

Public Equity

Annual Review

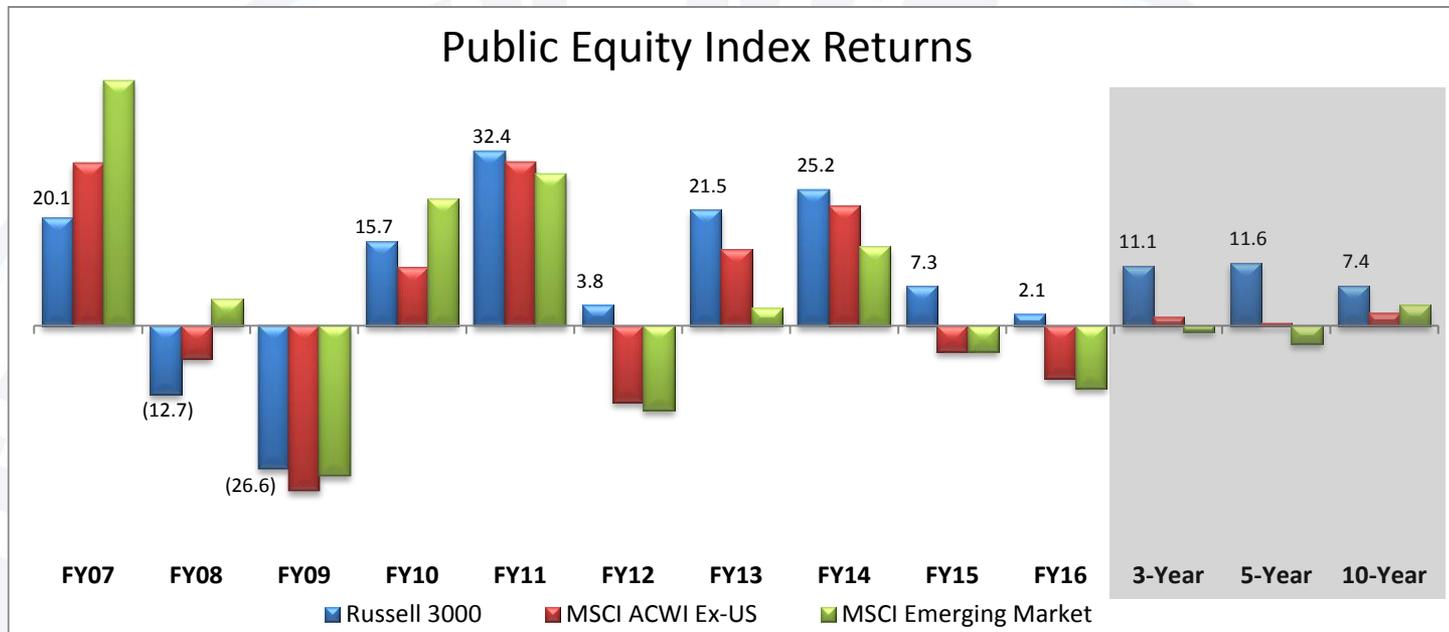
November 2016



SUMMARY

FY2016 continued to be heavily influenced by geopolitical and macro events

- Global demand concerns
 - Uncertainty in Europe – Greece; sustainability of Europe’s recovery, Brexit
 - U.S. interest rate hike anticipation – impact
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- **U.S. broad equity market gained 2.1% (Russell 3000) – Large Cap 4.0%; Small Cap -6.7%**
 - **International markets struggled; developed (-10.2% MSCI EAFE) & emerging (-12.1% MSCI EM)**



DIFFICULTIES

Challenging as markets were largely influenced ...

- Macroeconomic events, global monetary policy, & asset flows
 - Largely determined the direction of the market, and winners & losers
 - Fundamentals haven't carried as much weight when evaluating the merits of an investment

Magnitude of shift to passive has been a headwind for fundamental investors

- Over past 10 years: \$1.5T from active, \$2T to passive

Two big themes pointing to the same targets for investment

- Macro events create volatility and push investors towards U.S. and to shift towards safer assets
- Low investment rate environment - bond investors enter the equity markets in search of yield
- Both point to high dividend payers with low volatility (primarily defensive sectors)

Difficulty for fundamental investors

- Growth managers struggled as market's upward trend has not been due to cyclical leadership
- Value managers struggled as market leaders' valuations are unjustified



