NEW MEXICO

PUBLIC EMPLOYEES' RETIREMENT ASSOCIATION

INVESTMENT COMMITTEE MEETING

April 13, 2021

This meeting of the Public Employees' Retirement Association Investment Committee was held on the date cited above via Zoom tele/videoconferencing. Steve Neel, Chair, called the meeting to order at approximately 9:01 a.m.

1. Roll Call

Trish Winter, Executive Assistant, undertook the roll call. Meeting attendance met quorum with the following members present:

Committee Members Present
Steve Neel, Chair
Paula Fisher, Vice Chair [arrived at 9:06 a.m.]
Lawrence Davis
Loretta Naranjo Lopez

Committee Members Absent
Diana Rosales Ortiz

Other Board Members Present
Francis Page
Tim Eichenberg
Shirley Ragin
David Roybal

Staff
Greg Trujillo, Acting Executive Director
Susan Pittard, General Counsel
Trish Winter, Executive Assistant
Anna Williams, CFO
Dominic Garcia, CIO
Kristin Varela, Deputy CIO
LeAnne Larranaga Ruffy, Head of Equity
Aaron Kayser, Investments
Isaac Beckel, Investments
Isaac Olaoye, Investments
Karyn Lujan, SmartSave Plan Manager
Marlena Riggs, Budget Manager

Other
Tom Toth, Wilshire Consulting
James Walsh, Albourne
Sarah Grist, Albourne

2. Approval of Agenda

A motion to approve the agenda was made by Mr. Davis and seconded by Ms. Naranjo Lopez. The motion to approve the agenda passed by roll call vote as follows:

Steve Neel, Chair	Yes
Lawrence Davis	Yes
Loretta Naranjo Lopez	Yes

3. Approval of Consent Agenda

A motion to approve the consent agenda was made by Mr. Davis and seconded by Ms. Naranjo Lopez. The motion to approve the agenda passed by roll call vote as follows:

Steve Neel, Chair	Yes
Lawrence Davis	Yes
Loretta Naranjo Lopez	Yes

4. Current Business

A. Performance & Risk Update

1. Information Item: February 2021 Preliminary Flash Performance
   [Exhibit 1: February 2021 Preliminary Flash Performance]

Thomas Toth presented the Wilshire Consulting February 2021 Preliminary Flash Performance report, noting his comments and updates were subsequent to the last in-depth quarterly performance package that was presented to the Committee at the last meeting.

Referring to the portfolio asset allocation as shown on page 2 of the report, Mr. Toth noted this ended February at just under $16.5 million. He said he considered the takeaway from this, was that the portfolio's actual allocation sits very close to the policy index, so the portfolio is being managed in a prudent way to maintain true to the strategic asset allocation.

Regarding the credit portfolio, Mr. Toth said this was positive for February. Mr. Thomas advised at the end of Q1 there would further in-depth performance and commentary around markets to provide, which he believed would be presented at the Committee's June meeting.

Questions and Discussion

Directing a question to Mr. Garcia, Chair Neel asked generally what percentage of the private assets were waiting for December 31 marks.

Responding, Mr. Garcia reminded the Committee that approximately a third of the portfolio has lagged marks. He said that for private assets, such as private equity, private real estate, private infrastructure, private credit, approximately 80 percent of the portfolio is December 31 and not February 28. So, there is an inherent lag of three to four months in private assets, which is the nature of these assets.

Chair Neel asked when the flash for Q1 performance was anticipated. Mr. Garcia responded they would have a flash that day, or the next.

There were no further questions regarding the flash report presented to the Committee.

B. Active Risk Budget Update Part II

a. Information Item: Portable Alpha Review
[Exhibit 2: Portable Alpha Review]

Mr. Garcia reminded the Committee that they had reviewed the Active Risk Budget the previous month per Board and Committee governance and that the Active Risk Budget talks about how much additional risk is willing to be taken for active management, and how much return is expected for that.

