

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

August 24, 2022



Presented for Review and Approval

December 07, 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  
August 24, 2022– 8:30 a.m.**

**TRUSTEES PRESENT**

Catherine Melvin, Chair  
Jim Kee, Vice-Chair  
Brian Barth, Member  
Neika Clark, Member  
Craig Hester, Member  
John R. Rutherford, 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  
DeeDee Sterns, Director of Human Resources  
Kathryn Tesar, Director of Benefits Communications  
Gabrielle Schreiber, Director Office of Procurement & Contract Oversight  
David T. Veal, Chief Investment Officer

**ERS STAFF PRESENT**

Jason Avants, Information Systems  
Georgina Bouton, Group Benefits  
Carlos Chujoy, Investments  
Raquel Colon, Investments  
Kurt Cressotti, Internal Audit  
Amy Cureton, Investments  
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  
Tressie Landry, Internal Audit  
Ricardo Lyra, Investments  
Jamey Pauley, Executive Office  
Tanna Ridgway, Investments  
Bob Sessa, Investments  
Nile Stork, Information Systems  
Ariana Whaley, Executive Office  
Annie Xiao, Investments

**VISITORS PRESENT**

Sam Austin, NEPC  
Phil Dial, Rudd & Wisdom, Inc.  
Christy Fields, Mekeeta  
Rob Goldthorpe, NEPC  
Jeff Hardy, UnitedHealthcare  
Asif Husain, CBRE  
Colleen McGlamry, UnitedHealthcare  
John Posey, Legislative Budget Board  
Casey Sharp, BCBSTX  
John Shearman, Albourne  
Charlie Smith, LBB  
David Toller, Optum RX  
Aaron Vale, CBRE

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

### **6. 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 2:23 p.m. on Tuesday, August 16, 2022, as required by Chapter 551, Texas Government Code, referred to as "The Open Meetings Law".

### **7. 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 2:23 p.m. on Tuesday, August 16, 2022, as required by Chapter 551, Texas Government Code, referred to as "The Open Meetings Law".

### **8. Consideration of the Minutes to the May 11, 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 May 11, 2022, Joint Meeting of the Board of Trustees and Investment Advisory Committee.

The IAC then took the following action:

**Move** that the Investment Advisory Committee approve the minutes of the Joint Meeting of the Board and IAC held on May 11, 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, Ryan Bailey, Ruby Muñoz Dang

The Board of Trustees then took the following action:

**Move** that the Board of Trustees approve the minutes of the Joint Meeting of the Board and IAC held on May 11, 2022.

**Motion** by Jim Kee, second by Craig Hester

Final Resolution: Motion Carries

Abstain: John R. Rutherford

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

There were no questions or further discussion on this item.

### **9. Introduction of Newly Appointed Trustee**

Mr. Porter Wilson, Executive Director, presented the Introduction of Newly Appointed Trustee.

Mr. Porter introduced the new Board of Trustee Mr. Rutherford, who was appointed on May 19, 2022 by Governor Abbott. For a term, that expires August 31, 2024.

Mr. Rutherford gave an overview of his extensive career and accomplishments.

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 excess return of 189 basis points over a five-year period. He noted that this is the highest level of performance of the trust within thirty years, adding approximately \$3 billion of value to the Trust.

Mr. Veal stated that the biggest contributor to the Trust was Private Equity contributing 99 basis points to the five-year outperformance. Private Real Estate contributed 28 basis points and Global Credit contributed 29 basis points.

In response to the Board, David discussed how Private Markets calculate gains. He explained that the gains are marked to market.

Mr. Veal stated that all asset classes remain within their policy ranges with the exception of Private Equity, which is 1.7% above its policy benchmark of 18%. The growth of private markets has shifted the management of the Trust so that the majority of the Trust is now externally managed (externally 57% and internally 43%) and less liquid (The trust is now 41% illiquid).

