

# FISCAL YEAR 2019 INVESTMENT PLAN



September 2018

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September 1, 2018

Board of Trustees  
State Universities Retirement System  
1901 Fox Drive  
Champaign, IL 61820

RE: *Fiscal Year 2019 Investment Plan*

Dear Board of Trustees:

The Investment Staff is pleased to provide the SURS Investment Plan for Fiscal Year 2019. This document was developed in order to formalize the strategic plans for the investment portfolio for the coming year and provide transparency of the planning process. The Investment Plan for Fiscal Year 2019 marks the eighth year of the formal plan for the SURS investment program.

The Investment Plan reviews the results of Fiscal Year 2018 and defines the strategy for Fiscal Year 2019 in accordance with the Board-approved asset-liability study and Investment Policy. Since financial markets are dynamic, revisions to the plan may be required and will be communicated to the Board in a timely manner.

The SURS portfolio returned 8.25% during Fiscal Year 2018, net of fees, exceeding the policy portfolio return of 7.86%. Strong relative performance from SURS active managers overall was the primary contributor to the above benchmark return. From a long term perspective, the SURS portfolio has performed well, earning an 8.5% annualized rate of return over the past 30 years, well in excess of both the 8.1% policy portfolio return and the 7.25% assumed rate of return.

When compared to a universe of other large public funds, the SURS return ranks slightly below median for the one- and three-year periods and above median for the five- and ten-year periods ending June 30, 2018. Asset allocation is the primary determinant of universe ranking. As of June 30, 2018, the defined benefit plan is valued at approximately \$19.0 billion while the Self-Managed Plan (SMP) is valued at approximately \$2.5 billion (including forfeiture and disability reserve assets).

A key accomplishment during FY 2018 was the completion of searches for a defined benefit plan general investment consultant and a defined contribution consultant for the SMP. These searches resulted in the selection of PCA as the general investment consultant and Cammack Retirement as the SMP consultant. These firms will partner with SURS to provide oversight to the existing portfolio, and formulate and implement strategies designed to efficiently achieve portfolio objectives. Other key accomplishments during Fiscal Year 2018 include:



- Preliminary discussions on development of formal investment beliefs;
- Initiation of asset-liability study by PCA;
- Revision to procurement policy to allow more efficient processes when new strategies are introduced while maintaining or improving the rigor of evaluation;
- Consideration of private real estate and other real estate strategies, resulting in commitments of \$60 million to two real estate debt strategies and \$300 million to core plus real estate strategies;
- Implementation of additional commitments to the private equity portfolio in accordance with the pacing model approved in June 2017;
- Education on the hedged strategies portfolio and consideration of potential alternative strategies, which resulted in retention of three firms that provide options-based strategies.

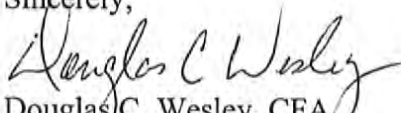
Numerous projects are planned for Fiscal Year 2019, including, but not limited to, the following:

- Adoption of investment beliefs;
- Completion of an asset-liability study;
- Completion of asset class structure studies following completion of the asset-liability study;
- Review of the Investment Policy Statement;
- Completion of a transition manager search;
- Continued review of opportunities to include firms owned by minorities, females and persons with a disability in the investment program.

The Manager Diversity Program (MDP), which focuses on investment management firms owned by minorities, females, and persons with a disability (MFDB), continues to be a high priority. As of June 30, 2018, the MDP is valued at approximately \$3.4 billion. In total, assets under management with MFDB firms are approximately \$5.8 billion or 30.1% of the Total Fund.

The Investment Plan for Fiscal Year 2019 contains additional details on Fiscal Year 2018 accomplishments and strategic initiatives for Fiscal Year 2019. The investment team is focused on successfully completing the projects planned and prudently positioning the portfolio for the future. A long term focus is of utmost importance. I look forward to discussing the *Fiscal Year 2019 Investment Plan* at future meetings.

Sincerely,

  
Douglas C. Wesley, CFA  
Chief Investment Officer

cc: Martin Noven, Executive Director



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## I. Purpose

The Investment Plan reviews the results of Fiscal Year 2018 and defines the strategy for Fiscal Year 2019 in accordance with the Board-approved asset-liability study and Investment Policy<sup>1</sup>. **This Plan is intended to be a living document. Since financial markets are dynamic, revisions to the plan may be required during the year. In the event of changing circumstances or opportunities during the year, items will be discussed with the Board as necessary.**

## II. Overview

### Background

The State Universities Retirement System (SURS) is the administrator of a cost-sharing, multiple employer public employee retirement system. SURS membership includes employees of the public universities and other affiliated organizations. Currently, SURS membership totals more than 230,000 active, inactive and retired participants. SURS maintains both a defined benefit and a defined contribution plan, known as the Self-Managed Plan (SMP). As of June 30, 2018, the defined benefit plan is valued at approximately \$19.0 billion while the SMP is valued at approximately \$2.5 billion (including forfeiture and disability reserve assets). The investment portfolio is broadly diversified across equities, fixed income, real estate, private equity, commodities and other opportunistic investments. Approximately 43% of the portfolio is currently managed in passive or structured active strategies while the remaining 57% is managed in active strategies.

