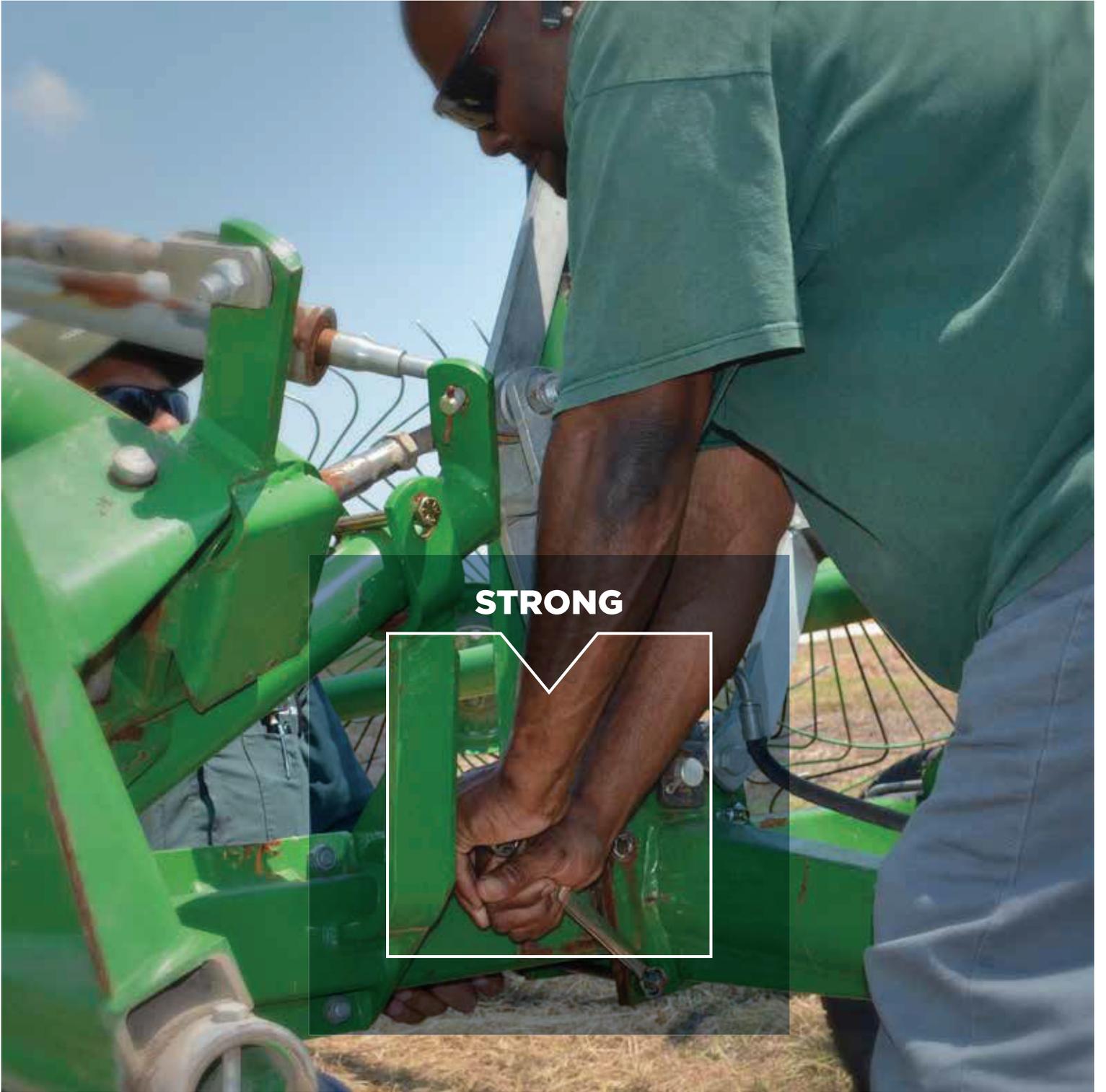


# INVESTMENTS

- SECTION 3 -

YOUR  
EFFORTS  
CREATE A  
BETTER  
FUTURE FOR  
EVERYONE



**STRONG**



**HMEPS**  
HOUSTON MUNICIPAL EMPLOYEES PENSION SYSTEM

The Board of Trustees (“Board”) of the Houston Municipal Employees Pension System (“System”) has adopted an Investment Policy Statement (“IPS”) as a framework for the investment of the System’s assets. The authority to amend the IPS rests solely with the Board. The following provides an overview of the IPS.

