



SCHOOL EMPLOYEES RETIREMENT SYSTEM OF OHIO

BOARD MEETING HIGHLIGHTS

APRIL 2022

Board Education Session: Investing in Commodities

In October 2021, following significant staff research, SERS began investing in a commodities-only fund for the first time. Since there is no dedicated policy allocation for commodities, staff is gaining exposure through the Opportunistic and Tactical portfolio.

Angelique Richardson, relationship manager, and David Chang, senior managing director, partner, and commodities portfolio manager with Wellington Management, provided the Board with an overview of the importance of commodities in an investment portfolio and the philosophy they are using to manage SERS' account.

Commodities is a diverse asset class with 50 different investments available within the agriculture and livestock, energy, industrial and precious metals sectors. Some of the investments include cotton, wheat, soybeans, cattle, oil, natural gas, aluminum, nickel, and gold.

The main reason to have exposure to commodities in an investment portfolio is that they are a good hedge for rising inflation. Historically, commodity returns outpace inflation by 5 to 10 times during periods of high inflation. Chang noted that commodities perform especially well when inflation is caused by the low supplies of goods, which is what the U.S. is experiencing now.

Inventories are a good indicator of supply and demand, and commodity supply is at its lowest point in 40 years. Supply is being constrained by lack of production, especially in below-ground commodities such as oil and mining. The worker shortage and reduced investment in locating and tapping into new sources are the reasons production is not keeping pace with demand.

Even though the energy transition away from fossil fuels is proceeding slowly, it is increasing demand for nickel, copper, and lithium, which are necessary for the production of solar panels, batteries, and other parts necessary for capturing and storing renewable energy.

SERS is invested in Wellington's NA CIF II Commodities Portfolio. Wellington seeks to outperform the benchmark through commodity selection, futures contract selection with maturities from one month to ten years, and keeping sector weight between +15% and -15% of the benchmark.

Chang also said that understanding commodity cycles and managing roll yields, which is the difference between maturing contracts and futures contracts, is crucial to their success.

Global Private Credit Portfolio Review

Investment staff gave the Board an overview of SERS' global private credit portfolio.

Global private credit was approved as a new asset class in 2020 with a target allocation of 5%. During the implementation phase, the target was set at 3% by the end of FY2022 and 5% by the end of FY2023.

The role of private credit in the Total Fund is to provide risk-adjusted returns in excess of those provided by publicly traded fixed income securities, and to generate a consistent stream of income. Its performance objective is to provide returns in excess of the three-month Treasury bill, plus 4.5% net of fees.

RETIREMENT BOARD

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As of February 28, 2022, the global private credit portfolio had a market value of \$690.6 million, and its allocation was 3.9% of the Total Fund.

For the one-year period ending February 28, 2022, the portfolio returned 13.2% net of fees, which exceeded the policy benchmark by 8.6%. The portfolio generated a yield of 6.8% in 2021. Staff noted that the portfolio's returns are expected to moderate from the high levels seen during the post-pandemic recovery, especially within the stressed/distressed debt and structured credit strategies.

There are several strategies within private credit investments, each with different risk and return parameters. SERS' private credit portfolio is made up of four different strategies: direct lending, with a target allocation of 80%; stressed/distressed debt, with a target allocation of 10%; structured credit/other, with a target allocation of 10%; and mezzanine, which does not have a target allocation at this time.

The direct lending strategy consists of senior secured loans to middle market companies. Stressed/distressed debt includes companies undergoing operational challenges or operating in out-of-favor industries. Structured credit/other is comprised of investments in commercial mortgage-backed real estate and other securities. Finally, mezzanine consists of subordinated debt, with little structural protections in place for the lender.

For FY2022, staff is focused on increasing the allocation to 5% by making new investments that fit within SERS' investment policy, ensuring appropriate risk and return characteristics are present with the new target allocation, and making new investments that generate consistent income for the Total Fund.

Economic and Financial Update

CIO Farouki Majeed updated the board on the economic conditions in the U.S as of February.

U.S. inflation continued to rise in February. Headline inflation, which includes gasoline and food, rose 7.9%, while core inflation, which excludes food and energy, rose 6.4%. As of March, inflation reached a new high of 8.5%.

U.S. GDP increased at an annualized rate of 6.9% for the fourth quarter and 5.7% for 2021, but GDP growth for 2022 is expected to moderate with the first quarter of 2022 estimated at 1.8%.

The labor market remains strong with 678,000 jobs added in February. However, consumer sentiment has dropped to its lowest point in 10 years due mainly to increasing inflation.

Global economic recovery also continues, although it remains challenged by worldwide supply disruptions, energy and food price surges, and material and labor shortages. The Russia – Ukraine war also poses additional risk to the global recovery.

SERS Keeps Current with Proxy Voting Issues

Chris Collins, SERS' government relations officer, provided the Board with an overview of new and/or updated proxy issues for 2022.

Because SERS owns stock in public companies, the System is responsible for voting on a number of shareholder issues. To keep pace with the volume of issues that require a vote each quarter, SERS uses the proxy voting services of Institutional Shareholder Services (ISS) to vote on the System's behalf according to SERS' proxy voting policy and custom guidelines.

