

NEW MEXICO
PUBLIC EMPLOYEES RETIREMENT ASSOCIATION
INVESTMENT COMMITTEE

October 26, 2017

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, 33 Plaza la Prensa, Seminar Room, Santa Fe, New Mexico.

1. Roll Call

Roll call occurred indicated the presence of a quorum as follows:

Members Present:

John Melia, Chair
John Reynolds, Vice Chair
Dan Esquibel
Loretta Naranjo Lopez
Jackie Kohlasch

Member(s) Absent:

James Maxon [excused]

Other Board Members Present:

Dan Mayfield, Chair - Retiree
Claudia Armijo - State
Patricia French - Municipal

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
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 Murphy, Compliance Officer
Mark Montoya, Investment Analyst

Others Present:

Tom Toth, Wilshire
Anna Hanika-Ortiz, LFC
Paul Lium, Nationwide
Ron Merriman, Retiree
Harvey Leiderman, Board Fiduciary Counsel

2. Approval of Agenda

Mr. Esquibel moved to approve the agenda as published. His motion was seconded by Mr. Reynolds and passed by unanimous [4-0] voice vote. [Ms. Kohlasch was not present for this action and arrived immediately thereafter.]

3. Approval of Consent Agenda

Chair Melia said he reviewed the minute and found them accurate and complete.

Mr. Reynolds moved to approved the consent agenda and Ms. Kohlasch seconded. The motion passed by unanimous [5-0] voice vote.

4. Current Business

CIO Dominic Garcia thanked the committee for meeting in the seminar room which he hoped would facilitate a robust and collaborative discussion. This is an experiment in team development. This is an open meeting and being recorded. He suggested that the Investments Committee as well as staff may benefit by meeting every other month.

Ms. Naranjo Lopez asked staff to assure that telephonic participation is available in the seminar room. She noted that she recently returned from a three-day seminar where she learned that most trustees were involved in due diligence, RFPs and overseeing investments. Reducing the meetings to every other month concerned her. Mr. Garcia said he looked forward to discussing these items in detail during the afternoon workshop. He encouraged the Committee to focus on high-level strategic issues.

Mr. Esquibel raised concern that the seminar room was not conducive to the public. The room lacks microphones and the live radio output which could decrease transparency.

Deputy Director Trujillo advised the Committee that if today's meeting is successful, the seminar room will be equipped to accommodate all communications. In terms of live video streaming, Mr. Trujillo said the capability is there. Mr. Garcia assured the Board that there was no intent to subvert transparency.

1. Investment Division Updates – September 2017

Deputy CIO Pérez was not present and Mr. Dominic provided the reports. He said the

recent financial environment has been supportive for risk assets: growth assets, stocks and corporate bonds. Inflation continues to be contained below 2 percent in a normalizing interest rate environment while still maintaining an accommodative central bank policy.

During September, equities rallied about 2 percent and corporate bonds rallied at 1 percent; both supportive for the PERA fund.

Mr. Garcia reported that the fund reached an all-time high of \$15.26 billion, an increase of \$72 million from August. He reviewed the asset allocation comparison of actual to target. Real assets continue to be 6.8 percent below the asset allocation target. The overweights are in global equities and risk reduction and mitigation. During September the under- and overweights served the fund well. He reviewed performance noted the total fund returned 80 basis points providing a small value add of 1 basis point. For the fiscal year-to-date, the fund has been strong and added value based on the allocation deviations and active management. The only detractor has been the credit-oriented portfolio which is down 67 basis points.

In response to questions posed by Mr. Reynolds, Kristin Varela, Portfolio Manager of Real Assets, pointed out that the benchmark is primarily liquid exposures – real estate or real assets – and the capital has not been deployed.

Mr. Esquibel referred to a recent article in *The Albuquerque Journal* that said PERA has not reduced any of the overall loss that was incurred in the past. He asked whether there was a way to increase investments to reduce the loss and continue to meet the policy goals in a conservative and safe manner. Mr. Garcia said that ties in with a planned discussion on risk balance. PERA needs to be in the market and take risks to meet the targeted return; the question is whether a portfolio can be developed to mitigate drawdowns and still meet the membership needs. Whether there is a feasible investment solution to help shore up the shortfall will need to be determined with the Committee. While there is no silver bullet, taking more risk is the way to overcome the shortfall; however, that could lead to a greater drawdown.

B. Action Item: International (Non-US) Emerging Market Equity Investment Management Services RFP Recommendation

LeAnne Larrañaga-Ruffly, Director of Equity, thanked Ms. Armijo for her service on the evaluation committee. The reason this RFP was issued was the current manager Aberdeen's 8-year contract expired. She discussed the RFP evaluation process that led to the recommendation to continue to utilize Aberdeen and approve the runner-up Axiom Investors on PERA's bench of approved investment managers.

Referred to the RFP process, Ms. Larrañaga-Ruffly said there were 45 respondents. The evaluation committee along with Tom Toth from Wilshire met and selected three semi-finalists. Following interviews, two finalists were selected for continued review and due diligence.

Ms. Larrañaga-Ruffly said Aberdeen's returns have been very positive.

Mr. Toth confirmed that Wilshire is in agreement with the recommendation as laid out by

staff. Aberdeen has had very strong performance since inception and its organization has deep globally-based resources. Wilshire also agrees with placing Axion Investors as a strategy on PERA's bench without funding. Axion has a growth-orient process compared to Aberdeen which is more value-oriented.

