

THE INVESTMENT COMMITTEE
OF THE
MARYLAND STATE RETIREMENT AND PENSION SYSTEM

MINUTES OF OPEN MEETING

September 18, 2018

The Investment Committee convened on Tuesday, September 18, 2018 at 9:25 a.m. in the 16th Floor Board Room of the State Retirement Agency, SunTrust Building, 120 E. Baltimore Street, Baltimore, MD.

Committee Members	Michael K. Barry	Stephen Kitsoulis
Attending:	David Brinkley (1)	Nancy K. Kopp
	Eric Brotman (1)	Theresa Lochte
(1) Via telephone	Peter Franchot	Richard Norman
	James Harkins (1)	Douglas Prouty
	Linda A. Herman, Vice-Chair	Michael J. Stafford, Jr.
	Sheila Hill	Lamont "Monte" Tarbox
	F. Patrick Hughes, Chairman	
Committee Members	David Hamilton	Charles W. Johnson
Not Attending:	Jamaal Craddock	
Also Attending:	Anish Bedi	John Kenney
	Susanne Brogan	Michael McCord
	Robert Burd, Deputy CIO	Stephen Muturi
	Antionette Butcher	Andrew Palmer, CIO
	Rachel Cohen, OAG	Stephen Reilly
	Eric Farls	David Rongione, Chief Internal
	Dimitri Grechenko	Auditor, Internal Auditing Div.
	Alex Harisiadis, OAG	Dan Schick
	Justin Hayes	Jody Shaw, OAG
	Levar Hewlett	Frederick "Beau" Smith
	Faina Kashtelyan	Toni Voglino
	Gregory Kasten	Patricia Wild
	Larry Katsafanas	
	Dean Kenderdine	

Mr. Hughes, Chairman, called the Investment Committee meeting to order at 9:10 a.m.

Item 1: CLOSED SESSION

On a motion made by Ms. Hill and seconded by Mr. Norman, the Investment Committee voted without objection to meet in closed session at 9:10 a.m. for the purposes of:

- (a) reviewing the closed session special Investment Committee minutes, pursuant to General Provisions Art., Section 3-103(a)(1)(i), the exercise of an administrative function; and
- (b) discussing an advice of counsel regarding proposed amendments to the indemnification policy, pursuant to General Provisions Art., Section 3-305(b)(7), to consult with counsel to obtain legal advice.

On a motion made by Ms. Hill and seconded by Ms. Lochte, the Investment Committee voted to adjourn closed session and return to open session at 9:25 a.m.

OPEN SESSION

Committee Members Attending:	Michael K. Barry David Brinkley (1) Eric Brotman (1)	Stephen Kitsoulis Nancy K. Kopp Theresa Lochte
(1) Via telephone	Peter Franchot James Harkins (1) Linda A. Herman, Vice-Chair Sheila Hill F. Patrick Hughes, Chairman	Richard Norman Douglas Prouty Michael J. Stafford, Jr. Lamont "Monte" Tarbox
Committee Members Not Attending:	David Hamilton Jamaal Craddock	Charles W. Johnson
Also Attending:	Phillip Anthony (DLS) Anish Bedi Frank E. Benham (Meketa) Hazel Bradford (P&I) Susanne Brogan Robert Burd, Deputy CIO Antionette Butcher Rachel Cohen, OAG Melody Countess Brian Croce (P&I) Jordyn Duerr (public) Eric Farls David Ferguson Janette Fernandez (DBM) Patricia Fitzhugh Anne Gawthrop Michael Golden Dimitri Grechenko Alex Harisiadis, OAG Justin Hayes Levar Hewlett	Faina Kashtelyan Gregory Kasten Larry Katsafanas Dean Kenderdine John Kenney Rob Kochis (Townsend Group) Thomas Kurowski (Alex Brown) Michael McCord Leanne Moore (Meketa) Stephen Muturi Andrew Palmer, CIO Stephen Reilly David Rongione, Chief Internal Auditor, Internal Auditing Div. Michael Rubenstein, (MLIS) Dan Schick Jody Shaw, OAG Frederick "Beau" Smith Michael Stark (Townsend Group) Toni Voglino Patricia Wild

During closed session, the Investment Committee discussed and took action on the following matters:

The Investment Committee reviewed and ratified the Closed Session minutes from the June 19, 2018 meeting; and

The Committee received legal advice regarding proposed amendments to the Indemnification Policy in the Investment Policy Manual.

