

# Absolute Return Strategy Process & Recommendations

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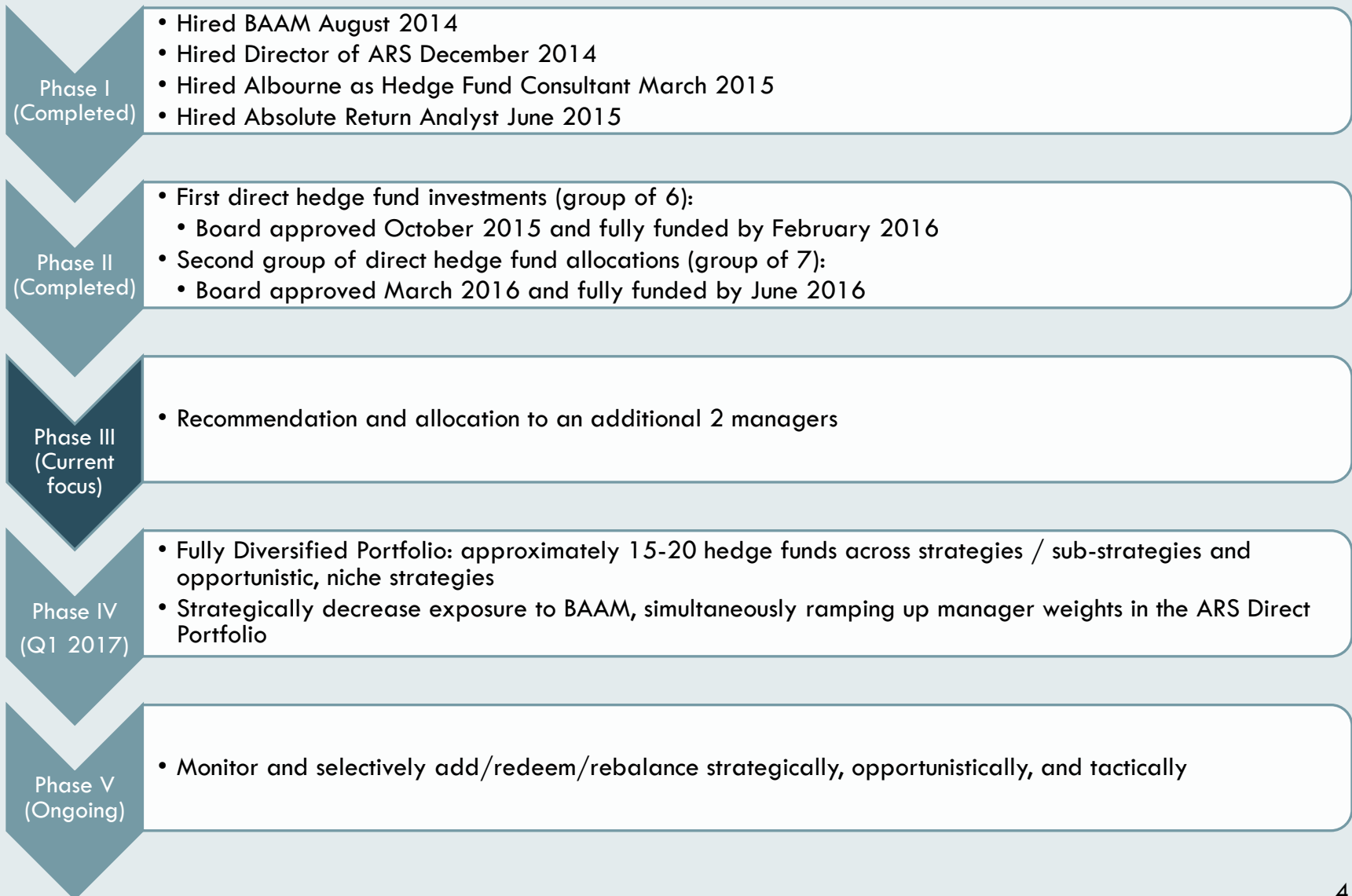
# Agenda

- I. ARS Search Process & Allocation Objectives
- II. Manager Search Process
- III. Manager Selection Recommendations
- IV. Requested Board Action