### Fiscal Year 2018 Performance Review

The SURS investment portfolio produced solid returns during Fiscal Year 2018, due primarily to continued favorable economic conditions and the resulting strong global equity markets. During FY 2018, the portfolio returned 8.25%, net of fees, exceeding the policy portfolio return of 7.86% by approximately 0.39%. The table below illustrates the performance of the overall SURS investment portfolio relative to the policy portfolio, as of June 30, 2018.

#### Investment Performance\* As of June 30, 2018

|                         | 1 Year | 3 Years | 5 Years | 10 Years | 20 Years | 25 Years | 30 Years |
|-------------------------|--------|---------|---------|----------|----------|----------|----------|
| <b>SURS</b>             | 8.2%   | 6.8%    | 8.1%    | 6.7%     | 6.4%     | 8.1%     | 8.5%     |
| <b>Policy Portfolio</b> | 7.9%   | 6.7%    | 8.1%    | 6.8%     | 6.3%     | 7.8%     | 8.1%     |

\*Net of investment management fees

The Total Fund's excess return relative to the policy portfolio for Fiscal 2018 was due primarily to strong performance of SURS' active managers relative to the benchmark. Eight of the nine public market asset classes either matched or exceeded the benchmark over the past year, with the hedged

<sup>1</sup> The SURS Investment Policies can be found at <http://surs.org/investment-policies>.

strategies portfolio as the lone underperforming public market asset class. SURS U.S. equity portfolio delivered the strongest absolute return, +14.9%, slightly exceeding the benchmark. SURS Emerging Market Debt portfolio was the only public market asset class that experienced negative absolute returns of -1.4%. The commodities portfolio was the best relative performing asset class, outpacing the benchmark by 4.2%. Global equity also delivered strong relative returns, exceeding the benchmark by 2.9%.

Of the private, illiquid asset classes, the real estate and private equity portfolios exceeded the benchmarks for the year while the opportunity fund portfolio (consisting of infrastructure investments) trailed the benchmarks for the one-year period. The private equity portfolio delivered the highest absolute performance for the fiscal year with a 17.5% return. Overall, 94% of the policy allocation either matched or outperformed the benchmark for the one year.

Performance of each of the broad asset classes during FY 2018 is shown in the table below.

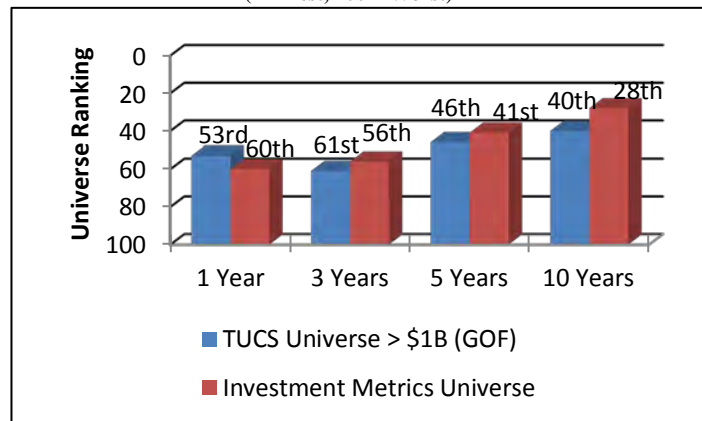
### SURS FY 2018 Asset Class Returns

| <u>Asset Class</u>                | <u>FY<br/>2018<br/>Return</u> | <u>Asset Class</u>                   | <u>FY<br/>2018<br/>Return</u> |
|-----------------------------------|-------------------------------|--------------------------------------|-------------------------------|
| SURS U.S. Equity                  | 14.9%                         | SURS Emerging Market Debt            | -1.4%                         |
| Dow Jones U.S. Total Stock Market | 14.8%                         | Performance Benchmark (Custom)       | -1.5%                         |
| <i>Excess Return</i>              | <i>0.1%</i>                   | <i>Excess Return</i>                 | 0.1%                          |
| SURS Non-U.S. Equities            | 7.4%                          | SURS Direct Real Estate              | 8.1%                          |
| MSCI ACWI Ex-US                   | 7.3%                          | NCREIF ODCE Index                    | 7.1%                          |
| <i>Excess Return</i>              | <i>0.1%</i>                   | <i>Excess Return</i>                 | <i>1.0%</i>                   |
| SURS Global Equities              | 13.6%                         | SURS REITS                           | 6.6%                          |
| MSCI ACWI                         | 10.7%                         | FTSE EPRA/NAREIT Developed Index     | 5.6%                          |
| <i>Excess Return</i>              | <i>2.9%</i>                   | <i>Excess Return</i>                 | <i>1.0%</i>                   |
| SURS Private Equity               | 17.5%                         | SURS Commodities                     | 11.5%                         |
| DJ U.S. Total Stock Market + 3%   | 16.8%                         | Bloomberg Commodity Index            | 7.3%                          |
| <i>Excess Return</i>              | <i>0.7%</i>                   | <i>Excess Return</i>                 | <i>4.2%</i>                   |
| SURS Fixed Income                 | 0.6%                          | SURS Opportunity Fund                | 3.6%                          |
| Bloomberg Barclays U.S. Aggregate | -0.4%                         | CPI + 5%                             | 7.6%                          |
| <i>Excess Return</i>              | <i>1.0%</i>                   | <i>Excess Return</i>                 | <i>-4.0%</i>                  |
| SURS TIPS                         | 2.1%                          | SURS Hedged Strategies               | 4.1%                          |
| Bloomberg Barclays U.S. TIPS      | 2.1%                          | Performance Benchmark                | 6.8%                          |
| <i>Excess Return</i>              | <i>0.0%</i>                   | <i>Excess Return</i>                 | <i>-2.7%</i>                  |
|                                   |                               | Secondary Benchmark (HFRI FOF Index) | 5.5%                          |
|                                   |                               | <i>Excess Return</i>                 | <i>-1.4%</i>                  |

