

NEW MEXICO
PUBLIC EMPLOYEES RETIREMENT ASSOCIATION
INVESTMENT COMMITTEE MEETING

February 28, 2019

This meeting of the Public Employees Retirement Board Investment Committee was called to order by Dan Mayfield, Committee Vice Chair, at approximately 9:00 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 preceded the Pledge of Allegiance and indicated the presence of a quorum as follows:

Members Present:

John Melia, Chair
Dan Mayfield, Vice Chair
Lawrence Davis [Appointed]

Member(s) Absent:

Steve Neel, Vice Chair

Other Member(s) Present:

Jackie Kohlasch
Maggie Toulouse Oliver
Loretta Naranjo Lopez

Staff Members Present:

Wayne Propst, Executive Director
Susan Pittard, Chief of Staff/General Counsel
Dominic Garcia, Chief Investment Officer
Greg Trujillo, Deputy Executive Director
Karen Risku, Deputy General Counsel
Dana David, Assistant General Counsel
Kristin Varela, Deputy CIO
Renada Peery-Galon, ASD Director
LeAnne Larrañaga-Ruffy, Director of Equity
Anna Williams, Chief Financial Officer
Karyn Lujan, Deferred Compensation Plan Manager

Others Present:

Thomas Toth, Wilshire Consulting
Paul Lium, Nationwide
Adam Hathaway, Parliamentarian
Lenora Chavez
Jake Salazar

Victor P. Baca
Frank Angel
Loretta Newman
Conny Maki
Isabel Vigil

2. APPROVAL OF AGENDA

Mr. Mayfield moved approval. His motion was seconded by Mr. Davis and passed by unanimous voice vote.

3. APPROVAL OF CONSENT AGENDA

Mr. Mayfield moved approval and Mr. Davis seconded. The motion passed by unanimous voice vote.

4. CURRENT BUSINESS

A. Information Item: CIO Update

Chief Investment Officer Dominic Garcia said staff develops a quarterly strategic letter for the Board's information. He reminded the Committee of the five-year strategic plan goals that he and his staff work on to meet PERA's objectives:

- Maintain appropriate strategic asset allocation to meet the actuarial discount rate assumption over the long run – over the past 10 years the return has been 8.44 percent. The challenge is building a portfolio for the next 10 years
- Work toward 30-year funding period of unfunded actuarial accrued liability
- Meet ten-year annualized returns to equal or exceed the policy benchmark – the benchmark was exceeded by 36 basis points with significant value-add to the fund
- Achieve a total investment cost at or below 85 basis points – management fees are estimated at 46 basis points

Staff has been working to bridge the gap to reach 7.25 percent return. The risk budget approved by the Board in 2018 is facilitating reaching the goals. While it appears PERA will meet their expected return, Mr. Garcia said the gains are expected from active management which is less reliable than beta.

Chair Melia asked about the return for the all passive Bogle/Reference portfolio. Mr. Garcia recalled the return at -6 percent while PERA achieved -2.5 percent. If over the past 10 years PERA was invested in the all-passive Bogle portfolio the fund would have \$1.3 billion less in its NAV than it has today.

Mr. Garcia referred to risk parity and multi-risk allocation noting that the Board approved an asset allocation policy change to integrate 10 percent multi-risk diversification.

In an effort to improve the economics in private asset investing, Mr. Garcia said staff is exploring co-investing and secondaries to lower fees and terms and will save

PERA money while making it money. In the public market, staff is investigating relaxing the long-only constraint.

In regard to risk balance, Mr. Garcia said it provides better true diversification; not necessarily capital but risk diversification. Risk balance aligns better with liabilities, withstands multiple economic scenarios and provides a drawdown profile. He reviewed the risk contribution of capital. In cumulative periods, Mr. Garcia reviewed a graph of how PERA would have benefited from the risk parity allocation noting in the long-run it does well. A measurement of the unit of return for the unit of risk was reviewed. He noted that while risk balance improves the risk return ratio it is not a silver bullet.

B. Action Item: Risk Budget & Strategy Target Return Update

Tom Toth, Wilshire Consulting, said the recommendation is no change to the active risk budget. Maintaining the same targets approved at the first risk budgeting exercise. The target is 1.5 percent with an expected range between 1 percent and 2 percent. Selection accounts for 35 percent of the 1.5 percent of the active risk. The allocation impact accounts for 85 percent. The level of active risk is expected to generate 1.5 percent. He concurred with Mr. Garcia's assertion that there will be variation around the performance.

