

TRS Investments Overview Part 1 Transcript

(Opening credits)

Rhonda Price: Hello and welcome to TRS today, a communications initiative of the Teacher Retirement System of Texas. I'm your host, Rhonda Price and our guest today is TRS Chief Investment Officer Britt Harris and Britt thank you very much for being with us today.

Britt Harris Oh, it is my pleasure.

Rhonda Price: Well, let's get started by asking about something that some of our viewers may not know about. Your mother was a teacher.

Britt Harris She was.

Rhonda Price: So how much did that fact influence your decision to join TRS?

Britt Harris Well you know that may be a trick question. You have a mother and you have a teacher-- two of the most influential people in anybody's life so I don't know whether mother influenced me so much as she told me that this is what I should be doing. But the truth is that this is the seventh fund that I've managed. I'm in the later part of my career. I've been with some wonderful funds around the country but I want to spend this last time with a fund that I really care about: 1.3 million people who do exactly what my mother did every day and that I really respect and honor and I think everybody in investment management is the same. So, she influenced me greatly. I have a board to report to. I have Texas teachers to report to, but my mother is probably my main boss.

Rhonda Price: And I know she must be very proud of you today. Does she tell you that a lot?

Britt Harris Well, it depends on how the market is doing.

Rhonda Price: Oh okay. That's good.

Britt Harris She told me the other day that I'm doing well so far.

Rhonda Price: Oh okay. All right then. Well, let's go on to our first question. And this is one we get asked quite often by our members. Now if the market should drop dramatically like it did back in 2008, how would our pension fund be impacted and how would member benefits be impacted?

Britt Harris The last cycle that you are referring to (which people now refer to as the great financial recession caused primarily by over leveraging the banks and real estate) was particularly deep but other than that, was relatively normal. When the end of the decline comes, which no one can predict precisely but when the political and economic conditions revert, the recession stops, the recovery begins and um the people who remain emotionally stable during that time prosper. So, as a result of that the fund that

was \$67 billion at that time is now over \$115 billion. That is despite the fact that we've paid out over \$25 billion you know since that time to our members for their payouts. We also receive ongoing contributions. The markets have recovered. We are now past the previous peaks of most of the markets around the world. And the investment division that works for the teachers has performed particularly well. So that is a long-winded way of saying that the declines happen. This particular decline was very severe. We try to be as honest and forthright with our teachers as we could be. We remained dedicated to the longer-term investing. Today the portfolio is fully recovered, plus several billion dollars. And these declines will happen again and we will hopefully perform the same.

Rhonda Price: Britt, with so many investment opportunities out there how do you decide which investment to make?

Britt Harris Well just imagine this. The Texas Teachers Fund is the 23rd largest investment portfolio in the world. This is an operation that um in a normal day if we ever had a normal day, makes \$5 million per hour. So this is not a normal function. We see investment opportunities literally in every asset class in every country in every currency you know around the world. So the amount and the breadth of opportunity that we see on behalf of teachers is vast. So, we have a great selection. Probably we have as good a selection as anybody, probably in the world. But, with that said, everything has to start from a long-term plan. So we have a solid long-term plan that we put in place. We then have highly qualified people who look into investments around the world and they work directly for the teachers here in Austin. There are about 110 of us. Then we have one of the world's probably most effective investment networks. Again covering every asset class around the world. Everybody who works for the teachers works on performance-based fees, meaning that they only get rewarded when they perform. So everything is completely aligned. We try to use some of the advantages that we have which is that we are large, long-term, we are very liquid and we are not levered. So you know when an opportunity arises that fits into that category you know we are one of the first ones to find it for the teachers.

Rhonda Price: Why does TRS use alternative investments, like hedge funds or private equity and real assets?

Britt Harris Sure. We get that question a lot. I think before we answer that question, the first thing to remember is that this is a very diverse fund portfolio. The portfolio is really divided by economic regime. So we think about investments in three different economic zones. One zone which would be considered to be a normal zone is global equity which does well. And then we have two other portfolios that hedge against periods of time like we saw in the great recession when um conditions don't support equity investment. A disinflationary portfolio and a reflationary portfolio. So the first thing is that the portfolio is very diversified. And all the... everything we do is either to enhance returns or improve them, the risk position of the trust. So in addition to the things that you mentioned we have a very large portfolio and very high-quality bonds. We have literally thousands of positions in public companies around the world. All of which are serving those two principal purposes. Sometimes both. Sometimes it is possible to increase returns and lower the risk depending on how correlated some of these things are. But specifically with the three that you mentioned, private equity serves primarily or almost exclusively to enhance our long-term returns. So for the last 10 years, our private equity portfolio has produced a

