

Public Agenda Item #12

Quarterly Report from Chief Investment Officer

May 17, 2023

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Investment Performance

Mission & Objectives



Prudently maintain a high-performing, well-diversified, and cost-effective portfolio to support the provision of earned benefits.



Add value vs. benchmark
over rolling five-year periods



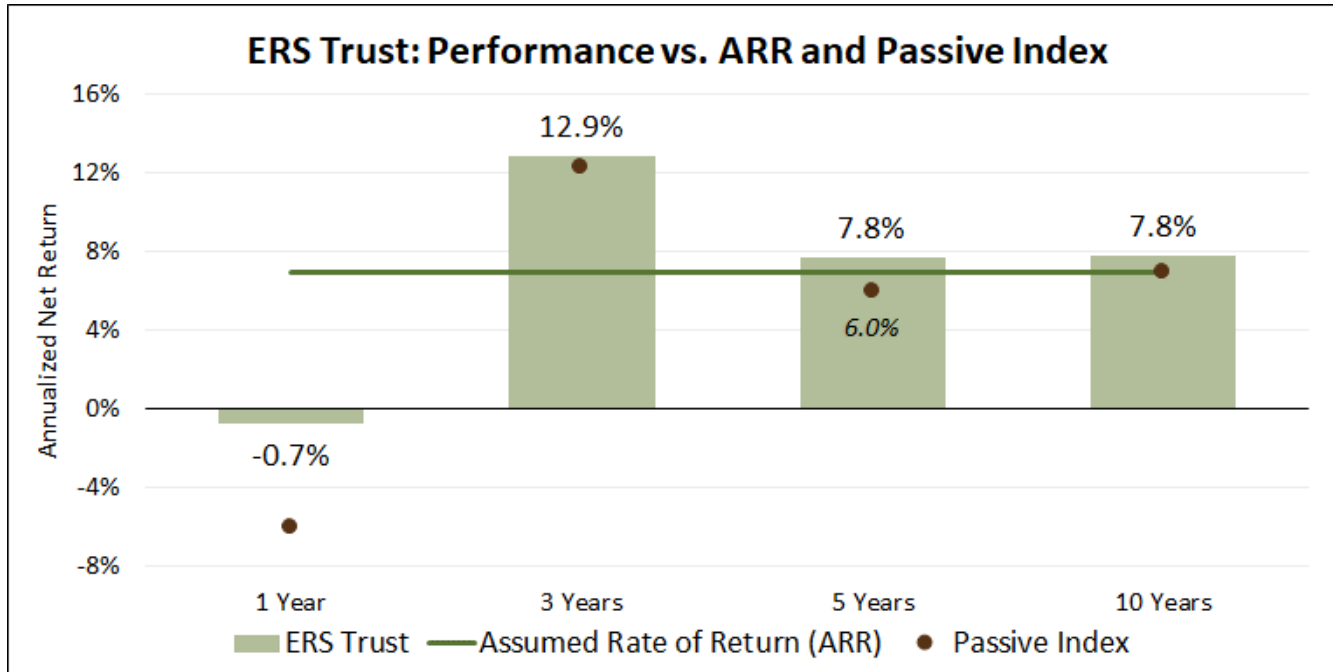
Earn appropriate returns
for the risks assumed

Retirement Fund Performance

Absolute Return



- Meeting strategic objectives despite weak returns from passive public market portfolios

