

**MINUTES OF A PUBLIC MEETING  
OF THE ARIZONA STATE RETIREMENT SYSTEM  
INVESTMENT COMMITTEE**

**Monday, August 29, 2022  
1:30 p.m. Arizona Time**

A quorum of the Investment Committee (IC) of the Arizona State Retirement System (ASRS) met in public session in person, in the First Floor Board Room of the ASRS Office, 3300 N. Central Avenue, Phoenix, Arizona 85012.

Mr. Mike Lofton, Chair of the Investment Committee, called the meeting to order at 1:31 p.m.

**1. Call to Order; Roll Call; Opening Remarks**

Present: Mr. Mike Lofton, Chair - virtual  
Mr. Kevin McCarthy, Vice Chair – virtual  
Ms. Diane Landis  
Mr. Jim Mueller – virtual

A quorum of the IC was present to conduct business.

Ms. Bridget French, ASRS IC Administrator, provided all attendees with virtual meeting guidelines.

**2. Approval of the Minutes of May 23, 2022, Public Meeting of the ASRS Investment Committee**

**Motion:** Mr. Mike Lofton moved to approve the minutes of the May 23, 2022, Investment Committee meeting. Ms. Diane Landis seconded the motion.

By a roll call vote of 4 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  
Ms. Diane Landis – approved  
Mr. Jim Mueller – approved

**3. Presentation, Discussion, and Appropriate Action Regarding the Investment Market Environment and Outlook, ASRS Investment Management Division House Views, and Investment Allocations**

Mr. Michael Viteri, ASRS Chief Investment Officer (CIO), introduced Mr. Chris Levell, NEPC.

Mr. Levell presented information on the second quarter economic environment, including inflation, unemployment, drops in the equity markets, and higher interest rates. The S&P had its worst start since 1970. Bear markets like today historically have lengthy recovery times. Mr. Levell discussed key market themes, including the historical relationship between fed funds and inflation and the closing of the gaps between them.

Mr. Samer Ghaddar, Deputy CIO, presented information and materials relating to public equity, performance, and valuations. The S&P 1500 Index and MSCI ACWI Index dropped significantly for the year's first seven months. The Federal Reserve started implementing its most aggressive monetary policy tightening cycle in decades. The markets rebounded in July after the second quarter's correction of approximately -16%. As of July 31, 2022, \$18.78 billion is invested in the Public Equity asset class, representing a 37.4% allocation within the Total Fund. We are at equal weight as of July 31, 2022, to our benchmark index: MSCI ACWI IMI.

Mr. Ghaddar presented information and materials relating to private equity market conditions, performance, and valuations, including total global private equity returns, number of buyout deals, and aggregate deal values. The ASRS projects that the rest of 2022 will continue to witness a drop in the number of deals and exits. As of August 3, 2022, \$6.2 billion is invested in the Private Equity asset class, representing a 12.5% allocation. The Private Equity team is being very selective in making new commitments.

Mr. Al Alaimo, Deputy CIO, provided house views to the Trustees on private equities relating to the Credit and interest-rate sensitive asset class. As of July 29, 2022, the ASRS had \$11.4 billion invested in the Credit asset class representing almost 23% of the total fund, which is above the target of 20%. The ASRS is overweight in the Credit asset class as the ASRS believes there are compelling investment opportunities to exceed the 7% target return of the total fund over an extended period. The ASRS thinks the most attractive investment opportunities in Credit are almost exclusively in private rather than public markets. The ASRS has created a well-diversified asset class of 18 strategies, including ten in Private Debt, three in Distressed Debt, and five in Other Credit.

As of July 29, 2022, the ASRS is underweight in the Interest Rate Sensitive asset class with an allocation of 6.9% versus a 10.0% Interim Strategic Asset Allocation (SAA) target. The ASRS is underweight as they do not expect the asset class to achieve the fund's target return.

Mr. Micheal Copeland, Private Markets Portfolio Manager, presented information and materials regarding the Real Estate Investment Portfolio. Real estate continues to have solid rental growth across the residential housing market. The ASRS targets 50% of the portfolio in residential housing. Rent growth, in general, is over 12% and continues to grow with high demand and a balanced supply for multi-family, single-family rental, industrial, and retail. Commercial tenants in Industrial real estate choose spaces with elevated amenities and better locations and are willing to pay premiums. The negatives of the current market include very high inflation and the high cost of goods and materials. Real estate transactions in this market have significantly declined because lending standards are tightening, and the higher interest rates. Residential housing demand has lessened because of interest rate hikes, which is a positive for rental housing.

Mr. Viteri presented information and materials regarding the preliminary performance data through July 31, 2022. The fund's market value is \$50.2 billion, which increased from \$48.6 billion. Mr. Viteri discussed the 1-, 3-, and 5-year rates, including how the 1-year rate compares with the ASRS peers.

