ARIZONA STATE RETIREMENT SYSTEM

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Paul Matson
Director

MINUTES

PUBLIC MEETING
OF THE ARIZONA STATE RETIREMENT SYSTEM
INVESTMENT COMMITTEE

March 23, 2020
1:30 p.m.

The Arizona State Retirement System (ASRS) Investment Committee (IC) met telephonically.

Mr. Michael Lofton, Chair of the IC, called the meeting to order at 1:31 p.m.

1. Call to Order; Roll Call; Opening Remarks

Present: Mr. Michael Lofton, Chair – via teleconference
Mr. Kevin McCarthy, Vice-chair – via teleconference
Mr. Clark Partridge – via teleconference

A quorum of the IC was present for the purpose of conducting business.

2. Approval of the Minutes of the December 16, 2019 Public Meeting of the ASRS IC

Motion: Mr. Kevin McCarthy moved to approve the minutes of the December 16, 2019 public IC meeting. Mr. Clark Partridge seconded the motion.

By a roll call vote of 3 in favor, 0 opposed, 0 abstentions, 0 excused and 0 vacancies, the motion was approved. The trustee votes were as follows:

Mr. Michael Lofton – approved
Mr. Kevin McCarthy – approved
Mr. Clark Partridge – approved

3. Presentation, Discussion, and Appropriate Action Regarding Portfolio Positioning, House Views and General Discussion

Mr. Karl Polen, Chief Investment Officer (CIO), presented the following:

- Coronavirus impacts have created a high likelihood of a recession and markets have responded with unprecedentedly rapid sell off in stocks and increase in volatility.

- Severe pressure on liquidity has emerged with some financial firms in distress from calls on repo lines.
- Economic and market recovery will hinge on progress in dealing with the virus, particularly in testing and data analysis so that a plan for economic remobilization can be developed.
- Portfolio positioning as of March 20 was 6% underweight in equities, balanced by overweights in interest rate sensitive, credit, and real estate. However, Mr. Polen noted that target positions will adjust on April 1 and with that adjustment, the equities underweight would only be about 3%.

Mr. Samer Ghaddar, Sr. Portfolio Manager of Equities, reviewed equity markets, noting the following:

- Equity markets remain under pressure with markets still priced to trailing earnings.
- Markets are not cheap, with values only returning to historic levels on trailing and forward P/E and still slightly expensive on cyclically adjusted P/E.

Mr. Micheal Copeland, Assistant Portfolio Manager of Real Estate, reviewed real estate and private equity markets, noting the following.

- Private equity markets have seen a disruption in deal closings because of a near term withdrawal of credit but expect deals to pick up as distress situations emerge.
- Energy markets are facing substantial distress because of price changes resulting from Saudi production increases.
- Real estate will see near term impacts from reduced rent collections and new leasing.

Mr. Al Alaimo, Sr. Portfolio Manager of Fixed Income, reviewed credit and core bond markets, noting the following:

- There is a robust opportunity to invest in credit in both new loans at new market pricing and in distressed situations.
- Fed action has caused interest rates on the 10-year to hit all-time lows but there has been unusual volatility in certain parts of the credit market in light of liquidity pressures.

4. Presentation, Discussion, and Appropriate Action Regarding Investment Performance

Mr. Polen presented interim fiscal year-to-date noting that fund assets had declined to $37 billion and estimated fiscal year-to-date returns was approximately -7.4%, both as of March 20.

The portfolio managers presented performance results for periods ending December 31, 2019.

Mr. Ghaddar reported that public equity performance of 25.5%, 11.7% and 8.4% underperformed benchmarks by 1.2%, .7% and .6% for the one-, three-, and five-year periods respectively. The underperformance is driven primarily from index selection and factor levers both of which were adjusted in early 2020 and have improved performance since then.

Mr. Copeland reported private equity performance of 9.1%, 13.8% and 11.6%, which outperformed benchmarks by 8.6%, 4.7%, and 2.9% for the one-, three-, and five-year periods, respectively. He further reported that real estate returns of 6.2%, 8.3%, and 9.8% outperformed benchmarks by 2.1%, 2.6%, and 2.1% for the one-, three-, and five-year periods, respectively.

Mr. Alaimo reported credit returns of 8.4%, 9.6%, and 8.0%, which outperformed benchmark by 2.7%, 2.6%, and 2.1% for the one-, three-, and five-year periods, respectively. Core bonds returns of 8.6%, 4.1%, and 3.3% underperformed benchmark by 8bp for the one-year periods but outperformed by 2bp and 25bp for the three- and five-year periods.

5. Presentation, Discussion, and Appropriate Action Regarding the Real Estate Implementation Plan

Mr. Taylor Mammen, Sr. Managing Director and Director of Institutional Advisory Services, RCLCO, and Mr. Jomar Ereso, Director of Asset Management, RCLCO, presented the real estate implementation plan, noting the following:

- The implementation plan was prepared in late 2019 and initially presented to ASRS in January. The plan was recalibrated in light of recent events by deferring indefinitely approximately $2 billion in initiatives previously identified.
- Starting in February, RCLCO began implementing stricter guidelines for underwriting individual property acquisitions and as market conditions become more apparent, approximately $300 million in individual transactions were cancelled or put on hold.
- The implementation plan does, however, contemplate continuing existing relationships, which have adequate unfunded commitments to pursue attractive opportunities as they arise and allows for limited new investments with strategic partners.
- The real estate program is designed to be overweight apartments and other residential strategies compared to the ODCE index and underweight to office and retail strategies.
- The target excess return is 1.5% per year with 2.7% of tracking error.

6. Presentation, Discussion, and Appropriate Action Regarding Independent Reporting, Monitoring and Oversight

Mr. Allan Martin, Partner, NEPC, reported that for periods ending December 31, 2019, total fund returns of 15.6%, 10.1%, 7.9%, and 9.2% exceeded benchmark by .9%, 1.8%, 1.6%, and 1.2% for the one-, three-, five-, and ten- year periods respectively. These returns place ASRS in the 74th, 17th, 11th, and 11th percentile among large public pension plans for the same time periods. He further noted that NEPC monitors ASRS asset class meetings and observed no instances of non-compliance with ASRS procedures or portfolio limitations.

7. Presentation, Discussion, and Appropriate Action Regarding Risk Management

Mr. Polen presented the risk management report prepared by MSCI noting that the measured risk in the actual portfolio is in line with the modeled risk in the SAA portfolio.

8. Presentation, Discussion, and Appropriate Action Regarding Compliance

Ms. Kerry White, Assistant Chief Investment Officer for Reporting, Compliance & Administration presented the compliance report noting that there were no instances of non-compliance for the reported period.

9. Request for Future Agenda Items

No requests for future agenda items were made.

10. Call to the Public

No members of the public requested to speak.

11. The next ASRS Investment Committee Meeting is scheduled for Monday, June 15, 2020 at 1:30 p.m.

Mr. Lofton noted the next IC meeting is scheduled for Monday, June 15, 2020 at 1:30 p.m.

12. Adjournment of the ASRS IC Meeting.

Motion: Mr. Clark Partridge moved to adjourn the meeting at 3:31 p.m. Mr. Kevin McCarthy seconded the motion.

Mr. Michael Lofton adjourned the meeting.

Respectfully submitted by:

Joyce Williams/Karl Polen
Investment Committee Administrator/Chief Investment Officer
ARIZONA STATE RETIREMENT SYSTEM