

**MINUTES OF THE**  
**NEW MEXICO EDUCATIONAL RETIREMENT BOARD**  
**INVESTMENT COMMITTEE**

**August 22, 2019**

**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. at the Educational Retirement Board, Suite A-319, 8500 Menaul Boulevard, N.E., Albuquerque, New Mexico.

**Members Present:**

Mr. H. Russell Goff, Chair  
Ms. Mary Lou Cameron  
Mr. Larry Magid

**Members Excused:**

None.

**Staff Present:**

Ms. Jan Goodwin, Executive Director  
Mr. Rod Ventura, Deputy Director  
Mr. Bob Jacksha, CIO  
Mr. Mark Canavan, Real Estate & Real Assets Portfolio Manager  
Ms. Kay Chippeaux, Deputy CIO, Public Securities & Credit  
Mr. Alan Myers, Public Securities & Credit Portfolio Manager  
Mr. Steve Neel, Deputy CIO, Alternative Assets  
Ms. Debbie O'Dell, Investment Operations Manager

**Others Present:**

Mr. Allan Martin, NEPC  
Mr. Kevin Tatlow, Top Tier  
Ms. Judith Beatty, Recorder

**b. Approval of Agenda**

The agenda was reprioritized pending arrival of Mr. Martin.

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

c. **Approval of Minutes: July 18, 2019**

Mr. Magid moved approval of the July 18 minutes, as submitted. Ms. Cameron seconded the motion, which passed unanimously.

d. **Introduction of Guests**

Chairman Goff welcomed staff and consultants.

#### **4. BANNER RIDGE FUND III (TE), LP – PRIVATE EQUITY**

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

Mr. Neel presented staff's recommendation of a \$100 million commitment to Banner Ridge Fund III (TE) and a \$40 million commitment to a direct distressed companion fund of funds managed by the same organization.

Mr. Neel said Banner Ridge partners was formed by the entire Siguler Guff secondary investment team to continue their successful strategy of making secondary investments in distressed private equity funds. He commented that this is an important element, because Fund III for the organization is actually Fund I. With respect to the ERB investment team's history with Siguler Guff and Banner Ridge, it identified this group in 2014 as part of its "workshop" process, when it was looking at secondary opportunities and identified them as a truly differentiated group in terms of what is normally seen in the secondaries market. Normally, secondaries are held with little monitoring until they reach fruition 10 to 12 years later, where the typical IRR is 10-12 percent with a 1.2x return. In marked contrast to other secondaries, the Banner Ridge team will execute on a trade and then regularly market-check to determine whether or not they should sell a position, so essentially it is an active management structure.

Mr. Neel also noted that, with respect to the ERB's relationship with Banner Ridge, in 2015, the ERB seeded this strategy at Siguler Guff as exclusive investor with \$50 million in their first fund. In less than two years, the return to the ERB was 1.3x-1.4x with a very robust IRR. Since then, the ERB has two other tranches of capital with them, which have also done very well in a period of about two years.

Mr. Tatlow spoke to the pros and cons of this investment. On the pro side, this is a focused strategy where there is definitely less competition, and the team has more experience in the sector than their peer secondary funds and fund of funds. The track record of the ERB's prior investments are top quartile by far on a distributed basis, and it is expected they will be top quartile for secondary funds on an IRR basis. Almost all existing investors are reinvesting in the new firm. On the con side, two investment team positions are not yet filled, and the work involved in organizing a new firm could be a distraction from investment sourcing activity.

Founder Tony Cusano appeared before the committee and made a presentation.

Mr. Cusano left the meeting.

Mr. Neel said ERB investment staff really likes this unique strategy and the fact that they are actively managing their portfolio, something that no other secondary firm does.

**Ms. Cameron moved that the Investment Committee approve a commitment of \$100 million to Banner Ridge Fund III (TE), LP and \$40 million for Banner Ridge DSCO Fund I, L.P., for the Private Equity 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. In addition, the Investment Committee grants staff discretion to invest an additional amount, not to exceed \$10 million, in secondary partnership interests offered by other limited partners in the fund, should they become available from time to time. Mr. Magid seconded the motion, which passed unanimously.**

#### **5. ZMC FUND III, L.P. – PRIVATE EQUITY**

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

Mr. Neel presented staff's recommendation of a \$50 million commitment to ZMC Fund III for the private equity portfolio. The ERB is an investor in Fund II, which has returned a 27.5 percent net IRR with a 1.6x multiple, placing it in the top quartile of 2015 vintage funds. ZMC III Fund's goal is to raise \$650 million with a hard cap of \$750 million. The target gross IRR is 20-25 percent with a gross multiple of 2.5x-3x.

