

NEW MEXICO
PUBLIC EMPLOYEES RETIREMENT BOARD
INVESTMENTS COMMITTEE MEETING

May 25, 2017

This meeting of the Public Employees Retirement Board Investments Committee was called to order by Chair John Melia at approximately 12:20 p.m. on the above-cited date in the Senator Fabian Chavez, Jr. Board Room, PERA Building, 33 Plaza la Prensa, Santa Fe, New Mexico.

1. The Pledge of Allegiance was followed by roll call by Deputy Director Greg Trujillo, which confirmed a quorum with the following members present:

Members Present:

John Melia, Chair
John Reynolds, Vice Chair [12:40 arrival]
Loretta Naranjo Lopez
Dan Esquibel [12:25 arrival]
Jackie Kohlasch
Cathy Townes [appointed for quorum]

Member(s) Absent:

James Maxon [excused]

Other Board Members Present:

Claudia Armijo
Dan Mayfield
Maggie Toulouse Oliver

Staff Members Present:

Susan Pittard, Chief of Staff/General Counsel
Greg Trujillo, Deputy Director
Jude Pérez, Interim CIO
Karen Risku, Deputy General Counsel
Renada Peery-Galon, ASD Director
Dana David, Assistant General Counsel
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 Returns
Christine Ortega, Portfolio Manager
Mark Montoya, Investments Division
Anna Murphy, Compliance Officer
Isaac Olaoye, Financial Analyst
Emily Lopez, Financial Specialist

Others Present:

Mark White, Albourne
Mike Krems, TorreyCove
Eileen Neill, Wilshire

2. APPROVAL OF AGENDA

Ms. Naranjo Lopez moved to approve the agenda as presented. Ms. Kohlasch seconded and the motion passed by unanimous voice vote. [Members Reynolds and Esquibel were not present for this action.]

3. APPROVAL OF CONSENT AGENDA

Chair Melia said he reviewed the minutes of the April meeting and they appeared complete and correct.

Ms. Naranjo Lopez moved to approve the consent agenda. Ms. Kohlasch seconded and the motion passed without opposition. [Members Reynolds and Esquibel were not present for this action]

4. CURRENT BUSINESS

A. Chief Investment Officer's Report

1. Investment Performance – April 2017

PERA Interim CIO Jude Pérez said the fund finished April with a balance of \$14.9 billion, up approximately \$100 million from the previous high water mark in April 2015. For the month, the fund was up 1.09 percent net of fees. For the one-year period, the fund is up 9.88 percent and fiscal year-to-date the fund is up 9.24 percent net of fees ahead of the actuarial target pace by 3.23 percent. All four asset categories within the allocation were positive.

2. Cash Plan Update

Mr. Pérez said the cash balance at BNYMellon was down \$41 million and the month finished with \$518 million in cash. He reviewed the sources and uses of cash during April. Along with the cash plan is the rebalancing report that reflects Board approved actions associated with the implementation plan. Approximately \$96 million was used to pay benefits and refunds and \$2 million went to operational expenses. Cash was also used to fund various asset categories to help in the implementation of the strategic asset allocation.

3. Other Updates

Mr. Pérez provided the following updates:

- The rebalancing is ongoing and consistent with the Board approved implementation plan

- There are four active RFPs:
 - Low-volatility – on site visits with the finalists are scheduled for June
 - Currency hedging – 13 responses
 - Emerging Equity – submission deadline 6/12
 - Real Assets completion strategy – submission deadline 6/5

B. Action Items: Alternative Asset Recommendations for approval to be funded according to the cash plan, and subject to legal review by General Counsel

1. **Recommendation to Commit up to \$100 million to EnCap Energy Capital Fund XI, LP**
[Exhibit 1: Staff recommendation re: EnCap]

Kristin Varela, Senior Portfolio Manager Real Assets, introduced Mark White from Albourne and representatives from EnCap appearing by video conference.

This is a follow-up investment, stated Ms. Varela and EnCap is expected to continue their proven strategy – to provide growth equity to high quality management teams with the principal objective of value creation through the acquisition and exploitation of oil and gas reserves. She demonstrated how this investment will assist PERA in meeting its target within the real assets portfolio. At this time, energy is an underallocated sector and this commitment will reduce that underallocation and assist in manager proliferation.

Ms. Varela reviewed the investment and corresponding timeframes of those investments that PERA has with EnCap: \$30 million to Fund VII in August 2007, \$25 million to fund VIII in October 2010 and \$27 million to fund IX in October 2012. EnCap has been a strong performer within the PERA portfolio.

EnCap was founded in 1988, located in Houston, with majority ownership held by the seven partners who are all active in the management of the firm. She outlined the firm’s success and discussed their commitment of personal investments in fund XI.

Mark White, Albourne, said when conducting due diligence in the energy space they identify key success factors which are proven elements to deliver above average returns and objectives for a particular asset class. EnCap excels at having strong technical expertise. Relationships are very important in the energy space and serve to open doors of opportunities in both the entrance and exit of strategies in this space. EnCap is a desired partner for many energy entities and has demonstrated an ability to add value through controlled interest in these entities.

There were no questions for staff, the consultant nor EnCap.

Mr. Esquibel moved to approve and forward the recommendation to commit up to \$100 million to EnCap Energy Capital Fund XI, LP according to the cash plan and subject to legal review by General Counsel. Ms. Naranjo Lopez seconded and the motion

passed without opposition.

Mr. Esquibel thanked Ms. Varela for the informative materials posted on-line regarding this investment.