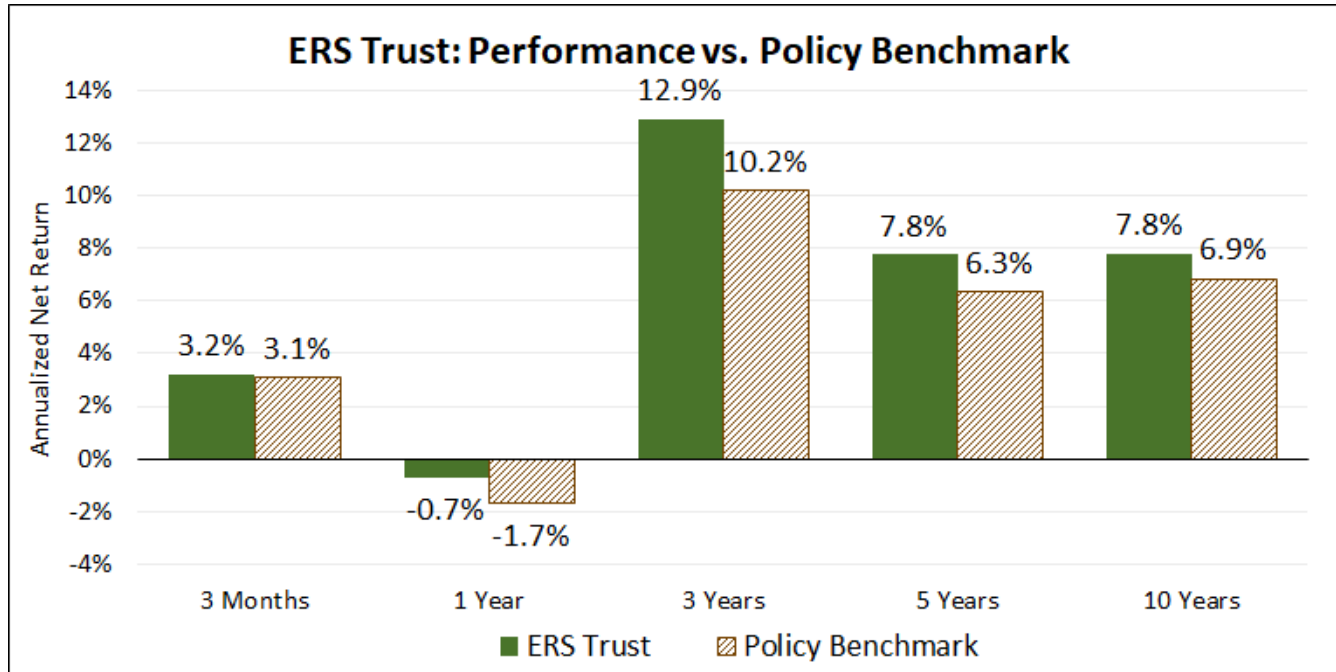


Retirement Fund Performance

Relative Return



- Strong performance vs. Policy Benchmark, including +142 bps on a 5-year basis

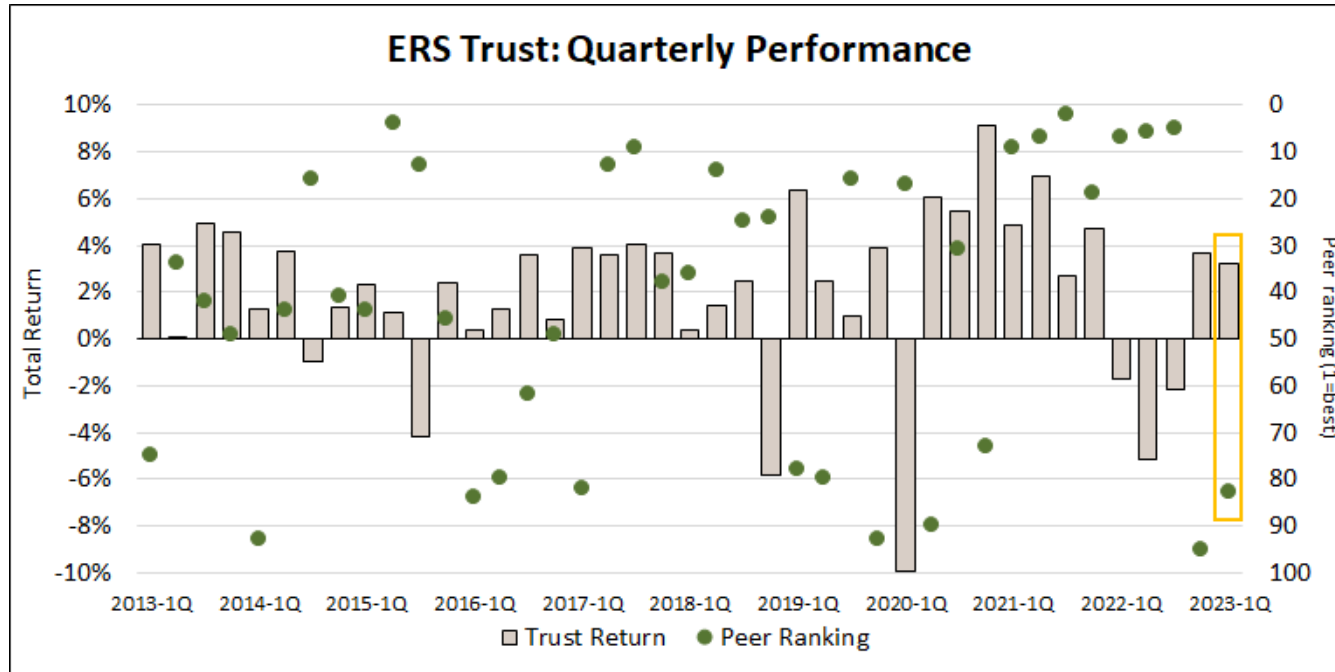


Retirement Fund Performance



Quarterly Performance

- Positive absolute returns for second consecutive quarter, though with low peer ranking