Ahead of the upcoming proxy season, SERS' internal proxy voting committee reviewed 32 issues that ISS expects to appear on proxy ballots in 2022. The committee relied upon guidance from the Board-adopted Corporate Governance Principles in deciding how SERS will vote.

To promote diversity on corporate boards, SERS continues to participate in the Midwest Investors Diversity Initiative (MIDI), a group of 16 institutional investors in the Midwest that engages public companies that also are located in the Midwest with the goal of encouraging diversity on their board of directors. This year, MIDI is

engaging with 19 Midwest companies that meet three parameters: 1) They have no women or people of color on their board based on best available public data; 2) They fail to disclose the race and gender of their boards; and 3) They fail to disclose their EEO-1 reports.

SERS also remains involved in the Investors for Opioid and Pharmaceutical Accountability (IOPA) Group. The IOPA is a group of institutional investors that engages with public companies associated with the opioid crisis and pharmaceutical pricing. Its objective is to encourage corporate governance reforms that include increased oversight and transparency.

SERS is also a part of the Investor Stewardship Group (ISG), which is a nationwide initiative that developed a Framework for U.S. Stewardship and Governance best practices. The ISG Framework has been recognized as the definitive corporate governance code in the United States, and includes basic investment stewardship and corporate governance standards for U.S. institutional investors and boardroom conduct. SERS is a signatory to the ISG Framework and continues to support the group's efforts.

Finally, SERS continues to be an active member of the Council for Institutional Investors (CII), and is supportive of its advocacy at the federal level.

Investment Committee Approves Real Assets Investment

The SERS Staff Investment Committee approved a commitment of \$50 million to Pretium Single Family Rental Fund III, a core plus strategy within the real assets portfolio.

This investment will be funded from cash reserves.

Total Fund Update

TOTAL FUND BALANCE		
January 31	February 28	Difference
\$18.14 billion	\$17.86 billion	▼ \$280 million
TOTAL FUND RETURN (net of fees)		
Fiscal Year	Calendar Year	3-Year
▲ 2.76%	▼ 4.03%	▲ 11.87%
TOTAL FUND RETURN vs. BENCHMARK		
Fiscal Year	Calendar Year	3-Year
▲ 1.30%	▼ 0.26%	▲ 1.13%

Board Approves Final Filing of Amended Administrative Rules under the Five-Year Review of Rules

The Board approved final filing of eight administrative rules that were reviewed by the Joint Committee on Agency Rule Review (JCARR).

Amended rule 3309-1-30 added language to clarify the statutory requirement that if a member is employed in a SERS position when the member's retirement application is filed, the effective date of retirement cannot be sooner than the month after the member's current employment ends.

Also amended were disability rules, 3309-1-40 and 3309-1-41. Notable changes involved disability benefit recipients who:

1. Were up for review under the "any occupation" standard; and
2. Reported annual earnings of 75% or more of their adjusted final average salary (FAS) under SERS.

In this situation, if the member's current medical records did not indicate a decline in the member's physical or mental capacity, the member's benefit would be terminated without a vocational evaluation or independent medical exam. In addition, these members will not have a right to appeal the termination of benefits to the retirement board.

Also, a right to a late appeal was added when the member was hospitalized or in a care facility at the time the notice of denial or termination was mailed.

Additionally, 3309-1-57, a rule on rules, was amended to reflect the current process by which SERS provides notice to interested parties of proposed new, amended, or rescinded administrative rules.

Health Care Update

SERS' Health Care Director Christi Pepe outlined staff's recommendation that SERS enter into a new contract with Express Scripts to provide pharmacy benefits and administration to eligible SERS benefit recipients.

With assistance from Buck Consulting, staff published a Request for Proposal intending to assess and contract for the lowest cost enrollee benefit and highest service value. Five responses were received.

Express Scripts, which has provided pharmacy management services to SERS enrollees since 2008, offered the lowest net pricing among proposals for projected pharmaceutical utilization. It demonstrated the highest value when considering technical capability, net drug cost, and prescription drug access. The Express Scripts proposal also included transition for SERS enrollees to the National Preferred Formulary, which offers more brand name drugs than the current formulary.

The Express Scripts proposal is estimated to provide \$71 million in cost avoidance over the three-year contract period.

The Board directed staff to negotiate a new three-year contract with Express Scripts to provide pharmacy benefit management services effective January 1, 2023.

Executive Director's Update

Actuary RFP to be Posted Next Month

Next month, SERS will issue a Request for Proposal (RFP) for an independent audit of SERS' actuary.

The RFP will be posted on the [Vendor Opportunities page](#) of SERS' website.

Search Underway for Chief Financial Officer

SERS has begun the search for a new Chief Financial Officer (CFO). Tracy Valentino, SERS' current CFO, announced her retirement effective this summer. The CFO search is being conducted externally by Hudepohl & Associates. Visit [SERS' Careers page](#) for more information.

Monthly Retirement and Survivor Benefit Transactions

For April, the SERS Board approved 280 active members for service retirements, and 19 survivor benefits for spouses and/or dependents.

May Meeting Dates

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