THE INVESTMENT COMMITTEE
OF THE
MARYLAND STATE RETIREMENT AND PENSION SYSTEM

MINUTES OF OPEN MEETING

September 22, 2020

The Investment Committee convened on Tuesday, September 22, 2020 at 9:40 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.

Committee Members Attending:	David Brinkley	Richard Norman
	Eric Brotman, Chairman	Douglas Prouty
	Peter Franchot	Anne Shelton
	Linda A. Herman	Michael J. Stafford, Jr., Vice Chairman
	Sheila Hill	Lamont Tarbox
	Nancy K. Kopp	
Absent	Michael K. Barry	
Also Attending:	Anish Bedi	Larry Katsafanas
	Frank Benham (Meketa)	Dean Kenderdine, Exec.Director
	Malcolm Blake (Townsend Group)	Rob Kochis (Townsend Group)
	Scott Bolander	Ratna Kota
	Robert Burd, Deputy CIO	Charles Lee
	Antionette Butcher	Michael McCord
	Rachel Cohen, OAG	Kyongdo Min
	Melody Countess	Stephen Muturi
	Mike Fang	Minh Nguyen
	Eric Farls	Runya Nie (FIRM)
	David Ferguson	Kyle Olson (NFP)
	Mimi Forbes	Ashu Pal
	Anne Gawthrop	Andrew Palmer, CIO
	Michael Golden	Ishwarya Parameshawaran (FIRM)
	Dimitri Grechenko	Stephen Reilly
	Kenneth Haines (Trustee)	David Rongione, Internal Auditing
	Alex Harisiadis, OAG	Dan Schick
	John Harris (Meketa)	Jody Shaw, OAG
	Philip Harris (FIRM)	Janet Sirkis
	Justin Hayes	Frederick "Beau" Smith
	Levar Hewlett	Michael Stark (Townsend Group)
	Angie Jenkins	Toni Voglino
	Dana Johns	Rui Zhang (FIRM)
	Faina Kashtelyan	
	Greg Kasten	

Mr. Brotman, Chairman, called the Investment Committee meeting to order at 9:40 a.m.

Treasurer Kopp thanked Mr. Brotman and Mr. Stafford for accepting the Chairman and Vice Chairman roles, respectively.

Item 1: Ratification of the Open Session Minutes

On a motion made by Mr. Prouty and seconded by Mr. Norman, the Investment Committee ratified the June 16, 2020 open meeting minutes with two small revisions. The attendance section was revised to remove Ms. Shelton's name, as she had not yet been officially appointed to the role of public advisor. In addition, page 6 of the minutes was corrected to reflect the "32nd percentile", and not 32nd quartile. The minutes were revised to reflect these changes.

Item 2: Investment Committee Roles and Responsibilities

Mr. Brotman noted planned changes to the structure of the Investment Committee meetings. He indicated that the Investment Committee should not address business intended for the full Board other than to give its opinion when necessary. The CIO should present first, prior to any consultant or guest presentations. Consultant and guest presentations should be brief and focused on only a few items to allow more time for Investment Committee member participation.

Mr. Brotman indicated that the Board's policies call for the review and revision of the Governance Charters and Policies of the Board of Trustees every three years and called the Committee's attention to the memo from the Executive Director that highlighted proposed changes to the Charter for the Investment Committee. Mr. Brotman called upon Ms. Cohen to discuss the proposed changes.

Ms. Cohen noted that currently the Board reviews all the charters and policies as prescribed every three years. She explained the proposed amendments for the Investment Committee's consideration to address statutory changes. The first amendment is to add Item 9, which provides for the Investment Committee to review and recommend to the Board an annual operating budget regarding personnel and operating expenses of the Investment Division. This is in line with new statutory authority the Board has with respect to the Investment Division. The second change is to revise Item 11 concerning financial incentives to the CIO to add language that requires only approved objective criteria be used subject to the restrictions set forth in the 2019 legislation (SPP Article § 21-118.1) and previously adopted by the Board.

