

NEW MEXICO
PUBLIC EMPLOYEES RETIREMENT ASSOCIATION
INVESTMENT COMMITTEE

January 25, 2018

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, Senator Fabian Chavez, Jr. Board Room, 33 Plaza la Prensa, Santa Fe, New Mexico.

1. Roll Call

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

Members Present:

John Melia, Chair
Dan Esquibel
Dan Mayfield
James Maxon
Loretta Naranjo Lopez
Jackie Kohlasch

Member(s) Absent:

None

Other Board Members Present:

Claudia Armijo
Natalie Cordova
Patricia French

Staff Members Present:

Wayne Propst, Executive Director
Susan Pittard, Chief of Staff/General Counsel
Greg Trujillo, Deputy Director
Karen Risku, Deputy General Counsel
Dominic Garcia, CIO
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
LeAnne Larrañaga-Ruffy, Director of Equity
Karyn Lujan, Deferred Compensation Plan Manager
Kristin Varela, Portfolio Manager of Real Assets
Christine Ortega, Portfolio Manager
Anna Williams, Chief Financial Officer
Anna Murphy, Portfolio Manager

Others Present:

Robert Santa, NM SPA
Rebecca Anaya, NM SPA
Don Wencewicz, AFSCME Retiree
Darrell Majors, AFSCME Retiree
John Doran, AFSCME Retiree
Joseph Luna, RPENM
Gerald Chavez, RPENM
Jeremy Vaughan, NM SPA

2. Approval of Agenda

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

3. Approval of Consent Agenda

Chair Melia said he reviewed the minutes 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

1. Cash Plan Updates

Deputy CIO Pérez noted that performance would be covered in the 2017 review. The cash account balance at BNYMellon at the end of December was up \$36 million over the previous month and the year ended with approximately \$278 million. He reviewed the sources of cash from a reduction in the risk mitigation portfolio and the global equity portfolio, illiquid asset distributions and redemptions, employee and employer contributions, and the suspense account.

The uses of cash during December were: \$105 million for benefits and refunds, \$3 million for operational expenses, \$181 million for an illiquid asset capital call, and \$622 million to fund real assets – the last step to reach the strategic asset allocation. Mr. Pérez noted that every asset category is within its policy range.

2. Other Updates

Mr. Pérez pointed out that the monthly performance, executive summary, risk report and the securities lending update are provided within the Committee packet.

B. Information Item: Performance and Risk Update – 2017 Year in Review

Anna Murphy, Portfolio Manager, said 2017 was an exceptional year for the fund supported in large part by an exceptional year in the market. There was historically low volatility and a bull market. The S&P ended every month with a positive total return: the first time in history for that index. At the same time it was in lowest percentile of volatility since 1930. Also exceptional was the low core inflation volatility.

Ms. Murphy offered the following points:

- The fund was up 13.96 percent net of fees
- The return represents a \$1.8 billion investment gain
- The asset allocation targets ended the year “spot on”
- Allocation effect provided an excess return
- Selection effect provided an excess return – making up more than half of the fund’s gross excess return
- Portfolio risk requires management which requires measuring risk
- The market expectation for volatility is 11 percent; in 2017 it was less than 1.5 percent in the aggregate for the fund
- The Sharpe ratio of 9.6 for the year was extraordinary
- 2017 was a great year for the fund but it should not be expected to go forward

In an effort to make a comparison regarding predicted risk measurements, Ms. Murphy identified where the fund was at the end of 2016 and the end of 2017 by capital allocation, contributions to risk and other measurements noting as the allocations came in line with the strategy the risk was reduced.

Using the story of Goldilocks as an analogy, while the market was “just right” for 2017 the market will change. 2018 is about understanding underlying risks, balancing those risks and budgeting those risks.

CIO Garcia thanked Ms. Murphy for her excellent presentation as did the Committee.

C. Action Item: 2018 Investment Work Plan
[Exhibit 1: 2018 Work Plan]

Mr. Garcia identified that the work plan establishes the goals for 2018. The three main goals of the five-year strategic plans are as follows:

- Maintain appropriate strategic asset allocation to meet the actuarial discount rate assumption
- Work towards a 30-year funding period of UAAL
- Meet ten-year annualized returns to equal or exceed the policy benchmark

These goals guide the Investment Division’s activities throughout the year. With the current portfolio allocations the expected return over the next ten years is 6.5 percent. The actuarial discount rate is 7.25 percent for the next eight years and 7.75 percent thereafter – at this point, the expected return falls 1.25 percent short. Staff will lay a foundation to close that 1.25 percent gap which will take time.

Mr. Garcia said staff has identified three major anchors to the foundation to accomplish this year: beta goals, alpha goals and operation/analytics/infrastructure goals. Portfolio managers

will lead the initiatives on these goals.

