I. EXECUTIVE SUMMARY

The Employees Retirement System of Texas (ERS) utilizes hedge funds to enhance the investment performance of the ERS Trust investment portfolio (Trust). The objectives of ERS' Hedge Fund Program is as follows: to emphasize capital preservation, to provide for an attractive risk-adjusted return, to deliver additive diversification benefits to the Trust, and to reduce the Trust's overall volatility. The underlying philosophy of the program is to attain risk-adjusted returns that are aligned with these objectives.

The ERS Hedge Fund Tactical Plan for Fiscal Year 2022 ("Tactical Plan") has been prepared by the Director of Hedge Funds. The Tactical Plan is intended to be a planning document that outlines the steps to be taken over the coming fiscal year. The purpose of the Tactical Plan is to provide the objectives of the ERS Hedge Fund Program and to address considerations relevant to the administration and success of the program. This Tactical Plan is only a guiding reference. It is not intended to overrule prudent hedge fund investment decisions.

While the Tactical Plan is considered prudent and effective, it may require amendment based upon the opportunities available in the market. The Tactical Plan proposes significant capital commitments for the 2022 fiscal year, but not all of the capital committed may be invested by ERS due to factors beyond ERS' control (i.e. travel restrictions, due diligence limitations, etc.). The strategy ranges given provide flexibility to the targeted commitment amount to account for varying market opportunities as well as availability of ERS resources. Moreover, the ERS Hedge Fund team and the ERS Hedge Fund consultant may request a change to the pace of investment in subsequent Tactical Plans in order to take advantage of market opportunities.

II. GENERAL ALLOCATION OVERVIEW

Hedge funds are utilized within asset classes to complement external managers and to support the asset class in achieving its individual objectives. The Absolute Return Portfolio (Portfolio) is considered a risk-mitigating portfolio, while the Directional Growth Portfolio is considered a return-seeking portfolio. These two portfolios are solely comprised of institutional hedge funds as described below. All hedge fund allocations are subject to the Investment Policy Statement and Hedge Fund Program Asset Class Guidelines.

Risk-Reducing

<u>Absolute Return Portfolio</u>

Initial allocations for the Absolute Return Portfolio were made on August 1, 2012. The Portfolio reached its target allocation of 5% of the Trust's assets during FY2015. As of April 30^{th}, 2021, the Absolute Return Portfolio is approximately 4.5% of the Trust's assets. Currently, the Portfolio is below its stated target allocation of 5%, but expectations are for the allocation to either meet or exceed this target allocation over the coming fiscal year. As a reminder, the Absolute Return Portfolio has an allowable strategy band of 0-10%. Allocating above the target would help the Absolute Return Portfolio remain close to its targeted 5% allocation as the Trust's assets continue to recover and increase over the current economic cycle.

As expected, much of FY2021 was a continuation of WFH (working from home) where the ERS Hedge Fund team executed upon previously conducted due diligence along with leveraging existing relationships. Much of the return generated during FY2021 was due to either relationships that were added or upsized during FY2020. FY2021 will end with the Absolute Return Portfolio allocating to one new deal and with a prospective deal going to the Internal Investment Committee prior to the August 2021 board meeting.

Additional investments were of consideration during the fiscal year, but often could not meet specific criteria. These may be revisited in FY2022 assuming the managers can continually meet the risk/ reward objectives of the Absolute Return Portfolio coupled with ERS' specific needs.

Outside of new allocations, significant progress was made during the fiscal year in reducing the number of side pocket investments. As of this writing, there is only one material side pocket investment that represents less than 1% of the Portfolio's assets. Its realization is expected over the next 12-24 months. During the fiscal year, a partial payment did occur which reduced the size of this investment.

During the fiscal year, the team also completed targeted reductions to certain strategies for either risk management or portfolio construction purposes.

