South Carolina Retirement System Investment Commission
Meeting Minutes

June 4, 2020 9:30 a.m.
Capitol Center
1201 Main Street, 15th Floor
Columbia, South Carolina 29201
Meeting Location: Video Presentation

Commissioners Present:
Dr. Ronald Wilder, Chair
Dr. Rebecca Gunnlaugsson, Vice Chair
Ms. Peggy Boykin, PEBA Executive Director
Mr. Allen Gillespie
Mr. Edward Giobbe
Mr. Reynolds Williams
Mr. William H. Hancock
Mr. William J. Condon, Jr.

I. CALL TO ORDER AND CONSENT AGENDA

Chair Dr. Ronald Wilder called the meeting of the South Carolina Retirement System Investment Commission ("Commission") to order at 9:30 a.m. Mr. Edward Giobbe made a motion to approve the proposed agenda as presented. Mr. Allen Gillespie seconded the motion, which was approved unanimously.

Mr. Michael Hitchcock, Chief Executive Officer noted that he had received additional comments regarding the draft April 2020 Commission Meeting Minutes that had been posted for review prior to the Commission meeting from Mr. William Condon and that they would be incorporated into the final Minutes if that was the desire of the Commission. The Chair asked Mr. Condon if he would summarize the nature of the additions to the Minutes. Mr. Condon stated that the first addition related to page 3 of the draft April Minutes as to the discussion of the Statement of Investment Objective Policies ("SIOP") that was approved. He explained that he wanted several additional sentences that gave detail about his comments, and secondly he wanted the word "questions" on page 3 changed to "comments". Mr. Hitchcock stated that the comments were consistent with points Mr. Condon raised during the discussion at the April meeting. The Chair asked the Commissioners if they had any objections. Dr. Rebecca Gunnlaugsson stated that she did not have any objections but would like to know exactly would be added. Mr. Hitchcock read the proposed comments into the record. There being no further questions or discussions, the Chair noted that the April Minutes would include the proposed additions. The Chair asked for a vote on the March Minutes, which was unanimously approved. The Chair then asked for a vote on the April Minutes, as amended, which was unanimously approved.

II. CHAIR'S REPORT

The Chair stated that nominations for the Commission Chair and Vice- Chair for the term of 2020 to 2022 were discussed at the April Meeting. Mr. William Hancock was nominated for the position of Chair and Dr. Wilder was nominated for the position of Vice-Chair. The Chair asked for any further nominations, none being heard, the Chair read the motion to elect Mr. Hancock to serve as Commission Chair, and Dr. Wilder to serve as Commission Vice-Chair, for the term commencing on July 1, 2020 and ending June 30, 2022. The motion passed unanimously.

The Chair thanked the Commissioners for their cooperation and thanked Dr. Gunnlaugsson for her assistance. He also thanked Mr. Hitchcock for his support. Mr. Hancock echoed the sentiments of the Chair.

III. CEO's REPORT

The Chair recognized Mr. Hitchcock for the CEO's Report. Mr. Hitchcock thanked the Chair and stated that, since the last meeting, the COVID crisis has continued to shape how RSIC Staff ("Staff") work. He said that Staff have risen to the challenge during the recent significant market turbulence. He also stated that Staff continues to amaze him with the work that has been uninterrupted, and Staff is able to continue to operate in the best interests of the beneficiaries.

Mr. Hitchcock gave an update on RSIC's budget. He explained that the pandemic caused a shutdown of the State's economy, which will impact the State's finances going forward. The General Assembly passed a continuing resolution to permit government to continue to operate past July 1, 2020 and carry forward appropriations from the prior year until the General Assembly passes a full budget. Mr. Hitchcock noted that RSIC only expends Trust funds, not general funds, and that RSIC did not request an increase in its budget this fiscal year. Therefore, the General Assembly's budget decisions do not impact RSIC in the same way as other state agencies. He stated that there was a freeze on the employer contribution amount into the Trust. Instead of a one percent increase that was scheduled for July 1, 2020, the increase will be put on hold by the continuing resolution. Mr. Hitchcock stated that the General Assembly may incorporate a freeze into the budget for the full fiscal year and then resume escalating increases in the next fiscal year. Mr. Giobbe asked about the differences in the Trust funds versus the General Funds. Mr. Hitchcock explained that RSIC will expend Trust funds in the following amounts: 55 percent for salaries and 40 percent towards operating expenses. He stated that he would send Mr. Giobbe the budget presentation.

