Joint Meeting of The Board of Trustees and Investment Advisory Committee Minutes August 19, 2020

ERS
EMPLOYEES RETIREMENT SYSTEM OF TEXAS

December 9, 2020

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JOINT MEETING OF THE
BOARD OF TRUSTEES AND
INVESTMENT ADVISORY COMMITTEE
EMPLOYEES RETIREMENT SYSTEM OF TEXAS

The August 19, 2020 meeting of the ERS Board of Trustees was held by video conference call as authorized under Section 551.127 of the Texas Government Code, in accordance with the governor's authorization concerning suspension of certain open meeting law requirements in response to the covid-19 (coronavirus) disaster. A quorum of members of the Board participated in the meeting remotely and are visible and/or audible to the public.

TRUSTEES PRESENT
Ilesa Daniels, Chair
Craig Hester, Vice-Chair
Brian Barth, Member
James Kee, Member
Catherine Melvin, Member

INVESTMENT ADVISORY COMMITTEE (IAC) PRESENT
Bob Alley, Chair
Gene Needles, Vice-Chair
Laurie Dotter, Member
James Hille, Member
Ken Mindell, Member
Didi Weinblatt, Member
Milton Hixson, Member

ERS DIRECTORS PRESENT
Porter Wilson, Executive Director
Tom Tull, Chief Investment Officer
Catherine Terrell, Deputy Executive Director
Paula A. Jones, Deputy Executive Director and General Counsel
Tony Chavez, Director of Internal Audit
Machelle Pharr, Chief Financial Officer
Wendy McAdams, Director of Operations Support
DeeDee Sterns, Human Resource Director

ERS STAFF PRESENT
Aaron Ismail, Internal Audit
Anthony Curtiss, Investments
Ariana Whaley, Government Relations
Tressie Landry, Internal Audit
Carlos Chujoy, Investments
Courtney Dunn, Investments
Kelley Davenport, Executive Office
Bruce Marton, Information Systems
Lanesia Jones, Investments
Leighton Shantz, Investments
Nora Alvarado, Group Benefits
Pablo de la Sierra Perez, Investments
Peter Ehret, Investments
Ricardo Lyra, Investments
Roger Nooner, Benefits Communications
Tanna Ridgway, Investments

VISITORS PRESENT
Sam Austin, NEPC
Michael Malchenko, NEPC
Stuart Greenfield, Public
Ta Lohachitkul, Albourne Partners Limited
John Claisse, Albourne, Partners Limited
Kyson Hawkins, Askia TorreyCove
Thomas Martin, Askia TorreyCove

Call to Order the Joint Meeting of the ERS Board of Trustees and Investment Advisory Committee

8. Call Meeting of the Board of Trustees to Order

Ms. Ilesa Daniels, Chair of the Board of Trustees (Board) for the Employees Retirement System of Texas (ERS), called to reconvene with the Investment Advisory Committee (IAC) to take up the following Joint Meeting of the Board of Trustees and Investment Advisory Committee agenda items.

A public notice of the ERS Board of Trustees containing all items on the proposed agenda was filed with the Office of the Secretary of State at 6:33 p.m. on Monday, August 10, 2020 as required by the Chapter 551, Texas Government Code, referred to as "The Open Meetings Law."

9. Call Meeting of the Investment Advisory Committee to Order

Mr. Bob Alley, Chair of the IAC, called the meeting to order and read the following statement:

A public notice of the Joint Meeting of the ERS Board of Trustees and Investment Advisory Committee containing all items on the proposed agenda was filed with the Office of the Secretary of State at 6:33 p.m. on Monday, August 10, 2020 as required by Chapter 551, Texas Government Code, referred to as "The Open Meetings Law."

10. Review and Approval of the minutes to the August 19, 2020 Joint Meeting of the Board of Trustees and Investment Advisory Committee – (Action)

Mr. Bob Alley opened the floor for a motion on the approval of the minutes from the May 20, 2020 Joint Meeting of the Board of Trustees and Investment Advisory Committee.

The IAC then took the following action:

Motion made to move that the Investment Advisory Committee of the Employees Retirement System of Texas approve the minutes of the Joint Meeting of the Board and IAC held on May 20, 2020.

Motion by Ken Mindell, seconded by Laurie Dotter
Final Resolution: Motion Carries
Aye: Robert G. Alley, Gene Needles, James R. Hille, Margaret “Didi” Weinblatt, Milton Hixson, Ken Mindell

The Board of Trustees then took the following action:

Motion made to move that the Board of Trustees of the Employees Retirement System of Texas approve the minutes of the Joint Meeting of the Board and IAC held on May 20, 2020.

Motion by Craig Hester, seconded by Brian Barth
Final Resolution: Motion Carries
Aye: Ilesa Daniels, James Kee**,** Craig Hester, Brian Barth, Catherine Melvin

There were no questions or further discussion.

11. Review and Consideration of Reappointment of Investment Advisory Committee Member– (ACTION – BOT)

Mr. Tom Tull, Chief Investment Officer, presented a recommendation to reappoint Mr. Jim Hille to the IAC for a three-year term ending August 31, 2023.

Mr. Tull explained that the IAC was established at the discretion of the Board and is currently made up of eight members. The IAC may have no more than nine members at any time. A quorum of the IAC meets quarterly with the Board and a considerable amount of members' time is spent reviewing investments for the Trust's Asset Class Investment Committees and related duties.

Mr. Tull highlighted Mr. Hille's investment expertise. Mr. Tull noted that Mr. Hille's term is set to expire on August 31, 2020. Mr. Hille has expressed a desire to continue serving on the IAC and the ERS staff recommends the Board reappoint Mr. Hille for another three year term expiring August 31, 2023.

There were no questions or further discussion on this item.

The Board of Trustees then took the following action:

Motion made to move that the Board of Trustees of the Employees Retirement System of Texas approve the reappointment of Mr. Jim Hille to the Investment Advisory Committee for a three-year term ending August 31, 2023.

Motion by Mr. Hester, second by Catherine Melvin
Final Resolution: Motion Carries
Aye: Craig Hester, Brian Barth, Ilesa Daniels, James Kee, Catherine Melvin

12. Annual Review and Consideration of ERS' Investment Policy – (Action)

Mr. Aaron Ismail, Investment Compliance Officer, presented the annual review of proposed changes to the ERS Investment Policy Statement.

Mr. Ismail provided background on the ERS Investment Policy Statement, noting that its purpose is to ensure that the Board's investment objectives and constraints are clearly communicated for managing the Trust's assets. The Investment Policy Statement contains ERS' investment philosophy, asset allocation and asset allocation targets, and other risk management principles. It is reviewed on at least an annual basis as a requirement of the policy.

Mr. Ismail explained that the Investment Policy Statement, or "IPS", was completely revised in March 2019, and was last updated in May of 2019. Mr. Ismail noted that ERS views the IPS as a living document, something that will evolve over time to accurately reflect the ERS investment program. Any changes will be brought to the Board and the IAC for approval.

Mr. Ismail described some of the goals of the IPS review process, including aligning the IPS with strategic decisions, reflecting changes in the business process and organization, and developing more of a principle based policy that is practical for the reader.

