

Joint Meeting of  
The Board of Trustees  
And  
Investment Advisory Committee Minutes

May 11, 2022



Presented for Review and Approval

August 24, 2022

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

**ERS Building – 9<sup>th</sup> Floor Conference Center – Rio Grande Conference Room  
1836 San Jacinto Blvd, Austin, Texas 78701  
May 11, 2022 – 8:30 a.m.**

**TRUSTEES PRESENT**

Catherine Melvin, Chair  
Jim Kee, Vice-Chair  
Brian Barth, Member  
Neika Clark, Member  
Craig Hester, Member

**INVESTMENT ADVISORY COMMITTEE (IAC) PRESENT**

Gene Needles, Chair  
Laurie Dotter, Vice-Chair  
Bob Alley, Member  
Ryan Bailey, Member  
Caroline Cooley, Member  
Jim Hille, Member  
Milton Hixson, Member  
Ken Mindell, Member  
Ruby Muñoz Dang, Member

**ERS DIRECTORS PRESENT**

Porter Wilson, Executive Director  
Cathy Terrell, Deputy Executive Director  
Jennifer Chambers, Director of Government Relations & Special Projects  
Tony Chavez, Director of Internal Audit  
Bernie Hajovsky, Director of Enterprise Planning Office  
Cynthia Hamilton, General Counsel  
Robin Hardaway, Director of Customer Benefits  
Diana Kongevick, Director of Group Benefits  
Shack Nail, Special Projects & Policy Advisor  
Machelle Pharr, Chief Financial Officer  
Gabrielle Schreiber, Director Office of Procurement & Contract Oversight  
DeeDee Sterns, Director of Human Resources  
Kathryn Tesar, Director of Benefits Communications  
David T. Veal, Chief Investment Officer

**ERS STAFF PRESENT**

Jason Avants, Information Systems  
Adriana Ballard, Investments  
Georgina Bouton, Group Benefits  
Carlos Chujoy, Investments  
Raquel Colon, Investments  
Kurt Cressotti, Investment Compliance  
Anthony Curtiss, Investments  
Kelley Davenport, Executive Office  
Pablo De La Sierra Perez, Investments  
Trudy Hill, Operations Support  
Mitch Holtz, Investments  
Lauren Honza, Investments  
Tiffani Jenkins, Benefits Communications

Lanesia Jones, Investments  
Ricardo Lyra, Investments  
Nick Maffeo, Investments  
Michael McCrary, Investments  
Jamey Pauley, Executive Office  
Davis Peacock, Investments  
Tanna Ridgway, Investments  
Bob Sessa, Investments  
Leighton Shantz, Investments  
Nile Stork, Information Systems  
Ariana Whaley, Executive Office

**VISITORS PRESENT**

Sam Austin, NEPC  
Phil Dial, Rudd & Wisdom, Inc.  
Rob Goldthorpe, NEPC  
Jeff Hardy, UnitedHealthcare  
Ray Hymel, TPEA  
Vernes Kekoza, Albourne  
Tom Martin, Askia Torrey-Cove  
Colleen McGlamry, UnitedHealthcare  
John Posey, Legislative Budget Board  
John Shearman, Albourne

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

### **5. Call Meeting of the Board of Trustees to Order**

Ms. Catherine Melvin, Chair of the Board of Trustees (Board) for the Employees Retirement System of Texas (ERS), called to convene 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 9:56 a.m. on Monday, May 3, 2022, as required by Chapter 551, Texas Government Code, referred to as "The Open Meetings Law".

### **6. Call Meeting of the Investment Advisory Committee to Order**

Mr. Gene Needles, Jr., Chair of the IAC for ERS, called the meeting to order and read the following statement:

A public notice of the ERS Investment Advisory Committee containing all items on the proposed agenda was filed with the Office of the Secretary of State at 9:56 a.m. on Monday, May 3, 2022, as required by Chapter 551, Texas Government Code, referred to as "The Open Meetings Law".

