ACTION SUMMARY

INVESTMENT COMMITTEE

January 18, 2018

Item	Action	Page #
APPROVAL OF AGENDA	Approved	3
APPROVAL OF MINUTES		
December 7, 2017	Approved	3
BLUE BAY DIRECT LENDING FUND III	$100 million (USD)	3
QUARTERLY REVIEW OF CONTRACTS		
ISS Proxy Research & Voting Contract ext.	Approved	5
ISS Litigation Filing contract ext.	Approved	6
Beach Point contract continuation	Approved	6
ICE Canyon contract continuation	Approved	7
Wilshire Atlas contract continuation	Approved	8
Bloomberg contract continuation	Approved	8
Legal contracts extension	Approved	9
Q4 PROXY VOTING REPORTS	Accepted	10
Q4 COMMISSION REPORTS	Informational	10
POSSIBLE LEGISLATION	Discussion	10
OTHER REPORTS AND DISCUSSION	Informational	10

MINUTES OF THE

NEW MEXICO EDUCATIONAL RETIREMENT BOARD

INVESTMENT COMMITTEE

January 18, 2018

1. a. CALL TO ORDER

A meeting of the New Mexico Educational Retirement Board Investment Committee was called to order on this date at 2:00 p.m. in the Educational Retirement Board Conference Room, 6201 Uptown Boulevard, N.E., Ste. 203, Albuquerque, New Mexico.

Members Present:
Mr. H. Russell Goff, Chair
Ms. Mary Lou Cameron [by telephone]
Mr. Larry Magid

Members Excused:
None.

Staff Present:
Ms. Jan Goodwin, Executive Director
Mr. Bob Jacksha, CIO
Mr. Mark Canavan, Real Estate Portfolio Manager
Mr. Steve Neel, Deputy CIO, Alternative Assets
Ms. Kay Chippeaux, Deputy CIO, Public Securities & Credit
Mr. G. Alan Myers, Public Securities & Debt Portfolio Manager
Mr. Aaron Armstrong, Portfolio Manager
Mr. Rod Ventura, General Counsel
Ms. Norma Henderson, CFO

Others Present:
Mr. Allan Martin, NEPC
Mr. Oliver Fadly, NEPC [by telephone]
Ms. Judith S. Beatty, Recorder

b. Approval of Agenda

Ms. Cameron moved approval of the agenda, as published. Mr. Magid seconded the motion, which passed unanimously.

c. Approval of Minutes: December 7, 2017

Mr. Magid moved approval of the December 7, 2017, minutes, as submitted. Ms. Cameron seconded the motion, which passed unanimously.

d. Introduction of Guests

Chairman Goff welcomed staff and advisors.

2. BLUE BAY DIRECT LENDING FUND III – OPPORTUNISTIC CREDIT

[Presenters: Kay Chippeaux, NEPC consultant Allan Martin, and NEPC research analyst Oliver Fadly, who was on the telephone.]

Ms. Chippeaux presented staff's recommendation of a $100 million commitment to BlueBay Direct Lending Fund III (levered, US dollar denominated). She said the firm came before the Investment Committee in 2015 as one of the finalists for the emerging market debt mandate. Although Blue Bay wasn't selected at the time, staff has kept in touch with BlueBay, which is now coming to market with a direct lending fund that is 100 percent European.

Ms. Chippeaux said this particular fund focuses on midmarket companies exclusively in Europe, which is within the NMERB's thesis of moving more directionally to Europe. She added that staff likes direct lending, but is not as optimistic about it in the U.S. as they are in Europe. She commented that Europe still has a lot to do with the banks; they are still deleveraging and there are more Basel regulatory requirements coming up that they will all have to conform to. Many of these middle market companies in Europe don't have access to the public markets, so are looking for private solutions to their financing needs.

