UNIVERSITY OF MAINE SYSTEM
Board of Trustees
Investment Committee

August 25, 2022
Zoom

Present: Committee Members: Kelly Martin; Chair, David MacMahon, Sven Bartholomew, and Trish Riley. **Non-Voting, Non-Trustee Committee Members:** Jim Bradley, and Matthew Skaves. **System Staff:** Tracy Elliott, Ellen Doughty, and Ryan Low. **Others:** Kelly Regan – NEPC, Josh Beers – NEPC, Barron Schmitt – CAPTRUST, Michael Pratico – CAPTRUST and Tim Griffin.

Absent: Lisa Eames.

Approval of Non-Voting, Non-Trustee Member – Timothy Griffin
Trustee Martin, Chair of the Investment Committee, and Board of Trustees Chair Riley, recommend the appointment of Timothy Griffin as a non-voting, non-trustee member of the Investment Committee. Mr. Griffin is a graduate of the University of Southern Maine (USM) and current Treasurer of the USM Foundation. A Portfolio Manager with HM Payson Co. of Portland, he manages over $400 million in assets for 120 clients including individuals, trusts, endowments, and institutions. He also serves on the Board of the Dempsey Centers for Quality Cancer Care, the State of Maine's Advisory Committee on Educational Savings, United Way's Brick and Beam Society, and the United Society of Shakers Sabbathday Lake, Inc.

> On a motion by Trustee MacMahon, which was seconded by Trustee Riley, and approved by a roll call vote of all Trustees present, the Board of Trustees, acting through the Investment Committee, approved the appointment of Timothy Griffin to a three-year term as a non-voting, non-trustee member of the Investment Committee effective August 25, 2022.

Investment Committee FY2023 Work Plan
Chair Martin stated that the Investment Committee annually reviews the committee work plan, which provides an overview of the agendas for the committee for the fiscal year. The Investment Committee's Fiscal Year 2023 work plan was provided to the committee prior to the meeting. The work plan will also be included in the September 11-12, 2022 Board of Trustees meeting materials as an information item.

Defined Contribution (DC) Plans - Quarterly Review
Michael Pratico, Senior Vice President, and Barry Schmitt, Principal, with CAPTRUST Financial Advisors, provided a quarterly update regarding the Defined Contribution Plan.

Industry Updates:
CAPTRUST reviewed Qualified Default Investment Alternative (QDIA) regulations noting that developments in the space include the introduction of Managed Accounts for participants nearing retirement as well as Target Date managers who alter their series to become more income friendly. No changes to the UMS plan's QDIA are being recommended at this time.

CAPTRUST also reviewed trends in plans greater than $250 million including continued use of automation features as an effective way to increase plan participation and increase employee contributions over time. In addition, CAPTRUST commented about distribution options which define how participants are permitted to withdraw money from their plans. Of plans surveyed by CAPTRUST, the percentage offering loans to participants has increased from 82% in 2016 to 90% in 2021. The percentage offering hardship withdrawals has also increased from 86% to 89% over the same time period.

CAPTRUST continues to monitor the progress of the SECURE Act, which was approved in Congress and is currently with the Senate. CAPTRUST noted that the SECURE Act includes language that would allow 403(b) plans to offer Collective Investment Trust (CIT) vehicles. Passage could have a significant positive impact on the UMS plan.

Market Commentary:
CAPTRUST provided market commentary noting the uncertainty that surrounded the start of calendar year 2022, soon followed by investor realization that more difficult times were likely going forward. The result was a broad-based repricing of risk, sending stocks and bonds lower during the second quarter. Special emphasis was placed on bonds where bond prices remained under pressure as interest rates continued their ascent. During the 2nd calendar quarter, the Bloomberg U.S. Aggregate Bond Index lost 4.7%, bringing the decline through June 30th to 10.4%.

Investment Review: CAPTRUST reviewed all funds in a manner consistent with the Investment Policy Statement. All funds are in good standing with two exceptions. CAPTRUST emphasized the following:

- ***Virus Ceredex Mid Cap Value (marked for review):*** The manager is benchmark-agnostic and willing to invest in higher growth businesses trading at above-market valuations. In addition to valuation and fundamentals, the investment process emphasizes dividends when screening for new ideas and every stock in the portfolio must pay a dividend. 2020 returns suffered from the strategy's dividend mandate as many consumer holdings eliminated their dividends due to the COVID-19 pandemic. Many of those stocks generated strong returns in the subsequent market recovery, but this strategy's dividend mandate had triggered their liquidation from the portfolio. In addition, given its high relative exposure to growth stocks, the strategy tends to lag in value-led markets. As a mid-value offering, CAPTRUST continues to recommend holding the strategy with the caveat that it will tend to underperform when growth is out of favor, such as in the year-to-date period. However, CAPTRUST is reviewing this fund closely with the expectation of improved performance. If performance doesn't improve, CAPTRUST may discuss alternatives at the next meeting.

- ***American Century Emerging Markets (marked for review):*** After posting strong relative returns in 2017, 2019 and 2020, performance has weakened for the fund more recently as its growth style has fallen out of favor. This recent weakness is weighing on the fund's intermediate-term results compared to the diversified emerging markets peer group. CAPTRUST continues to recommend the strategy due to its experienced team and disciplined process. The strategy has performed well historically when its growth style has been in favor. While the strategy has struggled relative to the core peer group and benchmark during this correction in the growth style, the last two months of positive relative performance is encouraging.

