

**NEW MEXICO**

**PUBLIC EMPLOYEES RETIREMENT BOARD**

**INVESTMENTS COMMITTEE MEETING**

**December 8, 2015**

This meeting of the Public Employees Retirement Board Investments Committee was called to order by Chair Dan Mayfield, at approximately 9:20 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. **ROLL CALL:** Executive Director Wayne Propst called roll and a quorum was established with the following members present:

**Members Present:**

Dan Mayfield, Chair  
Dan Esquibel  
Patricia French  
Stewart Logan

**Member(s) Excused:**

Louis Martinez

**Other Board Members Present:**

Loretta Naranjo Lopez  
John Reynolds  
Jackie Kohlasch  
Paula Fisher  
Kathy Townes  
Tim Eichensberg

**Staff Members Present:**

Wayne Propst, Executive Director  
Susan Pittard, Chief of Staff-General Counsel  
Jonathan Grabel, Chief Investment Officer  
Greg Trujillo, Deputy Director  
Danna Varela, Executive Assistant  
Karen Risku, Deputy General Counsel  
Jude Perez, Deputy CIO  
Natalie Cordova, Chief Financial Officer  
Joaquin Lujan, Director of Rates and Credit  
LeAnne Larrañaga-Ruffy, Portfolio Manager  
Mark Montoya, Financial Analyst  
Kristen Varela, Portfolio Manager  
Emily Lopez, Financial Specialist

Karyn Lujan, Deferred Compensation Plan Manager

**Others Present:**

Don Wencewicz, AFSCME Retirees

Paul Lium, Nationwide

Steve Costabile, Passport Fund

Jason McGann, Passport Fund

Tom Mattinson, Quadrant Enhanced

Andrew Junkin, Wilshire

Ted Benedict, Meketa Investment

Paul Cowie, Meketa Investment

Jamie Feidler, Cliffwater

**2. APPROVAL OF AGENDA**

No action was taken on this item.

**3. APPROVAL OF CONSENT AGENDA**

No action was taken on this item.

**4. CURRENT BUSINESS**

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

**1. Recommendation to Commit up to \$150 Million to Passport Fund I, LP – PineBridge**

*[Exhibit 1: Staff recommendation re: Passport-PineBridge; Exhibit 2: Cliffwater report re: Passport-PineBridge; Exhibit 3: Passport-PineBridge Report]*

LeAnne Larrañaga-Ruffy, Portfolio Manager, said this mandate was approved with another firm in March 2015. The contract was not completed due to business issues. Staff is now presenting a funding of this mandate with Passport/PineBridge. She said staff recommends investing up to \$150 million for an emerging market fund of one for the equity portfolio. It is estimated that this will be a commitment of \$50 million per year over the next three years. PineBridge is a global asset manager with over \$70 billion under management and has significant experience in the emerging market and in constructing separate accounts. She said this fund would complement the current private equity portfolio.

Steve Costabile, PineBridge, introduced himself as the overseer of the private funds group for the past 15 years at PineBridge and provided additional investment management history. PineBridge is a global asset manager with \$77.6 billion with various global strategies. They manage global equities and global fixed income as well

as alternatives. Of the firm's 230 investment professionals, 46 percent are located within the emerging markets. In terms of the private funds group, Mr. Costabile said they have 500 global individual limited partnerships and serve on over 100 advisory boards. "It is a very robust, broadbased platform..."

Jason McGann, PineBridge director, reviewed the proposed portfolio allocation recommended to PERA. Dividing the investment into thirds over a three-year time period allows the team to focus on high conviction opportunities and not force capital into a market. The approach is geographically diversified with a number of high growth markets primarily in Latin America but also in Asia, Sub-Saharan Africa and opportunistically in central and eastern Europe. The program is further diversified across different strategies. The focus is predominantly on small- and middle-market opportunities.

PERA CIO Grabel pointed out that this recommendation is within the private equity allocation and the GPs often have a limited partner advisory committee. Those committees work with GPs on issues related to adherence to limited partnership agreements and methodologies as they relate to valuation.