Mr. Garcia advised that Mr. Toth, Wilshire Consulting would present the Committee with an overview and the context of Portable Alpha within the broader Active Risk Budget. And that Mr. Walsh, Albourne, as specialty consultants on the Portable Alpha program, private assets, real estate, infrastructure, would present more detail about factor risks and stress tests in the portfolio.

Chair Neel provided the Committee background context on this item by explaining that Mr. Garcia and his team had been asked to prove the Portable Alpha strategy over the last year or so and provide the Committee a review of the program.

Mr. Toth provided a refresher on what the term Portable Alpha means, and the role it plays in the portfolio, which essentially reflects a concept that has been discussed through time, being the separation of Beta and Alpha within the portfolio.

Referring to the Portable Alpha program, Mr. Toth said this program assents to combine the two to capture a pure Beta return or the market return which is core fixed income for PERA. He said more detail on the Alpha return, which is driven by a combination of marketable alternatives managers or hedge funds with a high proportion of idiosyncratic exposure, would be provided by Mr. Walsh, Albourne, and Mr. Garcia. He said when both are put together that is what generates the PERA total return listed in the performance reports as the bonds plus composite, which is effectively core bonds plus the Alpha or idiosyncratic return.

Mr. Davis asked for more specific information on the Beta return core fixed as mentioned, along with what is the systematic risk and Alpha return that is currently looked for. Mr. Toth responded that the Beta return is the return of the core fixed income market, the three big components of which are treasury bonds, corporate bonds, and securitized products like mortgage-backed securities.

Mr. Toth explained the effective mechanics of Portable Alpha schematically, or how to do this effectively. He said the ultimate success or challenges for a Portable Alpha program are going to be driven by how well that Alpha pool performs because synthetic exposure with some very small level of tracking error will deliver the Beta return. He said the overall success, when all put together, will be driven by the Alpha strategy.

Referring to the Portable Alpha strategy characteristics on page four of the presentation, Mr. Toth advised he would speak generically to these, and Mr. Walsh from Albourne would speak specifically to these later in the meeting.

Mr. Toth stated that from a quantitative standpoint the Alpha strategies should be repeatable. That is, not reliant on one particular market environment to be successful, not cyclical, and that overly concentrated risks should be avoided.

Mr. Toth said he thought it was important for the Board when considering the sizing of the Portable Alpha portfolio to have a strong understanding of the liquidity profile of the total portfolio, not just Portable Alpha, so that in a stress scenario you are not forced to rein everything in at the least opportune time. He said taking into account the liquidity of the total portfolio was an important component when thinking about the size of a strategy like Portable Alpha. He said, similarly when considering strategies on the illiquid side of the equation, is thinking about how much illiquidity can be handled in the portfolio and still consistently pay out benefits to participants.

Mr. Davis asked for more information to be given to the Committee about the liquidity requirements and consideration of the overall portfolio. He asked on timeframes needed to liquidate these assets as they are not equities that can just be sold off.

Responding to Mr. Davis, Mr. Toth said when thinking about portfolio liquidity Wilshire Consulting recommends that the Portable Alpha component should be considered illiquid. He said there is varied liquidity across specific products, with options ranging from a 30 to 60-day notice period to quarterly, semi-annually, or annually. He said, importantly, many of these strategies have provisions where access to capital can be locked out, which is why Wilshire classifies Portable Alpha overall as an illiquid strategy and not something the total portfolio should count on to provide regular participant benefit commitments.

Mr. Garcia responded with two points on portfolio liquidity. He reminded the Committee that liquidity tier parameters, in general, were included in investment policy in 2020 to ensure enough liquidity in the portfolio. He said of the four-tier parameters, with tier four being the least liquid, the Portable Alpha program is a Tier 4. He also noted that capital investment has to be a minimum of 10 percent in tier one. He said that all objectives were being met and exceeded. Mr. Garcia also referred the Committee to the reference documents provided in the back of the meeting documents on a stress test undertaken on the portfolio. He said they had reviewed the worst 18-month period ever for bonds, and looked at the effect on the program if this occurred consecutively. He said they found the program could grow to up to $2.5 billion without any liquidity problems.