### **PURPOSE**

The IPS assists the Board in its role as fiduciary for the System’s investments by: a) specifying the Board’s expectations, objectives and guidelines for the System, b) clarifying the responsibilities of the Board, the staff, the consultants and vendors, c) setting forth an investment structure for managing the portfolio, d) encouraging effective communications, and e) establishing criteria to select, remove, monitor and evaluate performance of money managers and vendors on a regular basis.

### **INVESTMENT OBJECTIVES**

The investment objective of the total portfolio is to produce an annualized investment return over the long term that exceeds the actuarial return rate assumption for the System. This will help the Board to achieve its overall objective of providing adequate retirement benefits to the members of the System.

The System’s investment performance is compared to a policy portfolio comprised of market indices, which are consistent with the overall investment policy. The policy portfolio reflects a passive implementation of the target investment policy. Effective October 1, 2017, the Board approved an updated asset allocation for the System’s investment portfolio, along with an updated policy portfolio.

The System’s investment performance is also evaluated by comparing it to a group of its public fund peers. The public pension fund universe used for comparative purposes is the Wilshire TUCS Master Trusts – Public Universe.

### **ASSET ALLOCATION**

The System’s asset allocation provides an efficient mix of assets that is designed to provide a return profile that is consistent with the System’s long-term portfolio risk and return objectives. The Board periodically undertakes strategic studies to address the appropriateness of asset classes to be considered for inclusion in the target asset allocation, and to define the targeted percentage to each asset class to achieve the desired level of diversification.

The System’s current asset allocation, included in Table 1, became effective October 1, 2017.

### **DIVERSIFICATION**

The System invests in seven major asset classes (Global Equities, Fixed Income, Real Estate, Private Credit, Private Equity, Inflation-Linked, and Absolute Return) as a method to maximize overall fund diversification. Further, the System engages the services of numerous professional investment managers and invests in private partnerships and other private entities. The managers retained are expected to utilize varied investment approaches that, when combined, will exhibit return characteristics that are similar to the asset class proxy utilized in the strategic asset allocation plan. As of June 30, 2019, the System utilized 83 investment managers/funds, several of which have multiple mandates. Cash inflows and outflows are directed within the targeted asset class to the various managers/funds so that actual characteristics of the portfolio will be consistent with the strategic plan. No investment manager is permitted to have more than 20% of the fair value of the System’s assets.

### **REBALANCING**

The IPS requires a periodic adjustment, or rebalancing, of assets be made to ensure conformance with policy target levels. Such rebalancing is necessary to reflect sizable cash flows and performance imbalances among the various asset classes that may occur over time. During fiscal year 2019, Staff directed the rebalancing of assets within the asset allocation targets in response to market dynamics and the System’s liquidity needs.

### **INVESTMENT MANAGER GUIDELINES – PUBLIC MARKETS**

Investment managers are subject to guidelines and objectives incorporated in the investment management agreements entered into by the Board and the respective investment managers. Investment managers are expected to perform their fiduciary duties as prudent people skilled in such matters and, further, are

expected to comply with all applicable State and Federal statutes governing the investment of retirement funds. Within the context of the guidelines, investment managers have full discretion with respect to the purchase and sale of individual securities and portfolio weightings. Portfolios are to be managed in a manner similar to other portfolios within an organization with similar guidelines and performance objectives.

The Board requires that all investment managers seek best execution for all trades ordered on behalf of the System.

### **MANAGER EVALUATION**

Managers of portfolios are evaluated quarterly against predetermined benchmarks such as an appropriate market index or a comparable peer group. All public market managers are required to provide written reports to HMEPS outlining actions taken within their respective portfolios and the portfolio's investment performance. In addition, System personnel and professional consultants engaged by the Board monitor managers' performance, material changes in the managers' organization and conformity with their guidelines and objectives.

Managers that do not meet expectations will be placed on probation (for public market managers) or watchlist (for private market funds). Staff and the consultant will increase monitoring of these managers/funds, evaluating factors such as changes in the assets in the portfolio, changes in investment style, peer universe ranking and others.

