



SCHOOL EMPLOYEES RETIREMENT SYSTEM OF OHIO

BOARD MEETING HIGHLIGHTS

OCTOBER 2020

Education Session: Does a 50/50 Allocation Split between U.S. and Non-U.S. Equities Still Make Sense?

When reviewing U.S. and non-U.S. equity investment returns over the last decade, U.S. equity returns have broadly outperformed non-U.S. and emerging market equity returns. Board members as well as investment staff and consultants regularly question or receive questions regarding the allocations within global equities.

Joanna Bewick and David Lindberg of Wilshire Associates, SERS' independent investment consultant, led an education session that detailed many of the decision points considered when addressing global equity allocations. They cited several reasons why continuing the 50/50 allocation split between U.S. and non-U.S. equities continued to be a solid strategy.

History

Historical trends are a valuable resource.

1. Economic conditions around the world change: In the 1970s and 1980s, developed markets outside the U.S. dominated equity returns; in the 1990s and 2010s, the U.S. dominated equity returns; and in the 2000s, emerging markets dominated equity returns.
2. U.S. dollar appreciation/depreciation affects U.S. equity returns: When the dollar depreciates, non-U.S. equity returns are higher; when the dollar appreciates, U.S. equity returns are higher.
3. Historically, the U.S. dollar has gone through "super cycles" of appreciation and depreciation. Trending data indicates that the dollar could be nearing the end of the current appreciation cycle.
4. Historically, developed market and U.S. equity performance are cyclical: one typically outperforms the other for several years, and then it reverses. This is why it is important to have both U.S. and non-U.S. equities in the portfolio.

Valuation

The price of stocks at the time they are purchased is a major factor in gauging how profitable returns will be on those assets. Currently, the price of U.S. equities are higher than their historical long-term averages while non-U.S. and emerging market equities are lower than their historical averages. This means that there is a higher probability that returns on non-U.S. and emerging market equities will produce higher returns than U.S. equities in the near future.

Market Concentration

As of August 2020, the top five positions in the S&P 500 (Apple, Microsoft, Amazon, Google, and Facebook) account for 24% of the index's total market cap, which is the highest share since the 1970s and 60% larger than the 48-year average. Over the last two years, these five companies have returned 115.6% while the rest of the S&P 500 has returned -1.5%. This imbalance makes the U.S. equity market vulnerable to repricing.

Stock Leadership

Over the last 10 years, 74% of the best performing stocks were non-U.S. Reducing exposure to non-U.S. equity would mean dismissing these opportunities.

Risk Reduction

Over the last 50 years, Wilshire's data shows that a 50/50 allocation split between U.S. and non-U.S. equities reduces portfolio risk more than an 80/20, 90/10, or 100/0 allocation splits. Wilshire's current projections indicate that increasing SERS' allocation to U.S. equity up to 70% modestly reduces expected returns and risk, while

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portfolio efficiency remains the same.

Global Private Equity Portfolio Review

Staff presented a review of SERS' \$1.42 billion global private equity portfolio.

Currently, the portfolio consists of 27 general partners that manage 66 funds. SERS is also a participant in four co-investments.

Co-investment opportunities arise when a general partner elects to make an investment that exceeds the amount they are willing to commit from their fund, and invites fund investors to provide additional capital to complete the funding of that investment. Co-investments limit the partner's fund exposure and provide an opportunity for fund investors to participate in specific investments that provide diversification and additional return potential. An added benefit of participating in co-investments is that no additional management fees are incurred. SERS' co-investments have returned 13.5% (net) since inception.

As a result of the recent asset allocation study, SERS' global private equity portfolio target allocation increased from 10% of the total fund to 12% on July 1, 2020. The goal is to get the portfolio to 11% of the Total Fund by June 30, 2021, and to 12% by June 30, 2022.

Currently, investments in the private equity portfolio consist of 79% buyouts, 19% special situations, and 2% venture capital. The portfolio also has a 75%/25% U.S./non-U.S. split with 90% being primary commitments, 8% legacy fund-of-fund commitments, and 2% co-investments.

Finally, the global private equity portfolio has been SERS' best performing asset class over the last 10 years. Despite a return of 2.57% in FY2020, private equity has realized a 14.56% return over the last 10 years. According to an independent assessment by the American Investment Council, SERS' private equity returns over the last 10 years ranked 9th in the nation when compared to all other U.S. public pension funds. In addition, since 2013, the private equity portfolio has been cash-flow positive, meaning distributions have reached levels that exceed contributions to private equity managers.

Objectives for FY2021 include managing commitments to get the portfolio to its new 12% allocation target, seeking additional co-investment opportunities, and researching and identifying new managers that offer compelling opportunities and return expectations that can boost the portfolio's performance.

