**Investment committee of the Executive Council**

**Minutes of the Meeting**

Date: February 13, 2019

Committee members:
The Rev. Andrew Walter
Mr. Dale Akinla
Ms. Marion Austin
Mr. Kurt Barnes
Ms. Janet Brown
Ms. Holli Powell
Mr. John Talty
Mr. James Simon

Consultants:
Ms. Carissa Tepovich, *Mercer Investment Consulting, Inc.*
Mr. Chris Cozzoni, *Mercer Investment Consulting, Inc*.

Staff:
Mr. Doug Anning
Ms. Joanne Brockway
Ms. Nancy Caparulo
Ms. Margareth Crosnier de Bellaistre
Mr. Lloyd Mondal

Regrets:
Mr. Gordon Fowler

1.0 General

Fr. Walter called the meeting to order at 10:02 AM with a quorum present. He began with prayer.

The minutes from the November meeting were moved, seconded, and approved with one small editorial change.

2.0 Treasurer's report

2.1 Mr. Barnes discussed the report he had posted to the Extranet. Income in 2018 was generally in line with the budget and expenses were below budget. A surplus of about $1 million resulted in 2018. Looking at the triennium, the result is a budgetary surplus of close to $4 million, owing to increased contributions from dioceses, offset by lower than expected rental income but higher than expected fees from the General Convention (GC). The under-spending was focused in the first year of the triennium, where work in church planting and racial reconciliation was just initiated. $1 million was re-budgeted during the triennium to cover that work.

2.2 Some modest revisions were made to the 2019 budget to cover things not done in 2018. Normally, funds do not carry over from one triennium to another but the carry-over was necessary to meet the work that had to be done on the General Convention Office (GCO) software.

2.3 With regard to Economic Justice loans, about $500K is available for investment. There was not a quorum at the last meeting so applications could not be approved.

2.4 The parking lot in Austin was sold in December 2018 with net proceeds of about $20 million after expenses and paying off the purchase loan. This represents a 13% annual return. $19 million is currently in the short-term reserves. Mr. Barnes will propose to EC that the amount be removed and invested in a custodial trust that will be overseen (IC long-term portfolio). Additions and withdrawals would be at the discretion of the Executive Committee of the EC in discussion with the presiding officers and treasurer. The dividend declared for the trusts in 2019 is $1.11 per share. The $19 million would generate about $790K in dividend income to the budget, whereas the short-term reserves would earn 1%.

3.0 <u>Liaison Updates</u>

3.1 There is no liaison to the Committee on Corporate Social Responsibility as yet. Mr. Barnes explained that the committee meets by phone about four times a year to review the church's corporate engagement in specific areas. These are discussions with corporations (gun manufacturers, Dick's sporting goods, polluters, etc.) engaged in activities that do not fit the socially responsible guidelines established by GC and EC. The most active time of the year is the fall, when the committee reviews and identifies corporations it wants to engage in dialogues with, or present shareholder resolutions to. Mercy Investment Services acts as consultant with the committee. Pat Zerega, a board member of the Interfaith Center on Corporate Responsibility, is the contact. CPG is also a part of that committee, of which Bishop Doug Fisher is chair. There is funding in the budget for one face-to-face meeting during the triennium.

3.2 Fr. Walter asked for a volunteer to fill the liaison position. Ms. Brown expressed her interest and the matter was closed.

3.3 Fr. Walter is liaison to the Economic Justice Loan Committee (EJLC). There was no quorum at the last two meetings. A meeting has not been scheduled in 2019 as yet. Ms. Crosnier de Bellaistre will contact the chair.

4.0 <u>MERCER</u>

4.1 Mr. Cozzoni walked the committee through the information he had provided concerning emerging market equities. He noted the benchmark review will be pushed to the next meeting and the focus for this meeting will be the market, owing to its recent volatility. The DFMS portfolio was down at the end of 2018 but there has been significant recovery at the beginning of 2019. The document on Market Environment, which had been posted to the extranet, was then reviewed. Fixed income was the only protection in 2018.

4.2 Through Friday of last week there has been a turn-around across the board and all market sectors are up. There is some expectation that interest rate increases are not expected going forward or will be muted. There was a big drawdown in 2018 and volatility is more normal after years of low volatility.

4.3 Economic growth was strong in 2018 but is expected to be lower in 2019 and 2020. There will not necessarily be a recession but a downward trend in growth. The bond market has historically been a better predictor of the economy. The market anticipates one more increase in interest rates. Mercer thinks perhaps one to two increases.

4.4 Mercer advises maintaining a diverse portfolio. The US still looks expensive even with slowing growth; tax cuts are fading; the FED will raise rates in 2019. Europe looks more attractive going forward but there are significant risks (UK, Italy) and slower growth. Emerging markets are trading at a 10% discount to their long-term average. China's growth is down to 6.5%.

4.5 Ms. Tepovich discussed market performance. The portfolio was down 6.9% net for 2018 but is up in January 2019 by 6% before the final numbers are in.

4.6 The asset allocation reveals a very diversified portfolio, about 50/50 mix with US and non-US and 7% in emerging markets. There is a mix of US and global bonds. Hedge Funds did fairly well against equities and REITs. The typical foundation target return is 5% plus inflation.

