# State Investment Commission

**Monthly Meeting Minutes**
**Tuesday, July 21, 2015**
**9:00 a.m.**
**URI Alton Jones Campus**

The Monthly Meeting of the State Investment Commission (SIC) was called to order at 9:17 a.m., Tuesday, July 21, 2015 at the URI Alton Jones Campus.

## I. Roll Call of Members

The following members were present: Ms. Faith LaSalle, Mr. Thomas Mullaney, Ms. Paula McNamara, Mr. Frank J. Karpinski, Ms. Marcia Reback, Ms. Marie Langlois, and Treasurer Seth Magaziner.
Also in attendance: Mr. John Burns, Mr. David Glickman, and Mr. Allan Emkin from Pension Consulting Alliance, general consultant; Mr. Greg Balewicz, Ms. Xiaole Sun and Mr. Scott Conlon of State Street Global Advisors, index manager; Mr. Thomas Lynch and Mr. Steve Nesbitt of Cliffwater, alternative investment consultant; Chris Crosby of Nautic Partners; Ms. Sally Dowling and Susan Leach DiBlasio of Adler Pollock Sheehan, outside counsel; Ed Devlin, Chloe Kelly and David Blair of PIMCO; Mr. Jay Shruzziery, Mr. Russ Devlin, and Ms. Maureen Joyce of AEW; Ms. Anne-Marie Fink, chief investment officer, and members of the Treasurer's staff;
Mr. Thomas Fay and Mr. J. Michael Costello were absent.
Treasurer Magaziner called the meeting to order at 9:17 a.m.

## II. Approval of Minutes

On a motion by Mr. Mullaney and seconded by Ms. Langlois, it was unanimously
**VOTED: To approve the draft of the minutes of the June 24, 2015 meeting of the State Investment Commission.**

## III. Asset Allocation Review

John Burns from Pension Consulting Alliance gave a summary of the plan's investment philosophy and asset allocation. He noted the plan is mature and around 60% funded. The portfolio's targeted return rate is 7.5%, average for funds similar to Rhode Island's. He described the actual allocation of the portfolio and its sources of risk. The target for global long-only equities is to be 38% of the fund; at this level equities will represent 62% of portfolio risk. He said that the rest of the portfolio is constructed to offset this risk through diversification. He commented that one of the challenges the plan faces is reaching the expected return of 7.5% in the current investment environment. He described two portfolio changes since 2007 to reduce risk: first, core fixed income was repositioned to focus on stability and liquidity; second, the role of real estate was redesigned to become more income-oriented with more core assets. He concluded by noting that risk management is always a challenge and that the fund has to balance risk management with meeting expected returns.

The committee asked questions and discussed.

## IV. Private Equity Overview and Briefing

Mr. Tom Lynch from Cliffwater delivered a summary of investments in private equity. He gave an overviewof the portfolio's strategy and performance, noting that the fund has received returns greater than its investment. The private equity portfolio is well diversified by strategy and has outperformed public indices by a large margin.

Then, Mr. Chris Crosby of Nautic Partners made a presentation describing through the specific example of Nautic Partners what private equity funds do and how they generate returns. He gave an overview of his fund, as well as a case study of a specific investment. He described the ways that his fund looks for returns in their investments: improving operating margins, paying down debt, and deploying free cash flow. The committee asked questions and discussed.

## V. Private Equity Fund Recommendation

Mr. Lynch of Cliffwater gave a brief introduction on Capital Spring Investment Partners, a niche private debt strategy. He explained the portfolio is looking for more growth in this fund and would have a higher liquidity than traditional private equity.

Mr. Richard Fitzgerald, Managing Partner and Co-Founder, and Ms. Kristin Reilley, Vice President of Investor Relations, from Capital Spring Investment Partners then presented Capital Spring Fund VI. Mr. Fitzgerald began by explaining their strategy invests in branded franchise restaurants. They focus on quick service and fast casual restaurants, which are not as vulnerable to recessions. He said that Capital Springs was the only option for borrowers in the restaurant industry who cannot access bank loans. He mentioned the competitive advantages Capital Spring has in this space: a team with deep industry experience and relationships with the brand franchisors that support the businesses they lend to. He described the terms of the $500 million fund: management fees of 1.5% on called capital and 20% performance fee to the general partner after the limited partners have earned a 7% return with a catchup provision for the general partner's share.

