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Proceedings

NEW YORK CITY TEACHERS' RETIREMENT SYSTEM
INVESTMENT MEETING

Held on Thursday, February 3, 2022 via Videoconference

ATTENDEES:
DEBRA PENNY, Chairperson, Trustee
DAVID KAZANSKY, Trustee
THOMAS BROWN, Trustee
CYNTHIA COLLINS, Trustee, Mayor's Office
ALISON HIRSH, Trustee, Comptroller's Office
PATRICIA REILLY, Teachers' Retirement System
SUSAN STANG, Teachers' Retirement System
ROBIN PELLISH, Rocaton
MICHAEL FULVIO, Rocaton
DEVON ALEXANDER, Rocaton
VALERIE BUDZIK, Teachers' Retirement System
LIZ SANCHEZ, Teachers' Retirement System

REPORTED BY:
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ATTENDEES (Continued):
MATT LASKOWSKI, Teachers' Retirement System
GREG ZELIKOVSKY, Office of the Actuary
DAVID LEVINE, Groom Law Group
SUMANTE RAY, Mayor's Office
MICHAEL HADDAD, Comptroller's Office
JOHN DORSA, Comptroller's Office
KOMIL ATAEV, Teachers' Retirement System
ISAAC GLOVINSKY, Teachers' Retirement System
ARISTEA AFTOUSMIS, TRS
SANFORD RICH, BERS
ROBERT FENG, Bureau of Asset Management
REBECCA YEH, Bureau of Asset Management
JIMMY YAN, Bureau of Asset Management
ENEASZ KADZIELA, Bureau of Asset Management
JOHN GLUZSAK, Bureau of Asset Management
JOHN ADLER, Mayor's Office
PHILIP DUKES, Mayor's Office
MIKE KOENIG, Hamilton Lane
KEVIN BALAOD
MARC RIVITZ, StepStone
DEV SUBHASH, StepStone

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MS. REILLY: Good morning. Welcome to the investment meeting of the Teachers' Retirement Board of February 3, 2022. I am going to start by calling the roll.

Thomas Brown?

MR. BROWN: Here.

MS. REILLY: Cynthia Collins?

MS. COLLINS: Here.

MS. REILLY: Alison Hirsh?

MS. HIRSH: Here.

MS. REILLY: David Kazansky?

MR. KAZANSKY: Present.

MS. REILLY: Debra Penny?

MS. PENNY: Here.

MS. REILLY: We have a quorum. Turn it over to you, Madam chair.

MS. PENNY: Thank you very much, Patricia. Good morning, everyone. First on our agenda we will have the market outlook by Robin and Mike from Rocaton.

MR. FULVIO: Good morning, everyone.

MS. PENNY: Good morning, Michael.

MR. FULVIO: Just making sure we have that. Okay. Hopefully that's an easy-to-read

visual for everyone to follow along. And Robin, did you want to begin that discussion? I think you are on mute, Robin. Robin, I think you are on mute.

MS. PELLISH: Sorry about that. I had technical difficulties. Sorry about that. Can everybody hear me now?

MS. PENNY: Yes.

MS. PELLISH: Great. So this discussion is really intended to follow up on last month's presentation about capital markets during 2021. And as I mentioned during that discussion, it's interesting to review the data and look back on where we have been in 2021 and prior years, but the real question is so what? What does that mean going forward?

And so we have tried to put together a few thoughts on where we are today and what that might mean in terms of capital markets and asset class risk and return, and therefore, what it might mean for the Board as it considers various recommendations with regard to the Teachers' pension fund and the 403(b) plan and that's the context for this

discussion.

