

Public Agenda Item #8a

Review, Discussion and Consideration of the Hedge Fund Program:

Market Update and Program Overview

August 16, 2016

Robert C. Lee III, CFA, CHP, Director of Hedge Funds
Anthony Curtiss, CFA, Hedge Fund Portfolio Manager
James Walsh, Partner, Portfolio Analyst, Albourne America

Hedge Fund Program: Overview

Agenda



- Staffing Update
- Hedge Fund Portfolio Overview
- Absolute Return Portfolio
- Directional Growth Portfolio
- Other Hedge Fund Allocations
- Industry Review presented by Albourne Partners

Hedge Fund Program: Overview

Staffing Update



- Current Staff
 - Robert C. Lee III – Director of Hedge Funds
 - Anthony Curtiss – Portfolio Manager
 - Panayiotis Lambropoulos – Portfolio Manager
 - Nicholas Maffeo – Analyst
- Consultant
 - Albourne Partners

Hedge Fund Program Overview

Hedge Fund Portfolios



- **Absolute Return Portfolio**
 - Risk-Reducing Hedge Fund Portfolio
 - Diversification and low correlation
 - Low beta to Trust, low volatility
- **Directional Growth Portfolio**
 - Return-Seeking Hedge Fund Portfolio
 - Complementary to external managers
 - Directional and tactical market beta
- **Other Hedge Funds**
 - Within asset classes as appropriate

Hedge Fund Program Overview

Performance Metrics



Annualized Stats (ITD through 5/31/16)	Return	St.Dev.	Information Ratio	Sharpe Ratio
Absolute Return Portfolio	5.23%	2.63%		1.89
<i>90-day T-Bills + 400bps</i>	4.25%	0.09%	0.42	43.55
<i>HFRI FOF Composite</i>	3.30%	3.58%	0.95	0.85
<i>HFRX Global Index</i>	0.76%	3.72%	1.94	0.13
Directional Growth	11.20%	11.24%		0.97
<i>MSCI ACWI TR</i>	4.75%	10.96%	3.44	0.41

Hedge Fund Program Overview

Performance Overview



Absolute Return Portfolio			
	12-month	36-month	ITD (46 mo)
Absolute Return Portfolio	0.04%	11.67%	21.60%
90-day T-bills + 400bps	4.53%	13.27%	17.32%
HFRI FOF Composite	(5.89%)	4.93%	13.27%
HFRX Global	(6.99%)	(3.21%)	2.93%
Strategy Breakdown			
ERS Relative Value	(1.47%)	6.17%	16.93%
<i>HFRX Relative Value</i>	(7.63%)	(7.99%)	(3.96%)
ERS Event Driven	(5.43%)	6.48%	18.38%
<i>HFRX Event Driven</i>	(7.48%)	(4.65%)	6.27%
ERS Equity Long/Short*	4.09%	28.42%	32.37%
<i>HFRX ELS</i>	(7.74%)	0.69%	3.37%
ERS Macro	2.91%	7.52%	12.28%
<i>HFRX Macro</i>	(4.53%)	0.41%	(0.67%)
ERS Opportunistic*	4.26%	18.51%	18.51%

