



# *SCHOOL EMPLOYEES RETIREMENT SYSTEM OF OHIO*

## **BOARD MEETING HIGHLIGHTS**

### **MAY 2017**

#### **No Changes to SERS' Asset Allocation**

Upon completing the asset liability review that began in September 2016, Chief Investment Officer Farouki Majeed recommended to the Board to keep the current asset allocation. The allocation is 22.5% for US equity, 22.5% for non-US equity, 10% for private equity, 20% for fixed income and cash, 15% for real assets, and 10% for multi-asset strategies. Wilshire Associates, SERS' general investment consultant, supported this recommendation.

SERS and Wilshire explored numerous change options, most involving reduction of the multi-asset strategies portfolio and increases in dedicated mandates such as high-yield bonds, emerging market debt, and master limited partnerships.

Per its policy, SERS is required to perform an asset allocation review every three-to-five years; however, staff is committed to reviewing economic conditions and SERS' return outlook annually, and will adjust the asset allocation as necessary.

#### **Investments Quarterly Report**

David Lindberg of Wilshire Associates, provided the Board with an update of current investment conditions in the U.S., and SERS' third quarter investment results for FY2017.

The U.S. stock market was up 5.61% for the quarter, which marked the sixth straight quarter of US equity gains. The labor market showed signs of stability with an unemployment rate below 5%, with indications that employees were leaving jobs voluntarily through retirement rather than through layoffs.

During Lindberg's presentation, he addressed Board concerns about current and future investment returns.

Despite being warned that investment returns over the next 7-10 years could be lower than expected, this year's returns are currently above 10%. While this is a welcome surprise, Lindberg explained that market fluctuations during any one-year period can cause higher or lower than expected returns, but returns over longer periods like 10 years are a better indication of a market cycle. Current economic conditions seem to indicate a forward-looking market cycle of lower investment returns compared to the one-year trailing period. He urged the Board to stay focused on long-term returns because that is the best indicator of the pension fund's financial health.

Lindberg agreed with the Board that future investment returns alone were not likely to be high enough to significantly improve the financial status of the pension fund.

In the third quarter, SERS' total fund returned 4.49% net of fees, which was above the policy benchmark by 0.56%. Over the last 12 months, the total fund returned 9.22% net of fees, which was above the 8.40% benchmark. All portfolios produced positive returns for the quarter.

Staff also reported that in the last five years, SERS has been able to reduce investment fees from approximately 80 basis points to 67 basis points, which is a 16% decrease.

#### **Global Equities Annual Portfolio Review**

As part of the Board education program, investment staff presented a review of the global equities portfolio.

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#### RETIREMENT BOARD

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*Chair, Employee-Member*

MADONNA D. FARAGHER  
*Vice-Chair, Employee-Member*

JEFFREY T. DELEONE  
*Appointed Member*

JAMES HALLER  
*Employee-Member*

CHRISTINE D. HOLLAND  
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CATHERINE D. MOSS  
*Retiree-Member*

JAMES A. ROSSLER, JR.  
*Appointed Member*

DANIEL L. WILSON  
*Appointed Member*

BEVERLY A. WOOLRIDGE  
*Retiree-Member*

The strategic role for the portfolio is to earn a return premium over treasury bonds by assuming ownership risk in publicly listed companies. The allocation target is 45%, with a range of 35% to 55%. The allocation within the global equities portfolio is 50% to the US equity portfolio, and 50% to the non-US equity portfolio, with a range of 40-60% each. Currently, SERS' global equities portfolio represents 46.2% of the total fund.

The US equity portfolio experienced negative relative returns over the last fiscal year due to manager underperformance, higher risk stocks outperforming lower risk stocks, and cyclical sectors outperforming defensive sectors.

The non-US equity portfolio has consistently outperformed the benchmark in the 1-year, 3-year, 5-year, and 10-year periods.

Staff objectives for FY2018 include improving the US equity portfolio structure by ensuring managers are optimally positioned for the portfolio; improving the risk/return profile by confirming SERS is being compensated for the active risks it is taking; and rebalancing the portfolio as appropriate.

