



# Annual Review: Fixed Income

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# Fixed Income Asset Class Objectives

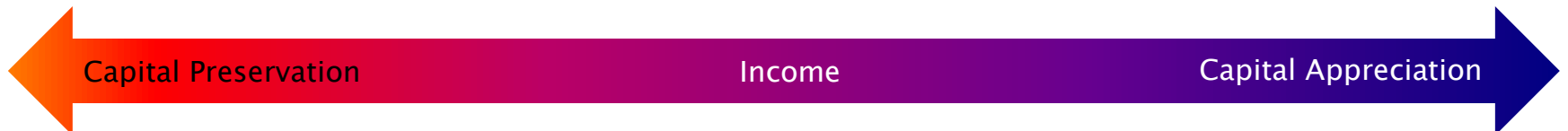
The Fixed Income asset class is separated into two portfolios:  
**Core Fixed Income and Non-Core Fixed Income (NCFI)**

## IPS Objective for the Core Fixed Income Portfolio:

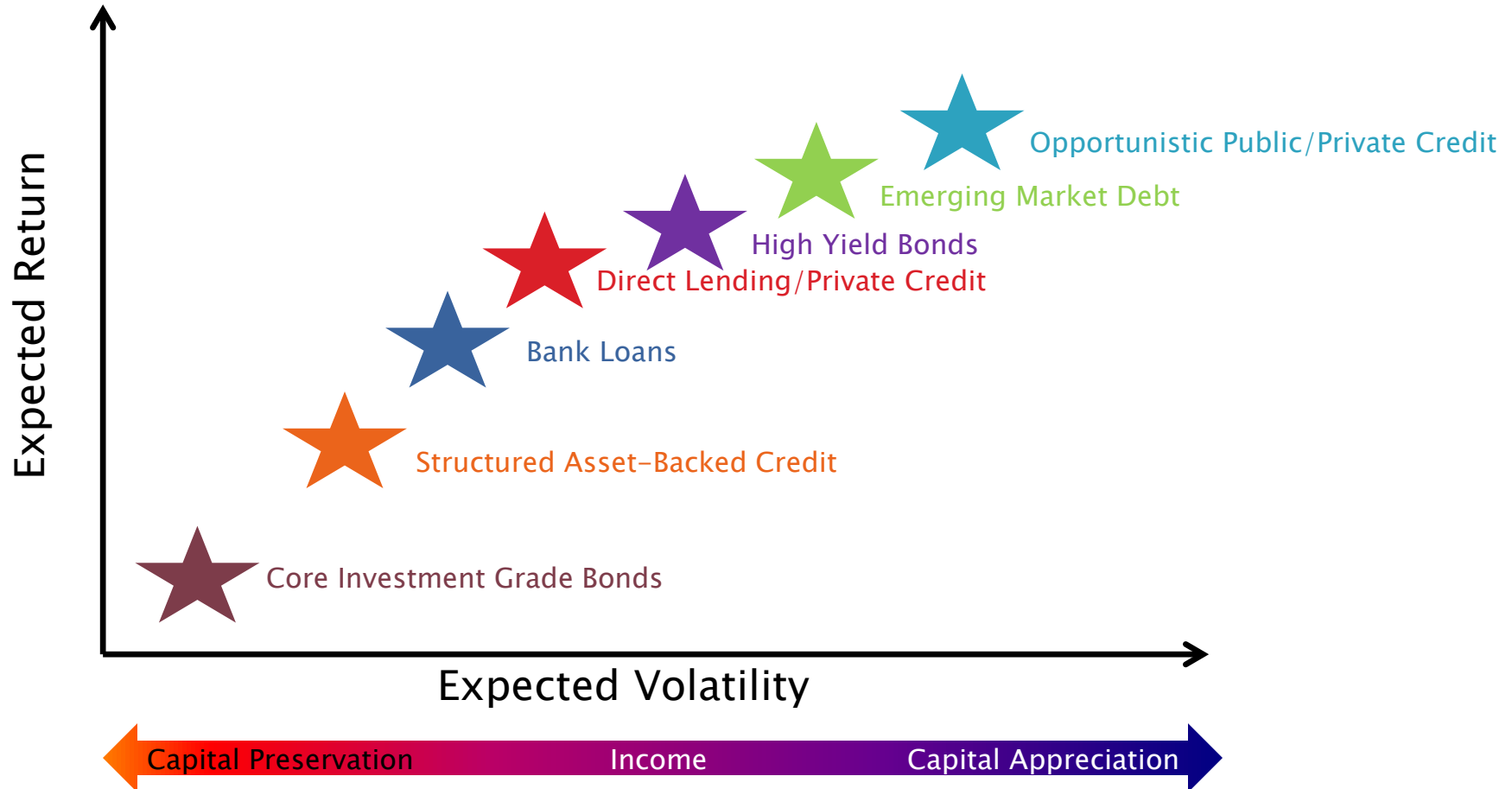
*“The core fixed income asset class **diversifies** the risk of the overall investment portfolio with a secondary goal of **capital preservation**. The overall objective is to exceed its benchmark performance net of fees over rolling five-year periods.”*