So I am going to launch in. Please interrupt me with any questions or comments. So the first slide, of course, is focused on inflation uncertainty and we talked about the dramatic rise in inflation during 2021 and that's continued during the beginning of 2022 and so the real question -- there are a couple of questions that this poses for us. One is do we believe that this level of inflation and rate of change in inflation is going to be persistent over the next several years, or do we think this is more in the nature of a transitory event? And the Fed has stopped using the word "transitory". We have largely stopped using the word "transitory" because it's been more persistent then we expected, but we still are fairly optimistic about the fact that inflation will -- certainly these rates of change in inflation -- we just saw a 7 percent increase in CPI printed in January of 2022. But we continue to believe that these dramatic rates of inflation and increases have been really a function of

responses to the COVID epidemic -- pandemic and the significant fiscal stimulus which led to very significant consumer demand as well as other factors including the supply chain problems are primary causes of the rates of inflation we have been seeing most recently, and we think that many of those causes, most notably the fiscal and monetary stimulus will be abating as we see Fed rate increases.

So nonetheless we are not seers, and it may be the case that these levels of inflation persist. So what does that mean for our work as we think about asset allocation and manager selection and strategy selection? And so we have put a few notes here. First, that equities -- and we have additional data in the deck about this -- equities have historically given investors the best chance of outperforming inflation over the long term. We talk a lot about inflation-sensitive assets and asset classes, and we do want to continue focusing on asset classes that may respond well to various inflationary environments, but over time what we have seen is that asset

classes that generate the highest level of returns are the best source of returns in inflationary environments and that's borne out by most of the historical data.

So the pension fund and the 403(b) funds are heavily invested across the globe, so that's a positive for us, but again, as we talk about various asset classes and their response to higher levels of inflation, we continue to believe that equities are the best source of real return for the portfolios we oversee. We continue to encourage other clients to invest in real assets and in multisector credit and TIPS although the timing of TIPS is a question, and how TIPS will actually perform in a high inflationary environment is also a question, but the portfolios, particularly the pension fund, has significant asset allocation to real assets and multisector credit particularly in the OFI allocation.

So we think that the funds are in general reasonably well positioned for higher levels of inflation, although again we expect

these levels of inflation to abate over the coming year. Can we go to the next slide, Mike? This slide talks to the point that I just recently made about US equity generally performing well in inflationary environments because of their higher returns. So again, in inflationary environments the goal is to get high rates of real return, and over most of these periods US equity has been able to do that. Next slide, please.

Was there a question? Okay. Sorry. All right. So this slide talks to the fact that although we are -- we encourage our clients to retain their significant allocations to equities, we recognize that valuations are expensive across every major asset class. Interest rates are historically -- remain historically low and asset class equity valuations remain historically high, so we have no -- we don't believe that generating returns out of either fixed incomes or equities will be an easy task over the next few years, and so this slide talks to the fact that in an environment where valuations are so

stretched that security and sector allocation will become increasingly important, and we have mentioned here we are talking about the importance of being active across a variety of asset classes and talk about the secular shift towards alternatives persisting because that's the ultimate exercise of active management.

There is no passive alternative in the private market asset classes. The pension fund continues to have a very significant allocation to private markets, and we think that will serve the fund well over coming years. We have included a couple of slides in the back of this deck about active management because although there is a very strong argument that active management has a role to play in an environment where security selection will become so important, we think that the Board has exercised appropriate levels of skepticism about active management, and it has certainly not been a panacea over the past decade in terms of generating incremental returns and we can talk about that but we do think that active management has an

important role to play in generating returns in this very richly valued environment.

We can go to the next slide, Mike. Thanks. So here we are talking about the historically low level of interest rates, and this is not news to anyone listening to this presentation. The consensus is that the Fed will have a number of interest rate hikes during 2022, and the consensus appears to be that will start in March. We note here that the Fed has signalled three 25 basis points rate hikes in 20222. That has actually expanded to four, and perhaps the hike in March could be as much as 50 basis points. Nonetheless, it appears to be highly likely that we will start to see the Fed hiking rates, the Fed's fund rate in 2022, but nonetheless we are coming off historically low nominal and real yields.

Real yields continue to be negative and so in that environment, in which we expect interest rates to rise, the asset classes and investment strategies that seem particularly compelling are noted here. Shorter duration,

fixed income strategies. Strategies that are using floating rates. Again, we see a lot of those strategies in your OFI portfolio. Private credit transactions. Again, that is captured in your OFI portfolio, and we refer to selected equity strategies that targets stocks with earnings growth, otherwise known as value stocks, and we have seen resurgence of value versus growth stocks. We saw that in spades this morning with Facebook's price plummeting -- now known as Meta but we think this supports the argument for active management. Again, this will be a difficult environment for many sectors with rates rising and active managers should have an opportunity to add value through careful security and sector selection.

