

AGENDA ITEM DETAILS

Subject: *Opportunistic Credit Program - Market Update and Consideration of Proposed Opportunistic Credit Tactical Plan for Fiscal Year 2020 - (ACTION)

RECOMMENDED ACTION:

Move that the Investment Advisory Committee recommend that the Board of Trustees of the Employees Retirement System of Texas approve the Opportunistic Credit Program Annual Tactical Plan for Fiscal Year 2020 as presented in Exhibit A.

Contingent upon adoption of the above motion by the Investment Advisory Committee, staff recommend the following motion to the Board of Trustees:

Move that the Board of Trustees of the Employees Retirement System of Texas approve the Opportunistic Credit Program Annual Tactical Plan for Fiscal Year 2020 as presented in Exhibit A.

BACKGROUND:

At the August 23, 2017, Joint Meeting of the Board of Trustees (Board) and the Investment Advisory Committee (IAC), the Board adopted an asset allocation plan that included a new allocation investing 3% of the Trust's assets in Opportunistic Credit. At the December 2017 Board and IAC joint meeting, the guidelines and procedures for this asset class were adopted by the Board and IAC. At the March 6, 2019 Joint Meeting of the Board and IAC, the Board approved the Fiscal Year 2019 Tactical Plan, allowing for 0-2 investments or no more than \$270m, approximately 1% of the Trust's assets as of December 31, 2018.

No investments were made over the 12 months post the March 6, 2019 Joint Meeting of the Board and IAC. While initially designed to have a cross-asset team approach, the Opportunistic Credit Portfolio will now be managed in its entirety by the ERS Hedge Fund team. The ERS Hedge Fund team will continue to maintain a collaborative approach, and will coordinate and discuss ideas from other internal asset class teams.

The underlying philosophy of this allocation has not changed versus the approved Fiscal Year 2019 Tactical Plan. The portfolio is focused on seeking attractive risk-adjusted returns throughout the fixed income universe using a diverse set of private investments that are not a focus within other asset classes. These investments will act as a complement to existing credit-oriented strategies already residing within the Trust. Opportunistic allocations could be to niche strategies or opportunities that exist due to structural issues or to market dislocations.

Staff are in charge of preparing and presenting an Annual Tactical Plan (Plan) to ERS' Board of Trustees for its review and approval. This document is intended for planning purposes, which outlines the necessary steps to be taken over the remainder of the Fiscal Year 2020. The objective of the Annual Tactical Plan is to further meet the objectives of the Opportunistic Credit Portfolio. The plan also addresses considerations relevant to the administration and success of the portfolio. This Annual Tactical Plan is to be viewed as a reference guide to the construction of the Opportunistic Credit Portfolio. (Note: the Tactical Plan is not intended to overrule prudent hedge fund investment decision-making.)

As an opportunistic allocation, this asset class will only have capital deployed when compelling opportunities are present, and not to simply meet an allocation target. Given the broad mandate,

supporting efforts and expertise from the ERS Infrastructure, Private Equity, Real Estate, and Credit teams are expected.

The underlying philosophy of this allocation is to seek attractive risk-adjusted returns throughout the fixed income universe using a diverse set of private investments that are not a focus within other asset classes. These underlying investments will complement existing credit oriented strategies already residing within the Trust. Opportunistic allocations could be to niche strategies or opportunities that only exist for a period of time either during or slightly after an economic cycle is in recession.

Expectations for over the next 12 months are to focus on 0-3 investments totaling less than \$300 million, or approximately 1% of the Trust's assets measured as of December 31, 2019.

STAFF RECOMMENDATION:

Staff recommend that the Board and IAC adopt the Opportunistic Credit Program for Fiscal Year 2020 Tactical Plan as attached in Exhibit A.

ATTACHMENT(S):

1. Exhibit A - Opportunistic Credit Program Annual Tactical Plan FY 2020
2. Exhibit B - Opportunistic Credit Program Asset Class Guidelines