Mr. Neel said the ERB sourced this through an earlier investment in VSS (Veronis Suhler Stevenson), a structured equity fund where one of their positions was in Cast & Crew, a software package that pays people in the entertainment industry. VSS was on the debt side, and ZMC was on the equity side of the transaction, and the ERB's return on the debt side was close to 3x. ZMC was founded by Strauss Zelnick, who served as president of 20th Century Fox and currently serves as interim CEO of CBS.

Mr. Neel said ZMC Fund III will follow a similar strategy to the predecessor fund and make control buyout investments. The fund will invest primarily in the U.S. and focus on the media and communications sectors. ZMC is a value-oriented investor that typically invests in transitional growth companies seeking a partner to help drive growth and special situations, which can include operational turnaround, carve-outs and spin-offs from larger organizations. ZMC works to add value through a hands-on management approach and drives operational efficiencies and business development initiatives.

Mr. Tatlow noted that this is consistent with a theme in the private equity portfolio of working with sector specialists, who generally outperform the generalists because they know the industry and its associated pitfalls and challenges. The sector knowledge of the team is very strong. In an environment where there is a lot of impact from digital technology in the entertainment industry, they have already demonstrated their knowledge of this sector based on investments they have made.

Ms. Cameron moved that the Investment Committee approve a commitment of \$50 million to ZMC Fund III for the Private Equity 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. In addition, the Investment Committee grants staff discretion to invest an additional amount, not to exceed \$10 million, in secondary partnership interests offered by other limited partners in the fund, should they become available from time to time. Mr. Magid seconded the motion, which passed unanimously.

## **2. INVESTMENT POLICY STATEMENT/ASSET ALLOCATION APPROVAL**

[Presenters: Kay Chippeaux, Steve Neel, and NEPC advisor Allan Martin]

Mr. Martin presented a report on the recommended asset allocation:

- CURRENT TOTAL CASH: 1%/PROPOSED MIX: 1%
  
- Current Large Cap Equities: 16%/Proposed Mix: 14%
- Current Small/Mid Cap Equities: 3%/Proposed Mix: 3%
- Current Int'l Equities Unhedged: 5%/Proposed Mix: 5%
- Current Emerging Int'l Equities: 9%/Proposed Mix: 9%
- Current Private Equity 13%/Proposed Mix: 15%
- CURRENT TOTAL EQUITY: 46%/PROPOSED MIX: 46%
  
- Current Core Bonds: 6%/Proposed Mix: 6%
- Current EMD: 2%/Proposed Mix: 2%
- Current Opportunistic Credit: 18%/Proposed Mix: 16%
- CURRENT TOTAL FIXED INCOME: 26%/PROPOSED MIX: 24%
  
- Current Real Assets (Liquid): 0%/Proposed Mix: 0%
- Current REITs: 2%/Proposed Mix: 2%
- Current Core Real Estate: 1%/Proposed Mix: 1%
- Current Non-Core Real Estate: 4%/Proposed Mix: 5%
- Current Private Real Assets-Energy/Metals: 8%/Proposed Mix: 9%
- CURRENT TOTAL REAL ASSETS: 15%/PROPOSED MIX: 17%
  
- Current Absolute Return: 0%/Proposed Mix: 0%
- Current Other Diversifying Assets: 5%/Proposed Mix: 7%
- Current Global Asset Allocation: 4%/Proposed Mix: 2%
- Current Risk Parity: 3%/Proposed Mix: 3%
- CURRENT TOTAL DIVERSIFYING STRATEGIES: 12%/PROPOSED MIX: 12%

Mr. Neel noted that staff put together a liquidity analysis on the portfolio a couple of weeks ago before reviewing the asset allocation with the following results: 60 percent of assets were liquid within 120 days, and 40 percent of the assets were liquid within about one week.

Ms. Chippeaux said staff is proposing to add some light leverage to the portfolio, which can be used to improve the risk and return profile and diversification in the portfolio. She said it could also help in doing timely rebalancing when necessary and would allow for flexibility in situations where there is illiquidity. She said staff doesn't intend to use any of the leverage for speculative risk, and in fact it may actually decrease risk through additional diversification.