### **7. Review and Approval of the Minutes to the March 9, 2022, Joint Meeting of the Board of Trustees and Investment Advisory Committee – (Action)**

Mr. Gene Needles, Jr., IAC Chair, opened the floor for a motion on the approval of the minutes from the March 9, 2022, Joint Meeting of the Board of Trustees and Investment Advisory Committee.

An error, found by Mr. Hester, was noted and corrected in the minutes.

The IAC then took the following action:

Motion made 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 March 9, 2022.

Motion by Caroline Cooley, second by James R. Hille

Final Resolution: Motion Carries

Aye: Gene Needles, James R. Hille, Milton Hixson, Ken Mindell, Caroline Cooley, Laurie Dotter

The Board of Trustees then took the following action:

Motion made 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 March 9, 2022.

Motion by Jim Kee, second by Brian Barth

Final Resolution: Motion Carries

Aye: Neika Clark, Jim Kee, Craig Hester, Brian Barth, Catherine Melvin

There were no questions or further discussion on this item.

### **8. Consideration of Reappointments to the Investment Advisory Committee – (Action: Board Only Vote)**

Mr. David T. Veal, Chief Investment Officer, presented the Reappointments of the Investment Advisory Committee.

Mr. Veal recommended that Mr. Ken Mindell and Ms. Laurie Dotter be reappointed to the Investment Advisory Committee, based on their skills and experience.

The Board of Trustees then took the following action:

Motion made that the Board of Trustees of the Employees Retirement System of Texas approve the reappointments of Mr. Ken Mindell and Ms. Laurie Dotter to the Investment Advisory Committee for three-year terms ending May 31, 2025.

Motion by Brian Barth, second by Jim Kee

Final Resolution: Motion Carries

Aye: Craig Hester, Brian Barth, Neika Clark, Jim Kee, Catherine Melvin

There were no questions or further discussion on this item.

#### **9. Consideration of Annual Review of the ERS Incentive Compensation Plan**

Director of Human Resources DeeDee Sterns, and ICP Compensation Program Specialist Jamey Pauley, presented the annual review of the ERS Incentive Compensation Plan (ICP).

The presentation included a review of the primary objectives and various key features of the ICP, as well as a summary of the ICP awards over the last five years. The presentation included a review and discussion of the material changes which staff proposed making to the ICP. A draft of the plan with the recommended changes was included for Board review. The final plan will be presented for Board approval at the August Board meeting. This agenda item was informational only.

There were no questions or further discussion on this item.

#### **10. Quarterly Report from Chief Investment Officer**

Mr. David T. Veal, ERS Chief Investment Officer, presented the Chief Investment Officer's Report to review the performance, risk, and expenses of the Trust.

Mr. Veal discussed Trust performance showing the rate of return has been above the Policy Benchmark across all time horizons including an outperformance of 175 basis points over the trailing five-year period. He noted that this is the highest level of relative performance for the Trust within at least thirty years, adding approximately \$3 billion of value to the Trust.

It was noted that the biggest contributors to such strong relative performance were Private Real Estate, Global Credit, Rates, Private Equity, and Hedge Funds, with Private Equity accounting for 96 basis points of the 175 basis points. The only detractor was Public Equities, which accounted for -7 basis points.

Mr. Veal stated that all asset classes remain within their policy ranges with the exception of Private Equity, which is 0.5% above its policy benchmark of 18%. The shift in the asset mix toward of private markets has made external management the majority of the Trust (54% externally and 46% internally) and the Trust overall less liquid (36% illiquid).

Priorities for 2022 include but are not limited to, completion of the Asset/Liability Study and recommended annual updates to the Investment Policy Statement. Mr. Veal expects that the final Asset/Liability Study will be delivered to the Board for consideration at the August Board meeting.

There were no questions or further discussion on this item.

#### **11. \*Consideration of Quarterly Review of Investment Performance and Risk Update**

Mr. David T. Veal, Chief Investment Officer, Mr. Carlos Chujoy, Director of Risk Management, and Mr. Sam Austin, NEPC, presented investment performance for the first calendar quarter of 2022.