Item 4: Representatives from UNITE-HERE Local 7

Ms. Eileen O'Grady from UNITE-HERE spoke about worker conditions at the Baltimore Marriott Waterfront hotel. The System owns part of this hotel indirectly through a real estate investment fund managed by UBS (UBS Trumbull Property Fund). She contended that the hotel employees do not earn

enough and are not provided enough hours of work, leading to struggling financial conditions. In addition to employees being scheduled for fewer hours, benefits, including paid time off, have been cut. UNITE-HERE Local 7 is advocating for Marriott to allow workers to decide if they want to unionize. Ms. O'Grady requested that the Board of Directors support this effort and ask UBS to also support the effort.

Two hotel employees also spoke. Mr. Kheron Douglas, who has worked for the hotel for five years, shared his situation and associated financial challenges.

Mr. Jose Ramirez, (with translator Ms. Marisha "Mishy" Leitolum) who has worked for the hotel for eleven years, also described the hardships of reduced hours and pay.

Mr. Hughes asked if the employees work for UBS or Marriott. Ms. O'Grady answered that the workers work for Marriot.

Mr. Hughes asked if the property has a master lease. Ms. O'Grady replied that she was not sure and would have to do some research.

Comptroller Franchot thanked the hotel employees for their work in Maryland, as well as thanked UNITE-HERE for representing many private employees across Maryland. Comptroller Franchot asked which organization has more influence in this matter. Ms. O'Grady responded that UBS, as the owner, has more say in this matter.

Treasurer Kopp asked if the City of Baltimore, at the time of construction, discussed the operation and labor policies at the hotel, as Baltimore City assisted in financing the construction of the hotel. Ms. O'Grady responded that the construction process of the hotel does not influence the operation once completed.

Item 5: Ratification of Open Session Minutes

On a motion made by Mr. Norman and seconded by Ms. Hill, the Investment Committee ratified the June 19, 2018 open meeting minutes.

Item 6: Investment Policy Manual

Mr. Hughes explained that the Investment Committee was in receipt of the memo detailing the requested changes to the IPM.

On a motion made by Ms. Lochte, and seconded by Mr. Prouty, the committee approved the recommended changes to the IPM.

Item 7: Investment Division Fiscal Years 2019 and 2020 Budgets

Mr. Palmer explained that the Department of Budget and Management had requested budgets for fiscal years 2019 and 2020. Mr. Palmer presented the two budget proposals, adding that this request was approved by the Administrative Committee, and was now being brought to the Investment Committee, as part of the new budget authority. Mr. Palmer, in reference to the expenses associated with additional personnel, explained that it will take time to fully implement the hiring plan.

Comptroller Franchot asked about the compensation consultant and commented that the goal should be recruiting new talent. Mr. Palmer responded that the consultant will work with the Objective Criteria Committee in recommending objective criteria for the Board's approval and will use those criteria to help the Board create a holistic framework for creating and maintaining the compensation structure. The goal is to develop an appropriate and competitive salary structure with strong alignment of interests and pay for performance. Mr. Palmer noted that most of the System's peers have this authority, and such a structure will enhance the ability to effectively compete in the job market.

Mr. Hughes noted that the objective is to hire the best people, to be paid at market rates. He added that the long term goal is to lower overall expenses via internal management with better returns.

Ms. Herman asked if the Agency's expenses for administering the ORP and OPEB are reimbursed by each plan so that the System is not subsidizing others. Ms. Cohen commented that the ORP has its own expense account that is funded by the vendors. Mr. Burd noted that staff's time has not been allocated to the two plans. Mr. Hughes indicated that this issue needs further research. Mr. Kenderdine and Ms. Countess confirmed that all investment staff compensation is funded by the System. Mr. Kenderdine advised the Committee that staff would research this issue and report back.

Ms. Herman also highlighted that the cost of membership to CII, and asked for information relating to the benefits the System receives for this cost.

On a motion made by Ms. Hill and seconded by Mr. Prouty, the Investment Committee approved the fiscal years 2019 and 2020 budgets. Secretary Brinkley abstained.

Item 8: Meketa Contract Extension Recommendation

Mr. Palmer and Mr. Burd recommended to extend the contract with Meketa Investment Group for one additional year. The initial contract term of five years expires on June 30, 2019, and the System is entering into the optional two one-year extension periods. This recommendation is based upon the general positive response from the evaluation by the Board and Staff.

Mr. Brotman commented that for consistency purposes during this transitional period to internal management, the System should retain Meketa.

Ms. Herman requested a response from staff relating to Meketa's value added during their tenure. Mr. Burd responded that Meketa's analysis showed that changes to asset allocation added roughly 100 basis points to the value of the plan. In 2015, Meketa contributed about 60 basis points related to the extension of duration in the Rate Sensitive portfolio. In 2016, Meketa's recommendation to increase the allocation to emerging markets equities added about 40 basis points of value.

