



# ARIZONA STATE RETIREMENT SYSTEM

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*Paul Matson*  
Director

## MINUTES

### PUBLIC MEETING OF THE ARIZONA STATE RETIREMENT SYSTEM INVESTMENT COMMITTEE

December 16, 2019

1:30 p.m.

The Arizona State Retirement System (ASRS) Investment Committee (IC) met in the 14<sup>th</sup> Floor 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 1:44 p.m. due to technical difficulties.

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 – via teleconference  
Mr. Clark Partridge (joined the meeting at 2:14 pm)

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

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

**Motion:** Mr. Michael Lofton moved to approve the minutes of the September 16, 2019 public IC meeting. Mr. Kevin McCarthy 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), introduced the house views, noting that the portfolio remains conservatively positioned with a slight underweight to equities. Mr. Samer Ghaddar, Sr. Portfolio Manager of Equities, provided some comments on Gross Domestic Product, noting that growth had slowed through much of 2019 but consensus forecasts call for improvement in 2020. Mr. Ghaddar continued with views on equity markets, noting the following:

- Although growth slowed in 2019, equity markets advanced as investors adjusted to expectations of low interest rates continuing for the foreseeable future;
- U.S. equity valuations are stretched with PE ratios well above historic norms;
- International equity markets are more fairly valued with PE values less than one standard deviation above historic norms.

Mr. Micheal Copeland, Assistant Portfolio Manager of Real Estate, commented on private equity and real estate markets as follows:

- Fund raising in private equity has been robust, with high quality managers raising record size funds with very quickly;
- Real estate markets are mature with little distress but also little sign of oversupply;
- ASRS continues to favor residential property types, industrial, and “next gen” office;
- Fund raising has moderated and dry powder is below peak.

Mr. Al Alaimo, Sr. Portfolio Manager of Fixed Income, provided commentary on credit and interest rate sensitive assets as follows:

- ASRS continues to favor private credit strategies with investments now approaching 20% of total fund;
- the ASRS portfolio is well diversified across sectors, geography, and strategy with loans experiencing low credit loss;
- ASRS is underweight interest rate sensitive assets because low interest rates make the asset class unattractive with little potential upside from further reductions in rates.

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

Mr. Polen noted the following:

- Fiscal year-to-date returns through early December are about 4% with excess performance compared to bench mark of about 60 basis points(bp);
- Total fund assets are over \$42 billion as of the meeting date;
- For periods ended September 30, 2019, total fund returns were 4.9%, 9.1%, 7.2%, and 9.1% for the one-, three-, five-, and ten-year periods;
- These returns exceeded the benchmark by 1.1%, 2.0%, 1.7%, and 1.2%, respectively.

*Mr. Clark Partridge joined the meeting at 2:14.*

Mr. Ghaddar presented equity performance as follows:

- Total equity returns of 2.3%, 10.2%, and 7.7% were +.9%, -.1%, and +.1% different from benchmark for the one-, three-, and five-year periods, respectively;
- Public equity returns of .2%, 9.2%, and 6.9% fell short of benchmark returns by .6%, .6%, and .5% for the one-, three-, and five-year periods, respectively

Mr. Ghaddar described changes which have been made to the equity portfolios which have reduced tracking error and returned the public equity portfolios to near benchmark performance on a fiscal year-to-date basis.

Mr. Copeland described private equity and real estate performance as follows:

- Private equity returns of 12.8%, 14.8%, 11.6%, and 13.6% exceeded benchmark returns by 7.6%, 2.4%, 4.2%, and 1.8% for the one-, three-, five-, and ten-year periods, respectively;
- Real estate returns of 8.1%, 8.8%, 10.2%, and 11.5% exceeded benchmarks by 3.7%, 2.6%, 2%, and 2.6% for the one-, three-, five-, and ten-year periods, respectively;
- The separate account program was the strongest contributor with returns of 10.5%, 10.6%, 12.0%, and 13.1% for the one-, three-, five-, and ten-year periods.

Mr. Alaimo presented results for credit and interest rate sensitive portfolios as follows:

- Credit portfolio returns of 8.2%, 9.9%, and 7.7% exceeded benchmark by 1.7%, 2.5%, and 2.6% for the one-, three-, and five-year periods, respectively;
- Private debt contributed notably to these results with returns of 9.3%, 10.8%, and 10.3% for the one-, three-, and five-year periods;
- Interest rate sensitive returns of 10.2%, 3.0%, and 3.7% varied from benchmark by -.1%, +.1%, and +.3% for the one-, three-, and five-year periods.

## **5. 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.

## **6. 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 2.0 to 2.5% 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.

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

Mr. Allan Martin, Partner, NEPC, presented the independent monitoring and oversight report, noting the following:

- NEPC has reviewed and concurs in the return calculations;
- The investment program has met Board goals established for it in all cases, except three-year returns in equities, which were 10bp below benchmark and one-year returns in interest rate sensitive were 10bp below benchmark;
- Total fund returns placed the ASRS in the 16<sup>th</sup>, 6<sup>th</sup>, 11<sup>th</sup>, and 10<sup>th</sup> percentile for the one-, three-, five-, and ten-year periods, respectively;
- NEPC monitors asset class committee meetings for compliance with diligence and underwriting requirements and noted no areas of concern.

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

Mr. Polen reviewed the MSCI risk report noting that the MSCI risk model shows the ASRS portfolio implementation as consistent with SAA.

## **9. Presentation, Discussion, and Appropriate Action Regarding Compliance**

Ms. Lupita Breland, Sr. Portfolio Analyst, presented the compliance report, reporting that no instances of non-compliance were noted during the period.

## **10. Presentation, Discussion, and Appropriate Action Regarding ASRS Supplemental Salary Deferral Plan (SSDP) and Supplemental Retirement Savings Plan (SRSP)**

Ms. Breland presented the annual update, as of September 30, 2019, on the SSDP and SRSP Defined Contribution Plans, administered by Nationwide Retirement Solutions, noting the following:

- The SSDP plan was adopted in 2009 with more flexible features including availability of loans. There are nearly 6,000 plan participants in SSDP with \$237 million in combined savings.
- The SRSP plan was created in 1999 but has seen limited reception due to federally required plan features resulting in participation of only 143 people with \$10 million in combined savings.

The committee discussed the plans and Mr. Paul Matson, Ms. Breland, and Mr. Jim Keeler, Program Director at Nationwide Retirement Solutions, who was also in attendance, answered questions from the trustees.

## **11. Request for Future Agenda Items**

Mr. Lofton submitted four candidates to the Governor's office to fill two seats and he would like updates on that, if it's appropriate for this committee. Mr. Matson will follow up with Mr. Lofton regarding this request.

## **12. Call to the Public**

No members of the public requested to speak.

## **13. The next ASRS Investment Committee Meeting is scheduled for Monday, March 16, 2020 at 1:30 p.m., at 3300 N. Central Avenue, 14<sup>th</sup> Floor Conference room, Phoenix, Arizona.**

Mr. Lofton noted the next IC meeting is scheduled for Monday, March 16, 2020 at 1:30 p.m.

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

**Motion:** Mr. Clark Partridge moved to adjourn the meeting at 3:51 p.m. Mr. Kevin McCarthy seconded the motion.

By a 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

Respectfully submitted by:

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