Mr. Austin stated that the total Trust was down -1.7% for the quarter, Compared to its peers (public pension funds in the U.S. with assets greater than \$1 billion), ERS is in the seventh percentile,

meaning that 93% of peers performed worse. He added that the Trust was positioned defensively when markets were negative.

Mr. Austin stated that in a one-year period ended March 31, 2022, the Trust outperformed the Policy Benchmark by 4.1% and ranked in the first percentile among its peers. The Trust increased from \$32.02 billion to \$35.21 billion. This includes a \$4.18 billion net investment gain within the one-year period and a \$609 million net investment loss within the first calendar quarter of 2022.

For the five-year period ended March 31, 2022, the Trust outperformed the Policy Benchmark by 1.8% and ranked in the seventh percentile. On a risk-adjusted basis, the three-year and five-year Sharpe and Sortino Ratios of the Trust also outperformed those of the Policy Benchmark, indicating that active management has benefitted the Plan. The three-year and five-year Fund returns have also outperformed the actuarially assumed rate of return.

Mr. Austin concluded that over the past ten years, the Total Trust's returns have outperformed the Policy Benchmark by 0.8 % and outperformed the Plan's actuarial rate of return of 7.0%.

Mr. Chujoy discussed the outlook for the Trust, highlighting major headwinds and tailwinds during the quarter. The Heat Map of Global Stress Indicators chart showed higher expected risk levels in the market going forward. He stated that implied risk has risen across a number of asset classes since 2021.

Mr. Chujoy stated that liquidity has been a main driver of risk seeking assets. Another major source of risk has been the rise of inflation and the anticipation that the Federal Reserve will start quantitative tightening in June. He explained that the combination of interest rate risk and tighter liquidity makes financial conditions for return seeking assets very challenging.

Mr. Chujoy explained that commodity markets increased during the quarter. Equity investors were concerned about downside risk, while commodity investors were trying to hedge against rising prices on commodities.

Mr. Chujoy discussed that several traditional assets such as technology that are interest rate sensitive performed poorly. He added that European markets fell due to the geopolitical tensions between Ukraine and Russia. Gas, oil, wheat, corn, and some hedge fund strategies performed better than the traditional assets.

Mr. Chujoy concluded that ERS' Trust performed well. The Trust's performance had a higher return and lower risk relative to the Policy Benchmark.

There were no questions or further discussion on this item.

## **12. Consideration of 2022 Asset Liability Study**

Mr. David T. Veal, Chief Investment Officer, Mr. Carlos Chujoy, Director of Risk Management, Mr. Sam Austin and Mr. Rob Goldthorpe, NEPC, presented a draft of the 2022 Asset Liability Study.

Mr. Veal reminded the Board that the asset liability study evaluates the long-term trajectory of the funded state of the Trust given potential trajectories for the assets and liabilities. This analysis can then be used to help determine the optimal asset allocation in view of the long-term outlook for Trust liquidity.

Mr. Goldthorpe reviewed the main characteristics of the pension plans administered by ERS. He stated that of the three pension plans: ERS, LECOS, and JRS2, ERS is by far the main cost driver

He added with recent legislative changes (SB321) ERS is now on a much better path due to the state's commitment to "Legacy Payments" to the Trust to pay off the unfunded liability by 2054. NEPC's Capital market assumption expects the beta return of the Trust to be 6.6% over 30 years versus the 7.0% actuarially assumed rate of return.

Mr. Goldthorpe showed the Board several capital market assumptions showing how quickly the Trust could return to fully funded with different scenarios for asset returns.

Mr. Goldthorpe concluded that with other allocation changes and improvements on drawdowns, the trajectories of assets could change such that the funding outcomes could be different. Mr. Austin added that once Mr. Goldthorpe completes his preliminary analysis, the NEPC team would start comparing notes on different asset allocation mixes that would make sense between now and the time NEPC reports back in August.

The Board encouraged NEPC to evaluate multiple scenarios with a range of different asset allocation mixes. Mr. Austin commented that the Trust asset mix is already highly efficient, as opposed to some of its peers that have more constraints. He added that ERS staff continues to analyze different ways to achieve better returns by implementing the asset allocation differently.