### **INVESTMENT PERFORMANCE EVALUATION**

The Board reviews System investment performance on a periodic basis to evaluate conformity to the goals and objectives established in the strategic plan. The Board recognizes that financial markets from time to time may not support attainment of those goals and objectives. During such times, progress toward conformity is evaluated by comparing the System's performance to the policy portfolio and to the Wilshire TUCS Master Trusts – Public Universe. Investment results are calculated using a time-weighted rate of return.

### **PROXY VOTING**

The Board authorizes each investment manager to vote all proxies relating to securities held on behalf of the System. Each manager is expected to promptly vote all proxies and related actions in a manner consistent with the long-term best interests of the System and its participants and beneficiaries. Each investment manager is required to keep detailed records of all voting of proxies and related actions and to comply with all related regulatory obligations. The System's management staff periodically reviews each investment manager's policies and actions with respect to proxy voting.

## **INVESTMENT RESULTS**

### **LONG-TERM RESULTS**

The 10-year period ended June 30, 2019 has been a period of consistent growth for equity markets. The System performed well, generating double digit positive returns in five of the past ten fiscal years. Additionally, the System outperformed its peer group in seven of those ten years. The System's 5-year annualized return is 6.8%. The 10-year return stands at 9.7%.

As shown in the investment results (Table 2), HMEPS' total fund performance compares favorably to the median public fund, as represented by the Wilshire TUCS Master Trusts – Public Universe.

### **FISCAL YEAR 2019 RESULTS**

For the fiscal year ended June 30, 2019, the System returned 7.2%, exceeding the return of the median fund in the Wilshire TUCS Master Trusts – Public Universe of 6.6%.

The Investment Section was written by Chief Investment Officer Gregory Brunt, CFA, Investment Manager Douglas Wynkoop, CFA, and Financial Analyst Jumana Aumir, CFA.

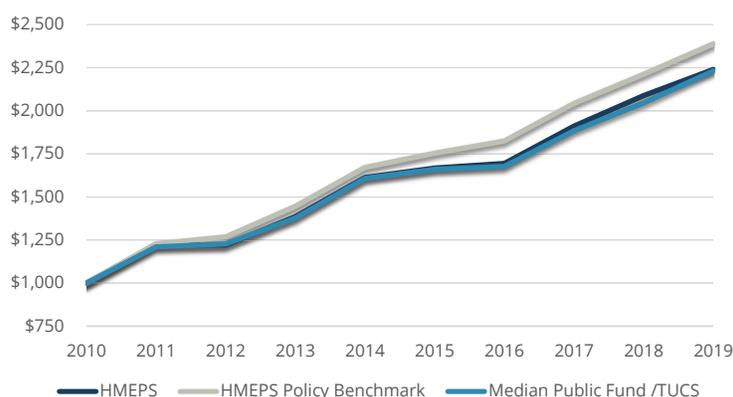
## SCHEDULE OF ASSET ALLOCATION

Table 1

Asset Class	Allocation		Investment Performance			
	Target	Actual	1 Yr.	3 Yrs.	5 Yrs.	10 Yrs.
Global Equity <sup>1</sup>	32.5%	32.3%	6.0%	10.7%	6.7%	n/a
<i>MSCI All Country World IMI</i>			4.6	11.4	6.0	n/a
<i>MSCI All Country World Min Volatility</i>			13.0	8.8	8.9	n/a
Fixed Income	10.0	13.5	6.8	5.3	4.1	6.8
<i>Barclays Aggregate Index</i>			7.9	2.3	3.0	3.9
<i>Merrill Lynch High Yield Master II Index</i>			7.6	7.5	4.7	9.2
Private Credit	5.0	1.1	8.8	n/a	n/a	n/a
<i>CSFB Leveraged Loan Index</i>			4.2	n/a	n/a	n/a
Private Equity <sup>2</sup>	17.0	22.9	14.1	15.8	12.9	13.6
<i>S&amp;P 500 Index + 3%</i>			13.4	17.2	13.7	17.7
Real Estate <sup>3</sup>	12.5	10.6	7.7	8.9	10.1	7.6
<i>NCREIF Property Index</i>			6.5	6.9	8.8	9.3
Inflation-Linked	15.0	14.0	2.1	5.3	-1.4	5.6
<i>CPI + 4%</i> <sup>4</sup>			5.7	6.1	5.5	5.7
Absolute Return	8.0	4.7	3.3	5.0	2.0	6.3
<i>LIBOR + 4%</i> <sup>5</sup>			6.5	5.8	5.2	4.8
Cash	-	0.7	n/a	n/a	n/a	n/a
Total Portfolio	100.0	100.0	7.2	9.7	6.8	9.7
<i>Policy Benchmark</i>			8.0	9.4	7.4	10.4
<i>Median of Wilshire Public Fund Universe/TUCS</i>			6.6	8.9	6.1	9.4