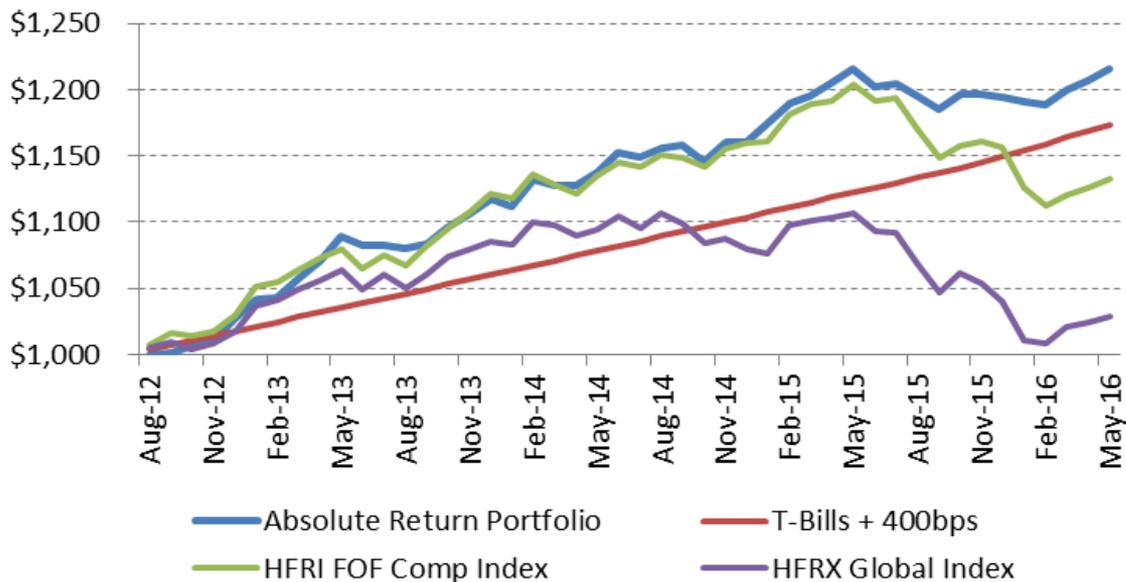
Directional Growth Portfolio		
	12-month	ITD (26 mo)
Directional Growth	0.69%	25.86%
MSCI ACWI TR Index	(5.00%)	10.57%

Hedge Fund Program Overview

Absolute Return Portfolio - Performance



Inception to Date – Value Added Monthly Index (ITD VAMI)

