

MINUTES

PUBLIC MEETING OF THE ARIZONA STATE RETIREMENT SYSTEM INVESTMENT COMMITTEE

June 15, 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 1:40 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.

Ms. Joyce Williams, ASRS Board Administrator, provided all attendees with telephonic meeting guidelines.

2. Approval of the Minutes of the March 23, 2020 Public Meeting of the ASRS IC

Motion: Mr. Clark Partridge moved to approve the minutes of the March 23, 2020 public IC meeting. Mr. Kevin McCarthy 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), introduced the topic noting that the ASRS is currently positioned neutrally with all asset classes within 1% of their strategic asset allocation target. He further noted that equity markets have held up surprisingly, given uncertainties on both economic and policy fronts.

Mr. Samer Ghaddar, Sr. Portfolio Manager of Equities, presented a macro overview and equity markets

information. He reported that consensus forecasts are for a gradual recovery from the virus pandemic with unemployment levels remaining above 5% through 2022. Economic effects of the pandemic have been mitigated through unprecedented fiscal and monetary stimulus targeted to protect incomes, stabilize credit markets, maintain liquidity, and support asset prices. With respect to equity markets, Mr. Ghaddar noted that the S&P500 is down only 7% for the calendar year while earnings are projected to be down 30%. The markets reflect both the effect of lower interest rates on required returns and a consensus view of an orderly return to normal earnings conditions. Private equity has seen a large reduction in deal volume but the rapid recovery in public equity markets is expected to be reflected in both deal volume and valuations in coming quarters.

Mr. Al Alaimo, Sr. Portfolio Manager of Fixed Income, provided an outlook on credit markets, noting that public credit markets declined precipitously in the first calendar quarter while well managed private credit portfolios held up relatively well and significantly outperformed in that time frame. He noted that the process will, to some extent, reverse in the current with a rapid recovery in public credit. He further reviewed interest rate markets with near record low rates for United States Treasury Securities, which are expected to continue for the foreseeable future.

Mr. Taylor Mammen, Sr. Managing Director and Director of Institutional Advisory Services, presented real estate outlook noting differential impacts by property type. He noted that multi-family properties have held up well in this recession with collections and leasing activity experiencing only minor impacts. Stay at home orders have accelerated the trend toward e-commerce and this is having a positive effect on industrial properties. Office properties have seen limited impact so far with generally long-term leases, but there is uncertainty regarding office utilization if physical distancing standards remain an expectation in the longer term. Retail and hotel are seeing severe impacts with low occupancy in hotels and many store closures leading to rent collection problems.

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

Mr. Polen provided an update on the most recent information, with preliminary results available on 80% to 90% of investment funds and assuming flat public markets for the balance of the year, estimated returns for the fiscal year would be approximately 1% compared to benchmark returns of approximately 0%. He then reported final results for periods ending March 31, 2020. He noted that total fund returns of -1.1%, 4.9%, 5.2% and 7.7% for the one-, three-, five- and ten-year periods were 2% below the benchmark for the one-year period and .8%, 1.3% and 1% above the benchmark for the three-, five- and ten-year periods.

Mr. Ghaddar and Mr. Micheal Copeland, Assistant Portfolio Manager of Real Estate, presented information regarding equities performance. Total equity performance was -9.1%, 2.4% and 3.9% for the one-, three- and five-year periods. This performance underperformed benchmarks by 3.2%, .4% and .3% for these time periods. Mr. Copeland explained that private equity returns are quarter lagged and the one-year benchmark was 27% for periods ending 12/31/2019, which was well in excess of the portfolio return of 11%. He noted, however, that private equity relative performance is expected to substantially improve in the coming quarter with expected outperformance for the one-year period ended 3/31/2020 of approximately 4.8%.

Mr. Mammen reported real estate results, which, like private equity, are quarter lagged. For periods ending 12/31/2019, real estate earned 4.3%, 6.8%, 8.5% and 11% for the one-, three-, five-, and ten-year periods. These returns trailed the benchmark by .3% for the one-year period and exceeded the benchmark by 1.4%, 1.2% and 1.7% for the three-, five-, and ten-year periods. Mr. Mammen provided an estimate for the one-year period ending 3/31/2020 of -.8%, which trails the benchmark by 4.6%. This underperformance is driven largely by poor performance in a credit portfolio, which held positions in REIT credits, which sold off heavily in the first quarter. The manager of this portfolio has forecast substantial recovery of these losses in coming quarters.

