NEW MEXICO

PUBLIC EMPLOYEES RETIREMENT ASSOCIATION

INVESTMENT COMMITTEE

November 29, 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 followed the Pledge of Allegiance and indicated the presence of a quorum as follows:

Members Present:
John Melia, Chair
Dan Mayfield, Vice Chair
Dan Esquibel
James Maxon
Jackie Kohlasch

Member(s) Absent:
None

Other Board Members Present:
Loretta Naranjo Lopez
Claudia Armijo
Cathy Townes
Tim Eichenberg

Staff Members Present:
Wayne Propst, Executive Director
Susan Pittard, Chief of Staff/General Counsel
Dominic Garcia, Chief Investments Officer
Karen Risku, Deputy General Counsel
Renada Peery-Galon, Administrator Services Director
Greg Trujillo, Deputy Executive Director
Kristin Varela, Deputy CIO
Joaquin Lujan, Portfolio Manager
Trish Winter, Executive Assistant
LeAnne Larrañaga-Ruffy, Director of Equity
Christine Ortega, Portfolio Manager
Anna Williams, Chief Financial Officer
Anna Murphy, Portfolio Manager
Emily Lopez, Financial Specialist
Mark Montoya, Investments Department
Isaac Olaoye, Investment Analyst
Frank Mihail, Investment Department

Others Present:
Tom Toth, Wilshire Associates
David Shulman, Senior Economist, UCLA
Jason Brady, President & CEO, Thornburg
Bob Jacksha, CIO, NM Education Retirement Board
Lenora Chavez, Retiree
Paul Lium, Nationwide
Carter Bundy, AFSCME

2. Approval of Agenda

For the record, Ms. Naranjo Lopez said she was not involved in the development of agenda item F and wanted it replaced with a request that all PERA investment staff, the Executive Director and the General Counsel produce the last three years of IRS Form 1040 Schedule D and individual retirement account annual statements, so the Investment Committee can confidentially review and report in executive session to the full PERA Board whether staff are qualified to invest on behalf of PERA and its members. [*See Exhibit 1 for entire agenda recommendation*]

Mr. Mayfield moved to approve the agenda as published. Dr. Kohlash seconded and the motion passed without opposition.

3. Approval of Consent Agenda

Mr. Mayfield moved to approve the consent agenda and Mr. Esquibel seconded. The motion passed by unanimous [5-0] voice vote.

4. Current Business

A. CIO Update

CIO Dominic Garcia introduced Frank Mihail who will work with the alpha team, and noted that the Investment Division is fully staffed.

CIO Garcia highlighted the strategic goals/performance measures and directions:

- Maintain appropriate strategic asset allocation to meet the actuarial discount rate assumption over the long run
- Work toward a 30-year funding period of unfunded actuarial accrued liability
- Meet 10-year annualized returns to equal or exceed the policy benchmark
- Achieve a total investment cost at or below 85 basis points

Mr. Garcia said three challenges have been identified to meet PERA’s goals:

- Meeting actuarial returns in a low return environment
- Maneuvering through late cycle economy
- Managing liability bulge and burgeoning negative cash flow

In terms of returns on investments, Mr. Garcia said the forecast is for modest to low returns.

B. New Mexico Panel of Experts Discussion on 10-year Investment Outlook
[*Exhibit 2: Shulman's presentation; Exhibit 3: Brady's presentation*]

Mr. Garcia said he invited the panelists to discuss their thoughts about the next 10 years in investing and the challenges for investors. He invited the panelists to introduce themselves.

David Shulman, Senior Economist UCLA Anderson Forecast, stated that 10-year forecasts are very difficult to make.

Jason Brady, CEO of Thornburg Investment Management, who has been involved in the market for the past two decades.

Bob Jacksha, CIO for the past 11 years of the New Mexico Education Retirement Board. Prior to that he served with the NM's State Investment Council and has 35 years of experience in the industry, and is a future PERA retiree.