Ms. Chippeaux stated that adding BlueBay to the opportunistic credit portfolio would increase the NMERB's allocation to Europe and to direct lending, which is where some of the better opportunities are today. The NMERB's credit portfolio is at 18.4 percent right now. The current target is 18 percent, and staff feels that this drawdown style fund will help maintain the weighting at around 18 percent.

Ms. Chippeaux said BlueBay has disclosed the use of a corporate affiliate. The Royal Bank of Canada owns BlueBay, and Charlie Byrne (one of the presenters today), who works for the Royal Bank of Canada, brought this deal to the NMERB.

Ms. Chippeaux noted that BlueBay fund is on NEPC's Preferred list.

Mr. Martin said NEPC has revised its capital market outlook and will be discussing it in an upcoming workshop. NEPC sees direct lending in Europe as a bigger opportunity than in the U.S. The U.S. is nine years into an economic recovery, while Europe is much earlier in the process. Because Europe is now experiencing accelerated earnings growth, the result of loans being paid back by companies, there is a good opportunity to invest.

Mr. Fadly discussed additional background on BlueBay. He said it is important to work with established "tier one" lenders, and NEPC sees BlueBay as best in class in that tier. He said NEPC underwrote BlueBay's last fund in 2015, and before that spend 18 months doing due diligence both here and in London. Not only have they been consistent in their pricing, but they have also been very consistent in their underwriting. NEPC likes their conservative approach.

Mr. Fadly said NEPC likes BlueBay's sourcing engine, and the direct lending team uses its personal network and the BlueBay network to originate deal flow.

Mr. Fadly noted that BlueBay Direct Lending Fund II, a 2015 vintage fund, earned a net IRR of 9.2 percent.

Mr. Magid asked Mr. Fadly to discuss the increase in fund size from €2 billion to €3 billion. Mr. Fadly responded that they are still funding deals from Fund II and have upsized the team. Although they lead most of the deals, they now can take bigger portions and do not have to split it or sell some off to another firm. NEPC is comfortable with the increased fund size based on the pace of deployment, the increased size of the team and the fact that they can hold a deal themselves.

Ms. Chippeaux introduced BlueBay representatives Charlie Byrne, Ben Harrild and Danielle Hootnick, who made a presentation.

Responding to Ms. Chippeaux, Mr. Harrild stated that Italy is not a core geography for BlueBay, as the credit protections there are weaker than in Spain and France. Spain will be a part of Fund III; they have done 7 percent of the risk in Fund II so far, and that is probably a reasonable expectation for Fund III. In terms of the size of the companies in Fund III versus Fund II, BlueBay is noticing an increasing awareness of what private debt can bring to the market. As they see an increasing awareness, they are seeing larger companies.

Ms. Goodwin asked what BlueBay is doing to improve diversification of its staff. Mr. Harrild acknowledged that they do not have many females on the investment team. While they are conscious of the importance of finding the best candidate, they recognize the need to improve diversity. Across the business, however, diversity is "good."

Mr. Harrild noted that the BlueBay team has invested a substantial amount of their own money in this strategy; across four funds, they have collectively invested €22 million.

Mr. Harrild commented that the team spends a lot of time on loan review and loan documentation in the investment process, and negotiate the loans themselves. This includes putting in place appropriate covenants when the risk in a loan is elevated. He added that they are seeing the emergence of "cov-lite" in the leveraged loan market, where there are no covenants in place at all.

[Representatives left the room.]

Mr. Jacksha said Ms. Chippeaux has been in touch with BlueBay for a number of years and knows them well.

Ms. Chippeaux said she really likes BlueBay because of their thorough due diligence from the ground up, and their focus on covenants, and following through on compliance with covenants, is important. She said they have a separate portfolio monitoring team, which is also important, and they regularly follow up on companies.

Ms. Chippeaux said staff and NEPC are recommending approval for the leveraged, U.S. dollar-denominated fund.