In addition, Ms. Cohen noted that there are current statutory citations that are not reflected in the charters. Due to timing constraints, these additional proposed language changes are not included in the recommendation. These proposals include policies related to risk, including climate risk and investment of System's assets, and to require that the Investment Policy Manual is to include a policy to implement the State's policies relating to minority business enterprises.

Ms. Cohen stated that she has sent the draft language to Mr. Palmer for review and discussion. She noted that adding this language will allow for cross-referencing, making it easier for the Committee to connect the two policies that per statutory requirements must be included in the Investment Policy Manual.

Ms. Kopp inquired whether adding these two latter items will have implications by not including other statutory items. Ms. Cohen responded that she will draft the language to explicitly address this concern and make it clear.

Mr. Brotman instructed Ms. Cohen to update the proposed language of the Charter and present it to the Investment Committee at the next scheduled meeting for the recommendation to the Board for adoption.

Ms. Shelton inquired as to the reason for not having a parallel requirement to provide documentation for manager hiring in Item 7 regarding notification of manager terminations.

Mr. Brotman responded that terminating a manager does not occur frequently, and there is a need for the Committee to be informed of the circumstances of the termination.

Ms. Cohen noted that this approach is also is based on the language of the law that delegates to the CIO, by statute, the authority to select managers and investment vehicles. The statute also requires the CIO to report manager terminations but does not require notification to the Committee prior to manager selection.

Ms. Shelton clarified that her question was concerning potentially notifying the Investment Committee after the hiring of a new manager.

Mr. Palmer responded that the termination notification provision is a forearming mechanism for Trustees because terminated managers may reach out to the Trustees trying to impact the decision. Sharing the information on the rationale for termination provides Trustees with knowledge in advance on the decision.

Item 3: Gold Option for ORP

Mr. Burd provided the background of the study for gold as a potential investment option in the core investment line-up for the Optional Retirement Program. He noted that during its June 2020 meeting, the Investment Committee requested information regarding gold related mutual funds and other diversifying strategies for possible inclusion in the ORP Core investment lineup. Mr. Burd introduced FIRM and NFP, consultants with respect to the ORP, to present their analysis of this matter.

Mr. Harris, from FIRM, outlined the objective and scope of the review for the ORP. He noted that the firm screened four Morningstar categories to identify possible options – gold and precious metal funds, market neutral funds, managed futures funds and long government bond funds. The main criteria used were: performance during bear market periods since 2000; correlation to the S&P 500 index; manager tenure and AUM; Sharpe Ratio and other return statistics and Morningstar ratings. FIRM also conducted a survey of the top ten recordkeepers representing $5.8 trillion of assets in relation to their utilization of alternative strategies as core fund line-up options. On average, gold and precious metal options were used by 4.66% of plan sponsors adopted as diversification options. The recordkeeper with highest use of such strategies was Fidelity at 8.7%.

Mr. Olson reviewed six funds across different categories. He covered peak-to-trough returns during different downturns and risk (standard deviations). He noted that gold funds generally performed well and outperformed S&P 500 index during 7 of 9 down market periods. Long government strategies however, had the best performance. He also reviewed correlations to the U.S. equity market. Gold funds exhibited low correlation, but long Treasury bond funds had the lowest correlation over the last ten years.
Mr. Brotman inquired whether the performance was reviewed during past bull markets.

Mr. Olson responded that Ms. Nie will present this data.

Ms. Nie further reviewed the performance analyses and noted several observations related to 5-year and 10-year returns, risk, beta, Sharpe ratios, and expense ratios.

Mr. Brotman noted that there was no action required at this meeting on this item.

Mr. Stafford commented that 8-9% of plans on Fidelity's recordkeeping platform include a gold/precious metals option. He noted that since there are 48 other investments options available in the ORP core line-up, adding a gold fund may be acceptable, commenting that in his view gold was uniquely uncorrelated to equity markets.

