OKLAHOMA STATE PENSION COMMISSION
Minutes
February 22, 2022

1. Call to Order

A meeting of the Oklahoma State Pension Commission convened on February 22, 2022 at 10:30 a.m. at the Oklahoma State Capitol. Written notice was sent to Commission members and interested parties, posted 24 hours prior to the meeting, and filed with the Secretary of State in compliance with the Open Meeting Law. The meeting was called to order once quorum was made.

Members Present: Commissioner Randy McDaniel – State Treasurer; Commissioner Cindy Byrd – State Auditor; Commissioner Avery Frix – House of Representatives; Commissioner Dana Webb – Designee for Steven Harpe, Director, OMES; and Commissioners DeWayne McAnally and James Ward – Governor Appointees.

Others: Ruth Ann Chicoine – Administrator; Mark Higgins - RVK; Thomas Schneider – Legal Counsel office of the Attorney General; Andrew Messer and Tim Allen – Oklahoma State Treasurer's Office; Joe Fox and Brad Tillberg – Oklahoma Public Employees Retirement System; Chase Rankin, Tim Van Horn, and Dana Cramer – Oklahoma Firefighters Pension and Retirement System; Sarah Green – Oklahoma Teachers Retirement System; Ginger Sigler and Deric Berousek – Oklahoma Police Pension and Retirement System; and Paul Pustmueller and Evan Walter – Bank of Oklahoma.

2. Approval of Minutes dated November 16, 2021

A motion was made by Commissioner Frix to accept the minutes of the November 16, 2021, meeting with a second from Commissioner McAnally: all approved.

3. Investment Performance and Actuarial Analysis - Mark Higgins – RVK, Inc.

Chairman McDaniel turned the meeting over to Mark Higgins of RVK.

Capital markets produced strong returns in the fourth quarter of 2021, an exceptional year for investors. The primary drivers were strong, double-digit returns from public equities, private equity, and real assets. Fixed income returns were largely flat.

At the root of the exceptional equity returns in 2021 was a draw down in the substantial excess savings rate that Americans and businesses maintained during first 18 months of the pandemic. Combined with low interest rates, the abundance of cash increased investor tolerance for higher equity valuations, which contributed to higher stock prices. Unfortunately, spending of excess savings also created inflationary pressures. These pressures were especially pronounced in the durable and non-durable goods sectors, as businesses suffered from supply shortages due to pandemic-related disruptions in production and logistics.

Persistent inflation has caused anxiety among investors. While impossible to predict when the current inflationary spike will subside, history suggests that it may not last as long as investors fear, similar inflationary events occurred immediately after the conclusion of World War I and World War II, these periods lasted approximately two years. An even more compelling reason that inflation will likely be temporary is the shifting perspective at the Federal Reserve.

Leaders at the Fed view the risk of inflation as a significant threat to the nation than marginal increases in unemployment. Fed leaders know that allowing high inflation to persist for too long could allow inflation expectations to shift upward, it becomes much more difficult to extinguish. This is the fear that is certainly at the forefront of the minds of policymakers at the Fed, which makes it much more likely that they will err on the side of being overly hawkish rather than overly dovish. Investors should brace for Federal Reserve policies that may be more aggressive and persistent than in the past.

As the Fed begins contracting the money supply over the next year or two, investors may experience volatility and price declines that go beyond what they have become accustomed to over the past several decades and may tempt investors to adjust long-term target allocations to “time the market.” For those experiencing this temptation, it may be helpful to recall the cautionary advice of Paul Volcker. While is true that we can predict with reasonable confidence that the rate of inflation will ultimately settle at the Federal Reserve’s target of 2%, we do not know the date when this will occur, we can pick the number, but we cannot pick the date; it is for this reason that we advise investors to remain committed to their long-term strategy and resist the temptation to time the current inflationary wave despite having increasing confidence that it is likely to be temporary.

During the 4th Quarter of 2021, the Oklahoma State Pension Funds produced solid single digit returns, ranging between 3.9% to 4.9% net of fees. Over the trailing year, returns across the seven plans were strong, ranging from 11.6% to 18.2%. Relative to policy benchmarks, performance was similarly strong, as five out of six plans outperformed their respective policy benchmarks net of fees.

In terms of performance attribution, the fundamental drivers have not changed much over the past year. In the case of the Oklahoma State Pension Funds, a handful of strategic decisions explain most of the strong performance. The Pension Plans have a high allocation to public equity. This is a sensible approach given the Plans’ extended time horizons, healthy funded statuses, and strong psychological and technical tolerance for risk. The plans benefitted from these decisions over the last year, capturing a substantial portion of the bull market in equities.