# I. ARS Search Process & Allocation Objectives



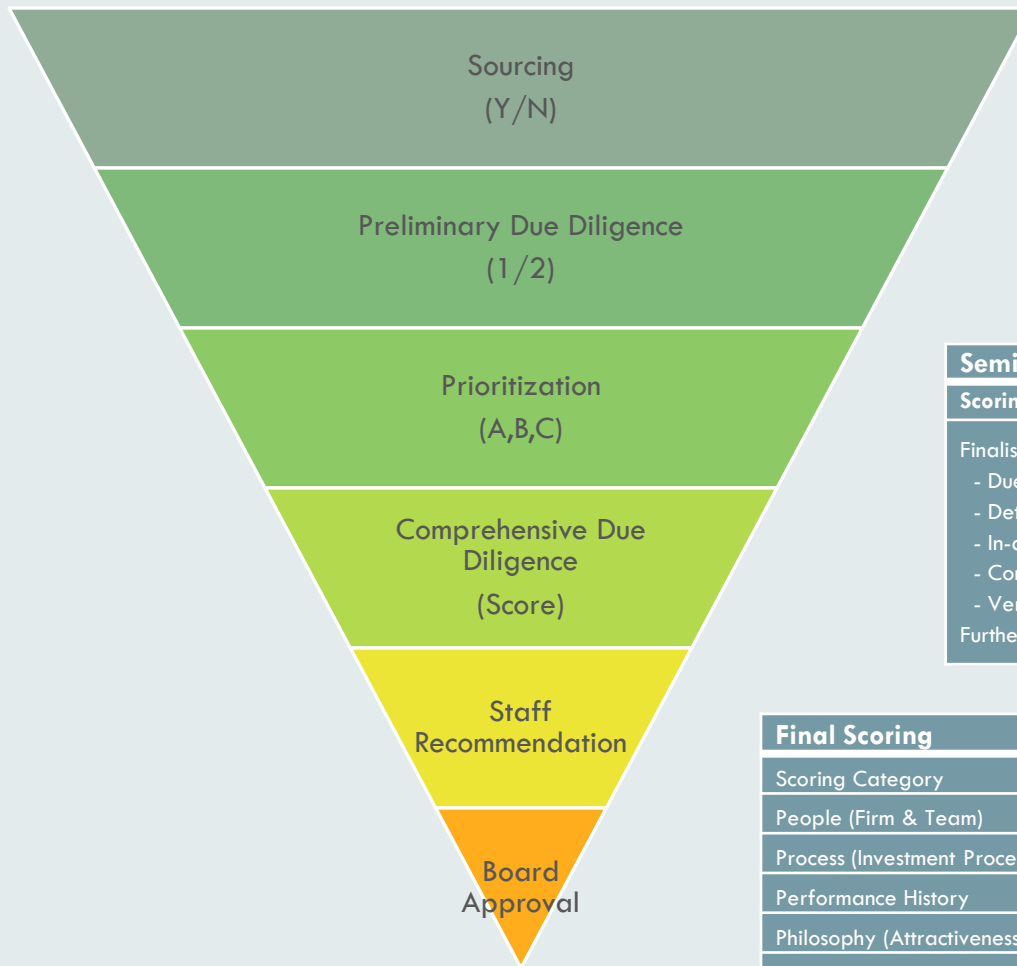
# ARS Search Process Timeline



## II. Manager Search Process



# Manager Search Process Review (1 of 3)



Manager Screen & Universe Analysis Scoring	
Scoring Category	Score / Outcome
<b>Manager Screen</b> - Is vehicle consistent w/ TMRS' objectives?	Yes - Take Meeting; No - Don't Take Meeting
<b>Manager Analysis</b> - Does vehicle have adequate capacity and timeline? - PPPPT Preliminary Review	1 - Advance; 2 - Stop Research

Semi-Finalist Scoring	
Scoring Category	Score
<b>Finalist Manager Review</b> - Due Diligence Questionnaire Review - Detailed PPPPT* Review - In-depth Manager Qualifications - Compliance with TMRS IPS - Verification of Research, References, Further Market Research	A - Prioritize for Final Due Diligence B - Perform More Research C - Stop Research / Manager not Selected