Mr. Palmer discussed the results of an analysis assuming that the asset allocation that was in place prior to the hiring of Meketa was still intact at full allocation. Based on this analysis, Meketa has added approximately 20-25 basis points annualized, consistent with the 100 bps cumulative value provided by Meketa.

Treasurer Kopp asked about the Staff's evaluation of Meketa. Mr. Palmer indicated that Meketa achieved high scores at plan level items, but lower rankings at the staff level with respect to collaboration on manager evaluation. He noted that staff and Meketa should work to improve in this area.

On a motion made by Mr. Brotman and seconded by Ms. Hill, the Investment Committee approved a one-year extension with Meketa Investment Group through June 30, 2020.

Item 9: Meketa Reports

Mr. Benham and Ms. Moore from Meketa presented Meketa's second quarter 2018 review detailing economic performance in the quarter as well as the System's portfolio performance.

Mr. Kitsoulis asked about risk-adjusted peer statistics. Mr. Benham responded this is difficult due to limited transparency in TUCS reporting, although the TUCS reports do provide some risk measures.

Mr. Stafford asked about other peer data sets. Mr. Benham noted that, in addition to TUCS data, Meketa also provides data based on the Investor Force universe.

Ms. Herman asked about median size of Investor Force peer group. Mr. Benham replied that while the Investor Force data provided in the report included public plans greater than \$1 billion, median size was not available. He indicated that the relatively large number of observations in Investor Force universe likely included most of the plans included in the TUCS database, as well as some smaller ones.

Mr. Barry asked about sources of tracking error against peers including risk profile, underweighting to U.S. stocks, and manager selection. Mr. Benham answered that each has played a part and highlighted a Boston College study affirming the significant influence that asset allocation has on investment performance.

Mr. Stafford inquired about a custom peer group. Mr. Benham pointed to staff's custom peer group included in the CIO report.

Mr. Hughes asked about the risk associated with the concentration in the technology sector vis-à-vis passive investing in the US, and also implied his preference for US equities over non-US markets. Mr. Benham discussed the advantages of investing in non-US stocks, in addition to domestic stocks.

Mr. Kitsoulas, referring to material provided by Meketa on the System's sensitivity to inflation, noted that while rates are low relative to the past fifty years, they are not low compared to longer time periods. He also questioned the notion that short-term TIPS are the best inflation hedge, as longer duration TIPS may be more effective in periods of stagflation. Mr. Kitsoulas also noted that outcomes are highly scenario dependent.

Item 10: Report from CIO

Mr. Palmer provided an update of key aspects of the System's portfolio through August. The portfolio was valued at \$52.6 billion, and finished the month +85bps vs the policy benchmark of +77bps. For the year ending August 2018, the portfolio returned 7.03% versus the policy benchmark 6.48%.

Mr. Palmer also reported personnel changes, with Greg Kasten being promoted to the role of Managing Director of the Quantitative Strategies and Absolute Return group from Private Equity. Also, Beau Smith moved into the role of Senior Risk Manager from Public Equity. The Fixed Income group lost a Senior Portfolio Manager, who left the Agency. Staff will be recruiting to fill the vacancies created by these moves.

Mr. Stafford asked for an update on the Absolute Return portfolio including where we want to be, compared to where we are now. Mr. Palmer shared that the portfolio has struggled and staff went through an evaluation of this portion of the portfolio. Staff turnover created challenges with new staff taking over this asset class. Significant time was spent improving fee alignment and level and redesigning the structure of the portfolio as part of ongoing discussions with the Committee and Meketa of this Committee. The expectation of this portfolio is to exhibit less correlation with other asset classes, as well as lower correlation among the mandates in the asset class. The prior construction exhibited a high concentration of low volatility managers, but exhibit high correlations among the managers. Mr. Palmer also commented that this portfolio should be considered as a low correlation, opportunistic program, and not purely a hedge fund portfolio. The Absolute Return portfolio was staffed by one, dedicated person for 25 months, with turnover of that single position. The experiences highlight the challenge to recruit and hire additional staff. Since 2016, several managers were terminated. Approximately \$1.5 billion in assets were terminated and redeployed into new funds.

Mr. Stafford expressed interest in hearing from Aksia sooner than next May.

Comptroller Franchot requested a report highlighting the changes that have occurred in the absolute return portfolio, as well as an analysis of the portfolio's performance over the last two years.

