NEW MEXICO

PUBLIC EMPLOYEES RETIREMENT ASSOCIATION

INVESTMENT COMMITTEE

December 14, 2017

This meeting of the Public Employees Retirement Investment Committee was called to order by John Melia, Chair, at approximately 9:00 a.m. on the above-cited date at the PERA Building, 33 Plaza la Prensa, Seminar Room, Santa Fe, New Mexico.

1. **Roll Call**

Roll call occurred after the Pledge of Allegiance and indicated the presence of a quorum as follows:

Members Present:
John Melia, Chair
John Reynolds, Vice Chair
Dan Esquibel
Jackie Kohlasch
James Maxon
Loretta Naranjo Lopez

Member(s) Absent:
None

Other Board Members Present:
Dan Mayfield
Claudia Armijo
Patricia French
Maggie Toulouse Oliver

Staff Members Present:
Wayne Propst, Executive Director
Susan Pittard, Chief of Staff/General Counsel
Greg Trujillo, Deputy Director/Chief Information Officer
Karen Risku, Deputy General Counsel
Dominic Garcia, Chief Investment Officer
Renada Peery-Galon, ASD Director
Dana David, Assistant General Counsel
Jude Pérez, Deputy CIO
Joaquin Lujan, Director of Rates and Credit
Trish Winter, Executive Assistant
Karyn Lujan, Deferred Compensation Plan Manager
Kristin Varela, Portfolio Manager of Real Assets
Christine Ortega, Portfolio Manager
Anna Murphy, Compliance Officer
Mark Montoya, Investment Analyst
Isaac Olaoye, Financial Analyst
Emily Lopez, Financial Specialist
Anna Williams, Chief Financial Officer

Others Present:
Rose Dean, Wilshire
Dan Wencewicz, AFSCME Retiree
James Walsh, Albourne Partners
Darrell Majors, AFSCME Retiree
Mark White, Albourne

2. Approval of Agenda

Dr. Kohlasch moved to approve the agenda as published. Her motion was seconded by Mr. Esquibel and passed by unanimous [6-0] voice vote.

3. Approval of Consent Agenda

Chair Melia said he reviewed the minute and found them accurate and complete.

Mr. Esquibel moved to approve the consent agenda and Mr. Maxon seconded. The motion passed by unanimous [6-0] voice vote.

4. Current Business

A. Investment Division Updates

1. Investment Performance – October 2017

Deputy CIO Jude Pérez noted that he would be updating the Committee on October numbers. The fund completed October with a balance of $15.4 billion, an all-time high for PERA. For the month the fund was up 86 basis points net of fees and the balance up $93 million after benefit payments. For the fiscal year to date, the fund is up 3.89 percent net of fees and 1.5 percent ahead of the actuarial target.

Mr. Pérez reviewed the monthly asset category returns: global equity composite was up 1.78 percent; risk mitigation composite was up 9 basis points; credit book composite was up 22 basis points; real asset composite was down 39 basis points for the month and up 94 basis points for the fiscal year. Overall, the portfolio has performed as expected.

2. Cash Plan Update

Mr. Pérez said the cash account balance at BNYMellon was approximately $62 million and the month ended with $443 million in cash. The cash is invested in the overlay program and thus exposed to the market. He identified the different sources of cash.

3. Other Updates

Mr. Pérez noted that the fund's risk continues to be reduced as the equity exposure is decreased.

B. **<u>Action Item</u>: Benchmark Update and Review**
[*Exhibit 1: Wilshire Benchmark Recommendations*]

Rose Dean, Wilshire, said one of the key elements in the portfolio implementation is selecting the appropriate benchmarks against which the performance of the portfolio can be measured. The purpose of benchmarking is to serve as a clear and objective tool against which to evaluate the performance of the entire portfolio and the managers that make up that portfolio. She reviewed the three parts that make up the benchmark: 1) performance attributions – where does the performance come from; asset allocation or active managers; 2) insight into how much return is achieved for the unit of risk taken; and 3) evaluates active management. The appropriate benchmark should have a return and risk characteristics that reflect the portfolio and the assets class in which invested, but more importantly the benchmark should have minimal misfit when compared to the investment strategy that is measured, e.g., the benchmark and portfolio should be aligned in objectives.

