

NEW MEXICO

PUBLIC EMPLOYEES RETIREMENT BOARD

INVESTMENTS COMMITTEE MEETING

July 28, 2016

This meeting of the Public Employees Retirement Board Investments Committee was called to order by Chair Dan Esquibel at approximately 9:20 a.m. on the above-cited date in the Domenici Room at New Mexico State University, Las Cruces, New Mexico.

1. The Pledge Allegiance preceded roll call by Executive Director Wayne Propst and a quorum was established with the following members present:

Members Present:

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

Member(s) Excused:

John Reynolds

Other Board Members Present:

James Maxon
John Melia
Cathy Townes
Jackie Kohlasch

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
Jude Perez, Deputy CIO
Joaquin Lujan, Director of Rates and Credit
Trish Winter, Executive Assistant

Others Present:

Edwardo R. Castillo, NMDOT
Rick Little, State Representative
Greg Smith, Las Cruces City Councilor, District 2
Charlie Marquez, PERA Contractor

Joshua Kestler, BNY Mellon, Hedgemark
Jean-Francois Crousillat, BNY Mellon – Hedgemark
Jamie Feidler, Cliffwater
Tom Toth, Wilshire

2. APPROVAL OF AGENDA

Ms. French moved to approve the agenda as presented. Her motion was seconded by Ms. Naranjo Lopez and passed by unanimous [6-0] voice vote.

3. APPROVAL OF CONSENT AGENDA

Mr. Mayfield moved to approve the consent agenda. Ms. French seconded and the motion passed without opposition.

4. CURRENT BUSINESS

A. Chief Investment Officer's Report

1. Investment Performance – June 2016

PERA CIO Jon Grabel said the fund finished the month of June as well as the fiscal year with \$14.1 billion. The performance of the fund was up 51 basis points, net of all fees and expenses, notwithstanding the Brexit vote which reduced the performance by an estimated 200 basis points. For the quarter the fund was up 1.73 percent and for June the cash balance increased by \$90 million. PERA lagged the benchmark for the month and the quarter. The tracking error will persist until the portfolio is more representative of the new strategic asset allocation.

Mr. Grabel said for the fiscal year the fund was up 48 basis points and for the second year in a row below the actuarial target. This was a very hard year starting with a very material market correction out of China and ending with Brexit. During the year there were fears of slowing global growth and recession throughout the world. There was commodity deflation, terrorism, natural disasters, Zika, Ebola – this has been a very tough year. Negative interest rates and political uncertainty contributed to the investment challenges in the fiscal year.

In step with the Team Building presentation that encouraged celebration of small victories, Mr. Grabel reported that:

- PERA had a positive year and recovering more than \$1 billion since the market lows in February
- Rebalancing provided approximately 40 percent of the Fund's investment gains for the fiscal year
-
- The agency has a "fantastic team"

Mr. Grabel referred to PERA's 3-, 5- and 10-year returns that are below target. However, over the long term (30 years) PERA has a positive performance. These results are indicative of the investment environment.

Ms. French reminded the participants that PERA pays out annually \$1 billion to its members.

Mr. Grabel reported that equities were down 34 basis points for the month and down 2.5 percent for the fiscal year. PERA's risk mitigation/downside protection which is the core bond portfolio and source of liquidity that was up during the month by 1.76 percent. For the fiscal year the risk mitigation/bond portfolio was up 6.81 percent. Credit was up 39 basis points for the month and up 1.63 percent for the fiscal year. The real assets composite was up 1.76 percent for the month and down 1.47 percent for the fiscal year. Liquid real estate was up 4.7 percent for the month and 15.05 percent for the fiscal year. Real estate has been the best performing strategy in the portfolio over the past fiscal year. For the fiscal year the illiquid component of that portfolio was up 16.52 percent. Liquid real assets were up 5.16 percent for the month and down 17.46 percent for the fiscal year. Illiquid real assets were up 95 basis points for the month and down 14.88 percent for the fiscal year.

