

**ARKANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM
MINUTES OF THE MEETING OF THE BOARD OF TRUSTEES
27th ANNUAL EDUCATIONAL SEMINAR
TUESDAY, OCTOBER 25, 2016**

The Board of Trustees of the Arkansas Public Employees Retirement System held its Twenty-seventh Annual Educational Seminar beginning at 8:30 a.m. and concluding at 4:30 p.m. on Tuesday, October 25th at The Capital Hotel in Little Rock.

BOARD MEMBERS PRESENT:

Mayor David Morris, (City Employee), *Vice-Chair*, Searcy, AR
Ms. Ouida Wright (State Employee Member), Conway, AR
Mr. Bill Gaddy (State Employee Member), Little Rock, AR
Ms. Carol Bevis, (Other, Non-State Employee), Little Rock, AR
Hon. Andrea Lea, (Ex-Officio Member), State Auditor
Ms. Autumn Sanson, (Ex-Officio Member), State Treasurer's Office
Ms. Gail H. Stone (Executive Director), APERS

BOARD MEMBERS ABSENT:

Mr. Artee Williams (State Employee Member), *Chair*
Mr. Larry Walthers, (Ex-Officio Member), Department of Finance and Admin.
Judge David Hudson, (County Employee), Fort Smith, AR

ADDITIONAL VISITORS PRESENT:

Mr. Ryan Ball, Callan Associates, Inc.
Ms. Brianne Weymouth, Callan Associates, Inc.
Mr. Bo Abesamis, Callan Associates, Inc.
Mr. David Hoffman, Gabriel Roeder Smith
Mr. Mita Drazilov, Gabriel Roeder Smith
Mr. Damian Handzy, StatPro
Mr. Mike Wickline, *Arkansas Democrat-Gazette*
Mr. Aaron Kelley, AQR Capital Management
Mr. Sudhir Anantharaman, AQR Capital Management
Mr. Aaron Roberts, Artisan Partners
Ms. Jessie Wilson, Baillie Gifford
Ms. Fraser Thomson, Baillie Gifford
Mr. Joe Faraday, Baillie Gifford
Ms. Jackie Dimitri, Blackstone Group
Mr. Bill Murphy, Blackstone Group
Mr. Carlos Pacheco, BNY Mellon Corp.
Mr. Mike McDermott, BNY Mellon Corp.
Mr. Dan Smith, BNY Mellon Corp.
Mr. Jerry Castellini, CastleArk Management
Mr. Ed Clark, CastleArk Management
Mr. Kevin Dolsen, CastleArk Management
Mr. David Bridges, Fidelity Institutional Assets Management
Mr. Sue Curran, Fidelity Institutional Assets Management
Mr. Lance McInerney, Fidelity Institutional Assets Management
Ms. Melissa Moesman, Fidelity Institutional Assets Management
Mr. Greg Golden, Golden Capital Management
Mr. Jon Cangalosi, Golden Capital Management
Mr. Blaise Keane, Heitman Capital Management
Ms. Anne Westbrook, Heitman Capital Management
Mr. Scott Horrell, Horrell Capital Management
Ms. Kimberly Horrell, Horrell Capital Management
Ms. Leanne Smith, INTECH
Mr. Adam Craig, INTECH
Mr. Vassilios Papathanakos, INTECH
Mr. David Farmer, Invesco Real Estate
Mr. Mark Blackburn, Invesco Real Estate

Ms. Dyice Ellis-Beckham, Invesco Real Estate
Mr. Joe Munoz, LaSalle Investment Management
Mr. Jim Hutchinson, LaSalle Investment Management
Mr. Matthew Walley, LaSalle Investment Management
Mr. Anthony Dote, Lazard Asset Management
Mr. Michael Bennett, Lazard Asset Management
Mr. Al Marley, Lombardia Capital Partners
Ms. Nora Harris, Lombardia Capital Partners
Mr. Louis Cohen, MacKay Shields
Mr. Stephen Buckley, MacKay Shields
Mr. Jeff Coons, Manning & Napier Advisors, Inc.
Mr. Erik Schonberg, Manning & Napier Advisors, Inc.
Mr. Todd Bailey, Mellon Capital Management
Mr. James Blake, Newton Capital Management
Mr. Dan Bezalel, Newton Capital Management
Mr. Barry Beers, Pinnacle Forest Investments
Mr. Hank Page, Pinnacle Forest Investments
Mr. Michael Collins, Prudential Investment Management
Ms. Rupal Shah, Prudential Investment Management
Mr. Florian Eitner, SSI Investment Management
Ms. Wambui Lynch, SSI Investment Management
Mr. Patrick White, Stephens Investment Management
Mr. Ryan Crane, Stephens Investment Management
Mr. Doug Engelman, TA Associates Realty
Mr. Zander Grant, Wellington Management Company
Mr. Ed Baldini, Wellington Management Company
Ms. Susan Schmidt, Westwood Management Company
Ms. Kim Calhoun, Westwood Management Company