There is also a legacy manager that is in liquidation, which has a limited amount of investments that may be transferred over to the Opportunistic sleeve within the Portfolio. This is consistent with similar investments (i.e. side pockets) which have no defined liquidity event on the horizon. The aggregate amount of these legacy assets is de minimis (less than 0.25%). The ERS Hedge Fund team is working with the manager to find a liquidity solution.

Looking into FY2022, the current environment remains uncertain with some countries dealing with ongoing pandemic issues. Vaccine distribution remains uneven between countries with emerging markets struggling the most. In other instances, countries have varying degrees of hesitancy in taking one of the available vaccines. This has created an uneven economic recovery across the world.

The ERS Hedge Fund team remains positive that hedge fund strategies should continue to offer attractive rates of return. The environment will be challenging given low interest rates globally, high valuations within many public markets, and suppressed volatility due to both fiscal and monetary policy. As the global economy reopens and monetary policy is withdrawn, this could lead to bouts of volatility. Generally, that type of operating environment has been good for hedge fund strategies due to both security selection and positioning (i.e. short exposure). In addition, there remains the potential for a mini distressed cycle in the event the economic recovery becomes elongated (i.e. slower growth but persistent) coupled with businesses being negatively affected due to higher levels of debt and the potential for higher interest rates.

At this time, the focus remains on finding diversifying strategies that can offer a unique return profile with a low degree of correlation to the Portfolio's existing underlying managers. In other instances, some degree of correlation will be accepted for a degree of diversification to existing strategies. This may occur based either on strategy or geography. These statements hold true across all five of the strategy sleeves within the Absolute Return Portfolio.

Within Relative Value strategies, there is no clear strategy needs, so a heavier emphasis will be on the ongoing monitoring of existing relationships versus the sourcing of new opportunities. The portfolio is highly diverse by strategy given its healthy allocation to multi-strategy hedge funds. This has been further complemented with allocations to relative value specialists. The ERS Hedge Fund team remains mindful of a rising rate environment and its impact on a portfolio that has a heavy fixed rate credit component.

Event Driven strategies remain a priority over the coming fiscal year. Similar to the needs within Relative Value, the Event Driven exposure needs diversifying strategies. This has been challenging to find given that many Event Driven strategies carry a higher level of directionality in their portfolio and can be prone to left-tail events. Diversifying aspects might include adding a manager in a new geography with a smaller asset base. In other instances, this could be to a more traditional strategy that is lacking within the portfolio. The ERS Hedge Fund team remains positive on Event Driven strategies given the uneven economic recovery. This should lead to more corporate events including M&A, restructurings, divestitures, spin-offs, etc.

In regards to Equity Long/Short, the Absolute Return Portfolio remains cautious on increasing its exposure. The current direct equity exposure is near the historical high of the program (~19%). The strategy can range from 0% to 30%. As a reminder, the Portfolio on boarded a U.S. focused manager that operates with a low net exposure (20-40%) near the end of FY2020. The one new investment made during FY2021 was to an Asian market neutral strategy. ERS has a high degree of confidence in this manager and feels that it is a prudent way to invest in a volatile region. Due diligence on this investment was fairly easy given that it is an affiliated organization of an existing relationship. It should be noted that the Asian allocation occurred in conjunction with a reduction to an existing European long/short manager. This was primarily done to keep the overall direct equity allocation within a reasonable range. If the operating environment remains robust for Equity Long/Short strategies then a potential increase could occur. At this point, the direct equity allocation has an emphasis on both the U.S. and Asia. This emphasis represents a mix of strong stock selection within the U.S. while Asia offers the potential for idiosyncratic alpha opportunities in trading.

