

**South Carolina Retirement System Investment Commission  
Meeting Minutes**

**February 4, 2016**

**9:30 a.m.**

**Capitol Center**

**1201 Main Street, 15<sup>th</sup> Floor**

**Columbia, South Carolina 29201**

**Meeting Location: Presentation Center**

**Commissioners Present:**

Mr. Edward Giobbe, Chairman

Dr. Rebecca Gunnlaugsson, Vice Chair

Ms. Peggy Boykin

Mr. Allen Gillespie

Dr. Ronald Wilder

Mr. Reynolds Williams

Mr. Curtis Loftis, State Treasurer

**Others present for all or a portion of the meeting on February 4, 2016:**

Geoff Berg, Betsy Burn, Andrew Chernick, Lily Cogdill, Kim Cornell, John Farmer, Robert Feinstein, Mitchell Goldsmith, Michael Hitchcock, Adam Jordan, Tricia Miller, Weiyi Ning, and Kathleen Shealy, from the South Carolina Retirement System Investment Commission; Clarissa Adams and Burt Cassell from the State Treasurer's Office; Suzanne Bernard and Tim McEnery from Aon Hewitt Investment Consulting; Tammy Nichols from the South Carolina Public Employee Benefit Authority; Honorable Jeffrey Bradley, South Carolina House of Representatives; Blythe Littlefield from the South Carolina House Ways & Means Committee; Sam Griswold and Wayne Pruitt from the State Retirees Association of South Carolina; Muriel E. Andre and Carlton Washington from the South Carolina State Employee Association; Bruce Crouch, Tom Posey and Stephen G. Younts from SC ETV; and M. Sean Cary from Creel Court Reporting.

**I. CALL TO ORDER AND CONSENT AGENDA**

Chairman Edward Giobbe called the meeting of the South Carolina Retirement System Investment Commission ("Commission" or "RSIC") to order at 9:30 a.m. The Chairman referred to the proposed meeting agenda and asked for a motion to adopt the agenda. Dr. Ronald Wilder made a motion to adopt the agenda as presented, which was seconded by Dr. Rebecca Gunnlaugsson and unanimously approved.

The Chairman asked for a motion to approve the Minutes of the Commission Meetings held on September 17, 2015, October 22, 2015, and November 19, 2015, as presented. Mr. Allen Gillespie made a motion to adopt the minutes, and Dr. Wilder seconded the motion. The Motion was unanimously approved.

Mr. Hitchcock introduced the Honorable Jeff Bradley, member of the South Carolina House of Representatives, from Hilton Head Island and Ms. Blythe Littlefield, a budget analyst from the House Budget Committee of the House Ways & Means Committee.

**II. ASSET ALLOCATION PROPOSAL**

The Chairman recognized Mr. Geoff Berg, Acting Chief Investment Officer, to present an asset allocation proposal.

Before discussing the asset allocation proposal, Mr. Berg re-introduced the topic of portable alpha, an implementation strategy that had been discussed at the Commission's November 19, 2015 meeting. Mr. Berg reviewed the building blocks or components of the portable alpha strategy that Staff was recommending as part of the proposed asset allocation plan, the rationale for utilizing portable alpha, the key risks to the Plan and how those risks were addressed. Mr. Berg concluded his initial comments by noting that, as Staff envisions structuring this implementation strategy, portable alpha should provide a risk-efficient way of improving plan returns in a low interest rate environment.

Mr. Berg introduced Ms. Suzanne Bernard from Aon Hewitt ("Aon Hewitt"). Ms. Bernard explained that portable alpha was a common structure used by investment managers to equitize cash they may be holding, or to otherwise improve upon an expected market return. Discussion ensued regarding the program and possible risks involved, including counter-party risk. Mr. Berg noted that one of the advantages of the Commission's existing relationship with Russell Investments is that they perform comprehensive, ongoing counter-party analysis and maintain lists of approved counter-parties.

Extensive additional discussion ensued with questions and comments from commissioners regarding the program. Mr. Berg stressed the importance of successfully identifying and using low beta or market-neutral type strategies in order to not inadvertently obtain market beta ("market leverage"). Mr. Loftis asked if a portable alpha strategy had been utilized in the past and Ms. Bernard confirmed that a version had been implemented as recently as 2011 or 2012. Mr. Berg noted that the current proposal is structured differently than the portable alpha strategy used previously. Mr. Loftis expressed concerns about the strategy. Ms. Bernard addressed these concerns and opined that this type of strategy did not represent a material change in the overall allocation. It was also noted that if interest rates began to rise, Staff and Aon Hewitt would revisit the utility of the portable alpha program.

