



ARIZONA STATE RETIREMENT SYSTEM

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Paul Matson
Director

MINUTES

PUBLIC MEETING OF THE ARIZONA STATE RETIREMENT SYSTEM INVESTMENT COMMITTEE

September 16, 2019
1:30 p.m.

The Arizona State Retirement System (ASRS) Investment Committee (IC) met in the 14th Floor IMD Conference Room of the ASRS Office, 3300 N. Central Avenue, Phoenix, Arizona 85012.

Mr. Michael Lofton, Chair of the IC, called the meeting to order at 1:30 p.m.

The meeting was teleconferenced to the ASRS office at 4400 E. Broadway Boulevard, Suite 200, Tucson, Arizona 85711.

1. Call to Order; Roll Call; Opening Remarks

Present: Mr. Michael Lofton, Chair
Mr. Kevin McCarthy, Vice-chair

Excused: Mr. Clark Partridge

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

2. Approval of the Minutes of the June 17, 2019 Public Meeting of the ASRS IC

Motion: Mr. Kevin McCarthy moved to approve the minutes of the June 17, 2019 public meeting of the Investment Committee. Mr. Michael Lofton seconded the motion.

By a 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 – approved
Mr. Clark Partridge – excused

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

Mr. Karl Polen, Chief Investment Officer (CIO), provided an introduction to the discussion on house views and portfolio positioning, noting the following:

- ASRS remains conservatively positioned with target underweights to equities of approximately 3%;
- ASRS has reduced risk in its portfolio because of equity valuations which are above historic norms, inverted yield curves and other economic indicators of slowing activity and heightened geopolitical risks; and

- Mr. Polen provided background on the potential implications of supply disruptions in the energy sector in light of attacks on Saudi energy facilities noting that if it remains an isolated incident the effects will be minimal, but that if violence escalates leading to prolonged outages the effects could be quite pronounced.

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

- Valuations are high with a cyclically adjusted PE of 29, although this is mitigated by historically low interest rates and recent earnings growth;
- Valuations are highest in U.S. large cap and comparatively favorable in small cap, which has led to a rotation to that sector;
- Markets have seen increased volatility with concerns about trade policy, Brexit, inverted yield curve and slowing growth.

Mr. Micheal Copeland, Assistant Portfolio Manager of Real Estate, presented views on the private equity markets, noting the following:

- Pace of fund raising has moderated;
- Deal multiples and exit volume have recently moderated; and
- Because of favorable returns and other factors the private equity portfolio has grown in relation to other sectors, leading ASRS to increase thresholds on quality requirements for new commitments in order to moderate them.

Mr. Al Alaimo, Sr. Portfolio Manager of Fixed Income, provided views on credit and interest rate sensitive assets, noting the following:

- ASRS remains positive on private debt markets and believes it can continue to earn net returns in the 9% to 11% range, depending on strategy;
- ASRS has recently shifted its investment to focus on strategies with lower business cycle exposure; and
- ASRS views core bond markets of U.S. Treasury obligations and investment grade corporate obligations as unattractive, with likelihood of persistent low rates in light of foreign central bank policies.

Mr. Copeland provided views on real estate markets, noting the following:

- ASRS remains in the market buying property, but with a cautious and strict discipline around investment criteria;
- Cap rates are low compared to historic norms, but spreads to treasuries are higher than typical; and
- Property fundamentals remain generally positive with appropriate supply/demand balance in most markets.

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

Mr. Polen introduced the discussion on investment performance with a discussion on fiscal year to date performance, noting that FYTD returns of around 1.5% are about 50bp higher than benchmark returns. With respect to reporting periods ending June 30, 2019, he noted the following:

- One-year returns of 6.56% exceeded benchmark by 1.4%;
- Three-year returns of 9.91% exceeded benchmark by 2.1%;
- Five-year returns of 6.62% exceeded benchmark by 1.8%;
- Ten-year returns of 10.36% exceeded benchmark by 1.3%; and
- The dollar value addition from the ten year excess returns is \$4.8 billion.