Mr. Shulman said the forecast has not changed for the past nine months and is considered a 3, 2, 1 world for gross national product growth. Three percent this year, two percent next year and one percent in 2020. The recent forecast by Goldman Sachs, JP Morgan and Morgan Stanley are all similar. When growth is slowed to 1 percent any little thing can knock the economy into recession. With a recession, the recent gyrations in the stock market will look small. The inflation environment is higher than what it was in the past, and experts think it will exceed the Federal Reserve inflation of 2 percent inflation in 2019 and continuing in 2020.

Mr. Shulman mentioned that the forecast did not calculate the huge drop in the price of oil that has taken place in the past few weeks. He noted that making a forecast for 10 years out is difficult when there is a problem at two weeks out.

Long run economic growth appears to be 1.8 percent to 2 percent which has to do with the growth of the labor force and productivity in the economy. The Federal Reserve's number is 1.7 percent to 1.8 percent. The consumer price index has a projection of 2.9 percent for 2019, and if oil stays at $50 a barrel it will drop to 2.4 percent or lower. This will make it very hard to get high returns.

Wages/compensation is increasing, which has implications on domestic corporation profits growing slower than the overall economy. The federal deficit will be more than a trillion, putting pressure on interest rates, which squeezes corporate profits after taxes. In the long-run, the 10-year Treasury could be between 3.75 percent and 4.25 percent.

Jason Brady said he was looking at where investors are within the cycle and what is the discount rate on the US economy. Referring to consumer confidence, Mr. Brady said peaks in confidence tend to correlate to peaks in the cycle, and coincide with recession. He emphasized that past performance does not guarantee future results. In the past 30 to 40 years, there has been a significant increase in foreign ownership of US Treasuries. Japan and China were the main buyers and both of those economies' growth rates are slowing. He discussed how low rates have affected the market. If inflation continues to rise, rate rises are less about a real change and more about an inflationary change.

Mr. Brady said that the return on fixed income is highly correlated with yield.

The return is more challenging and the volatility is more challenging. As long-term holders and investors it may present opportunity. The next 30 years of investing will be very different.

Bob Jacksha, NMERB CIO, quoted either Yogi Berra, Neils Bohr, or Nostradamus, that, "forecasting is difficult especially when it is about the future." ERB's process is similar to PERA in that they work with consultants, actuaries and review what other public plans are doing to determine an investment rate. They conduct asset allocation studies and determined that the probability of reaching 7.25 percent was 48 percent. He was not uncomfortable with the probability and preferred looking at it within a range. All of the predictions are wrong at the end of the day.

Mr. Jacksha mentioned the Fed's quantitative easing program where they bought US Treasuries and MBS and as that goes down it will raise the yield on those assets. However, the price on what is held today will go down.

Ms. Naranjo Lopez asked the panelists whether any had a relationship with staff and Mr. Jacksha knew staff because he has worked for ERB etc. for many years and none had a business relationship.

Ms. Naranjo Lopez asked if there had been a budget for the panelists, and Mr. Garcia said the panelists have volunteered their time.

Mr. Mayfield remarked that PERA has lowered its discount rate several times in the past few years and asked whether 7.25 percent seemed reasonable. Mr. Jacksha said ERB has the same rate and assumes a 48 percent probability. Mr. Shulman said he would consider 6+ percent rather than 7. The risk a pension plan faces when there are outflows and the market goes down is that sales will be made in a down market.

Mr. Jacksha pointed out that the demographics have changed. Young people means growth in the economy and the developed world no longer has a young population. Instead it is an aging population.

Chair Melia asked whether the panelists knew of any experts in their fields who expected the next 10 years to have better returns. They responded in the negative and Mr. Jacksha added that Pimco and Bridgewater have lower forecasts.

Director Propst thanked Mr. Garcia for arranging the panel and said there was consensus regarding the difficulties of investing out of the liabilities. He announced that Bob Jacksha was named one of the top CEO by *Chief Investment Officer Magazine*.