STAFF PRESENT:

Mr. Jay Wills, APERS Deputy Director
Mr. Carlos Borrromeo, APERS Chief Investment Officer
Ms. Susan Bowers, APERS Associate Director of Investments
Ms. Jessica Middleton-Kurylo, APERS General Counsel

NEWS MEDIA NOTIFIED:

A letter of notification of the Arkansas Public Employees Retirement System Board meeting was sent to the Arkansas Democrat-Gazette, the Associated Press, Television Station KLRT/FOX16, Radio Station KARN, and Radio Station KAAY. This letter of notification is pursuant to A.C.A 25-19-101 (Act 93 of 1967) as amended -The Freedom of Information Act.

WELCOME:

Mr. Borrromeo welcomed everyone to the 27th Annual Trustee Educational Seminar and introduced the Trustees to all the investment managers. He explained the new, electronic format of the seminar and reminded everyone about the Bull and Bear Award at the end of the conference. Mr. Borrromeo introduced the Trustees and then introduced the theme for this year's Educational Seminar: Risk. He said after each panel spoke, there would be a round of Questions and Answers, before moving to the next area of risk. He then gave a brief biography of the guest speaker who would be presenting later in the day, before turning the microphone over to the two Callan consultants to speak on Consultant Risk.

CONSULTANT RISK:

- Ms. Brianne Weymouth, Callan Associates
- Mr. Ryan Ball, Callan Associates

Mr. Ball discussed how Callan puts an investment portfolio together for their clients. They stressed diversity in the portfolio and staying away from unproven strategies in an effort to capture the 7.5% needed by their institutional clients. Ms. Weymouth discussed how as return expectations have declined over the past 20 years, investors seeking a fixed rate of return, such as 7.5%, have been compelled to "risk up" their portfolios, taking on more risk,

complexity, illiquidity, and volatility. Plan sponsors were struggling to get every bit of income out of their portfolios.

CUSTODIAL RISK:

- Mr. Bo Abesamis, Callan Associates
- Mr. Dan Smith, BNY Mellon
- Mr. Damian Handzy, Stat Pro (formerly Investor Analytics)

Mr. Abesamis spoke of the responsibility of the Investment Consultant to protect the assets of the clients and the definition of custody. He spoke of the “Custody Rule” and how the Back Office and Middle Office at Callan supported the highly visual Front Office, ensuring that the assets are accounted for the interest of investors and beneficial owners.

Mr. Smith detailed how Custodial Banks, such as BNY Mellon, mitigated risk for their clients. While the banks took no responsibility for the performance of the investments, it was their duty to make sure the client’s investments were always accessible to them, within the constraints of the investment vehicle. He noted how the complexity of investments and evolving marketplace will determine competitiveness, survival of the fittest, and discipline in managing client expectations.

Mr. Handzy talked about Market Risk Analytics and explained how his company looked for potential financial losses due to diversification, correlations and sensitivities to factors as well as risk by manager and asset class.

BREAK

DOMESTIC EQUITY RISK:

- Mr. Ed Baldini, Wellington Management
- Mr. Al Marley, Lombardia Capital
- Ms. Susan Schmidt, Westwood Group

Mr. Baldini noted that Wellington’s group for “Manager Analytics” had formed about ten years ago to focus on how active equity managers take risk. They used a set of predetermined factors to understand the biases of active managers. This allows Wellington to structure multi-manager portfolios and still manage the over-all volatility of the portfolios through various market cycles.