Mr. Lynch mentioned that Capital Springs has a unique strategy and unique skills that gives it a competitive advantage. He also stated that their biggest risk is a copy-cat entering the market. He recommended a $30 million commitment.

On a motion by Ms. Langlois, and seconded by Ms. McNamara, it was unanimously
**VOTED: To invest $30 Million in Capital Spring subject to negotiating fund terms.**

## VI. Real Estate Overview and Briefing

Mr. David Glickman of Pension Consulting Alliance gave an overview of the pension fund's real estate allocation. To provide diversification from public equities, most of the assets are invested in core real estate. The purpose of these investments is to diversify, preserve capital, and provide reliable current income. He said that PCA is continuing to review when publicly traded real estate (REITs) might be appropriate for the portfolio. He described how in the past year the portfolio has added more non-core funds. Real estate continues to be sought-after investments so there are no bargains. Despite this, PCA believes that if thoughtful, long-term-focused investment managers can be found, real estate investments will deliver the expected rate of return.

Next Mr. Jay Shruzziery, Mr. Russ Devlin, and Ms. Maureen Joyce of AEW described how core real estate managers generate returns by speaking specifically about AEW and their strategy. The firm follows a bicoastal strategy, focusing on the coastal cities with higher barriers to entry. Mr. Devlin spoke about the research team at AEW. He said that they utilize their research to provide their property investors an understanding of the risks involved in each investment. Mr. Devlin stated that it is important to remember that real estate is not a bond and cash flows grow with the economy. Thus real estate is able to offset any effects from rising interest rates. He mentioned that 2015 returns have been good so far and they expect this year's returns to be good too. Ms. Joyce gave a short case study of a property and how AEW is generating returns through its management.

## VII. Real Estate and Infrastructure IPS Adoption

Treasurer Magaziner asked if there was any discussion or feedback on the Real Estate Policy Statement. Ms. Fink framed the conversation by articulating the goal of developing a comprehensive Investment Policy.

On a motion by Ms. McNamara and seconded by Ms. Langlois, it was unanimously
**VOTED: To adopt real estate, private and public infrastructure policy statements.**

## VIII. Actuarial and Plan Overview

Ms. Fink introduced Frank Karpinski, the Executive Director of the Employee Retirement System of Rhode Island. Mr. Karpinski gave a summary of what the Employee Retirement System and Retirement Board do. Specifically as impacts the SIC, the Retirement Board conducts the actuarial audits and certifies the annual contribution rates. Ms. Fink pointed out that the 7.5% target return is set by the Retirement Board with input from the actuary. Following Ms. Reback's question, Mr. Karpinkski clarified that there is an expected 5.5% rate of return plus 2% for inflation. Mr. Karpinski talked about the mediation changes and its effects.

## IX. Macro Overview and Strategic Speaker

Ms. Fink introduced the team from PIMCO including Mr. Ed Devlin, Portfolio Manager, Mr. David Blair, Senior Vice President, and Ms. Chloe Kelly, Account Manager. Ms. Kelly gave a summary of PIMCO's relationship with the State of Rhode Island. Mr. Devlin presented PIMCO's views of the economy over the next 3-5 years. He argued that in the past few years financial performance has outpaced the economy because of accommodative monetary policy. Currently PIMCO is focused on when the Fed was going to stop hiking rates instead of the question most others are asking, which is when is the Fed going to start hiking rates. Their team is looking to understand what the neutral interest rate will be. He said that sector asset allocation decisions can add a lot of value because of the volatility in monetary and fiscal policy. He recommended diversifying portfolios across asset classes and across equity risk factors. The committee asked questions and discussed.

