

**EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE
ANNUITY AND PENSION BOARD**

Minutes of the Investment Committee Meeting
held February 9, 2023 via teleconference during COVID-19

The meeting was called to order at 9:00 a.m.

Committee Members Present: Matthew Bell
 Deborah Ford
 Timothy Heling
 Thomas Klusman, Chair
 Rudy Konrad
 Nik Kovac
 Aycha Sawa

Committee Members Not Present: Molly King

ERS Staff Present: Jerry Allen, Executive Director
 David Silber, Chief Investment Officer
 Erich Sauer, Deputy Chief Investment Officer
 Dave Walters, Pension Investment Analyst – Sr.
 Thomas Courtright, Pension Investment Analyst
 Dan Gopalan, Chief Financial Officer
 Gust Petropoulos, Deputy Director Disability
 Jan Wills, Board Stenographer

Others Present: Jason Ellement, John Jackson, Mike Joecken, Adam Lozinski, Callan; Pat Beckham, Aaron Chochon, Larry Langer, Cavanaugh Macdonald; Terry Siddiqui, DS Consulting, Inc.; three members of the public called in.

Callan 2023 Asset-Liability Study Phase 1 Presentation. Mr. Silber stated the Asset-Liability Study is completed every three to five years, with the last Study completed in 2020. He said Callan is presenting phase 1 of the Study now because last year there was a historic rise in interest rates, which had a material impact on the capital market assumptions that Callan uses, and the actuary will be asking the Board to select the discount rate that the Fund's liabilities are measured on at its February meeting. Mr. Silber said Committee members can ask any questions of Callan on capital market assumptions, asset allocation, and expected rate of return. He said Callan has put together three types of asset class mixes that are meant to be representative of risk and return considerations for the Committee to see. Mr. Silber concluded that Callan would later have Phase 2 and Phase 3 presentations.

Mr. Joecken said both equity and fixed income for the third or fourth time in 100 years had negative returns at the same time in a calendar year, so capital market assumptions were adjusted and Callan moved the Study to three years instead of five. He noted as they get more information from the actuary, Callan will move forward with Phase 2 and Phase 3 presentations. Mr. Joecken stated today they would discuss capital market assumptions, lay out alternative asset mixes, and help the Committee get comfortable with the discount rate.

Messrs. Ellement and Lozinski of Callan's Capital Markets group discussed the Capital Market Assumptions with the topics of Why Make Capital Markets Projections?; Callan 2023-2032 Capital Market Assumptions; Inflation Forecasts: Survey of Professional Forecasters, 10-Year Horizon; 10-Year Breakeven Rate: Bond Market Forecast of Inflation; Yield Curve Continued to Rise and Became Inverted in Second Half of 2022; 10-Year Expected Returns; Comparison of Core Fixed Income Return Components; 10-Year Expected Equity Returns; U.S. Equity Market: S&P 500 Valuation Measures; U.S. Equity Market: Return of Cash; and 2023 vs. 2022. Discussion ensued.

Ms. King arrived at 9:40 a.m.

Messrs. Ellement and Lozinski also discussed Alternative Asset Mixes, including the topics of 10-Year Returns; 30-Year Returns; Public Fund Actuarial Discount Rates; and Preliminary Liquidity Stress Test on Current Target. Discussion ensued.

Mr. Klusman advised that the Investment Committee may vote to convene in closed session on the following two items as provided in Section 19.85(1)(e), Wisconsin State Statutes, to deliberate or negotiate the purchasing of public properties, the investing of public funds, or conducting other specified public business, whenever competitive or bargaining reasons require a closed session. The Investment Committee may then vote to reconvene in open session following the closed session.

Ms. King asked Committee members and Staff for a moment of remembrance for the loss of Officer Jerving and said our thoughts go out to his family and colleagues.

It was moved by Ms. King, and seconded by Mr. Heling to convene in closed session. The motion carried by the following roll call vote: AYES: Mses. Ford, King, and Sawa; Messrs. Bell, Heling, Klusman, Konrad, and Kovac. NOES: None.

The Committee convened in closed session at 10:49 a.m.