4.7 Compared with its peer universe, DFMS performance underperformed in the last quarter; the peer group has more than 25% in alternative assets. When the markets are up, DFMS portfolio looks good but when the market is down, it looks poor. Even in the 2018 downturn, DFMS outperformed the benchmark. Wells Capital out performed. Boston Partners under performed. Utilities had the best return for the year, where there is an underweight.
International Equity did well but was down 13% for the year. The benchmark was down 14.2%. Active managers did well. Lazard out performed. First State rebounded relative to the benchmark. Hedge Funds were down 3.2% but both managers outperformed their benchmarks. Fixed income underperformed because of overweight in corporate bonds. Brandywine struggled because of emerging markets positions.

4.8 Mr. Talty asked about changes in the portfolio to create alpha vs the benchmark. Mr. Cozzoni observed that the DFMS managers are higher beta but that the portfolio is in line with the target allocations. Concern was expressed about Blackstone's performance. Mr. Barnes noted that there is something there that has occurred in the past three years that should be explored. Mercer will do an attribution for the next meeting.

5.0 <u>Emerging Markets</u>

5.1 Ms. Tepovich cited two Emerging Markets (EM) managers in the portfolio, First State and DFA, which complement each other having different strategies. The Committee has decided to replace First State for a combination of reasons, most having to do with corporate changes and turnover. Mercer looked for another bottom-up, fundamental strategy-oriented manager to interface with DFA. Trilogy and Sands made the cut, both being quality/growth oriented. They are similar in strategy and approach. Trilogy holds 80-90 stocks with some top down elements in their approach. Sands has 30-50 stocks, is benchmark agnostic, and a high tracking error. Trilogy is being acquired by GW&K which is considered to be a positive move. Sands has demonstrated better downside protection.

6.0 SANDS CAPTAL

6.1 At 11:00 AM Luke Ingelhart and Neil Kansari from Sands joined the call. In business since 1992, Sands has done long-term, high-quality growth investing globally. The strategy is based on quality, low turnover, and market leadership. They focus on idiosyncratic companies with prudent business models that sustain over time and that deviate from the market. They look for elements of innovation, forward-thinking growth, cherry-picking the best companies.

6.2 Mr. Kansari explained the primary goal, regardless of strategy, is to identify high quality businesses, that can grow earnings 5-7% over a decade. He explained the changes in EM generally speaking and the composition of the Sands portfolio specifically. The company is optimistic about opportunities in Asia, especially emerging Asia. Their aim is to be on the right side of change with leaders in the economy, favoring companies that can create wealth for investors over time. Theirs is a team of 40 individuals solely responsible for research across all strategies on 115 companies globally.

6.3 Sands left the call at 11:30 AM and GW&K/Trilogy joined the meeting.

7.0 GW&K/TRILOGY

7.1 Bill Sterling, Michael Clare, Pablo Salas, and Brad Miller were in attendance and reviewed in detail the presentation that had been posted to the Extranet. GW&K/Trilogy merger was favorably mentioned. Theirs is an experience of EM over 45 years with assets under management of $38 billion. They are looking at recommending a mutual fund for the DFMS. The focus here is risk-sensitive growth investment.

7.2 Mr. Salas discussed more in detail the process the company uses. Qualitative and quantitative screens are used and they interview at least 1000 companies a year. Minimum investment in the mutual fund is $2 million. Total fees for their institutional class is 88 basis points. The minimum can be waived if necessary.

7.3 With thanks given to the presenters, they departed at 12:03 PM.

8.0 Discussion

8.1 Fr. Walter reiterated that these two presentations were heard today to provide a replacement for First State and a complement to Dimensional Fund Advisor. Ms. Tepovich noted the volatility of Sands and the quality/growth approach of Trilogy. There is $12 million invested with First State. Mr. Simon and Ms. Austin felt more comfortable with Trilogy, having been impressed with the research that that company does. It was noted that the volatility with Sands might be a major concern for Mr. Barnes, who had had to depart the call at 11:20 AM.

8.2 Motion was made to replace First State with Trilogy, seconded, and carried without opposition after additional brief discussion.

8.3 Mr. Cozzoni and Ms. Tepovich will work with Ms. Crosnier de Bellaistre to make this change.

9.0 Wrapping Up

9.1 The work plan for the balance of the year was looked at. Mercer will delve into the underperformance in the last quarter and will report with attribution at the next meeting. A benchmark review will be done. Another discussion of Hedge Funds might be in order. The Asset Allocation will be revisited two meetings from now.

9.2 Mr. Akinla asked about private equity not being on the list and was informed that this has been discussed a couple of times with the committee deciding not to proceed with it. However, the topic could be looked at again if there were renewed interest.

9.3 There was no need identified for an executive session; so, a motion was made, seconded, and carried to adjourn.

Father Walter adjourned the meeting at 12:14 PM with thanks to all participating.

NEXT MEETING: Friday, May 17, face-to-face and in New York.

Respectfully submitted,
Nancy Caparulo
Staff support to the committee