If we could turn to the next slide. So this slide focuses on investing beyond the US equity market. So again, this refers to the historically rich valuations in the US equity markets that we have seen enormous returns over the past decade on an average annual basis for the US equity market and the pension

fund continues -- as do the variable funds continue to be globally diversified and the Board is always focused on looking beyond US equities but this is probably an opportune time to reinvigorate that focus and consider markets that may be even more attractive than the US equity market at this point in time. We refer here to emerging markets which look reasonably attractive from a valuation perspective, and again the Board has invested in a significant way in emerging markets, again both in the Passport Fund and in the pension fund.

Moving forward, we can spend a few minutes on China, but China here is noted as the world's second-largest economy. Some forecasts call for China to overtake the US as the world's largest economy within the next decade, and so that means that special attention probably should be paid to this market. We are seeing institutional investors increasingly think about investing in China as a standalone strategy rather than using -- investing it in that market as part of a

basket of emerging market countries. China now is above 40 percent of the MSCI Emerging Markets Index and probably deserves some specialized attention. So that's a topic we may want to address over the coming year whether we want to think about China as a standalone market.

Moving forward, this talks about the fact that although this is going to be a difficult environment, there are opportunities to take advantage of trends. We talk about techification on this slide, but I think these trends are being addressed in many ways throughout the portfolios in both your public and private markets. We note here on the bottom of the slide is decarbonation, and certainly the Board is actively investing in sustainable strategies and taking advantage of this trend, which will again persist for decades but will be a significant driver of change within the capital markets.

Moving forward to the next slide, this is -- this talks about the sustainability revolution. Again, it drives home the

importance of the work the Board is doing in terms of thinking about how to mitigate the risk of climate change on the portfolios it oversees as well as taking advantage of opportunities generated by the sustainability revolution, and we have seen virtually all of the flows into asset management products over the past year have been accounted for by flows into ESG equities strategies. So it's been a significant driver of change within the asset management industry, and we know the Board is spending a significant percentage of its time focused on how to implement these kinds of strategies throughout the portfolios.

Moving forward, next -- I just want to, if we could, go into the active management strategies. This is an interesting chart that has very small numbers, so I apologize for that, but what this does is address the question of active management and the Board members know that we spend a lot of time thinking about how we should implement different asset classes, whether we should do that in active or passive implementation, and

I have spent a fair amount of this presentation talking about the opportunities for active management in various asset classes. But active management still remains a very difficult strategy to successfully implement, and I think the Board has been very judicious in selection of active management strategies.

Maybe I can point to a couple of numbers here. What this chart does is it takes Morningstar -- largely Morningstar data and looks at mutual funds, and how they have performed relative to their benchmarks in a variety of strategies, so for example, if we look at US large cap mutual funds, and let's look at the five-year set of columns all the way over to the right. We can see that among US large cap mutual funds over the past five years, about 60 percent of the value strategies have outperformed their value benchmark, but less than a quarter of the growth strategies have outperformed their benchmark. Conversely, if we look at US small cap strategies over the past five years, we

can see over three quarters of those strategies have outperformed their benchmark.

So the point here -- and there is a lot of data but the point here is that the selection of active managers continues to be a very difficult exercise and one that we certainly deserve spending a lot of time and careful thought on and we can't assume that active managers will consistently outperform passive strategies because of the difficult environment, but it's an effort worth spending a lot of time on. So with that I am going to conclude my comments and see if there are any questions or comments on this deck.

MS. PENNY: Thank you so much, Robin. Does anyone have any questions for Robin about the presentation? Okay. I guess not. So thank you again for that. Next on the agenda we have basket clause resolution. Mike, you are going to speak about it?