There being no further questions or comments, this concluded Mr. Hitchcock's presentation.

IV. CIO's REPORT

The Chair recognized Mr. Geoff Berg, Chief Investment Officer, for his report. Mr. Berg stated that in light of the turmoil in the first quarter, he would spend a few minutes discussing some of the economic and market impacts of COVID-19, provide a brief update on steps that have been taken to simplify the portfolio in alignment with the asset allocation simplification framework that was approved at the last meeting, and review the Plan's performance. Mr. Hitchcock echoed Mr. Berg's introductory comments, reiterating that the changes to be discussed by Mr. Berg had been made to align the portfolio with the five asset class plan adopted at the last meeting, not in response to current market conditions.

Mr. Berg outlined the array of economic, market, health, and workplace challenges which RSIC faced during the first quarter. He stated that RSIC had remained focused on managing the Plan's liquidity position to avoid becoming a forced seller of assets, and noted that RSIC maintained its key risk exposures by rebalancing at the end of March, which permitted the Plan to more fully participate in the markets' recovery.

Mr. Berg reminded the Commission that at the end of April, the Commission adopted a simpler policy allocation that would formally take effect in July 2020. He stated that RSIC was well on the way to implementing most of the necessary changes, but would likely be more methodical as it related to some of the credit exposures, waiting until spreads reached more acceptable levels.

Mr. Berg reviewed the impacts of the economic downturn in different areas of the economy, including job losses, industrial production, and impacts on various sectors. He explained that the industries with the greatest losses were leisure and hospitality, healthcare and education services, professional and business services, retail, and manufacturing.

He noted that the percentage of lower income households which had experienced employment income decreases was greater than higher income households. Mr. Berg noted that this is important to South Carolina because one-third of jobs in South Carolina were in sectors hardest hit by the pandemic.

Mr. Berg then gave the Commission an overview of the impacts of COVID-19 on consumption patterns, housing, commercial real estate, and other markets, including energy.

Performance Update

Mr. Berg provided a performance update. He noted that during the quarter, the Plan was down approximately 15 percent, resulting in the fiscal year-to-date return being down nearly 11 percent, compared to the Policy Benchmark's negative 12 percent return for the quarter and negative 7 percent return fiscal year to date. He also stated that during the nine months of the current fiscal year, $3.1 billion in benefits had been paid, compared to

$2.7 billion of deposits into the Plan, and the investment performance had been meaningfully negative in dollar terms thus far.

He then provided detail of the performance on an asset class by asset class basis, pointing out that three months ago the performance had been overwhelmingly positive, but the magnitude of decline across many markets had pulled down returns.

Mr. Berg informed the Board that, for SIOP compliance purposes, the Plan's private market exposure at March 31, 2020 had exceeded the upper end of its range. He explained that this resulted from the overall decline in the Plan value, which had caused private markets assets to total 26 percent of total Plan value. He noted that this had likely reversed in the ensuing weeks, as markets had rebounded considerably since the end of March.

Mr. Berg reiterated that this had been a very difficult quarter for the Plan across the board, but he noted that he had seen early evidence of the benefit of the simple Policy portfolio that the Commission adopted in April, noting that the simple Policy portfolio outperformed the current Policy portfolio by a wide margin, both in the first quarter (3.2 percent) and fiscal year to date (3.1 percent).

Mr. Berg provided an overview of the actions that RSIC had taken over the last few months to transition the Portfolio to the simplified framework. He stated that Staff had taken a number of actions including: moving the public equity portfolio into "passive" investments; further reducing the Plan's liquidity risk by increasing passive core bond exposure in the overlay; reducing most off-benchmark exposures where it did not involve crystalizing meaningful losses; and determining spread levels at which certain of the remaining off-benchmark credit exposures would be reduced.

Mr. Berg noted that these changes are expected to reduce cost by more than $40 million annually.

He indicated that the private equity and private debt benchmarks are lagged by three months, so that as of March 31, these benchmarks had not yet been adjusted to reflect impacts from the COVID-19 pandemic. He explained that in the quarter ending June 30, these benchmarks could be expected to pull down the total Plan policy benchmark return by about 2.4 percent because of how the benchmarks are constructed.