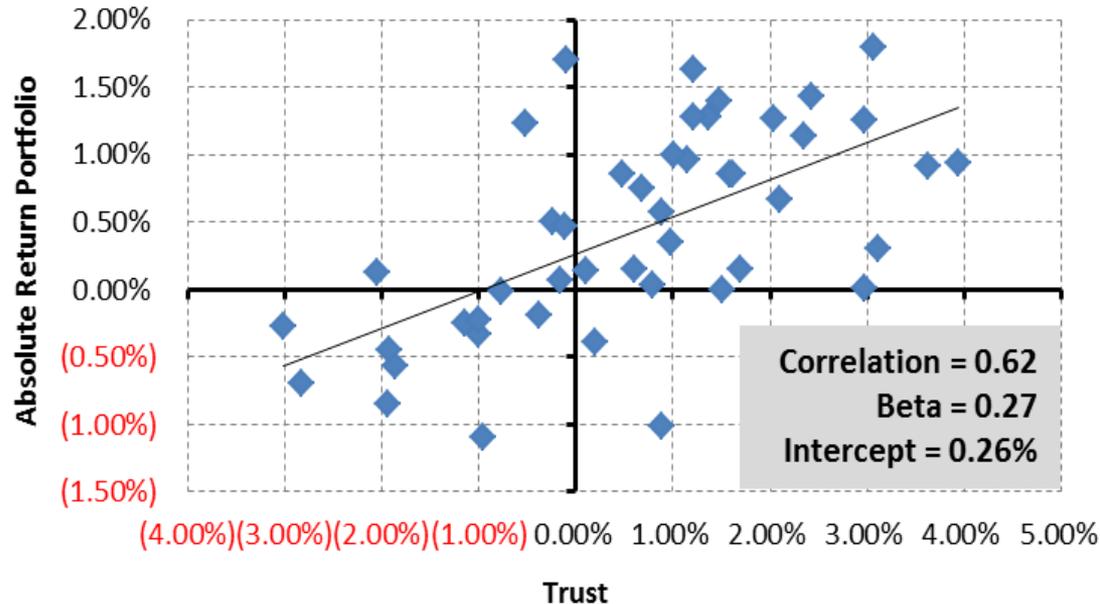


Hedge Fund Program Overview

Absolute Return Portfolio



Absolute Return vs Trust

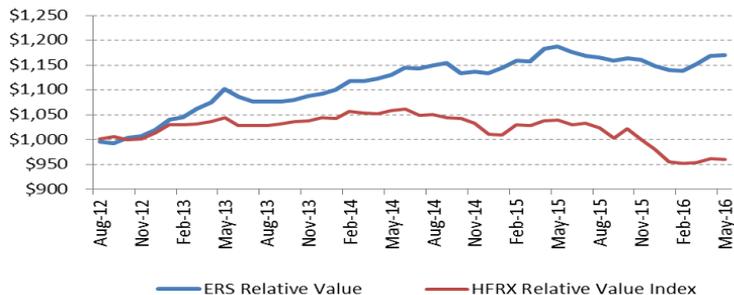


Hedge Fund Program Overview

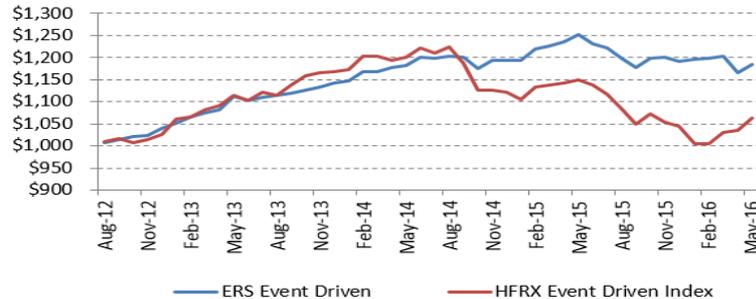
Absolute Return Portfolio - Strategy VAMI



Relative Value



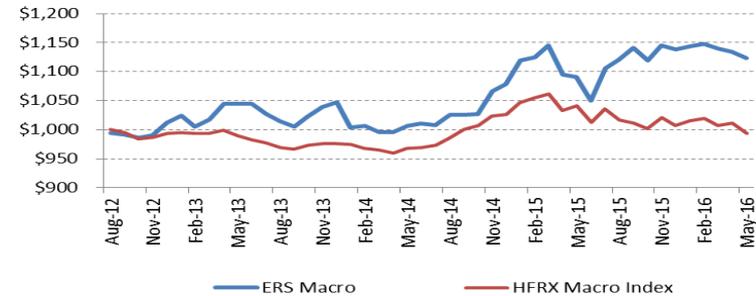
Event Driven



Equity Long/Short



Macro



