

NEW MEXICO
PUBLIC EMPLOYEES RETIREMENT ASSOCIATION
INVESTMENT COMMITTEE

March 29, 2018

This meeting of the Public Employees Retirement Investment Committee was called to order by Dan Mayfield, Vice 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:

Dan Mayfield, Vice Chair
James Maxon
Loretta Naranjo Lopez
Jackie Kohlasch

Member(s) Absent:

John Melia, Chair
Dan Esquibel

Other Board Members Present:

Natalie Cordova
Tim Eichenberg
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, Chief Investments Officer
Renada Peery-Galon, ASD Director
Dana David, Assistant General Counsel
Kristin Varela, Interim Deputy CIO
Joaquin Lujan, Portfolio Manager
Trish Winter, Executive Assistant
LeAnne Larrañaga-Ruffy, Director of Equity
Karyn Lujan, Deferred Compensation Plan Manager
Christine Ortega, Portfolio Manager
Anna Williams, Chief Financial Officer
Anna Murphy, Portfolio Manager
Emily Lopez, Financial Specialist

Others Present:

Tom Toth, Wilshire Associates,
Don Wencewicz, AFSCME Retiree
Jack Braden, AFSCME Retiree
Bob Samuel, CIM Group
Aysun Kilic, Rothschild Asset Management

2. Approval of Agenda

Dr. Kohlasch moved to approve the agenda as published. Her motion was seconded by Mr. Maxon and passed by unanimous [4-0] voice vote.

3. Approval of Consent Agenda

Vice Chair Mayfield said he reviewed the minutes and found them accurate and complete.

Mr. Maxon moved to approve the consent agenda and Dr. Kohlasch seconded. The motion passed by unanimous [4-0] voice vote.

4. Current Business

A. Chief Investment Officer's Report

CIO Dominic Garcia said, at the last education session, the question of how the investment team would bridge the gap – the 1 percent deficit in expected returns - and he is prepared to propose initiatives to help PERA meet the 1 percent. He also explained how the risk budget framework can be used to identify areas of enhancement in the future. First, PERA will build an appropriate strategic asset allocation to meet its discount rate. Today's discount rate is 7.25 percent over the next eight years when it rises to 7.75 percent. The Investment team's goal is to build a portfolio that can match that over time. Secondly, the team will work to make the 10-year return meet or exceed the 10-year benchmark returns. Using a series of graphs, Mr. Garcia demonstrated how, over the next few years, the portfolio's market beta will rise from the current 5.75 percent to 6.15 percent thus meeting the discount rate at 7.75 percent by 2020 year end. He noted that allocations to private assets are expected to gain the portfolio an addition 60 basis points, and by being better risk balanced in asset allocations, the portfolio will be more efficient with its existing risk and execute a better return, reaching 6.75 percent by this year end. He highlighted how selection and allocation would improve over the next few years.

Mr. Garcia noted that reaching the goal will require diligence on behalf of staff, the Board, the Investment Committee and PERA's consultants. He pointed out that at the request of Board members the time horizon has been reduced from the original five years to, instead, meet the goal within three years.

Mr. Garcia said other considerations will include strengthening the governance structure, attracting additional talent to increase accountability for implementation of decisions to reach the desired results, staff compensation, an update of complex investment structures, and enhanced reporting capabilities to strengthen alignment with current and future partners.

In response to Ms. French's question of whether increasing staff would result in a reduction of consultants, Mr. Garcia said he did not anticipate changes to the consultant structure. A more detailed report regarding staff needs will be presented during the budgeting process.

Ms. Naranjo Lopez said she wanted to ascertain whether the Board has effective mechanisms for monitoring implementation decisions relating to Board policy. She asked that this item be included on the Board Retreat agenda, adding that the monitoring is the Board's responsibility. She mentioned that it concerned her that the Board is taking action on investment related issues via the consent agenda.

B. Investment Division Updates
1. Cash Plan & Rebalance Update

Mr. Garcia advised the Committee that Kristin Varela is serving as PERA's interim Deputy CIO and added that she is doing a great job.

Ms. Varela noted that the monthly performance summaries were provided for both January and February 2018. In January, the fund hit a high mark of \$15.86 billion. Focusing on February, Ms. Varela said it was less positive, given the market volatility. The Fund was reduced by 2 percent, dropping the balance to \$15.46 billion.

Ms. Varela reviewed the cash flow data, noting the STO account covered benefits, and for February that amount was \$97 million. Private partnership calls totaled \$54 million and approximately \$51 million was received in distributions. Additionally, each of the asset allocations are within their target ranges.

2. Manager Selection Activity Report
3. Other Updates

Ms. Varela identified this as a new report with familiar components. The investment team is seeking to strengthen its oversight and mechanisms for oversight within implementations, and this report functions in that regard. She reviewed the manager selection process, from identifying a portfolio need, through to staff proposal to the Chief Investment Officer.

Ms. Naranjo Lopez said that in order for the manager selection process to be effective, the Board needs to participate as they did in the past. She requested that this five stage process be reviewed at the Retreat to ensure the Board is meeting its fiduciary responsibility.

Ms. Varela highlighted the strategies currently moving through the manager selection process. She reviewed the Alpha Team's review of The Resolution Fund IV LP, an illiquid private equity partnership. The Fund will focus on existing well-manager and profitable middle-market businesses. This is a follow-up investment for PERA, with investments in Fund II at \$25 million and Fund III with \$45 million. This opportunity has been approved by the Chief Investment Officer as well as PERA's consultant.

