NEW MEXICO

PUBLIC EMPLOYEES RETIREMENT BOARD

INVESTMENTS COMMITTEE MEETING

November 17, 2016

This meeting of the Public Employees Retirement Board Investments Committee was called to order by Vice Chair Dan Mayfield at approximately 9:42 a.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. Executive Director Wayne Propst called roll which indicating a quorum with the following members present:

Members Present:
Dan Mayfield, Vice Chair
Paula Fisher
Patricia French
Loretta Naranjo Lopez
John Reynolds

Member(s) Excused:
Dan Esquibel, Chair

Other Board Members Present:
Jackie Kohlasch
James Maxon
John Melia
Brad Winter

Staff Members Present:
Wayne Propst, Executive Director
Susan Pittard, Chief of Staff/General Counsel
Jon Grabel, Chief Investment Officer
Greg Trujillo, Deputy Director
Karen Risku, Deputy General Counsel
Jude Perez, Deputy CIO
Renada Peery-Galon, ASD Director
Natalie Cordova, Chief Financial Officer
Joaquin Lujan, Director of Rates and Credit
Trish Winter, Executive Assistant
Misty Braswell, Assistant General Counsel
David Dana, Assistant General Counsel
LeAnne Larrañaga-Ruffy, Director of Equity
Mark Montoya, Investments Division

Lalleh Dayeny, Investments Division
Karyn Lujan, Deferred Compensation Plan Manager
Kristin Varela, Portfolio Manager
Emily Lopez, Financial Specialist
Christine Ortega, Portfolio Manager

Others Present:
Jamie Feidler, Cliffwater
Tom Toth, Wilshire
Paul Lium, Nationwide
Lou Moreno, Nationwide
Charles Huebner, RCP Advisors

2. APPROVAL OF AGENDA

Ms. French moved to approve the agenda as presented. Her motion was seconded by Ms. Fisher and passed by voice vote.

3. APPROVAL OF CONSENT AGENDA

Ms. French said she reviewed the minutes and they appear to be in order and moved to approve the consent agenda. Mr. Reynolds seconded and the motion passed without opposition.

4. CURRENT BUSINESS

A. Chief Investment Officer's Report

1. Updates

PERA CIO Jon Grabel said that given the advanced timing of this meeting, the monthly performance report is not prepared. He outlined the 15-day process to prepare a monthly report. The fund performance for the first fiscal quarter for FY17 was rather strong; however, October will show a loss in excess of 1 percent.

Investment staff has discussed the uncertainty following the election and anything said would be speculation on speculation. He mentioned three scenarios that staff contemplated: a slightly higher growth environment, a no-growth environment, and a recessionary situation with lower government inflows/less tax revenues making it harder to stimulate growth. Economic political forces are not in play just in the United States: they are in play globally. There is rising nationalism and populism around the world -- Brexit, regime change, etc. Historically the political risk that had been considered when developing portfolios was less about developed markets and more about emerging markets. He opined that was no longer true. Political risks exist today globally. He reminded the Committee that managing a pension is not a confidence game and it is "foolish, arrogant, dangerous" for anyone to suggest they can see into the future. Scenario testing is constructive and helpful especially in today's environment.

Mr. Grabel provided the following updates:

- RFP: Illiquid Investment Consultant. The evaluation committee is scheduling finalists visits and a recommendation is expected after those visits. The REIT RFP was issued last week and there have been 40 acknowledgements by firms interested in participating
- The VAR (value at risk) inched up during September. Globally equities' contribution to risk is coming down

B. <u>Action Items</u>: 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 $75 Million to NM PERA RCP Small Cap PE Fund I, LP

[*Exhibit 1: Staff recommendation re: RCP; Exhibit 2: Cliffwater Report; Exhibit 3: RCP Report*]

LeAnne Larrañaga-Ruffy, director of equity, this fund of one will seek to invest in small and/or emerging private equity managers. This is defined as a private equity manager raising our first or second fund with AUM of less than $250 million. This is a joint venture with two state pension funds – a $10 billion fund and a $100 billion fund. This fund of one is similar to the one that PERA has with PineBridge.