Dr. Wilder asked Mr. Berg if consideration had been given to using managers within the portable alpha program that offered lower fee levels than current hedge fund managers. Mr. Berg stated that those types of solutions were actively being investigated by Staff, and emphasized that Staff only wants to pay for skill. Mr. Loftis asked whether staff had a proposal for a specific dollar amount to allocate to this strategy. Mr. Berg replied that the proposal is for ten percent of the Plan.

Mr. Berg then reviewed several asset allocation-related topics which had been discussed at the Commission's November 2015 meeting: (a) the reduction of the cash allocation by three percent, (b) the addition of three percent to equities, and (c) the elimination of static targets to private equity and private debt. Mr. Berg then noted that, as a result of discussions with the commissioners and Aon Hewitt, certain modifications to the asset allocation concept discussed in November were being proposed. Mr. Berg presented the

modifications and reviewed the other elements of the recommended asset allocation – called “Portfolio A (modified)”. The modifications included:

- (a) the addition of a new proposed “Other Opportunistic” component within the Opportunistic allocation, which could house investments offering either high returns, diversifying characteristics or both (such as commodities, CTAs, alternative beta strategies, and insurance strategies);
- (b) the “Other Opportunistic” allocation would effectively eliminate the dedicated allocation to Commodities;
- (c) a new framework which clarified the purpose for all hedge funds. Mr. Berg explained that the intent of *portable alpha hedge funds* was to generate expected returns without incurring significant market beta, while the inclusion of other hedge fund strategies would be expected to be more compelling than the public market equivalent (in this case, the 50/50 GAA benchmark);
- (d) creating a dedicated allocation to public REITs and instituting a floating target weight for private real estate (consistent with the changes approved in November for private equity and private debt); and
- (e) modest adjustments to the target weights for public equity, GAA, hedge funds and EMD.

The commissioners discussed various elements of the Portfolio A (modified) proposal and how the changes could benefit the Plan. Mr. Berg noted that a multi-year glide path was appropriate to allow for a prudent migration of the Plan to the new target asset allocation. It was noted that the Opportunistic allocation, in particular, will require a glide path to reach its ultimate 12% target allocation. It was also noted that, in addition to the recommended asset allocation (Portfolio A (modified)), information had been provided for the Commission regarding one other, more aggressive asset allocation, along with information about the asset allocation concept presented to the Commission in November 2015. The expected returns, standard deviations, and other aspects of these three alternatives were discussed.

The Commission recessed from 11:03 a.m. to 11:17 a.m.

The Chairman recognized Ms. Bernard, who summarized elements of Aon Hewitt’s comprehensive asset allocation review document and offered additional commentary regarding the asset allocation proposal and related topics. She stated that Aon Hewitt recommended Portfolio A (modified) as presented by RSIC Staff. Ms. Bernard discussed various peer universes, as well as the pros and cons of such universes, including their limited utility as benchmarks. She opined that although it is important to be cognizant of where the Commission stands in relation to its peers, that comparison should not drive decision-makers. Ms. Bernard also discussed several of Aon Hewitt’s recommended metrics for measuring the success of an investment program, noting that the most important metric, in Aon Hewitt’s opinion, is having sufficient assets to meet the obligations to Plan beneficiaries over time, followed by meeting the Plan’s return expectations without incurring unnecessary risk. Ms. Bernard concluded her portion of the presentation and

turned over the discussion to Mr. Tim McEnery of Aon Hewitt, who summarized his firm's medium term view of the markets.

Mr. Loftis stated his concerns regarding the Plan's expected nominal returns and related issues, including funding issues and potential rating agency concerns.

A lengthy discussion regarding the asset allocation proposal and related topics ensued. The Chairman noted some of the differences between public pension funds and corporate pension plans. Ms. Boykin stressed the importance of reviewing Plan performance on a quarterly basis, particularly if contribution rates are increased.

After additional discussion, Dr. Wilder moved that the Commission:

- (a) adopt the asset allocation designated as Portfolio A (modified) on red number page 46 in the open session agenda package (including the glide path set forth therein) and as presented in the attached chart, as presented by the Acting CIO and Aon Hewitt and discussed during the Commission meeting (the "Asset Allocation Plan");
- (b) confirm the following additional changes for clarity:
  - (1) The target weight to private real estate will be treated in the same manner as private equity and private debt as approved in the November 19, 2015 Commission meeting, with respect to the floating target; and
  - (2) the entire Opportunistic allocation will have a future target weight of 12%, however, the three sub-allocations (GAA, Opportunistic Hedge Funds (non-PA), and Other Opportunistic) will have floating target weights determined by their actual weight); and
- (c) direct that the approved Asset Allocation Plan be incorporated into, and made a part of, the SIOP effective July 1, 2016; and
- (d) authorize Staff to make any technical revisions, or formatting edits, consistent with the action taken by the Commission.