Ms. Naranjo Lopez asked which PERA staff actively monitors or anticipates idiosyncratic returns.

Responding to Ms. Naranjo Lopez, Mr. Garcia explained that PERA staff work internally as functional teams. He said there is a Long-Short Alpha functional team, of which he is the sponsor. He said this team also includes a lead person, a backup, and recruitment is underway for a further backup. In addition, he said they work hand-in-hand with Albourne as the specialty consultant, collectively monitoring and doing diligence on the strategies.

Thanking Mr. Toth for his explanation of how portfolio strategies play out, Chair Neel said he thought an important point of caution was that during market distress in situations where correlations coalesce this has less effect, as seen in 2008 and Q1 2020. Chair Neel advised the Committee that he, Mr. Toth, and Mr. Garcia had previous discussions on correlations. He asked Mr. Toth to brief the Committee from a broader perspective on discussions around truncated periods where correlations were fairly high so Committee members could understand that the Alpha source has to be truly idiosyncratic – absent that this is just leverage, and that is not the mandate.

Responding, Mr. Toth said in this situation where markets are falling at the time the Alpha strategies are losing value as well, the downside is compounded as opposed to being idiosyncratic or independent of those market movements. He said where that becomes most acute are during periods like the credit crisis and the 2020 shutdown.

Referring specifically to previous discussions with Chair Neel, Mr. Toth said these have been around the correlation of the Alpha portfolio to markets in 2020, particularly coming out of the pandemic shut down in March. He said they were higher correlations in the sense that in a lot of cases almost every asset was relatively highly correlated because they were all recovering – some more strongly than others –

and moving up from that pandemic shutdown, and so over a short period, higher correlations were seen than would want to be seen over longer-term periods. He advised that in the modeling of the risk budget, they assume low correlation/no correlation of the Alpha portfolio to the market. He said those are meant to be very long-term multi-year forecasts for correlation to take into account that for some periods, months, or quarters, correlations are higher than would be liked.

Chair Neel thanked Mr. Toth for providing the Committee a broader context.

Mr. Toth pointed out to the Committee that FAQs had been included in the presentation to help with understanding some of the risks and the challenges of finding good alpha strategies.

Mr. Davis said as he was not on the Committee for the first iteration of Portable Alpha, had there ever been a margin call on a first Portable Alpha and, if so, how was this paid for?

Responding, Mr. Toth said one of the key differences with this iteration versus the iteration during the credit crisis is the beta, and that the alpha is being ported over. He said the beta for the initial Portable Alpha program was the S&P 500 US equity markets which are much more volatile. He said they were not working with PERA at the time, but it was his understanding that there were margin calls associated with the beta which did necessitate utilizing available cash in other parts of the portfolio. He said that was a risk that manifested because of the volatility of that underlying beta. He said they would not expect the same level of volatility in this implementation because it is the beta's core fixed income and a more stable asset class.

Mr. Garcia added that over the past year, particularly the first half of 2020, he thought they went through one of the worst stressors for the program, and they did not have any margin or stressors. He said the stress test done on liquidity indicated as it is now a much bigger program that could be withstood. He agreed with Mr. Toth's comments on having a more diversified and stable beta component as a huge differentiator. He said was not with PERA during the first iteration either, but historically there were margin calls, and the big error of the program then was that the beta was removed at the wrong time. He said he thought that risk now is much more muted in the construct, and that part of that just having lived through one of the biggest stressors for the program.

Mr. Garcia introduced Mr. Walsh, Lead Consultant with Albourne for the program, and private real assets. He informed the Committee that Albourne were chosen as advisors as they were considered a world-leader in long-short alpha strategies over a long period.