Ms. Naranjo Lopez asked if any of the panelists incurred trouble, regulatory settlements, litigations, and whether their firms belong trade associations, and if so, how much does the firm pay annually and how are the payments justified. Mr. Brady said Thornburg has had clean audits and SEC opinions and no regulatory challenges. He did not have the trade association information with him. Mr. Jacksha said the questions didn't apply because he is with a pension fund. Mr. Shulman said he is at an academic institution and it doesn't apply.

Ms. Armijo thanked Mr. Garcia and the panelists for sharing their expertise. Mr. Maxon agreed.

Mr. Eichenberg said the expertise that Mr. Garcia brought to the table was remarkable and the reason he attended today's meeting.

C. Performance and Risk Update (Q3 2018)

1. Quarterly Market Review

Tom Toth, Wilshire Consultants, pointed out the information is as of September 30th. Over the past few months, markets have turned more volatile. The past three quarters have shown some acceleration in GDP growth. Importantly, that has come at the same time as a continued fall in unemployment. With unemployment below 4 percent, inflation pressures have increased and the Federal Reserve has increased the pace of interest rate increases while reducing the size of their balance sheet. He noted that the Federal Reserve's actions have driven a strong divergence between rates in the U.S. and rates globally. It has been a strong dollar period and more expensive exports are a headwind for U.S. GDP growth. As the dollar strengthens it makes exports more expensive and demand is likely to soften.

Mr. Toth reviewed Wilshire's asset class assumption and noted global equity, 6.5 percent; core bond, 4 percent; and real assets, 2.15 percent. The most recent time period on a year to date basis has been extraordinarily challenging stated Mr. Toth. One challenge has been market breadth, and the vast majority of asset categories are negative on a year to date basis, which is a direct reflection of the discount rate adjustment.

Mr. Toth noted that the numbers for the fourth quarter and the first two months will be challenged. Diversification does work and it is expected that over the longer time period it will benefit the fund.

2. PERA Performance

Anna Murphy, Portfolio Manager, reviewed the portfolio's performance and risk through the first quarter of FY19. She referred to a pyramid that illustrates the total fund risk budget for 2018. The total fund versus the reference portfolio, demonstrated that the actual fund, net of fees, tracked well within expectations and the reference portfolio, and added $200 million in value. Tracking the fund to the policy portfolio shows that while the year has been challenging in terms of diversification because all asset classes experienced negative returns, Ms. Murphy highlighted that the policy benchmark outperformed the reference year to date by 40 basis points. The policy portfolio has more diversification in market exposure than a reference portfolio. As compensation for diverging from the policy portfolio/the active risk has earned the portfolio 1 percent active return.

Ms. Murphy noted that portfolio allocations are in line with the strategic asset allocation and, pre-July 2018, all asset classes were outperforming the policy net of fees. Credit and real assets were the primary contributors to active return. She noted that global equity was hurt by a slight non-U.S. tilt; however, allocation determinations have been made to shift that issue. The relative risk of global equity and risk reduction allocations has allowed some capital preservation in this volatile market. Looking ahead, staff will continue to evaluate how best to position the portfolio for some of the shorter term dislocations.

Chair Melia congratulated staff on generating alpha.

D. Action Item: Benchmarks
[*Exhibit 4: Amended Benchmarks*]

Per PERA's annual work plan that was approved by the Board in January 2018, Kristin Varela, Deputy CIO, said it was the appropriate time to review the benchmarks.

Mr. Toth said benchmarks are meant to convey a clear and objective framework for performance evaluation. He reviewed the process for selecting an appropriate benchmark stating that the benchmark(s) should accurately reflect the types of risk set out in the portfolio.
Mr. Toth identified the benchmark recommended changes explaining that some of the changes are housekeeper/naming convention, more accurately reflects management, reduces currency in the benchmarking, and better tailors the benchmark to PERA's allocations.

Mr. Esquibel moved to approve the benchmark adjustments as recommended. His motion was seconded by Mr. Maxon and passed by unanimous [5-0] voice vote.

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

Ms. Varela highlighted the August cash report, noting that $1 million was paid out in distributions for payment of benefits, of which $63 million came from the investment pool cash account. The cash account is continuously replenished to meet the benefits. September also had a distribution of $1 million with $57 million from the investment pool cash account.