Ms. Cameron moved that the Investment Committee approve a commitment of $100 million to BlueBay Direct Lending Fund III (levered, USD-denominated) for the Opportunistic Credit Portfolio. The commitment is subject to New Mexico State Law, Educational Retirement Board policies, Educational Retirement Board approval for placement agents and negotiation of final terms and conditions, and completion of appropriate paperwork. Mr. Magid seconded the motion, which passed unanimously.

3. QUARTERLY REVIEW OF CONTRACTS

a. Institutional Shareholder Services Proxy Research & Voting contract extension

[Presenter: Alan Myers]

Mr. Myers said Institutional Shareholder Services, Inc. (ISS) provides proxy services, and the NMERB's proxies are voted automatically for the S&P 500 and S&P 400. Exceptions between the NMERB Investment Policy and ISS recommendation require a manual vote by NMERB. In those cases, ISS refers the proxy to the NMERB for review and a manual vote. He said ISS provides the NMERB with their research into each one of the proxies and each one of the votes on the proxy, and they do a fairly in-depth analysis of each one of those issues. The Investment Committee reviews the proxy voting reports on a quarterly basis.

Mr. Myers said the NMERB has used ISS's proxy services since 2010 and would like to continue this contract. The NMERB extended the contract for two years in 2012, and then for four years in 2014. The current contract expires in March 2018.

Mr. Myers said the maximum amount for this contract is $50,000 annually; however, last year, the NMERB only paid $18,000 in fees.

Mr. Magid moved that the Investment Committee authorize the extension of the contract with Institutional Shareholder Services, Inc. for proxy services for a term of up to four years with the right to cancel upon 30 days of notice, subject to, and contingent upon, New Mexico State Law, Educational Retirement Board policies, and negotiation of final terms and conditions and completion of appropriate paperwork. Ms. Cameron seconded the motion, which passed unanimously.

b. Institutional Shareholder Services Litigation Filing contract extension

[Presenter: Alan Myers]

Mr. Myers stated that Institutional Shareholder Services, Inc. (ISS) provides securities class action services on all of the NMERB's holdings by external managers as well as the internal portfolios that the NMERB manages, and files claims on behalf of NMERB regarding class action litigation for which the NMERB is eligible in the U.S., Canada and the Netherlands. When ISS sees an issue in a country that is not part of this group, they will notify the NMERB of any class action being carried out by other legal firms and provide the background and contact information so that the NMERB can follow up through its general counsel to decide whether it wants to become part of those services.

Mr. Myers said the NMERB contracted with ISS for services in July 2014 for an initial two-year period, which was subsequently extended for an additional two years. The current contract expires on June 30, 2018. The fee cannot exceed $70,000 per year, but for the last fiscal year, total charges were $35,000.

Mr. Myers said ISS has effectively and efficiently filed claims for all relevant class actions, and has distributed monetary settlements to the NMERB in a timely manner. Their reporting is comprehensive and informative, and he would recommend approval to extend the contract for a term of up to four years.

Mr. Magid moved that the Investment Committee authorize the extension of the contract with Institutional Shareholder Services, Inc. for securities class action services for a term of up to four years with the right to cancel upon 30 days of notice, subject to, and contingent upon, New Mexico State Law, Educational Retirement Board policies, and negotiation of final terms and conditions and completion of appropriate paperwork. Ms. Cameron seconded the motion, which passed unanimously.

c. Beach Point contract continuation

[Presenters: Kay Chippeaux and NEPC advisor Allan Martin]

Ms. Chippeaux said staff is recommending that the Investment Committee approve the continuation of the limited partnership agreement with Beach Point SCF I LP for another four years. Beach Point manages the account primarily in high yield bonds, senior bank loans and distressed debt, and occasionally invests in some equity.

Ms. Chippeaux said Beach Point is the NMERB's largest single manager in the entire portfolio and has been managing money for the NMERB since March 2004. In the past three years, from the original $500 million investment, the NMERB has withdrawn almost $260 million, and that investment is still well over $500 million in the portfolio. She said staff has been very happy with Beach Point's performance and advice, and is requesting approval to continue this contract.

