

2018 Absolute Return Strategy (ARS) Recommendations

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Agenda

- I. ARS Objectives and Background
- II. Opportunity Set and Sourcing
- III. Portfolio Construction
- IV. Manager Recommendations
- V. Requested Board Action

I. ARS OBJECTIVES AND BACKGROUND

Absolute Return Strategy Objectives

- Objective

- Purpose is to diversify equity and credit market risk by targeting hedge fund return streams that are independent of the directionality of the broad stock and bond markets. The ARS portfolio will be invested in a wide variety of hedge fund strategies, with specific constraints on overall portfolio risk and individual manager exposure.
- Performance objective is to exceed the benchmark, defined as the HFRI Fund of Funds Diversified Index, net of fees, and to earn in excess of the appropriate long-term benchmark (3-month LIBOR + 500 basis points) on an ongoing rolling 5-year period.

- Investment Philosophy

- Predicated on manager skill in:
 - Rotating (long/short trading) market factors based on valuation
 - Navigating less liquid, non public and opaque markets
 - Navigating special situations
 - Predicting and capturing market trends
- Accordingly, ARS is not an “asset class” (or market sector)

ARS Timeline

Phase I (Completed)

- Hired BAAM August 2014 (Custom Fund of Hedge Fund Vehicle)
- Hired Director of ARS December 2014
- Hired Albourne as Hedge Fund Consultant March 2015
- Hired Absolute Return Analyst June 2015, new ARS Analyst hired September 2017

Phase II (Completed)

- Fully Diversified Direct Portfolio: 18 hedge funds across strategies / sub-strategies, geographies and opportunistic strategies
- Board approval began in 2015
- Strategically decrease exposure to BAAM Treaty Oak, simultaneously ramping up manager weights in the ARS Direct Portfolio

Phase III (Ongoing)

- Monitor existing allocations in Direct Portfolio
- Selectively add/redeem/rebalance strategically, opportunistically, and tactically
- Source, research, and pursue new, niche strategies and co-invest opportunities
- Winding down Treaty Oak and will be fully direct when completed (if approved)

II. OPPORTUNITY SET AND SOURCING

Unique Sourcing Strategies

▶ Existing BAAM Treaty Oak

- Maturation of account purpose
- Wind down existing
- Upsize some existing sleeves and strategies
- Leverage past performance
- Traditional scoring process not applicable

▶ Varde Asia Credit

- Traditional scoring process utilized
- Consideration across different sub-strategies and geographies
- Expand existing relationship
- Unique opportunity

Final Selected Managers Scoring Matrix

Final Due Diligence Scoring Matrix – Aggregated Results*

Recommended Manager/Fund	Manager Score†	Comparable Mgr. A Score	Comparable Mgr. B Score
Varde Asia Credit Fund, L.P.	100.0	87.5	87.5
BAAM Stone Oak Fund, L. P.	n/a	n/a	n/a

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

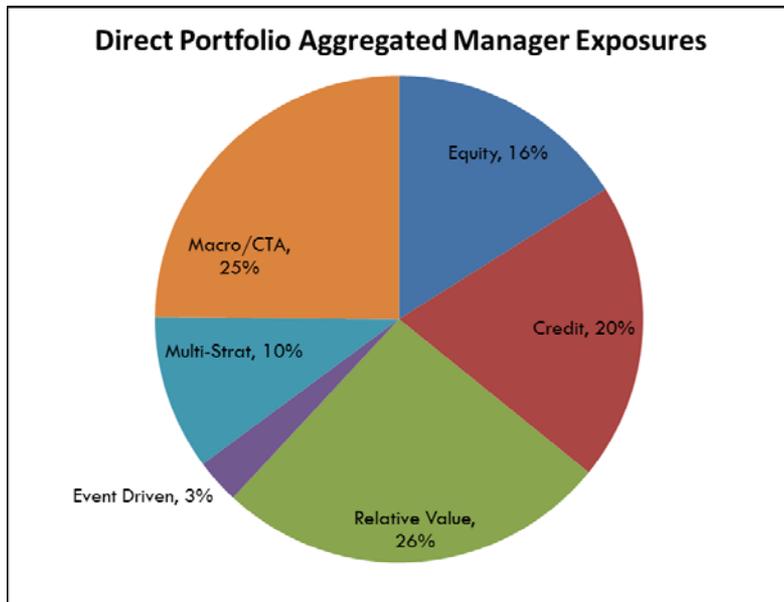
†Selected managers standardized to a score of 100 to allow comparability among selected managers
No direct comparable for Stone Oak, as will be discussed.