RCP will serve as the facilitator using their platforms and relationships to source these funds. RCP has 15 years in the market and will target first or second funds which will create a long-term relationship with access to future funds.

Ms. Larrañaga-Ruffy identified how this investment fit within PERA's strategic asset allocation plan. She noted that the global equity portfolio should reach its target by early 2017. RCP fits well within PERA's portfolio with US buyouts in the lower/middle market.

Cofounder of RCP Charlie Huebner said they are an independent, employee-owned, private equity, fund of funds advisor, co-investment and secondary manager. The firm has a focus on the North American small to middle market sector. They make 15 manager selections a year and have been doing so for 15 years with extraordinary performance.

RCP's investor base is global with 2/3s in the US. The investment philosophy that runs through all of RCP's activities is that smaller capitalization buyouts can produce superior returns to investors relative to other sectors within the private equity asset class. RCP has noticed that there is particular benefit in getting in early. This program doubles down on the strategy that RCP has practiced for the past 15 years looking for newer managers in their earlier years. Higher opportunities can carry higher risk with smaller managers carrying greater organizational risk. He noted that this was not a fund of funds product.

Mr. Huebner said the goals of this program will be financial and strategic. With a lot of liquidity in the market, access is very difficult and RCP has the ability to capture managers when they are embarking on what he said should be their best performance.

Mr. Huebner noted that RCP is doing this without a management fee and strictly on a 10 percent carry over a 10 percent preferred return. Although it is unusual for the market, RCP determined this was the direction they wanted to proceed in this program. RCP is paid when the portfolio performs.

In response to Ms. French's question regarding Cliffwater's involvement in this review, Mr. Feidler said Cliffwater has known RCP for a few years. Ms. Larrañaga-Ruffy said PERA staff frequently talks with Cliffwater consultants Feidler and Zadra about investments.

Mr. Grabel confirmed that PERA always looks at more than one manager for any given mandate.

Ms. French moved to recommend a commitment of up to $75 million to RCP Advisors to manage a dedicated fund to invest in small, emerging private equity partnerships, to be funded according to PERA's cash plan, subject to approval of legal documentation by General Counsel. Ms. Naranjo Lopez seconded and the motion passed without opposition. [Mr. Reynolds was not present for this action.]

2. Recommendation to extend Professional Services Agreement No. 090600041 through March 31, 2017, for Active US REIT Investment Management Services provided by LaSalle Investment Management, LP

Kristin Varela, portfolio manager of real assets, said the request before the Committee is for a short-term contract extension between PERA and LaSalle. LaSalle's contract expires December 31st and in order to have adequate time to conduct a competitive and thorough RFP process for REIT investments, staff is requesting a three-month extension. LaSalle's contract with PERA is nearing its maximum allowable eight-year term.

PERA has issued an RFP for Global and US REIT investment management services with a submission deadline of December 12, 2017.

Ms. French introduced a motion to recommend to the Board an extension for the PSA #0960600041 with LaSalle through to March 31, 2017. Her motion was seconded by Ms. Naranjo Lopez and passed without opposition. [Mr. Reynolds was not present for this action.]

D. Q1 FY17 Performance Review
[*Exhibits 4 & 5: Wilshire reports*]

Tom Toth, Wilshire, said Wilshire was keeping their eyes on a couple of "planks" since the elections and considering the likely impact they might have on the economy, capital markets, interest rates, etc. Managing the portfolio in an uncertain environment is different from the rhetoric of the campaign and what capital markets actually do. Diversification within the portfolio is considered the primary hedge against any one particular outcome.

Mr. Toth pointed out that there is an across the board low return environment.

Expectations for equities globally are under 6.5 percent. Inflation has crept up 5 basis points and continues to go up as inflation expectations continue to increase since the election. There was a robust consumer sentiment before the election. Unemployment is sub 5 percent, below what economists refer to as the "natural rate" of unemployment. Debt appears to be normalizing and showing a decrease.