Mr. Costabile said it is important to be active on advisory boards and in addition to the tasks Mr. Grabel mentioned, they also work to clear any conflicts of interest. PineBridge is there on behalf of its clients.

Jamie Feidler, Cliffwater, noted that Cliffwater sits on advisory boards in the same capacity as PineBridge.

Responding to Mr. Logan's question, Mr. Grabel said this is US dollar denominated. Some of the funds may not be dollar denominated but the mechanisms are from PERA's cash which is all dollar denominated.

Ms. Larrañaga-Ruffly said PineBridge was one of the top firms during the RFP evaluation. Staff has conducted an onsite due diligence and has been working on this mandate since early 2014. Mr. Grabel said when the contract negotiations with the original awardee terminated, staff discussed the issue with Cliffwater and then re-engaged in very detailed discussions with PineBridge.

Mr. Grabel said if the recommendation is approved PERA would commit up to \$150 million into a fund of one. PERA would be the limited partner in that fund of one. PineBridge would be the general partner in the fund named Passport.

Mr. Costabile discussed the expertise within their team and reviewed the broad themes – education, finance and pharmaceuticals – currently in Latin America.

Ms. French moved to recommend approval of a \$150 million commitment to Passport Fund I, LP, PineBridge to the PERA Board. Mr. Logan seconded and the motion passed by unanimous [4-0] voice vote.

**2. Recommendation to Commit up to \$70 million to Quadrant Enhanced Debt Fund, LP**

*[Exhibit 4: Staff recommendation re: Quadrant; Exhibit 2: Cliffwater report re: Quadrant; Exhibit 5: Quadrant Report]*

Joaquin Lujan, Director of Rates and Credit, indicated this is the fourth and final private real estate recommendation for budget year 2015. Staff and Cliffwater concurrently recommend committing up to \$70 million to Quadrant Enhanced Debt Fund, a real estate debt fund that will originate and securitize commercial real estate loans collateralized by core US commercial properties. The value-added strategy targets a low teens rate of return over the 10-year life. A commitment to Quadrant would be a new relationship for PERA. A description of the process leading to this recommendation was included in the staff memo.

Kurt Wright, Quadrant CEO, said he has been invested in these projects since 1994. The team has \$6.1 billion of assets under management of all institutional investors. As a firm, Quadrant makes privately placed loans and originates loans on commercial real estate. Rather than buy the property, Quadrant will make a 75 percent loan to value loan, typically a 10-year fixed rate mortgage that amortizes over the life of the mortgage which then earns an interest rate. Quadrant's investment is likened more to a fixed income investment.

Mr. Wright said they have been doing this as a team for 20 years. The firm is owned by 10 working partners who serve as the firm's investment and management committees. Client capital is marketed broadly across the US to largely to commercial mortgage brokers across the US. There are currently 175 loans "on book."

Mr. Wright said their approach is old fashioned, ground-up, one at a time investing. The firm's mantra is "no delinquencies." He reviewed the firm's investment history since 1998; it has invested \$13 billion in 500 fixed rate mortgages over that period. He anticipated originating \$1.5 billion in 35 loans this year which has been the pattern the past few years. They have institutional quality borrowers and institutional quality properties.

Mr. Wright said Quadrant has a low loss experience: since 1998 they have experienced \$14 million of cumulative principal losses on \$12.7 billion of privately-placed originations. He noted the firm's returns since inception is 8.78 percent.

Mr. Lujan said this investment is within PERA's asset allocation private real estate sector and is a lower risk through a contractual return.

In response to Mr. Logan's question of how Quadrant builds in for bad loan loss margins, Tom Mattinson, Quadrant Executive VP, said the real risk is an interim default along the way because the property income has temporarily fallen. He explained their process of third-party appraisal that is peer reviewed, and an internal 10-year discounted cash flow evaluation.

Mr. Grabel said asset allocation is fundamentally the most important thing. This

manager provides greater diversity and a different risk adjustment basis. He noted that as the market regime changes this investment will be in a different cash flow stream and strengthen the portfolio.