Referring to previous questions and discussion, Mr. Walsh said that Albourne monitors all the alpha generators in PERA's portfolio on the Portable Alpha side, and the liquidity of the portfolio. He said the managers they utilize are all top quality and are monitored on an investment due diligence basis, and operationally, on a daily basis. Mr. Walsh said he thought a key thing that works in this Portable Alpha program is that the underlying beta is bonds, as opposed to equity. Referring to the earlier discussion about periods when Portable Alpha does not work, he said when there is stress in the market and correlations go to one, that tends to be an environment where equities do badly. He said that is what caused the problems around the global financial crisis in 2007-2008 with people needing to make margin calls when their Portable Alpha programs and equities were doing poorly. He said the opposite is usually true for bonds, and that bonds, particularly U.S. Treasuries are the "flight to safety" asset class, so when stresses occur in the market they tend to do well, which is a very clear differentiator.

Beginning his presentation, Mr. Walsh said the key things he would talk about would be idiosyncratic returns and stress testing.

Mr. Walsh said the two things they are looking for are a high idiosyncratic return and a diversified systematic return when there is one.

Mr. Walsh explained being diversified and ensuring where there is some systematic return that can be picked up from factors in the market, that are well diversified and different exposure is seen. He said this also showed that they change over time. He noted that from April 2020 a big pick up in systematic returns could be seen following the stress event at the beginning of 2020 due to the COVID crisis. He said it was with this in mind, he would talk about the stress tests.

Mr. Walsh stated that fixating on one crisis was dangerous, as it was already known that any subsequent crises won't be the same as the last. Instead, he said, they want to think about other ways of looking at crises.

Summarizing, Mr. Walsh said they take a highly systematic approach in thinking not just about the managers themselves, but the way the portfolio is built. He said that it is a high-quality well-constructed portfolio with managers who have a long track record of providing high alpha. They were looking for not only idiosyncratic return, but systematic returns which are well diversified, and that diversification will be increased. He said COVID has provided a real-world stress test, and much of the presentation had taken that into account, and stress periods tend to pump up risk numbers and correlations. He thought it was beneficial to have recently gone through a real-world stress period after a period of relatively low volatility and trending markets.

Chair Neel asked Mr. Walsh if, based on experience with other clients, he could discuss how different clients manage Portable Alpha or their alpha engine, and any nuances that that may be particularly interesting between clients. He said some are constructing alpha engines unto themselves, while he imagined others were maybe more of a turnkey.

Responding, Mr. Walsh said they see some clients who have been building alpha engines for a great deal of time, and they tend to be focused on diversification with a significant number of managers in their portfolio. They do not tend to rotate their portfolio quickly, which was a lesson they have learned over the last decade or so, that you find high-quality managers and keep a stable portfolio, and then work closely in terms of what you are trying to achieve. He commented there are also differences between how aggressive and cautious clients can be, with clients who were more cautious with their portfolios during the financial crisis doing better than those who were more aggressive.

Mr. Davis noted that the key term is hedging as a basic strategy for what is being done in Portable Alpha, and thanked Mr. Walsh and Mr. Garcia for their responses.

Thanking the presenters, Chair Neel asked how compelled they felt about the current makeup of the Portable Alpha engine at New Mexico PERA.

Responding, Mr. Walsh said he thinks it is a very strong portfolio, and that the team had also lined up some very strong and compelling managers to build it out, which are good reasons to build out the exposure.

Chair Neel asked about the maintenance and monitoring of the portfolio, what was world-class in monitoring the Portable Alpha portfolio, and what resources are needed in such a situation.

Responding, Mr. Walsh said the two resource parts are both what Albourne and the PERA team do. He said the way Albourne supports the PERA team is that they have over 70 investment intelligence analysts looking across alternatives, and approximately half of those are looking at managers like this and having regular conversations with them. They also monitor the portfolio and risks through their system, which PERA has access to also. He mentioned another thing to consider is that all managers in the portfolio get open protocol and risk exposure, so they are managing and monitoring not only what's happened to the portfolio but also what is currently happening to the portfolio now in terms of exposure.