Mr. Pérez discussed the beta which is simply the fund's policy index and the importance of maintaining a beta of one. The goal of beta is not to beat the benchmark but rather to capture it. Staff intends to recommend a risk balance asset allocation, provide education on the recommended framework and establish a path to increase expected long-term returns and risk balance. Staff will recommend the adoption of a reference portfolio for benchmarking and conduct an asset-liability study later in 2018.

Joaquin Lujan, Director of Rates and Credit, said alpha is simply edge – information or predicted edge that can be applied by buying or selling stocks, bonds, real estate, etc. It can create extra or incremental yield that can be generated above and on top of beta. He noted it is hard to build and keep an edge. Alpha is difficult to find, capture and add to the fund level profit after fees.

Mr. Lujan said staff will review and develop recommendations on risk budgeting, active risk budget, active management and implementation of active risk budget and glide path to alpha target. Stating it was not good enough to be lucky, Mr. Lujan said everything will be intentional – how much alpha was sought and whether that was that accomplished.

Mr. Garcia repeated that the fund needs to get from 6.5 percent to 7.75 percent. Staff has developed a two-pronged approach to bridge the gap: get a better beta and seek alpha. This year is the start of building the plan.

Mr. Pérez said to reach the beta and alpha goals PERA has to have a strong foundation of the investment division in operations, analytics and infrastructure. Staff has developed a detailed work plan provided in the Committee's packet material.

Mr. Garcia reviewed the summary schedule outlining the activities staff foresees over 2018. The work plan can be modified; however, at this point staff is requesting approval.

Ms. French thanked staff for their presentation.

Mr. Esquibel asked if the proposed five-tier work plan would address the anticipated high rate of retirement. Mr. Garcia said the work plan includes an experience asset liability study which will provide the retirement and benefit information. That information will inform where the asset allocation needs to be. The end need is a known and staff is working to develop a path for the portfolio that will meet that need. It will take multiple years to bridge the 1.25 percent which Mr. Garcia acknowledged as a large number.

Mr. Esquibel raised concerns that the positions vacated by retired baby boomers may not be filled thus reducing contributions. Mr. Pérez said that is part of the experience study and assumptions that the actuaries provide for PERA. Mr. Garcia said it is important to understand how different scenarios impact PERA's liability expectation and contribution rates. Ms. Armijo asked when staff will present what they can measure after one year, a year and half, two years, etc. because waiting five years was not acceptable. Mr. Garcia said staff acknowledges that

at this point they are behind the goal and by March 2018, staff will recommend a risk budget and active management target returns.

Ms. Armijo asked whether staff will provide the Committee what is necessary to measure success. Mr. Garcia said the work plan includes a reference portfolio which allows staff to compare over time how the beta and alpha portfolios are performing versus the asset allocation.

Ms. Naranjo Lopez asked whether other studies would be occurring during the year and whether the committee be updated on these studies. In the past, investment managers would present information to the Committee and she expressed concern that that no longer occurs, now staff is recommending that the Committee meet six times a year rather than monthly. Mr. Garcia said the work plan outlines the studies that will be engaged and in July the asset liability study will be presented.

Ms. Naranjo Lopez asked whether the Committee will be updated on the manager watchlist. She expressed concern regarding the Board's fiduciary responsibilities: "We are not meeting with the managers to know what they're doing and who they are...and then half a year we are not meeting."

Mr. Pérez said the Board will be apprised of fund performance at Board meetings. The watchlist is reported quarterly within the executive summary. The new Investment Policy Statement has a provision that the Board can request an investment manager to speak to the Board. Mr. Garcia said staff is following industry best practices.

Ms. Naranjo Lopez said the majority of pension plans do not operate the way the PERA's Investments Division is proposing and that concerns her.

Mr. Maxon moved to accept the 2018 Investment Work Plan. Mr. Mayfield seconded.

Mr. Esquibel supported the proposal that this committee meet less frequently adding that the fund benefits by staff staying focused on its task. With the additional time, he asked that the five-year plan be shortened to three years. Mr. Garcia said the speed of implementation can certainly be addressed. He agreed that an accelerated plan may be preferable but needs to be realistic.

Mr. Esquibel recommended re-evaluating the work plan mid-year to determine whether its duration can be shortened. Mr. Garcia noted that the work plan before the Committee is for 2018.

The motion passed by majority [5-1] voice vote with Ms. Naranjo Lopez casting the sole nay vote.

5. Other Business

Chair Melia congratulated Mr. Pérez on passing his level 1 CFA testing.

6. **Adjournment**

Having completed the agenda and upon motion by Ms. Naranjo Lopez and second by Dr. Kohlasch, Chair Melia declared this meeting adjourned at 10:00 a.m.

Approved by:


John Melia, Chair
PERA Investments Committee

ATTEST:


Wayne Propst, Executive Director

Attached Exhibit(s):

Exhibit 1: 2018 Work Plan