BOARD OF PENSION TRUSTEES
FOR THE
CITY OF JACKSONVILLE RETIREMENT SYSTEM
May 3, 2018

MINUTES

City Hall - St. James Building, Conference Room 3C: 2:00 P.M.

Members Present
Jeff Bernardo, Chairman
Shari Shuman
Sam Mousa
Diane Moser
Terry Wood

Staff Present
Joey Greive, Treasurer
Randall Barnes, Senior Debt Manager
Paul Barrett, Senior Investment Officer
Jaime Sawczyn, Pension Assistant

Others Present
Tim Johnson, PFPF Executive Director
Rick Patsy, PFPF Board Member
Craig Lewis, PFPF FIAC Member
Dan Holmes, Summit Strategies Group
Vince Stegman, Summit Strategies Group
Dan Pogue, Summit Strategies Group
John Lake, Summit Strategies Group

An audio recording of the meeting is available in the Pension Office.

1. **CALL TO ORDER**

   The Chair called the meeting to order at 2:06 p.m.

2. **PUBLIC COMMENT**

   None

3. **MINUTES**

   None

4. NEW BUSINESS

None

5. CONSENT AGENDA

None

6. INVESTMENT AND FINANCIAL MATTERS

Chairman Bernardo opened the meeting. There was some discussion about whether any vote would be taken place during the meeting. Mr. Mousa indicated that there was a quorum present. Mr. Greive said that there was not an intention for any votes to be taken today since this is an Investments Workshop, but if there is a Board decision to be made, then a vote could be taken.

Mr. Greive discussed how the Board had recently reconfigured the Investment Policy to allow for an allocation to Diversifying Assets. This workshop was put together to educate those present on private markets and diversifying investment strategies that would apply to the new allocation. Mr. Wood mentioned he that he found something saying that investments in hedge funds are prohibited. Mr. Greive clarified that investments in hedge funds for the PFPF are prohibited, but that the GEPP put the new Investment Policy through the proper steps at City Council and those types of investments are allowed. Ms. Shuman and Mr. Mousa asked Mr. Greive to clarify that there was nothing in the Code pertaining to GEPP that would be similar to the PFPF Code that excludes the ability to use hedge funds. Mr. Greive confirmed that there was not.

Mr. Greive introduced Dan Holmes from Summit Strategies Group, the Plan's investment consultant. Mr. Holmes introduced Mr. Stegman and Mr. Pogue, who are on hand to discuss private markets, and Mr. Lake, who will discuss other diversifying strategies.

Mr. Stegman discussed the three broad categories of private markets – private equity, private debt, and real estates. All are illiquid investments with long-term investment horizons. He spoke about various sub-strategies that exist within each private market category and the risk/return expectations of each.

Mr. Stegman gave a brief overview of private capital performance. He mentioned that, while there are certainly periods of time when public markets outperform private markets, over the long term private capital markets have a strong history of outperforming public markets. He went on to discuss the different sources of return, which include risk premium, liquidity premium, inefficient markets, and governance and control by the limited partners. He discussed how there was substantial untapped opportunity in the private markets due to the number of middle market companies not currently backed by a private capital sponsor.

Mr. Pogue discussed the mechanics of investing in private markets. There is a fundraising period, an investment period, and then a realization period. An interesting dynamic is that it is common for investors to only end up investing 60-80 percent of their total commitment over the life of the investment. Therefore, it is smart to “overcommit” so the Plan can achieve its target allocation to the space.

Mr. Pogue discussed the “J-Curve” effect associated with private investments, where returns are generally negative early on in the investment. This is because it takes some time for the investments in assets to start showing a return as they are realized. The returns are typically substantial enough to more than offset the early negative returns and achieve the desired return objective over the life of the investment.

Mr. Pogue discussed the typical fees charged by private markets managers. It differs by strategy, but a 2 percent management fee accompanied by a 20 percent carried interest fee applies. Mr. Lewis asked if there was some minimum return that would apply before managers would start applying the carried interest fee. Mr. Pogue said that typically there is an 8 percent preferred return that managers will agree to return to investors before that kicks in. Summit Strategies tries to leverage its scale and manager relationships to negotiate favorable fees for clients where possible.

Mr. Pogue indicated that manager selection matters, as there is a wide dispersion both to the upside and downside with regard to manager performance (more so than with public markets). This makes it important to achieve vintage year diversification, which spreads investments in private markets over time to achieve a more consistent return.