Over the past 30 years, the SURS portfolio has performed well, earning an 8.5% annualized rate of return, exceeding both the policy portfolio return and the 7.25% assumed rate of return<sup>2</sup>. In inflation-adjusted terms, the Total Fund returned 5.9% over this time period, exceeding the actuarial real assumed rate target of 4.5% (7.25% less the 2.75% assumed rate of price inflation).

When compared to a universe of other large public funds, the SURS return ranks in the third quartile for the one- and three-year periods and ranks above median for the five- and ten-year periods ending June 30, 2018, as illustrated in the chart that follows. Asset allocation is the primary determinant of a fund’s ranking in a peer universe.

**SURS Total Fund vs. Public Funds > \$1 Billion**  
 Periods Ending 6/30/18  
 (1 = Best, 100 = Worst)



### Fiscal Year 2018 Accomplishments

The following projects were completed during Fiscal Year 2018.

- Investment Consultant Search** – A consultant search was completed during FY 2018 resulting in the selection of PCA as general investment consultant for the defined benefit plan in February 2018. In addition, Cammack Retirement Group was selected as a defined contribution consultant at the March 2018 meeting. At the April 2018 meeting the Board approved the issuance of a Real Estate consultant RFP. The Real Estate consultant search is expected to conclude at the September 2018 meeting.
- Initiation of Asset-Liability Study** – PCA immediately introduced the Board to the importance of developing and documenting sound investment beliefs. At the same time, PCA introduced their asset-liability process to the Board. Initial asset-liability outputs will be presented to the Board in September 2018.
- Procurement** – After a collaborative process with staff and Board, an updated investment procurement policy was adopted in March 2018. The new procurement policy allows specialty consultants to operate more efficiently when introducing new strategies while maintaining or improving the rigor of evaluation. The procurement policy was drafted as a stand-alone policy and required a minor restatement of the Investment Policy. Diversity initiative goals were also updated in the Investment Policy update.

<sup>2</sup> On March 9, 2018, the SURS Board of Trustees approved lowering the System’s assumed rate of investment return to 6.75% from 7.25%. The rate was effective as of July 1, 2018.



- **Board Reporting** – Performance reporting and qualitative manager/strategy information dashboards have been constructed over the past year. Comments regarding the format and content of investment reporting will be considered as updates continue.
- **Consideration of Private Real Estate Debt and other Real Estate Strategies -**  
Staff completed a search for Real Estate Debt firms with the intent to commit \$60 million. Two firms, Oaktree Capital Management and Basis Investment Group (an MFDB firm), each received \$30 million commitments.

While not contemplated when preparing the Investment Plan, a recommendation to terminate the UBS Trumbull Property Fund was approved in December 2017. As a result, staff recommended a search for core plus real estate managers, which resulted in recommended allocations of \$200 million to the Blackstone Group and \$100 million to the Carlyle Group.

- **Implementation of 2017-18 Commitments in the Private Equity Portfolio –**  
Consistent with the Private Equity pacing plan approved in June 2017, the Board approved a commitment to the 2018 Adams Street Partners Global Fund in April 2018. Also, commitments to Mesirow Financial Private Equity commenced during the fiscal year. Additional commitments to private equity providers will be considered in FY 2019.
- **Education on the Hedged Strategies Portfolio and Consideration of Potential Alternative Strategies -**  
Hedge Fund Day occurred on November 9, 2017. PAAMCO Prisma and SURS' general investment consultant discussed the current hedge fund structure and provided detailed reviews for several underlying managers.

At the October 2017 Investment Committee meeting, the Board approved a search for Equity Index Option Risk Premia Capture Strategies. In general, these products use options-based strategies to capture a volatility risk premia and typically offer a risk reduction benefit in the form of a lower correlation to the equity market. The search concluded in February 2018 with the retention of three firms: AQR Capital Management, Gladius Capital Management, and Neuberger Berman. All three strategies were funded in late FY 2018, with the hedge fund-of-fund portfolios serving as the funding source.

- **Self-Managed Plan (SMP)** – At the March 2018 Investment Committee Meeting, the Board hired Cammack Retirement Group (Cammack) to be the consultant for the SMP. Cammack has completed their initial assessment of the plan and will present to the Board in September 2018. Cammack has met with existing providers in the SMP to fully understand the services provided as well as additional service capabilities. Cammack and SURS staff have been conducting planning calls in preparation for beginning a provider search in late FY 2019.
- **Commitment to Diversity** – SURS continues to be strongly committed to diversity throughout the investment program. In total, 20 firms owned by minorities, females, or persons with a disability (MFDB) directly manage a total of \$5.8 billion, or 30.1% of the Total Fund, as of June 30, 2018. SURS employs a multi-strategy approach designed to maximize opportunities for qualified firms.