Ms. Larrañaga-Ruffy said PERA will continue to pay the same fee to Aberdeen which is very competitive. Aberdeen has been working under a performance fee since 2009.

Mr. Toth said transition costs for changing managers is "meaningful" which also strengthens the recommendation to stay with Aberdeen. He noted that Wilshire's manager research process is rigorous. Without hesitation, Mr. Toth said, he had no loyalty to any manager.

Ms. Naranjo Lopez requested verification that the recommended manager is under ERISA. Dana David, Assistant Counsel, said the contract is standard and specifically designates that. A series of questions posed by Ms. Naranjo Lopez regarding compliance were answered in the positive and as far as liquidity constraints, Mr. Toth said there were no long lock up periods or inabilities for PERA to assess capital.

Ms. Armijo said the process was thorough and she felt the correct recommendation was made.

Mr. Esquibel moved to recommend to the Board that PERA continue to utilize the investment management services of Aberdeen Standard Investments for the emerging market equity mandate, which is approximately 1 percent of the total fund and to approve Axion Investors as a secondary strategy, to remain on PERAs bench of approved investment managers for possible utilization of services in the future, and as approved by the Board. Ms. Naranjo Lopez seconded and the motion passed by unanimous

C. Chief Investment Officer's Report
1. Investment Concept Introduction

Mr. Garcia said his CIO reports will focus on the large strategic topic and market observations. This month the focus will be on key investment topics: reference portfolio and risk balance. A reference portfolio is a simple passive allocation to stocks (60 percent) and bonds (40 percent). A policy portfolio is the asset allocation target. An active portfolio is the deviation away from the target asset allocation portfolio. The question is whether PERA's portfolio provides added value from the reference portfolio.

Mr. Toth said the reference portfolio is a comparison tool that assists in determining whether the utilization of additional assets classes gains value.

Mr. Esquibel brought up management base fees and suggested PERA's contracts be reworked so managers are only paid when they beat the benchmark. Mr. Toth said staff has worked hard to reduce the cost of implementation and is always looking to negotiate better fees. It is the manager's expertise that PERA is seeking rather than just low fees.

Ms. French recalled that former Board member Victor Montoya would grill managers that were not making PERA money yet still earning a fee.

Comparing the reference portfolio, Mr. Toth said the benchmark portfolio has a reduced expected risk with the same expected return; the policy/beta portfolio has a higher expected return and slightly higher risk and the total alpha/beta portfolio has a higher expected return attributed to value from active management and a higher level of risk.

Using a graph showing the growth of a dollar invested over a 10-year period and charting the reference portfolio, PERA's policy benchmark and PERA's fund, Mr. Garcia said the question is whether the decisions that PERA made over that period added value and performed better than the reference portfolio. It did not. The total PERA results over that period have underperformed/detracted value compared to the policy portfolio and reference portfolio.

Chair Melia said "we can't have these results again." Mr. Garcia agreed that the results are not acceptable adding what has detracted has been PERA's process or decision making ability to implement the policies. He said "what gets measured, gets managed." PERA needs to question its methods and review its governance model and decision making as well as define roles.

Pointing out that PERA has changed its asset allocations and lowered its rate of return, Ms. French asked what can be done immediately. Mr. Garcia said aside from everyone improving their tasks, decision making and governance models need to change. He said these issues will be developed further during the afternoon study session with Harvey Leiderman, Board fiduciary counsel. The portfolio has not been optimized because of implementation. Bottom line, staff and the Board are risk managers.

Ms. Armijo said what is needed is more information supported by facts to flesh out the "why" of the underperformance.

Mr. Garcia said the RFP process does not add value. Determining the macro and micro issues and who participates in each is essential.

Mr. Leiderman said he looked forward to the afternoon session where many of the questions coming forward can be addressed with observations.

Ms. Naranjo Lopez said she respected the intent of meeting in this room as expressed by Mr. Garcia but she didn't agree. She added that holding an Investment meeting every other month was not acceptable.

In regards to risk balance, Mr. Garcia said it is important to consider how stocks and bonds contribute to the overall risk.

Mr. Toth said while a 60 (stocks)/40 (bonds) portfolio seems diversified from a dollar allocation, most of the risk contribution comes from stocks. PERA's current portfolio has a better risk balance than the 60/40 with 70 percent of the risk from global equity, 17 percent from

real assets and 11+ percent from the credit and a small portion from risk mitigation. PERA's portfolio should hold up better in periods of equity market difficulty with a reduced vulnerability. Identifying when growth is high what assets do well and are there assets that can protect the fund when growth is low is an important task.

Mr. Garcia referred to a graph showing the rolling 10-year return over 40 years of the different asset class returns. Until 2008 stocks, bonds and even cash were doing well and the reference portfolio was meeting the target returns. The last 10 years have been very challenging.

Concluding this review, Mr. Toth noted that risk balanced portfolios are less concentrated in a single risk and are less dependent on a single favorable economic environment, risk balance investing requires a long-term perspective since investors will deviate from their peers.

2. Other Updates

Mr. Garcia said PERA has rescinded one of its previously recommended redemptions.

5. Other Business

None was presented.

6. Adjournment

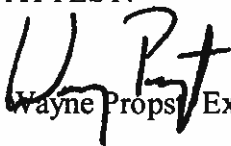
Having completed the agenda and upon motion by Mr. Reynolds and second by Ms. Kohlasch, Chair Melia declared this meeting adjourned at 11:25 p.m.

Approved by:



John Melia, Chair
PERA Investments Committee

ATTEST:



Wayne Probst, Executive Director