- ***Vanguard Target Date (QDIA – In good standing):*** Vanguard Target Retirement posted mixed results relative to peers and the benchmark, but most vintages outperformed during the second quarter. The vintages that underperformed were the ones approaching and just in retirement (2020 – 2030). This part of the glidepath is where Vanguard has a slightly larger equity allocation compared to peers and the benchmark, and it weighed on performance given the equity market's continued slide. The rest of the glidepath carries an equity allocation that is in line with the industry average or slightly below.

<u>NEPC Managed Investment Pool (MIP), Pension, and Operating Funds</u>

<u>Performance Reviews</u>
Kelly Regan, Senior Consultant with NEPC, reviewed performance for all three UMS portfolios with the following highlights.

Operating Fund: The Operating Fund declined 2.8% during the quarter ended 6/30/2022, net of fees, closing out the fiscal year with a market value of $317 million. During the 2nd calendar quarter, managers were in-line with their respective benchmarks in aggregate (Composite vs. Allocation Index). Over longer-term periods, the Fund has outperformed the Allocation Index. At the end of the 2nd quarter, the asset allocation of the Fund was within policy ranges. Ms. Regan reviewed the Environmental, Social, and Governance (ESG) dashboard for the first time for the Operating Fund. She noted that, while the Investment Committee recently adopted an ESG strategy in May 2022 for this Fund, it has a high incorporation of ESG already in the portfolio.

Defined Benefit Pension Fund: The Pension Fund declined 7.4% during the quarter ended 6/30/2022, net of fees, closing out the fiscal year with a market value of $20.4 million. At the end of the 2nd quarter, the asset allocation of the Pension was close to policy targets. Ms. Regan also reviewed the ESG dashboard for the first time for the Pension Fund. She noted that, while the Fund has recently adopted ESG (May 2022), the Fund has a high incorporation of ESG already in the portfolio.

Managed Investment Pool (MIP): The Managed Investment Pool (MIP) with a market value of $335 million as of 6/30/2022, declined 10.5% during the 2nd quarter of the calendar year, net of fees. The MIP's value decreased $100 million from the 1st quarter due to declining equity and fixed income markets and from Maine Maritime Academy's redemption of its investment in the MIP. The MIP ranked at the 64th percentile of the Endowments and Foundations universe during the 2nd quarter. Longer term ranks have fallen short of the median due to manager underperformance and because the MIP does not have an allocation to private equity, while most peers do. At the end of the 2nd quarter, the asset allocation of the MIP was within policy ranges. Ms. Regan noted recent actions included terminating Morgan Stanley and Kabouter and funding the SSgA EAFE index and Axiom International Small Cap. Ms. Regan also reviewed the ESG dashboard for the MIP noting that ESG incorporation in the Portfolio continues to be strong.

<u>International Equity Manager Recommendations – Managed Investment Pool & Operating Fund</u>
Kelly Regan provided an overview of a fossil fuel free international equity strategy (Silchester Exclusion Trust) for consideration in the Managed Investment Pool (MIP) and in the Operating Fund. She noted that Silchester's flagship international equity strategy is 1-rated at NEPC and the fossil fuel free version will be the same team and process as the flagship product; however, the Exclusion Trust may have higher tracking error due to the negative screening. The product will exclude the Carbon Underground 200 list of securities which is in-line with the System's divestment policy.

For the MIP, Ms. Regan recommended replacing the current SSgA MSCI EAFE index with the Silchester Exclusion Trust. She presented information on how Silchester would complement the MIP's other international equity strategy (JO Hambro).

For the Operating Fund, Ms. Regan noted that the Fund does not have a direct allocation to International Equity, but that the Vanguard Total World Stock index has a portion invested in international equity and US equity. Ms. Regan recommended moving from this Vanguard product to a 65% allocation to an S&P 500 index fund (SSgA) and 35% allocation to the Silchester Exclusion Trust to derive similar exposures as the Vanguard fund.

The Pension Fund could not invest in the Silchester Exclusion Trust given the small size of the total portfolio assets under management.

On a motion by Trustee Bartholomew, which was seconded by Trustee Riley, and approved by a roll call vote of all Trustees present, the Board of Trustees, acting through the Investment Committee, approved the following investment manager changes:

- Terminate SSgA MSCI EAFE index and replace with Silchester Exclusion Trust for approximately 5% of total MIP Portfolio assets.

- Terminate Vanguard Total World Stock index and replace with SSgA S&P 500 Index Non-Lending for approximately 5% of total Operating Fund assets and Silchester Exclusion Trust for approximately 2.5% of total Operating Fund assets.

Private Equity Education

Kelly Regan and Josh Beers of NEPC provided educational materials regarding the benefits and considerations for private equity investing, along with implementation options to consider when starting a private equity program. They discussed what an allocation to private equity could look like for the MIP and illustrated a sample portfolio on what a 10% allocation would mean for the portfolio. At a 10% allocation the MIP's asset allocation would be more similar to peers and could potentially improve future return expectations. If the MIP allocated to private equity, NEPC discussed implementation options with regards to direct investments, fund of funds as well as the number of many manager relationships and funds that the System would potentially invest with. They also discussed the administrative burden of a Private Equity allocation, some of which NEPC could relieve by providing additional services to assist with capital calls, legal reviews and selecting the funds to invest with.

Additional information about the meeting can be found on the Board of Trustees website:
https://www.maine.edu/board-of-trustees/meeting-agendas-materials/investment-committee/

Adjournment
Tracy Elliott for
Ellen N. Doughty, Clerk