Market Summaries
December 2020

ERS®
Employees Retirement System of Texas

Table of Contents

Domestic Equity Market Summary

U.S. equities continued their ascent in December with major indexes up 3% to 5%. Returns were positive across the board, with small-cap and mid-cap stocks continuing to lead the way. Collectively, the market shifted focus to the Georgia runoff elections and the prospects of additional stimulus as local COVID-19 shutdowns accelerated throughout the month.

In terms of S&P 500 sector performance, a rise in Financials coincided with dramatic increases in the 10-year yield. The Information Technology and Financial sectors rounded out the top performers list for the month. Utilities and Real Estate were the worst performers—ending the month roughly flat. The high-flying 2020 sectors, Information Technology, Communication Services and Consumer Discretionary, remained the year-to-date winners.

Strength in December was fairly consistent as the market began to switch focus to the Georgia runoff elections. Mid-month, the FDA issued an emergency use authorization of the Pfizer and Moderna vaccines, which contributed to enthusiasm for markets and sectors that had been out of favor during the pandemic. By month-end, another round of COVID-19 stimulus was passed and signed into law resulting in improvements to consumer confidence.

Economic indicators continued to show strengthening GDP (gross domestic product) while labor market improvements softened, Leisure and Hospitality accounted for the majority of job losses. U.S. nonfarm payrolls declined 140,000 for the month. The weekly initial unemployment claims report remained above the one million mark throughout the month due to the spike in COVID-19 infections. Existing home sales declined due to low inventory, while mortgage applications remained above 2019 levels.

About 5% of the S&P 500 reported third quarter earnings in December, and strength continued from earlier in the earnings season. About 2% of companies reported a positive sales surprise, with 16% beating on earnings. Consumer Discretionary and Consumer Staples were the only sectors to report a majority miss on sales, and all sectors, besides Consumer Staples, posted a majority of beats on earnings. Information Technology, Health Care and Industrials were particularly strong.

In terms of the S&P 500 stocks, Energy, Pharmaceuticals and Information Technology stocks posted the strongest returns. Enphase Energy, Nielsen Holdings, Alexion Pharmaceuticals, NetApp and Diamondback Energy were the five best performers, all were up more than 20%.

Table 1: Benchmark Returns

Index	Close	December 2020 (%)	Year to Date (%)
NASDAQ	12,888.28	5.7	43.6
S&P 500 Growth	2,577.22	4.0	32.0
Dow Jones Industrial Avg.	30,606.48	3.3	7.2
S&P 500	3,756.07	3.7	16.3
S&P 600 Small Cap	1,118.93	8.2	9.6
S&P 400 Mid Cap	2,306.62	6.4	11.8
S&P 500 Value	1,267.18	3.3	-1.4

Table 2: S&P 500 Economic Sector Returns

Sector	December 2020 (%)	Year to Date (%)
Information Technology	5.7	42.2
Consumer Discretionary	2.4	32.1
Communication Services	3.1	22.2
Materials	2.3	18.1
Health Care	3.7	11.4
Industrials	1.1	9.0
Consumer Staples	1.4	7.6
Utilities	0.4	-2.8
Financials	6.1	-4.1
Real Estate	0.9	-5.2
Energy	4.3	-37.3

