UNIVERSITY OF MAINE SYSTEM
Board of Trustees

Investment Committee

September 23, 2014
UMS, Rudman Board Room

Present at UMS: Committee Members:  Karl Turner, Chair; Marjorie Medd, and James Geary.  
Staff:  Tracy Bigney, Tracy Elliott and Rebecca Wyke.  Others:  Kelly Regan (NEPC), Barry Schmitt (CAPTRUST), Jim Soucie (MMA) and Doug Wellington (MMA)

Present at USM via Polycom:  Committee Members:  Mark Gardner.  Others:  Jay Roney (NEPC)

Present by Phone:  Committee Member:  Gregory Johnson

Absent:  Committee Members:  Samuel Collins, Shawn Moody, Jack Moore and James Mullen.

Trustee Turner, Chair, called the meeting to order.

Fixed Income Manager Selection – Defined Benefit Pension Plan

At the May 23, 2014 meeting, the Investment Committee discussed diversifying the Core Fixed Income allocation in the Defined Benefit Plan given the recently revised target of 27% to this asset class category.  Currently the full allocation of approximately $11 million is invested with PIMCO Total Return.  Subsequently, Kelly Regan reviewed a Core Fixed Income Manager Search Book with Tracy Elliott and Jack Moore. They selected three firms for consideration:  J.P. Morgan Asset Management (J.P. Morgan), Income Research and Management (IR+M), and Vanguard.

At the September 23, 2014 meeting, the Committee received presentations by J.P. Morgan and IR+M. Vanguard was not asked to present as the Committee is familiar with the Vanguard Total Bond Fund which is a current investment in the Operating Fund.

J.P. Morgan – Fixed Income Manager Presentation

Wally Theado, Portfolio Manager, and David Sultan, Client Advisor, with J.P. Morgan joined the meeting by polycom providing an overview of the firm, investment process, philosophy, and the J.P. Morgan Columbus Bond Strategy.

JP Morgan Investment Management Inc, established in 1987, is 100% owned by their parent company, JPMorgan Chase & Co. The JP Morgan Core Bond product was established in 1986 and currently has $53 billion in assets under management. The mutual fund product has a fee of 40 basis points and has daily liquidity.

JP Morgan follows a disciplined value-driven approach for this product, based on bottom-up fundamental analysis. They follow a longer term investing versus a trading mentality with a style that emphasizes research and individual security analysis, rather than large macro bets. Portfolios are well diversified and of AA+/AA average credit quality. Risk management is embedded throughout the process, seeking to limit downside risk relative to a benchmark. Portfolio duration has tracked the benchmark historically and is typically within +/- 10% of the index. Currently, the product’s duration is 4.68 years compared with the BC Aggregate of 5.46 years. The core bond fund turnover is 15%. We can expect that risk positions will be balanced, but performance may lag
during Treasury rallies. This product has strong risk-adjusted returns over the periods reviewed with meaningful lower volatility compared with the Morningstar US Intermediate Term Bond Category.

The fixed income team, with 13 portfolio managers and 13 research analysts, is distinguished principally through their expertise and approach in securitized bonds, which are a large part of the aggregate index. JP Morgan’s experienced team of professionals, quantitative approach to securitized bonds, conviction level in expressing portfolio views, and the tactical use of mortgage credit provide the basis for future excess returns. The use of mortgage derivatives to express portfolio views and to enhance yield is also an expected source of excess returns.

**IR&M – Fixed Income Manager Presentation**
Matt Drasser, Vice President, and Ed Ingalls, Senior Portfolio Manager and Principal, with IR+M joined the meeting by polycom providing an overview of the firm, investment process, philosophy, and the IR+M Aggregate Strategy. IR+M is a boutique firm established in 1987, is 100% employee owned, and specializes only in investment grade fixed income. Portfolios focus on income maximization and positive convexity characteristics with a focus on niche areas of the markets. Their expected alpha is sourced in their understanding and ability to identify the mispricing of esoteric securities. With this product, UMS could expect good performance in most market environments, with potential to lag slightly during credit bear markets.

The IR&M Aggregate product has $5 billion in assets under management with 15 portfolio managers, 14 research analysts, and 5 traders. The investment philosophy for this product is value-oriented, targeting duration neutral to the benchmark with bottom-up security selection. This is a commingled fund with monthly liquidity and a fee of 39 basis points.

**Action Taken – Fixed Income Manager Selection**
On a motion by Trustee Marge Medd, which was seconded by Trustee Karl Turner, the Investment Committee approved the addition of the J.P. Morgan Core Bond Fund (R6 Class Shares) to the Defined Benefit Plan portfolio for an approximate 13.5% or $5.3 million core fixed income allocation.