Mr. Ismail stated that the changes were reviewed and discussed extensively internally. The staff proposed changes to various sections throughout the IPS, as reflected in the redline version in Exhibit A to the agenda item.

The first proposed change is related to the section on asset allocation and transitions for certain asset classes. Staff recommended changes to the section to better reflect the calculation methodology of the asset classes for purposes of the total fund benchmark calculation. The second proposed change clarified that the asset class guidelines are internal documents that do not require Board approval.

The next item regarding the ERS Code of Ethics detailed the process of monitoring and reporting violations by the Investment Compliance to the Executive Office and the Board. The fourth item discussed table one and two of the IPS, where staff felt updates were needed to more accurately reflect approval or recommendation authority for key tasks. In addition, there were minor changes throughout the IPS to improve clarity and communicate the importance of risk management in the ERS Investment Program.

IAC member Mr. Alley requested that Mr. Ismail discuss the proposed change to Chapter VI, Asset Allocation and Transition. Mr. Alley asked to confirm that the ERS investment consultant, NEPC, had provided their input in terms of best practices and measuring the performance of that asset class during a smaller time period.

Mr. Ismail said that the ERS staff wanted to allow flexibility in the calculation methodology, which the current language didn't allow.

Mr. Tull stated that NEPC is aware of how we transition assets. He noted that this methodology is evaluated at the beginning of every year. Mr. Tull mentioned that NEPC is comfortable based on what ERS is doing and some of this relates back to the Senate Bill 322, which they responded on and worked with for ERS.

Mr. Austin, consultant for NEPC, confirmed that Mr. Tull stated their position correctly. NEPC reviewed this issue in detail during the Senate Bill 322 reporting, and they are comfortable with ERS' process.

There were no questions or further discussion on this item.

The IAC then took the following action:

Motion made to move that the Investment Advisory Committee of the Employees Retirement System of Texas Approve the Investment Policy Statement attached as exhibit A to the agenda item.

Motion by Gene Needles, seconded by Bob Alley
Final Resolution: Motion Carries
Aye: Robert G. Alley, Gene Needles, Ken Mindell, James R. Hille, Margaret "Didi" Weinblatt, Milton Hixson, Laurie Dotter

Motion made to move that the Board of Trustees of the Employees Retirement System of Texas Approve the Investment Policy Statement attached as exhibit A to the agenda item.

Motion by Jim Kee, seconded by Brian Barth
Final Resolution: Motion Carries
Aye: Craig Hester, Brian Barth, Ilesa Daniels, Jim Kee, Catherine Melvin

13. *Review of Investment Performance for Second Quarter of 2020 and Risk Update

Mr. Tom Tull, Chief Investment Officer, Mr. Carlos Chujoy, Director of Risk Management, Mr. Sam Austin and Mr. Michael Malchenko, NEPC, presented the investment performance for the second calendar quarter of 2020.

Mr. Tull commented that the Trust has been faced with challenging times and that the period ending June 30, 2020 is a snapshot in time. He stated that the numbers largely reflect the significant declines in the market from February and March and the lagged reporting received from alternative asset investments. Since the last Board meeting, the market has seen United States Gross Domestic Product register double digit negative growth of 32.9% annualized. Mr. Tull stated that this is a number the market had not seen since 1947. The market has seen economic stimulus through monetary and fiscal policy in the trillions of dollars. The effects of the COVID-19 pandemic continue to evolve although a number of vaccines are in phase 3. The market dropped 35% from the high on Feb 19, 2020 and recovered the loss completely by the close of August 18, 2020. This represents 126 trading days and the fastest recovery from a bull market ever seen in modern history. He reiterated that ERS is a selective buyer and seller through all the asset classes as well as long term investors. He stated that the Trust remains diversified which insulated the Trust on the downside while being able to benefit from the upside.

Mr. Austin gave a review of the Trust as of June 30, 2020. Mr. Austin stated that the most important thing is that for the last 10 years, as of June 30, 2020 the performance of the Trust has been 7.8%, exceeding the Trust's actuarial assumed return of 7.0%. The 1st quarter of this year was the fourth worst drawdown for the S&P 500 since January 1970 and the second quarter was the fourth best quarter since January 1970. He stated the Fund has beat the Fund Policy Index in FY15, FY17, and FY18. In FY19 the Trust return trailed the Policy Index by 0.1%. In FY20 (through June 30, 2020), it was the second time in the last five years that the Trust performance has significantly lagged the Total Fund Policy Index. Mr. Austin stated that calendar year to date the Fund was down 4.5%, net of fees. In comparison to peers, ERS ranked in the 58 percentile among the Investor Fund universe of U.S. public funds with AUM greater than $1 billion. In the first quarter, ending March 31, 2020, the fund was down 9.9% which would have placed ERS in the 17 percentile. He reiterated that the Fund was among the top quartile of funds in the country over the last five years in terms of risk-adjusted return measures like the Sharpe Ratio and Sortino Ratio. The policy benchmark ranked ERS in the eighth percentile out of 70 public funds in the Investor Fund peer universe.

Mr. Mindell commented that some of the March scores for private market and alternatives have not yet been reflected as of June and that those numbers could change. He stated that the lag often makes the Fund look as if it underperformed more than it really did. Mr. Mindell asked if NEPC could report the private equity and alternative lagged numbers through June so that the Board can see the actual return for the current year to date. He stated that would actually be good for everyone to see believing that the performance was actually better than what was shown.

Mr. Austin agreed and stated that most of the alternatives are not showing the rebound in the second quarter, and that the Board was looking at the drawdowns from the first quarter.

Mr. Austin stated that the tracking error has increased from 1.63% as of March 31, 2020 to 1.92%, due to the risk that was added in the second quarter. The Sharpe Ratio (The Sharpe ratio is a measure of risk-adjusted return.) also increased from 0.50 to 0.64. The Sortino Ratio (downside risk adjusted return) went up as well from 0.54 last quarter to 0.69. The largest detractor in the second quarter was private equity, down almost 2%, although Mr. Austin noted that in the prior quarter, private equity was the biggest contributor to the Trust's performance.

Mr. Hester asked what impact private equity's lag had on the total Fund's return.

Mr. Austin stated that the impact of the lag in performance was significant and that it was the biggest contributor to the downside performance. He explained that these are the same issues that come up in many other client meetings, especially due to the amount of volatility that the market has seen in the last few quarters.

Mr. Hille commented that the timing mismatch of private markets and alternatives doesn't give the Board a clear picture of how the Fund is doing. He commented that it is solvable by not focusing on any given quarter, but by focusing on the longer time frame. Another option he gave was to lag these benchmarks in order to match with the other asset classes' benchmark.

Mr. Austin stated that the correct way to look at private equity and alternatives returns is on an internal rate of return basis. The other asset classes are looked at on a time-weighted rate of return. He added that NEPC will take that under advisement.