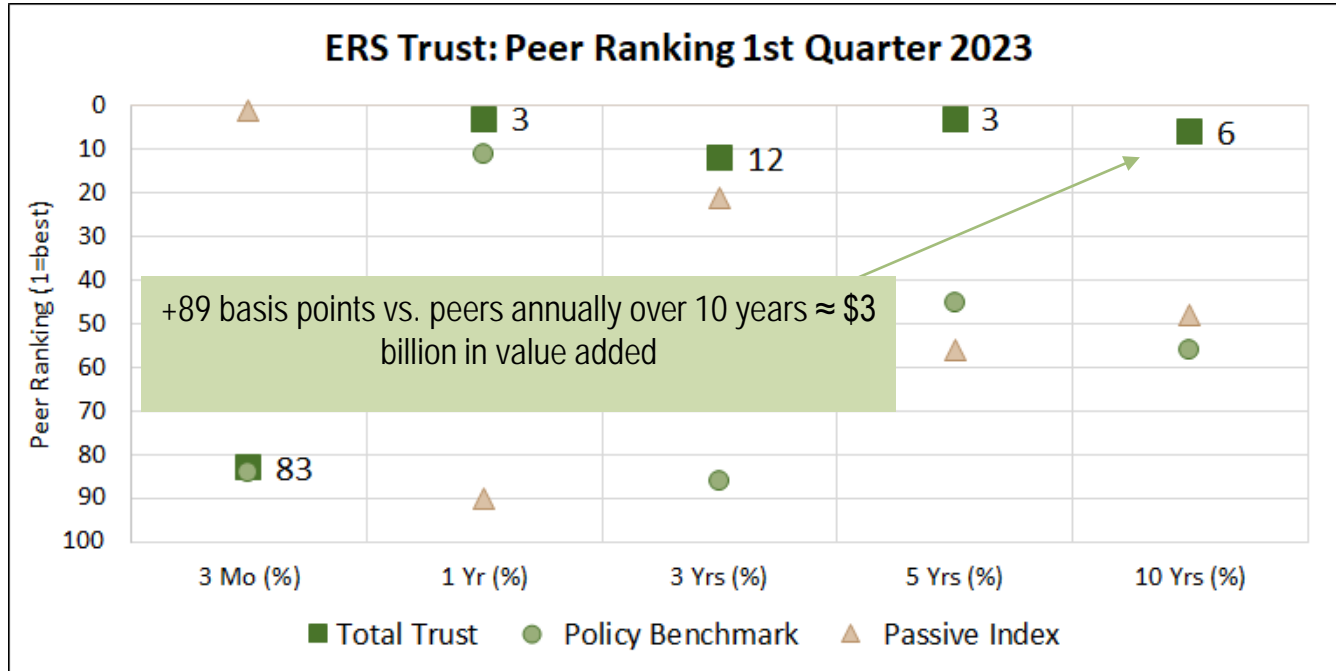


Retirement Fund Performance



Peer Rankings for Current Quarter

- Superior performance over long horizons, including top decile of peers over 5-10 years