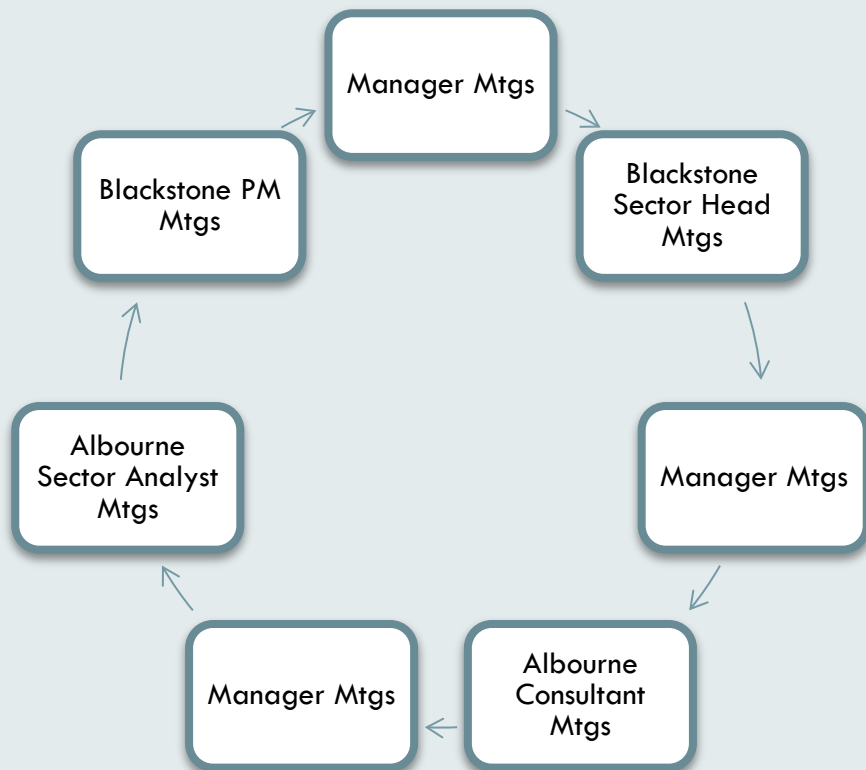
Final Scoring	
Scoring Category	Possible Points
People (Firm & Team)	0 - 25 points
Process (Investment Process & Risk Management)	0 - 25 points
Performance History	0 - 25 points
Philosophy (Attractiveness of Opportunity / Portfolio Fit)	0 - 12.5 points
Terms (Fees, Liquidity, etc.)	0 - 12.5 points
<b>Total</b>	<b>100<sup>†</sup></b>

\*PPPPT – People, Philosophy, Process, Performance, Terms

†Selected managers standardized to a score of 100 to allow comparability among selected managers.

# Manager Search Process Review (3 of 3)

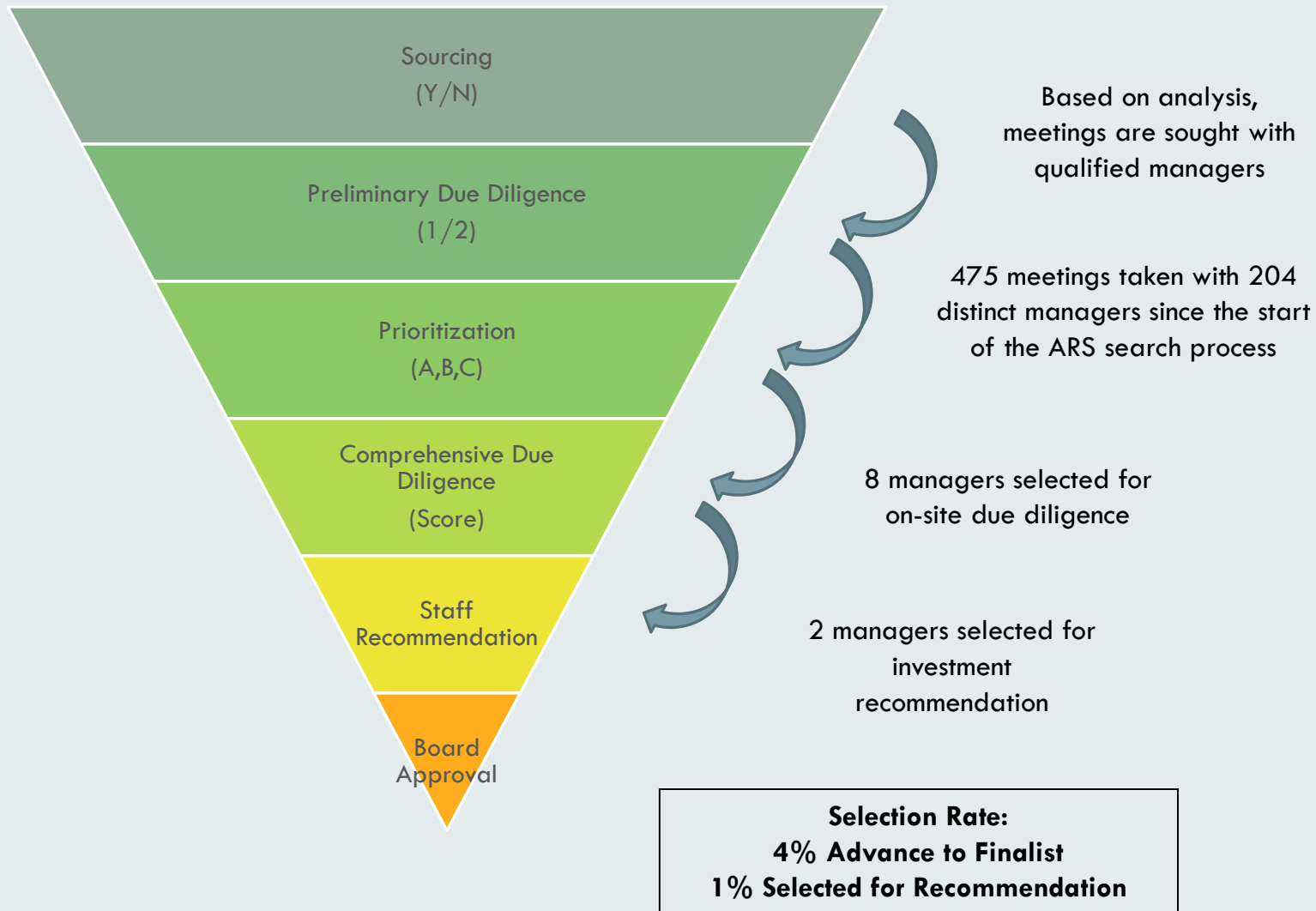
- Iterative Process
- Primary input from Albourne; Secondary from BAAM
- Meetings with consultants, portfolio managers and sector analysts used to ID areas of opportunity and to narrow the search field



