

# INVESTMENT

- SECTION 3 -



**Becoming  
stronger and  
better with time.**

*Elizabeth Baldwin Park* consists of 4.88 acres on Elgin Street in the heart of the city. The park was acquired in 1905 and is filled with numerous oak trees dating from that period. In 1912, a stone fountain dedicated to the wife of Houston's founder, Charlotte Allen, was installed in the park. The park is located in a proud old neighborhood undergoing revitalization in the form of renovated houses and newly built townhouses and businesses.



**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 outline 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 investment 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 participants 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 Equity, 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 (including in both public markets and private partnerships) with demonstrated skills and expertise in managing portfolios within each asset class. 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, 2020, the System utilized 86 investment managers, several of which manage multiple mandates. Cash inflows and outflows are directed within the targeted asset class to the various managers so that actual characteristics of the portfolio will be consistent with the strategic plan. No investment manager is permitted to manage more than 20% of the fair value of the System’s assets.

### **REBALANCING**

The IPS requires a periodic adjustment, or rebalancing, of assets 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 2020, 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 who do not meet expectations will be placed on probation (for public market managers) or watchlist (for private market managers). Staff and the consultant will increase monitoring of these managers, 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, 2020 has been a period of growth for equity markets. The System performed well, generating double digit positive returns in four of the past ten fiscal years. Additionally, the System outperformed its peer group in six of those ten years. The System's 5-year annualized return is 5.9%. The 10-year return stands at 8.3%.

### **FISCAL YEAR 2020 RESULTS**

For the fiscal year ended June 30, 2020, the System returned -0.9%.

**INVESTMENT REPORT**

The System requested that the independent investment consultant, Wilshire Associates, Inc. (Wilshire), perform a review of HMEPS' investments as set forth in Section 2D of the System's governing statute, Article 6243h, Tex. Rev. Civ. Stats., §2D(a)(1-8). Wilshire submitted the report to the System, along with its Executive Summary dated June 19, 2020, of its review of the System's investments as set forth in §2D(a) (1-8). The report provides the text of each subsection of §2D(a), sets forth the information reviewed by Wilshire, and states Wilshire's review and finding on each subsection. The report can be accessed on the System's website at <http://www.hmeps.org/assets/wilshire-2d-report-hmeps-2020.pdf>.

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%	31.6%	0.0%	5.2%	6.2%	n/a
<i>MSCI All Country World IMI</i>			1.2	5.5	6.1	n/a
<i>MSCI All Country World Min Volatility</i>			-2.5	5.7	6.9	n/a
Fixed Income	10.0	11.5	4.3	4.2	4.7	5.5
<i>Barclays Aggregate Index</i>			8.7	5.3	4.3	3.8
<i>Merrill Lynch High Yield Master II Index</i>			-1.2	2.9	4.6	6.5
Private Credit	5.0	2.8	4.0	n/a	n/a	n/a
<i>CSFB Leveraged Loan Index</i>			-2.3	n/a	n/a	n/a
Private Equity <sup>2</sup>	17.0	26.5	3.4	11.4	11.4	12.3
<i>S&amp;P 500 Index + 3%</i>			10.3	13.7	13.7	17.0
Real Estate <sup>3</sup>	12.5	11.2	-4.0	4.3	7.0	8.2
<i>NCREIF Property Index</i>			2.7	5.4	6.8	9.7
Inflation-Linked	15.0	11.3	-28.2	-8.1	-5.9	.02
<i>CPI + 4%</i> <sup>4</sup>			4.7	5.8	5.6	5.7
Absolute Return	8.0	4.6	-1.4	2.1	1.2	3.9
<i>LIBOR + 4%</i> <sup>5</sup>			5.4	6.0	5.5	4.9
Cash	-	0.5	n/a	n/a	n/a	n/a
Total Portfolio	100.0	100.0	-0.9	5.1	5.9	8.3
<i>Policy Benchmark</i>			4.4	7.0	7.0	8.0
<i>Median of Wilshire Public Fund Universe/TUCS</i>			2.9	5.9	6.1	8.4