2. Recommendation to Commit up to \$100 million to Cerberus Residential Opportunity Fund, LP – Fund of One
[Exhibit 2: Staff recommendation re: Cerberus]

Joaquin Lujan, Director of Rates & Credit, said the recommendation by staff and the consultant is to commit up to \$100 million in this opportunistic credit fund that will invest in re-performing mortgage assets in North America and Europe. This is a follow-up investment with Cerberus where PERA made a \$25 million commitment in 2006 to a distressed debt fund. PERA has received their commitment back and made \$40 million. The recommended strategy will target a 16 percent gross IRR with a two-year investment period.

Mr. Lujan said this strategy seeks to make markets of formerly out-of-favor residential and commercial mortgage markets. They will find, buy, securitize and sell re-rated and re-performing mortgage assets. He defined a re-rated and re-performing mortgage.

Cerberus and Cerberus Investors recently acquired FirstKey Mortgage which is a specialty servicer. The bank underwrites the loan and the payments, and interest goes to the lender. The servicer, FirstKey Mortgage, is in the middle of the transaction collecting payments, collecting escrow money, paying the taxes, etc. That recent acquisition provides Cerberus data on hundreds of thousands of loans across the country and First Key can facilitate by individually locating and buying mortgages.

Mr. Lujan said Cerberus has a tremendous competitive advantage in the purchase of these mortgages as well as the sale because of the higher yields and returns.

Cerberus representatives, Nicolas Rifino and Robert Richter, joined the proceedings via video conference. Mike Krems and Jeffrey Goldberger from TorreyCove were also present.

TorreyCove said this is a good investment for PERA and fits well within the portfolio to complete where exposure is lacking. The portfolio will be approximately 50 percent US and 50 percent European.

Mr. Esquibel said, in his mind the current economic environment increases in the liability issues with high risk mortgages. TorreyCove said solid information is the best defense and FirstKey provides that advantage in this investment partnership.

Mr. Lujan said in the event of default the collateral is the property which has greater value than the loan and the fund owns that collateral.

Mr. Esquibel moved to approve the recommendation to commit up to \$100 million to Cerberus Residential Opportunity Fund, LP, Fund of One, to be funded according to the cash plan and subject to legal review by General Counsel. Ms. Naranjo Lopez seconded and the motion passed without opposition.

C. **Information Item: Q3 FY17 Performance Report**
[*Exhibit 3: Wilshire, Numbers in Context; Exhibit 4: Wilshire, Q3 FY17 Investment Performance Summary*]

Eileen Neill, Wilshire Associates, noted that the March 2017 asset class assumptions are largely unchanged from the year-end assumptions and noted that high yield is slightly lower. The 12-month CPI is 2.4 and for many years it has been 1 percent or less indicating signs of meaningful growth in sectors of the economy and higher paychecks for workers. Unemployment is under 5 percent which is considered full employment and is regarded a driver for the higher numbers in consumer and manufacturing sentiment numbers.

Ms. Neill said the US equity market had another strong quarter which makes six positive quarters. Semi-conductors are leading the US economy. The non-US equity market had a strong return and emerging markets were the strongest performers within that sector. The developed markets in emerging market countries had positive results for the quarter, particularly Brazil and Australia that were commodity driven.

The US fixed income market, stated Ms. Neill, was relatively flat. High yield continues to provide strong returns in the fixed income market. Regarding the non-US fixed income market, PERA had better results which was attributed to the dollar being weaker relative to other currencies. Emerging market debt was the strongest bond market sector for the quarter.

In terms of the high yield bond market, PERA's portfolio lagged because it was a good quarter for the lower quality bonds and PERA tends to invest in higher quality bonds. She discussed real assets – REITs, private real estate and MLPs – all of which performed quite well for the quarter.

Referring to the quarter performance, Ms. Neill said as the policy allocation is being deployed, the asset classes are not quite at target causing a “misfit” effect. The fund did outperform for the quarter, however, for the fiscal year-to-date and the one-year-to-date relative results of actual versus policy there was underperformance which she attributed to an overweight in the risk mitigation strategies. For the quarter, all of the asset classes experienced positive results relative to their respective policies with the exception of real assets.

Referring to the managers on the watch list, Ms. Neill said only one manager does not pass the watch list test criteria, TimesSquare. She said it was rare for a fund with as many managers as PERA has to only have one manager on watch. She commended the

PERA staff and consultants for manager selection. TimesSquare is ahead of their benchmark for a fiscal year-to-date basis, and since inception they are ahead by 200 basis points. Wilshire does not see a long-term problem here but instead a market environment that has not been favorable. TimesSquare has the highest rating given by Wilshire.

Ms. Kohlasch requested additional information regarding the length of time DFA has been on the watch list and Mr. Pérez offered to forward that information.

Ms. Neill said statistically, even the best performing managers will underperform 20 percent of the time. She reviewed how managers on watch are monitored. It is not unreasonable that a manager could be on watch for a couple of years because it can take up to two years for an investment thesis to work its way out. Typically a manager is given a full market cycle, three years, over which to improve their performance.

In response to Mr. Esquibel's question of when PERA will meet its asset allocation targets, Mr. Pérez said this was the first month that three of PERA's four asset categories are within their approved bands as stated in Investment Policy Statement.

5. **OTHER BUSINESS**

None was presented.

6. **ADJOURNMENT**

Having completed the agenda, Chair Melia declared this meeting adjourned at 1:12 p.m.

Approved by:



John Melia, Chair
Investments Committee

ATTEST:



Wayne Propst, Executive Director

Attached Exhibits:

Exhibit 1: Staff recommendation re: EnCap

Exhibit 2: Staff recommendation re: Cerberus

Exhibit 3: Wilshire, Numbers in Context

Exhibit 4: Wilshire, Q3 FY17 Investment Performance Summary