SUMMARY

Shorter Term - Total Equity portfolios have provided down side protection

- Outperformance primarily driven by ...
 - Strong relative performance within the active Non-U.S. mandates
 - Overweight to U.S. Equities (best performing public equity market for the FY)
 - Slight underweight to Emerging Markets (at mid year prior to asset allocation change)
 - Partially offset by weaker relative performance within the U.S. Equity portfolios
 - Westfield / Westwood / Invesco / Mid caps

Longer Term – Both funds outperformed over the trailing 3-yrs & performed in line over the trailing 5-yrs

Public Equity Performance Review (Returns are Net)							
	% Fund	1 Year		3 Year		5 Year	
		KRS	Index	KRS	Index	KRS	Index
Pension							
U.S. Equity	26.0%	1.4%	2.1%	10.3%	11.1%	10.7%	11.6%
Non-U.S Equity	25.0%	(8.5%)	(9.7%)	2.1%	1.7%	0.5%	0.6%
Total Equity	51.0%	(4.3%)	(5.0%)	5.7%	5.5%	5.1%	5.2%
Insurance							
U.S. Equity	28.9%	2.3%	2.1%	10.6%	11.1%	10.9%	11.6%
Non-U.S Equity	26.0%	(8.6%)	(9.7%)	2.0%	1.7%	0.3%	0.6%
Total Equity	54.9%	(3.8%)	(4.9%)	5.9%	5.6%	5.2%	5.2%

KRS asset allocation changed as January 1, 2016

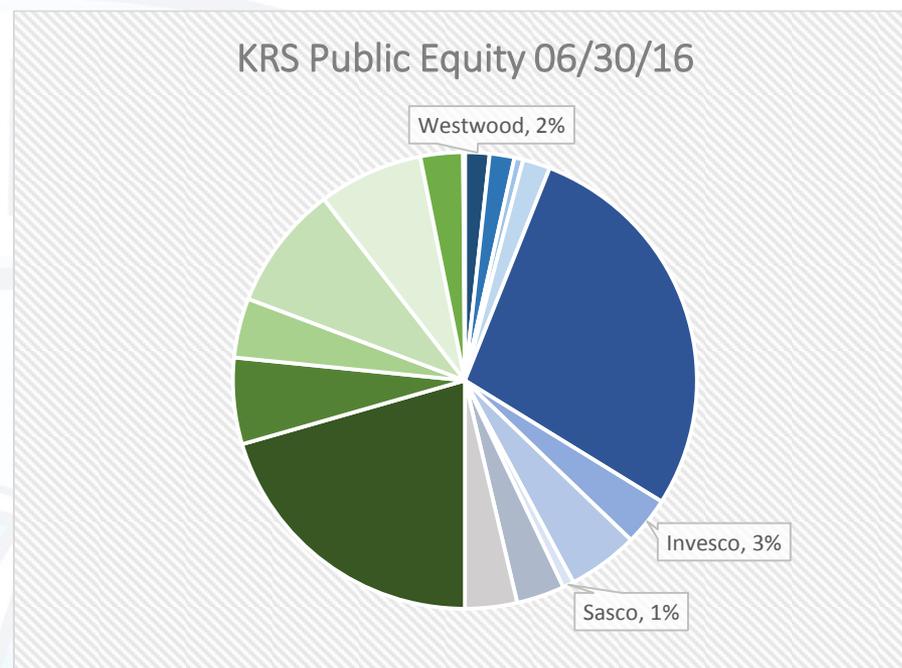
Prior - Pension: 20.5% US, 20% Non-US, 2.9% EM & Insurance: 20% US, 20% Non-US, 4% EM

06/30/16 POSITIONING

KRS's Total Equity Portfolios - as of June 30, 2016

- Pension: 51.0% of Fund, Valued at \$5.5 Billion
- Insurance: 54.9% of Fund, Valued at \$2.3 Billion
- Total of 13 External managers, 2 Internally Managed Funds (mandates: pension 17 / insurance 16)