Hedge Fund Program Overview

Absolute Return Portfolio - Correlations



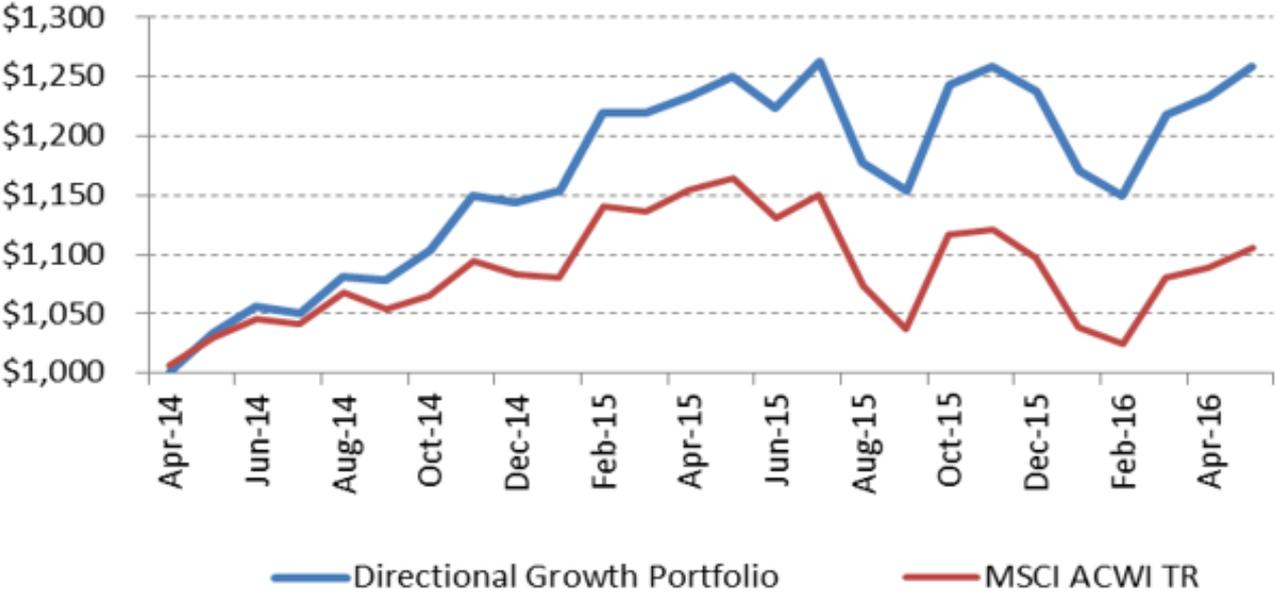
Strategy Correlation	Relative Value	Event Driven	Macro	Equity Long/Short	Opportunistic
Relative Value	1.00	0.55	(0.00)	0.18	0.42
Event Driven	0.55	1.00	(0.01)	0.35	(0.04)
Macro	(0.00)	(0.01)	1.00	0.33	(0.26)
Equity Long/Short	0.18	0.35	0.33	1.00	(0.05)
Opportunistic	0.42	(0.04)	(0.26)	(0.05)	1.00