Ms. Chippeaux said staff proposes to limit the use of leverage to 20 percent of the total portfolio value, although staff feels that use of the full 20 percent would rarely happen. She stressed that staff would monitor the fund's liquidity profile to be sure that the plan's obligations are always met.

Ms. Chippeaux said futures and options would be primarily used on the publicly traded assets to manage the portfolio in tactical ways. These would require very little initial cash outlay and then free up cash to be used to implement other tactical strategies for the portfolio.

Ms. Chippeaux said they would initially use an external manager to help them get started on investments they would like to make as well as implement trades, since no one on staff has experience trading derivatives. Possibly, the manager would be kept on as a permanent resource to call on when necessary.

Mr. Martin added that many plans have hired third parties to tactically move the portfolio around, and in many cases it is just rebalancing. He commented that this is a benign and straightforward methodology, and most plans are moving in that direction because it avoids having to force managers to buy and sell underlying securities. Once this in place, because they are using futures and options, the ERB has the ability to add some leverage. Many funds are now exploring that option.

Mr. Martin noted that the asset allocation targets, ranges and benchmarks are all contained within the Investment Policy Statement, so approval of the Investment Policy Statement will include the asset allocation.

Ms. Chippeaux reviewed amendments to the Investment Policy Statement, which included the following major changes:

- Under Investment Philosophy, adding: 8. Leverage can be used to meet portfolio asset allocation targets and tactically change the asset allocation within the ranges set under Appendix A, Asset Allocation. It can be also used to reduce portfolio concentration, to improve portfolio diversification and to improve the expected risk-return profile of the investment portfolio.

- Under Restrictions on Investments, Prohibited Securities and Transactions: Remove language prohibiting direct investment in Sudan. Adding: Portfolio leverage shall be limited to the use of derivatives and shall not exceed 20% of the total value of the portfolio excluding leverage.
- Newly amended Asset Allocation Policy on page 7. [Following discussion, the Cambridge PE Index benchmark under Private Equity was removed and replaced with ILPA Index.]

**Mr. Magid moved that the Investment Committee recommend the Board approve the changes to the Investment Policy Statement including the proposed Asset Allocation. Ms. Cameron seconded the motion, which passed unanimously.**

### **3. OPPORTUNISTIC CREDIT MANAGER CONTRACT EXTENSIONS**

[Presenters: Alan Myers and Kay Chippeaux.]

Mr. Myers stated that the Investment Services Procurement Policy requires a review of investment manager contracts every four years for certain types of assets that do not have a fixed term or termination date. Currently, three managers meet these criteria: PIMCO DiSCO II and Waterfall Asset Management, both in the Opportunistic Credit portfolio; and Emso Saguaro Fund, an Emerging Market debt manager.

#### PIMCO DiSCO II

Mr. Myers said that, in August 2011, the Investment Committee approved the transfer of \$200 million to PIMCO DiSCO II and the remaining assets were redeemed and used for opportunistic credit investments. An additional \$50 million was invested in October 2012, and the ERB has withdrawn \$200 million in three transactions since July 2015. Last year, the ERB received a distribution of \$37 million.

Mr. Myers said the DiSCO II Fund seeks to provide investors with enhanced returns principally through long-biased investments in undervalued senior and super-senior structured credit securities that are expected to appreciate in value over time. The fund may use leverage as part of its investment strategy. The fund's net annualized performance since inception through June 30, 2019, is 12.94 percent; while this is in line with the original return objective, PIMCO announced in 2015 that return expectations going forward would be in the 7-9 percent range. Approximate market value of the ERB investment in the fund as of June 30 is \$117 million, and the total opportunistic credit investments represent 18 percent of the total portfolio, which is in line with the old asset allocation target.

Mr. Myers said the fund is a limited partnership structure and doesn't require a formal extension of a manager contract. The term of the partnership is open-ended, so

meets the requirements of the Investment Services Procurement Policy to have a quadrennial review and approval by the Investment Committee for continued participation in the fund. Staff recommends a four-year extension of the fund investment.

**Ms. Cameron moved that the Investment Committee approve the continuation of the investment in the PIMCO Distressed Senior Credit Opportunities Fund II, L.P. for a period of four years ending October 7, 2023. Mr. Magid seconded the motion, which passed unanimously.**

### WATERFALL

Mr. Myers said the ERB originally invested \$250 million in two Waterfall Funds in August 2011. The Waterfall Eden Fund originally targeted 12-15 percent net returns by investing in high yield non-traditional asset backed securities that have structural complexity, providing the fund with an illiquidity premium as well as current returns and capital appreciation.