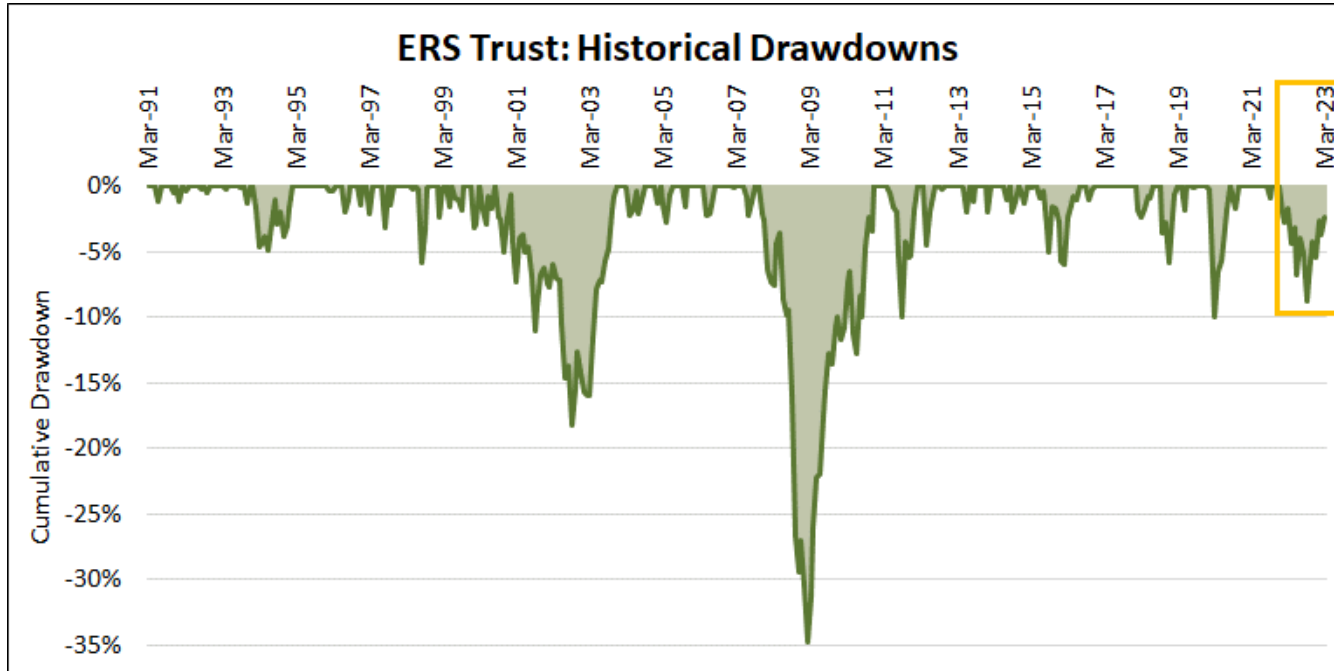


Retirement Fund Performance

Historical Drawdowns



- Fund performance recovering from down 9% to only down 3% currently

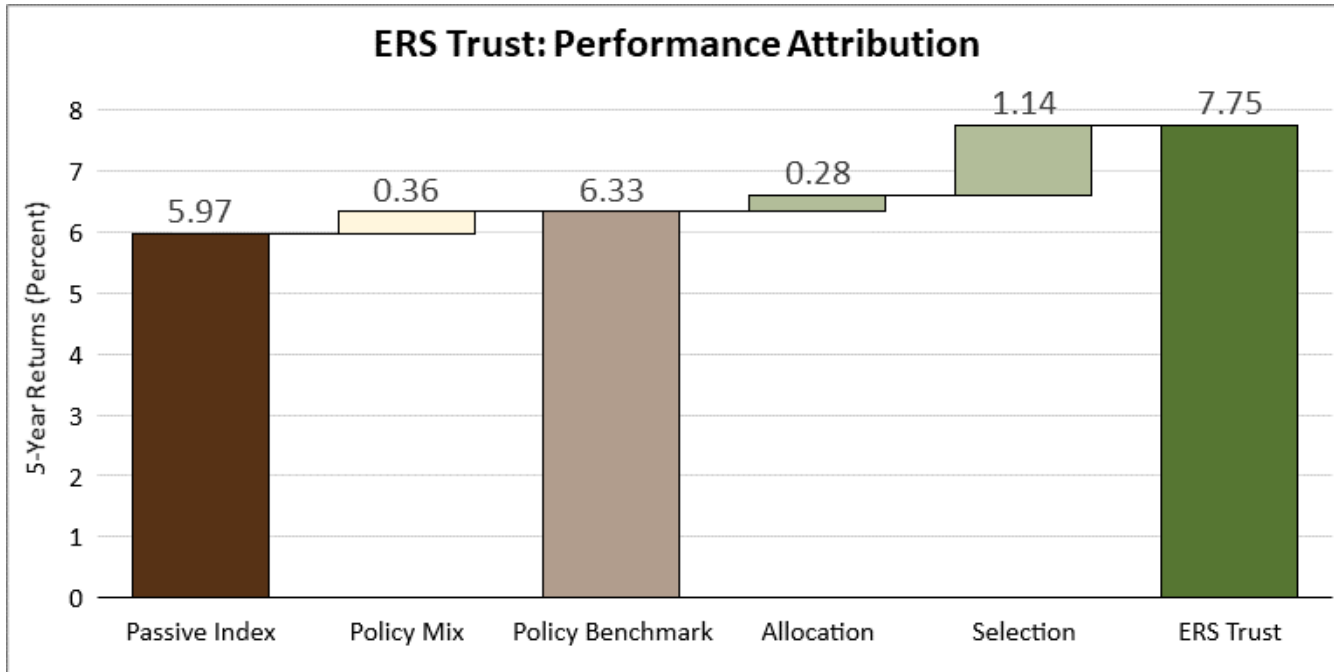


Retirement Fund Performance

Attribution Analysis



- Meaningful excess return from both asset allocation and security selection decisions

