

**THE INVESTMENT COMMITTEE
OF THE
BOARD OF TRUSTEES
MARYLAND STATE RETIREMENT AND PENSION SYSTEM**

MINUTES OF MEETING

May 16, 2017

The Investment Committee met on Tuesday, May 16, 2017. The meeting was held in the Board Room on the 16th floor of the State Retirement Agency, 120 E. Baltimore Street, Baltimore, MD 21202.

Members	Michael Barry	Linda Herman, Vice Chairman
Attending:	Eric Brotman	Sheila Hill
	David Brinkley	Larry E. Jennings, Jr.
	James Bush, Jr.	Charles Johnson
	Peter Franchot	Nancy K. Kopp
	Kenneth Haines	Theresa Lochte
	David Hamilton	Richard Norman
	James Harkins	Stefan Strein

Members Not	F. Patrick Hughes, Chairman
Attending:	James "Chip" DiPaula

Also Attending:	Victor Adekoya	Dean Kenderdine
	Phillip Anthony, MLIS	Stephen Kennedy, Albourne
	Frank E. Benham, Meketa	John Kenney
	William Boardman, KBI	Thomas Kurowski, Alex Brown
	Global Investors	Michelle Lowery
	Colleen Bower	Michael McCord
	Susanne Brogan	Mary Mustard, Meketa
	Robert Burd, Deputy CIO	Stephen Muturi
	Elizabeth Burton	Andrew Palmer, CIO
	Rachel Cohen, OAG	Stephen Reilly
	Melody Countess	David Rongione
	Eric Farls	Michael Rubenstein, MLIS
	David Ferguson	Dan Schick
	Anne Gawthrop	Jody Shaw, OAG
	Michael Golden	Frederick "Beau" Smith
	Dimitri Grechenko	David Tatkow, Albourne
	Alex Harisiadis, OAG	Toni Voglino
	Dana Johns	Edward Welsh, OLA
	Faina Kashtelyan	Pat Wild
	Gregory Kasten	

Ms. Herman called the meeting to order at 9:02 a.m.

Minutes

On a motion made by Mr. Harkins and seconded by Ms. Kopp, the minutes from the February 21, 2017 meeting, previously approved by Mr. Hughes, were unanimously ratified.

Report from the CIO

Mr. Palmer provided updates on business and initiatives of the Investment Division that were raised at the Committee's last meeting, including the topics of global equity mandates, the Investment Committee Charter and a deliverable document available to the Committee, the reduction in fees by \$20 million since 2016 and on-going efforts to reduce fees, and the creation of a peer universe that is similar in size, strategy, risk position, and funding status for the Maryland State Retirement and Pension System (the "System"). Mr. Palmer commended Ms. Burton for being named to CIO Magazine's "Top 40 Under 40." Mr. Palmer also notified the Committee that the internal management task force is ongoing and is in the process of hiring a consultant to assist in the development of internal management.

Mr. Palmer then presented the System's overall performance as of the quarter ending March 31, 2017, as set forth in the Portfolio Review document provided to the Committee. He commented on the performance attributes of the System which demonstrate that over the last 7 years, the system had been inconsistent in meeting two of its three primary objectives: achieving the actuarial return and earning greater than three percent real return. The system has been consistent in generating excess returns but in a fashion that increasingly achieves excess returns by losing less in down markets relative to the benchmark while capturing most of up markets. Mr. Palmer noted that he will work with staff to maintain the excess returns while achieving full participation in positive markets. In addition, he will work with staff to more directly incorporate the actuarial return in the portfolio implementation.

Comptroller Franchot commented that in light of the last three years' investment performance, which did not meet the actuarial assumed rate of return, the rate should be reduced so that the State and the local governments that are part of the System contribute more money. Ms. Herman noted the System's investments underperformed its peers, that better investment performance would obviate a need to lower the assumed rate. Comptroller Franchot expressed his concern with taking on more risk and buying stocks when valuations are high.