Mr. Stafford made a motion to include a gold fund in ORP at the next review cycle.

Mr. Brotman asked whether the Investment Committee has the authority to consider adding an investment fund to the ORP line-up, and how often the reviews occur.

Mr. Burd confirmed that it is the Committee's role to select funds for the line-up, as well as selecting the recordkeepers. He also noted that comprehensive reviews are conducted every two years and the next one will be May 2022.

Ms. Shelton requested Mr. Harris and the team to comment on pros and cons of adding gold funds in the line-up and whether they would recommend doing so. Mr. Harris noted that, while Fidelity's clients have high participation in gold funds, overall participation is relatively low. He also noted sophisticated investors, understanding portfolio construction, could access more niche products through the ORP's brokerage service as a way to approach this matter. He observed that average participants see a gold fund as a specialized option and often try to time the market, which tends to lead to adverse effects.

Mr. Brotman agreed with Mr. Harris that this is a good option for a brokerage service for more sophisticated participants.

Mr. Stafford restated his motion to include a gold fund option at the next practical opportunity. Ms. Herman seconded. The motion failed by a vote of 5 against to 4 in favor. Voting in favor of the motion were Mr. Stafford, Ms. Herman, Ms. Hill and Mr. Norman. Voting against the motion were Mr. Brotman, Ms. Kopp, Ms. Shelton, Mr. Tarbox and Mr. Prouty.

Item 4: Investment Policy Manual

Mr. Palmer presented three proposed changes to the Investment Policy Manual to reflect approved changes to the Real Estate benchmark and local currency Emerging Market Debt benchmark, as well as changing the frequency of a mandatory asset liability study from two years to five years. The recommendation is to ratify the IPM language which was previously approved by the Board.

A motion was made by Mr. Prouty and seconded by Mr. Tarbox. The motion was unanimously approved.

Item 5: Investment Division Fiscal Year 2022 Budget

Mr. Burd presented a recommendation to approve the FY 2022 budget for the Investment Division. Mr. Burd noted that actual expenses for fiscal year 2020 were $864K less than the amount budgeted largely due to a delay in implementation of the trade over management system and the lower than expected cost for the new private equity consultant. He also noted the requested budget for fiscal year 2022 is higher mainly due to increased salary and incentive compensation estimates.

Mr. Palmer presented a longer-term view of the budget to reflect the division's strategic plan. The budget increases are primarily driven by the gradual rightsizing of the compensation structure to the median level of the market as well as the Investment Division continuing to fill open positions. He noted the cost savings portion would come from directly managing public assets, starting with fixed income and moving into public equity. Mr. Palmer expects a much more meaningful impact on fee savings in coming years. Also, he noted that an increased co-investments initiative is part of an ongoing effort to reduce fees on the private investment side.

Mr. Brotman inquired why the 2022 budget numbers were omitted and wanted to see both annual and cumulative cost savings numbers.

Mr. Palmer responded that he will add the requested detail.

Mr. Stafford inquired whether benefits and other costs were included in the additional staff cost estimate.

Mr. Palmer responded that was the case.

Mr. Stafford further inquired about the asset composition of $22.5 billion that will be internally managed by 2025.

Mr. Palmer noted that much of the growth in internally managed assets is planned to come from maintaining the size of external asset managers for the next 5 years and internally managing the growth in assets, as the plan moves closer to fully funded status. The fee savings is reflected as an avoided cost and does not necessarily reflect terminating external managers.

Mr. Brotman requested more details relating to the 22 basis points in savings.

Mr. Stafford also inquired whether it is necessary to add more staff on the co-investment side because the Investment Division is already performing that function.

Mr. Palmer responded that the Investment Division is making co-investments and generating some savings, but it is not saving as much as it could. The Investment Division is not directly driving the co-investment process and having a dedicated co-investment team will result in significantly higher fee savings.