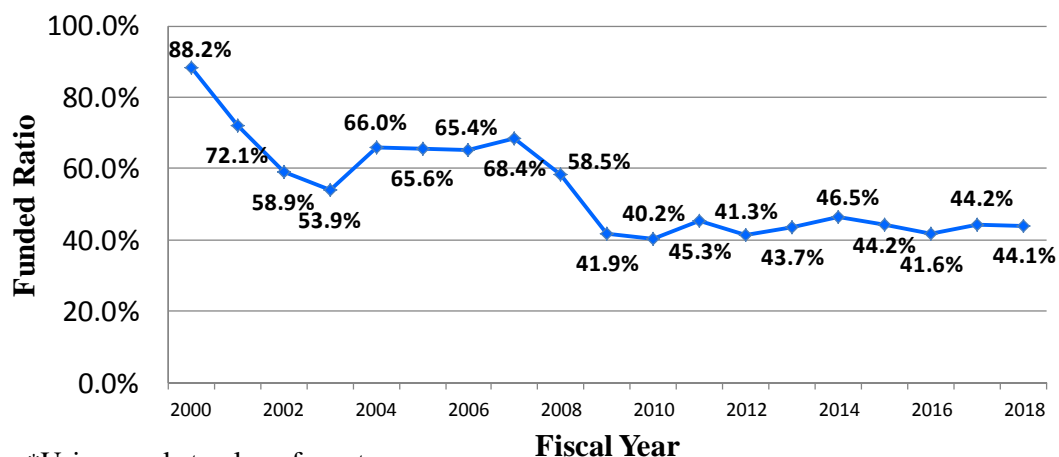
- The Manager Diversity Program (MDP) is a SURS-sponsored initiative designed to identify and provide opportunities to highly successful MFDB investment management firms. Managers in the MDP contract directly with SURS. As of June 30, the MDP totals \$3.4 billion and includes 18 minority- or female-owned investment managers across 21 strategies.
  - Increase in MDP assets of approximately \$467 million during Fiscal Year 2018.
  
- Second, SURS has retained Progress Investment Management (Progress), a minority-owned firm, to serve as a manager of emerging managers. This collaboration with Progress allows SURS to extend its reach into the minority manager universe. As of June 30, the Progress program includes 12 minority- or female-owned investment managers (with 13 mandates) and has total assets of \$495 million. The program includes investments in the non-U.S. equity, core fixed income, and emerging market debt asset classes.
  - Increase in assets with Progress of approximately \$67 million during Fiscal Year 2018.
  
- It is important to note that SURS' commitment to diversity extends beyond the bounds of the MDP and the Manager of Emerging Managers Program. In addition to the firms previously mentioned, SURS contracts with one other MFDB firm, bringing the total number of MFDB firms in direct partnership with SURS to 20. As mentioned previously, assets managed for SURS by these 20 firms are approximately \$5.8 billion, or 30.1% of the Total Fund, as of June 30, 2018.
  - Increase in total assets with diverse firms of approximately \$686 million during Fiscal Year 2018.

## Challenges

The continuing challenge to SURS remains the funding status of the Plan. Despite strong long-term returns, SURS remains substantially underfunded.

- SURS is estimated to be approximately 44.1% funded, as of June 30, 2018 (using the market value of assets and a 7.25% return assumption), a slight decrease from 44.2% funded, as of June 30, 2017.

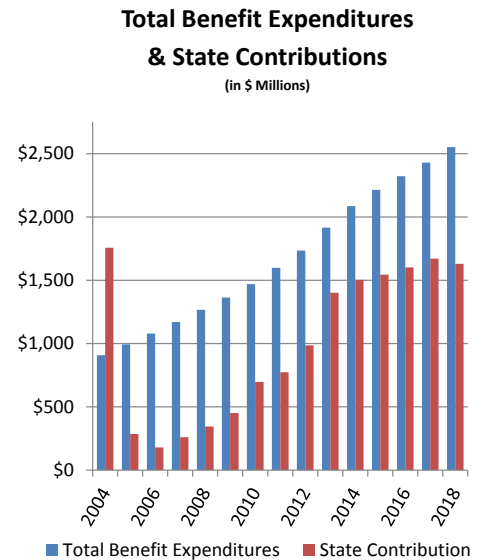
**SURS Funded Ratio\*  
FY2000 to FY2018**



\*Using market value of assets

- The unfunded liability is estimated to be approximately \$24.2 billion. It is important to note, however, that since FY 2011, SURS has received the full annual statutory contribution from the State of Illinois. The FY 2019 contribution is \$1.66 billion.

- The Plan’s cash needs continue to increase. SURS expects to pay approximately \$2.65 billion in benefit payments in Fiscal Year 2019, per the Fiscal Year 2017 actuarial valuation report prepared by SURS’ actuary, Gabriel Roeder Smith & Company.



### Trustee & Staff Education

SURS strives to provide high quality continuing education for the Board of Trustees and the staff. Educational topics are routinely included on Investment Committee agendas. In addition, longer, more in-depth educational sessions, often facilitated by guest speakers, are provided in periodic Investment Forums. These sessions provide both staff and Trustees the opportunity to expand their investment knowledge and keep current with new trends in the marketplace. Input is sought from Trustees on topics of interest for future educational sessions. A key focus is on identifying potential investment opportunities that could positively impact the investment portfolio.