Mr. Pogue pointed out that fundraising for private markets is at record highs, and there is a lot of “dry powder” (money sitting on the sidelines waiting to be deployed). This drives up valuations, which also makes it a relatively more expensive time to be investing in private markets – but not quite as expensive in public markets. Mr. Barnes asked Mr. Pogue to clarify dry powder. Mr. Pogue explained that dry powder was the part of the commitment that had not yet been called in for investment – the part still being held by the investor prior to the capital call. Mr. Barrett asked if the investor is paying fees on the dry powder. Mr. Pogue indicated that is the case for venture capital investments, but typically on other investments the industry is moving towards only charging fees on invested capital. Mr. Wood asked how often firms do valuations. Mr. Pogue said that firms do audited valuations every year. Mr. Wood pointed out that with the J-Curve effect the first few years could look bad from a return perspective. Mr. Pogue also pointed out that managers due quarterly and semi-annual valuations, as well. Ms. Shuman said that sometimes the timing issues of the valuations cause issues for the audits.

Mr. Mousa mentioned that many firms have contacted the City over the last few years who are interested in privatizing or monetizing City assets. He said it was interesting that a lot of their funding comes from pension funds. He asked if that was common. Mr.

Stegman said that at both the State and Local level there has been pretty broad adoption of private equity within pension investment portfolios. He said the strategy of operating steady assets by private equity has been prevalent for many years. For private equity managers, these types of assets are very predictably and, therefore, easy to underwrite. There was some discussion about what assets were steady and predictable. Mr. Stegman clarified that generally these are essential services that one might consume on a regular basis.

Chairman Bernardo asked if there was a “correct” or normal spread when you are talking about the risk framework associated with private markets. Mr. Stegman said Summit generally looks for a 3 percent return spread over time between public and private equity, and about 100-150 basis points between public debt and private debt. Mr. Holmes indicated that the market is probably on the lower end of the return spectrum given the current market environment where there is a lot of money being put to work and fewer available assets.

Mr. Pogue talked about which strategies Summit currently finds attractive. Currently, none of them are obviously undervalued, but they think there are opportunities available in the smaller end of the market or in unique “niche” opportunities where there is some operational advantage.

Mr. Stegman discussed the different implementation options, which include investing in “fund of funds,” direct investments, co-investments, and hiring someone to act as an advisor or “outsourced CIO” to manage the private capital implementation process. The different options were discussed from a fee, administrative, and diversification standpoint. Summit Strategies offers that type of service to its clients. Mr. Barrett asked about how quickly an investor would have to fund a capital call. Mr. Stegman said it is typically 10 days. Ms. Shuman asked how many clients use the Summit Strategies solution. Mr. Stegman said it was about 5 percent by capital, but about 15 percent by number of clients. Larger clients are less likely to use the service because they have more in-house staff to manage the process. Ms. Shuman asked if Summit does a new fund each year and how long they’ve been doing it. Mr. Stegman said the first fund was raised in 2016 and they are currently raising their second fund. Ms. Shuman stated that they don’t really have an IRR that can be used to compare to anything. Mr. Stegman agreed, but that the performance looks surprisingly good given the youth of the fund but it is still too early to tell. Ms. Shuman asked if they are finding fund managers or if they are investing in funds directly. Mr. Stegman said they are doing both fund managers and co-investments.

Chairman Bernardo clarified that using Summit would be like an outsourced CIO. The benefit would be administrative, but we would give up some control of what we invest in. Ms. Shuman said that we would then be evaluating the consultant, and not the manager. Chairman Bernardo asked if we signed up would we be tied to the program if we decided to get a different consultant. Mr. Stegman said there is a two-year decision cycle, but there are mechanisms so that you do not have to remain a Summit consulting client to continue the investment.

There was some discussion of fees related to the Summit Solutions offering. Mr. Holmes indicated there would be a fee for the consulting portion, and then an additional fee for the outsourced CIO function that covers the administrative portion. Chairman Bernardo asked if there was any advantage to accessing certain funds by using relationships and scale offered by a consultant like Summit or others. Mr. Stegman said that the manager views the consultant as a client as well, so the already established relationship does help consultants like Summit gain access and be able to offer certain opportunities to their clients.