Mr. Stafford noted that internal management is one of the biggest decisions that the Investment Committee has made so it would be helpful to provide greater detail regarding fee savings and co-investments.

Mr. Tarbox added that co-investments, from his experience, is much more resource-intensive given the short turnaround time required when compared to fund investments.

A motion was made by Mr. Prouty and seconded by Mr. Tarbox, to approve the estimated budget request for the Investment Division for fiscal year 2022. The motion was unanimously approved.

Item 6: Report from CIO

Mr. Palmer indicated that open items from the June meeting were addressed in a memo that was posted to the Director's Desk in July except for the gold investment option for the ORP which was discussed at this meeting.

In discussing performance, Mr. Palmer noted continued improvement in up-capture versus down-capture ratios in public equity. He highlighted that achieving higher upside capture is critical given the System's relatively lower equity exposure compared to peers and the importance of the equity segment in driving growth in system assets. The Investment Division also sought managers that can demonstrate outperformance with positive skew. He also noted the importance of managing beta exposure better.

Mr. Palmer reported a strong start to the fiscal year for both absolute and relative performance with the System outperforming its benchmark by 30 basis points in July. While September had seen a modest decline in absolute performance, he was hopeful that the relative outperformance would continue.

Mr. Palmer discussed the June 30, three-month performance attribution showing positive 23 basis points. Continued strong performance in private equity along with very strong performance by some of the public equity managers were the main drivers of this outperformance.

The fiscal year relative outperformance was 43 basis points, with positive private and public equity relative performance driving a 65 basis points positive selection effect. Mr. Palmer also pointed out the 19 basis points impact from allocation that was driven largely by tactical allocation decisions to manage portfolio betas. This enhanced tactical allocation ability was generated by creating a dedicated portfolio risk analysis capability that was able to produce more timely portfolio composition data and allow for better decision making.

Mr. Stafford inquired if the June 30 TUCS report was available.

Mr. Palmer responded that the June 30 report was included in the packet and highlighted improvements from prior years.

Item 7: Meketa Reports

Mr. Harris covered peer performance.

Mr. Benham covered the macroeconomic environment. The first two months of the fiscal year have been positive as equity markets have been strong, but volatility has increased. A large part of the rebound has been driven by technology stocks as the performance gap between tech and non-tech shares has been significant.

The reason for the rebound was partially due to strong economic news relative to prior expectations. The unemployment rate has returned to single digits and jobless claims have been declining rapidly. However, the rate of decline has been tailing off. Investors expect a more protracted period of high unemployment for the foreseeable future, partially explaining the market downturn so far in September.

He also noted some policy changes by the Federal Reserve such as adopting an average inflation target of 2% over an average period as opposed to a hard target of 2% previously. Also, the Fed plans to keep the federal funds rate near zero at least until 2023.

Mr. Benham commented on the election saying that both parties are expected to support fiscal stimulus. A Democratic sweep could lead to higher taxes and a corporate tax rate moving from 21% to 28%. The markets would prefer a divided government.

Mr. Benham summarized by saying lower interest rates would impact how to invest for some time. A Meketa-led working group, including Mr. Palmer, has been established to examine asset allocation in a low rate environment.

Mr. Brotman indicated he would like Meketa to present some of their findings at the November Investment Committee meeting or at the Board education session.

Item 8: The Townsend Group Report

Mr. Kochis reviewed the real estate market in general. He focused on three themes in the current market condition. He notes that COVID-19 impacted the real estate market in March leading to a dramatic market freeze in activity. He mentioned that returns have turned negative but not as significantly as might be expected because appraisers are hesitant to mark down assets when transaction data is limited.

Mr. Kochis noted that COVID-19 accelerated some of the trends such as tailwinds for logistics, warehouses and digital real estate while accelerating challenges in retail and office.

Mr. Kochis noted that the office sector, which is the largest sector in real estate, has been underweight in the System's portfolio because of the conscious decision by investment staff and this position could benefit the System over the intermediate term.