International Equity Market Summary

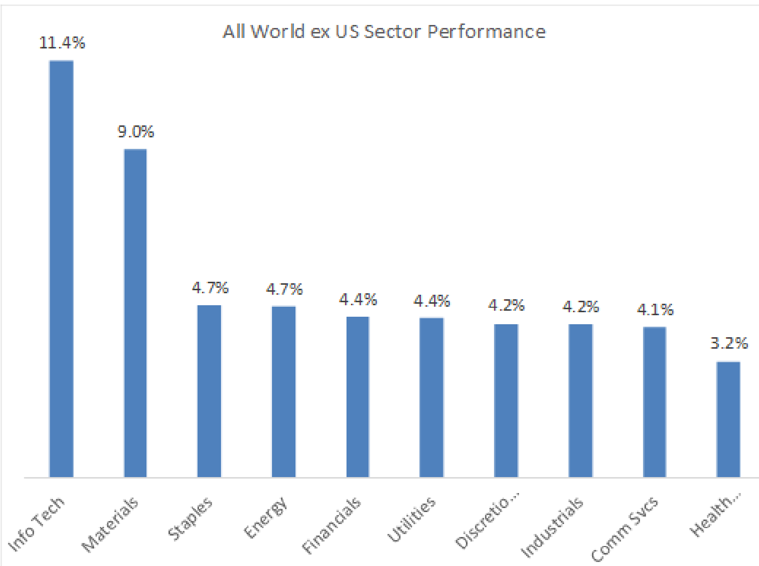
International stock markets, as measured by the MSCI ACWI ex U.S. Index, rose (5.4%) in December, after increasing meaningfully (13.5%) in November and declining (-2.1%) in October. Returns were again positive across all sectors for the second month in a row, as the risk-on environment and U.S. dollar weakness continued. Info Tech (11.4%) and Materials (9.0%) led the index while Communication Services (4.1%) and Health Care (3.2%) were the smallest contributors of performance.

EUROPE/PACIFIC: MSCI EAFE rose less than the broader international index in December (4.7%) after leading the group in November (15.5%) and lagging in October (-4.0%). Europe and Developed Asia saw positive returns for the second month in a row. Returns were positive across all sectors, with Materials, Info Tech and Discretionary leading the way, while Health Care was the laggard. U.K. performance slightly outperformed the group, in spite of Brexit negotiation uncertainty extending until a Christmas Eve deal. Japan lagged as COVID-19 cases reached new highs, and the government enacted a new stimulus package.

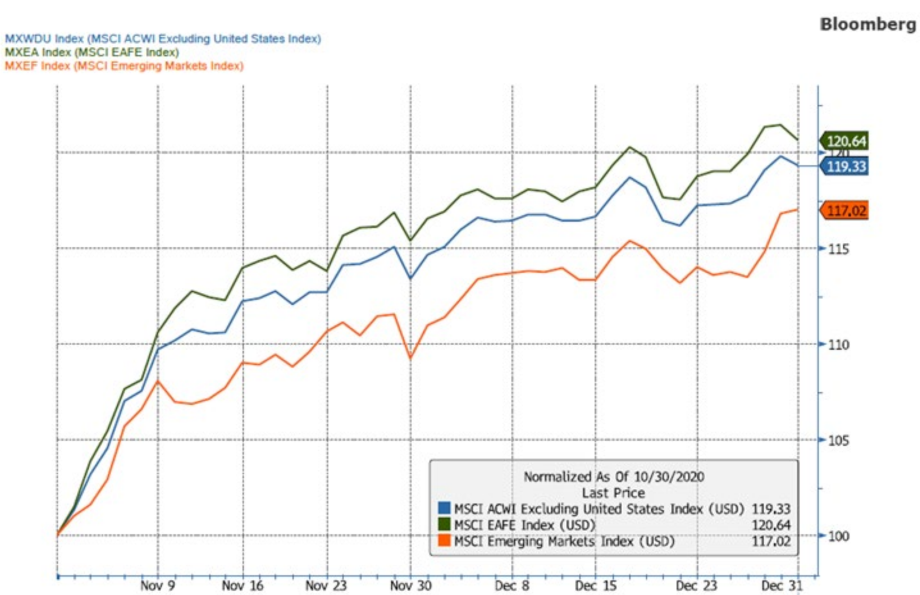
EMERGING MARKETS: MSCI Emerging Markets outperformed the broader international index in December (7.3%) after lagging the group in November (9.3%) and leading in October (2.1%). Emerging Market stock returns were positive for the third month in a row. Returns were positive across all sectors, with Info Tech, Materials and Health Care leading the way, while Discretionary and Telecom Services were the smallest contributors. From a country standpoint, risk-on markets Turkey and Brazil, along with South Korea, outperformed, while Saudi Arabia lagged as the only major country with negative returns.

