

**MINUTES OF THE
TEXAS MUNICIPAL RETIREMENT SYSTEM
Meeting of the Board of Trustees**

May 15, 2014 – 2:00 p.m.

May 16, 2014 – 8:30 a.m.

On May 16, 2014, the Board of Trustees of the Texas Municipal Retirement System (TMRS) reconvened for a meeting at 8:30 a.m. at TMRS Headquarters, located at 1200 North IH 35 in Austin, Texas, with the following members present:

Board of Trustees

Julie Oakley, Vice Chair

Jim Parrish

Bill Philibert

David Landis

Jim Jeffers

Absent: Roy Rodriguez

Present also were:

David Gavia, Executive Director
Ian Allan, Director of Internal Audit
Rhonda Covarrubias, Director of Finance
Eric Davis, Deputy Executive Director
Kristie O'Hara, Director of Human Resources
TJ Carlson, Chief Investment Officer
Leslee Hardy, Director of Actuarial Services
Debbie Munoz, Director of Member Services
Christine Sweeney, General Counsel
Bill Wallace, Director of Communications
Dan Wattles, Director of Governmental Relations
Scott Willrich, Director of Information Resources
Kristin Qualls, Director of Equities
Dimitry Shishkoff, Director of Risk Management
Jesse Pittman, Project Manager
Karen Jackson, Executive Assistant
Robert Klausner, Klausner, Kaufman, Jensen & Levinson
Marcia Beard, R. V. Kuhns & Associates
Ed Schwartz, ORG
Dr. A. Gary Shilling, A. Gary Shilling & Co., Inc.

Also in attendance:

Sherry Chapman, Investment Accountant
Debbie Farahmandi, Investment Operations Specialist

Howell Hollis, Investment Analyst
Peter Jeske, Project Specialist
Eddie Schultz, Real Estate Analyst
Michelle Mellon-Werch, Associate General Counsel
Candace Nolte, Controller
Nick O'Keefe, Senior Staff Attorney
Cindy Morse, Investment Support Analyst
Kate Reed, Investment Risk Analyst
Melissa Jerkins, Quantitative Analyst
Pete Krnavek, Information Systems Manager
David Rodriquez, Regional Manager – City Services
David Crow, Arlington Professional Fire Fighters
Bob Scott, Government Finance Officers Association of Texas
Chris Jones, Combined Law Enforcement Associations of Texas
George Kauffman, City of Garland
Scott Kerr, Texas State Association of Firefighters
Greg Shipley, Combined Law Enforcement Associations of Texas
Jerry Gonzales, Service Employees International Union
Greg Vick, alternate, Texas City Management Association
Ron Crabtree, Retiree
Bryan Langley, City of Denton
Joe Angelo, City of San Antonio
Keith Hopkins, Mesquite Fire Department

Ms. Oakley called the meeting to order at 8:30 a.m. and Mr. Jeffers gave the invocation.

1. Annual Economic Outlook

Dr. Shilling discussed how stocks are still below their peak even if stocks were adjusted for inflation. At the end of 2013, there was a lot of euphoria that the rally in stocks would continue and the economy is growing, but very slowly. This is the slowest recovery in the post-WWII period. This slowness is at least partially attributable to unemployment. The drop-out from the labor force is due to retirement of baby boomers and people staying in college. Some of the decline in the labor participation rate is offset by people 60 and over returning to the labor force. If the decline in labor force was not factored in, the unemployment rate would be closer to 13%.

Income has been shifting to the upper-end. Real median income, even now in recovery, is declining. Housing is another area of interest and prices are still off their peak. The housing rental market has been driving this sector. Stock prices are higher than their historical averages.

The reaction to the great recession by the Federal Reserve was to slash interest rates and to implement quantitative easing. Normally each dollar of reserves created by the Federal Reserve creates \$70 in lending, but currently they are getting \$1.3 to \$1 in lending. The Federal Reserve is now backing off the creating of these excess reserves.