Mr. Ghaddar presented equity results, noting the following:

- One-year total equity returns of 5.54% exceeded benchmark by 1.23%;
- The excess performance was driven by private equity returns, which exceeded their benchmark by 10.8%;
- Public equities underperformed by -1.13%; and
- The public equity underperformed because the ASRS portfolio is oriented toward size and value factors which were out of favor in the current growth environment.

Mr. Copeland presented real estate results, noting the following:

- Real estate returns of 7.6%, 8.9%, 10.5% for the one-, three- and five-year periods exceeded their benchmark by .9%, 2% and 1.8%, respectively;
- The top performers are the separate account and operating company models which have earned 13.4% and 17.1%, respectively on an inception to date basis.

Mr. Alaimo presented results for credit and interest rate sensitive portfolios noting the following:

- Credit returns of 9.05%, 10.15% and 7.22% for the one-, three- and five-year reporting periods exceeded benchmark by 3.5%, 2.1% and 3.1%, respectively;
- Interest rate sensitive returns of 7.79% for the one-year period trailed the benchmark by .08%;
- Interest rate sensitive returns of 2.4% and 3.23% for the three- and five-year periods exceeded benchmarks by .09% and .28%, respectively;
- The reason for the underperformance in the one-year period was that the portfolio was positioned anticipating interest rate increases which did not materialize.

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

Mr. John Krimmel, Partner, NEPC, presented the report from NEPC on behalf of Mr. Allan Martin, Partner, NEPC, noting the following:

- NEPC reviewed return and attribution calculations and concurred with them in all material respects;
- ASRS has fully or partially met all goals established for the investment program;
- ASRS returns place it in the top quartile for the one-year period and top decile for the three-, five- and ten-year periods compared to other public pension plans;
- Asset class returns exceeded their benchmark in all cases, except equity returns of 11.7% for the three-year period were 10bp below benchmark and interest rate sensitive returns of 7.8% for the one-year period were 10bp below benchmark;
- NEPC has confirmed that asset holdings comply with strategic asset allocation requirements; and
- NEPC observed asset class committee meetings and noted no areas of concern on investment process.

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

Mr. Polen noted that the MSCI Barra risk management analysis reflects that observed portfolio risk closely tracks the strategic asset allocation risk.

7. Presentation, Discussion, and Appropriate Action Regarding Compliance

Ms. Kerry White, Assistant Chief Investment Officer for Reporting, Compliance and Administration, reviewed the compliance report, noting that there are no compliance exceptions to report.

8. Presentation, Discussion, and Appropriate Action Regarding the 2019 Investment Committee Meeting Calendar

Mr. Michael Lofton reviewed the proposed 2020 IC meeting schedule. There were no alternative dates requested.

Motion: Mr. Kevin McCarthy moved to approve the proposed 2020 Board IC Meeting Schedule. Meetings are set to occur on the third Monday of the third month of each quarter as follows:

- Monday, March 16, 2020 at 1:30 p.m.
- Monday, June 15, 2020 at 1:30 p.m.
- Monday, September 21, 2020 at 1:30 p.m.
- Monday, December 21, 2020 at 1:30 p.m.

Mr. Michael Lofton seconded the motion.

By a vote of 2 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved. Since the two trustees who moved and seconded the motion were the only trustees in attendance and constituted a quorum, their actions reflected votes in favor of the motion.

9. Request for Future Agenda Items

There were no requests for future agenda items.

10. Call to the Public

No members of the public requested to speak.

11. The next ASRS Investment Committee Meeting is scheduled for Monday, December 16 at 1:30 p.m., at 3300 N. Central Avenue, 14th Floor Conference room, Phoenix, Arizona.

Mr. Michael Lofton noted the next IC meeting is scheduled for Monday, December 16, 2019 at 1:30 p.m.

12. Adjournment of the ASRS IC Meeting.

Motion: Mr. Kevin McCarthy moved to adjourn the meeting at 2:57 p.m. Mr. Michael Lofton seconded the motion.

By a vote of 2 in favor, 0 opposed, 0 abstentions, 1 excused and 0 vacancies, the motion was approved. Since the two trustees who moved and seconded the motion were the only trustees in attendance and constituted a quorum, their actions reflected votes in favor of the motion.

Respectfully submitted by:

Joyce Williams/Karl Polen
Investment Committee Administrator/Chief Investment Officer
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