## ILLUSTRATION OF GROWTH OF \$1000

Table 2



- 1 The Global Equity Policy: 3Q13 -Present: 75% MSCI All-Country World IMI (Net), 25% MSCI All-Country World Minimum Volatility Index (Net).
- 2 Beginning October 1, 2008, Private Equity is separate from Absolute Return. Prior returns were combined in the Private Equity composite.
- 3 Beginning October 1, 2008, Real Estate is separate from Inflation-Linked. Prior returns were combined in the Real Estate composite.
- 4 Inflation Linked Assets Custom Benchmark: 2Q11-Present: CPI + 4% annually; Prior to 2Q11: CPI + 5% annually.
- 5 Absolute Return Benchmark: 2Q11 - Present: Libor 3-Month Yield + 4% annually; Prior to 2Q11: Libor 3-Month Yield + 5% annually.

## SCHEDULE OF TOP INVESTMENTS

### SCHEDULE OF TOP PUBLIC EQUITY INVESTMENTS AS OF JUNE 30, 2019\*

<i>Name of Investment</i>	<i>Fair Value of Investment</i>	<i>Percent of Portfolio</i>
BlackRock MSCI ACWI MIC Index	\$ 248,868,966	8.1%
State Street Global Advisors REIT Index	114,087,511	3.7%
BlackRock ACWI ex-US Index	74,950,961	2.4%
Blackrock Equity Index Fund A	38,266,331	1.2%
State Street Global Advisors Global Natural Resources	33,591,085	1.1%
Blackrock MSCI Emerging Markets Free Fund	32,975,574	1.1%
Plains All American Pipeline	12,277,440	0.4%
Enterprise Products Partners	12,144,108	0.4%
Energy Transfer LP	11,727,218	0.4%
Magellan Midstream Partners	10,497,472	0.3%

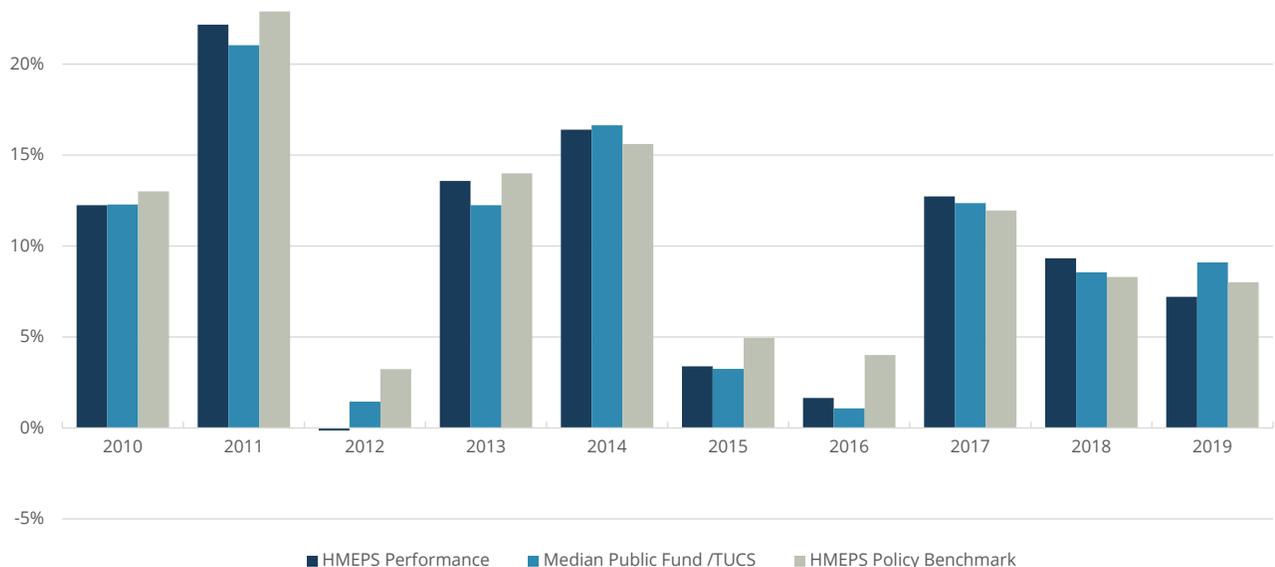
### SCHEDULE OF TOP DEBT INVESTMENTS AS OF JUNE 30, 2019\*