## IPS Objective for the Non-Core Fixed Income Portfolio:

*“The NCFI asset class **diversifies** the risk of the overall investment program and is designed to provide both **income** and **capital appreciation**. The overall objective is to exceed its benchmark performance net of fees over rolling five-year periods.”*



# Total Fixed Income Portfolio Opportunity Set

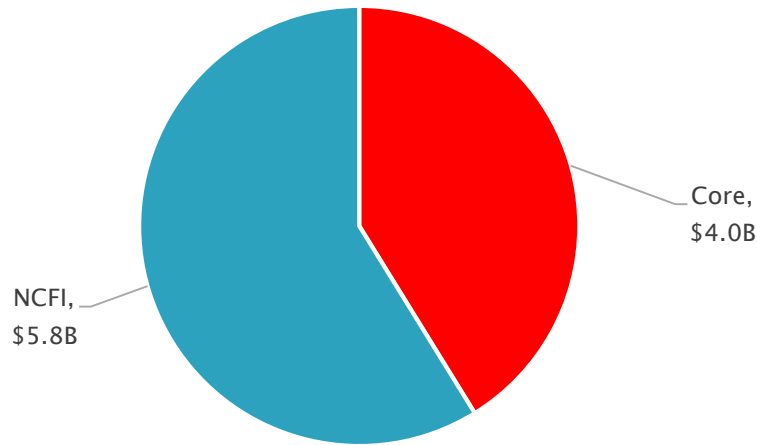


In addition to expected return and volatility, investment staff is constantly evaluating additional factors such as:

- Liquidity
- Fund structure
- Strategy
- Market and Economic Conditions

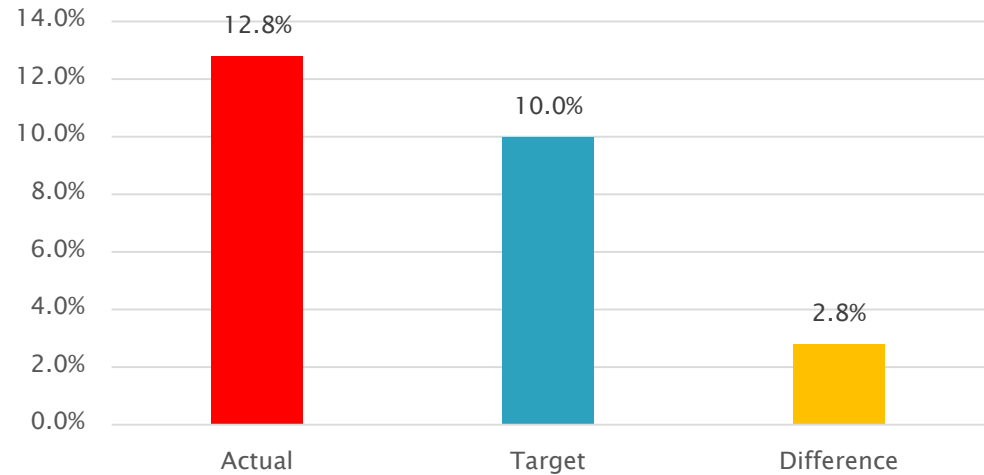
# Total Fixed Income Portfolio

TMRS Fixed Income Portfolio (as of 9/30/20)

