

FINAL
THE INVESTMENT COMMITTEE
OF THE
MARYLAND STATE RETIREMENT AND PENSION SYSTEM
MINUTES OF OPEN MEETING

June 16, 2020

The Investment Committee convened on Tuesday, June 16, 2020 at 9:08 a.m., via video-conference call with the host site at the Maryland State Retirement Agency, SunTrust Building, 120 East Baltimore Street, 16th Floor, Board Room, Baltimore, Maryland.

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|-------------------|---|-----------------------------------|
| Committee Members | Michael K. Barry | Sheila Hill |
| Attending: | Thomas Brandt | F. Patrick Hughes, Chairman |
| | David Brinkley | Nancy K. Kopp |
| (1) On Site | Eric Brotman | Richard Norman |
| | Jamaal R. Craddock | Douglas Prouty |
| | Peter Franchot | Michael J. Stafford, Jr. |
| | Kenneth Haines | Lamont Tarbox |
| | David Hamilton | |
| | Linda A. Herman, Vice-Chair | |
| Also Attending: | Victor Adekoya | Ratna Kota |
| | Anish Bedi | Charles Lee |
| | Frank Benham (Meketa) | Michael McCord |
| | Robert Burd, Deputy CIO (1) | Matthew Michaels (Summer Intern) |
| | Antionette Butcher | Kyongdo Min |
| | Austin Cline (Summer Intern) | Matt Mullarkey (Aksia) |
| | Rachel Cohen, OAG | Mary Mustard (Meketa) |
| | Melody Countess | Stephen Muturi |
| | Mike Fang | Runya Nie (FIRM) |
| | Eric Farls | Kyle Olson (NFP) |
| | David Ferguson | Ashu Pal |
| | Kellen Foley (NFP) | Andrew Palmer, CIO |
| | Anne Gawthrop | Ishwarya Parameshawaran (FIRM) |
| | Michael Golden | Stephen Reilly (1) |
| | Dimitri Grechenko | David Rongione, Internal Auditing |
| | Alex Harisiadis, OAG | Dan Schick |
| | John Harris (Meketa) | Jody Shaw, OAG |
| | Philip Harris (FIRM) | Anne Shelton |
| | Justin Hayes | Frederick "Beau" Smith |
| | Levar Hewlett | Brad Taylor |
| | Angie Jenkins (1) | Bill Tugaw (NFP) |
| | Dana Johns | Toni Voglino |
| | Faina Kashtelyan | Jennifer Wildeman (Aksia) |
| | Greg Kasten | Rui Zhang (FIRM) |
| | Larry Katsafanas | |
| | Dean Kenderdine, Executive Director (1) | |

Mr. Hughes, Chairman, called the Investment Committee meeting to order at 9:08 a.m.

Treasurer Kopp introduced the new Board of Trustee member (Thomas Brandt), who replaced Charles Johnson.

Item 1: Open Session Minutes

On a motion made by Mr. Brotman and seconded by Mr. Norman, the Investment Committee approved the May 19, 2020 open meeting minutes.

Item 2: Optional Retirement Program Review

Mr. Burd gave a brief explanation of the ORP, a 403(b) defined contribution retirement plan for eligible employees of Maryland's higher education institutions. The program's two approved vendors are Fidelity and TIAA-CREF. The System's ORP consultants, FIRM and NFP (sub-contractor), proposed the following changes based on their plan review, which they and Mr. Burd summarized for the Committee.

- Fidelity Recommendations
 - Change share class for Vanguard FTSE Social Index Fund from VFTAX to VFTNX to reduce expenses.
 - Replace AQR Global Equity Fund with Victory RS Global Fund for performance reasons.
 - Replace the Fidelity Freedom Target Date Series (active) with the Fidelity Freedom Target Date Index Series (passive) to improve performance and reduce expenses.
 - For all changes, map existing assets and future contributions.
- TIAA Recommendations
 - Change the share class for the Vanguard Institutional Index Fund from existing ticker VINIX to new ticker VIIIX to reduce expenses.
 - Replace the existing CREF Stock Account with the Hartford Core Equity Fund (HAITX) for performance reasons.
 - Replace the existing CREF Growth Account with T. Rowe Price Institutional Large Cap Growth Fund (TRLGX) for performance reasons.
 - Replace the CREF Global Equities Account with the Victory RS Global Fund (RGGRX) for performance reasons.
 - For all changes, map existing, eligible assets and future contributions.