Callan Real Estate Manager Search Update.

Approval of Real Estate Manager Search Finalists.

The Committee reconvened in open session at 11:35 a.m.

Mr. Klusman noted the Committee, in closed session, approved the Approval of Real Estate Manager Search Finalists.

Liquidity Analysis Memo. As a matter of information, Committee members received from Mr. Silber a Liquidity Analysis memo dated February 9, 2023. Mr. Silber commented that there has been a prolonged downturn in stocks and bonds since the beginning of 2022, with both down double digits. He stated this market environment creates a liquidity issue for the Fund because the Fund pays out more money in benefits than it receives in contributions, and investments have to be sold each month to make up for that gap. Mr. Silber said stocks are in the portfolio because Callan expects them to be worth more in the future than they are now. He said stocks are needed to achieve the 7.5% long-term target. Mr. Silber confirmed the Fund has enough liquidity to pay

benefits without selling any stock investments through March 2025, even if markets do not bounce back between now and then. He said the Committee has a guideline issue however, as the guidelines do not want the Fixed Income allocation to drop more than 3% below the 23% target. Mr. Silber said there is an interim 17.5% minimum Fixed Income allocation, effective until March 1, 2023, that the Board approved last November. He is recommending the ERS extend the interim minimum Fixed Income allocation to January 31, 2024 to provide Staff flexibility as it determines which investments to sell each month to cover the Fund's benefit payments. ERS is a long-term investor and hopes stocks rebound in 2023. However, Mr. Silber said he would continue to prepare contingency plans in case stocks do not bounce back in 2023. He said the Fund is in a good liquidity position in 2023 because the ERS intentionally went overweight to bonds at the beginning of 2022, and also because of the Committee's decision last November to raise cash by lowering the UBS target from 7% to 4%.

Approval of Statement of Investment Policy Update. Mr. Silber noted the redlined changes to extend, from March 1, 2023 to January 31, 2024, the footnote that allows the Fund's Fixed Income minimum range to be 17.5%, as mentioned in the Liquidity Analysis Memo. It was moved by Ms. King, seconded by Mr. Konrad, and unanimously carried, to approve the Approval of Statement of Investment Policy Update.

CMERS 4th Quarter 2022 Performance Update. As a matter of information, Committee members received the 4th Quarter 2022 Performance Update booklet. Mr. Sauer discussed the Relative Performance Expectations and said Value Equity Bias was significantly positive in CMERS' favor, Small Cap Equity Bias was a slight detractor, but Fixed Income Credit and Private Equity were also slightly in the Fund's favor. He said the Fund outperformed with the CMERS Total Fund (net) for Q4 up 5.6% with the CMERS Benchmark up 4.8%. Mr. Sauer said the one-year return for the ERS Total Fund (net) was -6.5% with stocks and bonds down. He said the -6.5% return did outperform the Fund's -10.6% benchmark return. He said the Fund's 10-year rolling return in 2022 was above 8% for most of the year, and ended at 8.1% with 90 basis points of outperformance. Mr. Sauer noted what generated outperformance in the 4th quarter was value, international stocks which performed better than domestic stocks, manager selection with value managers Brandes and the DFA Mandates, and Private Equity. He commented that the Growth Managers Polen and Blair detracted, as did the Overweight to Private Equity and the Underweight to Public Equity. Mr. Sauer said for the Total Fund vs. the Universe, the Fund was just outside the top quartile in the 4th quarter, but solidly top quartile in all the other time periods shown. He said even with the COVID drawdown, which is incorporated in the three-year and longer periods, it is nice to see those longer-term time periods stacking up so well against peers. Mr. Sauer then stated Public Equity had strong performance in the 4th quarter with Value being in the Fund's favor as well as Value and Small Cap for the one-year period. Mr. Silber complimented the Board for selecting and approving the Public Equity structure option in September 2022. He said the decision, which Staff was able to mostly implement before the 4th quarter started, added millions of dollars. Mr. Sauer noted the growth manager of MFS outperformed at 10.6% in the 4th quarter. He then commented that the Fixed Income Managers of Loomis and Reams generated outperformance in the 4th quarter and had protection on the downside. Mr. Sauer discussed Absolute Return and noted Aptitude, funded in the 4th quarter, was off to a good start with the portfolio they put together for CMERS. He said the goal of Absolute Return allocation was to make money when both stocks and bonds were down and UBS delivered on that this year at 8.9% for the full year. Mr. Sauer concluded that the Fund's value as of February 8 is \$5.76 billion, the

January estimate is that the ERS Fund is up 4.0% versus 4.2% for the benchmark, flat in February, with the year-to-date being 4.0% versus 4.2%. Mr. Klusman thanked the Investment Staff for an excellent report.

