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May 26, 2020

LFC INVESTMENT REPORT FOR THE QUARTER ENDING MARCH 31, 2020

This report details the comparative investment performance of the three investment agencies: the Educational Retirement Board (ERB), the Public Employees Retirement Association (PERA), and the State Investment Council (SIC) which manages the land grant permanent fund (LGPF) and the severance tax permanent fund (STPF).¹

INVESTMENT PERFORMANCE HIGHLIGHTS

- For the year ending March 31, 2020, the value of New Mexico's combined investment holdings for the pension and permanent funds fell by \$2.156 billion, or 4.2 percent annually, to an ending balance of \$49.5 billion. Over the last five years, the state's combined investment holdings grew \$4 billion, or 8.8 percent.
- One-year returns ranged from -4.5 percent (STPF) to -1.4 percent (ERB). Over the last 10 years, the funds' investment returns ranged from 6.24 percent (STPF) to 6.91 percent (ERB).
- Despite the downturn, the state's investment funds performed relatively well when comparing to peer funds greater than \$1 billion on a net of fees basis.
 - All funds performed in the highest quartile for the quarterly period, largely due to the pension and permanent funds' lower risk positions relative to others in the peer group, which remains a strength in a negative-outlook environment.
 - All funds performed above the median for the one- and three-year periods, and ERB and the LGPF performed above the median for the five- and ten-year periods.
- Returns for the remaining quarter in FY2020 are likely to remain muted, as interest rates are near zero and equity markets remain volatile and highly sensitive to the progression of the economy and the global pandemic. The challenging environment will continue to strain state investment growth, deviating from the recent pre-pandemic trend.
- With recent market volatility, the funds fell short of their long-term return targets for all reported periods, but all funds were within 100 basis points of their long-term targets for the ten-year period.²
 - Although the pension funds performed relatively well given the downturn, a long-lasting low interest rate environment could challenge the funds to revisit whether their actuarial assumptions on returns are realistic. In April, ERB voted to lower its investment return assumption from 7.25 percent to 7 percent.

¹ Agency performance and market environment information are derived from the investment performance reports submitted by PERA, ERB, and SIC for the quarter ending March 31, 2020.

² The funds' long-term return targets are 7.25 percent (PERA), 7 percent (ERB), 7 percent (LGPF), and 6.75 percent (STPF).

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INVESTMENT RESPONSES TO MARKET CONDITIONS

During the first quarter of 2020, the Covid-19 pandemic upended the U.S. economy with widespread supply and demand disruptions. Sudden job losses and shuttered commerce resulted in a collapse of equity markets that has significantly affected state pensions and investments across the country. Moody's Investors Service estimates that the result was a loss of \$1 trillion in value from public pension portfolios, or about 21 percent of the assets that pay for the retirement plans of state and local employees. In New Mexico, ERB and PERA lost \$3.1 billion in value in the first quarter, or about 9.21 percent and 10 percent, respectively. The permanent funds similarly lost \$2.5 billion, or 9.8 percent of asset value.

Table 1 provides the funds' investment returns for the quarter and one-, three-, five-, and 10-year periods ending March 31, 2020 compared with the funds' policy indices, which are a custom benchmark that show the returns that would have been generated if a passive investor consistently followed the agency's asset allocation targets according to their investment policy.

TABLE 1: Returns as of March 31, 2020 (Net of Fees)³

Returns (%)	<u>PERA</u>		<u>ERB</u>		<u>LGPF</u>		<u>STPF</u>	
	Fund	Policy Index	Fund	Policy Index	Fund	Policy Index	Fund	Policy Index
Quarter	-10.02	-16.45	-9.21	-9.74	-9.74	-9.07	-9.94	-9.02
1-Year	-3.09	-9.31	-1.44	-2.36	-2.64	-1.80	-4.46	-1.71
3-Year	3.21	0.65	4.43	4.35	3.88	3.97	3.22	4.08
5-Year	3.57	2.50	5.02	4.76	4.35	4.34	3.95	4.43
10-Year	6.29	5.45	6.91	6.49	6.68	6.94	6.24	7.01

Note: bold indicates returns that exceed the fund's long-term target

Table 2 below reflects the changes in the annual asset values of the funds. Changes in annual asset values reflect contributions (e.g. employer and employee pension contributions, and oil and gas royalty and severance tax contributions to the permanent funds), distributions (e.g. pension payments, distributions to permanent fund beneficiaries), and investment returns.