On a motion made by Mr. Stafford and seconded by Mr. Brotman, the Investment Committee unanimously approved the recommendation.

Mr. Brotman noted the results of the satisfaction survey. The ORP consultants explained that the survey was of benefits coordinators at each of the ORP's employing institutions. The consultants indicated that they had already discussed the survey results with the benefits' coordinators, and that the results were consistent with prior surveys.

Ms. Herman asked the percentage of assets participants may direct to their self-directed brokerage accounts. Mr. Burd responded that he believed the maximum was 90%, but would confirm this level as a follow-up item. Ms. Herman noted that some defined contributions have participants sign an acknowledgement form stating that the participant is responsible for the investment choices made within the self-directed brokerage account and that the Board does not evaluate or review the holdings in the self-directed brokerage accounts. She asked if the Board was requiring participants to sign such an acknowledgement and offered to send the sample Montgomery County is currently using. Staff noted they would evaluate the possibility of using an acknowledgement form.

Mr. Stafford made a motion for the consultants to present additional options that could potentially further diversify the funds available to ORP participants in the core investment line-up. The motion requested that the consultants return with an analysis of mutual funds focused on gold related stocks, and other potential diversifying strategies for the Board's consideration. Ms. Herman seconded the motion. The motion was approved by Mr. Brinkley, Treasurer Kopp, Comptroller Franchot, Mr. Haines, Ms. Hill, Mr. Craddock,

Mr. Norman, Mr. Hamilton, Ms. Herman, Mr. Brandt, Mr. Stafford and Mr. Barry. Voting against the motion were Mr. Prouty, Mr. Brotman, Mr. Tarbox and Mr. Hughes.

Mr. Brandt noted that the ORP is very similar to the State supplemental retirement plans and suggested that the various staff, Boards and consultants could share information.

Item 3: Asset Allocation and Benchmark Review

Mr. Benham gave the Board an overview of public equity market, which has recovered in the U.S., and Federal government actions that have been implemented to re-energize the economy. Treasurer Kopp mentioned that most of the funds allocated by the Federal government had not been distributed yet. Mr. Benham agreed and said that they had not yet seen a recovery in the economy but that the public markets were moving in anticipation of the government stimulus. Mr. Benham continued to explain that short term and long term rates in the U.S. had declined across the yield curve and were likely to remain that way for an extended time period. Inflation has been around 2.0% over the past two decades and that was also likely to remain subdued.

Meketa did not make any recommended changes to the System's asset allocation policy. Mr. Benham indicated they would come back over the course of the year to review various themes that could potentially improve the risk-adjusted returns of the System's assets. These themes will include a further analysis of the implementation of private markets, the use of plan level leverage, climate change as an asset allocation factor and the convexity of the portfolio.

Meketa made two recommendations for benchmark changes. For real estate, they recommended changing the benchmark from NCREIF ODCE gross (one quarter lagged) to NCREIF ODCE net + 40 bps. For local currency emerging market debt, they recommended changing the benchmark from Bloomberg Barclays Emerging Markets Local Currency Government Index -30 bps to Bloomberg Barclays Emerging Markets Local Currency Liquid Government Index - 30 bps.

For real estate, Meketa noted that many peer plans used NCREIF ODCE net, with some using a plus spread approach. They also thought that the gross index presented an unreasonably high hurdle given that on average this approach has a 100 bps spread over the net version. Meketa believes that the NCREIF ODCE net benchmark is appropriate for the core portfolio and the NCREIF ODCE net + 200 is appropriate for the non-core real estate allocation.