Over the course of the direct manager search processes, TMRS staff conducted 475 meetings with 204 distinct managers across a variety of strategies:

Strategy	Number of Meetings
Credit	100
Event Driven	33
L/S Equity	56
Macro	73
Relative Value	39
Multi-Strategy	45
Other	129
Grand Total	475
Distinct Managers Seen	204

# Manager Search Process Review (2 of 3)





# Final Selected Managers Scoring Matrix

Final Due Diligence Scoring Matrix – Aggregated Results*			
Recommended Manager/Fund	Selected Manager Score <sup>†</sup>	Comparable Mgr. A Score	Comparable Mgr. B Score
D.E. Shaw Valence Fund, L.L.C. (Valence)	100	93	91.5
Redmile Capital Fund, LP (Redmile)	100	94	86

\*Scoring matrices utilize difference calibrations depending on the strategy being utilized.

†Selected managers standardized to a score of 100 to allow comparability among selected managers.

# III. Manager Selection Recommendations



# Summary of Manager Recommendations

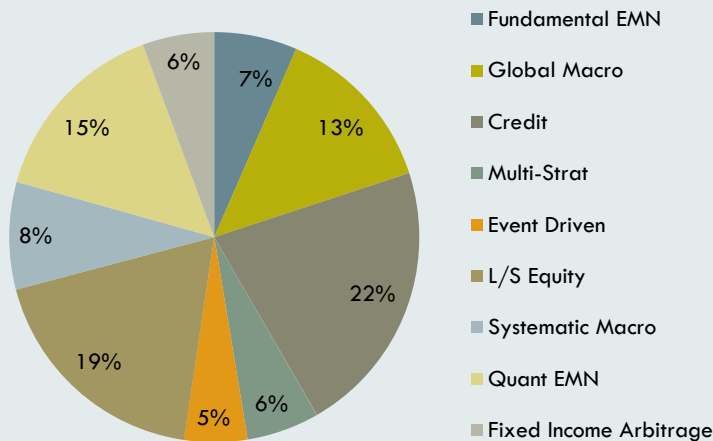
Recommended Fund	Strategy Classification	Recommended Amount
D.E. Shaw Valence Fund, L.L.C. (Valence)	Relative Value	\$70 million*
Redmile Capital Fund, LP (Redmile)	Long/Short Equity – Healthcare	\$60 million
<b>Total Recommendation</b>		<b>\$130 million</b>

\*Lift out from BAAM Treaty Oak. Amount is approximate based on current market value of position. Final amount TBD year-end 2016.