Ms. Varela identified the Alpha Team as three portfolio managers. With regard to review of the Resolution Fund, Mr. Garcia offered to make available the diligent reports. Ms. French requested that TorreyCove's report be made available to the Board.

Ms. Naranjo Lopez asked whether the manager was reviewed for a series of items: willingness to be an ERISA fiduciary, internal controls for insurance compliance with PERA's IPS, that their returns conform to the CFA institute global investment performance standards, liquidity constraints and she asked what the fees are. Ms. Varela said the fees fall under manager confidentiality and she would discuss that issue off-line. The manager is ERISA compliant and met all of PERA's legal requirements. This is a highly-rated manager and passed all of PERA's screenings. The liquidity question is different because this is not a liquid investment.

Ms. Naranjo Lopez said it concerned her that the Board was not meeting with managers. She requested that this be discussed at the Retreat.

Ms. French requested a report similar to what Cliffwater had provided, with manager ratings and pros and cons.

C. Performance and Risk Update
1. Calendar YTD 2018

Anna Murphy, Portfolio Manager, reminded the Committee of the market that defined 2017 and January 2018 which had steadily rising asset prices combined with historic low levels of volatility. The market changed in February, using a VIX index that measures market volatility and is considered a gauge of broad market volatility. With the aid of a graph, Ms. Murphy showed that, within a one-day period from the 5th to the 6th of February, the VIX shot up 200 percent; however, it came back down and stabilized at a level above where it was before. The market dynamics appear to have been a negative feedback loop, triggered by \$3 billion invested in ETFs that were short-indexed – investors taking direct bets against volatility increases. In the weeks prior to February 5th \$800 million in new money had floated in the ETF products. By the end of February there was \$2 billion left in those products, which she referred to as a rapid unwinding as investors raced out of the short volatility positions. She described the VIX over a ten-year period, and noted that the 2017 average level of VIX was the lowest during that 10-year period and it stabilized in line with the long-run level of the VIX. February appears to have been a reset on volatility to more normalized levels. She noted that, over a one-year period basis, the Fund has had less volatility and a higher Sharpe ratio than the policy benchmark, and it has delivered a positive risk-adjusted excess over the policy benchmark.

Ms. Murphy said that the fund has outperformed the policy benchmarks for all periods, net of fees, and preserved capital during February's increased volatility. She said the fund's positive excess return over the policy benchmark was attributable to strategy decisions rather than allocation drift. By reaching the allocation targets by the end of 2017, allocation effect was minimized/uncompensated risk and the excess performance can be isolated and attributable to strategy decision – inclusion of bank loans and hedged strategies in the credit portfolio as well as private investments across the Fund.

In summary, Ms. Murphy said the fund outperformed, net of fees, the policy benchmark by 96 basis points in February, 80 basis points for the calendar year, 143 basis points for the fiscal year and 66 basis points for the one-year period. The Fund has delivered approximately \$218 million in value added over the policy benchmark for the year-to-date period.

Ms. Murphy highlighted that the fund provided nearly a percentage point of capital preservation relative to the policy benchmark, despite the volatility.

Ms. Naranjo Lopez said the membership was greatly impacted in 2008 when the Fund declined and she did not want to see that happen again.

D. Action Item: Active Risk Budget

- 1. Approve Active Risk Budget**
- 2. Approve Active Strategy Return Budget**

[Exhibit 1: Wilshire Recommendations: pages 4 and 5]

Tom Toth, Wilshire Associates, reminded the Committee of the benefits of risk budgeting:

- Efficient utilization of risk to enhance total fund returns
- Provides accountability for implementation results relative to Board approved targets and ranges
- Attribution of total fund return drivers improves the process of monitoring and adjusting the portfolio over time to ensure member benefits

Mr. Toth said the risk budget process is the implementation of the portfolio construction. Along with staff, the consultant is recommending adopting an active risk budget target of 1.5 percent with a range of 1 percent to 2 percent. This range allows for some drift. Selection is expected to account for approximately 30 percent of the active risk, and allocation impact from both structure and illiquid implementation are expected to account for approximately 70 percent of the active risk. The active return is expected to be 1 percent for alpha/excess return within a range of zero to 2 percent. Allocation and selection are expected to offer equal returns.

Ms. Naranjo Lopez asked how the recommendation between consultant and staff functions. Mr. Toth said there is interplay between the two and, because of Wilshire's client base they have a solid view of active risk levels for other funds. Relative to other clients, PERA's risk level is fairly moderate. Endowments tend to have higher active risk target and higher allocations to illiquid assets.

Mr. Garcia reminded the Committee that the active risk budgeting recommendation and the process in which it was developed was discussed at length at the recent study session.

Mr. Maxon moved to approve the recommendation to adopt an active risk budget target of 1.5 percent with a range of 1 percent to 2 percent; and to adopt the active return budget recommendation of an active strategy return budget target of 1 percent with a range of zero to 2 percent. Dr. Kohlasch seconded and the motion passed by unanimous voice vote.

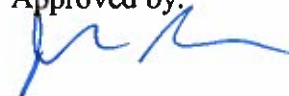
5. Other Business

None was presented.

6. **Adjournment**

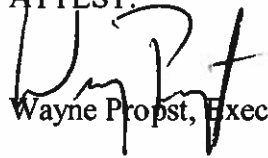
Having completed the agenda and upon motion by Dr. Kohlasch and second by Mr. Maxon, Vice Chair Mayfield declared this meeting adjourned at 10:20 a.m.

Approved by:



John Melia, Chair
PERA Investments Committee

ATTEST:



Wayne Propst, Executive Director

Attached Exhibit(s):

Exhibit 1: Wilshire Report re: Active Risk Budget