Priorities for 2023 include but are not limited to, attracting and retaining talent, continue to improve key processes focusing heavily on asset allocation and risk management to complete the governance review with NEPC. Lastly, now that the organizational restructuring is complete, Mr. Veal stated that the Investment team would sustain the success of these new initiatives by developing the new emerging leaders.

There were no questions or further discussion on this item.

#### **11. \*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 the investment performance for the second calendar quarter of 2022.

Mr. Austin stated that the total Trust has outperformed the policy benchmark, passive index, assumed rate of return, and peers (public pension funds in the U.S. with assets greater than \$1 billion) over the 3, 5, and 10 year.

Mr. Austin stated that in a one-year period ended June 30, 2022, the Trust outperformed the policy benchmark by 3.1%. The Trust increased from \$33.90 billion to \$33.03 billion. This includes a \$144 million net investment gain within the one-year period and a \$1.81 billion net investment loss within the second calendar quarter of 2022.

For the five-year period, ended June 30, 2022, the Trust outperformed the policy benchmark by 1.9%. On a risk-adjusted basis, the three-year and five-year Sharpe and Sortino Ratios outperformed the benchmark, indicating that active management benefitted the Plan.

Mr. Austin concluded that over the past 10 years, Total Trust returns outperformed the Policy Benchmark by 0.9% and outperformed the Plan's actuarial rate of return of 7.0% by 1.4%.

Mr. Chujoy highlighted the major headwinds and tailwinds during the quarter. The only tailwind was the signs of the inflation rate stabilizing. The Heat Map of Global Stress Indicators chart showed financial conditions continued to tighten up with interest rates on the rise and the market showing fears of a recession. The Treasury Spread model indicates a potential for a recession is in the near future.

Mr. Chujoy stated that rates volatility has been the main driver of risk during the quarter and that risk indicators remained at a high level implying higher volatility in the future.

Mr. Chujoy explained that performance was heavily challenged for the quarter as interest rates rose. Mr. Chujoy discussed that several traditional assets that are interest rate sensitive did poorly, such as technology and NASDAQ. Oil, corn, and the Russian ruble performed better than the traditional assets.

The ERS Trust was also negatively impacted because of the market delivering negative returns, but the diversification within the composition helped the Trust.

Mr. Chujoy stated that inflation was not just a US phenomenon, but also a global phenomenon. Inflation readings were both high for emerging and developing markets. He added that there was also a deceleration of economic activity relative to the first quarter.

Mr. Chujoy concluded that despite these challenges in the second quarter the Trust delivered positive relative performance by downshifting to more risk mitigating assets oppose to return seeking assets.

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. Sam Austin and Mr. Rob Goldthorpe, NEPC, presented the on the 2022 Asset Liability Study.

Mr. Veal reminded the Board that the asset liability study compares the long-term asset return trajectory and the analysis of the long-term liability study to help determine the best asset allocation and Trust liquidity.

Mr. Goldthorpe went over the changes NEPC has made to the asset liability study since the preliminary results were presented in May 2022 Board meeting. He discussed the data provided by GRS commenting it was instrumental in improving Legacy contribution projections. He stated that the main adjustment was a reduction in future normal cost that now allows for more of the unfunded liability to be paid down faster resulting in lower projected legacy contributions. He added stated that the models were updated to incorporate the most recent NEPC capital market outlook.

Mr. Goldthorpe showed the Board alternative mixes to provide comparative analysis alongside the Current Policy allocation. Mix A & Mix B: realistic mixes that marginally adjusts current targets. Mix C illustrated the potential of maintaining higher current targets to private equity and adding to hedge funds.

Mr. Veal discussed the staff's analysis of the Asset Liability Study Asset Allocation Mixes and concluded that staff believes Mix B represents the best balance of the evaluation criteria with some mixes would requiring significant turnover to achieve targets or some mixes included even lower level of liquid assets than the current portfolio.