Typically, Global Macro offers diversifying aspects during uncertain times. Generally, this has worked for the Absolute Return Portfolio in FY2021. The Portfolio's discretionary strategies (i.e. developed markets and Asia) performed very well. The Portfolio's emerging markets manager struggled over the year with bouts of U.S. interest rate volatility, movements in the U.S. dollar, and ongoing pandemic concerns affecting these markets. At this time, the ERS Hedge Fund team remains hopeful that the current manager base will be positioned to take advantage of movements in both interest rates and FX as global economies normalize. Any further consideration for new investments could occur within commodities. This is due to its historical low correlation to other hedge fund strategies. Further time could be spent looking for additive discretionary global macro exposure.

Given the market environment, the ERS Hedge Fund team will selectively review new Opportunistic investments. However, this exposure will be limited and has always been used sparingly. Opportunistic investments could be beneficial in capturing an illiquidity premium relative to public markets. In addition, there could be ongoing opportunities for longer lock event driven type opportunities.

The Absolute Return Portfolio remains diversified by strategy, region, and number of underlying managers. The current number of managers is 15, but one manager will be fully redeemed by the end of June 2021 while another still holds those de minimis investments noted earlier (< 0.25%). . Factors influencing the number of managers include the following: ability to source new investments, strategy capacity, conviction, alignment of interests, risk management, and transparency. When fully invested, it is anticipated that the Portfolio will consist of 15 to 20 allocations. As of this writing, ~90% of the Portfolio's assets are comprised of Core allocations (>$80 million). The largest allocations are primarily to multi-strategy managers that operate diversified portfolios and have longstanding track records. The level of manager concentration has grown with both the success of the underlying managers coupled with leveraging existing relationships during the pandemic (i.e. additional allocations).

The ERS Hedge Fund team remains focused on sourcing new investments that exhibit diversifying qualities to the current Portfolio. Further redemptions may be warranted from existing relationships in the event there is a need to seek exposure to strategies that either have a better opportunity set or offer a unique return profile that has more diversifying aspects. Given the program's maturity, new allocations will be selectively identified and sourced.

Return-Seeking

<u>Directional Growth Portfolio</u>

The Directional Growth Portfolio is comprised of individually benchmarked hedge fund allocations that have a market beta (approximately 1.0). As of this writing, the portfolio is comprised of one hedge fund allocation that is benchmarked to an appropriate equity index. Each respective investment is expected to either meet or exceed its benchmark over a full market cycle. No new investments are expected for FY2022.

Other Hedge Fund Allocations

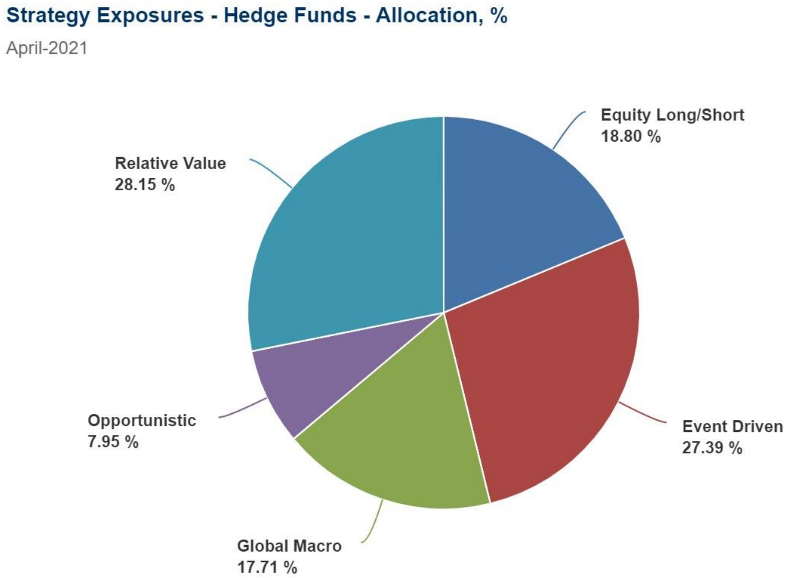
The ERS Hedge Fund team continues to work with a third party partner, PAAMCO Prisma, to source and allocate to emerging hedge fund managers. The ERS Launchpad ("Launchpad") initiative will act as an enhancement to the existing Hedge Fund program. In comparison, the Absolute Return Portfolio focuses on institutional hedge fund managers. A key and differentiating aspect for Launchpad is that ERS seeks a revenue share from all investments in exchange for a longer lock and early-stage investment. These are seeding transactions where capital allocations to these managers will not be used for working capital purposes. The first investment was made in September of 2019 to Cinctive Capital Management. Launchpad started with an initial approval of $150 million and the ERS Hedge Fund team also received an additional approval for $22.5 million in June of 2020. During FY2021, one additional investment occurred. This was to an organization called Phase 2 Partners. Phase 2 Partners is a spinout from an established manager called Philadelphia Financial. Phase 2 Partners is a manager that is focused on the Financials sector. ERS made an allocation of approximately $47 million.