### Total Fund Update

TOTAL FUND BALANCE		
February 28	March 31	Difference
\$13.03 billion	\$13.23 billion	▲ \$200 million
TOTAL FUND RETURN (net of fees)		
Fiscal Year	Calendar Year	3-Year
▲ 9.22%	▲ 4.49%	▲ 6.12%
TOTAL FUND RETURN vs. BENCHMARK		
Fiscal Year	Calendar Year	3-Year
▲ 0.81%	▲ 0.56%	▲ 1.30%

### SERS Commits to Four Investments

The Staff Investment Committee approved a commitment of up to \$50 million to LBC Credit Partners IV, a middle market direct lending strategy within the opportunistic portfolio.

The real assets investment is a \$50 million commitment to Carlyle Realty Partners VIII, a closed-end commingled strategy.

In the private equity portfolio, the committee approved a \$50 million commitment to Levine Leichtman VI, a middle market structured equity strategy, and a \$40 million commitment to Graham IV, a US middle market buyout strategy.

These investments will be funded from cash reserves.

### Executive Director's Update

#### Cost-of-Living Adjustment (COLA) Bill Introduced in the Senate

SB 151, the legislation SERS requires to make changes to the COLA, was introduced in the Ohio Senate on May 18. A companion bill is likely to be introduced in the House soon.

#### SERS Receives Good Fiduciary Audit Report Results

Every 10 years, the Ohio Retirement Study Council (ORSC) contracts with an independent auditor to conduct a fiduciary performance audit on each of the Ohio public pension systems. It audits board governance and administration, organizational structure and staffing, investment policy and oversight, legal compliance, risk management and controls, and IT operations.

The results of SERS' audit were reported to the ORSC at its May 11 meeting. The auditors described SERS as a "well-run organization" with "no red flags in any area." Funston Advisory Services LLC, which was the independent consultant that conducted SERS' audit, will report its findings to the SERS Board in June.

### **ORSC Releases Bi-Annual Investment Performance Results**

Also at the ORSC meeting, RVK, the ORSC's independent investment consultant, presented its six-month update of the Ohio pension funds' investment performance.

The report indicates that in general, the Ohio pension funds were increasing their diversification and reducing risk in their portfolios. In addition, the investment returns realized by all of the Ohio funds were considered to be respectable to very good, when compared to other pension funds in the U.S. SERS ranked in the 12th percentile or above nationally in returns over the 3-, 5-, and 7-year periods.

### **Health Care Update**

Alisa Bennett, an actuary with Cavanaugh Macdonald, presented the 2018 proposed rates for SERS' self-insured medical plans and prescription drug coverage. Bennett discussed the impact on the proposed rates of various recommendations for benefit changes to the non-Medicare medical plans, which included increasing deductibles and out-of-pocket maximums.

SERS staff presented recommendations for benefit changes to the Medicare program, which included increasing Emergency Room co-pay amounts from \$75 to \$100, and a change to the deductible for outpatient procedures.

In terms of pharmacy benefits changes, discussion included moving to mandatory home delivery for maintenance drugs and adopting the Express Scripts (ESI) Diabetes Care Value program for the non-Medicare program.

Moving to mandatory home delivery for maintenance drugs would save the plan \$800,000 annually.

### **Board Receives Education on Financial Statements**

At the Board's request, Tracy Valentino, chief financial officer for SERS, presented an educational session on financial statements. The session reviewed background information on key statements and the types of activities that impact financial results. Covered information included what accounts are reflected in SERS' financial reports, who uses the financial reports, and which financial reports are used most often. Additionally, the Statement of Net Position was explained, along with the impacts of the statement. Valentino also discussed the Statement of Changes in Net Position and the Statement of Cash Flows and their impacts.

### **Monthly Retirement and Survivor Benefit Transactions**

For May, the SERS Board approved 357 active members for service retirements, and 11 survivor benefits for spouses and/or dependents.

### **June Meeting Dates**

The next Board meeting will take place Thursday, June 15, and Friday, June 16 (if necessary) at 8:30 a.m.