TABLE 2: Fund Asset Values (Net of Fees) for Period Ending March 31, 2020

	ERB	PERA	LGPF	STPF	TOTAL
Ending Asset Value (3/31/20)	\$12,397.7	\$14,258.8	\$17,814.7	\$5,018.4	\$49,489.6
Annual					
Ending Asset Value (3/31/19)	\$13,020.2	\$15,337.7	\$18,077.7	\$5,210.4	\$51,645.9
Value Change – One Year	-\$622.5	-\$1,078.9	-\$262.9	-\$192.0	-\$2,156.3
Percent Change – One Year	-4.8%	-7.0%	-1.5%	-3.7%	-4.2%

SIC and PERA expect very low interest rates to be an ongoing challenge in the current investment environment. In its FY20 Annual Investment Plan completed prior to the recent downturn, SIC was already expecting the median public fund to return about 5.5 percent over the next 7-10 years. Fixed income securities, particularly Treasury bonds, have been an integral part of institutional investment portfolios, but

³ A fund's policy index is a custom benchmark that shows the returns that would have been generated if a passive investor consistently followed the agency's asset allocation targets according to their investment policy.

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with yields now near zero, adjustments may be needed to meet current growth strategies. For example, SIC investment staff have begun to raise questions regarding the role of Treasuries in a growth-oriented portfolio given the expectation for low returns. PERA investment staff acknowledged the difficulty in meeting actuarial hurdles and plans to manage this challenge through modest expected increases in risk premiums in its strategic asset allocation (although still lower than historical standards) and active management strategies. ERB lowered its actuarial return target by 25 basis points in April to 7 percent.

ASSET CLASS PERFORMANCE

The state's investment fund experienced the largest losses in its public equity asset classes, with domestic equity returns ranging from -8.8 percent to -11 percent, and international equity returns down 12.4 percent to 16 percent. However, each of funds began reducing their public equity exposure at the start of the downturn in attempt to minimize the losses – for example, the S&P 500 was down 19.6 percent by comparison. Fixed income assets provided no return for the permanent funds, while ERB's fixed income assets gained 6.2 percent and PERA's fixed income assets were down 3 percent.

Since the last large market downturn during the Great Recession, the state's investments have diversified their portfolios to a variety of asset classes to reduce risk. At times, this has meant that the state's funds underperformed during strong market rallies, but with the hope of minimizing losses during a period of decline. First quarter data indicates the relative success of this strategy, with the state's funds performing in the highest quartile for the quarter when compared to public funds of similar size.

Many alternative assets, such as private equity, real estate, and real assets, continued to provide positive returns to most of the funds for the one-year period. The ERB fund earned double-digit returns (11.1 percent) on its private equity investments for the one-year period, and the LGPF and PERA fund each returned about 5 percent on their private equity investments. The LGPF earned a 13.2 percent return on its real estate investments, although both the STPF and the PERA fund experienced losses in the asset class (-2.2 percent and -12 percent, respectively). Real assets provided a positive one-year return for all of the funds, ranging from 2.7 percent to 8.2 percent.

However, ERB investment staff warned that, due to a lag in reporting for many alternative strategies, these assets may show negative results in the subsequent quarter or quarters as March quarterly market values are incorporated in subsequent reports.