After PAAMCO Launchpad's second investment, ERS' capital had been fully called. Given the desire to grow the emerging hedge fund manager program, the ERS Hedge Fund team requested an additional $175 million from the ERS Board of Trustees during FY2021. The amount was approved and the ERS Hedge Fund team continues to look for an additional 2-4 new opportunities over the next 1-3 years.

Further information will be presented later in the year to the ERS Board of Trustees on the advancement of the PAAMCO Prisma Launchpad relationship. Lastly, it should be noted that the Launchpad entity resides within the Trust's Special Situations portfolio.

III. FUNDING TABLES

Absolute Return Portfolio



Strategy Class	Targeted Range		Actual
Relative Value	20%	60%	28%
Event Driven	0%	60%	27%
Equity Long/Short	0%	30%	19%
Global Macro	10%	40%	18%
Opportunistic	0%	30%	8%

As of April 30, 2021, the Absolute Return Portfolio is within its guidelines for each strategy classification. The Absolute Return Portfolio remains overweight both Relative Value and Event Driven strategies. These allocations are the foundation of the Portfolio.

Returns and Risk			
Return	**Absolute Return Portfolio Pension Plan Sleeve**	**HFRI FOF: Diversified Index**	**T-Bills + 350 bps - Blended**
LTD Annualized Return	6.53%	4.68%	4.64%
LTD Compounded Return	73.94%	49.18%	48.77%
Largest Month Gain	3.19%	3.71%	0.58%
Largest Month Loss	-4.01%	-7.00%	0.29%
% Positive Months	80.00%	69.52%	100.00%
LTD Value of $1000	$1,739.44	$1,491.80	$1,487.73
Risk	**Absolute Return Portfolio Pension Plan Sleeve**	**HFRI FOF: Diversified Index**	**T-Bills + 350 bps - Blended**
Standard Deviation	3.20%	4.69%	0.26%
Sharpe Ratio*	1.81	0.85	34.72
Max Drawdown (Start/Recovery)	Mar 2020 - May 2020	Feb 2020 - Jul 2020	n/a
Max Drawdown Depth	-4.01%	-8.19%	n/a
Months in Maximum Drawdown	3	6	n/a
Months to Recover	2	4	n/a
Benchmark Comparison		**HFRI FOF: Diversified Index**	**T-Bills + 350 bps - Blended**
Annualized Alpha		3.70%	17.37%
Beta		0.59	-2.14
Correlation		0.86	-0.17
R-Squared		0.74	0.03

The Absolute Return Portfolio continues to outperform its stated benchmark of T-Bills +3.50% (blended return) (Bloomberg Ticker: G0O1 Index (floating component)) on an annualized return basis. As a reminder, the HFRI FoF: Diversfied Index is the secondary index to the Portfolio and functions as a peer index.

The annualized standard deviation of the Portfolio remains below its stated minimum risk guideline of 4%. The maximum standard deviation guideline for the Absolute Return Portfolio is 8%. Expectations are for the standard deviation of the Portfolio to move higher as additional strategies are added coupled with expectations for volatility to increase in the current market environment.