Mr. Alaimo reported credit results for periods ended 3/31/2020 of 9.3%, 9.2%, 8.3%, and 7.7% for the one-, three-, five-, and ten-year periods. These results underperformed the benchmark by 2% for the one-year period and outperformed by 2.4%, 1.9% and 2.5% for the three-, five-, and ten-year periods. The credit portfolio is a

blend of public and quarter lagged private positions. However, in recent years it has transitioned to substantially all private positions and, as such, nearly all the positions are benchmarked against public market indices with an effective period end of 12/31/2019. The public benchmarks surged in that time frame. Mr. Alaimo provided an estimate of performance for the portfolio for periods ended 3/31/2020. During this quarter, public markets collapsed while the private portfolio experienced only minor losses. Mr. Alaimo estimated that the portfolio will earn a return of 4% for the one-year period ended 3/31/2020 while the benchmark lost 6.9% for an outperformance of 10.9% for the year.

Mr. Alaimo continued his presentation with a discussion of the interest rate sensitive portfolio. He reported that this portfolio earned 9.1%, 4.9% and 3.7% for the one-, three- and five-year periods, which outperformed the benchmark by .2%, .1% and .3% for the same time periods. The internal portfolios performed exceptionally well recently with outperformance of .6% in the most recent one-year period. This outperformance was achieved by unusual trading opportunities during March when spreads on high quality corporate credit widened substantially. The ASRS team capitalized on these opportunities generating substantial profits.

5. Presentation, Discussion, and Appropriate Action Regarding the Equities Implementation Plan and Private Equity Liquidity Compliance

Mr. Ghaddar and Mr. Copeland presented the equity implementation plan. They reviewed the prior implementation plan and described the focus on internal management, risk factors, alpha overlay, index selection and private markets as return drivers. While internal management and private equities have delivered results in line with expectations, the other strategies have underperformed and the equities team has recommended discontinuing them.

Mr. Copeland updated the committee on private equity pacing. With the drop in equity values earlier this year, private equity peaked at 22% of the total equity portfolio exceeding the 20% limit established in the 2018 strategic asset allocation. As a result of this, the team reevaluated the pacing plan and set lower targets which are expected to return the portfolio to compliance with this liquidity limit.

Mr. Ghaddar concluded the presentation by describing the excess return and tracking error expectations for each of the components of the portfolio in the implementation plan, noting that the portfolio will be managed with a goal of achieving 91bp per year of excess return with tracking error of 2.1%.

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

Mr. Allan Martin, Partner, NEPC, presented the NEPC oversight. He noted that they review ASRS team calculations as presented to the IC to confirm their accuracy and consistency with the State Street official book of record. He reviewed compliance with ASRS noting full or partial compliance in all cases. He commended the ASRS team for liquidity management during financial turmoil related to the onset of the pandemic maintaining high liquidity throughout. He also noted that ASRS performance compared to other pension plans placed it in the top decile for all of the one-, three-, five-, and ten-year periods.

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

Mr. Polen presented the risk report from MSCI, noting that risk increased to 28% during the first quarter of the year.

8. Presentation, Discussion, and Appropriate Action Regarding Compliance

Ms. Kerry White, Assistant Chief Investment Officer for Reporting, Compliance, and Administration, presented the compliance report, noting that there were no instances of non-compliance to report for the 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, September 21, 2020 at 1:30 p.m.

Mr. Lofton noted the next IC meeting is scheduled for Monday, September 21, 2020 at 1:30 p.m.

12. Adjournment of the ASRS IC Meeting.

Motion: Mr. Clark Partridge moved to adjourn the meeting. Mr. Kevin McCarthy seconded the motion.

Mr. Michael Lofton adjourned the meeting at 3:54 p.m.

Respectfully submitted by:

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