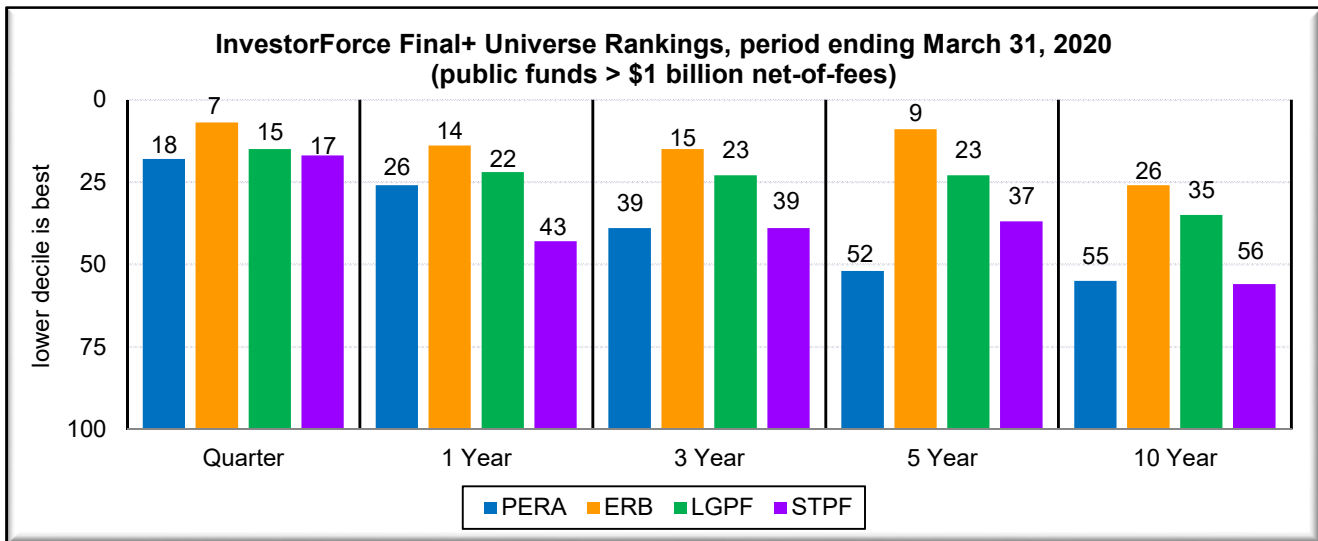
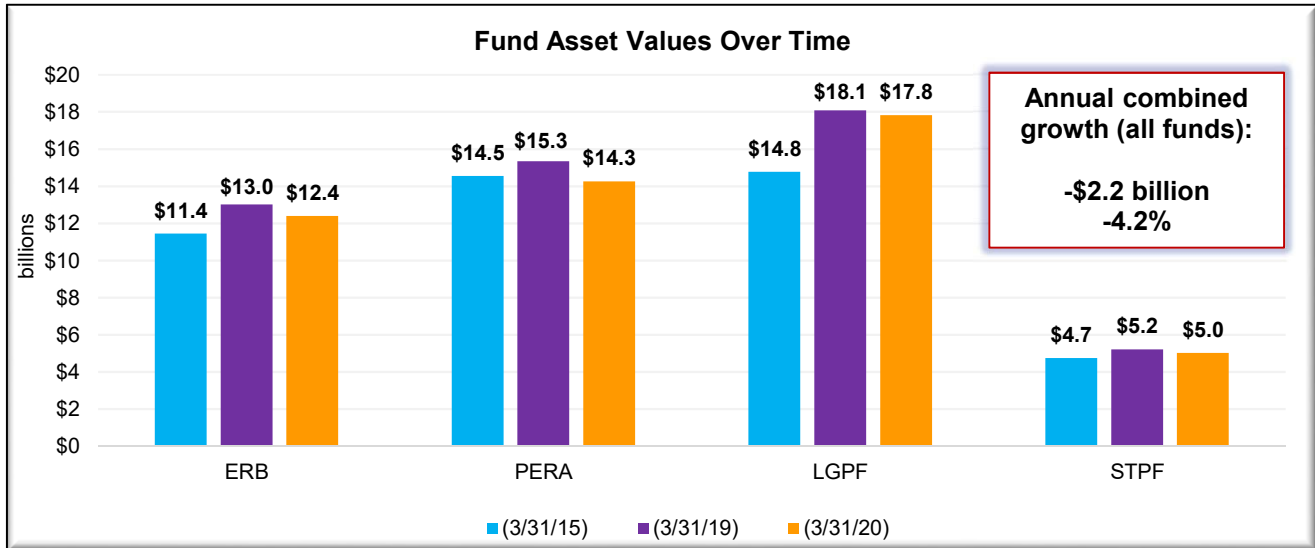
INVESTMENT PERFORMANCE DASHBOARD

The last page of this report illustrates the investment funds' performance for the periods ending March 31, 2020.

Investment Agency Performance Dashboard

Quarter Ending March 31, 2020

This report detail the comparative investment performance of the three investment agencies: the Educational Retirement Board (ERB), the Public Employees Retirement Association (PERA), and the State Investment Council (SIC) which manages the land grant permanent fund (LGPF) and the severance tax permanent fund (STPF).



Risk Profiles, Five Years Ending 3/31/20, Net of Fees				
Fund	ERB	PERA	LGPF	STPF
Standard Deviation*	5.9	6.8	7.3	7.4
Sharpe Ratio**	0.7	0.4	0.5	0.4
Beta***	0.4	0.5	0.5	0.5

*measures variability from the mean return; higher is more volatile

**higher numbers indicate higher return-to-risk level; a good ratio is 1 or better

***represents the volatility of the portfolio versus the S&P 500. Beta = 1: portfolio moves with the market. Beta < 1: portfolio is less volatile than market. Beta > 1: portfolio is more volatile than the market.

**Aggregate Value
of New Mexico
Investment
Holdings**

\$49.5 billion

Source: Agency
Investment Reports