The Absolute Return Portfolio remains slightly below its target allocation of 5% of the Trust's assets. Expectations are for the Portfolio to exceed its targeted allocation during FY2022. As a reminder, the Absolute Return Portfolio has strategy bands of 0-10%. The ERS Hedge Fund team plans to source new opportunities and further populate the Portfolio with attractive risk adjusted exposures over FY2022. As of April 30th, 2021, the current AUM for the Absolute Return Portfolio was $1,483,716,620. This amount equates to approximately 4.50% of the Trust.

Directional Growth Portfolio

As of April 30th, 2021, the Directional Growth Portfolio was comprised of one allocation. Historically, the Directional Growth Portfolio has focused on allocating to extension strategies (i.e. 130/30). These strategies are classified as Equity Long/Short and have historically been managed as a collection of individually benchmarked allocations.

All underlying investments within the Directional Growth Portfolio have an affiliated equity index benchmark and incentive fees are paid only on relative outperformance to this benchmark. Hence, these investments often exhibit a beta and correlation close to their underlying benchmark.

As a reminder, all potential allocations are requested by the ERS Public Equities team and sourced by the ERS Hedge Fund team. Historically, past investments have been customized solutions, which make this a more complex undertaking.

Fund	Current Allocation	Inception Date
MW TOPS World Equities (US) Fund L.P.	$475,867,349	04/01/14

Below are charts displaying relevant risk and return attributes of the underlying investments and relevant benchmarks. This information is as of April 30th, 2021.

Returns and Risk		
Return	**MW TOPS World Equities (US) Fund**	**MSCI AC World Daily Net Local (Total Return)**
LTD Annualized Return	15.46%	11.00%
LTD Compounded Return	176.77%	109.47%
Largest Month Gain	12.87%	11.43%
Largest Month Loss	-14.43%	-12.85%
% Positive Months	71.76%	69.41%
LTD Value of $1000	$2,767.74	$2,094.71
Risk	**MW TOPS World Equities (US) Fund**	**MSCI AC World Daily Net Local (Total Return)**
Standard Deviation	13.56%	12.90%
Sharpe Ratio*	1.08	0.79
Max Drawdown (Start/Recovery)	Jan 2020 - July 2020	Jan 2020 - Aug 2020
Max Drawdown Depth	-20.81%	-19.97%
Months in Maximum Drawdown	7	8
Months to Recover	4	5
Benchmark Comparison		**MSCI AC World Daily Net Local (Total Return)**
Annualized Alpha		3.82%
Beta		1.03
Correlation		0.98
R-Squared		0.95

Returns and Risk		
Return	**ERS Directional Growth Portfolio**	**MSCI AC World Daily Net Local (Total Return)**
LTD Annualized Return	13.44%	11.00%
LTD Compounded Return	144.23%	109.47%
Largest Month Gain	10.78%	11.43%
Largest Month Loss	-12.37%	-12.85%
% Positive Months	71.76%	69.41%
LTD Value of $1000	$2,442.29	$2,094.71
Risk	**ERS Directional Growth Portfolio**	**MSCI AC World Daily Net Local (Total Return)**
Standard Deviation	13.23%	12.90%
Sharpe Ratio*	0.95	0.79
Max Drawdown (Start/Recovery)	Jan 2020 - Jul 2020	Jan 2020 - Aug 2020
Max Drawdown Depth	-20.05%	-19.97%
Months in Maximum Drawdown	7	8
Months to Recover	4	5
Benchmark Comparison		**MSCI AC World Daily Net Local (Total Return)**
Annualized Alpha		2.29%
Beta		1.00
Correlation		0.97
R-Squared		0.94

IV. STRATEGY ALLOCATION COMMENTS

The commentary below will highlight key assumptions by strategy and provide guidance on the expected use of strategies and sub-strategies in FY2022.