Mr. Marley gave a brief overview of the two risks Lombardia felt were inherent in managing any client’s portfolio: systematic (market) risk and residual risk. He broke residual risk down into Specific Risk (stock-picking decision) and Extra-Market Covariance (factor weighting decision). Wrapping up, he acknowledged that outside forces such as the price of oil, U.S Presidential election, BREXIT and other geopolitical events were also risks that affected portfolio performance.

Ms. Schmidt discussed risk on a stock-specific level and how hidden interactions can complicate combining stocks in a portfolio. She categorized Westwood as being “Benchmark-agnostic” which added another level of risk. Ms. Schmidt noted the market was currently in the midst of the second longest Bull market on record putting most portfolio managers in an environment that they had never been in before.

INTERNATIONAL EQUITY RISK:

- Mr. Joe Faraday, Baillie Gifford
- Mr. Jeff Coons, Manning & Napier Advisors
- Mr. Michael Bennett, Lazard Asset Management

Mr. Coons spoke of how Manning & Napier divided “Investment Risk” into three basic types: Capital Risk (possibility of unrecoverable or permanent losses over investment time frame), Inflation Risk (chance of lost purchasing power resulting from investment earnings not keeping up with rate of inflation), and Reinvestment Rate Risk (risk of lost earnings

power or failing to achieve adequate total returns over investment time frame). He stressed that Volatility was not Capital Risk and should be thought of as a buying opportunity.

Mr. Faraday, of Baiollie Gifford, built on what Mr. Coons had outlined by discussing "Approach to Risk" and "Risk versus Opportunities". He noted that everyone was trying to take risks, but sought to do it in a controlled manner. There were three simple lines of defense when it came to risk in assembling a portfolio: get the stock research right; have broad, pragmatic guidelines in place to channel the risks; and challenge the facts to discover the truth. Mr. Faraday went further and used examples of regions and sectors could be looked at as a risk or an opportunity. He closed admonishing the audience that "Risk is not a bad word."

Mr. Bennett stated that Lazard's objectives were beating the benchmark by 200-300 basis points, at a very low level of risk. While they could not control the markets, they could control the stocks in their portfolios. He discussed the day-to-day volatility in the market and gave examples of perceived risk versus actual risk. Lazard mitigates macro uncertainty by avoiding large directional bets (staying balanced) and focusing on relative value ideas.

QUANT/CONVERSION RISK:

- Mr. Vassilios Papathanakos, INTECH
- Mr. Greg Golden, Golden Capital Management
- Mr. Florian Eitner, SSI Management Group

Mr. Papathanakos described the portfolio INTECH had maintained for APERS for the last 12 years. He said that risk management was a very big part of this mandate and INTECH's goal was to outperform over the long term, capturing the source of the outperformance volatility in ways that controls tracking error. He explained that they used a very systematic process and implemented it in a disciplined fashion. Volatility was at the core of how they built portfolios to capture the fluctuations.

Mr. Golden focused on how Golden managed APERS' enhanced large cap portfolio and stressed the need for a long-term investment horizon since equities were long duration assets. He showed the power of compounding and consistent results, detailing how Golden did this in a very risk-controlled framework.

Mr. Eitner commented how SSI had managed convertible bonds for APERS for over 26 years. He explained the features and attraction of convertible bonds. Specific risks associated with convertibles included equity valuation, credit, interest rates and concentration, with the first two being the most important. SSI focuses on buying Balanced Convertible Securities with greater upside participation than downside participation.

LUNCH

APERS BOARD MEETING

Ms. Stone announced the Mr. Williams had a family emergency and Vice-chair Mayor Morris would preside in his place. Ms. Stone convened the Special Board Meeting and recognized the presence of a quorum.