For emerging markets debt, Meketa explained that the proposed benchmark was very similar to the current benchmark, but has two distinct differences. The first difference is that the proposed benchmark's holdings represent the more liquid portion of the market, which better aligns with the System's opportunity set. The second difference is that the country allocations are capped at 10%, which creates a more diversified index. The countries most affected by the cap are China and South Korea. Meketa recommended subtracting 30 bps from the benchmark return to account for taxes and transaction costs that are not captured by the index but are incurred by U.S. investors.

Mr. Palmer commented that for the System to begin the year with an unlagged real estate benchmark, the current fiscal year will make the adjustment to remove the lag but will retain the existing gross benchmark. State Street currently holds the System's benchmark open long enough to capture the unlagged benchmark as it waits for final adjustments to the absolute return benchmark.

Mr. Stafford asked for staff to provide him with the fees for the real estate portfolio.

Ms. Herman asked for additional information as to the use of the blended benchmark for real estate. Mr. Palmer commented that the System has always had a blended real estate benchmark, and that the Board has not made a separate allocation to closed-end private real estate funds. Ms. Mustard said that Meketa had looked at non-core benchmarks, but in the end, decided to recommend a reasonable spread over the NCREIF

ODCE net. Ms. Herman noted that since the private real estate values (in State Street) are lagged, but the public real assets are not, how that could impact the comparability to the benchmark. Ms. Mustard replied that the core values (85% of the assets) would be current going forward, but the non-core piece would still lag. She added that while the spread method was not perfect, it represented a reasonable and operationally simple improvement over the current method.

A motion to approve the benchmark changes was made by Mr. Stafford and seconded by Mr. Prouty. The Investment Committee unanimously approved the recommendations from Meketa summarized above.

Meketa went on to discuss one of their investment themes, private markets. Currently, the System has approximately 27% of its assets in illiquid investments across private equity, private debt, real estate, natural resources & infrastructure and absolute return. Adding exposure to private equity should increase the expected return of the portfolio. Adding to private real estate and infrastructure has the potential to both increase expected return and provide added diversification from equity risk, depending on how they are implemented. Private markets represent an area where Meketa feels that Staff has the opportunity to generate the most alpha via fund and manager selection, noting staff's strong track record of adding value in private equity.

Meketa also outlined the potential risks associated with increasing private markets exposure. Overall, fees will increase. Given the size of the System, there are some limits to its ability to deploy a larger amount of capital in private markets. Private markets make the portfolio more illiquid, which may inhibit the System from being able to meet its obligations in a worst-case scenario. Illiquid assets cannot be rebalanced quickly, which can lead to unintended deviations from the policy benchmark.

Meketa and Staff studied the impact of illiquid assets and rebalancing and found that it did not have a meaningful impact on long-term returns.

Mr. Stafford asked what the short term returns would be for private equity. Mr. Benham responded that over the long term they expect a 300 bps premium over public markets for private equity. They believe this comes from higher leverage, having a controlling interest, and from the investments working in a less efficient market.

Ms. Herman requested Meketa provide the impact on risk and return on the portfolio if private markets were increased. She also requested Meketa provide a peer ranking of the System's private equity portfolio.

Mr. Palmer provided context for the consideration of additional private assets and leverage, two of the discussion topics planned for the year. He referred to the February meeting presentation by Meketa that showed the best risk adjusted plans were characterized by either high allocations to private assets, which improved returns and lowered reported volatility, or plan level leverage which produced returns similar to the System but at lower volatility. Working toward next year's asset allocation review, the Committee will have the opportunity to consider both options.

Item 4: Report from CIO

Mr. Palmer provided follow up on some topics from previous meetings:

- Mr. Palmer gave an update to the Board about the System's securities lending program. A study of the System's program for the first quarter, showed that the System had a 27% utilization rate vs. 7% for the peer group and the System made \$5.5 million in revenue versus \$2.5 million for the peer group (adjusted for size and composition).
- He noted that in response to a request from the Committee, staff had included an estimate of the costs of internal management in the quarterly fee report.

Mr. Palmer gave an update on the internal management program. He noted that staff is implementing a trade order management system, and expects it to be operational this summer. Also, staff has recently begun internal management of a \$1.3 billion long government bond portfolio.