III. PORTFOLIO CONSTRUCTION

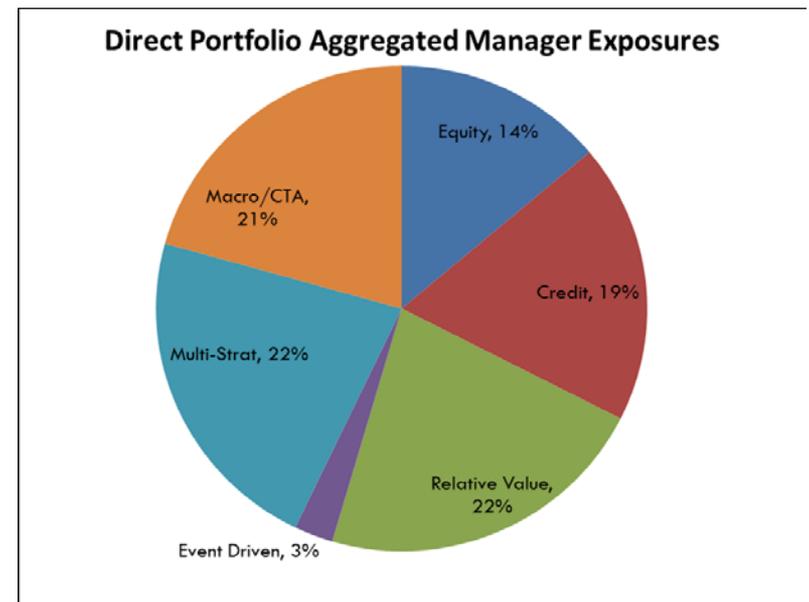
Manager Selection Portfolio Considerations

Strategy Diversification

Current Portfolio



Prospective Portfolio



*Exposures above include proposed investments.

IV. MANAGER RECOMMENDATIONS

Executive Summary of Manager Recommendation

Summary of Recommendations		
Recommended Manager/Fund	Strategy Classification	Recommended Amount
Varde Asia Credit Fund, L.P.	Credit	\$50 million
BAAM Stone Oak Fund, L.P. and Stone Oak Select	Multi-Strategy Opportunistic	\$250 million (Stone Oak Fund) \$100 million (Stone Oak Select)
Total Net Recommendations:		\$400 million

Top Candidate Characteristics – Varde Asia Credit

\$50mm recommendation

The Värde Asia Credit Fund (VAC) is an affiliate of the Värde Partners, Inc. global alternative investment platform; which oversees more than US\$13 billion of AUM and is headquartered in Minneapolis, Minnesota, with additional primary locations having been opened in London and Singapore. VAC will predominately be targeting corporate credit and special situations opportunities, but will also participate in stressed/distressed real estate. The geographic target of this opportunity set is the Asia Pacific region; including but not limited to India, Indonesia, Australia and New Zealand.

Highlights

Portfolio Manager(s): Ilfryn Carstairs

Firm AUM: \$13 billion

Employees: 290

Office Location(s): Singapore, Minneapolis, London

Investment Case

- *Experienced local presence integrated with global platform*
- *Global Co-CIO located in Singapore*
- *Strong historical track record in the region*
- *Broad opportunity set both in the near term and for future offerings*

Issues to Watch

- *Expansion of team to accommodate deal flow*
- *Geopolitical Emerging Market risks*

Top Candidate Characteristics – BAAM

\$350mm recommendation

This is a proposed transition from our current investment with Blackstone Alternative Asset Management (“BAAM”) dating back to the initial investment in 2014, named Treaty Oak. There is approximately \$610 mm remaining in the current account, down from the total investment of approximately \$1.5b. BAAM has run this portfolio for TMRS as a hybrid hedge fund-of-funds, with some one-off allocations to special situations opportunities. The current opportunity set that we are looking to take advantage of comes in the form of a custom vehicle. This is a combination of a custom Blackstone Special Opportunity Fund (“BSOF”) for \$250mm and a side car allocation of \$100mm. BSOF is a multi-strategy hedge fund targeting idiosyncratic opportunities across geographies and asset classes, while the individual investments in the sidecar are single security allocations where excess capacity exists after commingled and customized offerings have been allocated.

Highlights

Portfolio Manager(s): Greg Geiling

Firm AUM: \$450 billion

Employees: 2,300

Office Location(s): NYC HQ, 24 global offices)

Investment Case

- *Strong sourcing capabilities w/differentiated deal flow*
- *Experienced senior management team*
- *Streamlined and efficient process*

Issues to Watch

- *Expansion of products*
- *Turnover of investment staff*
- *Mark to market losses*

V. REQUESTED BOARD ACTION

Approval of Recommendations

- TMRS Staff and Albourne recommend that the Board of Trustees approve the selection of the following managers or their affiliates as referenced in the Board Communication Memo for investment in the specified strategies below:
 - Varde Asia Credit Fund, L.P.: \$ 50 million
 - BAAM Stone Oak Fund, L.P.: \$250 million
 - BAAM Stone Oak Select: \$100 million

DISCLOSURES

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 Managing General Partner (GP), any of its Associates or other data provider to TMRS or a TMRS service provider, and contained in these materials (i) may have been independently produced or modified by TMRS or the TMRS service provider; (ii) has not been reviewed or approved by the manager, Managing GP or any of its Associates; and (iii) may not reflect the historical performance or asset value reflected in the manager's, Managing GP's or any of its Associates' records and, therefore, should not be used for comparative purposes.