

**Seattle City Employees' Retirement System  
Investment Advisory Committee  
Annual Report for Fiscal Year 2021**

**To the Seattle City Employees' Retirement System (SCERS) Board of Administration:**

The Investment Advisory Committee (IAC) of the Seattle City Employees' Retirement System (SCERS) met with the Board's Investment Committee four times during 2021. Additional discussions with SCERS staff (Staff) around pertinent issues for the Investment Committee also occurred throughout the year. Following is the IAC's report for calendar year 2021.

**I. Statement of Purpose**

According to RCW 35.39.090, the IAC shall have the following duties:

- Make recommendations on general investment policies, practices, and procedures to the Board.
- Review the investment transactions of the Board annually.
- Prepare a written report of its activities during each fiscal year.

**II. IAC Membership**

Each member will serve a three-year term or until the Board acts to extend or end that member's appointment.

IAC members and their terms are:

- Keith Traverse (Chair), Cascade Asset Management Company (term: May 2021 - May 2024)
- Joseph Boateng, Chief Investment Officer, Casey Family Programs (term: January 2022 - December 2024)
- Dr. Cathy Cao, Associate Professor of Finance, Seattle University (term: July 2019 - June 2022)
- Steven Hill, former Senior Vice President of Human Resources, Weyerhaeuser; former Director, Washington State Department of Retirement Systems (term: July 2019 - June 2022)
- Dwight McRae, former Managing Director, Metzler Real Estate (term: January 2022 - December 2024)

**III. Major Developments for SCERS in 2021**

2021 investment activity includes:

- Staff continued research and development of a liability-aware investing (LAI) approach to be incorporated in SCERS's next asset-liability study (slated for 2023). Specifically, Staff collaborated with JP Morgan Asset Management to co-author a paper laying out a framework that would improve public pension performance measurement and asset allocation. The IAC notes that this work has advanced SCERS as a thought leader in public plan management.
- SCERS hired Dr. Leola Ross as Deputy Chief Investment Officer/Head of ESG and Mengfei Cao as Investment Officer to replace two team members who retired.
- SCERS continued to make progress with its positive action strategy regarding environmental, social and governance (ESG) issues that includes shareholder advocacy, integrating climate change risk into SCERS's investment process, and considering sustainability investments.

- Staff and NEPC conducted annual reviews for each asset class to educate and update the Investment Committee on their portfolio role, composition, and developments.
- Staff and NEPC continued their annual reviews of key strategic topics with the Investment Committee, including the investment risk framework, cost effectiveness analysis, and capital markets review.
- Public Equity: Staff and NEPC completed their research of the Japan equity market and recommended shifting a portion of the allocation from passive to active management. Accordingly, SCERS made a \$60 million investment to seed the ABS Japan Strategic Portfolio.
- Private Equity: SCERS recommitted to Adams Street Partners as its discretionary private equity manager with a third tranche allocation of up to \$280 million. Adams Street Partners also committed \$50 million of the second tranche allocation to underlying primary funds in accordance with the asset class pacing plan.
- Fixed Income: Staff evaluated private credit strategies for the Credit Fixed Income asset class but did not have sufficient conviction to proceed at this time.
- Real Assets: Staff and NEPC completed their research of international core real estate and recommended shifting from a US-only to a more global real estate allocation. Accordingly, SCERS committed \$60 million to JP Morgan Strategic Property Fund Asia. SCERS also committed \$25 million to Brookfield Strategic Real Estate Partners IV and \$20 million to Tiger Infrastructure Partners Fund III.

#### IV. Performance as of September 30, 2021

	Performance (Annualized)					Volatility
	1Y	3Y	5Y	10Y	30Y	10Y
Fund	23.3%	11.6%	10.7%	9.9%	7.7%	7.7%
Strategic Policy Benchmark	22.0%	11.4%	10.7%	10.2%	7.9%	7.6%
Reference Passive Benchmark*	19.9%	10.9%	10.5%	9.5%	N/A	N/M
Median Fund**	21.2%	10.1%	9.9%	9.6%	8.3%	7.8%

Performance is net of fees for all periods except for 30 years that is gross of fees due to data availability.

\*71% MSCI All Country World Equity Index; 29% Bloomberg U.S. Aggregate Bond Index

\*\*Peer group consists of public plans in the InvMetrics Public DB Universe, each with assets in excess of \$1 billion.

The Fund maintains three goals against which to assess performance:

1. The Fund seeks to achieve a net return over a period of 30 years that matches or exceeds the actuarial rate of return. The Fund has returned 7.7% gross of fees over the last thirty years, which is greater than the current actuarial rate of return of 7.25%.
2. The Fund seeks to achieve a net return over a full market cycle that matches or exceeds the Reference Passive Benchmark whose current composition is 71% Public Equity and 29% Core Fixed Income. The Fund has returned 9.9% over the last ten years (as a proxy for a market cycle), which is greater than the 9.5% return of the Reference Passive Benchmark.
3. The Fund seeks to achieve a net return over a period of five years that matches or exceeds the Strategic Policy Benchmark. The Fund has performed in-line with the Strategic Policy Benchmark (10.7% Fund, 10.7% Strategic Policy Benchmark) over the last five years.

For the one-year period ending September 30, 2021, the Fund returned 23.3%, outperforming the Strategic Policy Benchmark by 1.3%. Positive relative performance is primarily attributable to manager outperformance and style tilts in the Public Equity allocation that was partially offset by an overweight to Core Fixed Income.