Mr. Austin discussed that the Fund is managed 54% internally and 46% externally. The Fund allocation is made up of 18% risk reducing and 82% return seeking assets. The Fund's liquidity is made up of 34% illiquid assets and 66% liquid assets. Mr. Austin reported that the 10 year return through June 30, 2020 was 7.8% vs. the fund policy index return of 7.9%. For the three and five year period, ERS is in the middle of their peers in the 46% for the three year return. The median return for that peer group (72 Public Funds greater than a billion dollars) was 5.0% and ERS' return was 5.1%. The 5 year return for

ERS was 5.4%, identical to the peer group median return. Mr. Austin stated that the Fund's assets decreased to $27.44 billion from $28.67 billion in the last calendar year (from July 1, 2019 to June 30, 2020) which includes an investment gain of $76.49 million for the year. He stated that for the six months ending June 30, 2020, the Trust underperformed the policy benchmark by 2.9%. Mr. Austin commented that from March 31, 2020 the total assets increased from $26.16 billion to $27.44 billion. The investment loss in the first quarter was $3.1 billion. The investment gain in the second quarter recouped $1.6 billion dollars, or about half of the investment loss in the prior period.

ERS' performance on a risk adjusted basis continues to do well. Mr. Austin said that ERS is making the right diversification choices. The volatility in the portfolio, measured by annualized standard deviation, was 7.30% for the three years ending on June 30, 2020, placing ERS in the 13 percentile compared to its peers. He commented that the three year period ending on June 30, 2020, the return of 5.06% underperformed the benchmark by 0.56%. On a risk-adjusted basis, the Sharpe Ratio equaled the benchmark and the Sortino Ratio was in the 26 percentile on a peer comparison basis, but was not quite as good as that of the Policy Index. For the five year period ended on June 30, 2020, the Fund returned 5.43% and underperformed the policy benchmark by 0.62%. On a risk adjusted basis, the Fund's Sharpe Ratio (0.64 Total Fund vs. 0.63 Total Fund Policy Index) suggests that active management benefitted the Plan. The Sortino Ratio (0.69 Total Fund vs. 0.77 Total Fund Policy Index) indicates that the plan experienced greater downside volatility versus the benchmark.

Mr. Austin gave a snapshot of the asset allocation as of June 30, 2020 in the Portfolio. The fund drew down a significant amount in the Rates Portfolio in the second quarter. The allocation to rates was 12.7% as of June 30, 2020. This was down from the rates allocation of 17.4% as of March 31, 2020. From a liquidity standpoint the negative cash flow increased from 4% to 4.3% over the last five years. Three years ago, as of June 30, 2017 the market value was approximately $27 billion and was $27.4 billion as of June 30, 2020.

Mr. Tull stated that risk was taken out of the portfolio until the end of January. In February. Staff began to put risk back on and take money from the rates portfolio and continued that process until the month of August. Given the significant move in the market staff began to remove risk in the month of August.

Mr. Austin said that the asset allocation is well within the policy target ranges for all assets. He stated that the Fund was overweight in public equity, total rates, global credit, and private equity, but underweight in opportunistic credit and infrastructure as these portfolios are still in the building process.

Mr. Austin explained that in the short term the total fund had slightly less risk and also had slightly less return. In comparison to the median of large public pension funds, ERS had the same risk adjusted return.

Mr. Malchenko then discussed the total fund attribution analysis stating that the largest contributor overall was manager selection. Underperformance was ascribed to the underlying managers. The asset classes that underperformed the most were private equity, followed by global public equity, and total global credit. The positive areas was the Rates Portfolio which outperformed and contributed 0.2% in the last three months. He stated that in the one year, the fund underperformed approximately 3%, mostly as a result of manager selection. Underperforming asset classes were private equity, global public equities, and global credit in the one year Measurement period.

Mr. Austin pointed out that FY16 was the only other year that ERS had significantly underperformed its fund policy benchmark, underperforming by 2%. ERS' performance was 1% above the fund policy benchmark in FY17, and also 1.5% above the benchmark in FY18 and was essentially flat (3.0% versus 3.1%) in FY19.

Mr. Malchenko said that the total fund return outperforms the policy index 95% of the time. He stated that outcome was due to a good asset allocation policy set by the Board and that it focuses on the long term investment goal.

Mr. Malchenko discussed the rolling three year information ratio (a measure of investment management skill) showing that the manager skill is vastly positive. He stated that the rolling three year tracking error (active risk) has increased due to unprecedented uncertain times and added risk back into the Portfolio in February and March.

Mr. Malchenko advised the Board to continue to focus on long term asset allocation and policy that captures most of the upside returns while protecting on the downside. He stated that over the past 10 years, the total Fund return of 7.8% has outperformed the actuarial rate of return of 7.0%.

Mr. Hester asked NEPC to comment if ERS had a manager selection issue in the public equity side of the Portfolio.

Mr. Austin stated that the staff has been vigilant in seeking opportunities where they can when they see significant draw downs in valuations and that it was logical for the staff to put risk back on the table. He commented that no manager has outperformed in every period, but that he applauds the staff for looking at the composition of the portfolio as well as looking at external managers. He stated NEPC remains active in communicating with the Internal Public Equity Team on the observations of external managers.

Mr. Tull stated that this is an area of focus for the team. He said that portfolios had been consolidated to develop more intensive proactive management by the team in public equity and that an RFP process is underway in international equity. He stated that staff is getting close to working through that process.

Mr. Alley asked whether the highly volatile markets changed the team's thinking around private funding for real estate and private equity and if the team has learned any other lessons around liquidity.

Mr. Tull added that the staff monitors liquidity and that the Rates Portfolio effectively provided liquidity during this time. He added that on the alternative side, the staff contacted managers to ensure they were doing what they needed to be doing. He stated he has seen a lot of alternatives taking advantage of the market, picking up sales at a great price. Mr. Tull commented that real estate and anything related to leisure has been problematic and that the staff is working through those issues.

Mr. Chujoy gave a risk update for the second quarter of 2020. He stated that the global pandemic COVID-19 remains a challenge for most of the world. The pandemic resulted in a stay at home policy aimed to slow down the infection growth rate of the virus which in turn led to an economic shut down and a dramatic impact to the labor force. He also indicated that many questions surfaced regarding the reopening of the economy which caused much anxiety and uncertainty in the market.

Despite the uncertainties, Mr. Chujoy commented that the implementation of accommodating monetary and fiscal policy was welcomed by the markets; Financial markets bounced back from their lows despite a deteriorating economic back drop. Mr. Chujoy noted that the economic improvement was not uniform and that some pockets in the economy were impacted more than others. Mr. Chujoy stated that the service industry made up of retail, lodging, leisure, entertainment, restaurants/bars, and as well as the energy sector are still impacted and that these conditions still persist.

Mr. Chujoy stated that economic activity slowed down as the infection growth rate increased. But as the infection growth rate improved, economic activity picked up. He reminded everyone that even though the economy had picked up, the economy is a long way from pre Covid-19 economic activity.

Mr. Chujoy showed the Board that according to the Citi Economic Surprise Index, a measure of whether the economy performed better or worse than economic forecasts, had improved throughout the quarter. He showed that the Institute of Supply Management Manufacturing report, a measure of production activity, showed that the demand for business has done well in June and July. He then showed the Mortgage Application Index and noted that big ticket items, such as houses, had rebounded nicely as a reflection of the current low interest rate environment. Mr. Chujoy stated that according to the National Federation of Independent Small Business Optimism Index, an index that provides a reading of the health condition of small businesses, had collapsed and deteriorated rapidly as the pandemic unfolded and the stay at home policy took place. He stated since more of the economy reopened, index readings have recovered steadily since then.