2. Cash Plan Update

Mr. Grabel said the change in the fund balance for June was an increase of \$90 million. The month and fiscal year ended with approximately \$387 million in cash. He reviewed the sources of funds which included \$48 million from employer/employee contributions, \$25 million in private asset distribution, \$1 million from the corporate actions account (in-kind distributions, class action claims, etc.) and \$5 million from redemptions in the old portable alpha program. Uses of cash included \$90 million to pay benefits and refunds, which he anticipated will increase in July with the effect of the COLA. As a mature pension, the outflows are greater than inflows.

During the month, \$4 million was paid out for operational expenses including manager fees and \$50 million for private asset calls.

3. Other Updates

Mr. Grabel provided the following updates:

- RFP: Multi-Strategy Credit recommendation will be presented today
- RFP: Illiquid Investment Consultants – a dozen responses were received for the whole or partial mandate
- The monthly risk report produced by BNY Mellon highlights that in an up-market equity is great; in a down-market equity is not so great

B. Action Item: Approval of Dedicated Managed Account Platform with BNY Mellon

Mr. Grabel reminded the Committee that this item was discussed yesterday during the retreat; he noted the BNY Mellon representatives in the audience and offered to further discuss staff's recommendation.

Mr. Mayfield introduced a motion to approve the dedicated managed account

platform with BYN Mellon. Ms. French seconded.

Chair Esquibel requested that in the future he be made aware of the necessity of supermajority votes.

The motion passed by unanimous [6-0] voice vote.

C. Action and Information Items: Strategic Asset Allocation (SAA) Implementation

1. Information Item: Update on SAA Implementation

Mr. Grabel said last month the Board approved a similar item for the equity portfolio. This month begins the first of the nine tranches approved last month with the details of that movement in the July rebalancing report. He offered to schedule an educational session on transition management at the Board's request.

Tom Toth, Wilshire, noted that the change in asset allocation includes a fairly material shift in the amount of assets allocated to credit-oriented fixed income, increasing it to 15 percent of portfolio. The goal for the SAA was to be more risk balanced and more diversified away from the equity-centric portfolio.

The primary impacts for the credit portfolio implementation are a fairly meaningful increase to global high yield – bank loans as well as emerging market debt. The recommendation is to do that with the existing managers. Two new strategies and two new managers will be introduced for Board approval: Securitized credit with Ellington, and Multi strategy credit with Napier Park.

Joaquin Lujan, Director of Rates and Credit, said the objective and principles to be followed in the implementation is to when possible upsize strategies with current managers in good standing to provide for expedient change, increases the strategy manager conviction and reduces the possibility for portfolio drift. Additionally, it gains custody/control over assets and customizes strategies and investment guidelines to fit the PERA portfolio and possibly reduce fees. Implementation of these changes should be conducted prudently.

Mr. Lujan said staff recommends:

- Immediately rebalance the global high yield strategy with the existing manager in good standing, Guggenheim. Increase the commitment by \$15 million to reach \$209 million
- Immediately rebalance the secondary bank loan strategy with the existing manager in good standing, CVC Credit. Target to increase by \$50 million to reach \$104 million and change the vehicle from an investment through a commingled account into a dedicated managed account
- Immediately rebalance the emerging market debt strategy in two tranches with the existing manager in good standing, Lazard. Target to increase to \$419 million from \$188 million and change the vehicle from a commingled fund into

- a dedicated managed account
- A future step will be to allocate \$100 million to Ellington, investment in structured credit, taking the leveraged loan/structure credit dollar target
- Allocation of \$300 million to Napier Park to run a specialized, complicated credit strategy
- Continue to develop a recommendation regarding direct lending strategy
- Increase the allocation to distressed debt to meet the new target

Responding to Ms. French's question regarding manager fees, Mr. Lujan said while it is case by case, he was confident PERA would experience a savings. To the extent the manager does not want to negotiate with PERA, Mr. Grabel said the Board has the power to transition those assets to another manager.