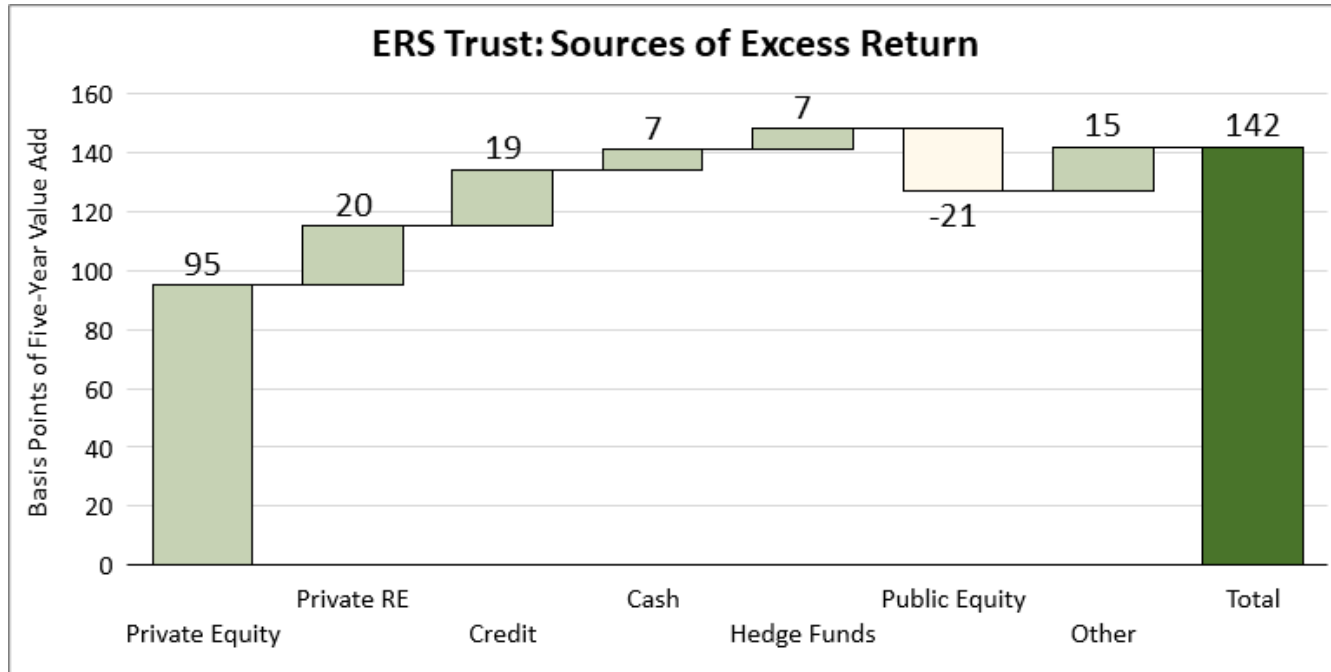


Retirement Fund Performance

Attribution Analysis



- Private equity, private real estate, and credit represent 95% of five-year value add

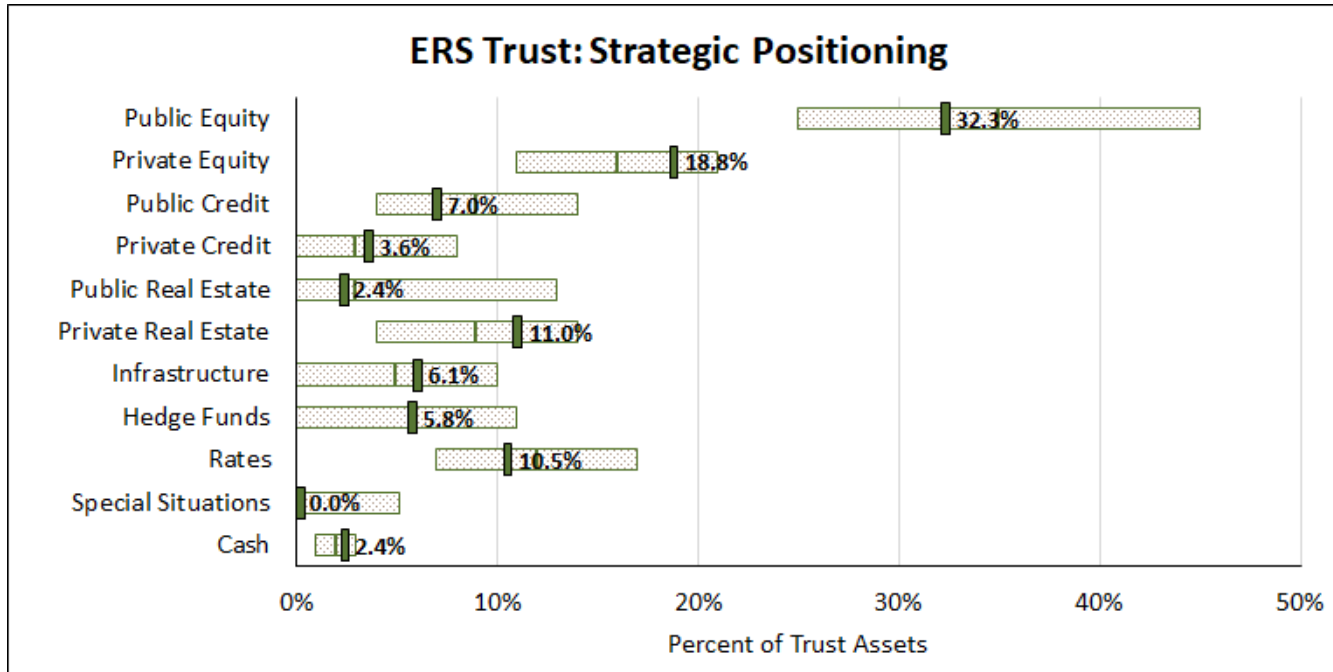


Retirement Fund Performance



Asset Class Positioning

- Asset classes within ranges including private equity at 18.8%, well below 21% maximum



Developments & Initiatives

Investments Division



- Focus on attracting and retaining talent
- Stewardship activities including proxy voting
- Investment Practices Review with NEPC
- Potential recommendations for IPS in August
- Division moves to 5th floor of legacy building
- RFQ for all seven investment consulting roles

ERS Approach to Valuation of Investments

Valuation Analysis

Accounting Standards



- Set by Government Accounting Standards Board (GASB)
- GASB Statement #72: Fair Value Measurement and Application
- Adopted by ERS beginning in Fiscal Year 2016



Investments for which
fair value is assigned by
ERS staff



Investments for which
fair value is assigned by
ERS managers

What is fair value?