Mr. Grabel said this is a 10-, 12-year commitment and the provisions within the contract are protections for investors. He said the consequences of committing capital for 10 years are significant and investment staff works closely with counsel.

Mr. Mattinson discussed the market for investing in commercial mortgages noting that as the economy improves and coupled with new construction in commercial real estate the market improves. Since the 3<sup>rd</sup> quarter of 2010 vacancy rates in office, industrial, retail and multifamily have improved every quarter. Rental rates have also improved. High quality commercial mortgages are attractive to fixed income investors, have a low incidence of delinquency, and are a very safe, stable asset class. He discussed the borrower they look for.

Mr. Mattinson said this fund will be limited to stable first mortgages on stable property in the US.

Ms. French moved to recommend to the Board a commitment of up to \$70 million to Quadrant Enhanced Debt Fund, LP. Her motion was seconded by Mr. Logan and passed by unanimous voice vote.

**B. Information Item: Core and Global Fixed Income Portfolio Review**

Andrew Junkin, President of Wilshire Consulting, thanked the Board for allowing them to serve PERA.

Mr. Lujan said staff and Wilshire undertook a fixed income structure study which resulted in a series of target related recommendation approved by the Board last December and implementation commenced.

Mr. Junkin reviewed the current composite versus the historical composite. Quality has increased over the years by separating core into different allocations. The duration has increased similar to the benchmark. This has reduced the tracking error. The total risk has decreased from 3.9 percent to 3.1 percent and meets the goals of capital preservation.

Mr. Junkin reviewed the risk exposures for the core sector which has similar characteristics to the plus sector's risk exposure. It is a very diversified approach to a return seeking component of fixed income. The total risk is higher than the traditional fixed income composite/core composite.

Mr. Junkin summarized that the move to bifurcate the portfolio into core and fixed income plus does provide a lot of clarity of the strategy. There is less holdings overlap. Also noted was a reduction in fees of \$3 million on an annual basis.

**C. Information Item:**

**1. 457(b) Q1 FY16 Plan Review**

Karyn Lujan, Deferred Compensation Plan Manager, directed the Committee to the plan's new "SmartSave" logo. The logo will better identify the plan as a part of PERA and the transition to the new logo should be completed soon. Plan participants were notified by mail that the new logo did not change any of their account information. All forms and marketing material will contain the new logo.

Ms. Lujan said the SmartSave plan received 603 new enrollment applications during the quarter almost doubling the number from last year during the same time period. She attributed this increase to the new easy enrollment forms. Two new entities adopted the plan. Participant call center hours were extended to Saturday. The FY15 audit was submitted to the Office of the State Auditor and continues in review status.

Ms. Lujan mentioned that during the contract for the plan's new investment consultant has been completed.

Paul Lium, Nationwide, said they will be using the new banner at workshops. He attributed the increase in enrollment to Nationwide's persistence. He discussed targeting efforts for additional enrollment.

Mr. Grabel said staff is thinking about the 457 plan in a strategic manner and will be meeting with Meketa Investment Group to deepen the strategic tactics to grow participation and the amount people are able to save.

## **2. 457(b) Q1 FY16 Investment Performance Review** *[Exhibit 6: Meketa Quarterly Report]*

Ms. Lujan introduced the Meketa representatives – the new investment consultant for the 457 plan.

Ted Benedict, Meketa Managing Principal, thanked PERA for their confidence and said upon the start of a new relationship, Meketa reviews the plan from top to bottom. He said PERA has a great plan in place. He reviewed the Meketa contents of their quarterly report which includes a commentary on capital markets, executive summary review of the plan, update on the firm, individual review of each investment strategy, general information on index performance, etc.

Mr. Benedict provided a plan summary as of the end of the 3<sup>rd</sup> quarter. Plan assets were \$475.8 million a decrease from the previous quarter because 3<sup>rd</sup> quarter was very difficult for capital markets. Stable value is the largest investment option with \$131 million, followed by the lifecycle portfolio, the index fund and Fidelity and Dodge & Cox stock funds.

