MINUTES OF MEETING
KENTUCKY RETIREMENT SYSTEMS
INVESTMENT COMMITTEE MEETING
AUGUST 9, 2022, 10:00 A.M., E.T.
VIA LIVE VIDEO TELECONFERENCE

At the August 9, 2022 meeting of the Kentucky Retirement Systems' (KRS) Investment Committee, the following Committee members were present: Prewitt Lane (Chair), John Cheshire, Lynn Hampton, David Adkins, and Pamela Thompson. Staff members present were David Eager, Victoria Hale, Kristen Coffey, Steve Willer, Joseph Gilbert, Jared Crawford, Ashley Gabbard, Phillip Cook, and Sherry Rankin. Also in attendance were Kentucky Retirement Systems' CEO John Chilton and County Employees Retirement System's (CERS) CEO Ed Owens, III, and KRS Trustees Ramsey Bova and William Summers, V. Others in attendance included David Lindberg, Craig Morton, and Chris Tessman with Wilshire Advisors, LLC.

Mr. Lane called the meeting to order.

Ms. Hale read the Legal Opening Statement.

Mr. Lane took a moment to express concern for all friends, retirees, and active members affected by the devastating flooding in Eastern Kentucky. He also congratulated Mr. Steve Willer and Mr. Anthony Chiu on their recent promotions.

Ms. Rankin took Roll Call.

There being no *Public Comment*, Mr. Lane introduced agenda item *Approval of Minutes – May 16, 2022*. Mr. Adkins made a motion and was seconded by Mr. Cheshire to approve the minutes as presented. The motion passed unanimously.

Mr. Lane introduced agenda item *Quarterly Trust Budget*. Mr. Steve Willer presented the Quarterly Trust Budget. Mr. Willer stated that this was the first year that KPPA budgeted trust expenditures. KPPA is required to report all investment expenses to the Public Pension Oversight Board (PPOB) by statute beginning November of 2022. In response, a working group was formed to discuss the Administrative Budget, as well as the Trust Budget. Mr. Willer advised that the Trust Budget will be reported to the CERS and KRS Investment Committees on a quarterly basis moving forward. The Trust Budget includes four main categories: consulting, legal, audit and contractual services. Mr. Willer stated that investment-related expenditures are paid directly from trust funds, but are not included in the administrative budget. Mr. Lane added that the working group discussed performance fees in detail and stated that it was difficult to establish a baseline for the line item. However, the working group was able to find a reasonable solution based on expected returns. Mr. Willer explained that high performance fees are indicative of outperformance well above and beyond benchmark thresholds and stated that the goal across all expenses is to minimize and get the most efficient use of the fees that are paid. Mr. Adkins commended Mr. Willer and the working group for compiling a great level of transparency. Mr. Adkins advised that members may not understand the context of the budgeted items; therefore, Mr. Adkins suggested that footnotes be added to include benchmarks and explanations. Mr. Willer agreed with the suggestion and stated that he will add footnotes moving forward to describe the services that each category provides. Mr. Eager also requested that important year-to-year changes also be footnoted. Next, Mr. Willer commented on manager expenses. He reported that manager expenses are broken out by plan, by asset type, and then by fee type. Mr. Willer stated that Staff is very efficient in the use of fees and negotiates fees. Staff works to minimize fees by focusing on opportunities to bring assets in-house and to manage more assets by the Office of Investments Staff. Mr. Willer stated that private markets, private equity, specialty credits, and real estate are higher fee markets; whereas, public equities and core fixed income tend to be lower fee markets.