The price that would be received from the orderly sale of an asset to another market participant on the measurement date.

Valuation Analysis

Methods for ERS Staff



- GASB 72 establishes a valuation hierarchy with three levels

①

Uses unadjusted quoted prices for identical assets in active markets.

Example: exchange-traded stocks

②

Uses quoted prices for identical or similar assets in active or inactive markets, or

Uses a model in which all significant inputs are observable.

Example: high yield bonds traded over the counter

③

Uses techniques in which significant inputs are unobservable.

Example: mortgage-backed securities

Valuation Analysis

Methods for ERS Managers



- Managers report Net Asset Value (NAV) of investment to ERS
- Governed by Financial Accounting Standards Board (FASB)
- US standards set by ASC 820, Fair Value Measurement



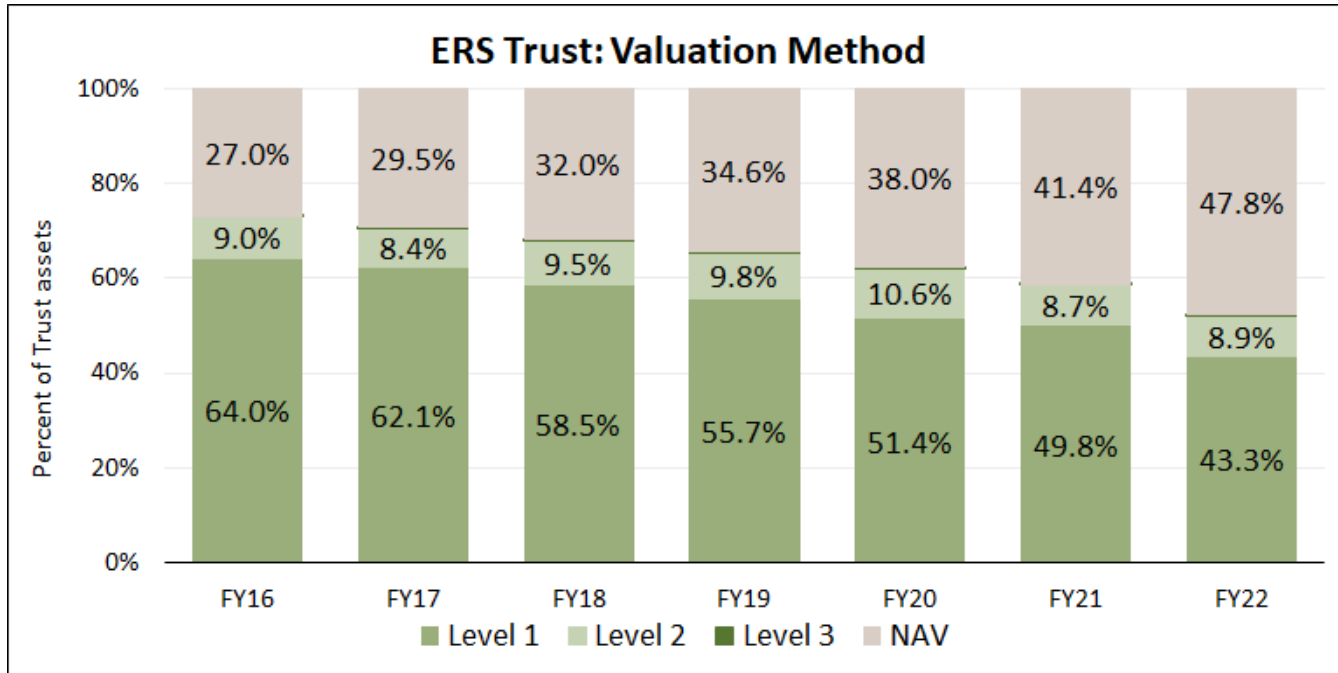
GASB 72 requires ERS to verify the consistent application of these standards

Valuation Analysis



Unrealized Gain/Loss by Asset Class

- Valuations increasingly determined by managers and less by ERS



Valuation Analysis

Methods for ERS Managers



- ASC 820 provides for three techniques to measure fair value

①

Market Approach

Uses prices and other relevant information generated by market transactions involving identical or comparable assets.

“Comparable Transactions”

②

Income Approach

Uses a financial model to convert future earnings to a single present amount based on current expectations about those future amounts.

“Discounted Cash Flows”

③

Cost Approach

Uses the amount that would currently be required to replace the service capacity of an asset.