Table 3: MSCI Monthly Returns

Index	Monthly Return (USD) (%)
MSCI ACWI ex U.S.	5.4%
MSCI EAFE	4.7%
MSCI Emerging Markets	7.3%



The chart above shows sector returns for the MSCI ACWI ex U.S. index in December, with Info Tech (11.4%) and Materials (9.0%) the top-performing sectors, and Communcation Services (4.1%) and Health Care (3.2%) the lowest.



The chart above shows the performance of the MSCI ACWI ex U.S. (19.3%), MSCI EAFE (20.6%) and MSCI Emerging Markets (17.0%) indices for November and December.

Public Real Estate Market Summary

The global real estate securities market as measured by the FTSE EPRA / NAREIT Developed Index was up 3.6% for December and ended the calendar year down 8.2%, underperforming the broader equity market MSCI World Index of +4.1% and +16.5%, respectively. December was another volatile month after generating the best monthly return in November (+13.2%). The market whipsawed on hopes of vaccines and more stimulus measures as the COVID-19 cases surged globally. The headlines of the new COVID-19 virus strain caused the market to sell off in the back half of the month, but quickly reversed course. All real estate regions posted positive returns, with the U.K. (USD +6.3%, local +3.8%) being the best performer, followed by Continental Europe (USD +6.1%, local +3.5%), Asia (USD +2.7%, local +1.3%) and North America (USD +2.5%, local +2.4%). Overall, major foreign currencies strengthened against the USD in December. Calendar Year 2020 was characterized by extreme volatility with March being the worst month in more than 10 years, (-22.6%), being largely offset by three months of volatility (November +13.2%, April +7.1% and December +3.6%). Global government bond yield changes were mixed in December with U.S. 10-year government bond yields rising to 0.91% from 0.84% in the previous month, while European government bond yields overall declined marginally.

Table 4: FTSE EPRA/NAREIT Developed Index Country – Total Return (USD)

Country	December 2020 (%)	Calendar Year to Date (%)
NORWAY	13.0	42.7
AUSTRIA	10.4	-5.3
SWITZERLAND	9.2	-0.4
GERMANY	7.6	25.3
FRANCE	6.6	-31.4
UNITED KINGDOM	6.3	-13.2
IRELAND	6.0	-1.4
FINLAND	5.8	11.9
SINGAPORE	4.6	-0.9
ISRAEL	4.3	-12.7
AUSTRALIA	3.7	-9.0
JAPAN	3.7	-9.8
GLOBAL	3.6	-8.2
NEW ZEALAND	3.6	-25.1
NETHERLANDS	3.4	-24.9
SWEDEN	3.3	9.0
USA	2.7	-10.2

Country	December 2020 (%)	Calendar Year to Date (%)
SPAIN	2.5	-26.6
ITALY	2.4	-32.4
BELGIUM	1.4	8.4
HONG KONG	-0.8	-12.2
CANADA	-1.2	-12.7

Australia's return of +3.7% was driven by the stronger local currency against the USD; local return was down 1.0%. The retail names led the Australian performance on the reopening prospects. Japan was up 3.7%, as Japan's government announced a 74 trillion yen stimulus package to support the economy. Similar to Australia, the Retail sector was the strongest performer, up 10.0%. Hong Kong was down 0.8%, being one of the worst performers, as subsector performance was mixed with the retail names advancing while the residential names underperformed. Furthermore, the Hong Kong government announced the start of the vaccination campaign in February, and unsurprisingly, the Retail and Hospitality sectors got a boost in sentiment. Hong Kong's November retail sales growth remained negative, but the pace of decline narrowed and was better than consensus estimates. Lastly, Singapore gained 4.6%, led by retail names, which were up 9.1%.

The EU approved a $2.2 trillion budget and stimulus plan, and the EU and U.K. finally reached an agreement on the Brexit deal after multiple years of negotiations. All European countries posted positive returns despite a new wave of lockdowns and travel restrictions amid rising infection cases and headlines of the new COVID-19 virus strain. While Europe's Retail sector asset value write-down accelerated, the retail names posted strong returns ranging from high single-digits to more than 20% with hopes of the vaccine rollout. Norway was the best performer (+13.0%) in December, driven by news on potential corporate Mergers & Acquisitions (comprising acquisitions, disposal, mergers and joint ventures).