Hedge Fund Program Overview

Directional Growth - Performance

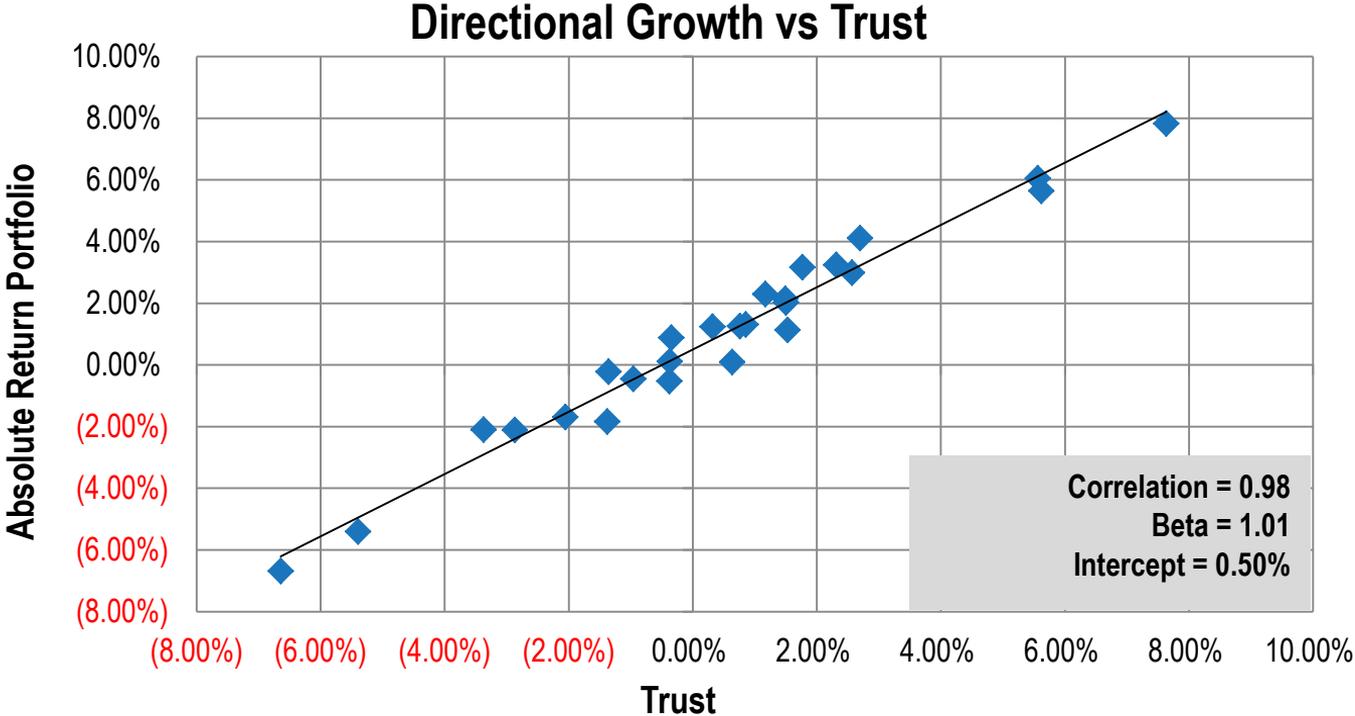


ITD VAMI



Hedge Fund Program Overview

Directional Growth Portfolio



Hedge Fund Program Overview

Allocation Summary



Manager Summary				Initial Allocation		NAV	Return
Manager	Strategy	Sub-Strategy	Geographic Focus	\$ (millions)	Date	5/31/16 (millions)	ITD (5/31/16)
Arrowgrass	Multi	RV/ED	US/Europe	\$ 80.00	20120731	\$ 122.61	24.21%
Southpaw	Event Driven	Distressed	US	\$ 80.00	20120731	\$ 95.97	19.96%
Aspect	Macro	CTA	Global	\$ 30.00	20121130	\$ 38.09	26.96%
Conatus	Equity Long/Short	Equity Long/Short	Global	\$ 60.00	20130228	\$ 58.92	30.04%
MW TOPS	Equity Long/Short	Equity Long/Short	Europe	\$ 60.00	20130228	\$ 78.03	35.12%
Pentwater	Event Driven	Merger Arb	US/Europe	\$ 50.00	20130531	\$ 25.22	3.88%
Stone Lion	Opportunistic	Liquidations	US	\$ 80.00	20130531	\$ 29.29	25.64%
Glazer Enhanced	Event Driven	Merger Arb	US	\$ 45.00	20130731	\$ 112.81	32.13%
Iguazu	Relative Value	Credit Long/Short	Emerging	\$ 100.00	20131129	\$ 118.91	18.91%
Magnetar	Relative Value	Structured Credit	Global	\$ 100.00	20131231	\$ 109.41	13.28%
Taconic	Event Driven	Multi-ED	Global	\$ 100.00	20140331	\$ 101.75	1.75%
Pharo	Macro	Global Discretionary	Global	\$ 60.00	20140430	\$ 63.91	6.52%
Northwest	Relative Value	Convert Arb	Emerging	\$ 50.00	20140530	\$ 72.68	8.33%
Castle Creek	Relative Value	Convert Arb	US	\$ 100.00	20141031	\$ 103.71	3.71%
GKC	Opportunistic	Factoring	US/Europe	\$ 120.00	20141231	\$ 44.51	7.44%
Stone Lion II	Opportunistic	Liquidations	US	\$ 40.00	20150227	\$ 19.03	-15.57%
Absolute Return Portfolio						\$ 1,194.86	
MW TOPS World	Equity Long/Short	Equity Long/Short	Global	\$250.00	20120428	\$314.61	25.58%
Directional Growth Portfolio						\$314.61	