MR. HADDAD: Yes, thank you. So as you know, we are all frustrated with our strategic asset allocation and the constraints placed upon us from the basket clause. Under a new

leadership with Comptroller Lander, he quickly has grasped this, gets it, is putting his resources into it, and once again we are working with Albany to try to get some resolution and some basket clause relief. A slight twist to our approach this year is we are offering -- I am going to speak to Albany about all three legislative branches -- an option. Same thing that we discussed last year was increasing the threshold on international equities that go into the basket from 10 percent to 30 percent, and we did that last year as well. In addition, we are giving them the alternative just increasing the basket clause from 25 percent to 35 percent. So we have done a fair amount of work to that.

The comptroller has reached out to the governor's office. There has been some contact there and our attempts are to try to get this in the governor's 30-day amendment to the executive budget. I would defer to Alison on probabilities or where we stand with all of this. Albany remains a mystery to me, but we are trying hard, working on it for all the

obvious reasons. And some of the things Robin brought up about the valuations in international equity as compared to US, as much as we would like to do that, we are at the max basket consumption now and we purposely are there because that's a scarce resource in our asset allocation and those are the asset classes that offer best risk/reward returns for us. So if we could do that, that would be great but we are constrained. We would have to get rid of something else in the basket in order to do that. So it is of paramount importance. It does constrain our ability to maximize our asset allocation, so we are working hard on your behalf to try to get that changed.

MS. PENNY: Thank you, Robin, and Mike from Rocaton, you did a study or you looked it over for us. Do you want to talk to us a little bit about what you think the advantages are?

MR. FULVIO: Sure. I am happy to take the lead, and Robin can certainly contribute. So one of the things we used asset allocation

tools that we have, one of the things we did was look at if you did ease the constraints in sort of a naive portfolio construction framework but also being guided by what we think are practical constraints for constructing any portfolio. What would the portfolio potentially look like without some of the basket constraints as they are written today. So if you ease some of the restrictions, you could create a portfolio that potentially increases return while taking a comparable amount of risk, and so from that standpoint, thinking through portfolio efficiency, is there a way to be a little bit more efficient with how you allocate risks across different asset class and achieve a slightly higher level of returns, and using those tools we were able to determine that it seems possible to do that and we think that again, in concert with the comments Mike made and how the resolution was written, we were able to prove out to ourselves that easing the restrictions at least provides the Board with some flexibility to achieve that objective of

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creating a more efficient portfolio and being able to benefit from some incremental return while maintaining some consistent level of expected risk that's consistent with what you have today.

MS. PENNY: And you think either option, international 10 to 30 or just 25 to 35, either one of those would be a help, would ease the restrictions?

MR. FULVIO: Yes.

MS. PENNY: Great. Thank you. Does anybody have any questions for either Mike Haddad or Mike Fulvio about this? Okay. Hearing none, I think, Patricia, we are ready for the resolution.

MS. REILLY: So this is a Resolution in Support of Modernizing New York State Retirement and Social Security Law, Section 177. "Whereas the" --

MR. KAZANSKY: Can we skip to the resolved?

MS. REILLY: "Resolved, that the Board supports an amendment to RSSL Section 177 to increase the permissible basket clause

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allocation in RSSL Section 177(9) or alternatively to increase the permissible allocation of foreign equity securities in RSSL 177(8) and agrees to convey said support to the appropriate legislative bodies and executive agencies; and be it further resolved, that the Chair or in her absence, the Executive Director, or in their absence, the Deputy Executive Director, is hereby authorized and directed to issue instructions and take any other action as may be necessary to implement this resolution."

MS. PENNY: Thank you, Patricia. Do I hear a motion?

MR. BROWN: So moved.

MS. PENNY: Thank you, Mr. Brown. So do I hear a second?

MR. KAZANSKY: Second.

MS. PENNY: Thank you, Mr. Kazansky. Any discussion before we take a vote? Any questions?

MR. KAZANSKY: Just one question briefly. The asset allocation, the last time we modified our asset allocation was when?

Anybody here know?

MR. HADDAD: March of '20. There was a couple of things going on at that time.

