

<b>IAC Members Attending</b>			
Peter Taylor	IAC Chair	Irv Rothenberg	Member
Steve Relyea	IAC Vice Chair	David Bach	Member
Robert Eaton	Member	Tim Schaefer	Member
Leona Bridges	Member/ Absent	Mike Lucki	Member
<b>Staff / Other Attendees</b>			
Ron Flatt	Director – Treasury Operations	Jonas Noack	Meketa – Investment Advisor
Scott August	Manager – Investments	Peter Meany	First State Investments
Laura Wirick	Meketa – Investment Advisor	Randy Paas	First State Investments
Hannah Schriener	Meketa – Investment Advisor		

The IAC Chair called the meeting to order and established a quorum on April 10, 2019 at 11:00 am.<sup>1</sup>

One member joined by phone due to unforeseen and unusual circumstances not within the power of the committee to control.

The IAC Chair asked if there were any amendments or changes to the minutes from the January 30, 2019, meeting. Upon a motion duly made and seconded, the minutes were approved as submitted. Three members abstained.

## **Item II: TRP Quarterly Report – Information Item**

This item was an information item and is presented at each quarterly meeting. The CSU’s investment advisor, Meteka Investment Group (“Meketa”), presented their Fourth Quarter 2018 Capital Markets Review which included reviews of historical investment returns for various asset classes and sectors, relative valuations, and economic statistics. Next, Meketa presented their Capital Markets Outlook. Finally, Meketa presented the TRP quarterly review and evaluation report as of December 31, 2018. Information in this report included the current asset allocation, an update on funding contributions, overall TRP performance versus its stated benchmarks, and detailed performance and characteristics for the TRP investment managers. As of December 31, 2018, the TRP market value was \$346.2 million, an increase of \$97.9 million from the prior quarter; \$120 million from funding contributions and -\$22.1 million from investment.

### **Key points:**

- As of December 31, 2018, all TRP asset classes complied with the Policy Ranges outlined in the TRP Investment Policy.
- As of December 31, 2018, the TRP since inception return was -2.60% compared to +4.35% for the TRP Strategic Benchmark and -4.31% for the TRP Policy Benchmark.
- The TRP returned -7.26% for the quarter compared to +1.36% for the TRP Strategic Benchmark and -7.19% for the TRP Policy Benchmark.
- TRP Fixed Income returned -0.43% for the quarter
  - While High Yield Bonds trailed the Barclay’s U.S. High Yield index by roughly 180 basis points (-6.36% vs. -4.53%), Emerging Markets Bonds outperformed the JP Morgan EMBI Global Diversified index by 105 basis points (-0.20% vs. -1.25%).

<sup>1</sup> Details on all meeting agenda items are included in the meeting materials as presented at the CSU Investment Advisory Committee (“IAC”) meeting dated April 10, 2019.

- TRP Equity had a down quarter on an absolute return basis of -12.26%
  - Despite the negative absolute return for TRP Equity, on a relative basis, TRP Equity outperformed the MSCI ACWI IMI by 102 basis points (-12.26% vs. -13.28%).
  - All three TRP equity funds ranked above the universe median within their peer universes for both the fourth quarter and the fiscal year-to-date period.
- TRP Real Assets was down -9.52% for the quarter, however all three sub-asset classes provided strong performance within their peer groups with returns ranking in the top quartile of each respective universe for the quarter.

Finally, the last section in this item contained a draft of the TRP Quarterly Investment Report as of December 31, 2018, to be presented to the CSU Board of Trustees in May. The TRP Quarterly Investment Report will be a consent item on the Board of Trustees agenda.

**Item III: Guest Speaker – Information Item**

The TRP’s Global Listed Infrastructure manager – First State Investments based in Sydney, Australia presented. First State’s Head of Global Listed Infrastructure and Client Relations discussed the current infrastructure market conditions and the First State Global Listed Infrastructure strategy.

**Item IV: 2020 Proposed IAC Meeting Dates – Information Item**

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|--------------------|-------------------------------------|
| • January 30, 2020 | Chancellor’s Office, Long Beach, CA |
| • April 7, 2020    | CSU East Bay, Hayward, CA           |
| • August 11, 2020  | Chancellor’s Office, Long Beach, CA |
| • October 6, 2020  | Chancellor’s Office, Long Beach, CA |

All meeting times 11 AM to 2:30 PST

**Item V: Funding Schedule Fiscal Year 19/20 – Action Item**

The purpose of Item V was to approve the proposed FY 19/20 TRP funding schedule with the goal of reaching the 30% statutory limit.<sup>2</sup> Total CSU Investments (excluding SMIF) in FY 19/20 are anticipated to fluctuate between \$4.0 billion and \$4.8 billion due to inflows and outflows in the Liquidity Portfolio (SWIFT) and the Intermediate Duration Portfolio (IDP). Funding the TRP to \$1.2 billion should maintain the TRP below 30% of the expected low market value for CSU Investments of \$4 billion. As of June 30, 2019, total TRP contributions will be below the \$600 million statutory limit.

Item V requested the IAC approve the following Recommendations for Action:

- Approval of the Proposed Funding Schedule on P. 173 of the meeting materials which proposed a dollar-cost-averaging funding schedule for the TRP with funding contributions of \$150 million per quarter through June 30, 2020, at which time the TRP value should be close to 30% of CSU Investments.
- Approval granting Chancellor’s Staff discretion to alter the Funding Schedule as needed beginning on July 1, 2019 to maintain the TRP below 30% of CSU Investments per the state law.

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<sup>2</sup> Per state law TRP investments may not exceed \$600 million as of June 30, 2019, and thereafter 30% of overall CSU investments.

