar report. He noted that there was a fairly tight band between the most and least aggressive funds with PERA close to the bottom with 85 percent equity.

Mr. Cowie stated the total equity allocation remains the same for the longer dated funds and in the more conservative portfolios there is a decrease to equity. He reviewed expected risk and return impacts for each of the dated funds.

Chair Reynolds asked when the asset allocations of the various lifecycle portfolios were reviewed and Ms. Lujan said that was February 2016. Mr. Cowie said most of Meketa's clients review their allocations at least annually. Ted Benedict, Meketa said with the addition of the new asset class of high yield bonds reviews would occur more frequently.

In response to Mr. Melia's question regarding passive or active management for the high yield bonds, CIO Grabel said it will depend upon the specific strategy. High yield is not the most efficient category and lends itself to more active management.

Mr. Mayfield moved to approve the revised asset allocation of the lifecycle portfolio to include a high yield bond fund. Ms. Kohlasch seconded and the motion passed by unanimous [4-0] voice vote.

B. High Yield Bond Fund Search

[Exhibit 2: PERA Staff Memo & Meketa Report]

Ms. Lujan said PERA and Meketa will conduct research on high yield bond mutual funds through databases and present the top candidates to the committee for a recommendation. She anticipated presenting between two and four candidates. Mr. Benedict reviewed the criteria for this highly regulated security that allows many different investors to pool capital and is managed by a single company. The product offers daily liquidity and there are inherent limitations.

Mr. Benedict said the search will include a minimum asset level of \$5 billion which protects PERA from certain business risks. The firm must manage bonds for at least three major defined contribution plans of similar size to PERA's SmartSave. Minimum performance standards and an institutional share class will be included in search criteria. The total process from today should take four to five months to implement. Ms. Lujan said the process includes working with Nationwide and its fund release schedule which occurs every other month.

Mr. Benedict assured the committee that Meketa has no conflict with any asset management company. Meketa is strictly an investment advisor for boards and institutional investors. "We do not manage assets ourselves and we receive no revenue compensation from any investment organization."

C. BlackRock Inflated Protection Bond Fund Replacement with a Passive TIPS Fund [Exhibit 3: Meketa Report]

Ms. Lujan said during the initial fund review performed by Meketa it was determined that there may be other TIPS (Treasury Inflation Protected Securities) funds that would provide a similar return with significantly lower fees.

Mr. Benedict said TIPS are securities issued by the US government in which the bond's principal is adjusted semi-annually at the rate of inflation according to changes in the CPI. The yield is lower than traditional government bonds because of the inflated adjustments and the market value of the TIPS will fluctuate based upon the market's expectation for inflation. TIPS have done quite well. Meketa expects, over the next 20 years, a 3.3 percent annualized return in TIPS. This is a very efficient asset class where trying to use active management to gain an increment of return is extremely difficult, stated Mr. Benedict.

Mr. Benedict discussed BlackRock's use of latitude to generate additional returns stating it has been difficult for them to do so. Compared to the index, BlackRock is under for one-, three-, five-, seven- and ten-year time periods and unable to add value.

Referring to page 27 in the Meketa book, Mr. Grabel pointed out that this is an example of managers trying to generate alpha by investing in different sectors. In some sense, that is an anathema to asset allocation.

Mr. Benedict said BlackRock has been underperforming the benchmark, has taken more investment flexibility than desired by the asset class and they are more expensive than an index would be. For those reasons, Meketa recommends that PERA consider an alternative TIPS option that employs passive management with lower fees. Many of Meketa's clients utilize a Vanguard product.

Chair Reynolds said the move to Vanguard was reasonable and there appeared to be committee consensus.

D. Q4 FY16 Investment Performance Review [Exhibit 4: Meketa Report]

Mr. Cowie said the plan assets reached \$501.3 million in June 30, 2016, an increase of \$7.2 million from the prior quarter. There were 19,238 participants at the end of the quarter with an average balance of \$26,058. Currently, 26 percent of the fund is stable value, 21 percent in the lifecycle portfolio, and three other portfolios make up the remaining percentage. He highlighted that the bulk of the asset inflow was within lifecycle funds.