Mr. Chujoy explained that the rebound in the market was a result of federal policy that led to an injection of a tremendous amount of money. A lesson learned from past economic crisis showed that acting fast in a crisis helps the economy, which is exactly what policy makers had done this time around.

Mr. Chujoy stated that risk levels have remained elevated despite the strong stimulus injected into the market. The increasing levels of risk are a reflection of the elevated number of job claims, increasing infection rates and threatening the opening of the economy, and the increasing number of bankruptcies and potential bankruptcies. He noted that year-to-date returns are a “tell-tale” of industries under stress such as oil energy, airlines, and retail industries. Mr. Chujoy also noted that although the broad market was rallying, these industries were not. Mr. Chujoy stated that because of expectations for potential negative outcomes in these industries, risk was priced higher for them.

Mr. Chujoy showed the Board how much exposure ERS had to these sectors. The energy slice represented only 5% of assets under management. The consumer discretionary, such as retail and restaurants, were only a small fraction of ERS’ exposure.

He continued that the internal investment operational risk due to COVID-19 is under control. During the pandemic, ERS’ investment division is still operating efficiently working from home, without disruption and that it is business as usual with fluid communication with external manager/consultants, and daily and weekly calls and videoconference meetings.

In terms of liquidity risk, as of June 30, 2020, the Fund maintains a little over 13% of liquid assets in US Treasuries and maintains over 1% in cash. The risk team continues to oversee any geopolitical risk arising in the international markets that may affect ERS’ investments.

Mr. Chujoy concluded by stating that the global pandemic continues to be an area of concern with daily cases reaccelerating as local business activity resumes and that a vaccine is still months away. The market showed early indications of a V-shaped recovery. Stress risk levels have receded from peak levels of the first quarter of 2020 although they are still elevated relative to their historical averages (implying a great deal of uncertainty still prevails in the markets.) Market recoveries are inconsistent across industries, with some lagging far behind the broader indices. He stated that a contribution to the portfolio’s risk analysis shows that the majority of the risk is borne in the return seeking asset class and, in particular, in the public equity asset class. The rates portfolio and illiquid assets such as private equity, private real estate, and infrastructure have helped the diversity of portfolio risk.

Lastly he stated that the risk team continues to monitor the operational, liquidity, valuation and geopolitical risks, and their potential impact to plan asset returns on an ongoing basis.

A member of the public, Mr. Stuart Greenfield, addressed the Board stating that he is concerned about the performance of the Fund. Mr. Greenfield commented that ERS could invest primarily in the S&P 500 to improve the Fund and provide a COLA to retirees. He asked the Board to concentrate on how to improve benefits and reduce the cost of the investment program.

There were no further question or discussion at this time and no action was required on this item.

14. *Hedge Fund Market Update and Program Overview

Mr. Anthony Curtiss, Senior Manager Director, Courtney Dunn, Analyst, John Claisse, CEO, and Tathata Lohachitkul, Client Relationship Manager, Albourne America, presented the Hedge Fund Program Market Update and Program Overview.

Mr. Curtiss said introduced current staff members Panayiotis Lambropoulos (Portfolio Manager), Nick Maffeo (Portfolio Manager), Courtney Dunn (Analyst), and Andrew Moore (Analyst). The consultant for the Hedge Fund Program continues to be Albourne Partners Limited. He commented that there has not been any turnover on the Hedge Fund Team.

Mr. Curtiss stated that the Absolute Return Portfolio is a risk reducing Hedge Fund Portfolio that is well diversified, has low correlation to the Trust, low beta (beta measures the volatility in the fund relative to its benchmark) to the Trust, and low volatility. Mr. Curtis went on to say that the Directional Growth Portfolio is a return seeking Hedge Fund Portfolio that acts as a complement to the Trust and it has a more directional and tactical market beta. He stated that hedge funds can also be used in other asset classes when appropriate.

The team manages approximately $1.8 billion in assets which equates to an increase in assets of $278 million on a year over year basis. He stated that the team has four new relationships. Over the fiscal year (FY) the team has received on behalf of ERS' partnership interest in each respective main hedge fund offering some "side pocket" investments that represent less than 2% of assets of the Absolute Return Portfolio.

Mr. Curtiss discussed that the primary objective of the portfolio is to outperform the benchmark, which is a 90 day T-Bill + 3.5% return. The team wants to maintain a beta to the Trust of 0.40 or lower and maintain a standard deviation (volatility) target of 4%-8%, while operating with a low correlation to the Trust.

Mr. Curtiss stated that the portfolio has been able to outperform its primary benchmark (+4.76%) with a +5.02% annualized return since inception. The beta to the Trust since inception is 0.34The standard deviation is a little below what the team expected given the current market environment. The realized standard deviation of the portfolio is 2.89% since inception, which is below the 4% targeted rate. He highlighted that the majority of the team's underlying managers are conservative in nature and that with additional equity allocations over the next 12 months the standard deviation should increase closer to the 4% range. The correlation to the Trust is currently 0.73 and was 0.65 at the end of December 31, 2019. Mr. Curtiss said that it should come down over a period of time as the environment normalizes and new diversifying allocations are added to the portfolio. Lastly, he stated that the monthly performance has been positive 78% of the time since inception.

Mr. Curtiss stated that the bulk of historical strategy exposures remains focused on Relative Value and Event Driven strategies. On a year over year basis, Global Macro exposure remains unchanged and Equity Long/Short exposure has declined slightly due to allocations to other strategies within the portfolio. The Opportunistic exposure has increased. Specifically, there has been a 2% increase associated with the "side pockets" and that one manager called capital over the last 12 months and is now fully allocated.

Mr. Curtiss stated that the geographic exposure remains focused on the developed markets such as North America and Europe. Asia/Emerging Markets exposure has increased, because the underlying managers are seeing opportunities in those markets. Within Asia/ Emerging Markets, it is a mix of liquid and less liquid strategies with further diversification based on both the strategy executed and the instruments traded.

Mr. Mindell complimented the ERS Hedge Fund Team on the appropriate asset allocation within the Absolute Return Portfolio. He said that he liked the fact that Equity Long/Short exposure was under represented/deemphasized along with having additional exposure to non-directional type strategies.

Mr. Curtiss stated that the team has been primarily focused on low net to market neutral exposures and has been active in increasing existing relationships and adding to new relationships that were in the late stage due diligence process before the pandemic. He added that the strategy classes in the portfolio are all within targeted ranges.

Mr. Curtiss gave the Board a high level overview of the different strategy classes. He explained that the Relative Value strategy is used when managers are trying to capitalize on the mispricing of an asset, and that typically exposure lacks market directionality (non-directional). Frequently, the strategy has a higher degree of leverage to capture small mispricings. He went on to explain that Event Driven strategies identify and analyze securities that are associated with a corporate event. Some examples of this strategy are mergers, divestitures, stress/distressed, and spin offs. The strategy often exhibits a longer bias profile within higher net market exposures which can result in a higher degree of risk for potential drawdowns. Global Macro exposure can either be directional or relative value with significant flexibility around the use of instruments traded. Some examples are derivatives, equity, fixed income, commodities, and currencies.