U.S. real estate securities, as measured by the FTSE EPRA / NAREIT U.S. Index, were up 2.7% for the month, continuing the index's positive performance in December, after posting the best performance in nearly a decade in November. Despite the headlines of continued COVID-19 outbreaks, as well as the new COVID-19 virus strain, the positive sentiment continued on the back of the COVID-19 vaccine deployment news, which subsequently caused the most cyclical REIT subsectors to continue to outperform. Most of the more defensive subsectors underperformed the index on a relative basis. Most of the REIT subsectors that were material calendar year-to-date underperformers, such as Health Care (+4.8%), Retail (+4.4%) and Lodging/Resorts (+3.9%), outperformed the REIT index. On the other hand, the REIT subsectors that exhibited relatively strong performance throughout the pandemic, such as the Industrial (+1.5%) and Residential (-0.8%) subsectors, underperformed the REIT index. Despite investor preference for more cyclical names in December, the Diversified (+4.2%) subsector, led by Data Centers and the Self Storage (+4.4%) space, managed to outperform. Notably, the Self Storage space was buoyed by the involvement of an activist investor in Public Storage. The outperformance in the Diversified subsector, via the Data Center names, was a result of some mean reversion after the Data Center names were seen as oversold after their November underperformance. Despite the lagging calendar year-to-date performance, the Office (+1.8%) subsector continued its underperformance for the month after several negative work-from-home corporate announcements continued to exacerbate fears on a delayed recovery in Office fundamentals.

Table 5: U.S. Sector Total Return

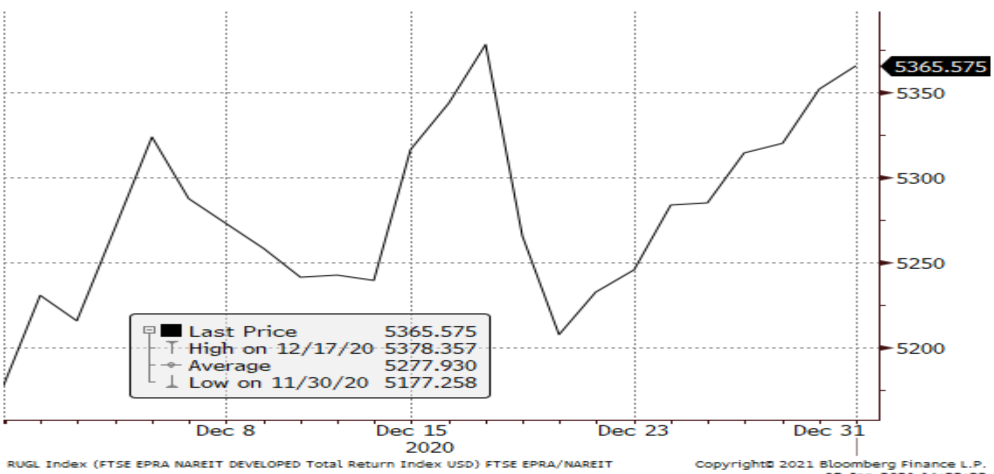
Sector	December 2020 (%)	Calendar Year to Date (%)
HEALTH CARE	4.8	-10.0

Sector	December 2020 (%)	Calendar Year to Date (%)
RETAIL	4.4	-26.9
SELF STORAGE	4.4	12.9
DIVERSIFIED	4.2	-3.1
LODGING/RESORTS	3.9	-20.1
US ALL SECTORS	2.7	-10.2
OFFICE	1.8	-18.2
INDUSTRIAL	1.5	12.4
RESIDENTIAL	-0.8	-13.9

The below chart illustrates the daily price change of FTSE EPRA/NAREIT Index for December.

On December 31 the index was at a level of 5366.