2. Manager Selection Activity Report

Ms. Varela said there have been no changes to the management selection process. The total fund overlay will assist staff in identifying short-term impacts. The risk balance is well within its process and she anticipated a recommendation early 2019. She reviewed the approved emerging market equity allocation to restructure global equity, which included terminating the contracts with two managers due to performance evaluation, reducing the allocation from 8 percent to 4 percent, utilizing the services of Axiom Investors and increasing the allocation to the global low volatility strategy managed by BlackRock.

3. Securities Lending Update – Q3 2018

Ms. Varela said the allocations are in line with the allowable lending limits and the account is closely monitored.

F. Action Item: Proposal to Amend PERA's 5 Year Strategic Goals & Strategic Asset Allocation to Direct Staff to Increase and Concentrate Portfolio Risk to Target 11 percent Return

Chair Melia said PERA Board Chair Maxon requested that Ms. Armijo, Mr. Eichenberg and Ms. Naranjo Lopez be given the opportunity to make a presentation at this meeting. Chair Melia said he reached out to the three. Ms. Naranjo Lopez has suggested that PERA invests its way out of the unfunded liability and not change the benefit structure/COLA. He developed the agenda caption and apologized if it did not accurately reflect what she requested.

Mr. Esquibel said he was not prepared to vote on an item that he has not had an opportunity to research.

Ms. Naranjo Lopez said she was not an investor and this was not her action item. She said that when she was asked to have an opportunity for input, usually staff will contact her and they'll determine whether it requires a budget. She found the agenda item "disturbing" and read her written comments. [*See Exhibit 1*] noting this was an opportunity to look outside the box.

Chair Melia said the comments from the experts today and as staff and the consultants have repeatedly said, "we cannot invest our way out of it."

Mr. Esquibel said Ms. Naranjo Lopez's idea of allowing staff to invest PERA's fund was interesting. Mr. Garcia said currently PERA's portfolio is 100 percent externally invested. The ability to invest internally would require additional staff. Staff is on the path to conduct some internal investing on LP vehicles, and could be co-investing with general partners in separate accounts. He envisions developing private asset investments and perhaps, in the future, public asset investing.

Mr. Maxon said the Board does not have the right to examine personal tax returns of any staff members as Ms. Naranjo Lopez's proposal sought. He noted that the Board is subject to the State's Open Meetings Act and has limits on what can occur in closed session.

Ms. Naranjo Lopez said she disagreed with the notion of following the tenets of Wisconsin's pension plan, and preferred looking at CalPERS. In response to Mr. Maxon's comments, Ms. Naranjo Lopez said she was never given the opportunity to work with staff on her recommendations.

Mr. Esquibel cautioned against attacking the person/staff and rather to focus on the subject matter. He said he has full confidence and trust in staff.

Ms. Townes said Ms. Naranjo Lopez's document [*Exhibit 1*] was deeply offensive to her. The staff is clearly educated and has the appropriate background and credentials for the positions they hold. Moving forward, she hoped the Board would demonstrate better decorum and respect for each other as well as for PERA staff. Too much Board time has been wasted on arguments lacking foundation and putting others down: "You don't elevate yourself by … downgrading someone else."

Ms. Naranjo Lopez said that as part of the Board's fiduciary responsibility it is important to understand staff's qualifications. She repeated that she wants the Board to look outside the box and not look at the same things over and over.

5. Other Business

None was presented.

6. Adjournment

Having completed the agenda and upon motion by Mr. Mayfield and second by Mr. Esquibel, Chair Melia declared this meeting adjourned at 11:55 a.m.

Approved by:

John Melia, Chair
PERA Investments Committee

ATTEST:

Wayne Propst, Executive Director

Attached Exhibit(s):
Exhibit 1: Loretta Naranjo Lopez: Proposed Agenda Item F
Exhibit 2: Shulman's presentation
Exhibit 3: Brady's presentation
Exhibit 4: Amended Benchmarks