#### **4. Presentation, Discussion, and Appropriate Action Regarding the Independent Reporting, Monitoring and Oversight**

Mr. Levell presented information and materials regarding the independent program oversight for the period ending June 30, 2022. The ASRS Investment Objectives to design, implement, and maintain an investment management program that maximizes rates of return for acceptable levels of risk have been accomplished with one goal partially accomplished. The ASRS has performed well in this turbulent market primarily because of the current asset class allocation.

Mr. Levell provided information concerning the expected 20-year return, peer comparisons, and the total fund performance net of fees. The diversification of the plan and the private market investments drove the plan's performance this quarter.

Mr. Allan Martin, NEPC, commented on the specifics of peer comparisons. The ASRS is in a larger plan than many of its peers, which means they are better diversified, with better managers.

Mr. Levell discussed asset class performance vs. benchmarks, cash management, SAA policy compliance, performance details, combined asset class committee meeting updates, and the performance summary of long-term disability.

#### **5. Presentation, Discussion, and Appropriate Action Regarding Investment Compliance**

Mr. Robert Butler, Investment Risk & Compliance Officer, presented information and materials regarding the internally managed portfolio's pre-trade compliance system, the custody bank investment compliance program, and the private markets investment compliance program.

Pre-Trade compliance was performed on all internally managed fixed income and equity portfolios for May 2022 – July 2022, and no exceptions occurred during the period under review.

The ASRS Custody Bank's Compliance Group performed compliance reviews on all public markets portfolios and the total fund level investments for the period April 2022 – June 2022. The ASRS Custody Bank's review found a few findings resulting from index changes, corporate actions, and informational flags. All findings were resolved. The total fund investments passed the five mandated investment limits statutes and the Arizona Restricted Country Test for all periods.

The population of real estate investments to be reviewed for 2021 has been identified and RCLCO is targeting to have the compliance review completed by the 4th quarter.

Regarding the Private Markets Investment Compliance Program, Meketa has completed nine compliance reviews for the 2020 period, and no material issues were identified during the reviews of these funds. An additional 30 funds are under review.

#### **6. Presentation, Discussion, and Appropriate Action Regarding the Current Asset Liability Study**

Mr. Paul Matson, Director, presented information and materials regarding the background and objectives of the asset liability study. Every 3-4 years, the ASRS performs an asset liability study to determine a strategic view as to how the portfolio should be structured. The expected outcomes of this study included the objectives to:

1. Maximize the long-term (geometric) average investment rate of return to minimize the long-term average contribution rate, subject to prudent risk levels.
2. Mitigate contribution rate volatility.

Mr. Matson indicated that the key inputs, which change through time, are:

- a. expected rates of return going forward
- b. standard deviation of movement of the assets
- c. correlation or co-movement of those assets in the portfolio

Mr. Matson discussed the academic risk measures, including standard deviations, Sharpe ratio, and Sortino ratio. Further discussion included contribution rate volatility to risk measures, funded status volatility with unsmoothed assets, and funded status volatility with smoothed data assets.

3. Achieve long-term full funding.
4. Ensure both short- and long-term liquidity.

The recommendation for the asset allocation is the "Mix 12" group. It is a migration from credit risk on the interest rate-sensitive side to equity risk, and a decrease in interest rate-sensitive exposure. It also migrates a percentage from real estate to private credit.

Mr. Levell presented additional information and materials regarding the asset allocation recommendation, including the projected increase of benefit payments, the actuarial value of assets and accrued liability, funded status, and the market value ratios.

Mr. Levell explained in detail the differences between both the current NEPC and ASRS assumption sets:

Mr. Levell presented a simulated range of outcomes of funded status over the next 30 years. He defined what risk is for the system and how the system is designed to express the volatility through contribution rates.

Mr. Levell discussed the series of mixes considered as alternative asset allocations and the comparison to ASRS peers. Mr. Martin commented on historical data regarding allocations to other assets and the reasoning behind such changes.

Mr. Levell continued his presentation on the analysis of differences between the NEPC and ASRS summary of return assumptions of the different asset mixes. In addition, he discussed the projected median funded status - unsmoothed asset values, median contribution rate (pension, health, LTD), 30-year average contribution rate, and 30-year standard deviation contribution rate. Mr. Levell presented a detailed financial scenario analysis of the asset mixes.

Mr. Martin and Mr. Matson commented on the next steps after the IC and the ASRS Board approval. Mr. Matson explained that the ASRS would create a implementation plans for the new asset allocation changes once approved.