FTSE EPRA/NAREIT Index Daily Price Change – December 2020



Private Real Estate Market Summary

The net asset value of the Private Real Estate Portfolio as of November 30 was approximately $2.4 billion. For the month, approximately $85 million in capital was called for the Private Real Estate Program, and distributions for the month were $54 million. Since inception of the program to date, total capital called is approximately $4.1 billion. From inception through the end of the month, approximately $3.1 billion was returned as income, capital gain or return of capital. The below chart summarizes the various capital calls and distributions for the current month, fiscal year-to-date and since inception.

Table 6: Capital Calls and Distributions

	December 2020	Fiscal Year to Date	Inception
Calls	($85) million	($143) million	($4.1) billion
Distributions	$54 million	$150 million	$3.1 billion
Net (Called)/Distributions	($31 million)	$7 million	($1.0) billion

ERS closed on one commitment for the month, a $50 million commitment to the Principal Digital Real Estate Fund. The Fund will focus exclusively on investing in U.S. data centers in primary and select secondary markets with structural drivers of growth driven by demographics, innovation-led industries, technology and globalization. This is a non-core, opportunistic strategy, which will pursue (i) ground-up development of state-of-the-art data center facilities and (ii) acquiring value-add assets or assets suitable for conversion to data centers within the U.S.

The commitment target for Fiscal Year 2021 is $300 million, with an upper range of $600 million. To date, ERS has closed on two investments for a total of $125 million of commitments. The ERS Private Real Estate Portfolio represents 7.8% of the overall System's assets, which is below the target of 9%. The near-term focus continues to be on renewed commitments to performing fund managers in which ERS has investments, commingled "club funds" with the potential to drive terms and conditions, niche property sectors, co-investments and select international investments. Since inception, commitments by ERS' Private Real Estate Program total approximately $5.2 billion.

Private Equity Market Summary

ERS Private Equity closed two investments during December (deals 6 & 7 in the table below). Private Equity's target for commitments for Fiscal Year 2021 is $800 million with a range of $600 million to $1.0 billion. As of December 31, the Private Equity Portfolio's net asset value was $4.9 billion, or 15.8% of the System's assets.

From program inception through December 31, ERS has closed on 117 funds and 59 co-investments with commitments totaling $10.8 billion (adjusted for currency exchange rates). In addition, ERS holds LP Advisory Committee seats on 71 active funds and six fund LP Advisory Observer seats.

Table 7: ERS Private Equity – Deals Closed During Fiscal Year 2021

Deal #	Fund Name	Fiscal Year	Geography / Strategy	Commitment (Local Currency)	Commitment (USD) (1)
1	Co-Investment # 57	2021	Secondaries - Global	$70,000,000	$70,000,000
2	Co-Investment # 58	2021	US - Buyout	$6,240,000	$6,240,000
3	Dover Street X Feeder Fund LP	2021	Secondaries - Global	$100,000,000	$100,000,000
4	KLS Capital Partners Credit Fund III, LP	2021	US - Debt	$30,000,000	$30,000,000

Deal #	Fund Name	Fiscal Year	Geography / Strategy	Commitment (Local Currency)	Commitment (USD) (1)
5	Brighton Park Capital Fund I LP	2021	US - Growth Equity	$40,000,000	$40,000,000
6	Co-Investment #57a	2021	Secondaries - Global	$30,000,000	$30,000,000
7	Co-Investment #59	2021	Asia - Buyout	$14,000,000	$14,000,000
Total					**$290,240,000**

Footnotes:

(1) Foreign exchange rates as of 12/31/2020

EURO / USD: 1.2299

Fixed Income Market Summary

December was another strong month for risk assets. Investor optimism around the COVID-19 vaccine rollout continued to outweigh record COVID-19 cases and hospitalizations. The S&P 500 returned another 3.84% while the Russell 2000 small-cap index returned 8.65%. In fixed income, High Yield and Emerging Markets returned 1.88% and 1.55%, respectively. The Treasury curve modestly steepened, but still allowed for a modest 0.11% return on the U.S. Treasury Index. Rates-sensitive assets closed out the year as the top performers. Investment Grade Corporates returned 9.89% while Treasuries returned 8%; this performance will leave limited upside as we start the new year. High Yield and Emerging Markets still notched very solid returns for the calendar year of 7.05% and 6.52%, respectively.

