ACTION SUMMARY

INVESTMENT COMMITTEE

October 19, 2017

MINUTES OF THE

NEW MEXICO EDUCATIONAL RETIREMENT BOARD

INVESTMENT COMMITTEE

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1. a. CALL TO ORDER

A meeting of the New Mexico Educational Retirement Board Investment Committee was called to order on this date at 1:00 p.m. in the Educational Retirement Board Conference Room, 1596 Pacheco Street, Santa Fe, New Mexico.

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

Members Excused:
None.

Staff Present:
Ms. Jan Goodwin, Executive Director
Mr. Bob Jacksha, CIO
Mr. Steve Neel, Deputy CIO, Alternative Assets [by telephone]
Ms. Kay Chippeaux, Deputy CIO, Public Markets and Credit
Mr. Pete Werner, Fixed Income Portfolio Manager
Mr. G. Alan Myers, Public Securities & Debt Portfolio Manager
Mr. Nathan Sax, Fixed Income Portfolio Manager
Ms. Amanda Padilla, Financial Analyst

Others Present:
Mr. Allan Martin, NEPC
Mr. Sam Austin, NEPC
Mr. Kevin Tatlow, Top Tier
Mr. Carl Boaz, Recorder

b. Approval of Agenda

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

c. Approval of Minutes of 8/24/2017

Ms. Cameron moved approval of the August 24 minutes, as submitted. Mr. Magid seconded the motion, which passed unanimously by voice vote.

d. Introduction of Guests

Mr. Martin introduced Sam Austin to the committee. Mr. Austin recently joined NEPC as partner and member of its Public Fund team, and would be supporting Mr. Martin in working with the NMERB.

Ms. Chippeaux introduced new fixed income portfolio manager Nathan Sax.

2. QUARTERLY REVIEW OF CONTRACTS

a. BlackRock Aladdin Contract Extension

[Presenters: Kay Chippeaux and Pete Werner]

Ms. Chippeaux stated that, under the NMERB Investment Services Procurement Policy, contracts for investment service providers are limited to an initial term of four years with a single contract extension of up to two years. BlackRock will be completing their initial three-year term in January 2018, and investment staff believes it is in the best interests of the fund to grant a two-year extension.

Ms. Chippeaux said staff would like to start bringing these contract renewals forward on a quarterly basis, which would make the process smoother and help staff to keep track of its contracts and doing RFPs on a timely basis. She said Amanda Padilla will be the main point of contact for investment services contracts going forward under this new schedule.

Mr. Werner said the NMERB began a new contract with BlackRock three years ago to provide a portfolio management platform for the new Core Bond Fund. Staff is very happy with the BlackRock Aladdin system. It has had three years to get it implemented and to fully utilize the functionality of the system, which remains very cost effective and is the gold standard in the industry in terms of buy side institutional fund management.

Mr. Werner said BlackRock has agreed to extend the contract for two years under the same terms and cost.

Responding to Chairman Goff, Mr. Werner said that the NMERB has beat the index on a regular basis since implementing the Aladdin system, not only reducing the fees it has had to pay, but also receiving some attention on Wall Street. He commented, "I'd call it a full success."

Ms. Cameron moved that the Investment Committee authorize the extension of the BlackRock contract for the Aladdin license for an additional two years, subject to, and contingent upon New Mexico State Law and Educational Retirement Board policies. Mr. Magid seconded the motion and it passed by unanimous voice vote.

b. <u>Discussion of Custody Bank Contract</u>

[Presenter: G. Alan Myers]

Mr. Myers said the custody bank contract with State Street Bank & Trust expires on June 30, 2018. Staff proposes that the contract be extended for an additional two years, as permitted by the NMERB Investment Services Procurement Policy.

Mr. Myers said NMERB transitioned to State Street in 2014 from JP Morgan. He commented that the NMERB's relationship with State Street has not been trouble free; there are a number of issues, including staff turnover. The additional monies that NMERB is paying to State Street have not resulted in better service; however, staff believes that initiating a search for a new custodial bank is not in the NMERB's best interest at this time and that staff would prefer to sit down with State Street and discuss the NMERB's concerns and negotiate a contract with incentives.

Ms. Goodwin noted that the RFP process is complicated, expensive and time consuming.

Mr. Myers added that there is no Operations supervisor to spearhead any transition to a new manager.

Mr. Martin said there are only four viable competitors, and all of his clients have fired all of these banks at one time or another and have never said that the bank they hired was significantly better than the bank they fired.