**Motion:** Mr. Mike Lofton moved to accept and forward to the ASRS Board of Trustees the following asset classes, asset class targets, asset class ranges and asset class benchmarks:

1. Public Equity with a target of 44%, a range of 34% to 54%, and utilizing the MSCI ACWI IMI Net USA Gross Index as the benchmark.
2. Private Equity with a target of 10%, a range of 7% to 13%, and utilizing the MSCI ACWI IMI Net USA Gross quarter lagged index as the benchmark.
3. Credit with a target of 23%, a range of 17% to 26%, and utilizing the S&P Leveraged Loan Index + 250 basis points as the benchmark.
4. Interest Rate Sensitive with a target of 6%, a range of 3% to 12%, and utilizing the Bloomberg Treasury Index as the benchmark.
5. Real Estate with a target of 17%, a range of 13% - 21%, and utilizing the NCREIF ODCE Index as the benchmark.

Ms. Diane Landis seconded the motion.

By a roll call vote of 4 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  
Ms. Diane Landis – approved  
Mr. Jim Mueller – approved

Mr. Jim Mueller left the meeting at 3:20 p.m.

## **7. Presentation, Discussion, and Appropriate Action Regarding Updates to the Strategic Investment Policies**

Mr. Matson presented information and materials regarding modifications to Strategic Investment Policies, SIP002 and SIP006.

The SIP002 needs technical changes and clarifications. The new position of Risk and Compliance Officer was added, in addition to referencing the Manager of Operations. The proposed updates include a reference to leverage previously in a different format and changes the total fund leverage target.

Ms. Landis asked for clarification on the application of the referred leverage. Mr. Matson confirmed the leverage is on the total fund.

Mr. Matson recommended that the policies no longer be called "Strategic Investment Policies" but

Strategic Policies. If a policy goes to the Board for approval, it is considered a Strategic Policy.

The SIP006 has technical clarifications and modifications. The new position of Risk and Compliance Officer was added, in addition to referencing the Manager of Operations. There are also clarifications on manager oversight and due diligence.

**Motion:** Mr. Mike Lofton moved to accept and forward to the ASRS Board of Trustees the following:

- Adoption of the updated Strategic Policies SIP002 – Tactical Positioning, Rebalancing, and Leverage: Pension, Health Benefit Supplement & Long Term Disability and SIP006 – Investment Manager, Partner, and Co-Investment Selection and Oversight.

Mr. Kevin McCarthy seconded the motion.

By a roll call vote of 3 in favor, 0 opposed, 0 abstentions, 1 excused, and 0 vacancies, the motion was approved. The trustee votes were as follows:

Mr. Michael Lofton - approved  
Mr. Kevin McCarthy – approved  
Ms. Diane Landis – approved  
Mr. Jim Mueller – excused

## **8. Presentation, Discussion, and Appropriate Action Regarding the Incentive Compensation Plan (ICP) for Internal Investment Professionals**

Mr. Matson presented the ICP's information, materials, and background. The ASRS ICP was designed to contribute to the ASRS' ability to achieve the following objectives:

1. Retain high-caliber investment professionals
2. Attract high-caliber investment professionals
3. Incentivize investment performance

The ASRS has significantly fewer investment professionals than other funds. The ASRS can maintain this smaller size as all are empowered to make decisions. Staff are more motivated and outperform their peers. Numerous technical changes are needed, including job descriptions and investment performance categories.

Fundamental changes include:

- Maximum incentive compensation range increased from 25% to 30%, effective July 1, 2022.
- Remove the requirement that total fund absolute returns/performance must be greater than 0% for any incentive compensation to be earned.
- Removed the ability to obtain excess outperformance credit in any area.
- Investment Operations Manager position added to ICP.

The Executive Director is not included in this policy but would review all the calculations and interpretations.

**Motion:** Mr. Mike Lofton moved to accept and forward to the ASRS Board of Trustees the following:

- Approval of the amended Incentive Compensation Plan for Internal Investment Professionals commencing fiscal year 2023 (the period from July 1, 2022 – June 30, 2023).

Ms. Landis seconded the motion.

By a roll call vote of 3 in favor, 0 opposed, 0 abstentions, 1 excused, and 0 vacancies, the motion was approved. The trustee votes were as follows:

Mr. Michael Lofton - approved  
Mr. Kevin McCarthy – approved  
Ms. Diane Landis – approved  
Mr. Jim Mueller - excused

## **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 scheduled ASRS Investment Committee Meeting is scheduled for November 28, 2022 at 1:30 p.m.**

Mr. Lofton noted the next scheduled IC meeting is scheduled for November 28, 2022, at 1:30 p.m.

## **12. Adjournment of the ASRS IC Meeting.**

Mr. Lofton adjourned the meeting at 3:34 p.m.

Respectfully submitted by:

Bridget French  
Investment Committee Administrator  
ARIZONA STATE RETIREMENT SYSTEM