There were no questions or further discussion on this item.

### **13. Consideration of Annual Review of Private Equity Program and Proposed Private Equity Tactical Plan– (Action)**

Mr. David T. Veal, Chief Investment Officer, and Mr. Ricky Lyra, Director of Private Equity, presented the annual review of the Private Equity Program and Proposed Private Equity Tactical Plan.

The Private Equity portfolio has had a strong performance across all time horizons beating its benchmark in the one, three, five, and 10 year periods, including +301 basis points over ten years.

Mr. Lyra stated that strong performance has increased the Trust allocation to Private Equity to 18.8%, causing the asset class to be over its 13% target and 18% limit. He added that since 2019 the team has been working to get closer to the target by taking a half billion dollars to the secondary market, cutting back on commitment targets by 20% in 2020, and cutting back another 25% on commitment targets this fiscal year.

Mr. Lyra explained that the portfolio grew by \$2.5 billion, causing the value to increase to \$6.5 billion, increasing the allocation to Private Equity by 600 basis points. Mr. Lyra stated that the team expects growth to slow, though the portfolio's cash flow is expected to remain positive given the maturity of the program and amount of NAV available.

Mr. Lyra discussed the diversification of the portfolio. He stated that the U.S represents 53.5%. He added that Buyout, Secondary, and Venture Capital are the largest strategies. The portfolio's largest sector is represented by 23.8% of Secondaries and Fund of Funds.

The Board asked questions regarding investment expenses in years 2021-2022. Mr. Lyra stated that recent increases in profit share payments to Private Equity managers were due to the volume of capital distributions received by ERS. Mr. Lyra emphasized that Private Equity managers only get their profit share when ERS gets its part of the profit, which is at least four times larger.

Mr. Lyra highlighted that the goal and objective for Fiscal Years 2022 and 2023 is to continue executing the capital plan and strategically adjusting the target allocation.

Mr. Lyra presented the proposed FY23 Tactical Plan. Mr. Lyra stated that the plan is to continue to reduce the pace of commitments and turn the allocation curve down to the target of 13% without sacrificing any potential co-investment, ability to negotiate any terms, or harm any relationships the team has with top performing managers.

Mr. Lyra commented that the team is requesting \$600 million dollars with a plus or minus range of 25%. The team expects to commit to 10 to 12 new funds and 3 to 4 co-investments. He stated that if the Private Equity allocation were currently at its target, the request would have been \$800 to \$850 million with 14 to 16 new funds and 8 to 10 co-investments.



The Board asked what would change if the target allocation were revised from 13% to 16% and whether the target range would then be \$750 to \$800 million. Mr. Lyra stated he would still want to see the allocation curve begin to bend downward before raising the target level of commitments. Mr. Lyra went over a pacing model assumption to show several ways to slow down the growth of the program.

The IAC then took the following action:

Motion made that the Investment Advisory Committee of the Employees Retirement System of Texas approve the proposed Private Equity Tactical Plan for Fiscal Year 2023.

Motion by James R. Hille, second by Laurie Dotter

Final Resolution: Motion Carries

Aye: Robert G. Alley, Gene Needles, Ken Mindell, James R. Hille, Milton Hixson, Laurie Dotter, Caroline Cooley

Motion made that the Board of Trustees of the Employees Retirement System of Texas approve the proposed Private Equity Tactical Plan for Fiscal Year 2023.

Motion by Craig Hester, second by Brian Barth

Final Resolution: Motion Carries

Aye: Craig Hester, Brian Barth, Neika Clark, Jim Kee, and Catherine Melvin

There were no questions or further discussion on this item.

#### **14. Consideration of Annual Review of the Hedge Fund Program and Proposed Hedge Fund Tactical Plan**

Mr. David T. Veal, Chief Investment Officer, Mr. Nicholas Maffeo, Director of Hedge Funds, and Mr. Panayiotis Lambropoulos, Hedge Funds Portfolio Manager, presented the Annual Review of Hedge Fund Program and Proposed Hedge Fund Tactical Plan.