The Pension Plans are invested more heavily in US equities, which have outperformed international equities for more than 10 years. Relative to peers, this strategic tilt drove higher absolute returns and relative performance. Several of the plans maintain allocations to private equity. The returns generated by these allocations were exceptional over both the trailing quarter and all periods extending back to 10 years. These returns were especially impressive for the Teachers and Public Employees Plans, which are also the largest plans.

Institutional investors are bombarded with marketing pitches on new investment strategies. Many of these strategies add portfolio complexity and higher costs without providing commensurate benefits. In comparison to peers, the Oklahoma Pension Plans have resisted to invest in these products, keeping fees low and avoiding the dilution of returns. Evaluating potential benefits and costs of active management, it is often the costs outweigh the benefits. The magnitude of the gap varies by asset class and the unique attributes of the investors themselves. The Oklahoma State Pension Plans have employed active management strategies that extracted benefits that have exceeded the associated costs. This has enhanced absolute returns and performance relative to peers.

Overall performance of the Oklahoma State Pension Plans is strong because of thoughtful, high-level strategic decisions, coupled with skillful execution. While there will be future periods of time in which these strategies suffer periods of underperformance, over the long term, they appear well-positioned for success in a manner that aligns with the Plans’ objectives, risk tolerance, constraints, and unique competitive advantages.

Asset class returns varied during the fourth quarter, with strong US equity markets driving the majority of performance. US equity returns were strong for the quarter. Relative to benchmarks, returns varied depending on a combination of style tilts (i.e., small/mid cap and value) and the relative performance of active managers. US equity returns ranged from approximately 6.0% (Firefighters) 5 to 9.4% (Wildlife). Longer term performance over 3-, 5-, 7-, and 10-year periods has lagged broad indexes of US equities. International equity returns were positive but lagged their US counterparts during the fourth quarter. Fourth quarter returns ranged from approximately 0.6% (Law Enforcement) to 1.9% (Judges). The use of active management in this asset class yields mixed results over long time periods. Three out of six plans with dedicated international equity buckets outperformed their respective indices over the 10-year trailing period. The Police plan measures total domestic and international equity against a broad, global benchmark of equities, and has outperformed over most trailing periods.

Fixed income returns were flat for the fourth quarter, as shorter-dated yields increased slightly. Returns ranged from approximately -0.3% (Firefighters) 5 to 0.7% (Teachers). Relative performance was mixed for the quarter, with four out of seven plans outperforming the Bloomberg US Aggregate Bond Index. Over longer periods of time, as measured by 7- and 10-year periods, most plans are exceeding or roughly flat against the index.

Real estate returns were generally positive for the quarter and over the trailing year, as prices continued to recover from post-pandemic lows. As reported by the NFI-ODCE Index, income returns of 0.8% continue to trend in line with historical levels, while price appreciation accounts for 6.9% of return.

Hedge funds returns varied considerably by Plan. Returns ranged from a low of approximately -16.7% (Firefighters)5 to a high of -1.9%. (Police). On a relative basis, plans investing in Hedge Funds suffered over the quarter, with relative performance ranging from approximately -17.3% (Firefighters)5 to -8.5% (Law Enforcement).

Private equity produced positive returns over the quarter, but the level of performance varied across the different pension plans. This variability is consistent with expectations given that each plan has different exposures by investment strategy and vintage year. Further, performance versus benchmarks varied considerably, but primarily since one plan (Teachers) uses a public equity benchmark, while the others use a private benchmark.

In aggregate, the 5-Year and 10-Year absolute and risk-adjusted returns for the Oklahoma Pension Plans continue to compare favorably relative to indices and peers. Four out of seven plans performed at or above median on both metrics. Performance is more favorable on an asset-weighted basis, with 89.4% outperforming the median plan over the trailing 10-year period.

A combination of strong investment performance and prudent liability management has substantially improved the financial health of the Oklahoma State Pension Plans. The exceptional returns of the past 10 years are unlikely to be repeated. Simultaneously, there is pressure on retiree cost of living due to inflationary pressures. Addressing both with a cautious approach will help ensure continued improvement in the financial health of the Oklahoma System.

No other discussion by the Commission.

4. <u>Adjournment</u>

A motion to adjourn was made with all in favor, meeting adjourned. The next regular commission meeting will meet June 14, 2022.

*Respectfully Submitted:*____________________________________
Ruth Ann Chicoine, Administrator