Mr. Toth highlighted the various matrices that are monitored to evaluate how the active component of the portfolio performs. He reviewed the three components that make up the risk framework: beta/market exposure, allocation/utilizing illiquid investments and active selection. The beta component is substantially larger than the other two because the market exposure is the primary driver of results. The total fund risk is expected to be 10.2 percent with an expected return of 7.35 percent.

Mr. Toth discussed the stress testing performed on the risk budget and found the probability of exceeding the upper band is about 26 percent or a one in four chance. The next step is to present an enhancement to the portfolio management process providing great accountability from staff to the Board.

Mr. Mayfield moved to adopt the recommendation of making no change to the active risk budget with a target of 1.2 percent with a range between 1 percent and 2 percent. Mr. Davis seconded and the motion passed by unanimous voice vote.

C. Information Item: Quarterly Staff Consultant Report, Risk Mitigation Portfolio Review

Joaquin Lujan, Director of Rates and Credit, said the PERA investment team manages four major asset categories: equity, real assets, credit and risk mitigation. He invited Mr. Toth to present the review of risk mitigation.

Mr. Toth said the strategic purpose of the four broad asset categories is because of their distinct and important roles in managing the portfolio through different

environments. Risk reduction and mitigation serve as economic diversifiers to equity risk through capital preservation properties and effective risk protection during periods of market turbulence, a source of income and a ready source of liquidity. The risk reduction and mitigation are meant to balance out the other asset classes.

A series of graphs were displayed to indicate how risk reduction and mitigation provide ballast in the portfolio.

Responding to Executive Director Propst's questions, Mr. Toth said Wilshire has been one of PERA's consultants for six years and has witnessed a remarkable change in PERA's portfolio and earning greater returns with less risk to the membership's money. Mr. Toth mentioned the evolution of PERA compared to its peers.

D. Information Items: Investment Division Updates

1. Cash Plan and Rebalance Update

Kristin Varela, Deputy CIO, said PERA is holding a healthy amount of equitized and invested cash which is used to pay benefits. January's benefit payments were \$102 million and out of that \$55 million was paid through the trust account. She noted that PERA was within strategic asset allocation targets. January's contributions were \$46 million.

2. Manager Selection Activity Report

Ms. Varela said the risk parity index replication was approved in June 2018 and staff worked to find a suitable manager for this strategy. The RFI process began in August 2018 and was sent to the 13 managers in this field. In February 2019, the Beta Team made a proposal to Mr. Garcia to approve Bank of New York Mellon Assets Management North America Corporation (AMNA). Over the ten months the portfolio will be funded from the passive global equity and the passive core fixed income portfolios. She reviewed the scope of work and MQs.

Ms. Varela reminded the Committee that staff has delegated authority to run the investment process internally. Ms. Naranjo-Lopez took issue with that.

Ms. Varela discussed the highly active strategies proposed by the 13 responders. As a policy allocation, staff did not want to bring additional risk into the portfolio. To meet that goal, a supplemental DDQ (due diligence questions) was issued to the 13 respondents. Following semi-finalist interviews AMNA was able to offer a low-cost implementation strategy. Wilshire created a 15 percent risk parity index, with the appropriate methodology in place to manage tail risk. AMNA will provide an index replication strategy of a risk parity benchmark customized for PERA's targeted return. This will be accomplished through liquid derivative base exposure. Staff was able to make this product cost efficient for PERA. The strategy will be funded over the next 10 month.

Mr. Garcia commended Ms. Varela and Wilshire on this unique solution they

developed for risk parity investing.

In December 2018, the Alpha Team proposed a follow-on investment with Adrian Infrastructure V in PERA's illiquid real assets. Infrastructure has a positive diversified nature to it, aligns well with PERA's liabilities, and creates a positive cash flow for the fund. Fund V will focus on European infrastructure and identifying mature stable assets.

3. **Securities Lending Update – Q4 2018**

Ms. Varela said PERA was in line with its allowances for lending out security. PERA loaned out an average of \$573 million in assets over the fourth quarter and from that received \$674 thousand in gross revenue. Securities lending is a mechanism to offset the cost of custody bank transactions. The program is highly liquid and limited to global equity and REITs to manage risk associated with securities lending.

Chair Melia commended staff and Mr. Garcia's bigger picture in bridging the gap with governance. He noted that as PERA Board members' participation in the investment selection process has declined, the returns have improved.

5. **OTHER BUSINESS**

None were presented.

6. **ADJOURNMENT**

Chair Melia declared the meeting adjourned at approximately 10:15 a.m.

Approved by:



John Melia, Chair
Investment Committee

ATTEST:



Wayne Propst, Executive Director