Speaking to the work of the PERA team, Mr. Garcia reiterated earlier comments that there are three members of a functional team who manage and oversee the portfolio. He said to an extent they replicate Mr. Walsh's comments about Albourne's services, focusing on the nine managers in the portfolio. He said they review monthly quantitative data at Prism, along with reviewing and speaking with managers regularly to update strategies and what is happening qualitatively. He said this is all a regular part of the PERA team's monthly and quarterly monitoring, and reiterated that they work hand-in-hand with the team at Albourne.

Chair Neel noted this was an informational agenda item, but as he had alluded to at the beginning of the presentations, Mr. Garcia and his team had been asked to prove out in concept the Portable Alpha Portfolio for expansion. He said he thought Mr. Garcia had indicated that he would like to anticipate moving the portfolio from $500 million to $1 billion, and this was the culmination of proving it out. He invited any Board or Committee members to express any outstanding views on any concerns or consternation about expanding the portfolio before stepping back and allowing Mr. Garcia and the team to execute on the expansion of this program.

Ms. Naranjo Lopez asked if this would be coming up at the next meeting for approval.

Chair Neel confirmed that it was not an action item, and that Mr. Garcia had the mandate to move forward autonomously. He commented that Mr. Garcia had not needed to pause this matter, but had reached an agreement with the Committee to pause and prove out the strategy over the last year.

Ms. Naranjo Lopez followed up that she would like the Committee and Board to understand that the CIO then assumes all the risk, and therefore there should be a performance review in six months.

Responding, Mr. Garcia said he would be happy to do that, and along with a six-monthly update, provide the Committee more regular updates at their monthly meeting.

Mr. Page asked Mr. Garcia to give detail on the ramp-up strategy of how they were going to reach $1 billion, and the timeframe to so.

Responding, Mr. Garcia Dominic said most of the work was done. He said they completed diligence and approval for nine managers, and are looking to include another two or three. He said predominantly, they would be adding an allocation to existing managers, then adding two more and potentially a third, which would be seen over the next couple of quarters.

Chair Neel asked if the beta piece would be the Barclays Agg, and not ported over any other beta. Mr. Garcia confirmed that was correct.

Ms. Fisher referred to Mr. Garcia's previous comments on due diligence having been done and approved and asked who approved the due diligence and whether it was the Board.

Responding, Mr. Garcia reminded the Committee that manager selection has been delegated to staff for approximately four years. He said they use a detailed five-step process that goes through a legal process and is done jointly and in parallel with the consultant. He also reminded the Committee that some members would be observing this internal process in the future.

Chair Neel noted that he thought it important for the Committee to know that the review today, and the discussion and the dialogue, was around transitioning from what was portable alpha under $500 million mandate to something a little bit more aggressive. He noted that was why he had wanted to make sure the Committee understood this agenda item and the implications of this area.

C. Asset Class Review & Update

1. Information Item: Risk Reduction & Mitigation.

Chair Neel suggested moving this item to the next Investment Committee meeting due to time constraints. Mr. Garcia and Mr. Toth confirmed they would be happy to do so.

Ms. Naranjo Lopez said would also like to look at educating the Committee on their responsibilities and liabilities around staff willing to take on risk, and therefore would like to review the Investment Policy.

Ms. Naranjo Lopez recommended the Investment Committee also include on their agenda a review of applications for the vacant position of Executive Director, given the level of the Investment Committee, and their unique position to review Executive Director applicants' investment backgrounds in investing, and support the Ad Hoc Committee running the search process.

Chair Neel said he agreed with Ms. Naranjo Lopez's comments on providing support to the Ad Hoc Committee. Speaking to Mr. Page, he said they were willing to help as needed. Mr. Page said this support would be welcomed.

5. Adjournment

Having completed the agenda, Chair Neel called for a motion to adjourn. A motion to adjourn was made by Ms. Naranjo Lopez. Chair Neel declared the meeting adjourned at 11:00 a.m.

Approved by:

Steve Neel, Chair
PERA Investment Committee

ATTEST:

Greg Trujillo, Acting Executive Director

Attached Exhibit(s):
Exhibit 1: February 2021 Preliminary Flash Performance
Exhibit 2: Portable Alpha Review