The IAC then took the following action:

**Move** that the Investment Advisory Committee approve the strategic asset allocation parameters of Mix B.

**Motion** by Laurie Dotter, second by James R. Hille

Final Resolution: Motion Carries

Abstain: Ken Mindell

Aye: Gene Needles, James R. Hille, Milton Hixson, Caroline Cooley, Laurie Dotter, Ryan Bailey, Ruby Muñoz Dang

The Board of Trustees then took the following action:

**Move** that the Board of Trustees approve the strategic asset allocation parameters of Mix B.

**Motion** by Brian Barth, second by Craig Hester

Final Resolution: Motion Carries

Abstain: John R. Rutherford

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

There were no questions or further discussion on this item.

### **13. Consideration of the Investment Policy Statement**

Mr. David T. Veal, Chief Investment Officer, Ms. Cynthia Hamilton, General Counsel, and Kurt Cressotti, Investment Compliance Officer, presented the Consideration of the investment Policy Statement.

Mr. Veal stated that he Board requires a review of the investment Policy (IPS) annually. Investments, Investment Compliance, and the Office of general Counsel reviewed the newly developed IPS.

The most significant proposed changes included:

- Updating the SAA parameters to balance liquidity & returns
- Address recommendations of NEPC governance report
- Improve upon the code of ethics/standards of conduct
- Revised for better policies for Scrutinized Investments and an improved management of the Group Benefit Funds

The IAC then took the following action:

**Move** that the Investment Advisory Committee approve the Investment Policy Statement.

**Motion** by Ken Mindell, second by James R. Hille

Final Resolution: Motion Carries

Aye: Ken Mindell, Gene Needles, James R. Hille, Milton Hixson, Caroline Cooley, Laurie Dotter, Ryan Bailey, Ruby Muñoz Dang

The Board of Trustees then took the following action:

**Move** that the Board of Trustees approve the proposed Hedge Fund Program Tactical Plan for Fiscal Year 2023.

**Motion** by Craig Hester, second by Jim Kee

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 the Incentive Compensation Plan**

DeeDee Sterns, Director of Human Resources, Jamey Pauley, ICP Program Specialist, David T. Veal, Chief Investment Officer presented the proposed changes to the ERS Incentive Compensation Plan (ICP) for Fiscal Year 2023.

The proposed changes included:

- Revising the three and five year performance periods to be weighted more heavily
- Increasing the minimum percentage attributable to Global Composite Performance (overall Trust)



- Further simplifying the Global Composite Performance calculation
- Reducing the waiting periods for new hires

The Board of Trustees then took the following action:

**Move** that the Board of Trustees approve the Incentive Compensation Plan for Fiscal Year 2023.

**Motion** by Jim Kee, 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.

#### **15. Consideration and Annual Review of Real Estate Program and Proposed Annual Tactical Plan for Fiscal Year 2023 – (Action)**

David T. Veal, Chief Investment Officer, Robert Sessa, Managing Director of Real Assets, Amy Cureton, Director of Private Real Estate, and Annie Xiao, Director of Public Real Estate presented the Annual Review and the Proposed Tactical Plan for 2023 for the Real Estate Program.

Mr. Sessa stated that the Real Estate Program is a combination of two return seeking programs. Public Real Estate (known as REITS) makes up about 2.8% of the Trust and Private Real Estate makes up 9% of the Fund.

Ms. Xiao stated that the REIT Portfolio totaled \$914 million dollars as of June 30, 2022. She added that 60% of the portfolio is US based and 36% is based in Asia and Europe.

Since inception, the REIT portfolio has outperformed its benchmark for the one, three, and 5 year since inception. The portfolio had a strong performance adding 101 basis points of value over the last five years. The outperformance was driven by allocation selection. Ms. Xiao explained the portfolio has a tracking error of 200 basis points, but has been well below that. She stated that the team intends to take more risk as the program matures.

Ms. Xiao state that going forward in year 2023 the team will focus on continuing to outperform respective benchmarks and be in compliant with the Investment Policy Statement while improving the investment process. The team is working on finding a replacement for a Domestic REIT portfolio manager (Tony Cardona) who departed in September.

Mr. Sessa stated the Private Real Estate target weight is 9%, and is currently under 11%.