Mr. Berg reviewed the most notable performance impacts versus policy for the quarter ended March 31. At the start of the quarter, core bonds were four percent underweight, which detracted from returns by 60 basis points. The GAA and Portable Alpha managers had a challenging quarter and their underperformance detracted from overall performance by a combined 130 basis points. In the Other Opportunistic portfolio, exposure to Master Limited Partnerships ("MLPs") detracted from returns by almost 40 basis points. Mr. Berg noted that the Plan had a strong relative performance in real assets portfolios (adding 41 basis points), as well as strong relative performance in equity options and public equity portfolios (adding 51 basis points).

He then turned the discussion to the performance framework. He stated that as a result of the severity of the downturn, each of the benchmarks, as well as our portfolio, had turned negative for most time periods. He noted that the Policy Benchmark had outperformed the

Reference Portfolio, while the Implementation Benchmark had lagged the Policy Benchmark.

Mr. Berg then reviewed the portfolio structure, which reveals the impact of two decisions: (1) the decision to overweight or underweight an asset class, and (2) the decision to make an asset class look different than its benchmark. For the quarter, there was a small underweight to equity options which had aided performance. Other decisions detracted from Plan performance: the Plan was slightly overweight in public equity; an underweight in the high-performing core fixed income asset class detracted from returns; portable alpha's hedge fund benchmarks were down materially in the quarter; and the Other Opportunistic portfolio's performance was negatively impacted by its small exposure to MLPs.

The next subject Mr. Berg addressed was quarterly attribution from manager selection. He noted that results were mixed. On the positive side, the Plan saw strong performance in Real Assets and Equity Options relative to the benchmark, while Mr. Berg noted that some small hedges in the overlay had served as a bit of a buffer to overall performance. On the negative side, Mr. Berg indicated that the GTAA portfolio had a very disappointing quarter and noted that RSIC continued to see disappointing performance from certain legacy private debt investments.

Plan exposure changes since December 31, 2019 were reviewed. Mr. Berg noted that the Bonds portfolio's active weight declined by three percent, but noted that this reflected a reduction in the cash position, which was deployed in order to rebalance the portfolio. He indicated that RSIC remained underweight Core Fixed Income at the end of the quarter, and was able to capitalize on the turmoil in the credit markets at the end of the quarter by adding some exposure in Mixed Credit. In the equity portfolios, Mr. Berg noted that RSIC continued to rebalance in February and March to maintain exposure.

Mr. Berg stated that he wanted to give the Commissioners a sense of how portfolio risk had changed. He shared estimates of the volatility of the portfolio over the past two years. He stated that three months prior, all three of the volatility estimates had been between eight and nine percent. He noted that this was a considerable jump and worthy of discussion. He explained that in extreme market environments like those recently experienced, we often see two things: (1) a significant spike in the volatility of all risky assets; and (2) the correlations among risky assets becoming less stable.

Mr. Berg concluded by stating that when this happens, it is critical that RSIC remain disciplined, stick to its rebalancing discipline, and buy assets that have declined in price. He noted that RSIC did this during the first quarter. After a brief discussion, he concluded his presentation.

V. STRATEGIC INVESTMENT TOPICS PRESENTATION – MEKETA INVESTMENT GROUP

a. Long- Term Investing in a Recession

Mr. Hitchcock introduced Meketa Investment Group ("Meketa") Ms. Alli Wallace Stone, Consultant, along with Mr. C. LaRoy Brantley, Consultant and Mr. Peter Woolley, Managing Principal, to present a report on Long Term Investing in a Recession. Mr. Brantley began by explaining some best practices of navigating a bear market. He noted that as long-term investors it is important to remain calm and disciplined in our investment approach. Mr. Brantley also explained that based on the effects of COVID-19 on the global economy, there is the possibility that the United States will enter into a recession during 2020.

Mr. Brantley reviewed the characteristics of a recession, one of them being a significant drop in economic productivity. He stated that there have been 11 recessions since 1947. He went on to provide some historic timelines and duration of extreme markets. He noted that bear markets tend to last two years, but the key to having a bear market is that the recovery exceeds 100% in the following bull market. He explained that portfolio diversification is crucial and that bonds have been important part of that. In response to a question from Mr. Gillespie, Mr. Brantley discussed how diversification can play a role in the portfolio and the impact on government intervention.