Educational topics for the coming year will be tailored to provide insight into efficient implementation of the new policy targets resulting from the completion of the asset-liability study.

### Corporate Governance

SURS continues to place a high priority on corporate governance. Proxy voting is one important component of the System’s corporate governance responsibilities. Additional actions pertaining to corporate governance include membership in the Council for Institutional Investors (CII), a nonprofit organization of more than 125 pension funds, foundations, and endowments with combined assets of more than \$3.5 trillion. CII’s mission is “to educate its members, policymakers and the public about corporate governance, shareowner rights and related investment issues, and to advocate on members’ behalf.”

### Investment Management Fees

SURS pays close attention to the level of investment management fees paid to its external investment managers. Fees are negotiated with investment managers prior to the commencement of the relationship with SURS and may be subsequently renegotiated, if appropriate, especially in instances where an investment manager receives an additional allocation(s). Fees vary significantly among investment managers, with the services of private markets managers, such as

those in real estate, private equity, infrastructure, etc., being generally higher than those of public markets managers.

During Fiscal Year 2018, staff negotiated more favorable fee arrangements with six new and existing investment service providers. In addition, a passive provider search resulted in more favorable fees for SURS. In aggregate, these fee reductions and asset reallocations are expected to result in approximately \$1.7 million in annual fee savings. In total, SURS paid approximately \$72.5 million or approximately 38 basis points in investment management fees and administrative expenses for Fiscal Year 2018. Total investment management fees for Fiscal Year 2019 are projected to increase by \$2.7 million from Fiscal Year 2018 budgeted fees.

### **III. Fiscal Year 2019 Strategic Initiatives**

Each year Staff undertakes initiatives to assist the Board with the goal of achieving more effective and cost-efficient implementation of investment strategies and positively contribute to the health of the System. The initiatives outlined below are often related and long term in nature.

#### **Adoption of Investment Beliefs**

With the assistance of PCA, SURS' general investment consultant, the SURS Board has embarked on a project to establish a set of Investment Beliefs. The objective of the Investment Beliefs project is to capture, in a deliberate manner, key high level beliefs that underpin the investment decision-making framework at SURS. Documenting such Beliefs allows current and future SURS Board Trustees and staff to utilize them as guiding reference for managing future investment activities. This project is expected to be completed during the first half of Fiscal Year 2019.

#### **Asset / Liability Study**

The purpose of an asset-liability study is to evaluate the interaction of SURS assets, liabilities, (future benefit obligations), and contributions. The liability and contribution forecasts are based on the recent actuarial experience study completed by SURS' actuary, Gabriel Roeder Smith & Company. SURS' general investment consultant, PCA, uses capital market assumptions to develop a range of acceptable portfolios (asset allocation). An asset-liability study combines the forecasts of plan liabilities and expected contributions with different asset allocations, allowing for a more robust evaluation of the possible financial condition (funded status) of plan over time.

The purpose of the asset allocation policy is to establish an Investment Policy framework for SURS with a high likelihood, in the Board's judgment, of realizing SURS' investment objective. This is a critical step as the continued sustained growth of SURS assets is a necessary component to achieving long-term sustainability. SURS last conducted an asset-liability study in 2014. The Strategic Policy Targets resulting from the prior study are shown on the following page.



### SURS Asset Allocation Policy Targets

| Asset Class                | Strategic<br>Policy %<br>(Approved June 2014) |
|----------------------------|---|
| U.S. Equity                | 23%   |
| Non-U.S. Equity            | 19%   |
| Global Equity              | 8%  |
| <b>Total Public Equity</b> | <b>50%</b>                                    |
| Core Fixed Income          | 19%   |
| Emerging Market Debt       | 3%  |
| TIPS                       | 4%  |
| <b>Total Fixed Income</b>  | <b>26%</b>                                    |
| Private Equity             | 6%  |
| Real Estate                | 6%  |
| REITs                      | 4%  |
| Hedged Strategies          | 5%  |
| Opportunity Fund           | 1%  |
| Commodities                | 2%  |
| <b>Total Alternatives</b>  | <b>24%</b>                                    |
| <b>Total</b>               | <b>100%</b>                                   |

Two key considerations of the current study are determining the key investment beliefs and objectives of the Board, as previously discussed, and the review of functional roles of SURS' assets. Given the challenging funded status of the System and the growing cash flow requirements to pay benefits, it is critical that any allocation policy approved by the Board generate returns that meet or exceed SURS' long-term investment objectives, while seeking to minimize the potential for near-term negative surprises.

The asset-liability study will be organizing SURS' current assets within a functional framework rather than the traditional descriptive-oriented asset-based framework, which means that assets will be grouped by similar risk profiles, rather than asset class name. In addition, a new class, Crisis Risk Offset, will be considered. Functional class descriptions being considered include:

- Non-traditional Growth – Provides growth in excess of Traditional Growth and holds most of the illiquid assets within the portfolio (i.e. Private Equity and Non-Core Real Estate);
- Traditional Growth – Provides growth in-line with traditional Public Equity markets similar to current Total Public Equity;
- Stabilized Growth – lower volatility strategies that are still driven by economic growth / equity beta (e.g., Credit, Emerging Market Debt, Options strategies, and Core Real Estate);
- Inflation Protection – strategies designed to protect principal or provide an offset during periods of high inflation (e.g., TIPS and Commodities strategies);
- Principal Protection – strategies designed to protect principal during most market environments and can be used as a source of liquidity (e.g., Core Fixed Income); and
- Crisis Risk Offset – strategies designed to produce significant appreciation during an extended equity crisis.