Ms. Cureton stated that Private Real Estate's allocation has increased over time due to strong performance. The portfolio outperformed the policy benchmark for the one-, three-, five-, and 10-year, including 400 basis points of value added over the last 10 years.

Ms. Cureton stated that the Private Real Estate is highly diversified with tilts toward residential and away from industrial.

Mr. Sessa discussed the geographic weights based on the Private Real Estate portfolio's' showing that 79% of the portfolio is US based. Asia makes up 14 % of the portfolio with very with no China centric funds.

In Fiscal Year 2023, the portfolio will continue to outperform its benchmark, execute on the tactical plan while responsive to adjusting commitments as needed.

In Fiscal Year 2023, the team is targeting \$200 million in commitments with a target range of \$100 million to \$300 million and three to six commitments with existing managers, but new relationships will be built.

The IAC then took the following action:

**Move** that the Investment Advisory Committee approve the Proposed Real Estate Tactical Plan for Fiscal Year 2023.

**Motion** by Laurie Dotter, second by Caroline Cooley

Final Resolution: Motion Carries

Aye: Ken Mindell, Gene Needles, James R. Hille, Milton Hixson, Caroline Cooley, Laurie Dotter, Ryan Bailey, Ruby Muñoz Dang

The Board of Trustees then took the following action:

**Move** that the Board of Trustees approve the Proposed Real Estate Tactical Plan for Fiscal Year 2023.

**Motion** by Jim Kee, second by John R. Rutherford

Final Resolution: Motion Carries

Aye: Craig Hester, Brian Barth, Neika Clark, Jim Kee, John R. Rutherford, and Catherine Melvin

There were no questions or further discussion on this item.

#### **16. Consideration and Annual Review of Private Infrastructure Program and Proposed Annual Tactical Plan for Fiscal Year 2023 - (Action)**

David T. Veal, Chief Investment Officer, Mr. Pablo de la Sierra Perez, Director of Private Infrastructure, presented the Annual Review and the Proposed Tactical Plan for 2023 for the Private Infrastructure Program.

Mr. de la Sierra Perez stated that as of March 31, 2022 the portfolio has had a strong performance across all time horizons, including 480 basis points over five years. The program has outperformed the benchmark for the three, five, and 10 year. Return has been driven by appreciation, current yield, and capital distributions. He added that since inception the portfolio the asset value and the cash flow continue to rise as the portfolio moves towards maturity.

North America makes up the largest component of the portfolio at 47%. The remainder is in Europe (14%), Asia (14%), and Latin America (16%). Mr. de la Sierra Perez stated that the portfolio is diversified, with 50% of the portfolio invested in power, midstream, and utilities 32% of the portfolio is made up of telecom.

Mr. de la Sierra Perez stated that for the 2023 Tactical Plan the team is proposing to invest in 3-6 investments and 2-4 co-investments with commitments totaling \$250 million with a target range of \$200 million-\$300 million.

In Fiscal Year 2023, the portfolio will continue to focus on co- investments/directs, execute on the tactical plan while responsive to adjusting the allocation strategy as needed, and continue to seek alternative benchmarks that best fit the portfolio. The team also plans to hire one senior analyst.

The IAC then took the following action:

**Move** that the Investment Advisory Committee approve the Proposed Private Infrastructure Tactical Plan for Fiscal Year 2023.

**Motion** by Ken Mindell, second by Laurie Dotter

Final Resolution: Motion Carries

Aye: Ken Mindell, Gene Needles, James R. Hille, Milton Hixson, Caroline Cooley, Laurie Dotter, Ryan Bailey, Ruby Muñoz Dang

The Board of Trustees then took the following action:

**Move** that the Board of Trustees approve the proposed Private Infrastructure 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, John R. Rutherford, and Catherine Melvin

There were no questions or further discussion on this item.

**17. Set Fiscal Year 2023 Meetings of the Board of Trustees, Investment Advisory Committee, and Audit Committee**

The Board was reminded of the Fiscal Year 2023 meeting dates.

**18. 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 Meeting adjourned at 2:30 p.m.