“Replacement Cost”

Valuation Analysis

Practical Example

- Assigning fair value regularly to a hypothetical home-based business



House

Value using **Comparable Transactions**
in the local real estate market

Business

Value using **Discounted Cash Flows**
from projections of future growth

Computer

Value using **Replacement Cost** based
on market research

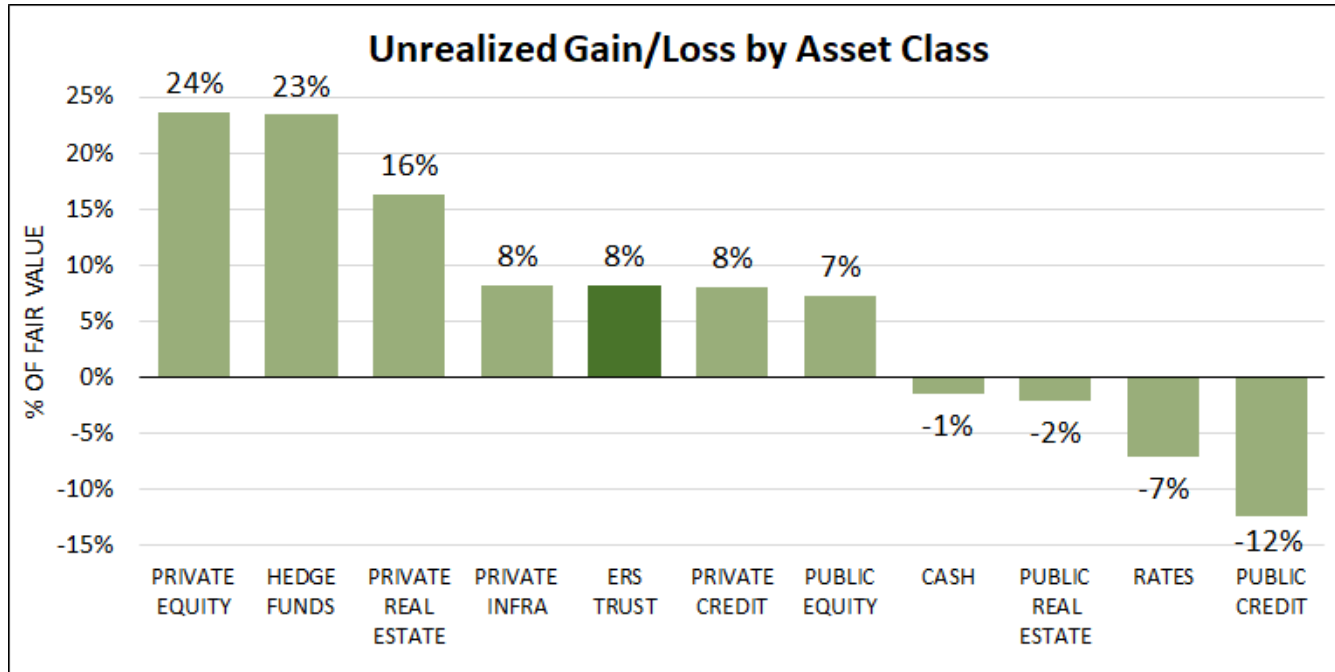
Assigning fair value to an asset
results in
unrealized gains
and/or losses
relative to what the owner paid
for the asset

Valuation Analysis



Unrealized Gain/Loss by Asset Class

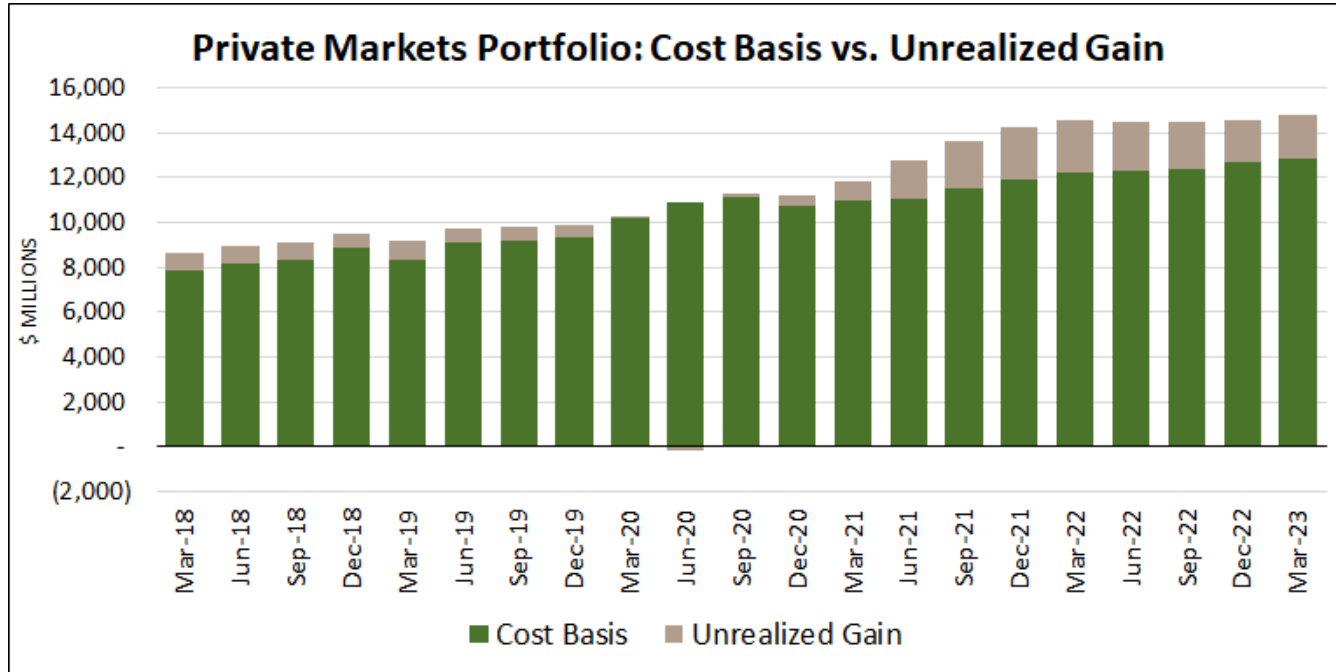
- Gains within private markets, losses in rate-sensitive liquid assets



