



Seattle City Employees' Retirement System

Investment Committee Meeting Pacific Building, 720 3rd Avenue, Suite 900, Seattle (206) 386-1293

Minutes, Thursday, August 31, 2023

IC Members Present: Sherri Crawford (Chair), Judith Blinder, Maria Coe, Joseph Hoffman, Jamie Carnell, Kimberly Loving

IAC Members Present: Keith Traverse (Chair), Joseph Boateng, Steve Hill, Dwight McRae

SCERS Staff Present: Jeff Davis, Jason Malinowski, Leola Ross, George Emerson, Mengfei Cao, Nina Melencio, Mark Schimizzze

Others Present: Mike Monaco (MMPL), Gary Smith (City Attorney's Office), Rose Dean (NEPC), Thao Nguyen (NEPC), Allan Martin (NEPC), Robert Goldthorpe (NEPC), Joe Ebisa (With.Intelligence), Tom Mikesell (LEG), Nathan Paulsen

Call to Order

Sherri Crawford, Chair, called the meeting to order at 12:00 pm.

Public Comment

There was no public comment.

Minutes

Approved Minutes from the July 27, 2023 Investment Committee.

Motion: Upon motion by Jamie Carnell, seconded by Maria Coe, the Investment Committee approved the minutes from the July 27, 2023 Investment Committee meeting. The motion passed unanimously (6-0).

Quarterly Performance Review – Q2 2023

Rose Dean of NEPC reviewed the performance report for the period that ended June 30, 2023.

Gross performance over the last 30 years is 7.2%, above the assumed rate of return of 6.75%. The return net-of-fees for the last 10 years is 7.7%, which is above the assumed rate of return and is outperforming the Passive Reference Benchmark.

For the one-year period ending June 30, 2023, the fund returned 7.3% net of fees, underperforming the Strategic Policy Benchmark by 0.8%. Assets increased from \$3.63 billion one year ago to \$3.85 billion for the period ending June 30, 2023.

On an actuarial basis, the funded status is estimated at 75.8%. On a market basis that revalues the liability based on NEPC's portfolio return assumption as of June 30, 2023, the funded status is 78.9%.

Asset-Liability Study Discussion & Preliminary Strategic Asset Allocation Recommendation

Robert Goldthorpe, Investment Director on NEPC's asset allocation team, reviewed the results of the asset-liability study and preliminary strategic asset allocation recommendation and answered questions from the Investment Committee (IC) and Investment Advisory Committee (IAC) members.

SCERS remains in a moderate funded position and is projected to improve current funding levels over the next 20 years as the unfunded liability becomes fully amortized. The Plan has improved its actuarial funded status over the past few years from 68% in 2019 to 76% in 2023. SCERS has also taken steps to reduce overall plan risk by lowering the investment return assumption from 7.25% to 6.75% in 2022.

Staff and NEPC's preliminary recommendation for the strategic asset allocation is 46% Public Equity, 11% Private Equity, 12% Core Fixed Income, 6% Long-Dated Fixed Income, 8% Credit Fixed Income, 12% Real Estate and 5% Infrastructure. As compared to the current strategic asset allocation, the changes are to reduce Public Equity by 2%, reduce Core Fixed Income by 6%, initiate a 6% allocation to the new Long-Dated Fixed Income asset class, and adding 1% each to Credit Fixed Income and Infrastructure.

The result is a portfolio that maintains a similar return expectation as the current policy with lower asset volatility and a more liability-aware portfolio as evidenced by lower funded status volatility. The changes to the portfolio are consistent with the results of the risk preference survey that was completed this year, which showed comfort with the existing portfolio and openness to incremental changes.

Mr. Goldthorpe discussed the recommended changes to the fixed income allocation. The inclusion of Long-Dated Fixed Income that is funded from Core Fixed Income will moderately increase the total portfolio's sensitivity to interest rate fluctuations while reducing reinvestment risk. Within Credit Fixed Income, the sub-asset class breakdown is recommended to change from 40% tradeable corporate debt to 20%, from 40% private debt to 60%, while maintaining the 20% allocation to emerging market debt.

Joseph Boateng asked how success would be defined based on the recommended changes to the strategic asset allocation. NEPC's definition of success for public pensions plans is the ability to meet the plan's liability. NEPC added the funded status monitor to the quarterly performance reporting which will be helpful in this regard.

Mr. Goldthorpe reviewed the economic and climate change scenario analyses. NEPC noted that SCERS was the first requester for climate change scenarios, which they now use for other clients. Climate change scenarios are not a forecast but rather an exercise to gauge the potential impact of climate change on the long-term drivers of asset class returns. Judy Blinder expressed concern with the potential impact of climate change on corporate defaults and infrastructure assets.

Jason Malinowski asked the committee for feedback on the preliminary recommendation.

Jamie Carnell commented that the increase in the Long-Dated Fixed Income allocation from 0% to 6% represents quite a jump and could be riskier. Staff responded that this is the first time considering long-dated fixed income under the new liability-aware investing framework. Long-dated fixed income is highly aligned with SCERS's liabilities and also offers a more attractive return now given the reset higher in interest rates.

Staff and NEPC will revert with a final recommendation at an Investment Committee meeting this fall.

Private Equity Deep Dive

Jason Malinowski and Leola Ross presented the annual deep dive of the Private Equity asset class that included its portfolio role, size, strategy, underlying investment managers, and performance.

Private equity is a critical return driver of SCERS's investment portfolio and has the highest expected return of any asset class although it is characterized by high risk and sensitivity to economic growth, high fees, and low liquidity. SCERS allocation is mature and diversified. SCERS has a current and target allocation of 13.8% (as of March 31, 2023) and 11%, respectively.

SCERS invests with two multi-manager firms, Adams Street Partners and Horsley Bridge Partners, in the Private Equity asset class. During the last twelve months, they have continued to invest committed capital in underlying private equity funds and received distributions from existing funds. Staff are transitioning responsibility for private equity pacing from Adams Street Partners to NEPC.

Mr. Malinowski provided more detail on the denominator effect. The denominator effect refers to unintended changes in a private market asset class allocation (in percentage terms) due to changes in the total portfolio's value. Private market valuations are reported on a lag and react slowly to changes in the market environment since companies are not priced on a public market exchange. The denominator effect is primarily a timing issue that eases naturally over time. Staff manages the denominator effect by making stable private market capital commitment over time.

Adjourn Meeting

Allan Martin of NEPC announced that he will be retiring in the next four to six months. Ms. Crawford thanked him for his work with SCERS.

<u>Motion:</u>	Upon motion by <u>Jamie Carnell</u> , seconded by <u>Judith Blinder</u> , the Investment Committee voted to adjourn the meeting at 2:02 pm. The motion passed unanimously (6-0).
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