He clarified that the System's next Investment Committee meeting would be on September 22, 2020, not the 15th as noted in the original Agenda, which is now revised.

Mr. Palmer went on to discuss the plan's recent performance. Assets fell by 8.3% during the first quarter with asset class returns varying widely. Equities were down 20%, but fixed income was up 10%. Private market performance is lagged for the quarter, so results will be known next quarter. Over the last five years, the plan's performance was below the target rate of return. Only private equity and real estate hit the actuarial rate of return. Over the last three months, the delayed pricing of private assets in natural resources and credit portfolios overstated the relative performance of those asset classes. Within the infrastructure allocations, MLPs did not perform well. However, Mr. Palmer noted that the Board's 2015 change to focus the rate sensitive portfolio on long government bonds has improved the overall System's performance by 75 bps per year.

Ms. Herman asked about the performance of the absolute return portfolio for the quarter. Staff explained that misfit effect relating to manager benchmarks that were different from the asset class benchmark led to the difference.

Mr. Palmer reviewed the tear sheets for the performance in April and May, citing that the public equity markets had recovered much of their earlier losses, bringing the overall fund to a positive return of 1.65% for the year through May, which did not quite keep up with the outflows for benefits.

Item 5: Absolute Return Review

Mr. Kasten began with a summary of the absolute return portfolio. He discussed the asset class's objectives, performance, restructuring and current initiatives.

Ms. Herman questioned the turnover in the portfolio in response to Staff's comments that the portfolio was improving. Mr. Kasten responded that staff had made many tweaks to the portfolio to diversify the performance, which should result in a portfolio with lower volatility and beta.

Ms. Herman asked if the portfolio could achieve a cash plus 4% return target. Mr. Palmer responded that neither the portfolio nor the benchmark had achieved that return target, but the changes to the portfolio over the last two years have improved his confidence in achieving that goal.

Aksia presented a brief market overview and a review of the absolute return program. Aksia noted that for Q1 2020, the multi-strategy, relative value and event driven sectors outperformed Aksia's peer universe. Only the tactical trading sector underperformed. Over the one and three-year time periods, the relative value and multi-strategy sectors had outperformed their respective HFRI benchmarks. Aksia highlighted the portfolio changes over the past three years and noted the portfolio continues to get more diverse. Historically, the portfolio had been dominated by macro/CTA (commodities trading advisors), multi-strategy and fund of funds, but has been transitioning to more opportunistic strategies that should be able to participate in areas where they have recently seen significant market dislocation. Aksia also showed an average of the System's management fees and performance fees, which were below their universe of monitored funds. Aksia made some suggestions regarding some additional strategies that staff may want to add to the portfolio.

Treasurer Kopp asked why the portfolio did not have any long-short equity managers. Mr. Palmer responded that these strategies have significant exposure to stocks, and that the System had equity exposure elsewhere. Staff did not want this portfolio to have a significant amount of equity exposure. Staff has been

adding risk to the portfolio without adding long-short equity strategies, but was considering adding a modest amount of long-short strategies to help achieve the cash +4% long term target.

Item 6: Meketa Reports

Meketa reviewed the System's performance. They mentioned that private credit and energy had been significant outperformers in the short term because of their lagged performance. Meketa highlighted the System's performance vs. the InvMetrics DB greater than \$1 billion peer group, which showed that the System's performance was in the fifth percentile for the first quarter and one year. In the same database for the greater than \$25 billion peer group, the System was in the 17th percentile for the quarter and 32nd ~~quartile~~ percentile for the 1 year.

Item 7: Review and Revise Criteria for Frequency of Asset Allocation Reviews

Mr. Palmer presented a recommendation of the Ad Hoc Committee on Governance to consider lengthening the interval between asset liability studies and evaluating the strategic asset allocation. The recommendation would increase the time in between asset allocation studies to every 5 years. Mr. Palmer anticipates that the study will be scheduled every four years to provide time for an extended discussion.