Mr. Curtiss stated that the Equity Long/Short strategy is the most traditional hedge fund strategy. It focuses on buying undervalued stocks while shorting stocks that are determined overvalued. He explained that the emphasis is placed on stock selection along with managing both net market exposure and leverage (gross exposure). The Opportunistic strategy is a portfolio return enhancement strategy that is often long bias exposure with capital being committed and then subsequently drawn down and deployed over a period of time (five year total term or less). Opportunistic investments often exhibit an asymmetric return profile.

Mr. Curtiss stated that since Inception, May 2020, the portfolio has been able to provide an annualized return with modest annualized volatility. The portfolio has a Sharpe ratio of 1.47 and a Sortino ratio of 2.41 (ratios that measures reward per unit of risk). Mr. Curtiss explained to the Board that whenever these ratios are over one it has a greater reward per unit of risk showing that the portfolio had exceptional performance. He went on to that the portfolio's largest drawdown has been 4% which is half when compared to most peers.

Mr. Curtiss explained that the Absolute Returns Portfolio annualized trailing performance was strong in the month of June, July, and August. Year to date the portfolio has had a return of +1.60%, the one year annualized return is +4.03%, three year annualized return is +4.13%, and the five year annualized return is +3.85%. The Absolute Return Portfolio's relative performance has easily exceeded the performance for its secondary benchmark (fund of funds) across most time periods. The portfolio's primary benchmark is an absolute benchmark. The Absolute Return Portfolio has lagged this benchmark for a period of time, but has still been able to outperform on a relative basis since inception. Mr. Curtiss said that the team allocates to conservative managers, the portfolio has historically had a larger credit component, the portfolio has historically had a lower level of equity exposure, and that the team is prudent about what long bias exposure resides within the portfolio. He went on to say that the team looks for long-bias exposure that is often more diversifying while many peers utilize more traditional plain exposure (i.e. structure credit). He added that the portfolio doesn't draw down capital as much and focuses on capital diversification.

Mr. Curtiss said that ERS is exiting from the Southpaw Credit Opportunities Fund. Distressed investing does not lend itself to being a lasting strategy through all market cycles. Instead, the Absolute Return Portfolio added to a large manager that could look across the credit spectrum. This is a recent allocation to Apollo Credit Strategies which executes a long/short credit strategy where distressed investing is a sub-strategy. Mr. Curtiss stated that the manager has done exceptionally well and that the exposure has been reduced. He stated that the team is constantly reviewing and visiting those relationships.

Mr. Mindell asked whether the Global Macro strategy return was worth the volatility risk. Mr. Curtiss stated that Global Macro strategies have been reduced given recent performance issues with one of the managers. He further noted that these strategies have the benefit of being uncorrelated and tend to outperform in uncertain environments. In addition, Mr. Curtiss stated that downside protection is a big focal point for the team. He commented that the team is looking to achieve high single digit returns with modest volatility. The portfolio has room to increase its volatility given that the Absolute Return Portfolio has not met its targeted volatility band. The team also understands that it needs to balance this risk as well.

Mr. Curtiss stated that the largest allocations remain focused on Relative Value and Event Driven strategies (collectively 62%). The portfolio remains diversified by both geography and strategy with over 70% of the portfolio being allocated to North America and Europe. The Absolute Return Portfolio has 13 holdings, but plans to increase the holdings to 15-20. He stated that 80% of assets are considered core relationships with allocations of $80 million dollars or greater.

Mr. Curtiss stated that liquidity remains a focus for all of the portfolio's allocations and that approximately 75% of the underlying assets can be redeemed within 12 months. New allocations will be focused on Relative Value, Equity Long/short, and Opportunistic strategies. Over the last year, the team has restructured the Relative Value strategy within the portfolio, but there is still the potential to add one or two new complementary strategies over the next 12 months. The initial focus is on Event Driven and Equity Long Short strategies. Mr. Curtiss stated that the Global Macro exposure remains additive given the uncertain market environment, but that it could be used as a source of funds depending on how the market environment normalizes.

The allocation to Relative Value strategies has only slightly declined on a year over year basis, and there has been several new more diversifying strategies added within Relative Value.

Mr. Curtiss stated that ERS remains sensitive to fees and actively negotiates fees. The team wants to remain flexible working with managers to find the best way to negotiate fees. He noted that ERS is willing to pay higher fees for strategies that outperform and are diversifying. Since inception, the negotiated fee savings estimate is approximately $19 million dollars and fiscal year to date (FYTD) the fee savings is estimated to be $1.3 million dollars. Mr. Curtiss added that on an asset weighted basis, ERS' fee structure is close to the industry's average and ERS has been able to outperform their Fund of Funds peers with a lower level of volatility and a more attractive risk adjusted return.

Ms. Dunn stated that management of the Directional Growth Portfolio is a joint effort between the ERS Hedge Fund Team and the Director of Internal Equity. She added that the objective of the portfolio is to complement the ERS Internal Equity Portfolio and provide a return enhancer within the Trust. The portfolio targets a return profile that generates an excess return above each respective underlying investment's benchmark. She stated that the underlying managers have primarily been extension strategies (i.e. 150/50). Ms. Dunn explained that the underlying funds have a targeted beta exposure that is in line with its benchmark and the investments exhibit a targeted tracking error (active risk, measure of risk in the fund due to active management of the funds) budget in the 5-7% range.

Ms. Dunn highlighted the portfolio's accomplishments. In most instances, relative performance has been strong and has met its internal objectives. The portfolio has assets of approximately $507 million dollars as of May 31, 2020. The bulk of the assets are in the TOPS World Equities Fund. As of July 31, 2020, ERS had fully redeemed from the Algert Japan 150/50 Fund. The decision was primarily due to performance and to fund an internal Japan equity portfolio which was a new initiative. The Directional Growth Portfolio has generated an annualized return above +9% with an annualized standard deviation of 13%. This equates to a Sharpe ratio of 0.64 Ms. Dunn noted that the Sharpe ratio is expected to improve. The MW TOPS World Equities Fund has been quite successful, relative to its benchmark on a risk return basis. The fund has a Sharpe ratio of 0.8 versus the benchmark of 0.5 showing that the fund has been able to outperform its benchmark with less risk.

She said there were several headwinds in Japan that impacted the Algert investment, including natural disasters, ongoing trade issues, and a challenging economic environment over the last two years. The environment has affected the equity market and this is shown throughout the manager's performance (i.e. negative Sortino and Sharpe ratios).

The trailing annualized relative performance for the MW TOPS World Equities Fund has outpaced its benchmark since inception. The relative outperformance is +4.2% since inception. She further stated that the Algert Japan Fund has underperformed its benchmark since inception in May 2018. The fund has bounced back since May and outpaced its benchmark by +124 basis points in June, and +441 basis points in July.

The MW TOPS World Equities (US) Fund has outpaced its benchmark across various time periods. She noted that the Algert Japan 150/50 Fund has underperformed its benchmark two out of three periods. ERS has fully redeemed from this manager as of July 31, 2020. Overall the Directional Growth Fund Portfolio has done exceptional since inception with only one down year in FY19 with a minimum decline of -74 basis points.

