NEW MEXICO
PUBLIC EMPLOYEES RETIREMENT ASSOCIATION
INVESTMENT COMMITTEE MEETING
August 29, 2019

This meeting of the Public Employees Retirement Board Investment Committee was called to order by Steve Neel, Committee Vice Chair, at approximately 10:05 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.

Roll call indicated the presence of a quorum as follows:

Members Present:
Steve Neel, Vice Chair
Dan Mayfield
Loretta Naranjo Lopez
Shirley Ragin

Member(s) Absent:
John Melia, Chair

Other Member(s) Present:
Jackie Kohlasch
David Roybal
Lawrence Davis
Maggie Toulouse Oliver
Tim Eichenberg
Patty French

Staff Present:
Susan Pittard, Chief of Staff/General Counsel
Dominic Garcia, Chief Investment Officer
Greg Trujillo, Deputy Executive Director
Renada Peery-Galon, ASD Director
Misty Schoeppner, Deputy General Counsel
Geraldine Garduno, Assistant General Counsel
Kristin Varela, Deputy Chief Investment Officer
LeAnne Larrañaga-Ruffy, Director of Equity
Anna Williams, Chief Financial Officer
Joaquin Lujan, Co-Head Alpha & Director of Rates & Credit
Karyn Lujan, Deferred Compensation Plan Manager
Trish Winter, Executive Assistant
Marah deMeule, OAG
Tania Maestas, OAG

Others Present:
Tom Toth, Wilshire
Adam Hathaway, Parliamentarian
Michael Krems, Torrey Coves

Others Present: **(continued)**
Jeff Goldberger, Torrey Coves
Ernie Marquez, AES
Tim Sanchez, AES
Lenora Chavez
Joseph E. Montoya, Retiree
Victor Baca, Retiree
Jake Salazar, Retiree
Robert Ochoa, Retiree
JoAnn Jackson, Retiree
Mark R. Pacheco, Retiree
Jeff Riggs, Board candidate

2. APPROVAL OF AGENDA

Ms. Naranjo Lopez moved approval as published. Her motion was seconded by Ms. Ragin and passed by unanimous voice vote. [Mr. Mayfield was not present for this action.]

3. APPROVAL OF CONSENT AGENDA

Ms. Naranjo Lopez moved approval and Ms. Ragin seconded. The motion passed without opposition. [Mr. Mayfield was not present for this action and arrived shortly thereafter.]

4. CURRENT BUSINESS

A. Information Item: Performance Update

1. CIO Update

Chief Investment Officer Dominic Garcia reminded the committee of the sustainable model for defined benefit public plans that are mission-centric and instituting pension best practices which includes flexible pension design, good governance, attracting and retaining talent and implementing portfolio best practices to create value. He presented a performance scorecard highlighting three objectives within PERA's strategic plan which the investment team strives to meet. The objectives are to maintain appropriate strategic asset allocations to meet the actuarial discount rate assumptions over the long run, meet 10-year annualized returns to equal or exceed benchmarks, and achieve a total investment cost at or below a benchmark cost relative to peers adjusted for fund size and asset mix. As of June 30th PERA meets all the objectives.

He reviewed that PERA has exceeded its three- ten- and 30-year return hurdles – thus meeting and exceeding the objectives. He also discussed results relative to a simple 60/40 portfolio, noting the outperformance that PERA has experienced since its inception due to a diversified investment portfolio.

The question of whether PERA's private asset allocation and illiquidity generate alpha relative to public markets, Mr. Garcia said the answer is yes, over 3 percent value-add over the public market equivalent, since inception.

Although not a supporter of peer rankings, Mr. Garcia said it is commonly asked about and the risk adjusted return is important. PERA generally has a lower risk/ volatility than its peers. On a risk adjusted basis, compared to 77 other funds in the univers, PERA ranked 17th for the fiscal year.

Looking forward, rather than into the past, Mr. Garcia said PERA has three huge challenges: bridging the gap, maneuvering through the late cycle economy, and managing liability bulge and burgeoning negative cash flow of the system.