**Market Outlook**
NEPC reviewed market risks and opportunities with the following themes remaining consistent:
- Investors would be wise to rebalance to policy targets and maintain portfolio risk balance.
- Allocate to emerging markets and private markets for higher returns in a low return world.
- Look for opportunities to be dynamic – particularly in credit markets.

**Managed Investment Pool (MIP)**

**Performance Review**
The Plan returned 3.7% during the quarter ended June 30, 2014 and 16.3% for fiscal year 2014. Long term returns have been favorable and have outperformed the policy and allocation index. The Plan ranked in the 41st percentile during the quarter ended June 30 and the 33rd percentile for the fiscal year. Long term rankings (7 and 10 years) are in the top quartile based on the InvestorForce Endowment & Foundation Universe. All asset classes had positive returns during the quarter ended June 30, 2014. The top performing managers for the fiscal year relative to their benchmarks were DFA, Globeflex, Commonfund, GMO, PIMCO All Asset, Permal and Blenheim.
Manager Due Diligence
NEPC’s Due Diligence Committee recommends a “Watch” status for PIMCO, “Hold” for Aberdeen and “No Action” for Westfield.

Recent Actions
At the beginning of April 2014, MIP cash movements included an outflow to fund Endowment distributions and an inflow of $7 million to fund the Other Post Employment Benefit Trust.

During the second quarter the following occurred:
- Loomis High Yield product transferred to the Loomis Multi-Sector Fixed Income Product.
- Landmark Equity Partners XV was funded as the Private Equity manager per the newly approved asset allocation targets.
- Mondrian EM Small Cap was funded in the Emerging Markets space complementing Aberdeen.

Defined Benefit Pension Fund

Performance Review
The Plan returned 3.3% for the quarter ended June 30, 2014 and 13.8% for fiscal year 2014. The Plan ranked in the 57th percentile of the Total Trust Fund Universe during the quarter ended June 30 and in the 66th percentile for the fiscal year. For the 10 year period, the Plan ranked in the 64th percentile. All asset classes contributed to outperformance during the quarter ended June 30, 2014. The top performing managers for the fiscal year relative to their benchmarks were PIMCO All Asset, Wellington and Permal.

Manager Due Diligence
NEPC’s Due Diligence Committee recommends a “Watch” status for one manager - PIMCO.

Recent Actions
In addition to cash movements for benefit payments, UMS made a $550,000 Plan contribution. Rebalancing in the portfolio occurred in August in order to get closer to the new policy targets. Per the newly approved asset allocation targets the following occurred during the quarter ended June 30, 2014:
- Loomis High Yield product transferred to the Loomis Multi-Sector Fixed Income Product.
- Blenheim was liquidated in full and funds were received in May 2014.
- Aberdeen was replaced by Mondrian Emerging Market Small Cap Equity.

Operating Fund

Asset Allocation
Plan assets as of June 30, 2014 were $240.9 million, decreasing $39.8 million from March 31, 2014. Currently the Plan is overweight in the Income Pool (55.5% v 50.0%) and the Total Return Pool (28.4% v 25.0%) and is underweight in the Liquidity Pool (16.1% v 25.0%). Throughout the year, asset allocation will change based on cash inflows and outflows. NEPC reviews this on a monthly basis.

Performance Review
The Plan returned 1.5% during the quarter ended June 30, 2014 and 4.8% for fiscal year 2014. Long term returns remain favorable. The top performing managers for the fiscal year were those in the
Total Return Pool, including Permal, Vanguard and PIMCO All Asset, which had the highest absolute returns.

Manager Due Diligence
There are currently two manager updates by NEPC’s Due Diligence Committee with a recommendation of “Watch” for PIMCO and “Client Review” for Windhaven.

Defined Contribution Plan – June 30, 2014 Quarter Review.

Barron Schmitt, Senior Vice President with CAPTRUST Financial Advisors, provided an administrative review of the Defined Contribution Plan, and a performance review of the investment offerings for the quarter ended June 30, 2014. The UMS’ June 2014 transition to a sole recordkeeper model went very well. Plan assets held by TIAA-CREF at June 30 stood at $1.3 billion for all participants. Given historical allocations within TIAA-CREF, it is not surprising that the top two investments with the most participant assets are the TIAA Traditional Annuity product and the CREF Stock account. The Plan is also seeing considerable investment activity in the Vanguard Target Date series. At June 30, participants had retirement assets of $130 million that continued to be invested with the three prior vendors – VALIC, Fidelity, and ING.

Mr. Schmitt reviewed the three investment options that scored below 80 following the CAPTRUST methodology as described in the previously adopted Investment Policy Statement for this Plan. The three funds identified as marked for review are the CREF Inflation-Linked Bond account, the PIMCO Total Return Institutional fund, and the Eagle Small Cap Growth R6 fund. All funds were above 70; therefore, none were recommended for termination.

Adjournment.

Submitted by
Tracy Elliott for
Tracy B. Bigney, Clerk