Investment Program Looking Ahead
Texas Municipal Retirement System
August 2009
Diversification and Risk

Background and introduction:

- TMRS was invested in 100% bonds due to plan design
  - Lacking diversification
  - Potentially insufficient return given long-term market dynamics

- There is another way
  - Broad diversification and a long-term perspective can lead to higher returns without undue risk
  - Legislation in 2009 will allow for diversification and management to total return objectives
Recent Portfolio Events

- Domestic Equity has been added to the portfolio
  - Passive (or indexed) exposure
  - Dollar cost averaging to minimize risk
  - 6% position as of 6/30/2009

- International Equity has been added to the portfolio
  - Passive (or indexed) exposure
  - Developed countries only to date
  - Dollar cost averaging to minimize risk
  - 6% position as of 6/30/2009

- Fixed income investments - interest rate risk has been reduced and portfolio has become more diversified

- 100% externally advised by best in class fiduciary
Investment Program Timeline

An expected timeline follows

Will be dynamic and require updates as we move through time

TMRS Timeline

August 2009
- Timeline discussion
- Core plus fixed income update
- 2009 Q2 Performance update

September 2009
- Core plus manager selection
- Authorization for real estate consultant search
- Real estate review and discussion

December 2009
- Real estate consultant selection
- Year in review

2010 - 2012
- Further equity diversification
- Further fixed income diversification
- Potential real estate funding
- Real return education presentation
- Private equity education presentation
- Absolute return education presentation
- Potential funding alternative investments
Fixed Income – Timeline

- **Fixed income diversification:**
  - Additional sub-asset classes within fixed income offer potential diversification benefits and enhanced returns to the fixed income allocation as well as the overall portfolio. The role of fixed income as a deflation hedge, anchor to safety, or need for income will be considered.

- Core plus fixed income manager search initiated: Jun 2009
- Manager interviews and selection: Sep 2009
- Non-US and Emerging Mkt fixed income considered: 2010
- Passive core fixed income allocation considered: 2011
- High Yield fixed income allocation considered: 2012
Current Fixed Income Diversification

- **Fixed Income Structure:**
  - Core plus manager search and selection is expected to be completed over the next couple of months

- **Diversification into a core plus strategy is expected to provide:**
  - Manager diversification
  - Diversification of fixed income asset class by including high yield and non-U.S. exposures
  - Higher expected returns through the expanded opportunity set, greater flexibility, and higher risk exposures
  - Suitable alignment with current resources and non-discretionary mandates

- Core plus strategy is targeted for 10% of the total portfolio to be implemented in a prudent and cost effective manner.
Core Plus Fixed Income Manager Search

- The core plus fixed income manager search is well under way

- TMRS Staff and R.V. Kuhns have so far:
  - Agreed on the minimum criteria for manager inclusion
  - Identified and invited 9 managers to participate based on minimum criteria
  - Reviewed proposer responses and additional data analysis
  - Conducted telephone interviews
  - Interviewed semi-finalists at TMRS offices

- Upcoming Steps:
  - RVK and Staff select finalists, and conduct manager site visits (early September)
  - Board interviews & potentially selects recommended manager(s) (September 25th)
Equity – Timeline

- **Equity diversification:**
  - Continuation of additional allocation increase to US and international equity by approximately 1.5% per month.
  - Further diversification within equity portfolio by introducing additional sub-asset classes.

- International small cap and emerging markets considered: 2010
- Structure and implementation recommendation: 2010
- Manager recommendations and selections: 2010
Real estate: 

Real estate provides an alternative source of income and is often used as a substitute for fixed income. The nature of direct ownership of core properties can range in expected returns and volatility.

- Real estate education and discussion: Sep. 2009
- Real estate consultant selection: Dec. 2009
- Potential implementation: 2010-2013
Alternative Investments – Timeline

- **Alternative investments:**
  - Alternative investments, with low correlation to traditional asset classes, are typically utilized by investors to further increase returns and decrease portfolio volatility. Other risks besides volatility will be discussed.

- Real return educational presentation: 2010-2011
- Private equity educational presentation: 2010-2011
- Absolute return educational presentation: 2010-2011
- Potential manager recommendations and selections: 2011-2013
Summary

- **Continue progress toward optimal diversification in an incremental manner by approving final target and interim 2009 and 2010 targets**
  - Continue to increase and diversify equity allocation
    - 2009 increase current exposures
    - 2010 consider adding non-U.S. small cap and emerging markets exposures
  - Continue to diversify fixed income allocation
    - 2009 add core plus mandate (including exposure to high yield and non-U.S.)
    - 2010 continue to diversify fixed income
  - Introduce real estate allocation
    - 2009 seek real estate consultant
    - 2010 real estate manager searches
  - Introduce real return allocation
    - 2010 introduce TIPS or commodities