

MINUTES

PUBLIC MEETING OF THE ARIZONA STATE RETIREMENT SYSTEM INVESTMENT COMMITTEE

December 21, 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 1:36 p.m.

1. Call to Order; Roll Call; Opening Remarks

Present: Mr. Michael Lofton, Chair – via teleconference
Mr. Clark Partridge – via teleconference

Excused: Mr. Kevin McCarthy

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 September 21, 2020, Public Meeting of the ASRS IC

Motion: Mr. Clark Partridge moved to approve the minutes of the September 21, 2020, public IC meeting. Mr. Michael Lofton seconded the motion.

By a roll call vote of 2 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 – excused
Mr. Clark Partridge – approved

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

Mr. Al Alaimo, Sr. Portfolio Manager of Fixed Income, provided an outlook on credit markets, noting that the ASRS private credit portfolio is slightly overweight. Mr. Alaimo reported that there are compelling investment opportunities to exceed the performance of the Credit asset class benchmark over time in private debt, distressed debt, and other credit. Mr. Alaimo added that although the economic disruption caused by COVID-19 has created

the most attractive environment for private credit investment opportunities in recent years, staff generally does not believe that public credit markets offer attractive investment opportunities in comparison to the private markets. He further reviewed interest rate sensitive markets, noting that the Federal Reserve has continued to keep short-term rates low and should continue this trend for the foreseeable future. Mr. Matson added that there will be ongoing dialogue to determine appropriate target ranges for this asset class.

Mr. Samer Ghaddar, Sr. Portfolio Manager of Equities, presented a macro overview and equity markets information. He reported that US Gross Domestic Product (GDP) contraction is better than expected by year-end. GDP is now projected to contract by approximately 3.6% in 2020, compared to a projected contraction of 5.5% earlier in the second quarter of 2020, and growth rates are still expected to accelerate to an average of 4% in 2021. Mr. Ghaddar noted that unemployment levels are forecast at 8.2% for 2020 compared to 11% previously, European Union GDP growth is to reach -7.7% in 2020 but projected to rebound to around 4.7% growth rate in 2021, and emerging markets GDP growth is to reach -0.8% in 2020 and projected to rebound to a 5.0% growth rate in 2021. Earnings for the S&P 500 are on the path to full recovery, with quarterly earnings per share near the pre-crisis level. With sights set on the economic recovery ahead, staff is positioned to take advantage of the recovery with tactical positioning in small-cap versus large-cap and emerging markets versus developed markets.

Mr. Micheal Copeland, Assistant Portfolio Manager of Real Estate, presented the outlook on Private Equity, noting that fundraising continues to be slow, particularly for managers without a long track record. In spite of the effects of COVID-19, private equity deal activity has picked up considerably since the first quarter of 2020, and managers have been able to create liquidity with a return to 2019 levels.

Mr. Taylor Mammen, Sr. Managing Director and Director of Institutional Advisory Services, RCLCO, 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. Extended months of working from home has created uncertainty for the future of office properties and may result in structural changes in demand. Hotel properties are seeing severe impacts with low occupancy in hotels. In retail, rental collections have rebounded from April lows, but the COVID-19 outbreak has accelerated long-term trends that challenge brick and mortar retail, particularly malls and power centers. Single-family has remained strong in low-density housing, both for-sale and rental, and with historically high occupancy. Regarding real estate capital markets, Mr. Mammen made several observations. Transaction volume plummeted in 2020 by 55% year-over-year. Low-interest rates and loss of investor interest in real estate both drove higher valuations.

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

Mr. Ghaddar reviewed investment performance for periods ending September 30, 2020. He noted that total fund assets are at about \$42 million and returns for the fiscal year-to-date are approximately 5%. Total fund returns of 4.4%, 6.1%, 8.3%, and 8.8% for the one-, three-, five-, and ten-year periods underperformed benchmarks by 1.4% for the one-year period but outperformed benchmarks by 0.5%, 1.3%, and 1.3% for the three-, five-, and ten-year periods. Total equity returns of 5.7%, 5.9%, 9.6%, and 9.7% for the one-, three-, five-, and ten-year periods underperformed benchmarks by 2.5%, 0.4%, 0.5%, and 0.1%, respectively.

Mr. Alaimo presented interest rate sensitive results for periods ending September 30, 2020. The returns of 7.3%, 5.4%, 4.5%, and 3.9% for the one-, three-, five-, and ten-year periods outperformed benchmarks by 0.3% for the one-, and five-year periods, 0.1% for the three-year period, and 0.2% for the ten-year period. Mr. Alaimo then reported credit results for June 30, 2020. The returns of 5.3%, 7.8%, and 8.2% for the one-, three-, and five-year periods outperformed benchmarks by 4.8%, 3.4%, and 2.3%, respectively.