Ms. Shuman asked what Summit's vision was for the future of their offering. Mr. Stegman said the fund portion had $28 million of capital committed and the co-investment portion has $58 million of capital committed, and they are currently continuing to raise capital. He said he could see those growing to $50 and $100 million, respectively, by the end of the year. He said Summit is sensitive to capacity, so that they wouldn't raise capital if they weren't confident they would be able to place it.

Mr. Wood raised a question about liquidity. Mr. Holmes said that is something to be cognizant of considering pension reform, because liquidity will be a factor over the next 13 or so years. He urged the Board to analyze the fund's liquidity needs over time and determine how much they are willing to allocate to illiquid assets before it is decided what assets to purchase. There are plans to do an asset/liability study this year. Mr. Wood asked if the Hancock Timber allocation would be taken into account on the illiquidity analysis. Mr. Holmes indicated that they would, and that we are working to determine ways to exit that position without taking a severe haircut. Mr. Mousa asked if it was possible to define when capital calls would come in. Mr. Stegman said that it is generally whenever the call comes in, but that private debt may be a little more predictable given its shorter investment timeline. Mr. Mousa asked Ms. Shuman how much of her portfolio is in private equity. Ms. Shuman answered that it was about 12-15 percent.

The discussion turned to hedge funds. Chairman Bernardo mentioned that the term "hedge fund" has a negative connotation when it really refers to strategies that managers have undertaken to take advantage of market dislocations. He also stressed that their fees are high, but investors will not invest in hedge funds over time if their fees are not worth the risk. He urged the Board to see hedge funds as truly diversifying, especially the hedge funds that are non-directional and have very low correlation to the market. They are a tool in the box for de-risking a portfolio when other means are not attractive.

Mr. Wood asked when Summit would be looking to do the asset/liability study. Mr. Greive said that it is already on the list for them to do this year. Mr. Holmes said they would begin work on it as soon as they receive the final actuarial report, which Mr. Greive said he had just received and would send to Summit shortly. Mr. Greive explained that this a typical study that is done about every 3 years, and that it will help the Board understand how much liquidity the portfolio would need in a time of stress, which will help determine how much the Board may want to allocated to illiquid investments. Mr. Greive also mentioned the safety nets the City put into place as part of the Pension Reform.

Mr. Lake came up to discuss Diversifying Strategies, which are commonly described as hedge funds. He said a lot of the criticism of hedge funds has been about relative return recently between hedge funds and domestic equities, which have performed really well. He indicated it is unlikely for the recent performance to continue, and that hedge funds are a way to help mitigate the risk of the potentially huge pullback of equities during a downturn.

Mr. Lake described the different types of opportunities, which are broadly categorized as non-traditional investment opportunities. He broke the opportunities down into growth, income, and diversification. Mr. Lake described growth opportunities as getting 75 percent of the equity-like return, with only 50 percent of the volatility. Income strategies have bond-like volatility with low correlation to fixed income. Diversification strategies take advantage of dislocation in markets.

Chairman Bernardo asked if it was common to cycle through different strategies during different parts of the market cycle. Mr. Lake said that it is very hard to time the market, and that the best thing to do is maintain a diversified and consistent approach.

Mr. Lake indicated that, given the Plan's return requirements, Summit would be likely to recommend implementing a growth strategy. Mr. Lake went on to explain the differences between long only, market neutral, and long/short strategies. He went on to discuss historical performance of hedge fund strategies, pointing out that hedge fund returns generally fall somewhere between equity and fixed income returns. To illustrate how hedge funds perform during times of crisis, Mr. Lake went over calendar year returns – pointing out that when equity markets were down, hedge funds may have also been down, but performed better than equities. He also discussed the risk-adjusted return of hedge funds versus equities and fixed income.

Mr. Lake also discussed the performance of the different strategies over time. He then went through the different strategies and how some are more correlated to the equity markets than others.

Mr. Holmes wrapped things up saying that Summit would conduct the asset/liability study. He also said that the fund needs to have at least a 10 percent allocation to these types of assets for them to achieve the desired effect on the portfolio. The plan is to do the study over the next couple of months.

7. ADMINISTRATIVE

Mr. Greive mentioned that the new Pension Administration Manager, Tom Stadelmaier, would be starting on May 14.

8. OLD BUSINESS

None

9. **INFORMATION**

Chairman Bernardo mentioned that the next meeting would be May 24, 2018, at 2 p.m.

10. PRIVILEGE OF THE FLOOR

None

11. ADJOURNMENT

There was no further business and Chairman Bernardo adjourned the meeting at 4:11 p.m.