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, 2020\***

<i>Name of Investment</i>	<i>Fair Value of Investment</i>	<i>Percent of Portfolio</i>
BlackRock MSCI ACWI MIC Index	\$ 219,368,365	7.7%
Blackrock Equity Index Fund A	153,117,830	5.4%
State Street Global Advisors REIT Index	91,180,294	3.2%
Blackrock MSCI Emerging Markets Free Fund	39,304,578	1.4%
State Street Global Advisors Global Natural Resources	24,766,216	0.9%
BlackRock ACWI ex-US Index	23,024,712	0.8%
Enterprise Products Partners	8,423,685	0.3%
Energy Transfer LP	7,535,295	0.3%
MPLX	7,521,949	0.3%
Magellan Midstream Partners	7,156,032	0.3%

**SCHEDULE OF TOP DEBT INVESTMENTS AS OF JUNE 30, 2020\***

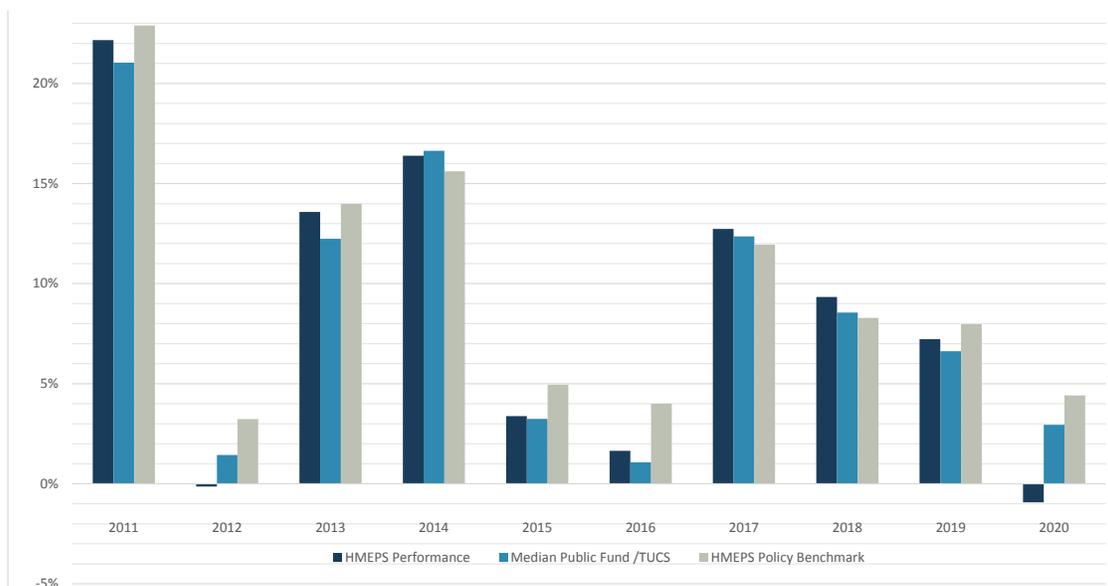
GMO Emerging Country Debt	\$ 20,748,843	0.7%
Alliance Bernstein Emerging Market	19,260,188	0.7%
BlackRock U.S. Debt Index (Barclays Aggregate)	17,876,684	0.6%
US Treasury 08/25 2.0	3,256,650	0.1%
US Treasury 11/29 2.375	3,236,119	0.1%
Asurion Second Lien	3,012,450	0.1%
US Treasury 4/23 3.125	2,935,437	0.1%
One Call Corp Senior Secured 144A 07/24 11.5	2,870,974	0.1%
New Star Metals 2016 Term Loan	2,265,864	0.1%
MH Sub 1 LLC Term Loan B	2,049,061	0.1%