The asset-liability study is expected to conclude sometime in mid-FY 2019.

### **Investment Policy Review**

Staff will work with PCA to recommend modifications to the Investment Policy to reflect changes resulting from the completion of the asset-liability study.

### **Transition Manager Search**

A search for transition managers is currently underway. SURS may utilize this short list of providers to assist in executing manager transitions in its investment portfolio. These transitions may involve several types of securities, including: global equities, global bonds, global inflation-linked securities, exchange-traded and OTC derivatives, and currencies, among others. The goal is to retain a focused group of transition managers that, when needed, can transition portions of the SURS investment portfolio.

### **Diversity Initiatives**

SURS will continue to review opportunities in the investment program to consider the utilization of minorities, females and persons with a disability. Investment managers of diversity are always encouraged to participate in the search process if an applicable strategy/mandate is identified.

### **Investment Manager Oversight, Due Diligence, and Risk Management**

A critical duty of the investment team and PCA is to monitor the numerous investment managers under contract with SURS. Each manager plays a role in the success of the overall program and extensive resources are utilized to ensure the strategies are functioning as desired. Risk management monitoring of the program continues to expand and evolve.

### **Fees and Compliance Oversight**

SURS continuously strives to obtain the most favorable fee terms from investment providers. Negotiations and asset reallocations during FY 2018 resulted in annual savings of approximately \$1.7 million. Compliance monitoring efforts include continuous interaction with PCA as well as the custodian, Northern Trust.

## IV. Fiscal Year 2019 Asset Class Initiatives

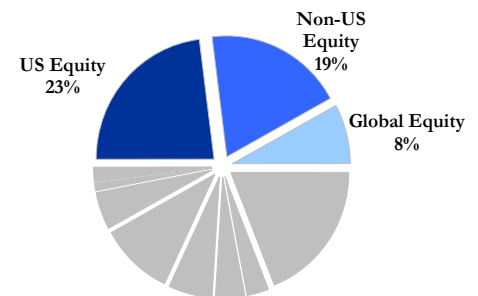
As mentioned previously, the asset-liability study currently in progress will organize SURS’ assets within a functional framework rather than the traditional asset-based framework currently employed. As a result, upon approval of the new functional class roles and strategic policy targets, adjustments to the portfolio are expected during the coming fiscal year.

### Asset Class Structure Studies

Upon completion of the asset-liability study, the Board, with the assistance of PCA and staff, will begin a review of each of the asset class structures in an effort to enhance the effectiveness and cost-efficiency of each portfolio. These reviews are expected to be the primary asset class initiatives in FY 2019, with the resulting implementation potentially spanning multiple fiscal years.

### Public Equity

The current long-term target allocation for public equity is 50% and includes strategies focused on U.S., non-U.S. and broad global equity markets. Implementation is achieved through passive, structured active and active strategies. In aggregate, the public equity portfolio (U.S., non-U.S. and global equity) is 1.0% overweight relative to the strategic policy target.

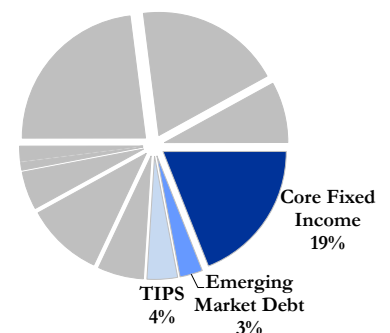


#### FY 2019 Initiatives:

The asset-liability study and introduction of functional roles will be the primary area of focus for the public equity portfolio during FY 2019. Continued emphasis will be on monitoring the portfolio and underlying investment managers for performance that meets or exceeds expectations and for compliance with the Investment Policy and investment manager guidelines. PCA, the general investment consultant for SURS, will assist in the monitoring and strategy efforts.

### Fixed Income

The long-term target allocation for fixed income is 26% and includes core/core-plus, TIPS and emerging market debt strategies. Implementation is achieved through both passive and active strategies. Overall, the total fixed income portfolio is 0.3% overweight relative to the strategic policy target.



#### FY 2019 Initiatives:

A key focus during Fiscal Year 2019 will be a review and reassessment of the fixed income portfolio to determine the optimal structure in what is likely to be a rising interest rate environment going forward. The new structure will be consistent with the functional class definitions currently being considered by the Board. The portfolio will continue to be monitored to ensure that the underlying investment managers meet or exceed expectations for performance as well as compliance with the Investment Policy and investment manager guidelines. PCA will assist in the monitoring and strategy efforts.

