Investment Committee of the Executive Council

Minutes of the Meeting

Date: November 15, 2019

Committee members:
The Rev. Andrew Walter
Mr. Dale Akinla
Ms. Marion Austin (by phone)
Mr. Kurt Barnes
Ms. Janet Brown
Mr. Gordon Fowler
Mr. James Simon
Mr. John Talty

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

Staff:
Ms. Nancy Caparulo (by phone)
Ms. Margareth Crosnier de Bellaistre
Mr. Lloyd Mondal

Regrets: Ms. Holli Powell

1.0 <u>General</u>
Fr. Walter called the meeting to order at 9:02 AM EST and began with prayer.

The minutes from the August meeting were moved (Brown), seconded (Fowler), and approved as presented.

2.0 <u>Treasurer's Report</u>

2.1 Kurt reviewed the posted report. Income and expenses are both in line with the budget. Dioceses are paying in line with pledges; 85 dioceses have pledged at the mandatory 15%. Waivers have been approved for 8-10 dioceses, and another 5-6 dioceses remain in discussion with the Assessment Review Committee. One has been denied a waiver (Dallas) due to the process they use for giving - 6% to TEC budget and deciding where else they will give. Springfield has not applied for a waiver. 50% of dioceses pledged at full asking in 2012 when 21% was the level.

2.2 EC approved the revised 2020 Budget in October. Higher income is anticipated. Kurt described various sources of diocesan income against which the Assessment is levied. Fewer waivers will be required in 2020 largely owing to dioceses that have made major commitments to reach 15%, significantly Pennsylvania. $16 million of the proceeds from the sell of the Austin parking lot is residing in a trust fund whose income will support the budget.

2.3 Insurance renewals have seen significantly increased premium costs.

2.4 In the budget revision, $750K was approved to renovate the 5th floor of the Church Center building to accommodate a flexible conference room. It can accommodate 75 people but is divisible by folding walls for smaller groups. There will also be a sound studio where the PB can shoot videos and podcasts. In the $750K, there is a 10% overage calculated.

2.5 The triennial budget has $900K of increases related to costs associated with new tenants (Hardware Store, physical therapists on 7); however, costs will be recovered over time. All space is now rented. There is an anticipated $20,000 budget surplus for the triennium at this date.

2.6 With regards to the investments, active management has produced excess returns. New co-investors are realized each quarter. Custodial accounts represent $173 million out of the $480 million total portfolio value. Individual parishes and dioceses invest in individual trusts with no minimum required.

2.7 The Investment Policy Statement (IPS) was discussed regarding the need to update specific to the actions of the Executive Council.

3.0 Liaison Reports

3.1 Committee on Corporate Social Responsibility (CCSR) has necessitated additions this year in the IPS exhibits. The environmental investment guidelines language has been relocated. GC resolved to "establish" human rights guidelines and another resolution provided "implement" the guidelines. EC has approved that IC will not invest in a corporation that denies human rights nor any corporation complicit in denying human rights in the occupied territories of Palestine/Israel. The criteria for identifying whether a corporation is "benefitting" from business in that location is that they are selling goods there. Myanmar and other countries also abuse human rights, so care was taken to use neutral language in the resolution presented to EC. A separate resolution discussing monitoring was limited to $10K. Because MSCI now does the screening for fossil fuels, they might be hired to screen for human rights. Motorola, Israel Discount Bank and Caterpillar were placed on the no-buy list. A question arose as to whether or not there is a report that analyzes the screen in this area. A lengthy discussion covered the rationale to determine the depth of the screen. Kurt agreed that an analysis could be done on the three no-buys. Noted: a company cannot be engaged in dialogue if there are no stock holdings. Comingled funds and index funds may have the securities in them with a codicil that provides for an exception. The group discussed fine-tuning the screens to allow for offsets. They also discussed a resolution that EC passed regarding engaging the underwriters of the Saudi ARAMCO planned IPO.

3.2 Discussion turned to the impact these resolutions have on approving the IPS and, further, about how these resolutions impact the committee's fiduciary responsibility. Issues were raised:

- How can we adopt prior to the analysis of the screened versus unscreened portfolios, comparing characteristics, tracking error, etc.?
- Was CCSR mindful of the potential impact on the returns?
- It is IC's job to determine what cost is being assumed by making these decisions.

Ultimately, it was agreed that the analysis would be done and understood, then, a follow-up conversation with CCSR would take place. The committee will discuss the results online, read thoroughly the IPS and agree – or not – to accept the IPS prior to the next meeting.

3.3 EC acknowledged that the church invested in gun manufacturers to continue dialogue. Kurt will follow up with Russ Randall to learn his thoughts about the ARAMCO IPO. A list will be compiled of corporations with whom the church might want to have dialogue. Kurt discussed Mercy's consultancy and the valuable recommendations that have come from that relationship. Janet reported on the latest SEC proposed rule which will greatly impact the work of CCSR (i.e. $2000 to file if you own a stock for 3 years then $15,000 if you own it for 2 years; lastly, $25,000 if you own it for just one year). There is a 60-day comment period before those rules are finalized.

3.4 EJLC had a meeting in September and will meet again in December. There is $1.5 million available for investment and several loans coming up for renewal.

4.0 Mercer Reports

4.1 Mercer began with a review of the posted reports. In the market, Treasuries have gone up recently; year-to-date equities and fixed income have done very well; large cap growth is up 29%; and the lowest, small cap value, is up 17%. REITS have done very well with falling interest rates in 2019, as has fixed income. Long-dated bonds was one of the best performing asset classes.