Mr. Cowie reviewed the investment options' performance with the market value, percent of assets, cash flow for each individual option and performance over

various time periods. PERA's active funds have done well compared to peers. He noted that active managers have had a really tough time over the year. The Franklin Templeton Global Bond fund had disappointing returns where the benchmark is up 10.7 percent and they remain flat.

Mr. Cowie characterized the performance of the lifecycle portfolios as generally positive.

Responding to Mr. Esquibel's question regarding Brexit and the market, Mr. Grabel said it is unknown. The S&P 500 is at an all-time high, the NASDAQ is at its 2000 highs, the Dow is close to its high; but it is a zero and negative rate environment. That environment may relate to Brexit in the isolationism/protectionism. The Bank of England cut its rates to the lowest ever – that is telling to today's environment – and speaks to PERA lowering its actual rate of return assumption. Brexit may be the effect rather than the cause of what is going on in the global economy.

Reviewing the investment expense analysis, Mr. Cowie pointed out that with the exception of Principal Diversified Real Asset fund and the Fidelity Diversified International fund, PERA is below the fee median for all the investment options.

E. Q4 FY16 Plan Activity Review
[Exhibit 5: Nationwide Report]

Mr. Grabel said he and Ms. Lujan had a meeting with Nationwide Program Director Paul Lium and his team members to discuss:

- Investment behavior: The asset allocation of the participants is at best random. They discussed how best to optimize asset allocation which may be done through “white labeling” and focusing on investment strategy. In DC plans, participants think about their balances and staff will be challenged to assist participants in equating an asset number into an income number
- Marketing and outreach: Improving the message and determining the actual goal. Rebranding to PERA's SmartSave and the EZ enrollment are great steps. The challenge is how and when to reach people
- Pricing: The annual administrative fee is \$52 per participant. The median balance is \$6,700 and that means half the participants are paying above 78 basis points just in administrative fees
- Electronic initiatives: Currently everything is paper based and PERA may consider work on changing legislation to facilitate more technology with the DC plan

In response to Ms. French's question, Mr. Lium said for a flat rate, \$52 is inexpensive but relative to the median balance it is high. He said with a revenue neutral solution, Nationwide is totally onboard.

Ms. Lujan reported that 580 employees joined SmartSave during the quarter along with two employers. She said PERA, Meketa and Nationwide have been developing fund fact sheets for the lifecycle portfolios. Bernalillo County is consolidating their DC plans and all of the assets are being moved to PERA's SmartSave.

Mr. Lium thanked staff for the partnership and the creation of this committee. Easy enrollment has been a great asset. The plan will grow substantially with Bernalillo County joining the plan. Nationwide has an information/enrollment blitz occurring to enroll as many people as possible in Bernalillo.

DC plans originally were part of an agency's HR department. Mr. Grabel said the topic of how the Department of Labor fiduciary rules for DC plans and its impacts on some employers in the state may be a good agenda item.

Ms. Naranjo Lopez requested comparison information of participation since Nationwide's inception and any additional information.

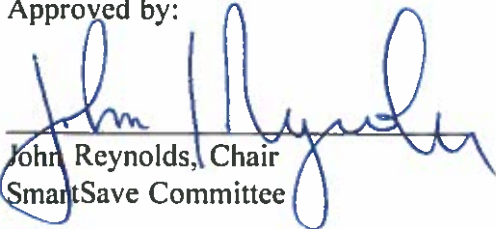
5. **OTHER BUSINESS**

None was offered.

6. **ADJOURNMENT**

Upon motion by Ms. Naranjo Lopez and second by Mr. Mayfield, Chair Reynolds adjourned this meeting at approximately 11:55 a.m.

Approved by:


John Reynolds, Chair
SmartSave Committee

ATTEST:


Wayne Propst, Executive Director

Attached Exhibits:

- Exhibit 1: PERA Staff Memo & Meketa Report*
- Exhibit 2: PERA Staff Memo & Meketa Report*
- Exhibit 3: Meketa Report*
- Exhibit 4: Meketa Report*
- Exhibit 5: Nationwide Report*