In response to the recommendation on moving the studies to once every 5 years, Ms. Herman asked Meketa whether there were significant changes to their return assumptions over the last several years that might support conducting valuations more frequently than every 5 years. Mr. Benham responded that there has been a gradual decline in return assumptions and sometimes there has been some market noise in their assumptions.

The recommendation provided for an annual review of the asset allocation and a number of potential triggers for conducting a comprehensive study.

A motion to approve was made by Mr. Prouty and seconded by Mr. Haines, the Investment Committee unanimously approved the recommendation.

Item 8: Review of the Criteria for the Chief Investment Officer's Evaluation

Mr. Kenderdine asked the Investment Committee to approve the content and questions of the CIO's evaluation.

Ms. Herman asked if there had been any recent changes to the evaluation. Mr. Kenderdine said there had not been any recent changes. Ms. Herman asked if there could be a section added to the leadership section relating to internal management. The Investment Committee agreed and Mr. Kenderdine will draft some recommendation language and circulate it to the Committee.

Item 9: 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 FY20 Travel Plan - Update
- Quarterly ORP Performance Report
- OPEB-PHBT Update
- New Hire Manager Report
- Monthly Fund Summary Tearsheet

On the Directors Desk:

- Broker Commission Reports
- Quarterly Manager Fee Report

Presentation of Resolution

On behalf of the Board of Trustees, Treasurer Kopp wanted to present Mr. Stephen Kitsoulis with a resolution of the Board of Trustees in recognition of his years of service as a member of the Investment Committee. Mr. Kenderdine read the following resolution.

WHEREAS, Stephen M. Kitsoulis was appointed in 2017 to serve as a Public Advisor to the Investment Committee of the Board of Trustees of the Maryland State Retirement and Pension System;

WHEREAS, Stephen M. Kitsoulis, through his investment acumen and knowledge, keen market insight and unbiased advice, contributed greatly to the mission of the System's Investment Committee and earned him the appreciation and respect of his fellow committee members and investment staff;

WHEREAS, Stephen M. Kitsoulis, during his three years of dedicated service, provided valuable guidance to the committee on ways to improve governance and increase productivity of Investment Committee meetings;

WHEREAS, Stephen M. Kitsoulis arrived to every Investment Committee meeting fully prepared, having thoroughly read all meeting materials and formulated questions for consideration by the Investment Committee and investment staff;

WHEREAS, Stephen M. Kitsoulis was ever collegial, respectful of presenters, appreciative of staff and attentive to the comments of his fellow committee members;

WHEREAS, Stephen M. Kitsoulis performed all his responsibilities in an exemplary and professional manner and, by virtue of his commitment to public service, courteous nature and wise approach to fund management, will be missed by the Board of Trustees and System staff;

NOW, THEREFORE, BE IT RESOLVED, by the Board of Trustees of the Maryland State Retirement and Pension System, that deep appreciation and gratitude are hereby expressed to Stephen M. Kitsoulis for his service that reflects great credit on the Maryland State Retirement and Pension System and the people of Maryland.

BE IT FURTHER RESOLVED that the Board of Trustees hereby records and gratefully acknowledges his valued service by the presentation of this resolution.

The resolution will be sent to Mr. Kitsoulis as he was not present for meeting.

Treasurer Kopp welcomed Anne Shelton who is the new appointed Public Advisor and who will be replacing Mr. Kitsoulis.

Item 10: Motion by the Investment Committee to meet in Closed Session

Ms. Herman requested that the Committee convene in closed session to discuss the performance and portfolio investments of a specific fund manager.

On a motion made by Treasurer Kopp and seconded by Mr. Brotman, the Investment Committee voted without objection to meet in Closed Session at 12:58 p.m. for the purposes of:

- (a) Reviewing the closed session Investment Committee minutes, pursuant to General Provisions Art., § 3-103(a)(1)(i), the exercise of an administrative function, and General Provisions Art., § 3-305(b)(13), to comply with a specific statutory requirement that prevents public disclosure,

- namely, General Provisions Art., § 3-306(c)(3)(ii), requiring that the minutes of a closed session be sealed and not be open to public inspection; and
- (b) Discussing performance of a specific manager, and details regarding the portfolio investments of the manager, pursuant to Md. Code Ann., General Provisions Sec. 3-305(b)(13), to comply with a specific law that prevents public disclosure about a particular proceeding or matter, and General Provisions Sec. 4-335, to protect confidential commercial information provided to the System by a third party.