As of: 06/30/16	PENSION		INSURANCE	
	MV	%	MV	%
U.S. Equity				
Westwood	95.57	3.42	38.21	3.15
River Road - DAV	96.21	3.44	46.92	3.87
River Road - FAV	34.59	1.24	14.83	1.22
Westfield	106.63	3.82	42.66	3.52
Internally Managed S&P500	1,561.20	55.88	741.52	61.15
Internal Equity	-	-	-	-
Invesco	190.73	6.83	-	-
Internally Managed Mid Cap	276.04	9.88	146.93	12.12
Sasco	43.67	1.56	18.31	1.51
Systematic	187.04	6.69	78.44	6.47
Northern Trust Global	202.35	7.24	84.74	6.99
	\$2,794.03	50.98	\$1,212.56	52.63
	Target	50.39	Target	50.00
Non-U.S. Equity				
BlackRock, Inc	1,101.35	40.99	472.81	43.33
American Century	328.64	12.23	131.68	12.07
Franklin Templeton	226.29	8.42	83.79	7.68
Lazard	471.98	17.57	168.77	15.47
LSV	392.63	14.61	174.80	16.02
Northern Trust Global - SC	159.60	5.94	-	-
BlackRock, Inc - SC	-	-	57.75	5.29
Transition/KRS Intl	6.29	0.23	1.69	0.15
	\$2,686.78	49.02	\$1,091.29	47.37
	Target	49.61	Target	50.00
Total Public Equity	\$5,480.81		\$2,303.85	

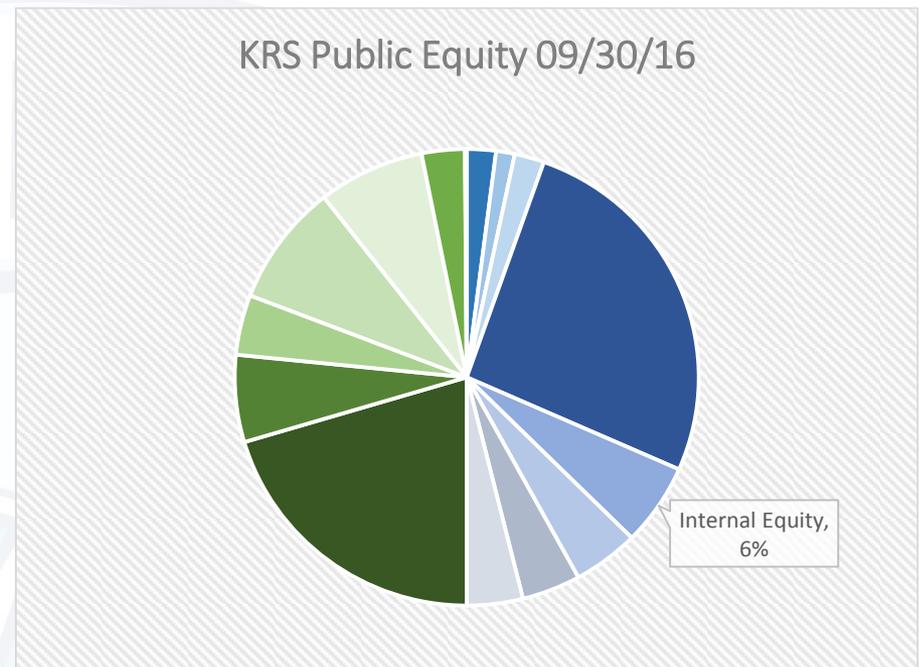


09/30/16 POSITIONING

KRS's Total Equity Portfolios - as of September 30, 2016

- Pension: 51.9% of Fund, Valued at \$5.7 Billion
- Insurance: 55.4% of Fund, Valued at \$2.4 Billion
- Total of 10 External managers, 3 Internally Managed Funds (mandates: pension 15 / insurance 14)

As of: 09/30/16	PENSION		INSURANCE	
	MV	%	MV	%
U.S. Equity				
Westwood	-	-	-	-
River Road - DAV	116.67	4.05	54.16	4.34
River Road - FAV	74.80	2.60	32.27	2.59
Westfield	119.26	4.14	51.65	4.14
Internally Managed S&P500	1,508.54	52.42	638.41	51.15
Internal Equity	333.86	11.60	127.67	10.23
Invesco	-	0.00	-	0.00
Internally Managed Mid Cap	264.83	9.20	152.25	12.20
Sasco	-	0.00	-	0.00
Systematic	235.47	8.18	99.36	7.96
Northern Trust Global	224.22	7.79	92.36	7.40
	\$2,877.65	50.16	\$1,248.13	51.70
	Target	50.39	Target	50.00
Non-U.S. Equity				
BlackRock, Inc	1,167.38	40.83	505.42	43.34
American Century	352.66	12.34	141.32	12.12
Franklin Templeton	243.00	8.50	90.23	7.74
Lazard	492.66	17.23	176.19	15.11
LSV	424.34	14.84	188.78	16.19
Northern Trust Global - SC	172.25	6.03	-	-
BlackRock, Inc - SC	-	-	62.41	5.35
Transition/KRS Intl	6.50	0.23	1.76	0.15
	\$2,858.79	49.84	\$1,166.11	48.30
	Target	49.61	Target	50.00
Total Public Equity	\$5,736.44		\$2,414.24	