Mr. Benedict said it was a good quarter for active management. Across the lifecycle portfolios all but the 2015 fund outperformed their benchmarks. He noted that the 2015 portfolio would be merged into the conservative portfolio.

Three funds underperformed their benchmark and their peers: BlackRock Inflation Protected Bond, Templeton Global Bond Fund, and Principal Diversified Real

Assets Fund.

Paul Cowie, Meketa Senior VP, reviewed the assets of the plan and how those funds are invested. The lifecycle plan is divided into four tiers: lifecycle funds, 20 percent of the capital; core-array, 17 percent of the capital, active bonds, 59 percent; and aggressive funds, 4 percent.

Ms. French asked whether there was a watchlist for the managers. Mr. Grabel said the investment policy does not currently contain a mechanism for an official watchlist. Ms. French asked that the Board be advised of underperformances.

Mr. Cowie reviewed the plan's expenses with a comparison of the median expense ratio for each investment category. Each, except one, is below median. Meketa reviewed each of the share classes utilized by PERA and noted that PERA's funds have performed very well against peers.

Mr. Cowie reviewed how the glide path compares to peers in regard to the lifecycle portfolio. PERA is generally across the board more conservative.

Mr. Benedict said Morningstar, which is used for comparison purposes, is one of the largest mutual fund database companies globally, containing data on up to 6,000 mutual funds.

### **3. 457(b) Roll-down/Glide Path of Lifecycle Portfolios**

Ms. Lujan said the lifecycle portfolio is based on a target year which is when the participant wants to start withdrawing funds. The portfolios provide diversification and can be characterized as a low maintenance manner in which one can participate in a DC plan. There are six lifecycle options offered in 10-year increments; adding five-year increments will be investigated. She discussed how the portfolios are rebalanced and the glide path is part of that process. The 2015 portfolio will be removed from the lineup and those participants will transition to the conservative portfolio. Those participants' contributions will decrease in equity and increase in fixed income and stable value. The 2025 portfolio will become the earliest option.

Ms. Lujan discussed the timeline/process for the transition. The participants don't have to do anything but they can change fund election at any time.

Ms. Lujan said the contribution to a lifecycle fund depends on what the participants can comfortably contribute and when they want to access the funds.

Mr. Grabel said the mantra for a defined contribution plan is not timing the market; it's time in the market. The more saved for a longer period of time the better off one will be.

Ms. Lujan said there are no requirements of which portfolio a participant can be in. She offered to place a note in the letter going out to the 2015 portfolio members

advising them that if they don't respond to the letter they will be transitioned in the most conservative fund.

**D. Information Item: Listed Infrastructure RFP MQs and Timeline**

Kristin Varela, Portfolio Manager, said this is a re-issuance of the RFP and the MQs have been reviewed in the past. The original RFP was issued on April 1<sup>st</sup> and ten proposals were received; due diligence was initiated. However, due to staff departures the process was not completed. Staff is not prepared to reissue the RFP. She reviewed the MQs noting that PERA is requesting the availability of the respondent's historical performance data – at least \$1 billion in total assets under management, at least three US tax-exempt pension funds - and other qualification were noted. The firms are being asked to minimize their exposure to energy-related master limited partnerships.

Ms. Varela said the only real change to the original RFP is the request to limit the energy-related MLP structure and a few changes to the scope of work.

**5. OTHER BUSINESS**

None was presented.

**6. ADJOURNMENT**

Upon motion Mr. Logan and second by Ms. French, Chair Mayfield declared this meeting adjourned at 11:25 a.m.

Approved by:



Dan Mayfield, Chair  
Investments Committee

ATTEST:



Wayne Propst, Executive Director

**Attached Exhibits:**

*Exhibit 1: Staff recommendation re: Passport/PineBridge*

*Exhibit 2: Cliffwater report*

*Exhibit 3: Passport/PineBridge Report*

*Exhibit 4: Staff recommendation re: Quadrant*

*Exhibit 5: Quadrant Report*

*Exhibit 6: Meketa Quarterly Report*