

NEW MEXICO

PUBLIC EMPLOYEES RETIREMENT BOARD

INVESTMENTS COMMITTEE MEETING

February 25, 2016

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

1. & 2. Roll call preceded the Pledge of Allegiance and indicated the presence of a quorum as follows:

Members Present:

Dan Esquibel, Chair
Dan Mayfield, Vice Chair
Paula Fisher
Patricia French
Loretta Naranjo Lopez
John Reynolds

Member(s) Excused:

None

Other Board Members Present:

Brad Winter
James Maxon
Jackie Kohlasch
Cathy Townes

Staff Members Present:

Wayne Propst, Executive Director
Susan Pittard, Chief of Staff-General Counsel
Jon Grabel, Chief Investment Officer
Greg Trujillo, Deputy Director/Chief Information Officer
Renada Peery-Galon, ASD Director
Natalie Cordova, Chief Financial Officer
Misty Braswell, Assistant General Counsel
Dana David, Assistant General Counsel
Jude Perez, Deputy CIO
Joaquin Lujan, Director of Rates and Credit
LeAnne Larrañaga-Ruffy, Director of Equity
Danna Varela, Executive Assistant
Mark Montoya, Financial Analyst

Kristin Varela, Portfolio Manager
Emily Lopez, Financial Specialist
Karyn Lujan, Deferred Compensation Plan Manager
Christine Ortega, Portfolio Manager
Zarina Martinez, ASD
Lalleh Dayeny, Investment Division

Others Present:

Paul Lium, Nationwide
Anna Hanik Ortiz, LFC
Jennifer Salazar, OAG
Mark Williams, Cliffwater
Thomas Toth, Wilshire

2. APPROVAL OF AGENDA

Ms. French moved to approve the agenda as presented. Her motion was seconded by Mr. Mayfield and passed by unanimous voice vote. [Ms. Fisher was not present for this action.]

3. APPROVAL OF CONSENT AGENDA

Ms. French said she reviewed the minutes and found them accurate and complete. She moved to approve the consent agenda and Mr. Mayfield seconded. The motion passed by unanimous voice vote. [Ms. Fisher was not present for this action and arrived shortly thereafter.]

4. CURRENT BUSINESS

A. Chief Investment Officer's Report

1. Investment Performance – January 2016

PERA CIO Jon Grabel said January was a tough month with the fund balance at the end of the month at \$13.4 billion, down 2.79 percent net of fees. That loss is \$433 million which equates to approximately one year of net pension payments. In the perspective of a loss of 2.79 percent – on a monthly basis the new custody bank provides thousands of scenarios of different securities, different asset categories across the globe and measures the value at risk – 95 percent of the time PERA will not lose more than 2.9 percent – that's called the monthly VAR (value at risk). The plan has been moving in the wrong direction for the fiscal year and fiscal year to date the plan is down 5.49 percent.

Mr. Grabel noted that the losses are not attributable to a PERA-specific event and the Board remains vigilant to the long-term mission.

Mr. Grabel reviewed the asset category returns for January. Public equities: domestic equities, international equities were down. Over the last calendar year there has been a big spread between the returns of domestic and international equities with US

equities outperforming international by 8 percent.

Ms. French asked whether PERA should revisit the asset allocation which reduced the domestic and increased the international. Mr. Grabel said the question is not US versus international but rather public equity which is the biggest driver of the portfolio. As far as contribution to risk in PERA's current portfolio across all asset categories, 70 percent of it is from the US. The portfolio has a heavy bias to the US.

Mr. Grabel said fixed income/core portfolio was up 1.36 percent confirming the benefit of a diverse portfolio. The fixed income plus portfolio was down 84 basis points for the month. He identified the lag time in the reporting of alternative assets and said absolute return was down 61 basis points, private equity was up 66 basis points, real estate was down 2.11 percent, and real assets was down 3.2 percent.

Referring the anticipated asset allocation review presentation, Chair Esquibel asked whether the analysis will identify whether categories require rebalancing based on current market behaviors. Mr. Grabel said the major input for an asset allocation is projected returns for major asset categories and an analysis of the associated volatility. The analysis Wilshire will present at the March Investment meeting looks at optimizing the behaviors of different types of categories.

2. Cash Plan Update

Mr. Grabel said the change in fund balance was down about \$433 million. The month finished with a little over \$350 million in cash. In terms of sources and uses of cash, for January there was \$20 million in private asset distributions, \$153 million came in from hedge fund redemptions, and \$47 million from employer and employee contributions. Uses of cash included \$89 million in benefits and refunds, \$1 million in operational expenses, \$67 million for private asset capital calls and \$8 million was placed in the future's collateral account.