MANAGEMENT STYLE

KRS US Equity Portfolio – as of 06/30/16

- Passive – LC/MC 65.8%
- Active – LC/MC 27.0%
- Enhanced – SC 7.2%

KRS Non-US Equity Portfolio – as of 06/30/16

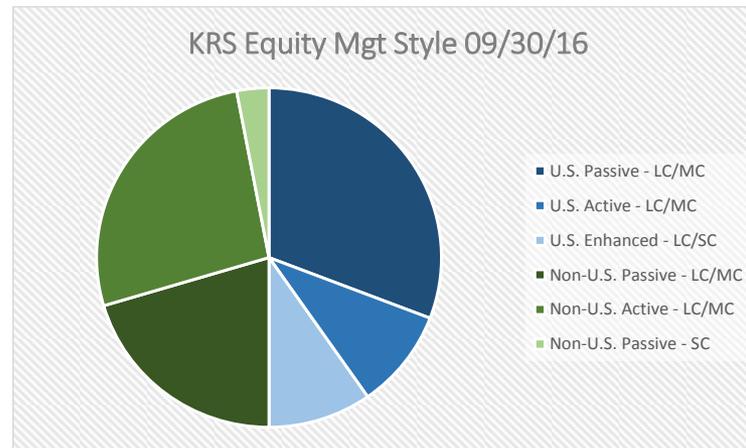
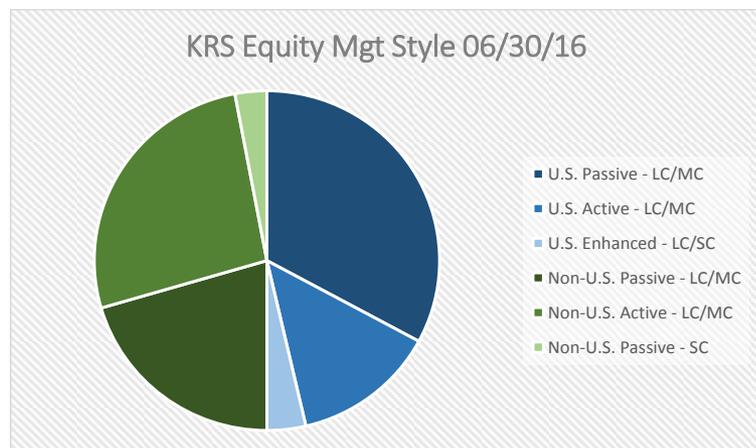
- Passive – LC/MC 41.0%
- Active – LC/MC 53.1%
- Passive – SC 5.9%

KRS US Equity Portfolio – as of 09/30/16

- Passive – LC/MC 61.6%
- Active – LC/MC 19.0%
- Enhanced – LC/SC 19.4%

KRS Non-US Equity Portfolio – as of 09/30/16

- Passive – LC/MC 40.8%
- Active – LC/MC 53.2%
- Passive – SC 6.0%



FY2016 ACTIVITY

Participated in a significant total fund rebalance

- Exited 3 emerging market equity mandates
- Increased U.S. Equity allocation through passive mandates: \$303m pen / \$142m ins
- Increase Non-U.S. Equity allocation: \$335m pen (52/48 p/a), \$147m ins (56/44 p/a)

Funded an initial allocation to Scientific Beta, a multi-factor index provider

- Potential anchor for a new U.S. equity core-satellite structure: \$340m pen / \$130 ins

River Road “FAV” strategy funded

- Run in tandem with RRAM DAV strategy (asset shift DAV > FAV): \$143m pen / \$49m ins

Manager relationships terminated

- 3 U.S. Equity managers / 1 Non-U.S. Equity manager
 - Performance + additional contributing factors

Participated several smaller rebalance trades

- Exposure rebalance, contributions, cash raises

Began a U.S. Small Cap search & Change to Non-U.S. Small Cap mandate approved; however, temporarily on hold.