Hedge Fund Program Overview

Fee Savings



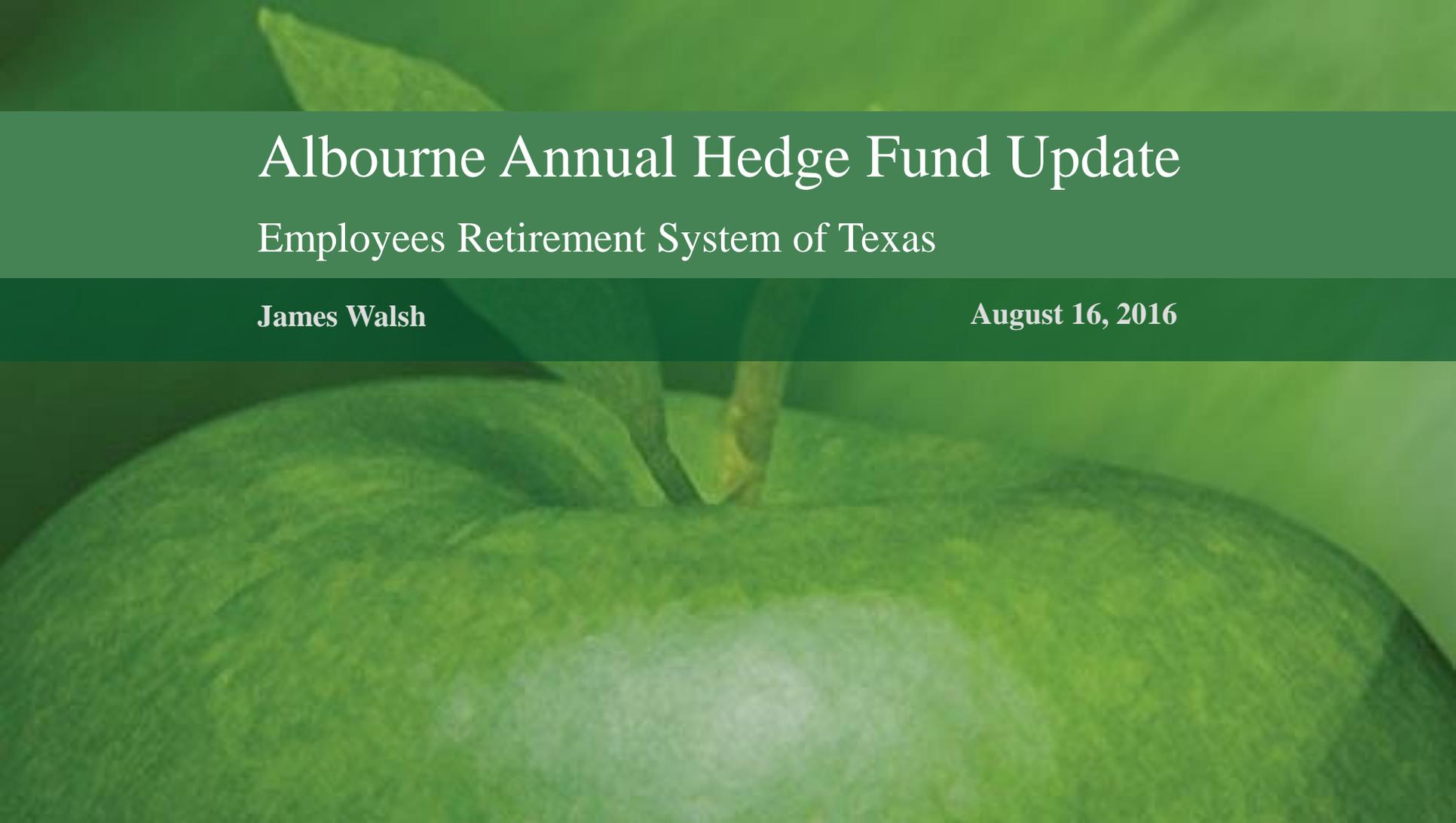
- **Management Fee: 1.09%**
- **Incentive Fee: 19.29%**
- **Funds with Hurdle Rate: 48.51%**

Hedge Fund Program: Overview

Other Hedge Fund Allocations



- **Public Real Estate**
 - Full redemption as of February 2016
- **Credit**
 - One Credit-Oriented Event-Driven strategy
 - One Opportunistic strategy focused on liquidations
- **Fee Savings (realized savings from negotiations)**
 - \$17.4 million since inception
 - \$4.2 million Fiscal Year-to-Date through May 2016