# Portfolio Considerations

## Strategy Diversification

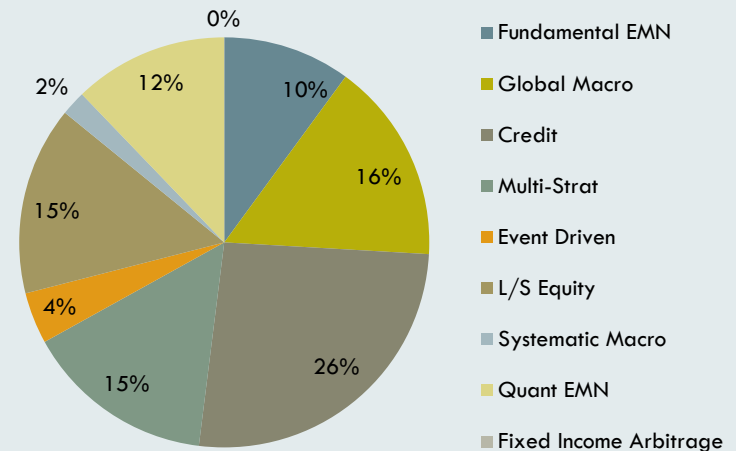
**ARS Direct Portfolio**  
(post September recommendations)  
Exposure by Strategy



- Proposed ARS Direct Portfolio has 15 managers vs. BAAM's 35 managers
- Both portfolios are similarly diversified across strategies

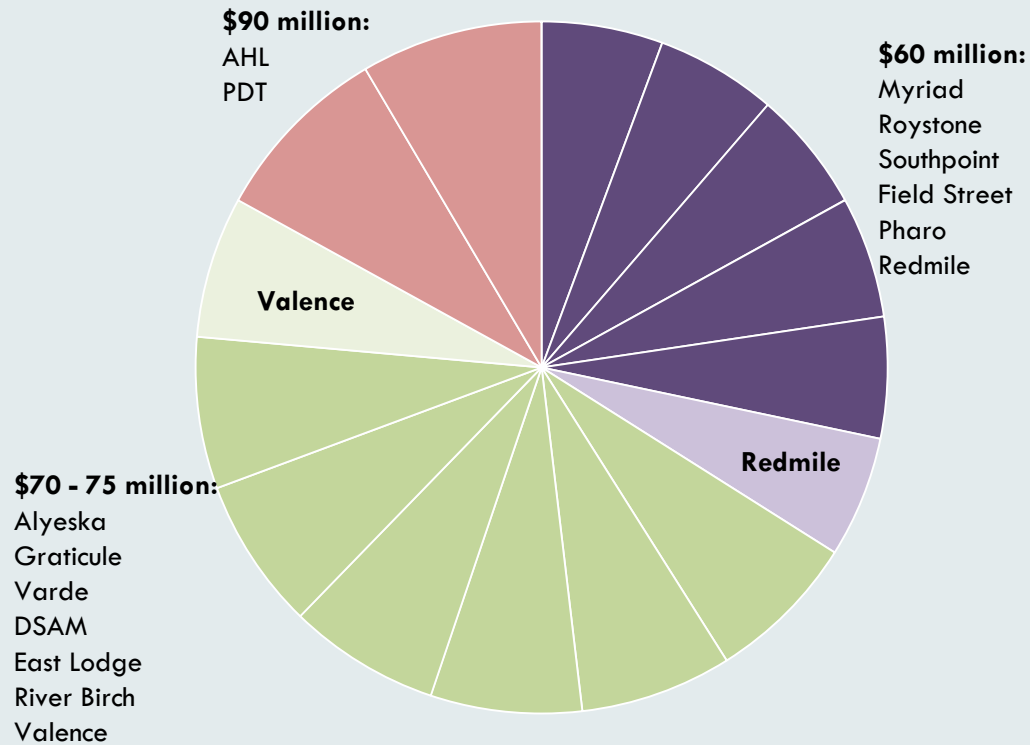
- Staff focused on identifying consistent alpha at the individual manager level as well as portfolio construction considerations
- Addition of Valence and Redmile takes into account individual investment quality as well as diversification benefits at the manager, strategy, and portfolio level