Mr. Grabel said there was a breach of the upper limit of the core fixed income program which coincided with PERA's new portable alpha program with \$100 million going into that program and \$60 million was taken from core fixed income. That helped to fund a mandate and comply with the rebalancing policy.

3. Other Updates

Mr. Grabel said equities are the biggest driver of the portfolio. Staff conducted an analysis of the change in fund balance over the past year and public equities, which make up 47 percent of the assets, accounted for about 75 percent of the change of the total fund. A balance across asset categories, a reduction in the risk of permanent loss and the prevention of wild swings in the fund balance are all necessary in developing the portfolio. He said he believed the 2014 adopted assets allocation is better than what had been previously and there is still room for improvement.

Mr. Grabel provided the following updates:

- The Investment Division is fully staffed
- LeAnne Larrañaga-Ruffy is one of four finalists for the *Institutional Investor* Public Fund Intelligent Investor Awards for Private Equity
- Response from the Listed Infrastructure RFP have been received
- The Multi-Strategy Credit RFP is ready for re-issuance
- A risk reporting capabilities training session will be scheduled for April or May

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

In an effort to provide a more efficient process and extract the “sales” from the Committee meeting, Mr. Grabel said this month the advisor/consultant and staff will make a direct recommendation to the Committee with a focus on how the investment fits into the portfolio.

1. Recommendation to Commit up to \$75 Million to Brookfield Infrastructure Fund III, LP

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

Kristin Varela, Portfolio Manager, said staff and the consultants are presenting the recommendation to invest in this global infrastructure partnership that will be held within the real assets portfolio. PERA committed to Brookfield’s Fund II in October 2013 in the amount of \$40 million.

Ms. Varela reviewed the real assets portfolio noting that 75 percent is comprised primarily of growth oriented oil and gas opportunities. If approved, the infrastructure allocation will increase from its current allocation of 20 percent to 26 percent of the real assets portfolio. This commitment will facilitate greater geographical diversification.

The strategy is basically ownership of physical structures, facilities and systems that provide a central service to a community. This fund will fit in PERA’s real asset portfolio as a core foundation.

Mark Williams, Cliffwater, said Brookfield is a very large investment management corporation. Fund II is performing at expectation within the low-mid teens. In fact, Fund II was making distributions from operating yield within a few months.

According to Cliffwater’s report, Ms. French said the firm lacks a succession plan and 20 percent of it is owned by senior executives. Mr. Williams said he appreciated the concern and noted that the organization is very large, developed over a 100-year period and has gone through multiple successions. The firm has approximately 30,000 employees.

Mr. Williams outlined Cliffwater's private asset due diligence process. Companies are discussed internally, references checked, an audited cash flow analysis occurs and an on-site full due diligence occurs.

Ms. Varela noted that the majority of investors in Brookfield funds II and III are large institutional investors.

Mr. Williams said Cliffwater conducted a complete and thorough revision of the report presented for Fund II. The fund size of III is substantially larger than II as is the market opportunity. He confirmed Fund III will be \$10 billion with their first close targeted for March 31st. Brookfield has already received substantial indications of interest from their existing clients and expects to reach \$10 billion at the March 31st close. The fund has a hard cap of \$12 billion which they also anticipate reaching.

Mr. Grabel said Brookfield has over \$200 billion in management. The firm can raise \$10 billion easily with a soft circle for \$12 billion. This is core infrastructure and not a speculative commitment to an emerging manager.

Mr. Williams said if approved PERA's investment will be slightly above the middle of the investing pool. There are some sovereign wealth funds that are committing \$500 million.

Ms. Varela noted that Brookfield's customer service has been great with constant updates. She described PERA's due diligence noting that Sam Pollock, Senior Managing Partner & CEO, Infrastructure Group, and Chris Harris, Senior Vice President, Client Relations visited the PERA office October 2015 to discuss PERA's current investment as well as fund raising for Fund III. Discussions continued with the firm as well as internally in weekly meetings. Brookfield completed PERA's due diligence documents.

Mr. Grabel informed the Committee that the Investment staff works together and not in silos. This recommendation had a very long lead time with a tremendous amount of behind the scenes work. He noted that the weekly staff meeting rotates the chair position and there is a review of the existing portfolio as well as a draft memo review process.

Mr. Grabel said part of Cliffwater's contractual responsibilities is to conduct operational diligence which PERA staff lacks the resources to carry out. In terms of the business diligence, the investment diligence and market opportunity is duplicative as it should be.

Mr. Reynolds moved to recommend a commitment in the amount of \$75 million to Brookfield Infrastructure Fund III, LP. Ms. Naranjo Lopez seconded and the motion passed by [4-0] voice vote. [Members French and Mayfield were not present for this action.]