Table 8: Index Returns

Index	Total Return December 2020 (%)	Total Return Calendar Year 2020 (%)
Barclays Capital Intermediate Credit	0.47	7.08
Barclays Capital Intermediate Treasury	0.03	5.78
U.S. Treasury	-0.23	8.00
U.S. Agency	0.11	5.48
Corporate	0.44	9.89
Securitized	0.25	4.18
U.S. Corporate High Yield	1.88	7.05
Emerging Markets	1.52	6.52

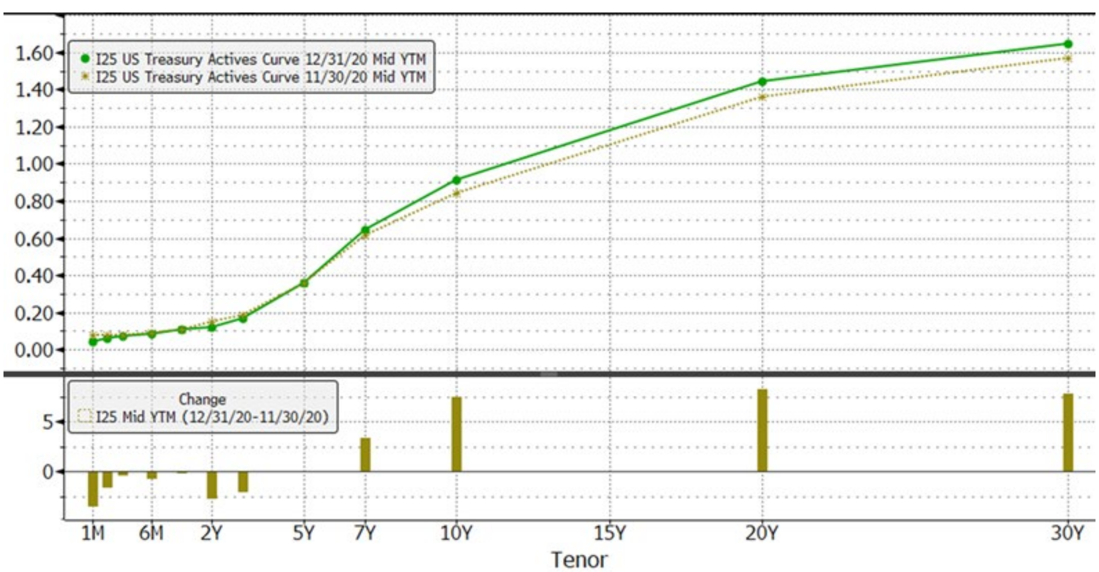
- **Labor**: The economy lost 140,000 jobs during the month, missing expectations of 50,000 jobs added. The unemployment rate held steady at 6.7%. The unemployment rate remains very high, providing a case for additional monetary and fiscal actions.

- **Inflation**: The Federal Reserve's preferred measure of inflation, Core PCE, was at 1.4% year-over-year, well below the Fed's 2% target. The Fed has signaled that it is willing to let inflation run above 2% in the future to target a longer-run 2% average.
- **Housing**: The housing market has remained relatively robust. Existing home sales declined 2.5% month-over-month as inventories are extremely low amid a very hot market. New home sales declined 11% month-over-month.
- **Durable Goods**: Durable goods orders increased 0.9% month-over-month, which continues to signal an expansion of the industrial sector, but the measure has declined from 1.3% month-over-month.

2s-10s U.S. Government Yield Spread

The chart above shows the yield spread between 10-year and 2-year Treasuries. Treasuries increased from 69 basis points to 79 basis points.

U.S. Government Yield Curve



The chart above shows the current shape of the yield curve versus one month ago.