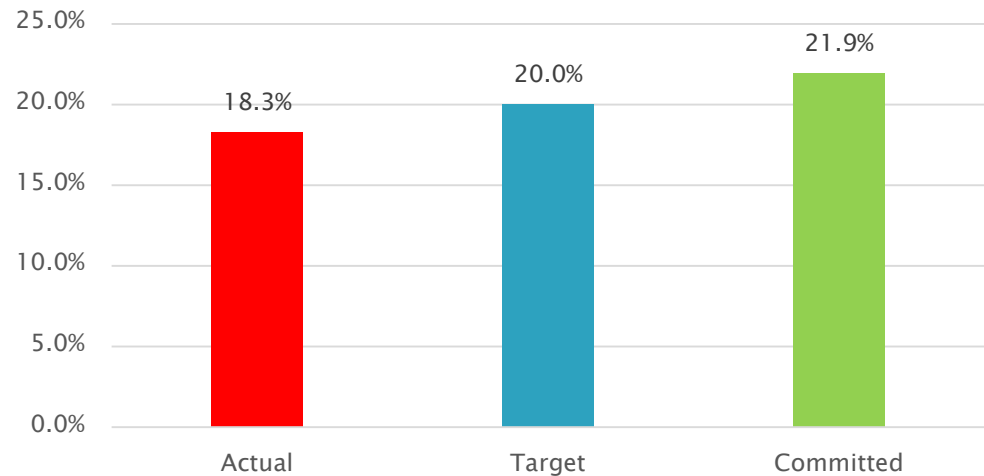


- Core Fixed Income continues to fund NCFI and other asset classes.
- NCFI represents 18.3% of the total portfolio on an invested basis and 21.9% on a commitment basis.

Core Fixed Income (as of 9/30/20)



Non-Core Fixed Income (as of 9/30/20)



# Core Fixed Income

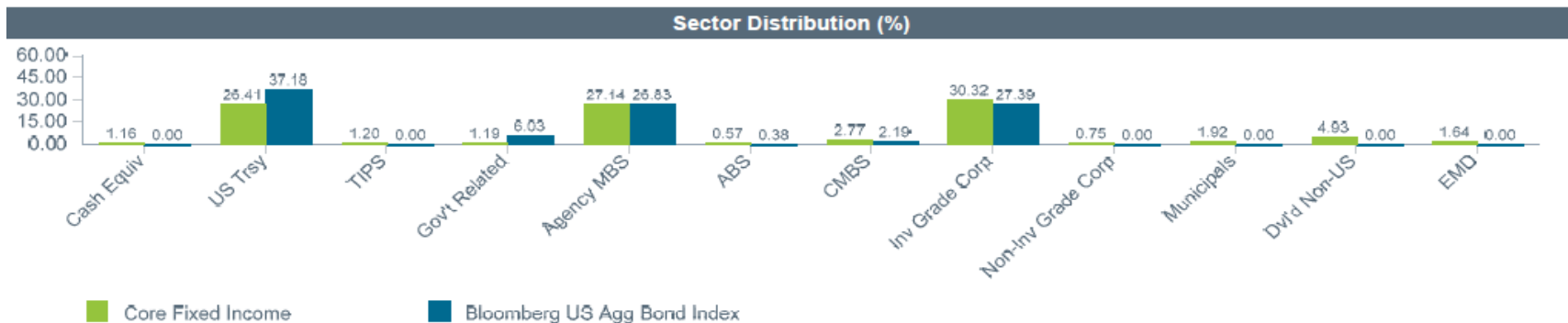
The TMRS Core Fixed Income portfolio includes securities from both the Core and Core Plus sectors. Investment managers buy securities in these sectors based on TMRS' desired credit quality and maturity profile.

## Core Sectors

- US Treasuries
- US Agencies
- US Mortgages
- Investment Grade Corporates
- US Municipal Bonds
- Asset Backed Securities
- Commercial Mortgage Backed Securities

## Core Plus Sectors

- US Treasury Inflation Protected Securities
- Global Inflation Linked Bonds
- High Yield Corporate Bonds
- Bank Loans
- Non-US Corporate Bonds
- Non Agency Mortgage Backed Securities
- Emerging Markets Debt



# Core Fixed Income Performance

Period Ending September 30, 2020 (Net All)

	MKT VAL	% of plan	1 Month	3 Months	YTD	1 Yr.	3 Yrs.	5 Yrs.	7 Yrs.	10 Yrs.	ITD	Incept Date
NGROA03 – TMRS – TOTAL CORE FIXED INCOME	4,033,009,046	12.81	-0.01	0.91	7.6	7.88	5.65	4.54	4.17	3.84	7.53	01-01-89
TMRS – Total Fixed Income Index (Daily)			-0.05	0.62	6.79	6.98	5.24	4.18	3.97	3.64		701-01-89
<b>Excess</b>			<b>0.04</b>	<b>0.3</b>	<b>0.81</b>	<b>0.89</b>	<b>0.41</b>	<b>0.36</b>	<b>0.2</b>	<b>0.2</b>	<b>0.53</b>	