BOARD MEMBERS PRESENT:

Mayor David Morris, (City Employee), *Vice Chair*, Searcy, AR
Ms. Ouida Wright (State Employee Member), Conway, AR
Mr. Bill Gaddy (State Employee Member), Little Rock, AR
Ms. Carol Bevis, (Other, Non-State Employee), Little Rock, AR
Hon. Andrea Lea, (Ex-Officio Member), State Auditor
Mr. Autumn Sanson, (Ex-Officio Member), State Treasurer (*non-voting*)
Ms. Gail H. Stone (Executive Director), APERS

BOARD MEMBERS ABSENT:

Mr. Artee Williams (State Employee Member), *Chair*
Mr. Larry Walthers, (Ex-Officio Member), Department of Finance and Admin.
Judge David Hudson, (County Employee), Fort Smith, AR

STAFF PRESENT:

Mr. Carlos Borromeo, Chief Investment Officer, APERS
Ms. Susan Bowers, Associate Director of Investments, APERS
Mr. Jay Wills, Deputy Director, APERS
Ms. Jessica Middleton-Kurylo, APERS General Counsel

ADDITIONAL VISITORS PRESENT:

Mr. Ryan Ball, Callan Associates, Inc.
Ms. Brianne Weymouth, Callan Associates, Inc.
Mr. David Hoffman, Gabriel Roeder Smith
Mr. Mita Drazilov, Gabriel Roeder Smith

APPROVAL OF NEW EMPLOYER: SOUTH BEND FIRE DISTRICT

Ms. Stone noted that per A.C.A § 24-4-729, the APERS board must approve all new employers. The South Bend Fire District is seeking entrance into APERS and has one employee. Mr. Wills had reviewed their application and found it acceptable. Their entrance now required a vote of approval from the board.

Mr. Gaddy motioned to approve the South Bend Fire District into APERS. He was seconded by Ms. Wright. Mr. Will explained that they were an instrumentality of the state and therefore could not seek inclusion into LOPFI. Motion passed unanimously.

OFFICE OF STATE PROCUREMENT GUIDANCE - REQUEST FOR PROPOSAL

Ms. Stone explained that at the request of the board, she had sought advice from State Procurement regarding requirements for performing an RFP. She had talked at length with Mr. Ed Armstrong, the director of State Procurement, who said the APERS' board had full discretionary powers in such matters. Ms. Stone explained the unusual situation between Horrell Capital and Mr. Ellis Sloan to him and he opined that the Board had acted correctly in this matter, however if the trustees wished to perform an RFP, OSP would assist and the process would take about six months. Mr. Armstrong cautioned that changing investment managers for reasons other than institutional investment reasons was a slippery slope. He did make it clear that the Board was under no obligation to do anything that is outside its fiduciary capacity.

Mayor Morris thanked Ms. Stone for her report and asked if there was any interest by the Board to continue the discussion or take any action. There were no responses to his question.

DISTRICT JUDGES ANNUAL ACTUARIAL VALUATION - Presented by Mr. David Hoffman & Mr. Mita Drazilov of Gabriel Roeder Smith and Company

Mr. Hoffman reminded them that it was usually at this meeting that the board set the Employer rate for District Judges upcoming fiscal (2018) year. Reading off the handout, he listed the various computed Employer Contributions for the three different plans. For the "New Plan" and the "Paid-off Old Plan" he showed the calculations leading up to an Employer Rate of 24.82% (down slightly from 25.55% last year) and with a 12-year amortization. The "Still-Paying Old Plan" was shown at \$861,106 - the sum owed by all the old employers still paying and factored against a 19-year amortization.

After a short discussion, Ms. Bevis motioned to follow the actuaries' recommendation and adopt the 12-year amortization period with a District Judges Employer Contribution Rate for Fiscal Year 2018 of 24.82% (beginning July 1, 2017). The motion also covered the \$861,106 owed by the "Still-Paying Old Plan". Mr. Gaddy seconded. There was further discussion on the rates and Mr. Drazilov notified that board that those numbers were based upon a 7.5% Assumed Rate of Return. If the Board adopted a lower rate at the November meeting, these numbers would change substantially, so he proposed that the Board leave the rates unchanged until a later date. Mr. Gaddy withdrew his second, and after a minor discussion, Ms. Bevis also withdrew her motion.

Ms. Wright motioned to leave the Employer Rate at 25.55% for now and she was seconded by Ms. Bevis. Motion passed.

ADJOURNMENT:

There being no further business, the board meeting was adjourned.

APERS EDUCATIONAL SEMINAR RESUMES

KEYNOTE SPEAKER:

After lunch, Mr. Borromeo introduced Mr. David Bridges, a security analyst at Fidelity Institutional Assets Management, who presented his views on Risk from current market events and his optimistic outlook for the global economy.