Ms. Dunn noted that hedge funds are being used in other asset classes. This includes the joint effort between ERS and PAAMCO PRISMA. The PAAMCO Launchpad made its first investment in September of 2019 to Cinctive Capital Management. This is an Equity Long/Short Fund that targets no-beta exposure to the market. The manager has generated a year to date return of +4.5% through May and generated a return of +23 basis points since inception. She stated that the ERS Hedge Fund Team is working on a second investment with the PAAMCO Launchpad over the next 12 months and that the goal is to have one to three investment relationships overall. She stated that due diligence and sourcing is a joint effort across the organizations. The relationship with PAAMCO PRISMA is overseen by Panayiotis Lambropoulos.

Ms. Dunn stated that in March 2020 the Opportunistic Credit Portfolio was approved with 0-3 new investments. The allocation is overseen by Portfolio Managers Nick Maffeo and Panayiotis Lambropoulos. She added that the team has a specific focus of finding an initial anchor investment that is a multi-asset, multi strategy credit manager.

Tathata Lohachitkul, of Albourne stated that the Absolute Return Portfolio did exactly what it was mandated to do which was to mitigate drawdowns and limit correlations to traditional asset classes. Notably in the first quarter the portfolio significantly outperformed the tactical benchmark by close to +5% leading to an outperformance year to date through June of close to +4.7%. In March the Portfolio outperformed the tactical benchmark by close to +3%.

Three of the more recent additions to the portfolio included two multi strategy funds allocated to last year. One fixed income relative value allocation generated positive performance in March which helped mitigate portfolio drawdowns. The Absolute Return Portfolio's performance on a YTD basis was in the top quartile among pension, endowment, and foundation portfolios that are tracked by Albourne. The portfolio remains in compliance with policy guidelines. Mrs. Lohachitkul stated that the beta to the Trust for the Absolute Return Portfolio remains below the stated requirement of 0.40 (actual 0.34). In addition, the portfolio's strategy mix remains within the approved ranges.

Ms. Lohachitkul stated that Albourne's probability weighted forecast/outlook across three states (Base, Negative, and Positive) has changed since last year. She said that compared to last year, the probability assigned to each of the market states have changed to Negative (40%), Base (40%), and Positive (20%). She went on to say that weights were reduced in the Base/Central state and increased the weight in the Positive state.

Ms. Lohachitkul stated that at the Super Strategy Level, that Directional strategies are still forecasted to generate positive returns across all the three market states. In comparison, Equity Long/Short is now ranked second as opposed to third. This is given the higher expected return under a positive market state.

Mrs. Lohachitkul stated she believes the recent allocations to both multi-strategy including relative value managers puts the portfolio in a better position given the overall higher allocation to Relative Value strategies. Relative Value strategies are projected to be positive in both positive in two out of three states (i.e. Positive and Base). Relative Value strategies should underperform under a Negative state, but this is being driven by the negative returns associated with structured credit.

She said that the convertible bond space is attractive in 2020 and is set to be one of the strongest years for new issuance since 2006. New issuance volume often drives the strength of the opportunity set for the convertible bond arbitrage.

Ms. Lohachitkul added that there is inherent alpha in receiving allocations in the primary market as these allocations tend to be issued at a discount and bid up in value over the first few days after they are issued. In the secondary market, the increasing supply drives long-only investors to rotate their positions which creates greater diversion in pricing and in broad market cheapening. She stated that most estimates are indicating a 2 to 3% cheapness across the broader within convertible market.

Mr. Mindell asked Albourne if they could measure the value added by making the tactical shifts. Ms. Lohachitkul stated that the way they judge the success of the forecast is based on the relative rankings. This occurs when the top half of strategies outperform the bottom half of strategies. Over time Albourne has assessed that there has been a positive spread between the two groups.

Mr. Claisse noted that the due diligence process has changed under COVID-19. He stated that it has improved access to investment professionals' availability and that they have been able to achieve greater insight. He went on to say that documents have been easier to access online versus what was normally provided onsite. Mr. Claisse stated that many investors are relying on Albourne's virtual onsite visits as a proxy during this time. Mr. Claisse stated that Albourne reviews over 1,000 managers per year and has been able to provide that extension to ERS as well.

Mr. Mindell asked what Albourne had observed across the hedge fund manager universe during the drawdown in March and April. He asked Albourne to specifically comment on the opportunities within credit and if they had seen any stress within credit markets associated with borrowing/leverage.

Mr. Claisse said that the team saw challenges across all hedge fund strategies. In the second week of March, there was stress seen across liquid fixed income type strategies (i.e. fixed income arbitrage). The biggest dislocations were seen within structured credit due to forced selling. He added that most of those were mark to market losses.

Mr. Claisse said that everyone's business continuity has been tested by working from home. He stated that across the board people have exceeded that expectation.

Mr. Claisse discussed an Albourne bi-annual investment survey that showed that the median investor has $10 billion in assets. He stated that over 90% of allocators reported that they were bullish on their hedge fund portfolio over the next 12 months. In comparison, 50% of allocators were bearish on fixed income opportunities. Mr. Claisse went on to say that this reinforces the role of the Absolute Return Portfolio within the Trust as a diversifier with an emphasis on capital preservation. He added that a trend that he was seeing is that over 90% of public pension plans are now aggregating and reporting their fees across their portfolios. He emphasized that ERS has been tracking their fees accurately and uses Albourne's fee reconciliation services. ERS has saved over $20 million dollars in fees since the inception of the program.

Mr. Claisse stated that many investors are focused on understanding the factors of ESG and their influences on their portfolio. About a third of Albourne's allocators are incorporating ESG into their investment process with that statistic rising to 50-70% when including allocators that intend to look at ESG. He explained that the key reason investors say they are incorporating ESG is because they believe that these factors will improve their risk adjusted return. Investors are not necessarily trying to have an impact, but just understanding how to incorporate those into the investment due diligence process. The belief is that the capital flows linked to ESG factors will draw more opportunities going forward. Mr. Claisse stated that this should be considered when thinking about investing in various asset classes. Mr. Claisse stated that one focus within ESG is employment practices. This includes diversity, inclusion, and employment practices (i.e. harassment\ and equal pay). He also noted that Albourne recently launched a new diversity and inclusion due diligence questionnaire. He stated that the survey results for 2018 had approximately 70% of managers responding that reviewing diversity and inclusion aspects in the workplace as a low priority. By 2020, over 70% of managers noted the importance of reviewing workplace diversity and inclusion.

Mr. Hester asked Mr. Claisse to discuss fee strategies such as the "1-or-30" fee model and their merit versus other fee strategies.

Mr. Claisse stated that hedge fund fees have been evolving and that Albourne focuses on the shape and transparency of fees. He added that the "1-or-30" fee model is improving the alignment of interest. Albourne works closely with managers across the industry to advise them on fee structures. He stressed that managers should only get paid on delivering alpha and should amend their fee structures to improve alignment of interest. Overall, the hedge fund industry has seen progress with regards to fees and alignment of interest. He stressed that it is important that you pay fees for the best performing managers which may include fee structures beyond the traditional 2/20 fee model. He stated there is a supply and demand across the industry for the best performing managers. Managers need to understand and provide for the transparency of their fee structures and how they compare with other managers. Allocators only want to pay the appropriate fee for a given source of income stream/performance. Albourne actively works with the ERS Hedge Fund Team regarding fees and their monitoring of fees. He said that the team has done an amazing job of diligently monitoring and assessing fees for ERS.