The IAC members discussed the Recommendations for Action. Upon a motion duly made and seconded, the proposed Recommendations for Action were approved.

#### **Item VI: Intermediate Duration Portfolio (IDP) Framework – Information**

The IAC has overall responsibility, as delegated by the Board, to oversee all aspects of the TRP. Additionally, the IAC is responsible for understanding the overall investments of the CSU and each of the CSU portfolios as informed by Chancellor's Staff, investment advisors and/or investment managers.

During Item VI, Chancellor's Staff and Meketa presented the framework for a new Intermediate Duration Portfolio (IDP), which is expected to make up a majority of the CSU's investment assets going forward.

Per state law, the IDP must contain securities that conform to the restrictions of the California Government Code 16430, however the IDP may have a longer duration than the existing Liquidity Portfolio (SWIFT), which currently has a duration of 0.8 years and a yield of 2.59%.<sup>3</sup> In comparison, intermediate duration bond benchmarks, in current markets, typically have durations of around 4-years and yield above 3%. Normally, higher duration fixed income investments will result in higher income over time. In allocating assets to the IDP, the CSU is not attempting to time interest rate markets, but rather to earn a higher term premium over perpetuity on those assets not needed for immediate liquidity.

The purpose of the IDP is to provide an opportunity for modest, additional risk-adjusted return on CSU funds not needed for immediate liquidity. The IDP will accept higher principal volatility in comparison to the Liquidity Portfolio (SWIFT) in exchange for higher income and yield, but will not accept permanent principal impairment. Additional income earned from the IDP will support operations at the CSU campuses.

The Chancellor's Staff has monitored the Liquidity Portfolio's (SWIFT) cash flows closely and projects typical drawdowns from one enrollment period to the next will range between \$600 million to \$900 million. Sizing the Liquidity Portfolio (SWIFT) with an estimated range between \$700 million to \$1.5 billion based on the expected cycle of enrollment cash inflows and required outflows for funding for systemwide obligations, should maintain a minimum \$700 million value after the projected drawdowns, and allow for approximately \$1.2 billion to be invested in the TRP and \$2.1 billion in the Intermediate Duration Portfolio (IDP). Chancellor's Staff and Meketa will monitor and modify the size of the Liquidity Portfolio (SWIFT), the IDP, and the TRP as appropriate.

Meketa and Chancellor's Staff presented information related to:

- The goals and investment objectives of the IDP
- Historical and Current Yield Curves for various fixed income sectors
- Risk and Return characteristics for an intermediate fixed income portfolio, including various scenario tests
- IDP Investment Policy and Benchmark considerations

Chancellor's Staff will conduct an RFP concurrently for investment managers for the IDP and the Liquidity Portfolio (SWIFT). The Liquidity Portfolio (SWIFT) is due to be re-bid and requires a new RFP. Prospective Investment Managers may bid on both the IDP and the Liquidity Portfolio (SWIFT), however no single Investment Manager will be selected to manage assets in the Liquidity Portfolio (SWIFT) and the IDP. Chancellor's Staff is forming an RFP evaluation committee. The IAC discussed the composition of the RFP evaluation committee which may include IAC members, CSU campus representation, Chancellor's Staff and Meketa.

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<sup>3</sup> AS of February 19, 2019

Key Considerations:

- Chancellor's Staff and Meketa believe three to five fixed-income managers for the IDP, each with approximately \$400 to \$700 million under management, is appropriate.
  - This decision will depend on the results of the RFP process and the proposed fee schedules.
- Chancellor's Staff and Meketa do not advise placing significant additional constraints on the Investment Managers beyond those already required by California Government Code 16430. California Government Code 16430 already significantly limits credit risk.
- Chancellor's Staff and Meketa will work with investment managers hired to develop investment policies and guidelines that are most suitable for achieving the IDP's investment objectives.
- In future years, Chancellor's Staff and Meketa may recommend a small portion of the IDP be dedicated to specialist investment managers, such as investment managers focused on Agency Mortgage-Backed Securities, High Investment Grade Corporates, Long Duration US Treasuries, etc. However specialized investment managers are not in scope for the current RFP.

Chancellor's Staff and Meketa will continue to update the IAC on the development of the IDP and the RFP process at future meetings.

**Item VII – 2019 Annual Asset Allocation Update - Information**

The purpose of Item VII was to provide an annual update for the 2019 CSU TRP Asset Allocation Expectations. The 2019 CSU TRP Asset Allocation Expectations are based on Meketa's 2019 Annual Asset Study. Meketa's 2019 Annual Asset Study uses valuations as of December 31, 2018.

Meketa provided an overview of the updated asset allocation review and risk analysis given the TRP's Expected Average Annualized Return of Inflation + 4.5%.<sup>4</sup>

The long-term (20-year) annualized expected return for the TRP increased from 7% based on the 2018 study to 7.7% based on the 2019 study. The TRP's expected standard deviation decreased from 13.0% using the 2018 study to 12.2% based on the 2019 study. Given the market correction that occurred in late 2018, most asset classes now have improved valuations relative to a year ago, as well as wider spreads and higher yields on a fixed income.

However, as a result of the quick and significant improvement in market performance that took place in early 2019, some of the increased return expectation has already been captured. Meketa and Chancellor's Staff recommended no changes to the TRP asset allocation based on the updated expectations at this time.

The IAC Chair indicated the next meeting, scheduled for August 14, 2019 at 11:00 am, will be held at the California State Treasurer's Office in Sacramento.

There being no further business before the IAC, the meeting adjourned at 2:30 pm.

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<sup>4</sup> The long-term rate of inflation is assume at 2.5% per annum.