BlackRock U.S. Debt Index (Barclays Aggregate)	\$ 60,018,172	2.0%
GMO Emerging Country Debt	20,777,671	0.7%
Alliance Bernstein Emerging Market	19,440,190	0.6%
US Treasury 08/19 0.0	7,979,326	0.3%
US Treasury 08/19 0.0	4,989,194	0.1%
US Treasury 11/19 0.0	4,147,552	0.1%
US Treasury 09/19 0.0	3,601,066	0.1%
US Treasury N/B 04/21 2.375	3,464,849	0.1%
US Treasury N/B 08/25 2	3,185,193	0.1%
US Treasury N/B 11/23 2.75	3,105,249	0.1%

\* A complete list of the System's holdings is available at the System's office by appointment.

## PERFORMANCE BY FISCAL YEAR

Last Ten Years



**COMPARISON OF INVESTMENT RETURNS - YEARS ENDED JUNE 30**  
 (Calculated based on a time-weighted rate of return based on the market rate of return)

Period ending 06-30	Median of Wilshire Public Fund Universe/ TUCS				Barclays Capital Aggregate Bond Index				Merrill Lynch High Yield Master II Index				HMEPS Private Equity				S&P 500 Index				HMEPS Real Estate				NCREIF Property Index				HMEPS Inflation-Linked				Consumer Price Index				HMEPS Absolute Return				LIBOR			
	HMEPS Total Fund	HMEPS Policy Portfolio	HMEPS Fund Universe/ TUCS	HMEPS Global Equity	MSCI ACWI Min Vol	MSCI ACWI IMI	MSCI ACWI	HMEPS Fixed Income	Barclays Capital Aggregate Bond Index	Merrill Lynch High Yield Master II Index	HMEPS Private Equity	S&P 500 Index	HMEPS Real Estate	NCREIF Property Index	HMEPS Inflation-Linked	Consumer Price Index	HMEPS Absolute Return	LIBOR																										
2010	12.24%	13.00%	14.71%	n/a	n/a	n/a	17.00%	9.50%	27.53%	16.82%	14.43%	-9.52%	-1.48%	21.52%	1.05%	23.39%	0.34%																											
2011	22.17%	22.89%	21.19%	n/a	n/a	n/a	9.33%	3.90%	15.40%	22.54%	30.68%	10.92%	16.73%	39.72%	3.56%	13.94%	0.33%																											
2012	-0.14%	3.23%	1.25%	n/a	n/a	n/a	6.31%	7.48%	6.51%	11.00%	5.44%	3.78%	12.00%	-21.96%	1.66%	-0.86%	0.46%																											
2013	13.58%	13.99%	12.27%	n/a	n/a	n/a	5.99%	-0.69%	9.57%	7.85%	20.59%	12.80%	10.73%	14.52%	1.75%	10.87%	0.31%																											
2014	16.39%	15.61%	16.83%	21.92%	20.92%	13.84%	9.22%	4.37%	11.80%	14.31%	24.61%	9.11%	11.21%	22.33%	2.07%	7.28%	0.24%																											
2015	3.38%	4.96%	3.38%	2.22%	0.81%	6.59%	1.13%	1.86%	-0.55%	10.36%	7.42%	10.88%	12.96%	-9.14%	0.12%	2.65%	0.25%																											
2016	1.65%	4.02%	1.07%	-0.31%	-3.87%	11.55%	3.33%	6.00%	1.71%	7.05%	3.99%	12.95%	10.64%	-12.18%	1.01%	-6.92%	0.51%																											
2017	12.73%	11.95%	12.41%	16.34%	19.01%	6.05%	7.80%	-0.31%	12.75%	16.02%	17.90%	9.15%	6.98%	8.24%	1.63%	7.13%	1.02%																											
2018	9.33%	8.29%	8.45%	9.81%	11.14%	7.33%	1.50%	-0.40%	2.49%	17.22%	14.38%	9.87%	7.20%	5.78%	2.87%	4.65%	1.36%																											
2019	7.22%	7.97%	6.62%	6.05%	4.56%	13.00%	6.77%	7.87%	7.60%	14.05%	10.42%	7.68%	6.50%	2.05%	1.65%	3.27%	2.55%																											
3 Yrs.	9.74%	9.39%	8.89%	10.65%	11.41%	8.75%	5.32%	2.31%	7.53%	15.75%	14.19%	8.90%	6.89%	5.33%	2.05%	5.00%	1.79%																											
5 Yrs.	6.79%	7.40%	6.07%	6.66%	6.03%	8.87%	4.07%	2.95%	4.69%	12.88%	10.71%	10.09%	8.83%	-1.39%	1.45%	2.04%	1.22%																											
10 Yrs.	9.65%	10.42%	9.39%	n/a	10.32%	11.39%	6.75%	3.90%	9.22%	13.63%	14.70%	7.56%	9.25%	5.64%	1.73%	6.25%	0.77%																											