## Performance Goals:

- Exceed the Bloomberg Barclays US Aggregate Bond Index net of fees over rolling five-year periods. ✓

# **Non-Core Fixed Income Private Credit Allocation**

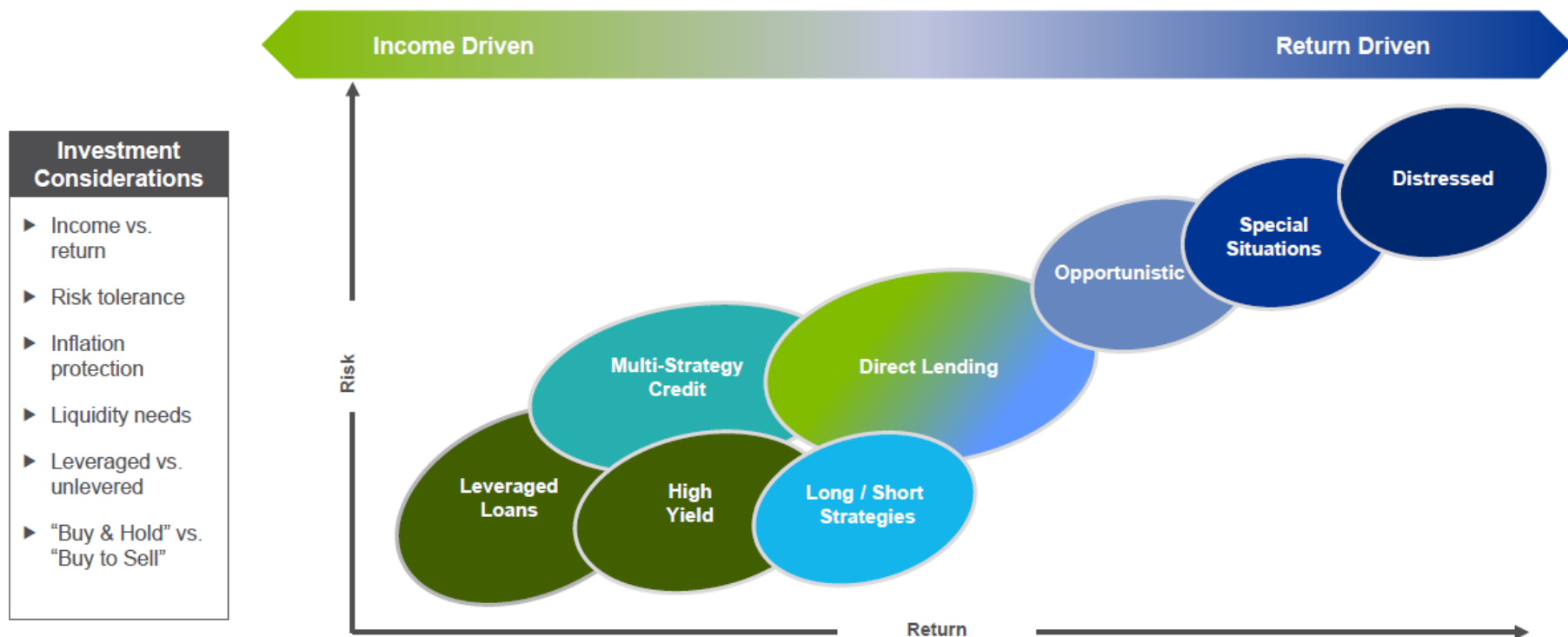
## **The Private Credit market opportunity exists because:**

- Traditional suppliers of private credit have decreased their lending appetite since the financial crisis.
- Bank consolidation and increased regulation has decreased the number of active lenders.
- Robust private equity market activity requires substantial private debt financing.
- Financing gap for private companies require alternative sources of capital.

## **Reasons Why TMRS Invests in Private Credit:**

- Capture illiquidity and complexity premium.
- Higher potential total return compared to traditional fixed income.
- Diversification across unique sources of return to improve risk profile and enhance performance.
- Better investor rights and protections due to privately negotiated loan documents.