Mr. Ferguson presented, and the Committee discussed, the performance of the System's private equity portfolio with reference to the Portfolio Review document. Mr. Ferguson outlined the results of a peer comparison of 25 pension funds versus the System's private equity portfolio, noting that the System's private equity portfolio has outperformed the median for the peer group for the 1 year, 3 year, 5 year and 10 year returns being ranked 3rd, 6th, 8th and 7th respectively. Mr. Jennings commented that the System should rank themselves against the best investors, not just public pension funds, which typically do not do well in private equity. Mr. Strein commented to staff that the private equity portfolio should be compared to public equities using a public market equivalent methodology. Mr. Ferguson responded that this comparison is performed and the private equity portfolio is over 200 basis points greater than public equities.

Mr. Ferguson then discussed staff's views on venture capital investing and the advantages of the asset class, as well as the importance and difficulty of accessing top-performing funds with reference to the Portfolio Review document.

Ms. Burton presented the performance of the absolute return portfolio from the Portfolio Review document, as well as staff's recent success and on-going efforts in negotiating reduced fees within the portfolio. Comptroller Franchot asked about fee negotiations, and Ms. Burton explained that underperformance and investors redeeming from hedge funds are contributing to the availability of lower fees. Mr. Franchot asked Mr. Ferguson about fee negotiations, and Mr. Ferguson noted that they are more difficult in private equity due to excess demand for high quality private equity managers.

Asset Allocation Recommendation

Mr. Benham and Ms. Mustard from Meketa presented to the Committee asset allocation policy options A, B and C, as set forth in the Asset Allocation Policy Review document provided to the Committee. Mr. Benham first presented option A, noting that it was the most similar to the current policy, preserving the risk posture, reducing the commodities allocation to 0%, moving 1% from international developed to emerging market equities, increasing credit by 1%, and increasing the natural resources and infrastructure allocation to 4%.

Mr. Benham presented asset allocation option B to the Committee and explained that this option is a higher risk-higher return portfolio that would increase public equity and private equity, decrease the allocation to rate sensitive assets by 2% and absolute return by 2%, and reduce the commodities allocation to 0%, and increase the natural resources and infrastructure allocation to 4%.

Mr. Benham presented option C to the Committee and explained that this option would include leverage on a total portfolio level. The growth/equity allocation would increase by 1% with international equities decreasing by 3%, US equities increasing by 1%, emerging market equity increasing by 2% and private equity increasing by 1%. Credit would increase 2% and real assets would be similar to option A and B with a 0% allocation to commodities and a 4% allocation to natural resources and infrastructure.

Mr. Jennings commented on the risks of leverage, and noted that the portfolio already has leverage in the underlying assets and cautioned against its further use.

Mr. Benham presented how asset allocation options A, B and C would have performed in various historical scenarios such as the global financial crisis in 2007 through 2009 and the interest rate spike in 1994 as noted in the Asset Allocation Policy Review document.

Mr. Brotman expressed concern about total portfolio leverage and reducing the absolute return portfolio given the current equity market valuations.

Mr. Benham described the academic case for leverage given reductions in the expected returns from all asset classes since 2009.

Ms. Herman referred to a memorandum on leveraged bonds that Mr. Palmer had previously released to the Committee and that includes information from Bridgewater. Ms. Herman explained that the leverage strategy was one that was implemented by her organization, the Montgomery County Employee Retirement Plans, and that it has been successful.

The Committee discussed the possibility of postponing the asset allocation decision pending more information. Ms. Herman asked that Bridgewater present at a June Investment Committee meeting so that the Committee could learn more about the leverage strategy, and evaluate different asset allocations where absolute return has an allocation of 5% and credit is allocated at 10%. Mr. Brotman requested to see a scenario where option B had an allocation of 16% to US equities and 8% to absolute return. Mr. Barry commented that he was not in favor of using leverage and requested to see a scenario that maintains the allocation to equity as is, increases the absolute return asset class and increases private credit. Mr. Strein requested information on the cost and term of the proposed leverage, and a scenario that has no increased allocation to private equity. Mr. Palmer commented that he would communicate by email with the Committee soliciting comments on the asset allocation options.

On a motion by Ms. Hill, and seconded by Mr. Bush, the Committee voted, all in favor, to defer the asset allocation action item to June 20, 2017 at a special meeting of the Investment Committee to be held prior to the meeting of the Board of Trustees.

Investment Policy Manual

This agenda item was deferred due to the asset allocation agenda item being deferred until the June 20, 2017 Board of Trustees meeting.

Meketa Reports

Mr. Benham and Ms. Mustard from Meketa briefly discussed the Quarterly Performance Report and provided an activity update.