Relative Value

Typically, Relative Value sub-strategies demonstrate a high degree of dispersion in return forecasts due to various underlying factors. However, a common characteristic among Relative Value sub-strategies is a lower net exposure that helps moderate risk and market beta. Relative Value sub-strategies can benefit from heightened or increasing intra-market volatility, spreads, and/or movement in interest rates. Therefore, ERS expects Relative Value sub-strategies to preserve capital in many baseline/down market scenarios.

In FY2022, the ERS Hedge Fund team will focus on finding complementary exposure to the existing holdings within Relative Value strategies.

Event Driven

Through their primary exposure to idiosyncratic corporate events, Event Driven strategies can provide a moderate long-term beta to equity markets. In most instances, sub-strategies such as distressed/high yield exhibit a higher beta relative to other sub-strategies such as merger arbitrage. This is not to say that merger arbitrage is a riskless strategy. This strategy often entails leverage and gap risk, with gap risk being associated with either a break in a merger deal or a mass deleveraging, especially within crowded trades. While leverage is a noteworthy risk, Event Driven strategies can provide a lower volatility exposure since leverage use is usually lower when compared to the other strategies described herein. Event Driven sub-strategies can perform well either in calm markets as deals close or in recovering markets where cheap distressed risk premium is available.

For FY2022, expectations are to prudently increase exposure to Event Driven strategies as ERS expects the global economy to be in the early stages of a new economic cycle. As the cycle improves, expectations are for further corporate developments to occur, which should bode well for Event Driven strategies. In particular to the Portfolio, the ERS Hedge Fund team may seek a U.S. or European based manager, but this will be dependent on their historical track record and portfolio fit. As highlighted earlier, many of these managers tend to struggle during market drawdowns for a number of reasons (i.e. imperfect hedges, higher market exposure, leverage, and/or crowded trades). At this time, the only noteworthy change during FY2022 was a small partial redemption from a dedicated merger arbitrage strategy. This is for portfolio construction and risk management purposes based on other holdings within the Absolute Return Portfolio.

The existing allocations within the Event Driven strategy sleeve are focused on opportunities primarily within Asia and the U.S. These are a mix of long/short credit opportunities coupled with diversifying strategies like convertibles, direct lending, and regulatory capital relief transactions.

Equity Long/Short

Of the five main strategies, Equity Long/Short provides the highest correlation and beta to equity markets. However, the strategy rarely generates absolute returns above equity benchmarks in bull markets. This is because Equity Long/Short strategies often provide lower net exposures with lower overall volatility. This offers varying degrees of downside protection in negative markets. Most Equity Long/Short managers provide both a high degree of liquidity along with access to more specific segments within the equity markets that includes niche strategies and industry/region specialists.

Expectations are to maintain current exposures within Equity Long/Short for FY2022. Any increase to this strategy would be either market dependent or a desire to raise market directionality.

Global Macro

There is a diverse array of Global Macro sub-strategies, which for purposes of this discussion, are broken down into systematic (often generically referred to as CTA) and discretionary. In summary, systematic strategies are often negatively correlated to other hedge fund sub-strategies and frequently exhibit a low correlation to individual markets. Systematic sub-strategies deliver a high level of diversification within a hedge fund portfolio and often provide their highest value-add in extended downward trending markets. Discretionary global macro sub-strategies are used either to provide specific directionality or to act as a hedge to macroeconomic events. They can be used to deliver either diversification or directionality to a hedge fund portfolio. Both strategies often use a high degree of leverage primarily through derivatives.

At this time, the Absolute Return Portfolio will maintain its current weighting to Global Macro strategies given the strong desire for strategies that are less correlated to both traditional equity and credit markets. These strategies offer the most flexibility and typically serve as an excellent hedge for higher inflation and elevated interest rates. Thus, there is hesitancy in reducing exposure at this time. The ERS Hedge Fund team also loosely follows commodity related strategies. However, it is challenging to find commodity related strategies that offer a consistent form of absolute return. Traditionally, the ERS Hedge Fund team has monitored sector focused managers, but has not considered them for a potential allocation.