Mr. Martin said several of his more sophisticated clients have been with Beach Point for a long time, and they have been very good partners.

Mr. Magid moved that the Investment Committee authorize the continuation of the limited partnership agreement with Beach Point SCF I LP for an additional four years, subject to, and contingent upon, New Mexico State Law and Educational Retirement Board policies. Ms. Cameron seconded the motion, which passed unanimously.

d. ICE Canyon contract continuation

[Presenter: Kay Chippeaux and NEPC advisor Allan Martin]

Ms. Chippeaux said the NMERB relationship with ICE Canyon began in June 2012 with investments in two different products—the ICE Canyon Global Credit Fund and the ICE Canyon Global Credit Alpha Fund. The Global Credit Fund looks at global credit opportunities, but their focus is on market dislocation and inefficiencies, while the Global Credit Alpha Fund has offered more idiosyncratic opportunities but is now in its harvest phase. Over the years, ICE Canyon has had some struggles with their performance, particularly in 2014. NEPC visited with them at the time and agreed with the NMERB that it should stay invested, and ICE Canyon is now starting to recover from their 2014 underperformance and has had a great year.

Ms. Chippeaux reviewed the schedules prepared by NEPC showing cumulative over/(under) performance compared to the benchmark from July 2012 through Q3 2017. Combined performance since inception of the two funds through November 30, 2017, is 4.0 percent against the asset class benchmark (50 percent Credit Suisse Leveraged Loan Index/50 percent Bank of America Merrill Lynch U.S. High Yield BB-B Rated Constrained Index) return of 5.9 percent. She commented that there have been times in the past when they did not do so well, but in the last year have done very well, and staff therefore feels that now is not a good time to pull out of this fund.

With respect to performance, Mr. Martin said NEPC felt that ICE Canyon had been out of phase with the market cycle and it was a market phenomenon that is now correcting. Their performance in the one-year period is now at 22.8 percent, so NEPC is comfortable with them.

Ms. Chippeaux also noted that ICE Canyon has asked the NMERB to consolidate its Global Credit Fund with their flagship hedge fund because NMERB is the primary investor left in this fund. ICE Canyon states that there will be no change in investment strategy and the two funds have been run pari passu to each other. Staff and NEPC are in favor of this, and NMERB legal counsel is reviewing the documents and comparing the terms.

Ms. Cameron moved that the Investment Committee authorize the continuation of the limited partnership agreement with ICE Canyon for an additional four years, subject to, and contingent upon, New Mexico State Law, Educational Retirement Board policies, and negotiation of final terms and conditions and completion of appropriate paperwork. Mr. Magid seconded the motion, which passed unanimously.

e.<u>Wilshire Atlas contract continuation</u>

[Presenter: Alan Myers]

Mr. Myers said staff is recommending that the Investment Committee approve the continuation of service under the current licensing agreement with Wilshire for their Atlas product, an integrated equity portfolio analytics system with databases for market price and reference data, for a period of up to four years, renewable annually. The NMERB has been with Wilshire since 2007. It was extended in March 2014 and will expire in March 2019.

Mr. Myers said Investment staff uses this product to optimize the S&P 500 and the S&P 400 passively managed portfolios by comparing the actual holdings' weights to the benchmarks' weights for each portfolio. The portfolio manager then determines which securities and the quantity of securities to buy or sell. The threshold for trading is 3 basis points.

Mr. Myers said the current license fee is $38,295 per year with each additional license billed at $3,500 per year.