There being no further questions, Ms. Stone reviewed some of the thematic mistakes made by peers. She explained four key mistakes by peers, which were (1) being risk-averse in times of market distress; (2) deviating from the plan by refraining from making private markets commitments and losing the opportunity to have adequate vintage year diversification; (3) over-allocating to illiquid assets and being forced sellers in down markets; and (4) seeking to market time and identity the bottom of a market downturn. Mr. Hitchcock noted that Mr. Berg and his team have done a fantastic job ensuring sufficient liquidity for the Trust, and that we do not become forced sellers. He also noted that we had planned for an economic downturn and were ready for this type of event.

Ms. Stone stated that it is crucial to rebalance the portfolio periodically and maintain an understanding of the portfolio's risk. Dr. Wilder asked about the frequency of rebalancing and the timing. Ms. Stone stated that there is not a huge difference from monthly, quarterly, and semiannually, but the key is understanding transaction costs associated with rebalancing. Mr. Gillespie emphasized that rebalancing should be systematic, in the frequency, the reasoning, and the type. Mr. Brantley underscored the importance of having discipline as an investor. Mr. Gillespie then asked how codified the rebalancing policy should be. Mr. Brantley replied that South Carolina is one of the most disciplined and detailed oriented and stated that there needs to be flexibility built in. Mr. Berg stated that he would connect with Mr. Gillespie after the meeting about rebalancing.

Ms. Stone stated that when it comes to opportunistic investments, we should be able to take advantage of them. We should stay the course and not try to market time or shift allocations during times of market distress. She noted that it is important to be forward-thinking, remain disciplined, and avoiding market timing, in order to be a successful long-term investor. The Fund's asset allocation is designed to meet the assumed rate of return over the long-term, despite the potential short-term impacts of a recession.

b. China Accounting and Auditing Results

Ms. Stone reviewed the Holding Foreign Companies Accountable Act that was passed by the Senate in May 2020, which increases transparency of foreign companies being traded on US exchanges. Chinese companies are likely to have the hardest time abiding by the new regulations. Ms. Stone explained that it could impact the Emerging Market Index and could hurt over 200 firms from China that are listed. She noted that the regulations provide three years before companies will be required to be compliant and that some will leave the US exchange for London and Hong Kong exchanges. She stated that in aggregate we do not have a lot of exposure to companies that will be affected in our portfolio.

Mr. Condon expressed concern and asked about defining the scope of lack of oversight. Mr. Woolley stated that there should be caps on country exposure and Meketa is examining China exposure right now. Mr. Berg stated the indexes are designed by people that think about these issues and cautioned that costs might increase. He also stated that he was considering approaching MSCI on how they construct the indexes and how they see the risk and mitigate risk through representation of various countries that do not comply with appropriate standards. Mr. Condon would like to share with Staff and Meketa the SEC's April 1, 2020 statement on Seven Public Risks to Contemplate.

There being no further questions, this concluded Meketa's presentations.

VI. DELEGATED INVESTMENT REPORT

The Chair recognized Mr. Berg for the delegated investment discussion. The following delegated investments were closed by Staff since the April 16, 2020 Commission meeting.

Asset Class	Investment	Investment Amount	Closing Date
Private Equity	Francisco Partners GP VI	Up to $100 M	April 16, 2020
Private Equity	Francisco Partners Agility II	Up to $50 M	April 16, 2020
Private Equity	CVC Capital Partners VIII	€100 M	May 1, 2020
Private Credit	Eagle Point Credit Partners	Up to $100 M	May 6, 2020
Private Equity	CD&R XI	$75 M	May 22, 2020
Private Equity	Bridgepoint Development Capital IV	Up to £75 M	May 28, 2020

A break was taken at 12:15 p.m. The Commission reconvened at 12:25 p.m.

VII. EXECUTIVE SESSION

Dr. Gunnlaugsson moved to recede into Executive Session to discuss investment matters and specific investments pursuant to S.C. Code Sections 9-16-80 and 9-16-320; and receive legal advice as needed from legal counsel pursuant to S.C. Section 30-4-70(a)(2). The motion passed by unanimous consent.

VIII. POTENTIAL ACTION RESULTING FROM EXECUTIVE SESSION

Upon return to open session, Mr. Hitchcock noted that the Commission did not take any action while in Executive Session.

IX. ADJOURNMENT

There being no further business, the Commission adjourned by unanimous consent.

[Staff Note: In compliance with S.C. Code Section 30-4-0, public notice of and the agenda for this meeting was delivered to the press and to parties who requested notice and were posted at the entrance, in the lobbies and near the 15th Floor Presentation Center at 1201 Main Street, Columbia, S.C., 5:01 p.m. on June 1, 2020]