Ms. Dean reviewed the six characters that benchmarks should have as developed by the CFA Institute: unambiguous, investable, measurable, appropriate, reflective of current investment options and pre-specified.

Overall, the benchmarks PERA is using are considered appropriate and well thought out. However, Wilshire is recommending a couple of changes where the benchmarks do not meet the characteristics, stated Ms. Dean. In the Global equity class, Wilshire recommends eliminating the Russell 3000 + 3 percent. According to the characteristics there is no way for a strategy to invest in a +3 percent benchmark. While it is a strategy that can be expected from a manager it is not an investable benchmark.

Responding to Mr. Esquibel's question regarding the Russell 3000 +3 percent benchmark, Mr. Pérez said it has been a benchmark during his tenure with PERA. Performance wise PERA has not hit the benchmark. It is not realistic to get a + 3 premium on a passive strategy. At this point, PERA wants its benchmarks more measurable to better judge performance.

Ms. French recalled that PERA's fiduciary counsel said PERA's main issue is its benchmarks. Mr. Pérez said this is exactly what Wilshire is addressing. Ms. Dean said the importance of having the right benchmark is to drive decisions according to the correct information.

Ms. Naranjo Lopez pointed out that there are many investment professionals who are against investing in private equity. Ms. Dean said whether private or public, equities are the highest risk investment versus fixed income or real assets.

Mr. Esquibel said PERA lowered the discount rate, which he was uncomfortable doing, and now staff and the consultant are recommending adjusting benchmarks, which again makes him uncomfortable. Without more research he was not ready to accept the suggestions.

Ms. Dean said changing the benchmark from Russell 3000 + 3 percent to Russell 3000 doesn't fundamentally change the portfolio's investments or implementations. It only provides a measure that is clear against which decisions can be made. This makes sure that PERA is within the best practices across the industry to ensure appropriate evaluations, stated CIO Dominic Garcia.

Mr. Garcia confirmed Ms. Naranjo Lopez's statement that the Investment Committee and Board will review and approve benchmarks.

Ms. Naranjo Lopez asked the following questions: How is private equity performance calculated on the basis of an asset class; how does staff assess that valuation of underlying assets as calculated by a given manager; and, does the fund have uninformed standards for private equity valuation? Mr. Pérez said the basic calculation for private equity is done through internal rate of return (IRR), which is best practice. Currently, all of PERA's private equity investments are performing as expected except one fund.

Ms. Naranjo Lopez asked whether PERA should shift to an all index investment model. Mr. Pérez said this is a discussion that the Board should have, although his professional advice was no.

Mr. Esquibel said he'd like to know SIC and ERB's benchmarks.

Mr. Reynolds recalled the inclusion of Russell 3000 + as having to do with alternative investments – private equity, hedge funds, liquidity premiums – and Wilshire was part of the recommendation. Each of the baskets or asset categories contained a blend of benchmarks and the Russell 3000 + was addressing alternative investment and in order to benchmark that, 3 percent was added. Strategic asset allocation was predicated on the expected returns that Wilshire put together based on the blends of various benchmarks. He said he supports simplification but has concerns that Wilshire is changing what they originally proposed.

Mr. Reynolds suggested that the discussion regarding risk budgeting may be the appropriate time to discuss benchmark changes. The Board needs to be vigilant that it gets the premiums it expects.

Ms. Dean said the purpose of benchmarking is to appropriately reflect the structure of the portfolio. The risk budget discussion is to understand what is from the market return without any active risk and how much of the return is from the active risk. The notion today is to see separate sources of return to allow the Board to determine whether it was worth paying extra for additional active return for that active risk. When those two items are not separated then the benchmark should be public market plus the expected premium.