Mr. Stark noted the System's portfolio was defensively positioned through a reduction in public REIT exposure, underweight to office and retail as well as lower leverage. The System's real estate portfolio posted second quartile performance compared to other Townsend clients. The System had been underweighted to opportunistic and value-add managers while waiting for opportunities to present themselves and the current decline is a good opportunity to increase investments in those strategies.

Mr. Brotman asked if Townsend was comfortable with the System's new real estate benchmark, and Mr. Kochis responded that they were. Mr. Brotman asked if manager selection caused the System's historical underperformance in the sector and Mr. Kochis responded that it was caused by the historical benchmark reflecting gross returns while the System reported returns net of fees. Mr. Brotman asked if there was on opportunity to reduce fees and Mr. Kochis responded that staff had done a good job of negotiating lower fees by concentrating in a few managers.

Mr. Brotman asked if the System could generate alpha in real estate and noted that, historically, the System needed about 90 basis points of tactical alpha to outperform. Mr. Kochis noted that the core managers essentially replicate the index, but that alpha can be generated with value-add and opportunistic investments at this time in the cycle. Mr. Palmer noted that staff is working to document a strategy in real estate that will increase focus on non-core strategies in down markets and allow them run off as the markets improve.

Ms. Shelton asked if the System could use REITs to access niche strategies like data centers. Mr. Kochis responded that it could but noted that REITs are subject to equity market volatility and that niche private strategies do exist.

Mr. Stafford inquired about the System's exposure to the assisted living sector and expressed concern about this sector. Mr. Kochis responded that the exposure is small and that heightened risk concerns should be temporary given the positive demographic trend over the longer-term.

Item 9: Committee Led Discussion

Mr. Palmer asked the public advisors on the committee what they are seeing and how they are managing through this period.

Mr. Tarbox said he is seeing mixed news on office with some lower demand but others taking the opportunity to add more space to spread out employees. He is also seeing a lot of distressed credit funds being raised but does not think that there will be enough opportunity to deploy the capital.

Ms. Shelton indicated that she is "staying the course" and not making significant asset allocation changes. They are investing in distressed in more liquid formats to maintain flexibility.

Item 10: 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 FY21 Travel Plan - Update
- Quarterly ORP Performance Report
- OPEB-PHBT Update
- New Hire Manager Report

On the Directors Desk:

- Broker Commission Reports
- Quarterly Manager Fee Report

Item 11: Motion by the Investment Committee to meet in Closed Session
Ms. Cohen read the annotate codes for the Committee to convene in closed session.

On a motion made by Mr. Stafford and seconded by Mr. Tarbox, the Investment Committee voted without objection to meet in Closed Session at 12:30 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) 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 Attending:	David Brinkley Eric Brotman, Chairman Peter Franchot Linda A. Herman Sheila Hill Nancy K. Kopp	Richard Norman Douglas Prouty Anne Shelton Michael J. Stafford, Jr., Vice Chair Lamont Tarbox
Also Attending:	Dean Kenderdine, Executive Director	

Item 14: Motion by Investment Committee to adjourn closed session
On a motion made and seconded, the Investment Committee voted without objection to adjourn closed session and return to open session at 12:55 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 June 16, 2020 meeting.

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

OPEN SESSION

Committee Members Attending:	David Brinkley Eric Brotman, Chairman Peter Franchot Linda A. Herman Sheila Hill Nancy K. Kopp	Richard Norman Douglas Prouty Anne Shelton Michael J. Stafford, Jr., Vice Chair Lamont Tarbox
Also Attending:	Dean Kenderdine, Executive Director	

Item 13: Motion by Investment Committee to adjourn meeting

Adjournment — There being no further business before the Investment Committee, on a motion made and seconded, the meeting adjourned at 12:58 p.m.

Respectfully submitted,

Andrew C. Palmer
Andrew C. Palmer
Chief Investment Officer