Valuation Analysis

Net Asset Value vs. Gain/Loss for Private Markets

- Private markets portfolio saw unrealized gains peak in late 2021

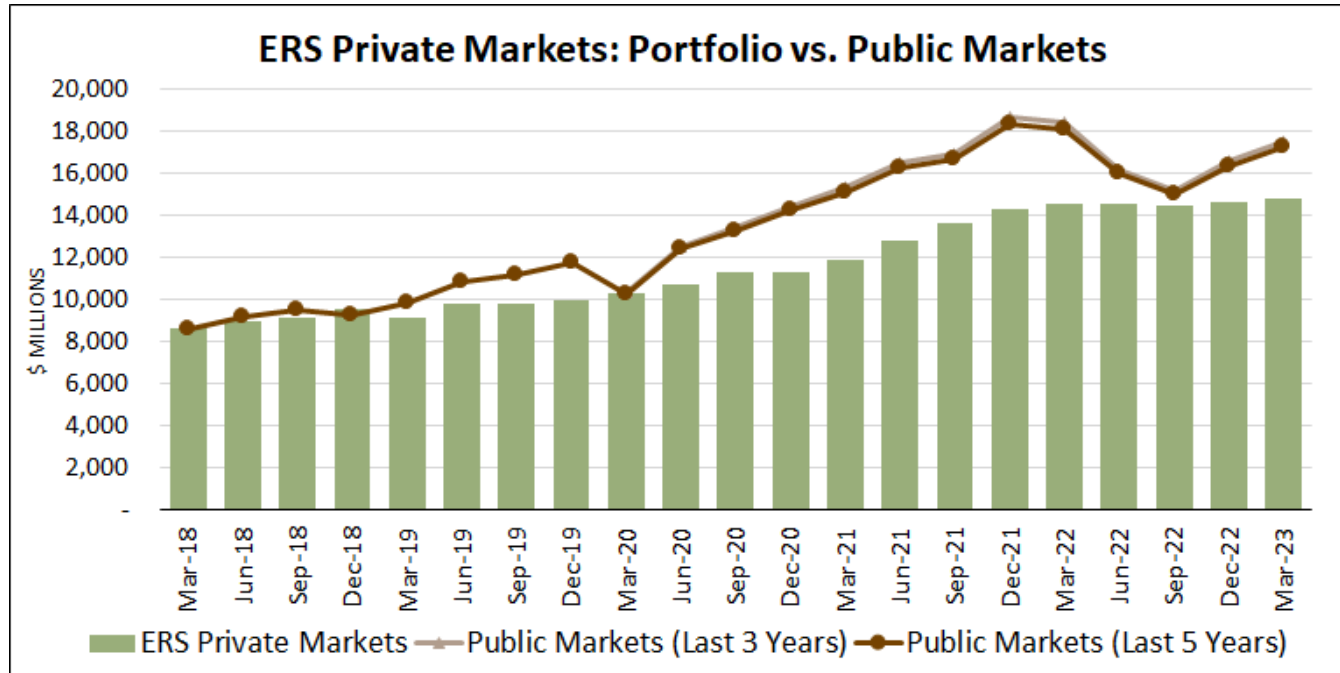


Valuation Analysis

Comparison to Public Markets



- Private markets portfolio undervalued by 14-15% vs. public markets



Valuation Analysis

Performance Measurement



- Current ERS performance reporting akin to cash accounting
 - Supports daily cash movements associated with GBP
- Group 4 gain sharing calculations akin to accrual accounting
- Custodian calculations verified by ERS performance specialist
- Global Investment Performance Standards (GIPS) since 2011

Discussion