Investment Beliefs

Texas Municipal Retirement System

Definition of Investment Beliefs

Investment beliefs set the direction for the Board's investment policy, investment practice and organizational culture.

- Investment beliefs articulate fundamental views of the Board on institutional investing and provide a foundation to guide investment-related decision making.
- Investment beliefs will help define how TMRS will create investment value, in an environment of uncertainty, risk and opportunity.
- A survey[1] of published investment beliefs reveals three essential elements for investment beliefs:
    1. A clear view of the capital markets (the inefficiencies to exploit, the risk/return relation, the relation between asset pricing and investment horizon)
    2. A competent organization (cost-effectiveness, organization-specific values)
    3. A view on societal issues that affect investments (sustainable investments, corporate governance).
- Studies[2] of best practice in institutional fund governance have highlighted the importance of the development of clearly stated investment beliefs as a core first step of an investment process.

[1] The Journal of Portfolio Management, Alfred Slager and Kees Koedijk

[2] Best-practice investment management: Lesson for Asset Owner from the Oxford-Towers Watson Project on Governance, Gordon L Clark and Robert Urwin

Definition of Investment Beliefs

The Board, Executive Director and investment staff are key to translating investment beliefs into investment practice. It is critical that these stakeholders are closely involved in the process of developing the investment beliefs.

- Increased transparency and a difficult environment for returns increase the importance of well-thought out investment policies for investors; a coherent set of investment beliefs provide the basis for a good investment policy. Investment beliefs improve stakeholder governance by setting guidelines for best practice.[3]
- To ensure organization coherence, the Board's investment beliefs for TMRS should be collective, not individual. By agreeing upon and codifying investment beliefs TMRS will be able to set a foundation for its decision making as well as encourage cultural alignment.

[3] The Journal of Portfolio Management, Alfred Slager and Kees Koedijk

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History of TMRS' Investment Philosophy

2009-01/2012

RISK MANAGEMENT

A. **Risk Philosophy**

The investment risk philosophy for the Board is based on the precepts of capital market theory that are generally accepted and followed by institutional investors, who by definition are long-term oriented investo

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VI. **ASSET ALLOCATION & REBALANCING POLICY**

A. **Investment Risk Philosophy**

The investment risk philosophy of the Board is based on the precepts of capital market theory that are generally accepted and followed by institutional investors, who by definition are long-term oriented investors. This philosophy holds that:

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V. **INVESTMENT BELIEFS**

The investment beliefs of the Board are based on capital market theories that are generally accepted and followed by institutional investors, who by definition are long-term oriented investors. These beliefs hold that:

1. Increasing risk is rewarded with compensating returns over time and, therefore, prudent risk-taking is justifiable for long-term investors.
2. Risk can be decreased through broad diversification of asset classes and investment strategies/Managers, as well as diversification of individual securities.
3. Over time, the relative performance of different asset classes is reasonably consistent. For example, over the long-term, equity investments have provided and should continue to provide superior returns over other security types and short term fixed-income securities can protect capital and provide liquidity in periods of depressed economic activity.
4. The primary determinant of long-term investment performance is the strategic, or long-term, allocation of assets among various asset classes.
5. The risk of short term (tactical) shifts between asset classes is hard to diversify and is therefore unlikely to be rewarded with any degree of reliability and therefore must be used judiciously.
6. The potential to increase risk adjusted returns, through active management, exists in most capital markets and is inversely dependent on the efficiency of the market.

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Sample Investment Beliefs

Sample 1	Sample 2	Sample 3	Sample 4	Sample 5	Sample 6	Sample 7	Sample 8
Invest for the long term.	We are a long-term investor whose primary mission is to maintain the viability of the retirement system.	Diversification strengthens the fund.	Asset class decisions are key	Liabilities must influence the asset structure.	We value effective governance, leadership and strong culture as essential for a world-class investor.	Portfolio construction should focus first on the allocation and balancing of risk; it is the allocation of risk that drives portfolio returns.	Our people drive our success.
Invest in people.	Our strategic allocation policy is the primary determinant of the asset portfolio's long-term return and asset portfolio's risk.	The global public investment markets are largely, but not completely, efficient.	Theories and concepts must be sound.	A long time investment horizon is a responsibility and an advantage.	We work to clear investment goals and accountabilities to meet our liabilities.	Diversification is critical because the future is unknown. Reliable diversification requires a fundamental understanding of the economic drivers of risk and return.	The best investment results come from people who are empowered to make decisions and are accountable for them.
Build a high performance culture.	While we can sacrifice some short-term liquidity to pursue a greater long-term return, the investment portfolio's net cash flows and ability to pay benefits on a year-by-year basis are key risk considerations.	Managing investment costs yields long-term benefits.	House capital market views are imperative.	System investment decisions may reflect wider stakeholder views, provided they are consistent with its fiduciary duty to members and beneficiaries.	We act as a long-term investor.	Every investment should be examined in the context of its potential return from beta (market return) to alpha (value added return); while separation is not always possible, every effort should be made to distinguish the two distinct return components.	Our brand is a strong and valuable asset.