Mr. Copeland presented private equity performance results for periods ending June 30, 2020. The returns of -3.2% for the one-year underperformed the benchmark by 4.5%, but outperformed benchmarks by 8.3%, 9.3%, and 11.6% for the three-, five-, and ten-year periods.

Mr. Jomar Ereso, Managing Director, Chief Compliance Officer, and Director of Asset Management, RCLCO, reported real estate returns for periods ending June 30, 2020. Real estate returns of -2.4%, 3.9%, 7.1%, and 7.2% for the one-year, three-year, five-year, and inception periods underperformed their benchmarks by 3.6% and .4% for the one- and three-year periods but outperformed by 1.5% and 1% for the five-year and inception-to-date periods. Mr. Ereso noted the strong performance of categories where ASRS retains investment control rights with inception-to-date returns of 9.2% and 15.4% in the separate account and operating company categories, respectively.

Finally, Mr. Ghaddar reviewed a more current total fund performance value, noting that the ending market value had reached \$44.3 million as of November 30, 2020.

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

Mr. Allan Martin, Partner, NEPC, presented the NEPC oversight. He noted that NEPC reviews ASRS team calculations as presented to the IC to confirm their accuracy and consistency with the State Street official book of record. Mr. Martin reviewed compliance with ASRS board goals, noting full or partial compliance in all cases. He commended the ASRS team for liquidity management during financial turmoil related to the pandemic's onset, maintaining high liquidity throughout. He also noted that ASRS performance compared to other pension plans placed it in the 70th, 39th, 33rd, and 14th percentile for the one-, three-, five-, and ten-year periods.

6. Presentation, Discussion, and Appropriate Action Regarding the Credit Implementation Plan

Mr. Alaimo presented the credit asset class implementation plan, noting the following:

- ASRS continues to view this asset class attractively with expected returns of 9% to 10% over the next several years;
- The portfolio is constructed with 19 active strategies, including four in U.S. private debt, two in European private debt, two in real estate and asset-backed, four in distressed debt, and seven in diversifying strategies such as life settlements and aircraft leasing, which are believed to have low sensitivity to business cycle risk;
- Because of the favorable prospects and opportunities of this asset class, ASRS has adopted a dynamic overweight to the category and anticipates investing and, for the next several years, maintaining exposure to the category of around 23% to 24% of total fund, compared to its target weight of 20%;
- The target excess performance for the asset class is 1.5% compared to its benchmark of the S&P/LSTA leveraged loan index. The expected tracking error is 3.5% per annum.

7. Presentation, Discussion, and Appropriate Action Regarding the Interest Rate Sensitive Implementation Plan

Mr. Alaimo presented the interest rate sensitive asset class implementation plan noting the following:

- Expected returns in the asset class are low due to global central banks interest rate policies and are estimated to be 1.0 to 1.5% for the next several years;
- Consequently, the ASRS is adopting a dynamic underweight strategy for this asset class;

- The expected excess performance is 10bp compared to the Bloomberg aggregate index with a tracking error of 12.5bp.

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

Ms. Kerry White, Assistant Chief Investment Officer for Reporting, Compliance, and Administration, first announced the promotion of Ms. Lupita Breland to Investment Compliance and Risk Officer. Ms. White then presented the risk report, briefly reviewing the diversification of the fund. The MSCI estimate of value at risk decreased to 26.12% during the quarter ended September 30, 2020. Mr. Paul Matson briefly reviewed definitions of risk and described staff's approach to managing the fund's risk for the Committee.

9. Presentation, Discussion, and Appropriate Action Regarding Compliance

Ms. White presented the compliance report, noting that there were no instances of non-compliance to report for the period.

10. Request for Future Agenda Items

Mr. Partridge requested a follow-up review of current investment in bonds and reconsidering moving more to U.S. Treasuries to address reductions of risk.

11. Call to the Public

No members of the public requested to speak.

12. The next ASRS Investment Committee Meeting is scheduled for Monday, March 15, 2021, at 1:30 p.m.

Mr. Lofton noted the next IC meeting is scheduled for Monday, March 15, 2021, at 1:30 p.m.

13. Adjournment of the ASRS IC Meeting.

Motion: Mr. Clark Partridge moved to adjourn the meeting. Mr. Michael Lofton seconded the motion.

Mr. Michael Lofton adjourned the meeting at 3:40 p.m.

Respectfully submitted by:

Joyce Williams
Investment Committee Administrator
ARIZONA STATE RETIREMENT SYSTEM