Update from Albourne

Mr. Tatkow and Mr. Kennedy from Albourne discussed the performance of the Absolute Return portfolio including the 12- and 36-month performance. Mr. Tatkow indicated that overall the portfolio is a balanced and conservative portfolio.

Mr. Bush requested that certain charts in the presentation be updated with legends for clarification and re-presented to the Committee.

Presentation of Resolution

On behalf of the Board of Trustees, Treasurer Kopp presented Mr. Strein with a resolution of the Board of Trustees in recognition of his years of service as a member of the Investment Committee.

Closed Session

On a motion made by Mr. Brotman and seconded by Mr. Haines, the Committee voted to meet in closed session (11:25 a.m.) in the Board Room of the SunTrust Building at 120 East Baltimore Street for the purpose of:

- a) interviewing candidates for the position of Public Advisor to the Investment Committee, pursuant to General Provisions Art., Section 3-103 (a)(1)(i), the exercise of an administrative function and General Provisions Art., Section 3-305(b)(1)(i), the appointment, employment, assignment, promotion, discipline, demotion, compensation, removal, resignation, or performance evaluation of appointees, employees, or officials over whom it has jurisdiction;
- b) selecting a candidate for the position of Public Advisor to the Investment Committee for recommendation to the Board of Trustees, pursuant to General Provisions Art., Section 3-103(a)(1)(i), the exercise of an administrative function and General Provisions Art., Section 3-305(b)(1)(i), the appointment, employment, assignment, promotion, discipline, demotion, compensation, removal, resignation, or performance evaluation of appointees, employees, or officials over whom it has jurisdiction;
- c) reviewing the closed session Investment Committee minutes, pursuant to General Provisions Art., Section 3-103(a)(1)(i), the exercise of an administrative function; and
- d) receiving a review of staff's due diligence of a venture capital fund manager, including the analysis of staff, pursuant to General Provisions Art., Section 3-305(b)(5), to consider the investment of public funds, and 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.

Members Attending:	Michael Barry David Brinkley Eric Brotman James Bush, Jr. Peter Franchot Kenneth Haines David Hamilton James Harkins	Linda Herman, Vice Chairman Sheila Hill Larry E. Jennings, Jr. Charles Johnson Nancy K. Kopp Theresa Lochte Richard Norman Stefan Strein
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Members Not Attending:	F. Patrick Hughes, Chairman James "Chip" DiPaula
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Also Attending:	Victor Adekoya ¹ Frank E. Benham, Meketa Susanne Brogan Robert Burd, Deputy CIO	Gregory Kasten ¹ Dean Kenderdine John Kenney Michael McCord ¹
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Elizabeth Burton¹
Rachel Cohen, OAG¹
Eric Farls¹
David Ferguson¹
Dimitri Grechenko¹
Alex Harisiadis, OAG¹
Dana Johns¹
Faina Kashtelyan¹

Mary Mustard, Meketa
Stephen Muturi¹
Andrew Palmer, CIO
Stephen Reilly¹
Dan Schick¹
Jody Shaw, OAG¹
Frederick "Beau" Smith¹
Toni Voglino¹

¹ In attendance for item (d) of closed session only.

On a motion made by Ms. Lochte and seconded by Mr. Haines, the Investment Committee returned to open session at 1:45 p.m.

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

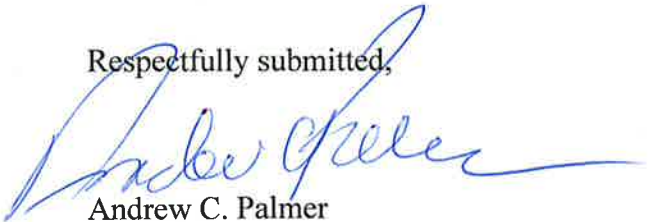
The Investment Committee reviewed and ratified the Closed Session minutes from the February 21, 2017 meeting.

The Investment Committee voted to recommend that the Board of Trustees appoint Stephen Kitsoulis to serve as a public member of the Investment Committee.

Adjourn Meeting

On a motion made by Ms. Lochte and seconded by Mr. Haines, the Investment Committee adjourned at 1:45 p.m.

Respectfully submitted,



Andrew C. Palmer
Chief Investment Officer