Mr. Magid moved that the Investment Committee approve the continuation of the license for Wilshire Atlas for a period of up to four years, renewable annually, subject to, and contingent upon, New Mexico State Law and Educational Retirement Board policies. Ms. Cameron seconded the motion, which passed unanimously.

f. Bloomberg contract continuation

[Presenter: Kay Chippeaux]

Ms. Chippeaux said staff is recommending that the Investment Committee approve the continuation of service under the current agreement with Bloomberg for financial information services for a term of up to four years. She said the NMERB has had an open-ended agreement with Bloomberg to provide financial information services for many years through its proprietary computer system. Bloomberg is considered a sole source provider, as there is not another entity providing the depth of information and analytics for portfolio management.

Ms. Chippeaux said current fees for nine terminals and service are approximately $205,000 per year.

Ms. Cameron moved that the Investment Committee approve the continuation of service under the current agreement with Bloomberg for financial information services for a term of up to four years, subject to, and contingent upon, New Mexico State Law and Educational Retirement Board policies. Mr. Magid seconded the motion, which passed unanimously.

g. Legal contracts extension

[Presenter: Rod Ventura]

Mr. Ventura presented staff's recommendation that the NMERB extend the existing contracts for investment legal services with Foster Pepper PLLC and K&L Gates LLP. Foster Pepper has been supplying legal services since 2006 and K&L Gates has had a contract with the NMERB since 2010. In February 2014, the Investment Committee approved the RFP method of procurement for legal services. After the Legal and Investment Departments evaluated the responses received, the Investment Committee approved four-year contracts with both firms. These contracts expire on June 30, 2018.

Mr. Ventura said Legal staff and Investment staff agree that both Foster Pepper and K&L Gates provide good services to the NMERB. Over the years, the NMERB has developed best practices with them, and they are quick and very responsive.

Mr. Ventura stated that, in the last three fiscal years, Foster Pepper had averaged $485,000 in annual fees, and K&L Gates had $155,000 of annual fees.

Mr. Jacksha said the major disadvantage of trying to find new law firms would be that if the NMERB switched, it would essentially have to train a new firm to become familiar with New Mexico law and issues important to the NMERB. There is a very steep learning curve. He said he would like to stay with these firms because they have been providing very good service.

Ms. Cameron moved that the Investment Committee authorize the extension of the legal services contracts for both Foster Pepper PLLC and K&L Gates LLP for an additional four years, subject to, and contingent upon, New Mexico State Law, Educational Retirement Board policies, and negotiation of final terms and conditions and completion of appropriate paperwork. Mr. Magid seconded the motion, which passed unanimously.

[Break.]

4. Q4 2017 PROXY VOTING REPORTS

Committee members reviewed the reports and found no outstanding issues.

Mr. Magid moved acceptance of the Proxy Voting Reports. Ms. Cameron seconded the motion, which passed unanimously.

5. Q4 2017 COMMISSION REPORTS

[Informational.]

6. POSSIBLE LEGISLATION

Mr. Jacksha reviewed draft legislation that would provide for an investment-performance-based framework for the compensation of PERA and NMERB investment staffs and exempting those agencies' investment staff positions from the State Personnel Act.

7. OTHER REPORTS AND DISCUSSION

Mr. Jacksha reported that finalist interviews for Operations Supervisor have been conducted and a selection made.

Ms. Chippeaux said she was pleased to report that Suhada Thanikkatt recently joined staff as a Fixed Income Analyst.

Mr. Jacksha said preliminary figures for December show a .6 percent return, or 6 percent for the fiscal year to date and 13.5 percent for the 2017 calendar year.

Mr. Martin commented that, while equities are having their day and a 60/40 plan is expected to bring in somewhat higher numbers, the NMERB will do well against very diversified lower risk funds. He said there have been nine consecutive quarters of positive U.S. equity returns. Mr. Jacksha said the NMERB's new target in equities is 33 percent; however, it is overweight right now at 37 percent.

8. NEXT MEETING: THURSDAY, FEBRUARY 15, 2018

The meeting was set at 2:00 p.m.

ADJOURN

Its business completed, the Investment Committee adjourned the meeting at 4:15 p.m.

Accepted by:

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H. Russell Goff, Chairman