SCHEDULE OF FEES AND COMMISSIONS PAID  
In Fiscal Year 2019

<i>Broker Name</i>	<i>Number of Shares</i>	<i>Commissions (\$)</i>	<i>Cents/Share</i>
Barclays Capital	754,765	13,370	1.77
BMO Nesbitt Burns Trading Corp.	7,414,501	2,946	0.04
BNP Paribas Securities Services	450,996	4,493	1.00
BOFA Securities Inc.	1,356,783	13,424	0.99
Capital Institutional Svcs Inc. Equities	5,293,550	18,604	0.35
Citigroup Global Markets	1,108,052	18,140	1.64
CLSA Singapore	393,199	2,420	0.62
Cowen And Company, LLC	168,876	5,708	3.38
Credit Suisse Securities	603,190	10,962	1.82
Davidson D.A. + Company Inc.	54,450	2,178	4.00
Deutsche Bank Securities Inc.	2,539,463	8,722	0.34
Exane S.A.	140,469	2,636	1.88
Fidelity Clearing	136,000	3,037	2.23
Goldman Sachs + Co.	631,107	7,166	1.14
Guzman And Company	222,287	3,260	1.47
HSBC Securities	314,182	2,096	0.67
Instinet LLC	8,883,288	31,889	0.36
J P Morgan Securities Inc.	2,950,335	26,738	0.91
Jefferies + Company Inc.	873,199	11,757	1.35
Jefferies International Ltd.	590,296	2,415	0.41
Maxim Group	567,399	12,699	2.24
Merrill Lynch And Co Inc.	184,176	2,939	1.60
Morgan Stanley Co Incorporated	4,382,899	27,110	0.62
National Financial Services Corp.	132,930	3,108	2.34
Piper Jaffray	66,025	2,641	4.00
Raymond James And Associates	149,994	3,334	2.22
Rbc Capital Markets	465,377	11,910	2.56
Redburn Limited	101,988	2,617	2.57
Robert W.Baird Co.Incorporate	149,732	3,711	2.48
Rosenblatt Securities LLC	166,771	3,339	2.00
Sanford C. Bernstein Ltd.	611,830	3,782	0.62
Smbc Nikko Capital Markets	398,300	2,481	0.62
Societe Generale	728,097	4,485	0.62
Stifel Nicolaus + Co Inc.	121,819	4,718	3.87
UBS AG	6,575,860	64,427	0.98
Weeden + Co.	187,247	3,016	1.61
Wells Fargo Securities LLC	528,223	8,769	1.66
Others	7,461,192	69,588	0.93
Total	57,858,847	426,636	0.74

SCHEDULE OF FEES AND COMMISSIONS PAID CONT.  
In Fiscal Year 2019

	<b>2019</b>	<b>2018</b>
Public Market Investments		
Global Equity	\$ 2,785	\$ 2,724
Fixed Income	1,174	1,259
Inflation Linked	1,416	1,024
Other Public Market	324	297
Non-Public Market (Invoiced)	0	75
Grand Total	<u>\$ 5,699</u>	<u>\$ 5,379</u>
Custodian Bank		
State Street Bank & Trust Company	368	370
Consultant Services		
Wilshire Associates, Inc.	284	284
Cliffwater LLC	550	550
Legal Services	70	53
Other Investment Expenses	1,048	1,027
Total Investment Expenses	<u>\$ 8,019</u>	<u>\$ 7,667</u>

Note: Dollar amount in \$000

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