Mr. Maffeo stated that the Absolute Return Portfolio is an externally managed risk-reducing or risk-mitigating portfolio to the Trust. The policy allocation has a target weight of 5% with a range of 0% to 10%. The return target for this portfolio is T-bills plus 3.50% or better. The Absolute Return Portfolio has beat its benchmark for the one, three, five year and since inception basis and has had strong returns across all time horizons.

The Board suggested that Hedge Funds use a hedge fund focused benchmark to be clear about how it is performing compared to other hedge funds rather than a hurdle rate.

Mr. Maffeo responded that the team tracks performance internally versus the HFRI Diversified and the HFRI Conservative Indices month over month. Mr. Veal added that the team is having discussions regarding what is the best benchmark to use.

The Board commented that the portfolio could take on more risk than being conservatively positioned low in the risk range.

Mr. Maffeo stated that the portfolio's risk levels have been below target, but the portfolio has still been able to deliver performance that has exceeded the primary benchmark. He added that with multi-decade high inflation, rising interest rates, and geopolitical tensions, he is comfortable with the portfolio's level of risk being closer to the lower end of the targeted range given that these factors may come into play throughout the course of the year.

Mr. Maffeo discussed the diversification and the geographic exposure breakdown of the portfolio. The portfolio remains diversified by geographies and is within the internal asset class guidelines.

Mr. Maffeo stated that the Directional Growth Portfolio is a return-seeking portfolio to the Trust. The management style is external via internal allocation decisions. Over the one year, three year, five

year, and since inception basis, performance has remained strong across all time horizons and risk levels have remained within guidelines.

Mr. Lambropoulos stated that Launchpad is a return-seeking program and is managed externally via a partnership with PAAMCO Prisma. It has a blended benchmark that is based on the underlying strategies within the portfolio.

Mr. Lambropoulos highlighted that since its inception less than 36 months ago, the Launchpad Program has outperformed its benchmark by approximately 200 basis points. The first investment in the program was to an equity market neutral strategy in September of 2019.

Mr. Maffeo discussed initiatives for 2023. Starting with the Launchpad Program, the team would like to propose the transition of this portfolio from the Special Situations Portfolio to the Hedge Funds Program at the beginning of Fiscal Year 2023. Mr. Maffeo commented that the team believes the portfolio is a better fit for the Hedge Fund Program given its stated objectives. Secondly, the team is proposing that the Directional Growth Portfolio transition to the External Public Equities team for Fiscal Year 2023.

The Board asked questions regarding liquidity of the Hedge Fund Program.

Mr. Maffeo proposed the Tactical Plan for Fiscal Year 2023:

- Absolute Return: 0-2 new exposures including replacements or enhancements to existing allocations
- Launchpad: 0-1 new exposures including replacements or enhancements to existing allocations
- Maintain emphasis on diversifying strategies to complement existing investments across all three allocations

The IAC then took the following action:

Motion made that the Investment Advisory Committee of the Employees Retirement System of Texas approve the Proposed Hedge Fund Tactical Plan for Fiscal Year 2023.

Motion by Robert G. Alley, second by Laurie Dotter

Final Resolution: Motion Carries

Aye: Robert G. Alley, Gene Needles, Ken Mindell, James R. Hille, Milton Hixson, Laurie Dotter, Caroline Cooley

Motion made that the Board of Trustees of the Employees Retirement System of Texas approve the proposed Hedge Fund Program Tactical Plan for Fiscal Year 2023.

Motion by Brian Barth, second by Craig Hester

Final Resolution: Motion Carries

Aye: Craig Hester, Brian Barth, Neika Clark, Jim Kee, and Catherine Melvin

There were no questions or further discussion on this item.

#### **15. Reminder Regarding Future Meetings - Adjournment of the Joint Meeting of the Board of Trustees and Investment Advisory Committee and Reminder of Upcoming Meeting Dates**

The Joint Meeting of The Board of Trustees and Investment Advisory Committee Meeting adjourned at 3:09 p.m.