Mr. Myers said the Waterfall Victoria Fund invests in pools of non-performing residential whole mortgage loans with an originally targeted return of 20 percent. Over the last several years, Waterfall has adjusted their expected returns to reflect changes in the market environment. In November 2013, the Waterfall Victoria Fund spun off some of its assets and formed the Sutherland Real Estate Investment Trust, which made an initial public offering in 2015 and trades on the New York Stock Exchange.

Mr. Myers stated that the ERB's investment in the Waterfall funds as of June 30 is \$457 million. The annualized return of Waterfall Eden has been 9.4 percent since inception as of June 30, which produced an excess return compared to the opportunistic credit benchmark of 4 percent. For the Victoria Fund, the annualized return since inception has been 10.2 percent, which produced an excess return versus the benchmark of 4.8 percent. He said the ERB receives quarterly dividends from the Sutherland REIT, which represent an approximately 10.25 percent annual return on the original investment.

Mr. Myers said the ERB's investments in Waterfall Eden and Waterfall Victoria do not require a formal extension of a manager contract. The terms of the investments are open-ended, so meet the requirements of the Investment Services Procurement Policy to have a quadrennial review and approval by the Investment Committee for continued participation in the Fund. Staff recommends a four-year extension of the Fund investments.

**Mr. Magid moved that the Investment Committee approve the continuation of the investments in the Waterfall Funds for a period of four years ending August 1, 2023. Ms. Cameron seconded the motion, which passed unanimously.**



### Emso Saguaro Ltd.

Mr. Myers said Emso manages one-half of the emerging market debt allocation. As of June 30, the market value of the account was \$104.79 million. The total allocation to emerging market debt is 1.7 percent of the ERB portfolio as of June 30. The asset allocation for this segment of the portfolio is 2 percent.

Mr. Myers said the ERB's relationship with Emso began in 2011 with their flagship fund. In April 2015, the ERB asked for and received approval to transition to the Saguaro Fund, which is a levered version of their flagship fund. The fund is a long-short emerging market debt hedge fund strategy aimed at achieving attractive risk-adjusted returns through combining top-down macroeconomic views with bottom-up fundamental analysis. The fund invests across emerging market countries and asset classes in both local and hard currency. The strategy aims to generate consistent low volatility returns through an increased focus on downside protection and capital preservation. The fund can use up to 1.5x leverage. The Saguaro Fund's annualized excess return inception to June 30, 2019 is 4.4 percent. Over the last four years, the fund has produced positive excess returns in all but one year. While Emso regards the current environment as broadly supportive of emerging markets, they are shifting their focus to more idiosyncratic opportunities.

Mr. Myers said the fund has a hedge fund structure and does not require a formal extension of a manager contract. The term of the partnership is open-ended, so meet the requirements of the Investment Services Procurement Policy to have a quadrennial review and approval by the Investment Committee for continued participation in the Fund. Staff recommends a four-year extension of the Fund investments.

**Ms. Cameron moved that the Investment Committee approve the continuation of the investment in Emso Saguaro Ltd. for a period of four years ending September 1, 2023. Mr. Magid seconded the motion, which passed unanimously.**

## **6. SMALL INVESTMENT-RELATED PURCHASES NOTIFICATION**

[Presenters: Alan Myers and Kay Chippeaux.]

Mr. Myers notified the Investment Committee that the Executive Director has approved eight small investment service contracts for renewal, as listed in the memorandum to the committee.

## **7. Q2 PROXY VOTING REPORT**

Mr. Jacksha said there were no highlights to report.

**Ms. Cameron moved acceptance of the Q2 Proxy Voting Report. Mr. Magid seconded the motion, which passed unanimously.**

**8. Q2 COMMISSION REPORTS**

[Informational.]

**9. OTHER REPORTS AND DISCUSSION**

None.

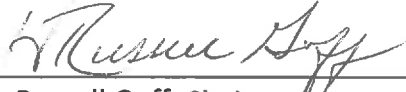
**10. NEXT MEETING: THURSDAY, SEPTEMBER 19, 2019**

The meeting was tentatively set for 1:00 p.m.

**ADJOURN**

Its business completed, the Investment Committee adjourned the meeting at 3:10 p.m.

Accepted by:

A handwritten signature in cursive script, appearing to read "H. Russell Goff", written in black ink.

---

H. Russell Goff, Chairman