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

## 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/ HMEPS Global						Bloomberg Barclays	
	HMEPS Total Fund	HMEPS Policy Portfolio	Fund Universe/ TUCS	HMEPS Global Equity	MSCI ACWI IMI	MSCI ACWI Min Vol	HMEPS Fixed Income	U.S. Aggregate Bond Index
2011	22.17%	22.89%	21.19%	n/a	n/a	n/a	9.33%	3.90%
2012	-0.14%	3.23%	1.25%	n/a	n/a	n/a	6.31%	7.48%
2013	13.58%	13.99%	12.27%	n/a	n/a	n/a	5.99%	-0.69%
2014	16.39%	15.61%	16.83%	21.92%	20.92%	13.84%	9.22%	4.37%
2015	3.38%	4.96%	3.38%	2.22%	0.81%	6.59%	1.13%	1.86%
2016	1.65%	4.02%	1.07%	-0.31%	-3.87%	11.55%	3.33%	6.00%
2017	12.73%	11.95%	12.41%	16.34%	19.01%	6.05%	7.80%	-0.31%
2018	9.33%	8.29%	8.45%	9.81%	11.14%	7.33%	1.50%	-0.40%
2019	7.22%	7.97%	6.62%	6.05%	4.56%	13.00%	6.77%	7.87%
2020	-0.93%	4.42%	2.95%	0.00%	1.17%	-2.50%	4.33%	8.74%
3 Yrs.	5.11%	6.97%	5.90%	5.19%	5.55%	5.75%	4.18%	5.32%
5 Yrs.	5.88%	7.00%	6.11%	6.19%	6.11%	6.94%	4.72%	4.30%
10 Yrs.	8.29%	8.86%	8.42%	n/a	9.10%	9.67%	5.54%	3.82%

## 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	ICE BofAML		S&P 500 Index	HMEPS Real Estate	NCREIF Property Index	HMEPS Inflation- Linked	Consumer Price Index	HMEPS Absolute Return	LIBOR
	U.S. High Yield Master II Index	HMEPS Private Equity							
2011	15.40%	22.54%	30.68%	10.92%	16.73%	39.72%	3.56%	13.94%	0.33%
2012	6.51%	11.00%	5.44%	3.78%	12.00%	-21.96%	1.66%	-0.86%	0.46%
2013	9.57%	7.85%	20.59%	12.80%	10.73%	14.52%	1.75%	10.87%	0.31%
2014	11.80%	14.31%	24.61%	9.11%	11.21%	22.33%	2.07%	7.28%	0.24%
2015	-0.55%	10.36%	7.42%	10.88%	12.96%	-9.14%	0.12%	2.65%	0.25%
2016	1.71%	7.05%	3.99%	12.95%	10.64%	-12.18%	1.01%	-6.92%	0.51%
2017	12.75%	16.02%	17.90%	9.15%	6.98%	8.24%	1.63%	7.13%	1.02%
2018	2.49%	17.22%	14.38%	9.87%	7.20%	5.78%	2.87%	4.65%	1.36%
2019	7.60%	14.05%	10.42%	7.68%	6.50%	2.05%	1.65%	3.27%	2.55%
2020	-1.10%	3.44%	7.51%	-4.03%	2.69%	-28.17%	0.71%	-1.42%	1.50%
3 Yrs.	2.94%	11.41%	10.73%	4.32%	5.44%	-8.13%	1.75%	2.13%	1.95%
5 Yrs.	4.58%	11.42%	10.73%	6.96%	6.77%	-5.92%	1.59%	1.22%	1.47%
10 Yrs.	6.48%	12.26%	13.99%	8.20%	9.70%	0.23%	1.71%	3.89%	0.89%

## SCHEDULE OF FEES AND COMMISSIONS PAID

In Fiscal Year 2020

	2020	2019
Public Market Investments		
Global Equity	\$ 3,094	\$ 2,785
Fixed Income	1,162	1,174
Inflation Linked	1,241	1,416
Other Public Market	0	324
Grand Total	<u>\$ 5,497</u>	<u>\$ 5,699</u>
Custodian Bank		
State Street Bank & Trust Company	571	368
Consultant Services		
Wilshire Associates, Inc.	284	284
Cliffwater LLC	550	550
Legal Services	50	70
Other Investment Expenses	1,458	1,048
Total Investment Expenses	<u>\$ 8,410</u>	<u>\$ 8,019</u>