Value Add Analysis. Mr. Walters said the Analysis looks at the incremental value that is created by making the choice to invest some of the Fund with actively managed strategies rather than using an entirely passive set of strategies. He said the Analysis looks at the cumulative value add since 1995, excluding Real Assets, where the Fund has added \$1.3 billion dollars, net of fees. He noted that in the past 10 years, \$635 million was added net of fees. Mr. Walters commented that Private Equity and Absolute Return, which the Fund first invested in during 2010 and 2014, respectively, contributed more than one-third of the Value Add in the 28 year analysis. He noted International Equity generated over \$380 million and Fixed Income generated \$274 million of added value. Mr. Walters stated that Public Equity and Fixed Income alone generated over \$800 million dollars of value add over the past 28 years, net of fees.

Due Diligence Reports.

Brandes Investment Partners. As a matter of information, Committee members received from Mr. Walters a Memorandum regarding the Brandes Investment Partners Due Diligence meeting he and Mr. Silber had with Brandes on September 15, 2022 (onsite) and November 30, 2022 (virtual). Mr. Walters said it was a routine visit and that Brandes has managed an International Equity Large Cap Value strategy for the Fund since January 1998. He noted Brandes has managed approximately \$339 million or 6.2% of the Fund's assets and is the largest strategy within Public Equity assets. Mr. Walters said Brandes is concentrated as it holds 55-85 individual stocks and they look for undervalued stocks positioned for long-term price appreciation. He noted Brandes has outperformed the benchmark since the strategy's inception. Mr. Walters commented that Brandes is in an ownership transition and they are making their fourth of 10 payouts, without any debt, to the retired founder Charles Brandes and the CEO reported their Firm remains profitable and their balance sheet is healthy. Mr. Walters concluded that in October 2019, Brandes finalized the initial transition of several back office functions to SEI, an outsourced service provider.

Earnest Partners. As a matter of information, Committee members received from Mr. Courtright a Memorandum regarding Earnest Partners Due Diligence Meeting that he and Mr. Sauer had with Earnest Partners on December 15, 2022. Mr. Courtright stated Earnest has managed a Mid-Cap Core Equity Strategy for the Fund since May 2005. He noted Earnest's back office operation capabilities are stable and they use a large, centralized 14-member team of professionals to implement the strategy and undertake security research as well as portfolio management. Mr. Courtright commented that three persons left the Earnest team since the last meeting the Investment Staff had with them in 2020, but Earnest has hired replacements for all three. He also said their Investment team has a disciplined process in securities research and portfolio construction, allowing Earnest to retain consistency and continuity across different market environments. Mr. Courtright said Earnest keeps focused on what the stocks' earnings results will be over the next three to five years. He said they use quantitative tools, such as a Return Pattern Recognition model and risk management tool called Downside Deviations, for determining stocks to invest in and to eliminate drawdowns in markets. Mr. Courtright concluded that Earnest is very capable to manage the Mid-Cap Core Equity Strategy.

Mr. Allen reminded Committee members to submit their Statements of Economic Interests to the Ethics Board, by February 28.

It was moved by Mr. Bell and seconded by Mr. Konrad to adjourn the meeting.

There being no further business, Mr. Klusman adjourned the meeting at 12:16 p.m.

Bernard J. Allen
Secretary and Executive Director

NOTE: All proceedings of the Annuity and Pension Board Meetings and related Committee Meetings are recorded. All recordings and material mentioned herein are on file in the office of the Employees' Retirement System, 789 N. Water Street, Suite 300.)