

**State of Alaska
Department of Revenue
State Investment Review Meeting
August 23, 2022**

MEETING SUMMARY

Meeting Details:

Start Time: 10:00 AM

End Time: 11:15 AM

Department of Revenue Staff present:

Lucinda Mahoney, Commissioner of Revenue
Brian Fechter, Deputy Commissioner of Revenue
Zachary Hanna, Chief Investment Officer
Pamela Leary, Director of Treasury
Victor Djajalie, State Investment Officer
Emily Howard, State Investment Officer
Scott Jones, Head of Investment Operations, Performance & Analytics
Ryan Kauzlarich, Assistant Comptroller
Michelle Prebula, State Investment Officer
Hunter Romberg, Investment Data Analyst
Alysia Jones, ARMB Liaison Officer

Investment Advisory Council (IAC) Members present:

William Jennings
Jerrold Mitchell
Ruth Ryerson

I. Introduction

The Commissioner thanked everyone for joining and handed the meeting over to Mr. Hanna.

Mr. Hanna said he would do a review of market and performance for Q2 and summarize where they ended up with respect to the asset allocations for FY23.

III. State Investments

Mr. Hanna said that Q2 was very challenging, with the Russian/ Ukraine crisis tipping the scales with respect to inflation. Driven by energy, other commodity prices, and shelter costs, the CPI reached 9.1% annualized in June, and backed down to 8.5% in July.

Mr. Hanna also noted there was significant wage pressure since employment remained very tight with 5.5 million more job openings than unemployed workers.

In an effort to control inflation, the Fed has raised rates 225 basis points (bps) through July and are expected to raise them five more times this year. Mr. Hanna commented that as a result of the Fed's actions and forward plans, yields have increased dramatically, with the 1-year portion of the yield curve up 230 bps, with half occurring in Q2. The 10-year portion was up 150 bps, with close to half in Q2 as well. This resulted in a second quarter of negative bond performance as rates reset.

Mr. Hanna explained international equities have trailed US equities throughout most of the pandemic and the Ukraine war has not helped. Corporate profits have also been growing much more slowly in 2022 with growth headwinds and the impact of inflation on profitability.

Looking at the periodic table of returns, Mr. Hanna noted that in Q2, everything was negative except for cash in which was marginally positive.

A. June 30, 2022 Performance – Commissioner’s Report

As of June 30th, the Commissioner was fiduciary for \$9.1 billion in state assets.

Mr. Hanna reviewed the relative asset allocations, which show the asset allocation deviations from the target at month end. All deviations are within bands and most of them were just prior to quarter-end rebalancing where they were largely brought back to target. He noted the biggest exception was GeFONSI I and II, which had high allocations to cash at the end of the fiscal year due to both high expected cash outflows at the start of FY23 and the transition to a shorter duration bond fund.

Looking at performance by asset class building block, Mr. Hanna explained fixed income was down 4.6% for the quarter, but the team did a good job delivering 12 bps of outperformance. Equities were also down; 16.7% for domestic and 13.64% for international. REITs were down 14.7%. Cash equivalents did have positive performance of 12 bps, 2 bps higher than the market and the tactical bond fund had a tough quarter with both rates rising and spreads widening for riskier bonds. He noted that most of this underperformance has reversed in the current quarter.

Mr. Hanna then walked through the fiscal year to date performance. He said returns had improved thus far in FY23, but that the markets remain quite volatile.

B. Non-Routine Investments

Non-routine investments are investment opportunities that fall outside the scope of the Department’s existing investment opportunity set.

Mr. Hanna stated that the Department does not currently have, nor is presently contemplating any non-routine investment opportunities.

A summary of the diligence process for evaluating any non-routine investment process is included in each SIR meeting packet, in the event such an opportunity arises, and remains a standing item on the quarterly meeting agendas.

C. Asset Allocation Process & 2023 Capital Market Assumptions

Mr. Hanna summarized the State Asset Allocation Process that he had explained in detail during the May meeting and then reviewed the actual asset allocations.

Mr. Hanna focused on updates to the open items discussed at the May meeting. He said the largest recommended change that they have now implemented was to add shorter duration bonds back into their asset allocation process.

He also said that they have restarted a Government 1-3 year bond portfolio, AY72, that they had used for years for short time horizon funds. Mr. Hanna congratulated Victor Djajalie and his team for an

outstanding job transitioning to this account while also handling the massive fiscal year-end cashflows this year.

Mr. Hanna reviewed the individual asset allocations, noting that they were only recommending longer duration bonds for portfolios with a long time horizon and often equity exposure, and that 20% of the allocation be in the form of the tactical bond portfolio. He clarified that they are not recommending any changes to the structure of the equity portfolios.

IV. IAC Comments

Ms. Ryerson asked a question about when GEFONSIs are negative, and when they posted them. Assistant Comptroller Ryan Kauzlarich responded that they post entry at the end of the year.

Dr. Jennings asked about Fidelity Tactical Bond response time. Mr. Hanna indicated that they were very responsive. Commissioner Mahoney suggested Fidelity be a potential speaker at a future meeting.

V. Future Agenda Items & Calendar Review

Mr. Hanna reviewed potential topics for the upcoming meeting.

The next meeting is scheduled for October 25, 2022.

VI. Other Matters for Discussion – None.

VII. Adjournment

There being no further items for discussion, the meeting adjourned at 11:15 a.m.