TECHNOLOGY RISK:

- Mr. Sudhir Anantharaman, AQR Capital
- Mr. Bill Murphy, Blackstone
- Mr. Dan Bezalel, Newton Investments

Mr. Sudhir of AQR Capital opened with the dangers of “cyber” when discussing investing risk. He stated that the cyber-attacks he had witnessed on various financial institutions were extremely targeted and were financially motivated.

Mr. Bill Murphy spoke about the changes in cyber security over the last 5 years. Early on, companies worked to build higher and thicker electronic walls to protect their assets. Today, corporations had multi-layer programs in place to detect and respond immediately to cyber-attacks. He acknowledged that capable electronic security came at a cost and said that Blackstone had grown their cyber security budget by over 300% in the last 5 years. He stressed that educating staff to be aware and report unusual activity was paramount to the success of the security programs.

Mr. Dan Bezalel, head of development at Newton Investments, emphasized the connections between Risk and Opportunity that had been discussed by prior seminar presenters. He noted that everyone in the room had at least one mobile device with them demonstrating how important it was to give people the right tools, but making sure that proper controls were securely in place. Mr. Bezalel stressed that “Security was a team sport” and described a culture where all employees were aware of the risks and participate in security.

BREAK:

REAL ASSET RISK:

- Mr. Jerry Castellini, CastleArk Management
- Mr. Hank Page, Pinnacle Timberland Management
- Mr. Doug Engelman, TA Realty

Mr. Jerry Castellini highlighted the special risks associated with “hard assets” and energy in particular. He spoke of the need for diversified portfolios with uncorrelated assets, which energy filled and spoke of the over-supply of crude oil from 2014-2016. Mr. Castellini explained that prices were recovering and the return on energy investments would be positive.

Mr. Hank Page discussed investment risks involved in managing timberland for APERS and reiterated the point that risk was not always negative. Timberland historically has a low correlation with most financial assets, but reflective of general economic conditions and timber grows regardless of current economic conditions. He discusses price and demand fluctuations, product substitution and local markets risks.

Mr. Doug Engelman spoke of TA’s closed-end, commingled, value-add Real Estate funds. He noted the portfolios risk was mitigated by diverse locations, property-type, industry exposure and timing of execution strategies. TA Realty believes revenue and net operating income growth associated with value-added investments can offset future capital market concerns.

FIXED INCOME RISK:

- Mr. Lou Cohen, MacKay Shields
- Mr. Michael Collins, Prudential Fixed Income

Mr. Lou Cohen discussed Credit Risk in a world with too much capital, technology and “stuff”. He explained these factors produced low yields, investors chasing high risk/reward and companies responding with more leverage and pursuing higher return opportunities. MacKay expected continued slow growth, elevated idiosyncratic risks and volatile credit markets.

Mr. Michael Collins wrapped up the discussion of risks in a Fixed Income portfolio, focusing mainly on Interest Rate, Credit and Liquidity Risk. He posed the question “What if these low rates are the new normal and not just the bottom of the cycle?” He felt that this was going to be the world for Fixed Income managers for many years to come. Mr. Collins explained which sectors Prudential was avoiding and which they were investing in based upon this perspective.

CLOSING REMARKS & BULL/BEAR AWARD – Presented by Mr. Carlos Borrromeo

Mr. Borrromeo thanked everyone for their assistance and participation at the Annual Educational Seminar and announced the 2016 Bull/Bear Award. He congratulated Lou Cohen, from MacKay Shields, who guessed within 11 points of the Dow Jones closing number on June 30, 2016. The actual closing number was 17,929. Mr. Cohen guessed 17,940. Mr. Borrromeo especially thanked Ms. Susan Bowers for all her work over her 38 years at APERS and commented that 2017’s Educational Seminar would be all his responsibility, since Ms. Bowers was retiring. He thanked everyone for their speculations last year and encouraged participants to leave their best guess for the Dow Jones closing number on June 30, 2017. The date for the 2017 Educational Seminar had already been set: October 24th. Then, as there was no further business, he closed the 27th Annual Educational Seminar.



Mayor David Morris, Chair



Ms. Gail Stone, Executive Director