Ms. Cameron moved that the Investment Committee recommend the board approve a two-year extension of the custody bank contract with State Street Bank & Trust Company, subject to, and contingent upon New Mexico State Law and Educational Retirement Board policies. Mr. Magid seconded the motion and it passed by unanimous voice vote.

c. <u>PanAgora Contract Continuation</u>

[Presenter: Steve Neel.]

Mr. Neel presented staff's recommendation to reauthorize the NMERB's $215 million commitment to the PanAgora Multi Asset Risk Parity product. The NMERB initially committed to PanAgora in December 2013 with a $155 million commitment. Since inception, PanAgora has generated an approximate 9.5 percent return.

Mr. Neel said Risk Parity is a methodology that aims to balance risk exposures in a given portfolio in order to avoid risk concentration. PanAgora seeks to diversify across assets that perform well in differing macroeconomic or business cycles. Those cycles are inflation and growth cycles where there is a positive economic surprise and a negative economic surprise. He said PanAgora has a platform that has grown to $52 billion in assets under management, of which $11 billion makes up their Risk Parity product.

Mr. Neel noted that this is one of the NMERB's asset classes that may be drawn down to help fund the new asset class of Diversifying Assets.

Ms. Cameron moved that the Investment Committee authorize the continuation of the PanAgora Diversified Risk Multi-Asset Fund, Ltd. Contract for an additional four years, subject to, and contingent upon New Mexico State Law and Educational Retirement Board policies. Mr. Magid seconded the motion and it passed by unanimous voice vote.

3. Q2 PRIVATE EQUITY REPORT

[Presenters: Steve Neel and Top Tier consultant Kevin Tatlow]

Mr. Neel and Mr. Tatlow presented this report, with the following highlights:

- Q2 return was 2.78 percent; one-year return 15.6 percent.
- Since-inception net return of 12.9 percent with a 1.4x multiple.
- Q2 increase in NAV: $17,974,717.
- At quarter end, the portfolio had $3.1 billion in net commitments to 75 private equity funds managed by 44 different managers.

Mr. Neel noted that, over the last year, the NMERB has received more than $250,000,000 in distributions through its private equity platform. In three of the last four quarters, ERB received more in distributions than it paid out in capital calls, which means that the program is very close to becoming self-sustaining.

Mr. Tatlow reviewed highlights from the portfolio.

[Mr. Neel signed off.]

4. PRESENTATION ON CLO EQUITY

Mr. Jacksha and Ms. Chippeaux made this presentation.

Highlights:

-- Most CLOs have similar terms and they are an important source of funding for U.S. non-investment grade companies.

-- Investors can select the place in the capital structure of the deal that meets their risk and return preferences.

-- CLOs use non-investment grade loans, whereas CDOs use asset-backed securities. The structures are similar, but there are some differences.

Ms. Goodwin asked Mr. Jacksha which group of assets is safer.

Mr. Jacksha responded that, structure aside, CDOs were higher rated but they didn't perform as well because of the mortgage meltdown after 2008. Today, it is harder to say which is better, although 10-year cumulative default rates show that CLOs had 0 defaults (AAA's and AA's) and CDOs had a 35 percent default rate in AAA's and a 43 percent default rate in AA's. This comes from the differences in the collateral; and because of the perception of the differences, different leverage was applied, with CDOs having a lot more leverage.

-- CLOs will often have some defaults on individual loans in the collateral pool during their lifetime, and there are different recovery rates that can be expected over time on CLOs. Appropriate stress testing is therefore very important before the manager issues a CLO and before an investor gets into a CLO. For instance, if there are early defaults, the CLO will have fewer loans available to help make future interest payments.

-- Because of the financial crisis, there was the perception that a lot of managers didn't have any skin in the game. The new regulation (Dodd-Frank) requires that a manager retain a 5 percent piece of the deal value issued either through taking 5 percent of the deal value of the equity, or a vertical slice of each of the different tranches. Risk retention vehicles have been created as a result of this.

Mr. Jacksha said staff is looking at a secondary transaction right now, which could be brought forward relatively soon. Ms. Chippeaux said she was very interested in this transaction, but did not want to proceed until the committee was comfortable with it.

6. OTHER REPORTS AND DISCUSSION

Ms. Chippeaux gave an update on the SMID transition. The NMERB made a trade today in the new index to test the pipeline to make sure everything was working between the brokers, custody bank and portfolio optimization software. She said everything should be up and running by mid November.

7. NEXT MEETING: Thursday, November 9, 2017

The meeting was scheduled at 1:00 p.m.

ADJOURN

Its business completed, the Investment Committee adjourned the meeting at 2:10 p.m.

Accepted by:

H Russell Goff

H. Russell Goff, Chairman