**BAAM Treaty Oak**  
Exposure by Strategy



# Portfolio Considerations

## Position Sizing



Sizing of managers is based on both qualitative and quantitative factors

# Top Candidate Characteristics – Valence (1/2)

**\$70 Million Recommendation**

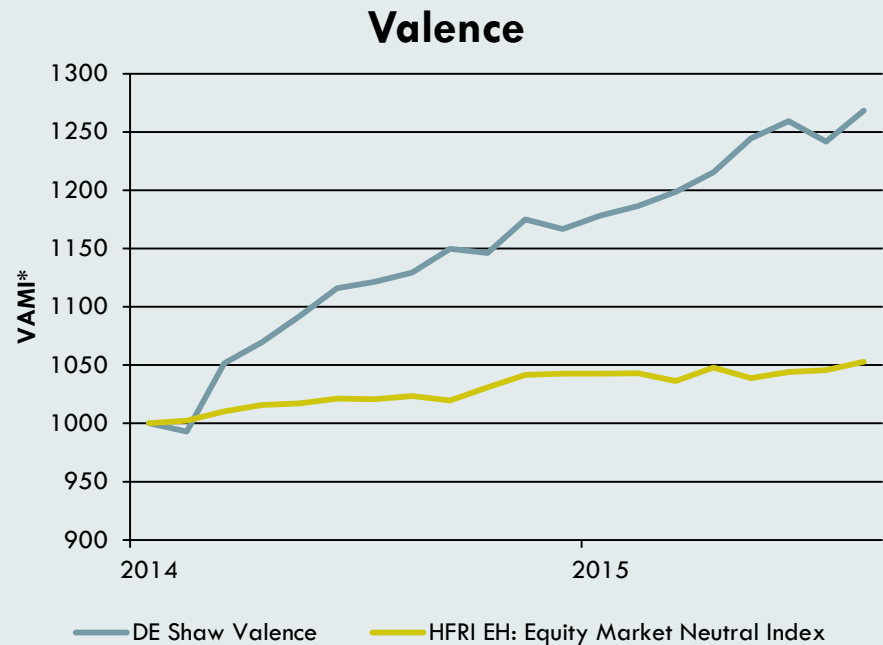
## Highlights

**Management:** Anne Dining, Julius Gaudio, Max Stone, and Eric Wepsic

**Firm AUM:** \$38 billion

**Employees:** 895

**Office Location(s):** New York, Boston, Princeton, Bermuda, Kansas City, Menlo Park, London, Hyderabad, Shanghai, Hong Kong



\*VAMI definition: “Value-Added Monthly Index” is the growth in value of a \$1,000 invested calculated by multiplying  $(1 + \text{current monthly rate of return}) \times (\text{previous month VAMI})$ .

# Top Candidate Characteristics – Valence (2/2)

## \$70 Million Recommendation

Valence is an equity-focused, multi-strategy portfolio that invests in statistical equity arbitrage, quantitative volatility and convertible arbitrage, and discretionary long/short equity trading strategies. This strategy is attractive to TMRS given its uncorrelated nature and high risk-adjusted return profile. This allocation is a lift out from the BAAM portfolio and so is not a new allocation to the ARS portfolio.

### Investment Case

- *Uncorrelated and attractive risk-adjusted returns*
- *Highly institutional organization*
- *Capacity*

### Issues to Watch

- *Transparency*
- *Leverage*

### Scoring Matrix

Category	Valence	Comp. Mgr. A	Comp. Mgr. B
People	25.0	19.0	22.0
Process	25.0	25.0	21.0
Performance	25.0	25.0	18.0
Philosophy	12.5	12.5	12.5
Terms	12.5	12.5	12.5
Total Points	100.0	94.0	86.0