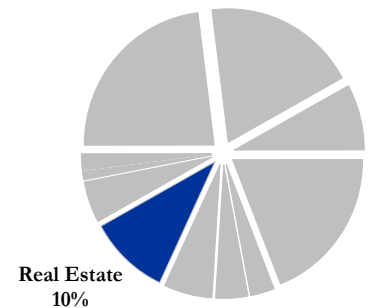
## Alternative Strategies

### Real Estate

As of June 30, 2018, investments in real estate investment trust securities (REITs) comprise 3.9% of the total portfolio, and investments in private real estate investments total 5.5% of the portfolio. Private real estate investments include both core and non-core exposures. The long-term strategic policy target mix allocates 4% to REITs and 6% to private real estate.

#### FY 2019 Initiatives:

The most near term initiative is to conclude the real assets consultant search in September 2018. The consultant will play a key role in the formulation of a long-term strategic plan for the real assets portfolio and will also update the pacing plan to ensure SURS annually deploys capital at a level which allows attainment of the strategic plan over time. New real estate commitments will likely commence in 2019.

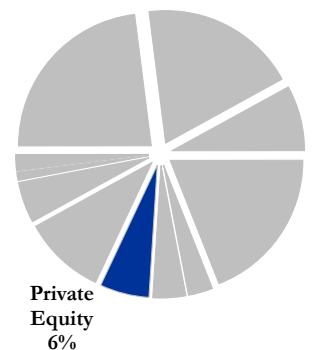


### Private Equity

As of June 30, 2018, the private equity portfolio comprises 5.7% of the total portfolio, slightly under the strategic policy target of 6.0%. Implementation currently is accomplished via fund-of-funds structures. The private equity portfolio is broadly diversified by vintage year, sub-class and geography.

#### FY 2019 Initiatives:

At the June 2017 Investment Committee meeting, the Board approved a five-year private equity funding plan, totaling \$1.7 billion. Implementation of commitments will continue in accordance with the funding plan. The pacing model will be updated during the year to allow for continued vintage year diversification. Other potential initiatives include consideration of a private equity consultant search (subject to Board approval) and discussion of implementation options to increase portfolio efficiency.

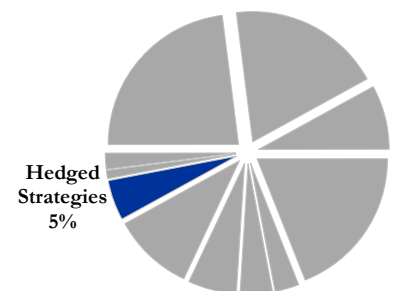


### Hedged Strategies

As of June 30, 2018, the hedged strategies portfolio comprises 5.0% of the total portfolio, in line with strategic policy target. This exposure is implemented through a combination of fund-of-hedge funds strategies as well as options-writing strategies.

#### FY 2019 Initiatives:

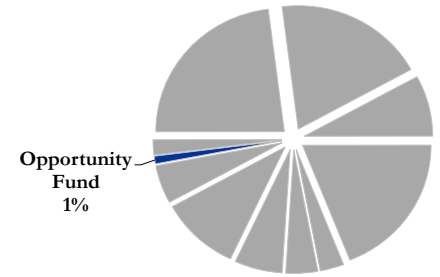
The outcome of the asset-liability study will determine the future course of this asset class.





### Opportunity Fund

As of June 30, 2018, the Opportunity Fund represents 0.6% of the Total Fund, slightly below the 1.0% policy target. Currently, infrastructure investments are the sole component of the Opportunity Fund.

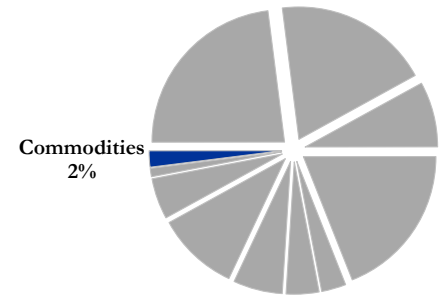


#### FY 2019 Initiatives:

Upon selection by the Board, the real assets consultant would oversee infrastructure investments as well. Initiatives for the infrastructure portfolio will be dictated by the asset-liability study results.

### Commodities

As of June 30, 2018, the commodities portfolio comprises 2.0% of the total portfolio, in line with the strategic policy target. Implementation is achieved through both long only and long/short strategies.



#### FY 2019 Initiatives:

The outcome of the asset-liability study will determine the future course of this asset class.

### Cash Overlay

A cash overlay program was implemented in September 2014. The program is designed to assist the Plan in remaining fully invested consistent with policy targets and to efficiently manage exposure to cash flows. The overlay program also allows efficient implementation of rebalancing and changes to asset allocation targets.

### Projected Timeline

A chart illustrating a projected timeline of the major investment projects slated for Fiscal Year 2019 is shown on the following pages. It should be noted that other projects may arise during the fiscal year, including, but not limited to, potential manager terminations or other ad hoc projects.



## V. Manager Diversity Program

### Overview

The Manager Diversity Program (MDP) is a SURS-sponsored initiative designed to identify and provide opportunities to highly successful investment management firms owned by minorities, females, and persons with a disability.