Mr. Lane introduced agenda item *Investment Review and Update*. Mr. Willer presented the Investment Review and Update. He stated that June was a difficult month for markets with rising rates and high inflation. There was deceleration in economic growth and concern whether or not growth would stabilize or increase, especially in the United States. Uncertainty has led to significant volatility across markets, stated Mr. Willer. Global equities were down about 8%, high-yield was down almost 7%, and core fixed income was down about 150 basis points. KERS Hazardous, KERS Nonhazardous, and SPRS all modestly underperformed their IPS benchmarks in June; resulting in underperformance and underweights in private equity and real estate allocations. This underperformance was offset by a strong performance in the specialty credit allocation. Ms. Bova asked what the management fee for the cash portfolio covers if the portfolio is managed internally. Mr. Willer stated that there is no fee for the cash portfolio and further reviewed the cash subcategories listed on page 7 of the meeting materials. Ms. Bova thanked Mr. Willer for the additional explanation. The KERS Nonhazardous portfolio was down 3.74%, KERS Hazardous was down 4.21%, and SPRS was down 2.92%. SPRS outperformed due to the overweight in cash which was a result of a general fund appropriation that was received in May of 2022. Mr. Willer presented the United States Fixed Income as of June 30, 2022 and reported that fixed income had decreased by 10.3% which was a historic measure. High-yield bonds had also decreased by 12.8% and loans were down by 4.6%. Commodities, private equity, and real estate produced positive performance for the fiscal year, stated Mr. Willer. Next, the Total Fund Attribution was reviewed. Mr. Willer stated that all plans held up relatively well against their relative benchmarks and peer universe; the KERS Nonhazardous was down 5.19%, KERS Hazardous was down 5.95%, and SPRS was down 4.63%. Mr. Willer reported that asset allocation was a negative driver of performance for the fiscal year across plans. He stated that the largest positive contributors to performance in an asset allocation within an asset class were high-yield, specialty credit, and core fixed income. The Plan Sponsor Peer Group Analysis was also reviewed: multi-statistics including return, standard deviation, and sharpe ratio. Median performance estimates were down about 9% for the fiscal year. Ms. Hampton asked if there was a reason that the one-year sharpe ratio was significantly lower than the three-year and five-year sharpe ratio metrics. Mr. Willer explained that the dispersion among plans was larger in the one-year metric; as shorter periods of the sharpe ratio are used, the bands on the graph extend. Mr. Eager added that if the plan is in the top quartile each year for a five-year period due to performance, then over the five years the plan is likely to be in the top 5% within the five-year universe. Mr. Willer stated that the plans tend to be out of range with real estate and real return underweights and overweights in cash, specialty credit, and core fixed income. However, the main focus is moving towards the allocation targets, said Mr. Willer. He advised that the Office of Investments has shifted away from commodity only mandates and are working to move to a multi-asset and inflation sensitive type of mandate which relies on inflation as a driver. This change would allow more capital to be deployed quickly, stated Mr. Willer. Mr. Adkins asked who sets the asset allocation targets, what the consequences are for not hitting or maintaining the targets, and who approves deviations from the targets. Mr. Willer advised that the CERS and KRS Investment Committees are responsible for setting the asset allocation targets and ranges. These guidelines are found in the Investment Policy Statements (IPS) which have been approved by the Investment Committees and ratified by their Board. Further, Mr. Willer assured Mr. Adkins that any deviations have been approved by the Investment Committee. Mr. Adkins asked if there is a set lifespan of these approved targets. Mr. Willer advised that there is no set lifespan; however, they are reviewed at least annually with revisions to capital market assumptions and efficient frontier analysis. Mr. Willer stated that the targets can change formally within the IPS and that there have been revisions to the IPS allocation targets and ranges in the past. Mr. Summers added that based on his experience, asset allocations are typically set for a 12-month period and are reevaluated if the allocations are not in range and or yielding the amount of return desired. Mr. Summers expressed the importance of being within the established asset allocation ranges. Mr. Eager reiterated that the managers do not make the decisions to amend the allocation ranges and targets. Mr. Lane advised that KRS does not operate on a 12-month window and that the expected returns are typically modeled out to 10 years. Further, Mr. Lane stated that the KRS Investment Committee and Investment Staff have made tactical decisions in the past and have a plan in place for the asset allocations that are out of range. Ms. Victoria Hale with the Office of Legal Services, advised that the KRS Investment Policy Statement states that "…the Board recognizes that each plan and any underlying fund have their own capacity to tolerate investment volatility or risk. The asset allocation guidelines of each fund will be reviewed annually..." In summary, the asset allocation must be reviewed at least annually, however, the Board or Investment Committee may choose to do so more often. Additionally, the KRS IPS states that "…the individual asset allocations of each pension and insurance fund constituent will be reviewed monthly by Staff relative to its target and asset allocation," said Ms.

Hale. Mr. Willer stated that Staff reviews the allocations on a daily basis. Mr. Lane thanked Mr. Willer and stated that the presentation was a great review and educational regarding asset allocations.

Mr. Lane introduced agenda item *Investment Compliance Report*. Mr. Jared Crawford, Investment Research Officer and Compliance Officer, presented the Investment Compliance Report for the quarter ending June 30, 2022. Mr. Crawford stated that the report is a work-in-progress and welcomed feedback from the Investment Committee. He reviewed the various visual aids and graphics in the report illustrating plan asset allocations and their targets. Mr. Crawford stated that he receives a compliance report daily. The only area not in compliance was the S&P 500 portfolio due to fractional shares held. Mr. Crawford suggested that a de minimus rule be established for exceptions. Mr. Joseph Gilbert advised that he is able to clean up these fractional shares via BNY Mellon. Mr. Lane thanked Mr. Crawford for his due diligence in ensuring that Trustees understand asset allocation clearly and efficiently.

Mr. Lane introduced agenda item *Staffing Update*. Mr. Willer provided an update on staffing within the KPPA Office of Investments. He announced that he is working with KPPA Human Resources and the Governor's Office on the development of new positions within the Division i.e. Senior Investment Analyst and an Investment Analyst. Mr. Willer believes three to four individuals could be hired for those roles to provide support across asset classes and functions. Mr. Willer stated that recruiting has been challenging and it will take time to fill these roles with the right candidates. Mr. Eager added that a search has begun for a Chief Financial Officer (CFO).

Ms. Hampton asked about rescheduling the November Investment Committee meeting to allow the Office of Investments more time to prepare. Mr. Eager stated that the change to the schedule would need to be voted on at a Board meeting to amend the schedule. Mr. Eager agreed to look at the schedule to determine if rescheduling is needed. Ms. Hale advised that the Chair may cancel the scheduled meeting and call a special called meeting to avoid the Board vote. Mr. Cheshire stated that rescheduling often causes attendance issues among Trustees who have planned their other engagements around the set calendar of meetings. It was agreed to not reschedule the meeting at this time.

There being no further business, Ms. Hampton made a motion and was seconded by Mr. Cheshire to adjourn the meeting. Copies of all documents presented are incorporated as part of the minutes of the Kentucky Retirement Systems Investment Committee meeting held August 9, 2022.

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CERTIFICATION

I do certify that I was present at this meeting and I have recorded above the action of the Committee on the various items considered by it at this meeting. Further, I certify that all requirements of KRS 61.805-61.850 were met in connection with this meeting.

Recording Secretary

I, as Chair of the Kentucky Retirement Systems Investment Committee, do certify that the Minutes of the meeting held on August 9, 2022 were approved by the Kentucky Retirement Systems Investment Committee on November 10, 2022.

Committee Chair

I have reviewed the Minutes of the Kentucky Retirement Systems Investment Committee Meeting on August 9, 2022 for form, content, and legality.

Office of Legal Services