Investment Committee Approves Real Assets Investment

The SERS Staff Investment Committee approved a \$100 million commitment to Lubert-Adler Recovery Capital and Enhancement Strategy, a non-core real estate strategy within the real assets portfolio.

This investment will be funded from cash reserves.

Total Fund Update

| TOTAL FUND BALANCE | | |
|---------------------------------|-----------------|-----------------|
| July 31 | August 31 | Difference |
| \$14.95 billion | \$15.34 billion | ▲ \$390 million |
| TOTAL FUND RETURN (net of fees) | | |
| Fiscal Year | Calendar Year | 3-Year |
| ▲ 6.21% | ▲ 3.03% | ▲ 7.66% |
| TOTAL FUND RETURN vs. BENCHMARK | | |
| Fiscal Year | Calendar Year | 3-Year |
| ▲ 0.93% | ▼ 0.45% | ▲ 0.29% |

Risk Management Update

Joe Bell, chief risk officer at SERS, delivered a risk management presentation to the Board. As risk management has taken on greater importance within SERS, Bell's presentation provided an overview of the Enterprise Risk Management (ERM) Team's composition and strategies for FY2021, as well as focused on the integration of risk management initiatives, and reviewed the complementary roles of risk management and internal audit on risk and internal controls.

After explaining risk itself and the types of risk responses, including acceptance, avoidance, mitigation, and transference, Bell's discussion examined the risk management lifecycle, risk versus audit, and the responsibility of risk. He stated that among its objectives, the ERM Team will work to establish a framework and risk appetite by department before meeting periodically with department leads for risk review.

The ERM Team already has created a Risk Register with risk-based scoring to use as a tracking tool for documenting possible and actual risks. The register, which is still in the preliminary development phase, will eventually be comprehensive and cover organization-wide aspects of risk.

Additionally, the ERM Team will investigate and simplify current emergency preparedness plans and design playbooks based on different types of events.

Executive Director's Update***New Voice Over IP Technology Improves Member Experience***

Recently, SERS implemented Voice Over Internet Protocol (Voice Over IP), a technology that allows staff to make and receive phone calls via an internet connection, rather than a phone line.

With this new technology in place, the Member Support Team (MST) is in a position to answer calls live, even while working remotely.

Since implementation, the average hold time has declined, with more than 90% of live calls being answered in under two minutes. In addition, the number of voicemails received has declined from 100 to 200 voicemails per day to 20 per day.

Board Allocates FY2021 Employer Contribution to Pension Fund

For FY2020, SERS' funded level increased from 70.5% to 71.5%.

Under the System's funding policy, the Board is allowed to allocate up to 0.50% of the 14% employer contribution rate toward health care if the funded ratio of the pension fund is at least 70%, but less than 80%. At the October Board meeting, Board members agreed to allocate the entire employer contribution of 14% to the pension fund because the Health Care Fund is projected to remain solvent over the next 27 years.

Sustainability Discussions Deferred

After reviewing some points of interest and progress made on the clarification of various topics, the Board collectively decided to defer pension sustainability discussions until next year.

The next phase will take the compiled data from concept to construction. During this pause, Board members will review the requested data provided by SERS' staff and actuaries, and take this opportunity to examine plan design.

Staff Charitable Efforts

Despite the need to cancel certain traditional fall events, SERS staff continues to look for ways to encourage community spirit and help others through charitable giving.

Even during a difficult year, when the SERS' United Way campaign moved to a virtual platform, staff stepped up and provided a total of \$18,161 through payroll deductions and one-time pledges.

Three Full-Time Board Seats Up for Election

Two employee-member seats and one retiree-member seat are up for election with the terms beginning July 1, 2021, and ending June 30, 2025. Any member of SERS, other than a disability benefit recipient, is eligible to run for an employee-member seat, and any SERS disability or service retiree is eligible to run for a retiree-member seat. For more details on election requirements or to download petition or certification forms, visit the SERS website at www.ohsers.org/about-sers/board-of-trustees/board-election.

Because of the ongoing state restrictions on large gatherings and efforts to maintain social distancing to reduce the spread of COVID-19, SERS is allowing petition signatures to be collected electronically through the SERS website. Those interested in running for one of the open active member Board seats must contact Tim Barbour (tbarbour@ohsers.org) to have an electronic form on the SERS website created with their name.

Monthly Retirement and Survivor Benefit Transactions

For October, the SERS Board approved 510 active members for service retirements, and 15 survivor benefits for spouses and/or dependents.

November Meeting Dates

The next regular Board meeting will take place Thursday, November 19 at 8:30 a.m., and Friday, November 20 at 8:30 a.m. (if necessary).