Mr. Palmer highlighted the improved System's up/down market capture, as well as rebalancing activities which took place over the second quarter. He also noted that the portfolio is very close to its strategic allocations with Private Equity at its target.

Mr. Barry inquired if staff has looked into China A shares. Mr. Katsafanas noted that staff is actively looking at opportunities to invest in China directly.

Mr. Stafford asked about the weight of emerging markets within MSCI All Country World Index and expressed concern about the System's large relative overweight in its policy. Mr. Benham responded this was a conscious decision made by the Board during its annual asset allocation process. Mr. Benham also mentioned that Meketa will present best practices on asset allocation in October.

Mr. Palmer reviewed the Investment Program Update, which provides a roadmap of future efforts and initiatives of the Investment Division. Mr. Hughes noted the presentation material is a key document and would like to see a project management or Gantt chart detailing progress going forward.

Mr. Barry asked about the 10-year vision of governance and the Board's involvement in internally managed strategies. Mr. Hughes responded that the Board approves the budget for the Investment Division and has significant input on investment structure and strategy. Mr. Palmer responded that internally managed strategies will be subject to the same scrutiny and due diligence as external mandates.

Item 11: The Townsend Group Report

Mr. Kochis and Mr. Stark from Townsend Group presented an update of the real estate market and the real estate portfolio. They stated that the Maryland portfolio is well positioned, and the environment supports a cautious investing approach. The portfolio is of significant size, but constructed with reduced risk and provides defensive positioning. The portfolio is efficiently constructed relative to the size of the total fund, with a manageable and efficient manager structure.

Item 12: Investment Reports

The Committee received the following investment reports:

- State Street Performance Reports
- Terra Maria Performance Reports
- Private Markets Performance Reports
- Securities Lending Report
- TUCS Report
- Division's FY19 Travel Plan - Update
- Quarterly ORP Performance Report
- OPEB-PHBT Update
- New Hire Manager Report

On the Directors Desk:

- Broker Commission Reports

Item 13: Motion by the Investment Committee to meet in Closed Session

On a motion made by Ms. Lochte and seconded by Mr. Norman, the Investment Committee voted without objection to meet in closed session at 12:48 p.m. for the purposes of:

- (a) discussing the System's investment in UBS's Trumbull Property Fund, pursuant to General Provisions Art., Section 3-305(b)(5), to consider the investment of public funds; and General Provisions Art., Section 3-305(b)(13), to comply with a specific statutory requirement that prevents public disclosure, namely, General Provisions Art., Section 4-335 preventing the disclosure of trade secrets and confidential commercial or financial information; and

(b) conducting an evaluation of the CIO's performance pursuant to General Provisions Art., Section 3-305(b)(1), consideration of a personnel matter.

CLOSED SESSION

Committee Members	Michael K. Barry	Stephen Kitsoulis
Attending:	David Brinkley (1)	Nancy K. Kopp
	Eric Brotman (1)	Theresa Lochte
(1) Via telephone	Jamaal Craddock	Richard Norman
	Peter Franchot	Douglas Prouty
	James Harkins (1)	Michael J. Stafford, Jr.
	Linda A. Herman, Vice-Chair	Lamont "Monte" Tarbox
	Sheila Hill	
	F. Patrick Hughes, Chairman	
Also Attending:	Susanne Brogan	Larry Katsafanas
	Robert Burd, Deputy CIO	Dean Kenderdine
	Antionette Butcher	John Kenney
	Rachel Cohen, OAG	Andrew Palmer, CIO
	Alex Harisiadis, OAG	Stephen Reilly
	Justin Hayes	Jody Shaw, OAG

On a motion made by Ms. Hill and seconded by Ms. Lochte, the Investment Committee voted to adjourn closed session and returned to open session at 1:18 p.m.

OPEN SESSION

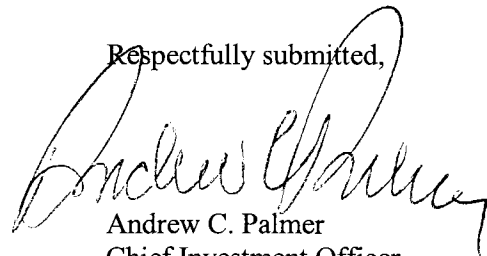
During closed session, the Investment Committee discussed and took action on the following matters:

The Committee discussed the System's investment in UBS's Trumbull Property Fund; and

The Committee conducted an evaluation of the CIO's performance.

Adjournment There being no further business before the Investment Committee, on a motion made by Ms. Hill and seconded by Ms. Lochte, the meeting adjourned at 1:18 p.m.

Respectfully submitted,


Andrew C. Palmer
Chief Investment Officer