# Top Candidate Characteristics – Redmile (1/2)

**\$60 Million Recommendation**

## Highlights

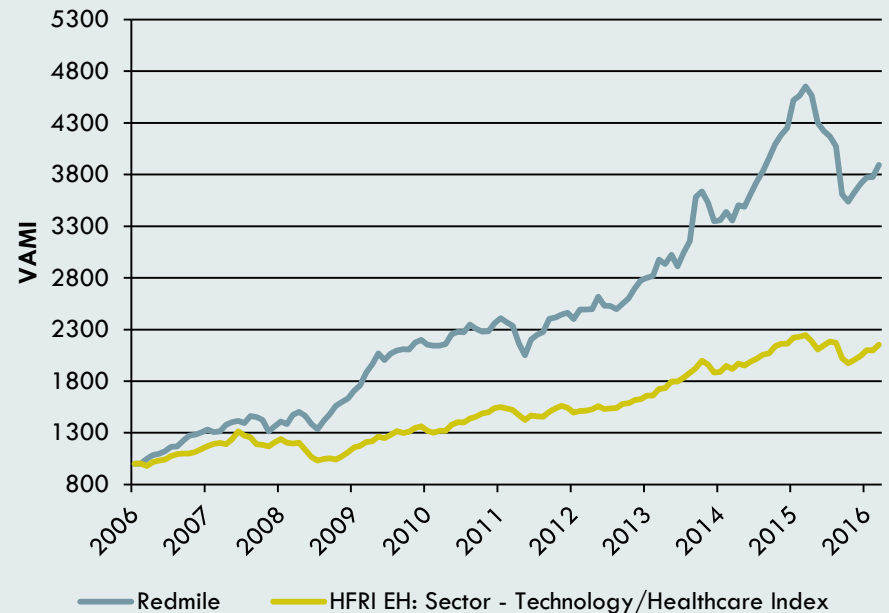
**Founder:** Jeremy Green

**Firm AUM:** \$1.6 billion

**Employees:** 23

**Office Location(s):** San Francisco & New York

## Redmile





# Top Candidate Characteristics – Redmile (2/2)

## \$60 Million Recommendation

Redmile invests long and short in global healthcare equities based on bottom-up fundamental analysis. In addition to the public equity investments, Redmile also invests up to 15% of the portfolio in private companies. The Fund's focus on the healthcare sector is attractive to TMRS given the low levels of intra-sector correlations within healthcare. In addition, TMRS expects that Redmile's focus on the biotech sector will add to volatility as well as the potential for outsized gains.

### Investment Case

- Senior, cohesive team
- Private investments
- Differentiation from generalists

### Issues to Watch

- Investor concentration
- Binary biotech exposure

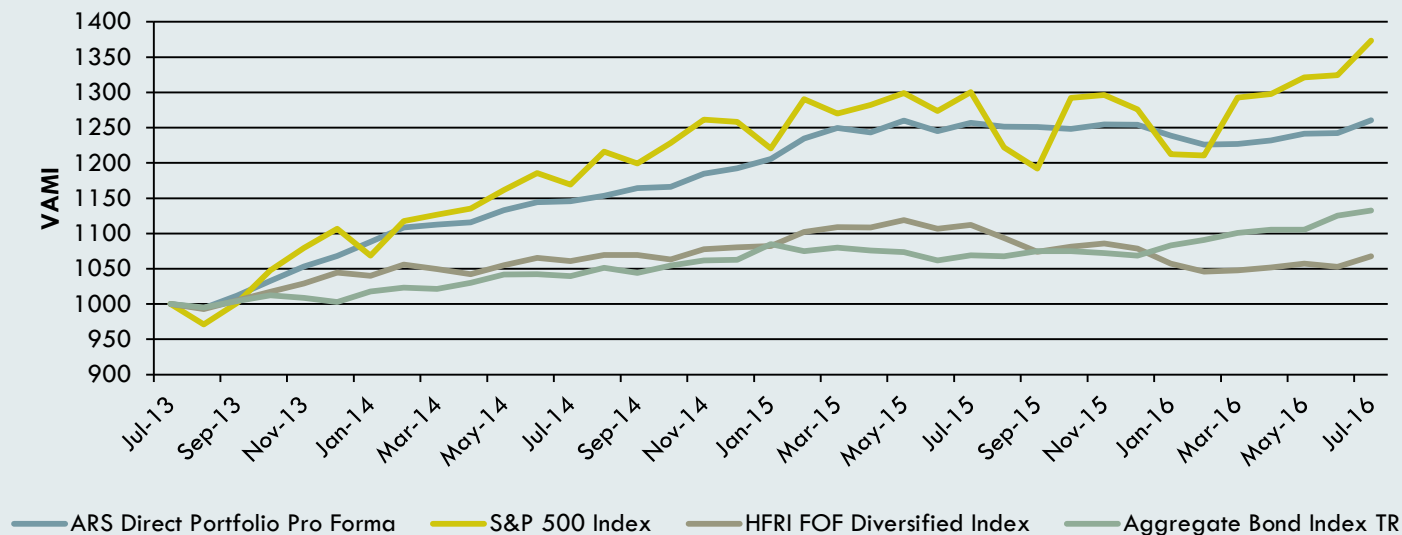
### Scoring Matrix

Category	Redmile	Comp. Mgr. A	Comp. Mgr. B
People	25.0	25.0	22.0
Process	25.0	25.0	25.0
Performance	25.0	25.0	25.0
Philosophy	12.5	8.0	7.0
Terms	12.5	10.0	12.5
Total Points	100.0	93.0	91.5