Albourne Annual Hedge Fund Update

Employees Retirement System of Texas

James Walsh

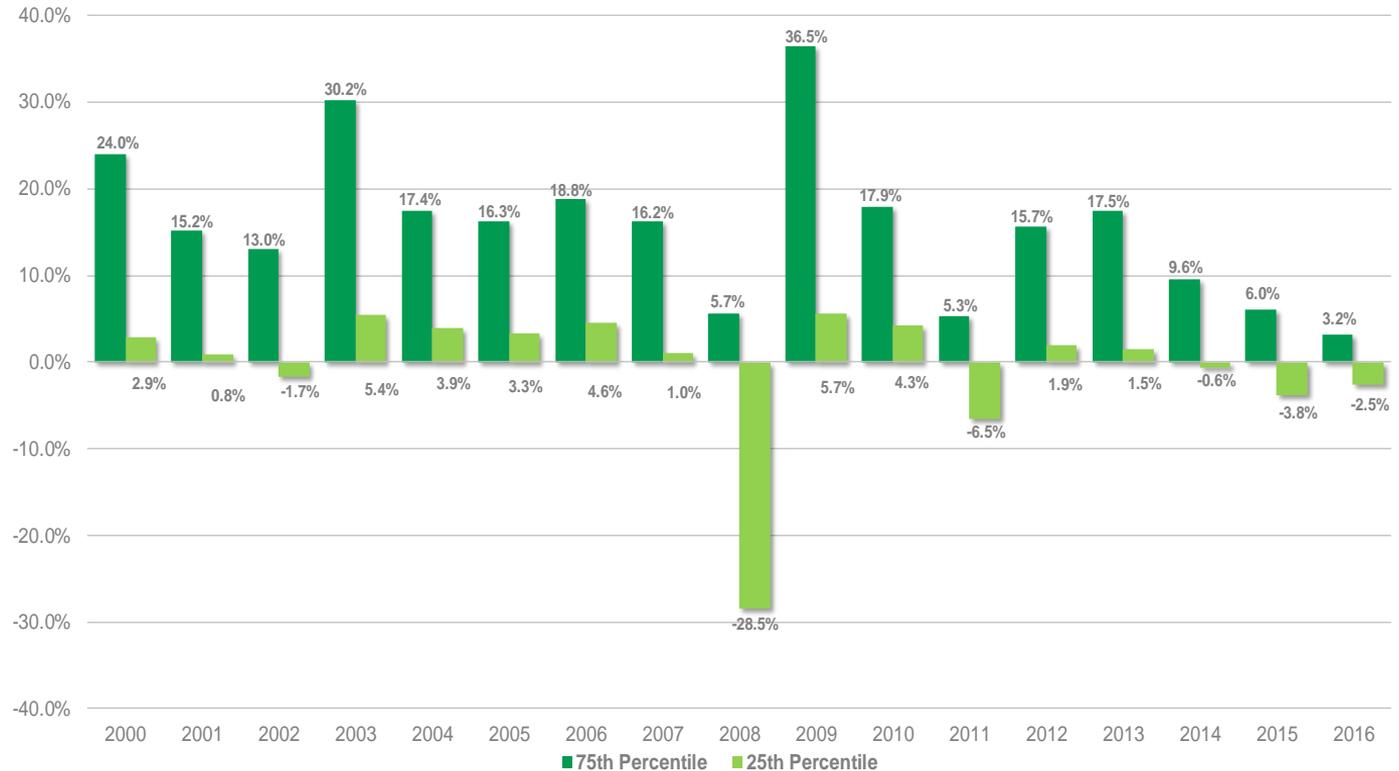
August 16, 2016

Overview

- **ERS Program Comments**
 - Performance: exceeded strategic objective since inception and exceeds tactical benchmark over latest 12-months
 - Beneficial fee arrangements estimated to have reduced costs by 61bp over past 12-months, or \$5.9m
 - Consistent outperformance of Dynamic Beta (implementable) benchmark
- **Strategy Outlook**
 - Challenging environment
 - Outlook with structurally higher volatility
 - Thoughts on outlook
- **Trends & Observations**
 - Resetting the fee discussion in a lower return environment
 - Co-investments & bespoke mandates to align portfolio needs and force down fees
 - Risk transparency