Note: Dollar amount in \$000

## SCHEDULE OF FEES AND COMMISSIONS PAID (CONTINUED)

In Fiscal Year 2020

<i>Broker Name</i>	<i>Number of Shares</i>	<i>Commissions (\$)</i>	<i>Cents/Share</i>
B. Riley & CO	116,221	3,339	2.87
Barclays Capital	4,240,585	19,448	0.46
BNP Paribas Securities Services	56,624,773	5,328	0.01
BOFA Securities Inc.	732,305	13,763	1.88
Canaccord Genuity Corp	166,815	3,308	1.98
Cantor Fitzgerald + Co.	502,009	8,486	1.69
Capital Institutional Svcs Inc. Equities	981,425	20,077	2.05
Citibank	784,624,513	19,862	0.00
CJS Securities INC	100,450	4,018	4.00
CLSA Singapore	1,897,384,947	11,104	0.00
Cowen And Company, LLC	1,235,050	13,001	1.05
Credit Lyonnais Securities (Asia)	1,019,245,996	7,299	0.00
Credit Suisse	123,104,585	14,776	0.01
Evercire ISI	739,323	6,012	0.81
Exane S.A.	3,691,157	3,247	0.09
Goldman Sachs + Co.	35,078,360	27,421	0.08
HSBC Securities	36,858,702	4,599	0.01
Instinet LLC	4,842,514,846	18,716	0.00
Investment Technology Group LTD	4,401,137	3,804	0.09
J P Morgan Clearing Corp	265,451	5,109	1.92
J P Morgan Securities LLC	489,798	3,830	0.78
J P Morgan Securities Inc.	67,815,315	6,211	0.01
Jefferies + Company Inc.	169,835,749	10,726	0.01
Jefferies International Ltd.	151,429,468	3,212	0.00
JOH. BERENBERG, GOSSLER & CO. KG	1,728,908	2,050	0.12
JONESTRADING INSTITUTIONAL SERVICES LLC	5,006,091	6,225	0.12
KEPLER EQUITIES PARIS	3,787,538	6,186	0.16
LIQUIDNET INC	730,868	5,500	0.75
MACQUARIE BANK LIMITED	22,521,595	2,960	0.01
Maxim Group	524,939	13,107	2.50
Merrill Lynch And Co Inc.	188,487,416	7,084	0.00
MIZUHO SECURITIES USA INC	52,259,349	2,047	0.00
Morgan Stanley and Co Incorporated	237,273,553	29,757	0.01
National Financial Services Corp.	429,792	8,582	2.00
North South Capital LLC	2,547,896	6,138	0.24
PAREL	8,006,395	3,139	0.04
PERSHING SECURITIES LIMITED	3,874,045	8,239	0.21
Piper Jaffray	206,806	2,427	1.17
Rbc Capital Markets LLC	852,413	13,744	1.61
RBC DOMINION SECURITIES INC.	3,259,924	2,089	0.06
Redburn (Europe) Limited	4,558,422	4,111	0.09
Robert W.Baird Co.Incorporate	94,560	2,454	2.60

## SCHEDULE OF FEES AND COMMISSIONS PAID (CONTINUED)

In Fiscal Year 2020

<i>Broker Name</i>	<i>Number of Shares</i>	<i>Commissions (\$)</i>	<i>Cents/Share</i>
ROTH CAPITAL PARTNERS LLC	73,500	2,872	3.91
ROYAL BANK OF CANADA EUROPE LTD	1,618,080	2,492	0.15
Sanford C. Bernstein Ltd.	664,620,770	11,037	0.00
SIDOTI + COMPANY LLC	85,575	3,423	4.00
Societe Generale London Branch	8,513,164	2,863	0.03
STATE STREET BANK AND TRUST COMPANY	704,622,417	14,302	0.00
Stifel Nicolaus + Co Inc.	604,932	18,689	3.09
UBS AG	1,073,181,351	36,614	0.00
VIRTU AMERICAS LLC	979,194	2,134	0.22
Wells Fargo Securities LLC	1,000,124	10,223	1.02
Others	906,102,091	25,552	0.00
Total	13,099,730,687	492,736	0.00