There were no further comments or discussion at this time and no action was required on this item.

15. Review and Consideration of Proposed Hedge Fund Annual Tactical Plan for Fiscal Year 2021 – (Action)

Mr. Anthony Curtiss, Director of Hedge Fund, and Ms. Courtney Dunn, Analyst, presented the Proposed Hedge Fund Annual Tactical Plan for the Fiscal Year 2021.

The strategies target ranges while allocations to Event Driven and Equity Long/Short strategies are expected to increase. The ERS Hedge Fund team has recently received approval for a high caliber Equity Long/Short strategy. This manager is a fundamental low net market exposure strategy that provides a diversifying aspect relative to the rest of the funds in the portfolio. ERS made an initial allocation to this fund on August 1, 2020, which is a satellite position.

The Absolute Return Portfolio currently makes up approximately 4.4% of the Trust's assets and is under the 5% target allocation. It should be noted that there is further flexibility given the allowable strategy band of 0-10%. She informed the Board that the team is expecting to make up to four new allocations for the Fiscal Year 2021. The focus will be on strategies that are diversifying to the rest of the funds within the portfolio. Most of these new opportunities will reside in Event Driven, Equity Long/Short, and Opportunistic strategies. She stated that the team will continue to focus on liquid strategies within both developed and emerging markets.

There were no questions or further discussion on this item.

The IAC then took the following action:

Motion made to move that the Investment Advisory Committee of the Employees Retirement System of Texas Approve the Proposed Hedge Fund Tactical Plan for Fiscal Year 2021.

Motion by Ken Mindell, seconded by Gene Needles
Final Resolution: Motion Carries
Aye: Robert G. Alley, Gene Needles, Ken Mindell, James R. Hille, Margaret "Didi" Weinblatt, Milton Hixson, Laurie Dotter

Motion made to move that the Board of Trustees of the Employees Retirement System of Texas Approve the Proposed Hedge Fund Program Tactical Plan for Fiscal Year 2021.

Motion by Brian Barth, seconded by Craig Hester
Final Resolution: Motion Carries
Aye: Craig Hester, Brian Barth, Ilesa Daniels, Jim Kee, Catherine Melvin

16. *Private Equity Market Update and Program Overview

Mr. Ricardo Lyra, Director of Private Equity, and Mr. Thomas Martin and Mr. Kyson Hawkins, Askia Torrey Cove, presented a market update and Private Equity Program overview.

Mr. Lyra provided an overview of the Private Equity Program Team and introduced Torrey Cove and stated that the team started working with the new advisor in April 2020.

Mr. Lyra introduced his Portfolio Managers Davis Peacock, Adrianna Ballard, and Tom Rashman. He noted that there was an open position on the team that will be filled in Fiscal Year (FY) 2021.

Mr. Lyra noted that the team committed $534 million dollars over the past 10 months. He stated that the approved FY20 budget was $800 million with a plus or minus range of 25%. Since June the team has closed on another three commitments which increased the total commitment level for the FY to $634 million dollars. Since June 30, 2020 the program has had $640 million of capital calls and $336 million of distributions.

The net asset value (NAV) of the portfolio remained approximately $4.1 billion being mostly flat, increasing by less than $36 million. The Private Equity Program went from 14.3% of the Trust to 15% over the same period. The increase was due to a higher portion of capital calls versus distributions in the Trust. The internal rate of return (IRR) for the portfolio since inception of FY19 was 11.6%, and the (IRR) for the portfolio since inception of FY20 was 9.5%. Performance was affected by the pandemic and fell by 214 basis points. Mr. Lyra explained that the portfolio had seen a significant slowdown in the first and second quarters of 2020. The slowdown is reflected in the decrease of Mergers and acquisitions activity seen in the Private Equity market.

Mr. Lyra showed different aspects of the Private Equity markets. He stated that Global M&A transactions and volume of leverage buyout transactions in the first quarter showed strong activity and that the second quarter showed the slowdown of activity. The volume of new leveraged loans in the first half of 2020 decelerated. The Global PE activity showed healthy fundraising activity in the market suggesting that GP's and LP's are getting ready for when the markets reopen.

Mr. Lyra went over the net asset value timeline for the last fiscal year. He stated that most strategies were growing strongly up to the end of 2019 with the exception of the energy sector which was showing signs of weakness. Over the first four months of the fiscal year, the Private Equity Portfolio saw 4% value growth. The energy sector had lost almost 10%. The second part of the year showed the effects of COVID -19 and the energy crisis where every strategy lost value over that period.

Mr. Lyra stated that over the past 10 months of FY20 the portfolio lost almost 8% in value due to the pandemic and energy crisis. On a positive note, Mr. Lyra stated that there were still positive returns for some strategies.

Mr. Lyra compared the portfolio's performance to industry benchmarks. He noted that the portfolio had outperformed the public market benchmark exceeding its return for the 1-, 3-, 5-, and 10-year period. Additionally, the portfolio has outperformed the Burgiss Private Equity database in the long term exceeding the median, 5-, and 10-year period. In the short term the ERS Portfolio did not outperform the Burgiss median due to the energy portfolio.

Mr. Lyra explained that compared to its peer group of pension systems ($5 billion or greater) in the median to long term the ERS portfolio exceeded the top quartile marks in the 3-, 5-, and the 10-year periods. In the short term, the portfolio did not beat the median of its peers' returns.

Mr. Lyra discussed portfolio management fees and carried interest, and explained the impact of the co-investment program on the buyout portfolio. He stated that the co-investment program was started in 2012 and that it significantly reduced the average management fees and carried interest. During the time period of 2007-2011 the management fees were approximately 19% and had decreased from the time period of 2012 to 2020 to an average of 16.2%. Due to Covid-19 resulting in the slowdown of activity, the average carry and management fee expected to pay on commitments for 2020 increased. He commented that the inability to reduce economic costs were due to fewer co-investment opportunities.

Mr. Lyra stated that ERS' ability to negotiate improved contract terms for ERS commitments and the establishment of strategic relationships particularly in the secondary market has reduced the portfolios overall carry and management fees from 18% for the 2007 to 2011 period to an average of 13% in the period 2012 to 2020. Mr. Lyra said that co-investment and strategic relationships have generated savings for the Private Equity programs. Since inception of the co-investment program, almost $85 million in savings has been realized in management fees and carried interest. Co-investments are expected to generate over $320 million in savings over the life of the current portfolio. The team's ability to negotiate with GP's has realized $40 million in fee savings. From contract negations the team is expecting to generate $150 million in total saving over the life of those funds. In total, co-investment contract negotiations expect to generate $450 million in savings.

Mr. Lyra discussed the portfolio's diversification and compliance with policy guidelines. He noted that North America accounted for 52.4% of the portfolio, 2.4% above the 50% minimum. Western Europe accounts for 25.6%. Asia represents 17.1% with the remainder allocated across other developed and developing markets. Sector guidelines set a maximum allocation of 20% and no single sector currently represents greater than 20% concentration. Diversified, which consists of secondaries and fund of funds, represents 31.8%. He explained diversification by strategy ranges and highlighted that all strategies were within their ranges.