CLOSED SESSION

| | | |
|-------------------|-----------------------------|-------------------------------------|
| Committee Members | Michael K. Barry | Sheila Hill |
| Attending: | Thomas Brandt | Nancy K. Kopp |
| | David Brinkley | Richard Norman |
| (1) On Site | Eric Brotman | Douglas Prouty |
| | Jamaal R. Craddock | Michael J. Stafford, Jr. |
| | Peter Franchot | Lamont Tarbox |
| | Kenneth Haines | |
| | David Hamilton | |
| | Linda A. Herman, Vice-Chair | |
| | | |
| Also Attending: | Frank Benham (Meketa) | Faina Kashtelyan |
| | Robert Burd, Deputy CIO (1) | Greg Kasten |
| | Antionette Butcher | Larry Katsafanas |
| | Rachel Cohen, OAG | Dean Kenderdine, Exec. Director (1) |
| | Melody Countess | Michael McCord |
| | Eric Farls | Matthew Michaels (Summer Intern) |
| | David Ferguson | Mary Mustard (Meketa) |
| | Anne Gawthrop | Ashu Pal |
| | Dimitri Grechenko | Andrew Palmer, CIO |
| | Alex Harisiadis, OAG | Stephen Reilly (1) |
| | John Harris (Meketa) | David Rongione, Internal Auditing |
| | Justin Hayes | Jody Shaw, OAG |
| | Angie Jenkins (1) | Anne Shelton |
| | | Brad Taylor |

Item 12: Motion by Investment Committee to adjourn closed session

On a motion made by Treasurer Kopp and seconded by Mr. Norman, the Investment Committee voted to adjourn closed session and return to open session at 1:12 p.m.

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

The Investment Committee approved the Closed Session minutes from the May 19, 2020 meeting.

Discussed performance of a specific manager, and details regarding the portfolio investments of the manager.

OPEN SESSION

Committee Members
Attending:

(1) On Site

Michael K. Barry
Thomas Brandt
David Brinkley
Eric Brotman
Jamaal R. Craddock
Peter Franchot
Kenneth Haines
David Hamilton

Linda A. Herman, Vice-Chair
Sheila Hill
Nancy K. Kopp
Richard Norman
Douglas Prouty
Michael J. Stafford, Jr.
Lamont Tarbox

Also Attending:

Frank Benham (Meketa)
Robert Burd, Deputy CIO (1)
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Melody Countess
Eric Farls
David Ferguson
Anne Gawthrop
Dimitri Grechenko
Alex Harisiadis, OAG
John Harris (Meketa)
Justin Hayes
Angie Jenkins (1)

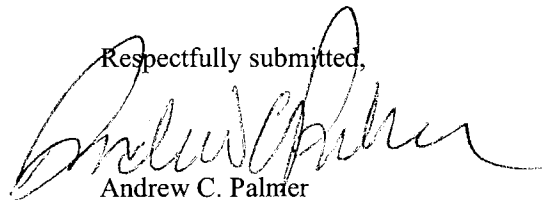
Faina Kashtelyan
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Larry Katsafanas
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Michael McCord
Matthew Michaels (Summer Intern)
Mary Mustard (Meketa)
Ashu Pal
Andrew Palmer, CIO
Stephen Reilly (1)
David Rongione, Internal Auditing
Jody Shaw, OAG
Anne Shelton
Brad Taylor

Item 13: Motion by Investment Committee to adjourn meeting

Adjournment

There being no further business before the Investment Committee, on a motion made by Treasurer Kopp and seconded by Mr. Norman, the meeting adjourned at 1:12 p.m.

Respectfully submitted,



Andrew C. Palmer
Chief Investment Officer