MR. KAZANSKY: And so I think we had an understanding that every three years we should look at it, so should the basket clause make it through Albany and that whole process leaving by the spring even if it's included in the budget, I guess we would then start to have discussions about what the asset allocation would look like going forward. It wouldn't be an automatic expansion that would necessarily benefit us right away or would there be some sort of immediate benefit prior to us deciding on the new asset allocations.

MR. HADDAD: No. My advice to you would be if we get relief, that we do -- and then when you get the CIO thing sorted out, we work with Rocaton to do another strategic asset allocation because it's a fundamental change to how we can allocate with that relief, and I think it requires a full-blown new asset allocation and I would also say ASAP given how beneficial it is to your portfolio.

MR. KAZANSKY: Great. Thank you.

MS. COLLINS: Debbie, this is Cindy Collins. I just want to say the mayor's office is in support of this resolution as well. We think it just provides the Board and the funds one more tool and takes away a restriction that hampers our ability to get the returns we need for our members, so we are in full support of it as well.

MS. PENNY: Does anybody else have anything for discussion? Okay. Then all those in favor, please say aye. Aye.

MR. KAZANSKY: Aye.

MR. BROWN: Aye.

MS. HIRSH: Aye.

MS. COLLINS: Aye.

MS. PENNY: Any opposed? Any abstentions? Okay. Motion carries in support of the resolution.

Now it's time for Passport Funds December 2021 performance review. Mike Fulvio, please take it away.

MR. FULVIO: I will take the lead and pass it to Devon for a quick update on markets

through January. Are folks able to see the Passport Funds report? So I think what I will do is touch upon December very briefly and then try to focus a bit more on the calendar year of 2021 in its entirety because it was a good year.

And in that vein December 2021 was also a pretty good month for markets. You can see from some of the numbers in the month column here was a positive month across the board for equity markets. So the Russell 3000 was up nearly 4 percent and non-US markets up a bit over 4 percent. The Diversified Equity Fund as a whole returned about 3.8 percent for the month. That was roughly in line, though slightly behind the global market composite benchmark which was up right around 4 percent. For the full calendar year of 2020, you can see the Diversified Equity Fund was up about 20.24 percent. The global market composite up about 23 percent and the hybrid benchmark up 2.3 percent. And I do want to comment very briefly that global composite benchmark you recall prior to July 1st that benchmark was

entirely the Russell 3000 Index and given the stronger return for the Russell 3 for the full year of about 26 percent. That's why that number for the first six months of the year did not include the international equity markets which comparatively underperformed the US during 2021. But nonetheless, a strong absolute return of about 20.2 percent last year, and you can see that's right in line with what we saw from the hybrid benchmark.

The only thing I will highlight as well, going back to some of the comments about active management, you can see the two remaining portions of the fund which include active management at the end of 2021 last year, the active US composite returns 22.4 percent versus its benchmark at 20 percent and the international equity composite also outperformed its benchmark to the tune of about 50 basis points. So it was generally a strong year for active management and these two composites last year, and what did detract from performance a bit last year in the quite strong equity market that we saw was the

defensive composite which was a component until right before the end of the year last year and that would have had really in what was a strong equity market didn't fully keep up as I don't think we would have expected in the past from that composite but nonetheless active management contributing quite notably to returns in each of those composites during 2021.

The Balanced Fund last year you can see returned about 5.2 percent, a bit ahead of its composite benchmark up about 4.6 percent. International Equity Fund returned 8.4 percent versus the composite benchmark of 8.3 percent and the Sustainable Equity Fund last year had a strong return as you can see up 3.3 percent outperforming the Russell 1000 Growth Index, which is its underlying benchmark. That index was up 27.6 percent. It was a strong year again for large cap growth stocks, which again drives the underlying returns for that benchmark. The US Equity Index Fund last year up 25.8 percent and the International Equity Index Fund up 7.9 percent.

So strong absolute returns across the board, and I will pause there to see if the Board has any questions on 2021 or December.

MS. PENNY: Thank, you Michael. Any questions for Michael? I guess not. So take it away, Devon.