Mr. Garcia discussed the low return environment and highlighted a few studies one showing that a trillion dollar public pension fund should expect a 6 percent return with a 12 percent volatility over the next 10 years.

To bridge the forecasted return gap, PERA is improving its risk diversification, increasing its private asset allocation and improving its active management selections. Implementation of these three strategies, Mr. Garcia expects these initiatives to improve 10-year returns by 1.4 percent.

In response to previous questions about the Nevada strategy, Mr. Garcia indicated that if PERA had adopted a similar strategy, the expected return would be just below 6% with a similar targeted risk profile.

Ms. Naranjo Lopez requested one-year results for each of the last two years compared to the universe of public pensions and a broad stock market index. Mr. Garcia referred to the peer comparison rankings for one, three, five and ten years. Ms. Naranjo Lopez said that was not the information she was looking for because the rate of return is not listed and she wanted the numbers of the stock market return to make her comparison.

2. Quarterly Market Review
3. Quarterly Performance Review

Tom Toth, Wilshire Consulting, referred to the cumulative performance of the portfolio relative to the reference portfolio indicating that PERA's portfolio has outperformed over the longer-term timeframe. He also reviewed PERA's portfolio compared to the policy index, and, again, PERA's portfolio outperformed. This indicates that the experience over the last ten years has been strong from an absolute and relative basis. He reminded the committee that the targeted return for the total portfolio is 7.35 percent with a risk level of about 10.2 percent, based on the adopted 2019 Risk Budget. The vast majority of the risk is driven by the market/beta risk and some active risk with the selection of active management across investment strategies as well as allocations. He then reviewed performance compared to the reference and policy portfolios during different timeframes.

Commenting that a study session was planned in the afternoon, Mr. Toth said that he would address what drove return deviations and how the portfolio's active risk is considered in expectations. Long-term 10-year performance on both an absolute and relative basis remains strong for the total fund. As of June 30th, the fund is at target weights for all asset classes.

Mr. Garcia said the division's strategic letter was posted on the Board Portal.

B. Information Items: Quarterly Staff Consultant Report: Wilshire & Torrey Cover – Global Equity

LeAnne Larrañaga-Ruffy, Co-head Alpha & Director Equity, said the review will demonstrate this has been an exciting year for global equity. The current target is 42.3 percent with a long-term target of 35.5 percent. The CIO set a new mandate for alpha seeking strategies and to provide proof of value in private equity.

Mr. Toth said global equity provides exposure to economic growth opportunities and an ever expanding stream of earnings and dividends and capital appreciation going forward. This is one of the dominant return drivers within the portfolio. Global equity includes many strategies. The expected return on the global equity portfolio is 7.4 percent with an expected risk of just under 18 percent.

Mr. Neel asked how risk was disaggregated between private and public. Mr. Toth said there are expectations for both. The private equity return assumptions are linked to the expectations of public return but adjusted for leverage levels, illiquidity premium and the expectation that the implementation of the private portfolio will be successful. Those items add up a premium which is about 2 percent relative to public equities and it comes with a higher level of assumed risk. Illiquidity and the valuation lags can camouflage some of the potential volatility in the portfolio. The benchmark is a global benchmark.

Mr. Toth said the global equity market comes with a risk across various segments from fundamental to technical. Discount rates are important and the interest rate level as it relates to the availability of leverage whether for public companies or private investments. Manager selection is critical, especially when bridging the return gap.

Generally speaking, the portfolio is overweight to public equity and underweight to private equity. The private equity exposure continues to build over time, stated Mr. Toth. The portfolio has a slight underweight to the U.S. and a slight overweight to developed international. Over the last year, the portfolio has outperformed relative to the policy index. Referring to a chart, he highlighted the high level and consistency of the private equity performance since 2014.

Michael Krems, Torrey Cover Consultants, presented information on private equity that has been in place since 2006 with a ramp up in activities starting in 2015. While still below the target exposure, the increased capital deployment is part of the strategy to drive to the target allocation.

Mr. Krems advised the committee that private equity has a lag in reporting from managers.