Below is the asset allocation of the Fund:

	SCERS Allocation	Strategic Policy Benchmark Weight	Difference
	9/30/21	2021	
Public Equity	48.3%	50%	-1.7%
Private Equity	13.4%	10%	3.4%
Core Fixed Income	20.8%	19%	1.8%
Credit Fixed Income	7.1%	7%	0.1%
Real Estate	8.4%	11%	-2.6%
Infrastructure	1.5%	3%	-1.5%
Cash + Overlay	0.4%	-	0.4%
Workout	0.1%	-	0.1%

## V. IAC's 2021 Activities

### Investment Committee Meetings

In February, the IAC joined the Investment Committee meeting to discuss the IAC's 2020 annual report and NEPC's investment outlook. Joseph Boateng communicated the IAC's recommendations. The IAC also contributed to the review of Q4 2020 performance.

In May, the IAC joined the Investment Committee meeting for a discussion on the investment risk framework, a deep dive into the Core Fixed Income asset class, and a review of Q1 2021 performance.

In August, the IAC joined the Investment Committee meeting to evaluate a recommendation to invest in the JP Morgan Strategic Property Fund Asia, to participate in NEPC's annual presentation on ESG matters, and to contribute to the review of Q2 2021 performance.

In November, the IAC joined the Investment Committee meeting to evaluate a recommendation to redeem from the Heitman American Real Estate Trust, participate in the annual cost effectiveness and fee study and contribute to the review of Q3 2021 performance.

The IAC also met with the Executive Director and Chief Investment Officer prior to each of the meetings listed above to discuss strategic projects and the agenda for upcoming meetings.

### Ad Hoc Involvement

The Investment Advisory Committee charter acknowledges explicitly that engagement of IAC members, collectively or individually, outside of the regularly scheduled meetings provides a great benefit to SCERS.

In January, Joseph Boateng and Steve Hill participated in a Staff presentation to the Board by comparing the impact of divestment and engagement on corporate behavior.

Throughout the year, IAC members contributed to Staff's research on investment managers.

## VI. Strategic Guidance

The IAC offers the following long-term guidance. These recommendations are evergreen. We note below certain recent initiatives consistent with this guidance.

### Commitment to Financial Sustainability

The IAC urges SCERS to renew its commitment to prudent financial management, which includes:

- Using a reasonable return assumption to judiciously estimate SCERS's liability.
- Holistically evaluating SCERS's financial position and the risks around it. This includes relating assets to the liability in analysis and communication: risk is the mismatch between plan assets and liabilities.

SCERS's recent and ongoing activity under this guidance includes:

- Reviewing the return assumption: SCERS conducted an actuary-led experience study in 2018 that culminated in reducing the investment return assumption from 7.5% to 7.25%, effective January 1, 2020. SCERS will perform its next experience study in 2022.
- Committing to periodic actuarial studies: SCERS intends to undertake studies every four years; as noted above, the next one is planned for 2022. The study will refresh assumptions on demographics, macroeconomic factors, and investment returns.
- Advising the City on contributions: In 2021, SCERS recommended that the City maintain its existing contribution rate. While the City could have lowered this rate and still met its commitment to pay the actuarially required contribution, the City accepted SCERS's recommendation.
- Advancing a holistic, liability-aware investment approach, as highlighted under III above.

### Focus on Fee Effectiveness

We encourage Staff to continue assessing fee effectiveness with respect to risk and return across asset classes and strategies. SCERS should continue to monitor vendor payments, compensation to plan fiduciaries, and accrued expenses such as carried interest. It should be attentive to fee transparency, especially in venture and growth equity investments. This focus on fees is particularly important as SCERS increases its exposure to private market investments.

In 2021, we note that SCERS continued and enhanced its process of tracking investment costs and reported them to the Investment Committee in November.

### Align Investment Beliefs with Processes and Resources

We encourage the Executive Director and Staff to make sure that resource allocation is consistent with the mission and beliefs outlined in SCERS's Investment Policy.

### Support Continual Learning

We encourage Staff and consultants to continue to implement the Board education plan to enhance the Board's understanding of the tradeoff between risk and return over the long-term.

We acknowledge that Staff and NEPC continued to provide educational presentations in Investment Committee meetings in 2021.

## VII. 2022 Recommendations

The IAC's specific recommendations for 2022 are as follows:

### Asset Allocation and Risk Management

- Ahead of the next asset-liability study (slated for 2023), SCERS should make fit for implementation its LAI framework and document this framework's influence on portfolio decisions.
- In 2022, SCERS should use LAI to:
  - Reexamine the role of Fixed Income in the Fund. This work should focus on return expectations, SCERS's near and medium-term cash needs, and the sensitivity of the system's funding ratio to movements in interest rates.
  - Evaluate the potential impact of elevated inflation on SCERS's financial position. This analysis should consider the behavior of the system's funding ratio in high inflation scenarios.
- Given its growing investments in/ commitments to private markets, SCERS should refresh its modeling to make sure the Fund would have enough liquidity to meet its obligations and to rebalance in stress scenarios.
- A feature of the uncertain future is the climate challenge, which presents both threats and opportunities. The IAC recommends that the Board:
  - Continue developing and refining the climate-related analysis SCERS uses in its investment decision-making.
  - Reinforce its positive engagement on climate change with the Fund's agents, including its consultant, its investment managers, and the managers of its portfolio companies.

### Fee Effectiveness

In 2022, Staff should validate the fee calculations for a sample of private market funds. SCERS should then determine if, given SCERS's resources and Adam Street Partners' validation work on SCERS's behalf, this work should be done across all direct private market funds.