The Federal Reserve is concerned with the possibility of deflation. The target is 2.0% inflation rate and the Federal Reserve wants inflation so they can have a cushion against deflation. Due to this period of low interest rates, investors are seeking out riskier investments. Areas like social media and biotech are drawing a lot of attention for their yields, but caution should be exercised. The current market we are in is considered “risk on”, but this bull stock market will not continue forever. The question is what will end the current market euphoria. Mr. Shilling believes an unexpected economic shock could precipitate the end of the bull market. Problems in China could provide the impetus: slowing growth, transition to domestic-driven economy, rising militarism, anti-corruption campaign, etc. The Chinese government is working to control currency speculation. Its shadow banking system has grown, but the government is trying to get control of this. If China cannot control these issues, it can impact our economy. Unattractive investments are: selected commodities (copper), developed country stocks and emerging market stocks. In the event of an economic shock, the safe havens are: U.S. dollar, Treasuries, low P/E stocks, high quality income producing securities.

2. Chief Investment Officer Management Update

Mr. Carlson began by noting that our general investment consultant RV Kuhns and Associates has officially rebranded themselves as RVK. He discussed staffing updates and noted that Kate Reed is 100% focused on compliance. We have hired two new analysts to work with our Risk Analysis team focusing on quantitative and data analysis. Mr. Carlson noted we are very close to hiring a Director of Absolute Returns and finalist interviews for the Director of Fixed Income position should be complete by late June. Mr. Klausner added that the personnel actions taken are an important exercise of the Board’s fiduciary duty. Mr. Carlson handed out and discussed the newly created “Systemwide Investment Pacing Plan”.

3. R.V. Kuhns Quarterly Investment Report

Ms. Beard began her remarks by looking at TMRS’ allocation compared to peers. The TMRS actual allocation has more exposure to fixed income than its peers, but the portfolio continues to move towards a well-diversified structure as the fixed income allocation is reduced. A slow and methodical pace into new asset classes and strategies via ongoing research and due diligence efforts, coupled with dollar cost averaging into new investments over multiple time periods continues to be prudent.

Ms. Beard reviewed fund performance versus benchmarks. The first objective is to beat the passive benchmark on a 5-year average, this objective was achieved. The second expectation is to beat the 7% long term return assumption, this objective was also achieved. The third objective is to beat the long term asset allocation benchmark. This objective was not met because we are not fully implemented to the policy target yet, and will not be for several years based on the phased asset allocation implementation. While performance relative to other systems is not an objective of the TMRS fund given the wide range in investment objectives and different benefit plan structures, it is generally of interest to be aware of the performance of other public pension systems. The main take away is in a strong equity

market, we will not perform as well, but we are better protected in down markets. Our portfolio is built with lower volatility, which results in lower return expectations. Continued movement to the policy target will improve performance over time.

4. Review Draft Pacing Plans, Investment Staffing and Resource Needs for 2014/2015

Mr. Carlson stated that this information is building upon the Staffing Resources Memorandum presented in February 2014. He presented the pacing plan, staffing and resource needs. This will not result in a budget amendment, but will likely result in a request to reallocate funds already allocated. Mr. Carlson reviewed how this plan is laid out, showing time and scheduling of various searches by asset class. He then reviewed each line item, discussing the current plans of the Investment Department. Timing of hiring analysts in comparison to creation of the asset class ground work was discussed.

5. Consider and Act on (a) Adoption of Amendment to the Strategic Plan Delaying the General Investment Consultant Search by One Year and (b) One Year Extension of General Consultant's Contract.

Mr. Carlson stated TMRS is very satisfied with the services provided by RVK. Staff would like more time to review the coordination of services provided by investment consultants and this one year delay would allow the time needed to continue to review the services of RVK, ORG and potential other consultants. Mr. Parrish pointed out that at some point this review does need to be done although he is not advocating against this action.

Mr. Parrish made a motion for the Board to approve the item as presented. Mr. Landis seconded the motion, which passed 5-0.

6. Consider and Act on Adoption of the 2014 Risk Based Audit Plan

This item has been postponed until the June 2014 Board meeting.

7. Call for Future Agenda Items

No items were mentioned.

Ms. Oakley thanked the Staff and the Consultants for all the preparation that went into this meeting and the Advisory Committee meeting.

The meeting was adjourned at 10:55 a.m.



David Gavia
Executive Director



Roel "Roy" Rodriguez
Chair, Board of Trustees