Mr. Garcia confirmed Chair Melia's observation that PERA was not lowering its expectations but developing better comparisons to determine active return.

Ms. Naranjo Lopez said PERA should shift to an all-index investing model and thus eliminate the market under performance and save over $500 million in fees over the next decade. Mentioning PERA's unfunded liabilities, Ms. Naranjo Lopez said there was no room for error and she requested a thorough analysis of benchmarking.

Mr. Garcia said Wilshire is recommending that clear benchmarks be established to serve as a measuring stick for the total portfolio.

Mr. Reynolds asked how the 10-year expectations for the revised custom blended benchmarks, based on a non-passive basis, changes. Mr. Garcia said, if implemented exactly as proposed by Wilshire it would be somewhat less because the illiquid assets are not included.

Mr. Reynolds said he appreciated the discussion and thinks this is what the Board should be discussing.

Mr. Reynolds moved that the Investments Committee approve the benchmark updates as proposed by Wilshire. Mr. Maxon seconded and the motion passed by majority [5-1] voice vote with Ms. Naranjo Lopez voting against.

C. <u>Information Item</u>: Real Assets Implementation Plan

Mr. Pérez said this is the final step in reaching the full strategic allocation in the real assets portfolio.

Kristin Varela, Senior Portfolio Manager, reviewed the timeline of the real assets portfolio starting in April 2016 and noted that great strides have been made to reach the 20 percent allocation. The recently approved liquid real assets portfolio solution strategy will be utilized to increase real assets by 4 percent bringing the real assets portfolio in line with its 20 percent strategic asset allocation. PIMCO will execute two specific strategies with an additional 2 percent to TIPS and 2 percent to commodities.

Ms. Varela noted that the real assets expected return falls slightly which she attributed to the lower expected return in TIPS; however, the risk also drops and the risk adjusted return improves. This will further reduce the portfolio's equity exposure.

D. Chief Investment Officer's Report

1. Updates

Mr. Garcia focused his updates on active risk. The total fund risk can be compartmentalized into two components: strategic asset allocation risk and active risk. Staff's focus throughout 2018 and forward will be on the active risk to ensure that it is budgeted and planned accurately.

Joaquin Lujan, Director of Rates and Credit, said it was important to define how much risk one is willing to take. The goal of active risk and active risk budgeting is about setting premise, measured and constrained levels of out of benchmark risk to reach the desired excess return. Implemented correctly and measured, staff believes a half to three-fourths percent can be achieved over the Bogle portfolio.

Mr. Garcia outlined what an active risk budget would look like with 2 percent extra volatility outside of the approved benchmarks. There is the unintentional active risk and the deliberate and measured active risk. He highlighted the engines or opportunities in active risk that are available to implement an additional 50 to 75 basis points. The question becomes how much extra risk does PERA want to take and what is the goal for taking that risk?

Mr. Lujan said the goals cannot be achieved without measurement. The process of active risk budgeting is another lever that the Board, as policymakers, takes on. Staff will continue to refine its plan of what active risk could look like.

Mr. Mayfield thanked staff, the consultants and the Investments Committee for their work on these issues.

Ms. Naranjo Lopez said part of the discussion regarding risk should include whether investing in alternatives is appropriate.

Mr. Garcia, on a second update item, said PERA has two consultants in its credit portfolio and staff finds that redundant and inefficient. As a result, Albourne will be assigned the portfolio. There will be a $30,000 savings. TorreyCove will continue to consult on the private equity side.

5. <u>Other Business</u>

Dr. Kohlasch asked that the family of the late Gregory Smith, Colorado PERA Executive Director, be kept in prayer.

6. <u>Adjournment</u>

Having completed the agenda and upon motion by Mr. Maxon and second by Ms. Naranjo Lopez, Chair Melia declared this meeting adjourned at 10:40 a.m.

Approved by:

John Melia, Chair
PERA Investments Committee

ATTEST:

Wayne Propst, Executive Director

<u>Attached Exhibit(s)</u>:
Exhibit 1: Wilshire Benchmark Recommendations