Key items of note:

- Developed in 2004 to identify and retain MFDB firms
- Managers contract directly with SURS
- Market Value of \$3.424 billion, as of June 30, 2018
- 6 components:

| Asset Class              | Number of MFDB Firms | Market Value* as of June 30, 2018 | Commitment Amount (Private Equity & Real Estate Only) |
|--------------------------|----------------------|-----------------------------------|---|
| <b>U.S. Equity</b>       | 6                    | \$1,488 million                   | N/A   |
| <b>Core Fixed Income</b> | 4                    | \$743 million                     | N/A   |
| <b>Non-U.S. Equity</b>   | 3                    | \$944 million                     | N/A   |
| <b>Private Equity</b>    | 2                    | \$79 million                      | \$200 million   |
| <b>Real Estate</b>       | 2                    | \$74 million                      | \$195 million   |
| <b>Total Hedge Funds</b> | 1                    | \$95 million                      |   |
| <b>Total</b>             | 18**                 | \$3,424 million                   |   |

\*Totals may not add due to rounding

\*\*18 firms and 21 strategies due to two strategies with one private equity investment manager, two strategies with one real estate manager, and two options strategies with one manager.

### Performance Objectives

The performance objective of the MDP is to seek annualized investment returns, net of investment management fees, in excess of the market goal for 1, 3, 5, and 10 year periods. While individual investment managers may underperform in any given year, the diversification within the program should limit the underperformance at the program level.

### Fiscal Year 2018 Performance Review

The MDP outperformed its benchmark during Fiscal Year 2018 primarily due to manager outperformance relative to the benchmark in the U.S. equity portfolios and the Core Fixed Income portfolios. The best relative performers included Piedmont, EARNEST, Gladius, and Garcia Hamilton. In terms of best absolute performance, Piedmont returned 16.8% versus 14.4% for the S&P 500, and Gladius returned 15.8% versus 14.4% for the S&P 500. As a result, the MDP was ahead of the benchmark for the one-year, as well as for the three-year, five-year, and since inception time periods.

**Investment Performance\***  
**As of June 30, 2018**

|                  | <b>1 Year</b> | <b>3 Years</b> | <b>5 Years</b> | <b>Since Inception</b> |
|------------------|---------------|----------------|----------------|------------------------|
| <b>SURS MDP</b>  | 8.7%          | 6.7%           | 7.5%           | 6.3%                   |
| <b>Benchmark</b> | 8.3%          | 6.6%           | 7.3%           | 6.2%                   |

\*Net of investment management fees

**Fiscal Year 2018 MDP Accomplishments**

As of June 30, 2018, the MDP is valued at approximately \$3.4 billion. A summary of MDP activities follows.

- SURS completed an RFP focused on MFDB firms to provide portfolios in multiple U.S. equity asset classes. The search resulted in the hiring of Denali Advisors, Matarin Capital, and a new allocation to Channing Capital.
- SURS made a commitment of \$30 million to the Basis Real Estate Fund I.
- SURS made an additional allocation of \$95 million to Gladius for a Volatility Risk Premia Options strategy.

SURS' commitment to diversity extends beyond the bounds of the MDP. In addition to the 18 firms utilized in the MDP, SURS contracts with two additional MFDB firms, bringing the total number of MFDB firms in partnership with SURS to 20. In the most recent Investment Policy, SURS has implemented guidelines for a graduation program for firms in the manager of manager funds to receive direct allocations from SURS. Also, SURS' hedge fund of funds providers are required to allocate at least 20% of each portfolio to MFDB firms.

Assets managed for SURS by these 20 firms are approaching \$5.8 billion, or 30.1% of the Total Fund, as of June 30, 2018.

**Fiscal Year 2019 MDP Initiatives**

Plans for the MDP in FY 2019 include the following:

- Expand industry outreach efforts
- Continue diligent monitoring of the overall program, manager structure, and risk parameters within the program
- Provide a thorough review of the MDP to the Board at the March 2019 Board meeting
- Identify potential opportunities to increase funding for existing qualified investment managers
- Continued interaction with system consultant, PCA, via more frequent discussions regarding MFDB investment managers



## VI. Self-Managed Plan

### Overview

The Self-Managed Plan (SMP) is a defined contribution option available to SURS members. The SMP has grown steadily since the plan's inception in April 1998. Highlights of the plan include:

- Approximately \$2.4 billion in assets as of June 30, 2018
- SMP forfeiture assets were \$16 million as of June 30, 2018
- Disability reserve assets were \$108 million as of June 30, 2018
- One Lead Administrator
  - Fidelity Investments
- Two Service Providers
  - Fidelity Investments (\$1.5 billion in assets)
  - TIAA (\$916 million in assets)
- 29 investment options as of June 30, 2018
  - Includes series of lifecycle funds in both TIAA and Fidelity lineups
- Over 21,000 Participants currently invested
  - 13,286 active participants
  - 7,754 inactive participants

### Fiscal Year 2018 SMP Accomplishments

- Hired Cammack Retirement Group to be the consultant for the SMP.
- SURS continued to utilize and monitor investment options with the lowest cost share classes available as a means to reduce participant cost and enhance investment returns.
- The Dimensional Target Date Retirement Income Funds were implemented August 31, 2018.
- The Vanguard Federal Money Market Fund was added on August 31, 2018, replacing the CREF Money Market Account.

### Fiscal Year 2019 SMP Initiatives

Plans for the SMP in FY 2019 include the following:

- Continue diligent monitoring of the overall program, providers and investment options.
- Provide a review of the providers, investment options, and fees at the September 2018 Board meeting.
- Continue interaction with Cammack via frequent discussions regarding the SMP.
- Begin a provider search in late FY 2019.