# The Opportunity Spectrum of NCFI Credit



- Investment Considerations**
- ▶ Income vs. return
  - ▶ Risk tolerance
  - ▶ Inflation protection
  - ▶ Liquidity needs
  - ▶ Leveraged vs. unlevered
  - ▶ "Buy & Hold" vs. "Buy to Sell"

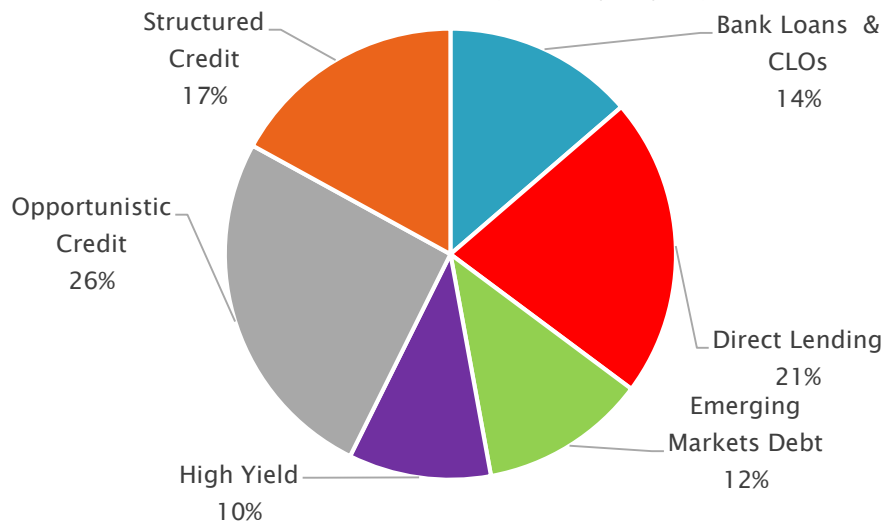
	Public Credit	Multi-Strategy Credit	Credit Long / Short Strategies	Direct Lending	Opportunistic	Special Situations	Distressed
Liquidity	Highly liquid	Monthly liquidity	Quarterly liquidity	Illiquidity premium	3-5 years horizon	3-5 years lock-up	8-10 years lock-up
Focus	Income	Income	IRR	Income	IRR & MOIC	Income and Capital Gains	MOIC

Source: BlackRock

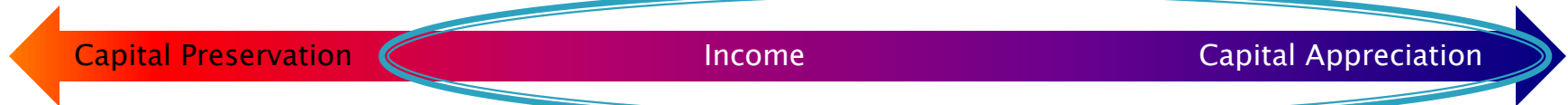
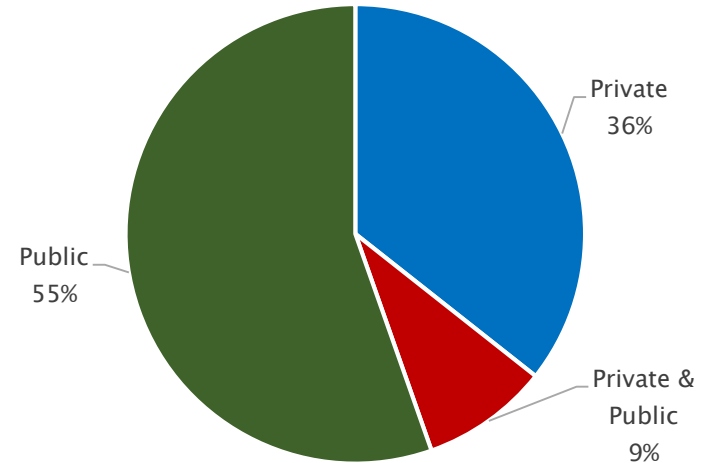


# Non-Core Fixed Income Portfolio Construction

NCFI Portfolio (as of 9/30/20)



NCFI Portfolio (as of 09/30/20)