Mr. Toth reviewed a chart that showed what happened to equity markets through past tightening cycles. Generally, equity markets have been positive during the 12 cycles depicted in the chart. Equity markets may be repriced and will likely go down. Managing that volatility was one of the key goals of the SAA work.

He referred to a global increase in fiscal stimulus. The market expectations, across the major economic zones, show the evolution and expansion of the Eurozone in Japan and at the end of 2018 the short-term interest rate in the Eurozone is expected to be negative 40 basis points and in Japan negative 15 basis points. The market expectations are materially different from what the Federal Reserve is saying.

Referring to the investment performance review, Mr. Toth pointed out that there still exists a mismatch between the current portfolio and the target portfolio. That mismatch is going to drive the relative performance for the total fund versus the benchmark to a much higher degree than any particular manager or investment structure. Through 9/30/16, there was a strong period in the market outperforming the policy which relates to PERA's overweight in equities. The total fund composites were shown in the new template which aligns with the SSA class buckets. Credit oriented fixed income from an absolute return perspective has been a challenged environment and has underperformed. The credit oriented fixed income portfolio is intentionally designed with a lower risk profile than the policy index.

E. Low Volatility Equity Update and Implementation Plan

Ms. Larrañaga-Ruffy reminded the Committee that the new SAA was approved in April and global low volatility (low-vol) equity was added to the global equity portfolio at 4.4 percent or approximately $700 million. In June, the Board approved the global equity implementation plan. BlackRock was approved as the transition manager to implement the mandate passively and gain exposure prior to the RFP process. She highlighted the purpose of the global low volatility equity is to reduce sensitivity to market volatility. General Mills, Procter & Gamble, and Colgate were provided as examples of lower volatility equities with stable earnings and strong balance sheets.

Mr. Toth reviewed comparisons of the low-vol relative to the broad market cap weighted index indicating that low-vol has outperformed on a risk adjusted basis and in most cases moderately outperformed. While Wilshire expects the returns to be fairly similar to market cap rated returns, they do expect less risk. He reviewed the upside and downside relative to the benchmark returns that the low-vols capture. Low-vol indexes have a lower standard deviation relative to market cap weighted; hence, there is a reduction in global equity volatility. Given the environment, Mr. Toth said there should not be a strict reliance on low volatility to generate returns. He explained how the strategy works with buy-write approach and said they tend to do well when realized volatility is lower than what was forecast.

Ms. Larrañaga-Ruffy said the global equity transition is in step five of nine in the process and is expected to be completed by the end of the first quarter 2017. BlackRock will have fully implemented the global low vol passive mandate by the same time. It is anticipated the mandate will include active and passive portions. MQs of the RPF will be presented to the Board in January 2017 and the RFP for the active portion issued in February. She noted that PERA has relationships with the largest index managers and will be able to implement the passive portion in a cost effective manner.

Mr. Reynolds asked whether writing options had been presented to the Board and Mr. Toth responded this was the initial introduction. He said the option writing has not been decided as part of the portfolio and is instead presented as part of its consideration and would be evaluated for product fit within the total portfolio.

Mr. Grabel said this is not staff or Wilshire sitting at a terminal selling or writing option contracts. The strategy would be to retain a manager who specializes in that to act on PERA's behalf. There are managers currently in PERA's portfolio that write, sell, and buy various option strategies.

Mr. Reynolds requested additional information on its contribution to reducing volatility.

Mr. Grabel noted that the equity composite includes a low volatility component.

5. OTHER BUSINESS

Ms. French mentioned an article in the *Albuquerque Journal* and thanked Mr. Grabel for his complimentary comments regarding the PERA fund.

6. ADJOURNMENT

Having completed the agenda, Vice Chair Mayfield declared this meeting adjourned at 11:40 a.m.

Approved by:

Dan Esquibel, Chair
Investments Committee

ATTEST:

Wayne Propst, Executive Director

Attached Exhibits:
Exhibit 1: Staff recommendation re: RCP
Exhibit 2: Cliffwater Report
Exhibit 3: RCP Report

Exhibits 4 & 5: Wilshire reports