# Hypothetical Portfolio Performance

## ARS Direct Pro Forma Returns

Cumulative Return versus Benchmarks

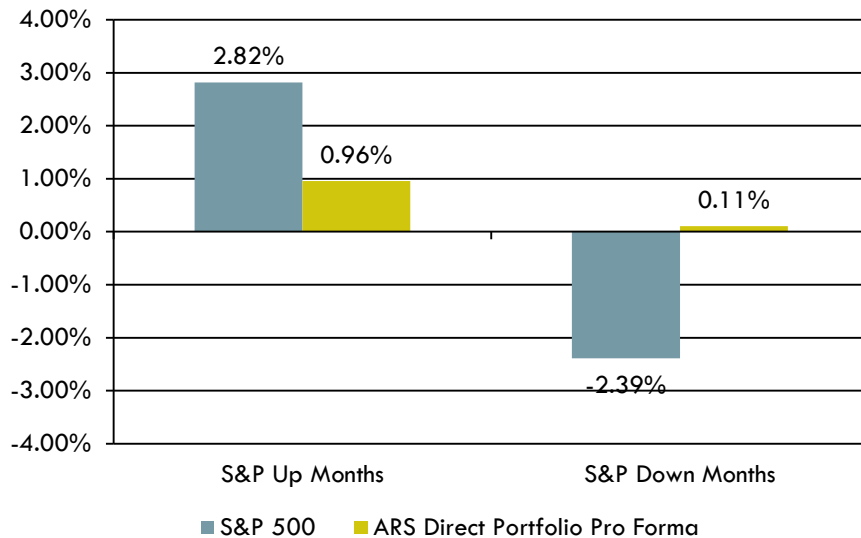


Performance Analysis: Aug-13 to Jul-16	Annualized Return	Annualized Volatility	Sharpe Ratio	Max Drawdown
ARS Direct Portfolio Pro Forma	8.02%	3.28%	2.45	-2.71%
HFRI FOF Diversified Index	2.20%	3.45%	0.64	-6.58%
S&P 500 Index	11.16%	10.95%	1.02	-8.42%
Aggregate Bond Index TR	4.23%	2.62%	1.61	-2.18%

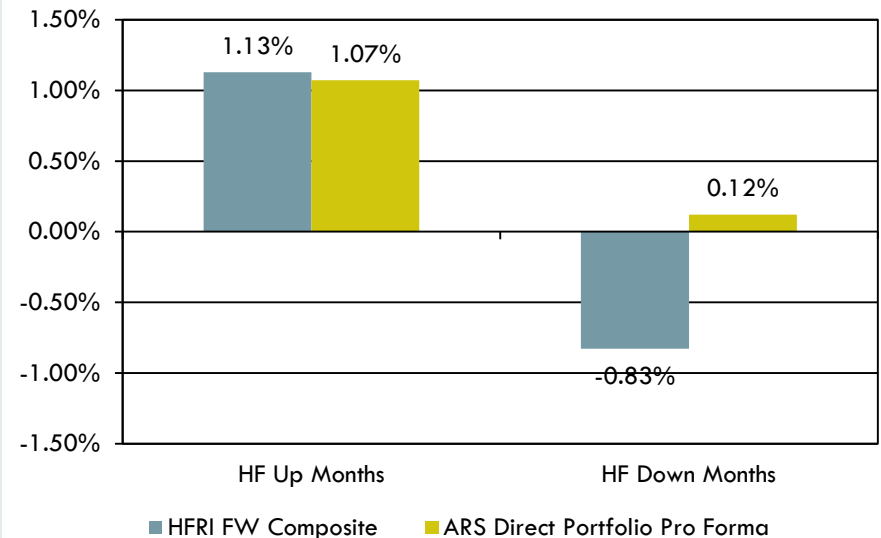
# Hypothetical Portfolio Performance

## Up/Down Capture

### Fund Performance Across S&P Up & Down Markets



### Fund Performance Across Hedge Fund Up & Down Markets



**Pro Forma Performance: August 2013 - July 2016**

## IV. Requested Board Action



# Approval of Recommendation

- TMRS Staff and Albourne recommend that the Board of Trustees approve the selection of the following investment strategies specified below:
  - D.E. Shaw Valence Fund, L.L.C. \$70 million\*
  - Redmile Capital Fund, L.P. \$60 million

# DISCLOSURE

*TMRS periodically discloses public information that is not excepted from disclosure under Section 552.0225(b) of the Texas Public Information Act. Information provided by a manager, a general partner or other data provider to TMRS or a TMRS service provider, and contained in these materials, may have been independently produced or modified by TMRS or the TMRS service provider.*