Sample Investment Beliefs

Sample 1	Sample 2	Sample 3	Sample 4	Sample 5	Sample 6	Sample 7	Sample 8
We are all risk managers.	Diversification improves the risk-adjusted return profile of the investment portfolio.	Internal management is critical.	Investment strategies must be forward looking.	Long-term value creation requires effective management of three forms of capital: financial, physical and human.	Price matters so we will be patient but ready to act.	Flexibility to opportunistically alter the portfolio away from risk-balanced when markets are driven to extremes as result of short-term economic cycles is an important portfolio management tool.	Taking risk is necessary to earn the returns required to meet our pension obligations.
Allocate wisely.	There are long-term benefits to managing investment costs.	The system can potentially capture illiquidity risk premium.	Public markets are generally informationally efficient.	The system must articulate its investment goals and performance measures and ensure clear accountability of their execution.	We believe diversification usually reduces risk more than return.		We engage in active management, with a global perspective, to earn higher returns because we believe markets can be inefficient.
Costs matter.	The equity risk premium is significantly positive over a long-term investment horizon although it can vary over time.	Managing short-term drawdown risk can positively impact the system's ability to meet its long-term financial obligations.	Market frictions are highly relevant.	Strategic asset allocation is the dominant determinant of portfolio risk and return.	In managing risk we recognize it is multi-faceted and not fully quantifiable.		Our investment strategy considers our risk profile, our plan assets and our liabilities.
Collaborate widely.	We benefit significantly when roles and levels of authority are clearly defined and followed.	Responsible corporate governance, including the management of ESG factors can benefit investors.	Internal investment professionals are the foundation of a successful investment program.	Risk to the system is multi-faceted and not fully captured through measure such as volatility or tracking error.	We believe that costs matter and can be managed.		The returns we can expect will not be constant over time.

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Sample Investment Beliefs

Sample 1	Sample 2	Sample 3	Sample 4	Sample 5	Sample 6	Sample 7	Sample 8
Diversity with care. Act with clarity.	Private market investments have an illiquidity premium that we can capture.	Alignment of financial interest between the system and its advisors is critical.	Trustee expertise should be utilized while ensuring separation between board oversight and staff management.	The system will take risk only where we have a strong belief we will be rewarded for it.	We manage environmental, social and governance issues as they can have an impact on the long-term performance of investments.		Total fund diversification, through effective portfolio construction, is fundamental to our success.
Sustainability impacts investing.	Utilizing engagement initiatives to address environmental, social and governance-related issues can lead to positive portfolio and governance outcomes.			Costs matter and need to be effectively managed.	We seek to achieve alignment of interests between ourselves, our beneficiaries and those acting on our behalf.		Strong relationships support our success.
Innovation counts.	It is extremely challenging for a large institutional investor to add significant value over market-representative benchmarks, particularly in highly-competitive public global equity markets.						Investing is a business.
							Good governance is good business and contributes to sustainable values.

Suggested Approach

The Board owns the Investment Beliefs. Staff provides guidance and analysis to the Board and, therefore, has influence on the Board's Investment Beliefs.

Investment Beliefs Survey

- Each Board member, the Executive Director and key investment staff will anonymously complete an investment belief survey designed to assist in identifying investment beliefs.
- Responses will be summarized and will help identify where there is consensus and where there is not.
- Differences in beliefs provide a great opportunity to discuss, analyze and to ultimately agree to a set of 8-12 investment beliefs.

Questions and Feedback

PORTLAND CHICAGO NEW YORK

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