Opportunistic

Opportunistic strategies are used to capitalize on either a market dislocation or structural market issue. Opportunistic strategies can resemble any single strategy mentioned above, but are often structured as long only. They can be used as either Core or Satellite exposures depending on the dislocation and opportunity set. An Opportunistic strategy is expected to provide an asymmetric risk/return profile that will help the portfolio achieve returns within its listed risk constraints.

In FY2022, new Opportunistic strategies will be considered on their own merit. There is the potential to find opportunites within less liquid strategies given that one should be able to capture an illiquidity premium given where valuations stand within public markets. In addition, there could be unique event driven opportunities that materialize later into calendar year 2022. This will be market dependent based on strategy and geography.

At this time, there is only one Opportunistic investment within the Absolute Return Portfolio. The manager provides a mix of specialty lending activities coupled with regulatory capital relief trades. This manager reopened in FY2021 after being closed for a number of years. The manager has noted an attractive opportunity set regarding regulatory capital relief transactions. ERS made an additional commitment of $25 million and relocked our existing commitment for a number of years. The aggregate commitment to the manager stands at $125 million. Lastly, great strides have been made in reducing the Portfolio’s exposure to side pocket investments. As of this writing, there is only one side pocket investment that represents less than 1% of the Portfolio’s assets.

V. SUMMARY

- The Absolute Return Portfolio is nearing its targeted allocation of 5% of the Trust’s assets. Expectations are for the Portfolio to exceed its targeted allocation in FY2022. As a reminder, the Portfolio has allowable strategy bands of 0-10%.

- The Absolute Return Portfolio has become more concentrated based on both the number and size of holdings. The Portfolio is comprised of high conviction holdings given the level and depth of due diligence executed by the ERS Hedge Fund team. In aggregate, ~90% of the Portfolio’s assets are considered Core allocations (>$80 million). The increased concentration over the last year is a mix of strong performance coupled with increasing allocations to existing relationships given the ongoing pandemic and the challenges of due diligence including travel. From a portfolio construction process, the entire Portfolio is structured similar to the Relative Value sleeve. The largest allocations are primarily to multi-strategy managers which are further complemented by specialist allocations.

- The Absolute Return Portfolio remains overweight Relative Value and Event Driven strategies. Expectations are to selectively add to these strategies that exhibit diversifying aspects. Further reductions may occur to strategies that exhibit higher correlations and/or a less robust opportunity set. The initial focus for FY2022 will be on Event Driven strategies, as these carry more directional market exposure and will benefit from an improving economic environment.

- Equity Long/Short exposure will be maintained given the desire to keep direct equity allocations at a modest allocation given the significant move in public equities. The Absolute Return Portfolio has traditionally been underweight Equity Long/Short, but today is at its historical high (~19%). The strategy band does allow for this allocation to grow up to 30%. Further allocations will be dependent on portfolio fit, while keeping in mind the Portfolio's aggregate beta guideline of 0.40 to the Trust.

- Global Macro exposure should remain relatively static given the diversity of underlying trading strategies including markets. Further consideration could be provided to commodity related strategies assuming they can exhibit the core tenets associated with the Absolute Return Portfolio. This would be defined as being a diversifying offering which is uncorrelated to traditional credit and equity markets with an emphasis on capital preservation.

- As hinted above, Opportunistic investments could be of interest depending on the opportunity set. The Absolute Return Portfolio sparingly allocates to traditional long only investments. If an attractive illiquidity premium could be captured then further consideration could be provided.

- The ERS Hedge Fund team continues to evaluate emerging hedge fund managers for the PAAMCO Prisma Launchpad relationship. Given the increased commitment, expectations are for 2-4 new allocations over the next 1-3 years.

- The Directional Growth Portfolio will remain dormant until further notice and there are no new allocations planned for FY2022.