## X. Hedge Fund Overview and Briefing

Ms. Fink introduced Cliffwater and one of the hedge fund managers present. Mr. Nesbitt gave a summary of the portfolio's equity hedge fund investments, saying 60% is in equity long-short strategies and 40% is in event-driven strategies. The beta of this allocation is 0.24. He described the risk taken in equity hedge funds as manager risk, counting on the manager's ability to harvest relative value between different individual stocks. Manager risk is uncorrelated to equity market risk.

Next Mr. Christian Leone, founder and chief of Luxor Capital Partners, presented an example of how hedge funds generate returns. He started with a background of his firm, its history and an overview of their strategy in making investments. Mr. Leone differentiated his hedge fund from mutual funds by pointing out the freedom to pursue a broad range of opportunities his fund has, as well as its low correlation to the returns of the market. He described an example where the fund can isolate value by owning a stock and shorting one of its divisions that is also publicly traded. He also walked through an event-driven long position, explaining how the firm found the investment idea and the extensive work and resources they put into researching it. He concluded by saying Luxor's biggest source of value creation has been identifying when to go in and out of different markets, for example distressed assets. The committee asked questions and discussed.

## XI. Fiduciary Training

Ms. Susan Leach DiBlasio of Adler Pollock went through a presentation on the fiduciary responsibilities of the SIC. She described the prudent investor standard and duties of fiduciaries, including the duty of loyalty, of disclosure, to obtain professional advisors and to diversify. She reviewed laws that govern investments.

## XII. Factor Tilts Recommendation

Treasurer Magaziner introduced State Street Global Advisors. Representing SSgA were Mr. Greg Balewicz, Relationship Manager, and Mr. Scott Conlon, Product Specialist and Ms. Xiaole Sun, Researcher within the Advanced Beta Strategies division. Mr. Conlon went over State Street's philosophy on advanced beta and the progress of their research on factor tilts conducted for Rhode Island. He said that they focused on factors that are well-known, intuitive and have empirical support, specifically valuation, momentum and quality. He presented the results of the multi-factor portfolio they designed specifically for Rhode Island. He described the method by which tilts were calculated and the characteristics of the resulting portfolio.

Ms. Fink said that the timing and diversification benefits of this investment would be good. She recommended this should be done in an incremental fashion. The committee asked questions, discussing the level and timing of this investment.

On a motion by Ms. Reback, seconded by Ms. McNamara, it was unanimously
**VOTED: To reallocate $250 million per quarter over the next 12 months from the market-cap weighted indexes into the SSgA Equity Factor Tilt Portfolio.**

## XIII. August Meeting

On a motion by Ms. Reback, seconded by Ms. McNamara, it was unanimously
**VOTED: For the SIC to cancel the August meeting.**

## XIV. Legal Counsel Report

Sally Dowling stated that she had nothing to report.

## XV. Chief Investment Officer Report

Ms. Fink reviewed the performance of the portfolio and market environment for the month of June. June was a tough month: equity markets fell 2.4% and bonds fell 1.1%. The fund was down 1.45%, better than both the basic 60-40 allocation and the bottom-up benchmark. The outperformers in the month were alternatives: real estate returns were positive while equity hedge funds and private equity were barely negative. Publicly traded infrastructure, MLPs, were the biggest detractor, though they did outperform their benchmark.

For the fiscal year, portfolio returns were 2.2%. In the past year, alternative investments have been stars of the fund. Risk remains well below the 60-40 on both a 3 and 5-year basis. She said that portfolio's asset allocation is working and that, over time, it will continue to improve.

## XVI. Treasurer's General Comments

Treasurer Magaziner noted that the fund's performance beat the global equities index and the Barclays fixed-income index showing the benefits of being diversified. He further noted that there are a few new projects the team is focusing on: 1) the College Bound 529 Program Manager proposals and 2) issuing an RFP for benchmarking current investment staff structure. Treasurer Magaziner thanked everyone for their time and efforts.

There being no other business to come before the Board, on a motion by Ms. Reback and seconded by Ms. McNamara the meeting adjourned at 4:30 pm.

Respectfully submitted,

**Seth Magaziner,**
**General Treasurer**