4.2 Observations were made about the market environment, the slowing of global growth and weakness is in the manufacturing sector. Mercer expects the global economy to continue its slowness but sees no recession in the near-term. The Federal Reserve is doing whatever they can to keep the economy growing. One negative is the risk around trade tariffs as the US-China relationship has a global impact. There is also uncertainty around Brexit.

4.3 US profits have grown steadily since the economic downturn, but the amount of profits going to employees is less. US has outperformed international developed stocks since 2008-09 and this trend continues. There is some concern about corporate credit. Investment grade bonds are becoming of lower quality and returns are expected to be lower going forward due to low interest rates.

4.4 Year-to-date performance through September 30, 2019, was discussed; the portfolio gained 14.6% YTD, finishing the third quarter with $473 million. US and international developed market equities provided strong, double-digit returns with US stocks posting the highest returns. Emerging markets stocks trailed and are behind the benchmark. Hedge funds were up 7.0% versus 5.2% for the benchmark. Fixed income outperformed, gaining 9.6% versus 8.5% for the benchmark. REITS experienced strong absolute returns, up 19%, but the manager, Brookfield, has consistently underperformed. As a result, Brookfield was recently downgraded by Mercer's research team.

4.5 Over the long term, the portfolio has returned 8% year over year, accommodating a 5% draw. The Church portfolio has a higher risk/return profile than its peers, which suffers in more volatile times. The manager updates revealed that the US stock managers, Edgewood and Westwood, have added value. In international equities, Lazard, Altrinsic and American Century all have performed well versus their respective benchmarks. Emerging markets underperformed the benchmark but the new manager, GW&K Trilogy, has outperformed since its addition to the portfolio. Blackstone and Mercer hedge funds are up 7% in aggregate so far in 2019, and both doing very well versus their benchmarks. Within fixed income, Brandywine underperformed recently, but Mercer has no concerns there. Lastly, Brookfield REITS continues to underperform its benchmark, and Mercer is recommending a new manager in that space. Mercer also mentioned that rebalancing is done when there are cash needs, at least quarterly and reiterated that, overall, the active managers have added value. Questions arose about hedge funds and their value in the portfolio. Mercer said that over the last five years, they have not been additive. They suggested that we have a deeper dive into the hedge fund allocation at an upcoming meeting.

4.6 Mercer evaluates active versus passive management in a couple of ways, looking at the efficiency of each asset class and the historical results. The group discussed active management in detail, looking at each asset class one by one. Mercer noted that it is difficult to add alpha in US large cap equities. However, the portfolio's US large cap managers have added value. Looking at US small and mid cap stocks, active managers have added value, and Mercer recommends using active management in this space. International equity managers have had difficulty adding alpha, and Mercer often recommends a mix of active and passive in this space. Emerging markets stocks have struggled to beat the benchmark which is surprising given that this asset class is so inefficient. Mercer continues to recommend active management for emerging markets. It was noted that the active managers can work within the Church's constraints. Concern was expressed about Lazard's response to the no-buy list. Mercer is not recommending any changes at this time. The question, 'what if we were to index all the US large cap stocks?' spurred a long discussion about historical and current market environments and the value of moving entirely to index versus keeping a mix of passive and active management. It was agreed that an eye would be kept on the US large cap space and discussed again.

4.7 Focus was turned to lowering the spend rates to 4.5% using the Monte Carlo simulation prepared by Mercer. The triennium budget has been developed with a 5% spend rate, which the IC has recommended lowering for some years. Mercer pointed out that maintaining real value of the portfolio (e.g. $731 million in 20 years) will allow spending at 5% but will not protect the corpus. A recommendation of 4.3% or 4.4% spending could do that. Discussion turned to the level of budget cuts that would result from a 4.3% payout. That would replicate the actions of GC in 2009, when one third of the staff was cut and a large amount of money was cut from Anglican Communion and TEC support. A request was made to re-run the simulation using only DFMS budgetary trusts which, as the Treasurer pointed out, are the only ones to consider. The simulation exercise will be shared with EC.

4.8 At present, Brookfield REITS has raised concerns due to a series of organizational and team changes which has impacted Mercer's confidence in the team. Two alternatives were presented for consideration, Principal and Cohen & Steers. Backgrounds and philosophy for both were discussed along with the ESG (Environmental, Social and Governance) ratings. Agreement was reached that the committee would talk with these managers via Zoom in February. In the end, Mercer would recommend either manager, Cohen & Steers having the edge based on the higher ESG rating.

4.9 The ESG ratings policy and guidelines were discussed in general. There is a goal of moving toward higher scores. All managers' scores were reviewed and the question arose as to whether a look at potential replacements for some of the managers, such as Edgewood and Crossmark. All agreed that conversations with the managers regarding their ESG ratings might be bilaterally helpful with plans to invite Edgewood, Westwood and Crossmark for discussion in 2020. Mercer will look for an index manager with a high ESG rating in the US large cap space. This will be discussed at the next meeting.

5.0 Mercer will re-do the Monte Carlo analysis and will determine the sustainable spending rate. This committee will decide if it is necessary to go to EC in February with a new IPS. The no-buy list will not be given to anyone until IC decides. Managers will be told that the IC is concerned about the ESG ratings and will be invited in to hear what is in the pipeline regarding those evaluations.

Dates for 2020: videoconference February 28 at 11:00 AM, May 29 in NYC at 9:00 AM, and a videoconference August 21 at 11:00 AM.

Meeting was adjourned at 12:14 PM.

Respectfully submitted,
Nancy Caparulo
Staff support to the committee