C. Information Item: Q2 FY16 Performance Review
[Exhibit 4: Wilshire – Q2 FY16 Report]

Tom Toth, Wilshire, highlighted some key economic indicators: inflation is less than 1 percent, consumer sentiment is very strong and above the 10-year average, and manufacturing is experiencing some strength. Consumer spending is the primary driver of the US economic growth which is moderate. Growth in home prices is above the long-term average but still moderate.

Referring to risk statistics, Mr. Toth said the beta – the level of market sensitivity of the portfolio – relative to the 10-year history is moving in a positive, more risk controlled manner. That was one of the key objectives in the asset allocation process. While the volatility/risk in the total portfolio is moderately higher than the policy itself, the trend in the standard deviation and index standard deviation shows a narrowing trend in the 10-year period.

D. Information Item: Emerging Market Debt Update – Fixed Income Plus

Mr. Grabel reminded the Committee that staff and the consultant will be providing asset category reviews.

Joaquin Lujan, Director of Rates and Credit, provided context and definition for the market highlights, notable features of the asset subcategory and context around the objective and performance of the mandate and how they fit into PERA's portfolio construction. EMD is approximately \$176 million which is 1.3 percent of the total fund. It is slightly over target because of a loss in equities. EMD is a fixed income sub-asset category that comprises bonds issued by less developed or "developing" countries. These bonds are considered to have a higher default risk versus developed country debt. Countries mentioned that fit in the EMD category were Mexico, Turkey, Indonesia, Poland, and Russia. He discussed how an investor may take on the risk of the local currency debt and that corporations in EMD countries can issue debt in local currency.

Mr. Lujan noted that EMD offers incremental yield, smart exposure to global growth economies, and measurable portfolio diversification benefits.

Mr. Toth highlighted the characteristics and opportunities in hard currency and local currency. He noted that investors are not willing to lend money in local currencies to countries that are generally considered non-investment grade.

Chair Esquibel asked about the ratings and Mr. Lujan said the rating is only one measure and is not wholly relied on by investors. Mr. Toth said ratings are used as guidelines.

Mr. Toth noted that there are different risks embedded in hard currency versus local currency EMD. Those different risks provide diversification and a broader

opportunity set to add value.

Noting that past performance is never indicative of future results, Mr. Lujan said EMD is expected to contribute meaningfully to the total fund. Mr. Toth said PERA's EMD manager, Lazard, is permitted to short opportunities. While the portfolio is down 3.6 percent net of fees, it is 224 basis points better than the index they are measured against.

E. Information Item: International Equity Update

LeAnne Larrañaga-Ruffy, Director of Equity, said in February 2015 the Board approved the recommendation to restructure the international equity allocation to eliminate one manager, increase the allocation to Northern Trust ACWI ex-US passive index and equalize allocations to the current EAFE and small cap managers while increasing the international equity exposure from 20 percent to 24.8 percent. The transition was completed in May 2015. The asset class has seven managers and they are all at target. The current allocation to international equity is \$3.1 billion and neither staff nor Wilshire have any recommended changes.

Mr. Toth said changes to structure are generally driven by the desire to mitigate or eliminate style and size tilt. At this time, the recommendation is to maintain the current structure.

F. Information Item: Multi-Strategy Credit RFP MQs and Timeline

Mr. Lujan said the RFP will be released on March 15th with a deadline for responses on April 15th. He expected the process to be relatively smooth with good results. Multi-strategy is within the fixed income plus portfolio and he reviewed the scope of work.

5. OTHER BUSINESS

Chair Esquibel asked about Cliffwater's watch list. Mr. Grabel said the items on watch are with private partnerships where PERA's money is locked up and there is very little recourse other than selling the interest in a secondary market at a huge discount.

Mr. Williams said Cliffwater has four of PERA's managers on watch list. EnerVest has suffered from the deteriorating commodity price environment. He said he has ongoing meetings with EnerVest. A loss is projected.

6. ADJOURNMENT

Upon motion by Mr. Mayfield and second by Ms. Fisher, Chair Esquibel declared

this meeting adjourned at 10:51 a.m.

Approved by:

A handwritten signature in black ink, appearing to be 'D. Esquibel', written over a horizontal line.

Dan Esquibel, Chair
Investments Committee

ATTEST:

Wayne Propst, Executive Director

Attached Exhibits:

Exhibit 1: Staff recommendation re: Brookfield

Exhibit 2: Cliffwater report

Exhibit 3: Brookfield Report

Exhibit 4: Wilshire – Q2 FY16 Report