ITEMS OF NOTE

- **River Road DAV (7.4% vs 2.4%)**

- Relative outperformance driven by stock selection & allocation (7 of 10)
 - Stock selection financial (REITs), consumer staples, industrials & underweight energy sector
- Firm AUM drop of \$2.1b; \$1.4b to 3 clients (\$900m SWF redeemed as oil price dropping)
- Staffing drop primarily due to closing Independent Value Strategy and back office positions

- **Westfield Capital (-8.3% vs 1.9%)**

- Underperformance driven by security selection; industrial, info tech, financial, and health care
 - Consol Energy: -200bps; Health care (pharma): -200bps, drug price pressures
- Allocation detracted: overweight energy / underweight consumer staples
 - Not having enough FANG stocks: valuations didn't justify risk/reward
- Firm AUM drop of \$4b; \$2.4b to outflows (3 clients account for 75% - 2 remain in other strategies)

- **Systematic (-3.7% vs 3.3%)**

- Driven by stock selection, but really in how it manifested through factor selection or exposure
 - Strategy foundation: invest in low P/E & stocks with strong earnings revisions
 - Overweighting those factors: -110bps & -40bps
 - Underweight REITs -190 bps; underweight dividends -145bps; underweight low vol -25bps
 - Firm AUM drop of \$4.3b, \$2.2b to outflows; Strategy \$4.9b to \$2.4b

ITEMS OF NOTE (CONT.)

• NTGI (-4.5% vs -6.7%)

- Relative outperformance driven by stock selection
 - Health care – underweight to bio-techs & pharma; +100bps
- Minimal exposure to stocks on its “no buy list” versus the index; those stocks returned -23.7%

• Franklin Templeton (-6.2% vs -9.8%)

- Outperformance at the sector level due to stock selection & an underweight to financials
- Country level attribution was slightly positive
- Gave up 150 bps of relative performance in last week of June due to Brexit vote
- Firm experienced \$91b in net outflows, greater than 80% from retail

• Lazard (-7.4% vs -9.8%)

- Driven by stock selection within materials, industrials, financials
- Benefited from slight o/w to emerging markets in 2nd half of year & underweight financials
- Gave up 200 bps of relative performance in last week of June due to Brexit vote

• LSV Asset Management (-13.6% vs -9.8%)

- Relative underperformance due to weak stock selection within utilities and materials
- Underweight to consumer staples was a hindrance
- Performed well versus style benchmark (-13.6% vs -14.3%)
 - “cheaper” in terms of P/E, P/CF, P/B

LOOKING FORWARD

- **Push towards a revamped U.S. Equity portfolio structure**
 - Review current mandates
 - Migrate towards already approved strategies
 - Explore new ideas
- **Continue to review low/managed volatility strategies**
 - Provide equity exposure with better downside protection
- **Staff will seek to implement a previously approved mandate change within the Non-U.S. small cap space**
- **Evaluate the use of passive versus active strategies; and location of use**
- **Continue working with CIO, RVK, & other staff members to implement any necessary portfolio changes, rebalances, and meet cash needs**

CONCLUSIONS / RECOMMENDATIONS

Conclusions

U.S. Equity investors were rewarded in FY16, while investments outside the U.S. produced losses. The U.S. has continued to be a safe haven in a global economy of geopolitical unrest and economic growth concerns. Investor appetite for safety combined with low interest rate policies have been a significant influence on asset flows. As such, U.S. equity markets have continued to rise on the backs of the defensive sectors, those with lower volatility and high dividend payouts.

KRS Total Public Equity portfolios fell during the year, but outperformed on a relative basis.

- The Non-U.S. portfolio produced approximately 120 bps of downside protection
- The portfolio benefited from an overweight to U.S. equities
- Further, the underweight to EM equities just prior to an asset allocation change added value
- Individual managers
 - Relatively uneventful from an organizational standpoint; some significant movements in AUM but no meaningful staffing changes
 - Performance was disappointing: 5 of 11 actively managed strategies added value over their respective indices

Recommendations

No recommendations at this time. With that said both Staff & RVK are closely monitoring several managers for either organizational or performance purposes and will promptly notify the committee if it is believed an action is required.