MR. ALEXANDER: Thank you. On the heels of what Mike was mentioning, after a strong 2021, January has been a rough year for equity markets led by all the sentiments that Robin had mentioned including inflation, monetary policy shift, geopolitical tension, and Omicron. All of which have contributed to a sharp increase in the volatility for the month. Not surprisingly, we saw less-than-stellar performance across the Diversified Equity Fund benchmark.

The global market composite was down by 5.46 percent for the month, and Diversified Equity Fund fell by 5 and a half percent for the month as well. However, those results were in line with the expected benchmark which also had negative performance due in part to market volatility. Moving over to the

Balanced Fund. Though equity was down by over 5 percent for the month, fixed income performed relatively stronger. That offered some diversification to offset negative equity returns in the Balanced Fund, which had a loss of 2 and a quarter percent for the month. In the International Composite Benchmark, one note here. Although all the benchmarks were down, on a relative basis the Equity Emerging Market Index actually performed slightly better than the rest of them. It was only down by 1.89 percent. So that's in comparison to the developed market benchmark. It actually outperformed. And moving over to Sustainable Equity Fund, January was again a tough month for the growth stocks in general. Given expectations for the Feds that the Fed would actually raise increase rate which would already have more of a meaningful impact on the broad equity market as a whole. So as a result we saw tough performances from Brown Advisory which performed -- which had a -- which resulted in 12.6 percent for the month. Slightly lower than the actual benchmark of

8.58 percent. And that's it. Any questions?

MS. PENNY: Okay. Any questions for Devon? I guess not. Thank you so much for that presentation, and just next time if you can give us a little bit better news, we would appreciate that. Work on that. Michael did a great job. Great news. No pressure. Do we have anything else for public agenda?

MR. FULVIO: That concludes what we had planned for.

MS. PENNY: All right. Thank you, Michael. Do I have a motion to move into executive session?

MR. KAZANSKY: So moved.

MS. PENNY: Thank you, Mr. Kazansky. Do I hear a second?

MS. HIRSH: Second.

MS. PENNY: Thank you, Ms. Hirsh. Any objection? All those in favor, please say aye. Aye.

MR. KAZANSKY: Aye.

MR. BROWN: Aye.

MS. HIRSH: Aye.

MS. COLLINS: Aye.

MS. PENNY: Any opposed? Any abstentions? All right. We are going into executive session, and just as a special note, thank you for TRS. They are working very hard, Liz and Ron and Susan for breakout rooms and it's definitely a lot of work and we appreciate it. So just hang on and we will find out where everyone is going.

(Discussion off the record)

MS. PENNY: Public session for the investment meeting on February 3rd. Ms. Stang, would you like to report out, please?

MS. STANG: Certainly. In executive session at the pension fund we received a presentation about rebalancing ranges and the market outlook. We received an update on a public equity initiative. We received a presentation for an emerging manager of manager within fixed income. Consensus was reached. We received a presentation in private equity. Consensus was reached. We received a recommendation in real estate consensus was reached. In executive session on the fund side, we received a recommendation

on a manager. Consensus was reached which will be announced at the appropriate time.

MS. PENNY: Thank you very much. Do we have anything else for public agenda? Okay. Hearing none, then do I hear a motion to adjourn?

MR. KAZANSKY: So moved.

MS. PENNY: Thank you. He said reluctantly, Mr. Kazansky. Do I hear a second?

MS. HIRSH: Second.

MS. PENNY: Any discussion? All those in favor?

Aye.

MR. KAZANSKY: Aye.

MR. BROWN: Aye.

MS. HIRSH: Aye.

MS. COLLINS: Aye.

MS. PENNY: Any opposed? Any abstentions? Okay. We stand adjourned. Thank you, guys.

(Time noted: 12:54 p.m.)

C E R T I F I C A T E

STATE OF NEW YORK   )
                     : ss.
COUNTY OF QUEENS   )

I, YAFFA KAPLAN, a Notary Public within and for the State of New York, do hereby certify that the foregoing record of proceedings is a full and correct transcript of the stenographic notes taken by me therein.

IN WITNESS WHEREOF, I have hereunto set my hand this 14th day of February, 2022.

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YAFFA KAPLAN