Mr. Kee asked if the percentage allocated to North America was a result of the team seeing more opportunities internationally. Mr. Lyra responded that historically the team has seen that one of the biggest growth drivers for the global economy has come out of Asia and that's why the team has grown their portfolio in that region of the world. The international exposure is driven by the team's belief that the global growth is coming from Asia and that is why the team has allocated more capital there.

Mr. Lyra stated that overall the team is being very careful where they allocate capital and especially careful when making any large allocations to riskier markets. He stated that the team does not have any big commitments coming up and that the team is being very diligent about how they are co-investing as the environment is still seeing delicate times with volatility. Lastly, he stated that is why the team is on the lower range of commitment goals for the year.

Mr. Lyra discussed portfolio strategies. He stated that the buyout is the largest strategy in the portfolio, followed by growth and venture capital. The secondary strategy represents 17%, energy 10%, and debt represents 8% of the portfolio. The guidelines for firm (manager) economic exposure should not exceed 20%. He stated that the economic exposure is made up of net asset value and uncalled capital. All managers are in guidelines with the economic exposure. The largest exposures of the portfolio are LGT, Landmark, and Pavilion, which are secondary funds and fund of funds that include a significant number of General Partners.

Mr. Lyra discussed the goals and objectives for FY20 and FY21. An internal audit conducted this year helped his team review the portfolio's processes and procedures, which was a good learning experience. In FY20 a new Portfolio Manager (Tom) was hired and is doing very well. In FY21 the team hopes to execute the new tactical plan utilizing the processes and procedures that were learned. He stated that the team will be developing an operations manual. The team plans to hire a new senior analyst.

Mr. Hester commented that it has been a good decision that the team has diversified in the Private Equity space since the portfolio has done much better than the public markets, stating that over the same time frame the S&P 500 had compounded at 6.4% versus ERS' 11.6%.

Mr. Martin highlighted that there is $9 billion dollars of committed capital as of December 31, 2019 and $3 billion of unfunded capital (capital that has been committed, but not yet drawn with partners) that can be used in an attractive deal environment. He added that was a nice cushion to use when the market stabilizes and the capital can be efficiently withdrawn.

Mr. Hawkins highlighted that the buyout segment is an area to focus on going forward, particular North America. He stated that certain buyout manager relationships will be added, generating income deal flow and a primary fund commitment perspective. He added that the portfolio performed well on an absolute return basis and also from a team mitigation perspective.

Mr. Martin stated that they would recommend using a tactically and more opportunistic basis with the secondaries funds. He commented that the portfolio remains balanced with no outperformance on global and North American funds. A substantial amount of global funds will have exposure in the U.S.

Mr. Martin stated that the performance in global and North America has offset the performance in Latin America which represents a relatively small portion of the portfolio.

He went over the performance across vintage year. The portfolio has a reasonably stable performance over time and had a slight dip during the latter part of the global financial crisis. The older vintage years have a positive net cash flow as they have been monetized and are largely realized. He stated that as expected, the unfunded commitments are concentrated in the most recent vintage years which is reasonable.

Mr. Martin went over quartile rankings which illustrate a distribution of quartile rankings by strategy and geographies. He stated that the portfolio had a notable outperformance within venture and growth and secondaries. This offset the underperformance in energy and debt. The proportion of global and North America investments have outperformed other regions. Mr. Martin stated that overall the distribution outcome is fairly consistent in what they see in other clients' portfolios.

Mr. Martin concluded that the long term performance remains attractive, while pre-Covid-19 short term relative performance has been impacted negatively by robust public equity markets. He stated that the portfolio is prudently diversified with the appropriate guidelines in place as a framework for future decisions. The global Covid-19 pandemic is an unprecedented event in our lifetime and that the market volatility and broad economic uncertainty are likely to be pervasive for some time and that patience, flexibility, commitment to the asset class, and consistent deployment will yield long term benefits.

There were no questions or further discussion on this item and no action was required on this item.

17. Review and Consideration of Proposed Private Equity Annual Tactical Plan for Fiscal Year 2021 – (Action)

Mr. Lyra presented the proposed tactical plan for Fiscal Year 2021 and explained that the team plans to commit $800 million, with a target range of $600 million to $1 billion over 8-12 new fund commitments and 3-8 opportunistic co-investments totaling $800 million dollars.

Mr. Lyra commented that assuming the overall Trust grows at the actuarial 7% on an annual basis, the portfolio would hit its target of 13% in approximately five years. He then stated that if the overall Trust grows at a slower pace such as 4% on a yearly basis, the portfolio would hit its target of 13% in approximately six years delaying the achievement of the target by one year.

Ms. Dotter asked about the due diligence process when sourcing new private equity managers. Mr. Lyra explained that the team has monthly meetings to brainstorm and discuss what fits within the portfolio. Full due diligence is completed by ERS and Askia Torrey Cove in a parallel process. He commented that it is a very hands on process. He stated he has not had any commitment with a manager that they have not been able to meet with face to face. The number of meetings have tripled to obtain as much information as possible.

Mr. Bob Alley, IAC Vice-Chair, opened the floor for a motion on the approval of the Private Equity Program annual tactical plan for Fiscal Year 2021.

There were no questions or further discussion on this item.

The IAC then took the following action:

Motion made to move that the Investment Advisory Committee of the Employees Retirement System of Texas approve the Private Equity Program Tactical Plan for Fiscal Year 2021.

Motion by Mr. Gene Needles, second by Ms. Laurie Dotter
Final Resolution: Motion Carries
Aye: Robert G. Alley, Gene Needles, James R. Hille, Margaret "Didi" Weinblatt, Milton Hixson, Laurie Dotter

Motion made to move that the Board of Trustees of the Employees Retirement System of Texas Approve the Proposed Private Equity Program Tactical Plan for Fiscal Year 2021.

Motion by Mr. Craig Hester, second by Mr. Brian Barth
Final Resolution: Motion Carries
Aye: Craig Hester, Brian Barth, Ilesa Daniels, Jim Kee, Catherine Melvin

18. Investment Advisory Committee Member Recognition

Ms. Daniels stated that she would like to thank Ms. Weinblatt for her service as an Investment Advisory Committee Member on behalf of the ERS Board of Trustees. She stated that Ms. Weinblatt's investment industry knowledge brought a wealth of experience to the Board and the Board would like to thank her for her time with ERS.

Mr. Bob Alley stated that as a valued member of the ERS Investment Advisory Committee, Ms. Weinblatt has supported the Board and the staff with the recent allocation study in 2020 and assisted in a major revision of ERS' Investment Policy. Ms. Weinblatt has also served with distinction as a member of the ERS' Texa$aver^{SM} Product Review Committee and an Asset Class Investment Committee.

Mr. Tom Tull presented a resolution that noted her accomplishments during her tenure and thanked her for her service.

There were no questions or further discussion, and no action was required on this item.

19. Reminder date for next Joint Meeting of the ERS Board of Trustees and Investment Advisory Committee, the next meeting of the Board of Trustees and the next meeting of the Audit Committee

The dates for the next meeting will be a two-day workshop held on Tuesday – Wednesday, December 08-09, 2020.

There were no questions or further discussion, and no action was required on this item.

20. Adjournment of the Joint Meeting of the Board of Trustees and Investment Advisory Committee

The Joint Meeting of the Board of Trustees and Investment Advisory Committee adjourned at 1:10 p.m.