HEDGE FUND MARKET SUMMARY

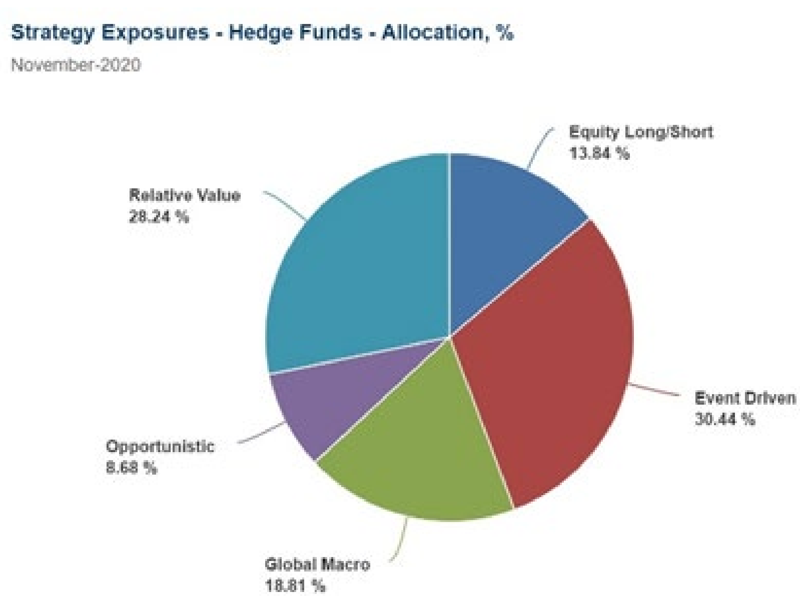
The Absolute Return Portfolio generated an estimated return of +2.71% for December. Please note that this return is still preliminary as several of the managers have less liquid holdings. The target return of 90-day T-bills plus 350 basis points returned +.30% over the same period. For the fiscal year, the Absolute Return Portfolio generated an estimated return of +6.69%, while the 90-day T-bills plus 350 basis points has returned an estimated +1.19%. The portfolio's secondary benchmark, the HFRI Fund of Fund Diversified, returned +3.01% for December and +6.90% for the fiscal year.

The equity and credit markets in December ended in positive territory across all major regions. During the month, the risk-on sentiment was supported by a $2.3 trillion stimulus package within the U.S. and €1.8 trillion in Europe in response to the ongoing global pandemic. COVID-19 cases surged during the month, and a new more contagious strain was discovered within the U.K. This led to a stricter lockdown within the region. This negative news was subsided by promising developments and the launch of vaccinations. The timeline of full availability of vaccinations remains uncertain, however many health care professionals have begun to receive vaccines in a phase 1 program. Within Europe, positive developments regarding the U.K. and the EU reaching a Brexit deal was also a tailwind for the markets.

For December, the S&P 500 returned +3.8%, while the FTSE 100 Index and the EuroStoxx50 returned +3.3% and +1.8%, respectively. The CSI 300 and the MSCI EM Index closed December +5.1% and +7.4%, respectively. During the month, bond yields in the U.S. mostly increased given the risk-on market backdrop and a new COVID-19 stimulus package. The demand for bonds was mixed, whereby demand was suppressed for U.S. Treasuries and European core bonds. In contrast, demand for European periphery bonds remained stable. December was a strong month for the ERS Absolute Return Portfolio and all managers ended in positive territory. The largest contributors during the month included event-driven manager Glazer (+11.7%) and multi-strategy manager Hudson Bay (+3.24%). There were no detractors for the month.

The graphs below indicate current (left) and historical (right) strategy positioning of the Absolute Return Portfolio as of November 2020 month-end. The five strategies (and current positioning) include relative value (28.24%), event-driven (30.44%), global macro (18.81%), equity long/short (13.84%) and opportunistic (8.68%). The ERS Hedge Fund team is focused on maintaining current portfolio exposures.

Current Strategy Exposure



Historical Strategy Exposure

Private Infrastructure Market Summary

ERS Private Infrastructure closed no new transactions in December. ERS Private Infrastructure's target commitments for Fiscal Year 2021 are $400 million with a range of $280 million to $520 million.

Since inception, Private Infrastructure has closed on 22 co-investments and 19 funds with commitments totaling $2.26 billion (adjusted for currency exchange rates). ERS holds an LP Advisory Committee seat on 18 funds and an observer seat on one fund. As of December 31, the Infrastructure portfolio net asset value was $1.13 billion, or 3.7% of the System's assets.