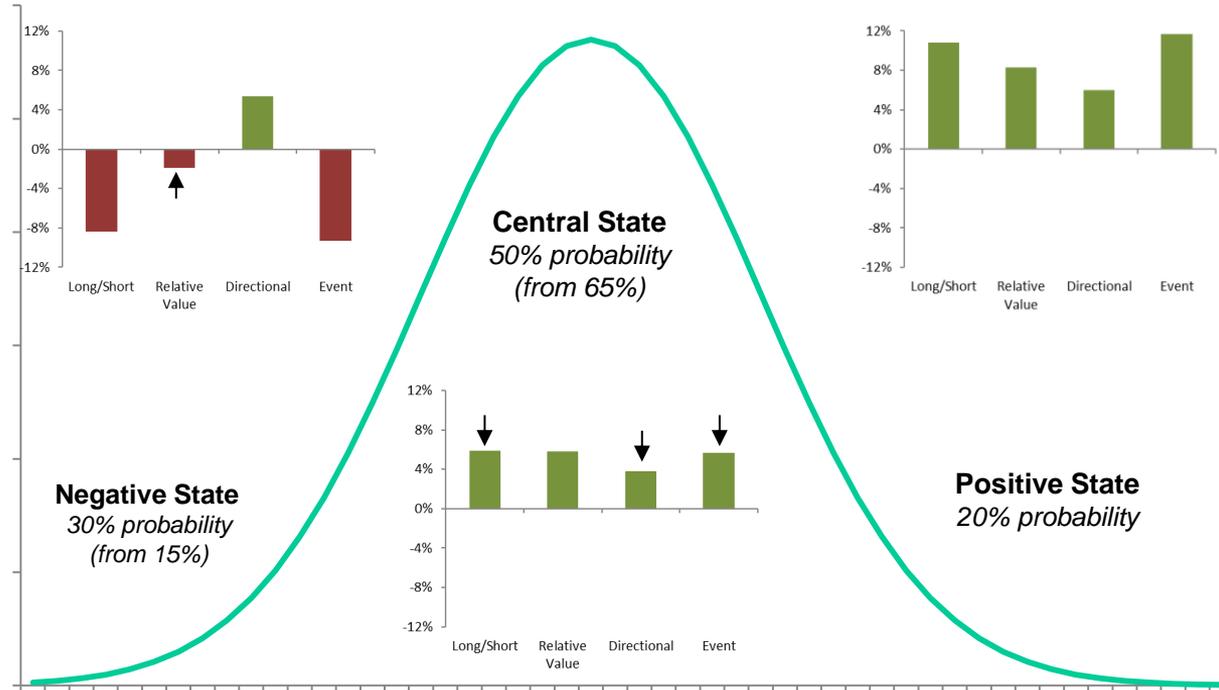
Strategy Outlook I

- **Narrower range more negative outcomes**



Strategy Outlook II

- Lower beta, improved alpha, greater downside risk



Trends & Observations

- **Resetting the fee discussion in a lower return environment**
 - Returning the appropriate performance/fee split
 - Not paying for beta (and alternative beta) and extending out crystallisation
 - Dynamic beta provides a key benchmarking and implementation tool
- **Co-investments and Bespoke mandates:**
 - ERS continues to actively and creatively embrace these customized investments
 - Developing Strategic relationships – better alignment & information flow
 - Sourcing a manager's highest conviction positions and lowering the overall fee load
- **Risk transparency – Open Protocol* update:**
 - ERS requires all Hedge Funds to report on Open Protocol format
 - Over 666 **funds** are reporting with combined assets greater than **\$1.3 trillion**
 - Total hedge fund assets of the reporting firms is now greater than **\$2.2 trillion**

*Open Protocol (www.theopenprotocol.org) is a consistent framework for the collection, collation and communication of risk exposures. The template, allowing for different levels (grades) of transparency, and a detailed manual to ensure consistent calculation of risk metrics, are publically available.

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