Mr. Gillespie seconded the motion, which was approved 5-1, with Mr. Loftis opposed.

### **III. EXECUTIVE SESSION**

Mr. Gillespie moved to go into Executive Session and discuss investment matters pursuant to S.C. Code Sections 9-16-80 and 9-16-320 and to receive legal advice from legal counsel pursuant to S.C. Code Section 30-4-70(a)(2). Dr. Wilder seconded the motion, which passed unanimously. The Commission reconvened in open session. Mr. Hitchcock reported that no reportable action had been taken during Executive Session. Any action that occurred in Executive Session, pursuant to S.C. Code Sections 9-16-80 and 9-16-320, would be publicized when doing so would not jeopardize the Commission's ability to achieve its investment objectives.

Mr. Gillespie made a motion that the Commission, based on the outcome of the personnel discussion and performance review conducted in Executive Session, authorizes the compensation increases for Mr. Hitchcock and Mr. Berg as discussed in Executive Session and directs the CEO and other necessary parties to take all action necessary to implement these decisions as approved by the Commission and directs that the salary increases will be disclosed to the public and in the minutes after the increases have been communicated to Mr. Hitchcock and Mr. Berg. Dr. Gunnlaugsson seconded the motion, which was approved unanimously. Effective February 4, 2016, Mr. Hitchcock's annual salary will be \$245,000 and Mr. Berg's annual salary will be \$250,000.

#### **IV. ADJOURNMENT**

There being no further business, Mr. Gillespie moved to adjourn. Dr. Gunnlaugsson seconded the motion, which passed unanimously, and the meeting adjourned at 2:05 p.m. [Staff Note: In compliance with S.C. Code Ann. Section 30-4-80, public notice of and the agenda for this meeting were delivered to the press and to parties who requested notice and were posted at the entrance, in the lobbies, and near the 15th Floor Presentation Center at 1201 Main Street, Columbia, SC, at 5:07 p.m. on February 1, 2016.]

# Portfolio A: Glide Path

	Current	Portfolio A (original)	Portfolio A (modified)	FY 2016- 2017	FY 2017- 2018	FY 2018- 2019
<b>Equity</b>	<b>43%</b>	<b>45%</b>	<b>47%</b>	<b>45%</b>	<b>47%</b>	<b>47%</b>
Global Equity (Hedged and Unhedged)	34%	21%	27%	26%	27%	27%
Global Equity (Portable Alpha)		10%	6%	5%	6%	6%
Equity Options Strategy		5%	5%	5%	5%	5%
Private Equity	9%	9%	9%	9%	9%	9%
<b>Conservative Fixed Income</b>	<b>12%</b>	<b>12%</b>	<b>12%</b>	<b>12%</b>	<b>12%</b>	<b>12%</b>
Short Duration	2%	2%	2%	2%	2%	2%
US Agg	10%	10%	6%	7%	6%	6%
US Agg (Portable Alpha)			4%	3%	4%	4%
<b>Diversified Credit</b>	<b>17%</b>	<b>19%</b>	<b>18%</b>	<b>18%</b>	<b>18%</b>	<b>18%</b>
Mixed Credit	5%	6%	6%	6%	6%	6%
Private Debt	7%	7%	7%	7%	7%	7%
EMD	5%	6%	5%	5%	5%	5%
<b>Opportunistic</b>	<b>20%</b>	<b>10%</b>	<b>12%</b>	<b>17%</b>	<b>13%</b>	<b>12%</b>
GAA (50 MSCI World/50 WGBI)	10%	10%	6%	10%	6%	6%
Hedge Funds (non-PA)	10%		4%	4%	4%	4%
Other Opportunistic*			2%	3%	3%	2%
<b>Real Assets</b>	<b>8%</b>	<b>14%</b>	<b>11%</b>	<b>8%</b>	<b>10%</b>	<b>11%</b>
Commodities	3%	3%				
Real Estate (private)	5%	8%	7%	5%	6%	7%
Real Estate (public REITS)			1%	2%	2%	1%
World Infrastructure		3%	3%	1%	2%	3%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>
<b>30 Year Portfolio Metrics - Q4 2015 Capital Market Assumptions*</b>						
Expected Nominal Return	6.96%	7.23%	7.34%	7.21%	7.33%	7.34%
Expected Real Return	4.87%	5.13%	5.24%	5.10%	5.23%	5.24%
Expected Risk (Volatility)	11.63%	12.45%	12.81%	12.69%	12.81%	12.81%
Sharpe Ratio	0.384	0.380	0.378	0.371	0.377	0.378