Diversification is defined as geography, industry, strategy and vintage year. The exposure by vintage year was outlined and characterized as adequate. The sub-sectors within capital equity include venture capital, early stage investing, growth investing, buyouts and fund-of-funds. Buyouts make up 2/3s of the private equity portfolio. Venture is at 23.5 percent and the fund of funds are special vehicles made for PERA in partnership with a management are at 10 percent. North America makes up the majority of exposure with meaningful exposure to Europe and the Asia Pacific market. He discussed the over exposure in the IT space and said it has served the fund well.

Mr. Krems said performance has been quite strong and in the three-, five- and ten-year periods the numbers are between 14.7 percent and 15.3 percent. Outperformance is also strong between 4 percent and 9 percent during the same time periods. The standout performers include the growth stage of venture capital portfolio as well as small buyouts. Again, this is looking backwards and allocations should be forward looking. Risk adjusted outperformance is how the portfolio should be viewed.

Mr. Toth said the portfolio is moderately defensively positioned from a beta exposure perspective which was beneficial in the 2018 selloff with a slight detraction in 2019. It is expected that the lower sensitivity to market moves will be beneficial to the portfolio.

Ms. Naranjo Lopez thanked the presenters for their report. She requested a listing of the managers making over 10 percent.

Ms. Larrañaga-Ruffy said currently this sector makes up 9 percent of the portfolio and 10 percent may be the ending number.

Mr. Neel asked where the high quality venture exposure came from. Mr. Krems said there is a wide deviation of returns in the venture space. There are some strong outperformers within PERA's portfolio which have been very beneficial. He highlighted New Enterprise Association (NEA) that PERA has investments in two funds. This diversified firm invests in early- to late-stage companies. DFJ and IVP were also mentioned. The exposure comes from a handful of managers and is not concentrated in any one investment. Jeff Goldberger, Torrey Cove, said it is mostly through late-stage venture and growth areas.

Mr. Neel commended Ms. Larrañaga-Ruffy and the team stating, "These are really excellent numbers."

C. <u>Information Item</u>: Investment General Consultant RFP Minimum Qualifications and Scope of Work

Deputy CIO Kristin Varela presented a preview of an RFP that will be presented to the Board in September for approval. Wilshire's contract will expire July 2020 and the RFP is being issued as a regular course of business. She highlighted the three main sections within the scope of work: Board consultation, selection of managers, and general consultant services. The MQs were reviewed as well as the consultant agreeing to fiduciary standards – not engaging in any affiliated operations, and confirming there is no affiliation with any investment manager conflicts.

D. <u>Information Item</u>: Investment Division Updates

1. Cash Plan & Rebalance Update (April, May and June 2019)

Ms. Varela highlighted that in April the fund paid out $102 million in benefits with $59 million from investments, in May the fund paid $102 million with $44 million from investments and in June the fund paid $103 million with $57 million from investments. For fiscal year 19, PERA paid $1.2 billion in benefits and $677 million was paid out of the investment accounts or 56 percent.

2. Manager Selection Activity Report

During the past quarter, two manager were approved in the illiquid sector, Montague and Petershill, stated Ms. Varela. She reviewed the two managers noting that Montague is a new relationship for PERA. However the firm has been in review since 2016. PERA has been invested with Petershill since 2010 which has a strong track record.

Ms. French requested that staff send additional information on Montague and how it is that communications began in 2016 and commitments made in 2019.

3. Securities Lending Update – Q2 2019

Ms. Varela indicated that the average assets on loan are approximately $550 million which is 4 percent of the total fund. The total revenue for the quarter was approximately $650,000. For the fiscal year, the total gross revenue to PERA for lending out its assets has totaled $2.9 million.

5. OTHER BUSINESS

Mr. Neel commended the CIO and his investment team on a great fiscal year with great numbers in the top quartile.

CIO Garcia was acknowledged for his accomplishment in being recognized as one of the top 30 public pension chief investment officers by *Trusted Insight*. Mr. Garcia expanded the praise to his staff.

6. ADJOURNMENT

This meeting was declared adjourned at 11:15 a.m.

Approved by:

John Melia, Chair
Investment Committee

ATTEST:

Wayne Propst, Executive Director