Mr. Toth said it typically takes two months to set up an account.

Mr. Grabel identified the procurement policy as an operational tool. The asset allocation can be implemented with the existing procurement policy. However, it clarifies and avoids an appearance of any ambiguity by approving the new policy.

2. Action Item: Credit Oriented Fixed Income Implementation Plan

Mr. Grabel said the source of funds for much of the rebalancing recommendations will be the cash on hand and as that cash grows, from the reduction in the global equity portfolio. There is no needless "churning" of the portfolio in order to implement this.

Mr. Lujan said that staff recommends that the IC approve:

- 1) Immediately rebalance the global high yield bond strategy with existing manager in good standing, Guggenheim, to new asset allocation target (up \$15 million, from \$194.8 million to \$209.6 million). Vehicle will remain separate account.
- 2) Immediately rebalance the secondary bank loan strategy with existing manager in good standing, CVC Credit, to new asset allocation target (up \$50 million, from \$54.2 million to \$104 million). Vehicle will change from commingled fund to dedicated managed account.
- 3) Immediately rebalance the emerging market debt strategy (in two tranches) with existing manager in good standing, Lazard, to new asset allocation target (up \$230 million, from \$188 million to \$419 million). Vehicle will change from commingled fund to dedicated managed account.

Ms. French moved to approve the three staff recommendations shown above. Her motion was seconded by Ms. Fisher and passed without opposition.

D. Discussion and Action Item: Approval of Updated Procurement Policy

Mr. Grabel discussed the current procurement policy stating that for investments and investment-related services PERA is exempt from the State's procurement policy. Historically, PERA has had different procurement methods with the core method for liquid or traditional assets being RFPs. The RFPs are open to the public and advertised through a practice that follows the policy. In 2014, the RFP was expanded to include an invitation only RFP or RFI (request for information) enabling PERA to articulate minimum qualification and utilize a database technology to find managers. This opens the fields to more than the largest money managers in any given category. For alternative and less efficient assets, Mr. Grabel said that process is different and entails working with the consultant, meeting with managers and having the IC and Board take action.

The updated policy does not change the method but instead is more closely aligned with the intent of the policy. The proposal expands the number of strategies opened to RFPs through a clearer definition of liquid assets and illiquid assets.

Mr. Grabel noted that the Committee was provided a redline draft of the current policy with proposed language. He highlighted the proposed changes:

- No changes made to evaluation committee structure
- Updated to reflect the four asset allocation categories
- Refined definitions of traditional assets to liquid assets and alternative assets to illiquid assets
- Clarified procurement of investment-related legal services
- Updated applicable citations
- Clarified document for potential third-party service providers

General Counsel Pittard said the procurement code was modeled after the State's and she reviewed the scope, purpose, legal authority, and roles and responsibilities.

Mr. Grabel continued the review with definitions, selection of solicitation process, illiquid investments, public notice, procurement processes, and evaluation of proposals.

Ms. Naranjo Lopez suggested deferring action and having staff provide a clean copy rather than a redline. Ms. Fisher agreed and she supported deferring action.

Chair Esquibel moved to postpone action to the August 9th committee meetings and schedule a study session (to include the previous and new investment policy) to go through each item paragraph by paragraph on this item for that date. Ms. Naranjo Lopez seconded and the motion passed without opposition.

Deputy CIO Perez noted that the investment policy is posted on the Board portal.

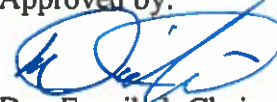
5. OTHER BUSINESS

None was presented.

6. **ADJOURNMENT**

With a motion and a second to adjourn, having completed the agenda and with no further business to come before the committee, Chair Esquibel declared this meeting adjourned at 11:00 a.m.

Approved by:



Dan Esquibel, Chair
Investments Committee

ATTEST:



Wayne Propst, Executive Director