## Structured Credit (17%)

- Ellington
- Voya
- Waterfall\*

## Bank Loans & CLO (14%)

- GSO
- Octagon

## Direct Lending (21%)

- Adams Street I\*\*\*
- Adams Street II\*\*
- Angelo Gordon\*\*
- Golub\*\*\*
- H.I.G. WhiteHorse\*\*
- TCW\*\*
- White Oak\*\*\*

## HY (10%)

- Columbia
- Neuberger Berman

## EMD (12%)

- Alliance Bernstein
- BlueBay

## Opportunistic Credit (26%)

- Bain
- Beach Point \*\*\*\*
- BlackRock GCO\*\*
- GoldenTree
- Marathon SPS\*\*\*
- Marathon ECO\*\*
- Marathon CLO RR\*\*
- PIMCO COF II\*\*\*
- PIMCO COF III\*\*
- Värde Private Debt Fund\*\*
- Värde Dislocation Fund\*\*

\* Opportunistic Mandate

\*\* Partially funded

\*\*\* Investment Period ended, on run-off mode



\*\*\*\* Mandate reallocated

# Performance

## Non-Core Fixed Income Performance Period Ending September 30, 2020 (Net All)

	MKT VAL	% of plan	1 Month	3 Months	YTD	1 Yr.	3 Yrs.	5 Yrs.	ITD	Incept Date
NGR0A11 - TOTAL NON-CORE FIXED INCOME	5,755,947,693	18.28	1.4	4.61	0.66	1.97	3.95	4.4	4.14	10-01-14
TOTAL NON-CORE FI WEIGHTED INDEX			2.59	5.43	0.02	1.26	3.61	3.99	3.4	10-01-14
Excess			-1.19	-0.82	0.63	0.71	0.34	0.41	0.74	

### Performance Goals:

- Exceed its benchmark performance net of fees over rolling five-year periods. 
- Measures of success are portfolio construction: identify best in class managers, balance concentration and diversification, ensure sufficient strategy diversification, etc. 

# FI Program Review – Accountability in Action

What did we say we were going to do?

## Fixed Income Initiatives Accomplished: Annual Review

Status

- Establish a due-diligence process to identify “best in class” manager opportunities  
*Sourcing, investment and operational due diligence, and leveraging Staff and consultant relationships were key factors enabling the identification of opportunities*
- Initiate & execute on manager selection, negotiation, and funding while maintaining consideration of portfolio construction and diversification looking forward 5 years  
*Recommendations and approval of selected manager investments and funding are executed on a dynamic timeline taking into account anticipated portfolio diversification and market regimes*
- Progress Non-Core Fixed Income Portfolio towards a target NAV while managing commitment levels, portfolio construction and access to best in class managers  
*Commitment levels, portfolio construction, and access to best in class managers have been successful, but deployment – somewhat outside of our control – has been a bit slower than expected*
- Construct and maintain the NCFI portfolio to accomplish TMRS’ investment objectives as a return driver and diversifier of risk  
*\$4.1 billion of non-core fixed income capital committed since Dec. 2015. \$5.9 billion in total for new mandates plus existing portfolio improvements. The risk/return profile of the invested portfolio achieves TMRS investment objectives*
- Monitor existing portfolio. Source, research, and pursue new strategies and co-invest opportunities  
*Additional strategies, including international exposure and co-investments may be used to further optimize the portfolio as well as blend down fees with existing funds*



# Fixed Income 2021 Agenda

- The NCFI portfolio is fully allocated on a committed basis. The next phase in portfolio management will require Staff to continuously evaluate asset allocation to potentially further improve performance.
- Opportunistically target complementary strategies/sectors across the private credit spectrum to produce uncorrelated/durable total returns.
- Conduct manager searches in 2021 to reinvest returns of capital from previous private credit investments (or other reasons) if needed.
- Continuously refine our manager due diligence process to improve the total return and risk profile of the Core and NCFI portfolios.
- Continue to assess and potentially implement direct investment mandates to drive down costs and improve net returns.

# Conclusion

- TMRS has made substantial progress towards its strategic fixed income objectives.
- The Core and NCFI portfolios have outperformed their benchmarks over the three- and five-year periods.
- The NCFI portfolio has generated attractive positive returns from diversified/differentiated sources as intended.
- We continue to take advantage of expansive private credit opportunity sets to refine the portfolio asset allocation.
- Select private credit strategies remain attractive sources of return but a cautious approach to underwriting is warranted given the substantial capital raised in this market segment.

## **DISCLOSURES**

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