return net with all expenses for our teachers of over 16% per year. As a matter of fact we recently were we found out that our team here in Austin has the best private equity returns of any large fund in the country. And so private equity is primarily for to take advantage of the fact that we are very long-term and very uniquely positioned in some of these asset categories and so private equities are for increased investment return. The second one you mentioned was real assets. The real asset portfolio first is for people's benefit is primarily real estate. It is also energy and things like that. Things that produce some sort of current income and that also have some sensitivity to rising inflation. So they provide some diversification against rising inflation. In the real estate area, though, we've got about a \$13 billion portfolio that we hold for the teachers in real estate around the world. Most of that I would say 80% of those investments were made after the financial markets' decline which was caused primarily by real estate. Meaning that we were able to go in at a time with our size or liquidity and our expertise and our network and purchase real estate at what has turned out to be relatively attractive prices. And since that time we've made probably between 13 or 15% per year for the teachers in our real estate portfolio. But it is therefore not only in, but also to hedge partially against rising inflation. And hedge funds would sometimes get a lot of people confused because it is too easy to forget what the term hedge means. Hedge means to hedge against a decline. So we have we use hedge funds to hedge against declines in the stock market or primarily by having a hedge fund strategy that if the stock market were to decline and of course the stock market does decline periodically. It will generally decline by much less than the stock market declines. And so therefore that allows us to optimize our total equity or total stock position more effectively. And then we also have a portfolio a vast portfolio I think is up about 12% over the course of the last year. And then we have a second portfolio which is much more conservative which is intended to outperform treasury bonds which as you know are yielding under 3%. And that portfolio is managed much more conservatively. It was up about five or 6% last year.

Rhonda Price: Well, some of our members may be concerned that certain investments are too risky. How is risk managed at TRS?

Britt Harris Well that is a great question. I appreciate you asking that because people don't think enough about risk. See what I want people to know is that you know effective investment management starts primarily with managing the risk. And we actually have three different groups that focus on nothing but overseeing the risks to the portfolio. The first group is a risk management team inside the investment management division. They monitor the economic conditions. They monitor financial market bubbles. They monitor for things like excessive leverage or too much illiquidity--things that really could be a problem for the portfolios and that's all they do. And so this is our risk management team. These people are highly qualified. Outside of the investment management division, so that we have a separation of duties, we also have a risk compliance group. And the risk compliance group monitors from outside the structure whether or not the investment management division is sustained within its risk guidelines. Every single day I get a report that tells us that we are within our investment guidelines. We're not...we seldom, we would never go outside of our investment guidelines on purpose and when we have, it's been very rare, it has been very small, and we correct it immediately. So that is the second thing. And the third is (you know it is) trust, but verify. So we also have a whole series of audits. If you would believe we have been audited 30 times in the last two or three years by internal experts, by external

experts across every single area that is significant in the investment process. We try to be as transparent as possible. And in those 30 times, we have passed every one with no significant findings. Those are the three primary ways that we manage risk. But as people I think know, who just live life, everything comes down to the type of people that you have. So the most important thing is having a culture of people who have high integrity. So before you ever get, before we even think about hiring in the investment management division, we don't ask primarily firstly about their intelligence or their investment experience, although that will be ultimately be very very important. The first thing we ask about is character. And the people who are in the investment management division I believe have the highest character and I think the track record that they have and put up shows that to be true.

Rhonda Price: What do you think is the biggest misperception people have about investments in general?

Britt Harris That it is difficult and it is hard and that it is complex. It is only difficult because of the volatility. You know the human brain--just to get into a little anthropology--the human brain is not wired up to invest well. We are all wired up to run away from things that are scary. When you meet a lion in the forest, what is the best thing to do? Run. You..after a market decline even though the prices have gone from \$100-\$60 we still have that same flight mentality. So, investors' brains (people's) brains are not going to be wired up to react correctly to changing economic and financial market conditions. For investing, to remain emotionally stable is paramount and every single human being can remain emotionally stable if they so choose. The second thing is that people because it's money you know people tend to think that it's more difficult than it actually is. Developing a sound long-term prudent investment policy doesn't have to be complicated. You just need to have some basic asset classes and reasonable practice of rebalancing things frankly. And keep your costs low. And I think most people can do very well. In fact many people could do just about as well as we do. And I think we spend our whole lives doing that. So what people misunderstand, and I think the other thing is that it is corrupt. It is not corrupt. You know you cannot manage other people's money on a long-term basis without being found out if you are corrupt. So we have had so much in the papers and a lot of it has been brought on the financial community itself but I think the third thing that people misunderstand is that they take the headlines of a few souls who have gone off the beaten path and lay that on to the entire industry. When the truth is the vast majority of people in this industry are hard-working trustworthy people just like the people they work for.

Rhonda Price: On a final note then how can members or retirees best stay informed about our investments program.

Britt Harris Well, I think one of the things people can do--we have a tremendous website. I think it has been completely revamped recently so they can access the website. On the website there is a lot of material. But one of the things that they will find on the website if they are interested is copies of every presentation that we make to the board or to the investment subcommittee for the board itself, for anyone else that is in the board room. So they can see exactly how we are investing, they can see the special presentations on different types of investments. And they can do that. And in fact, if they are really interested they can actually watch it directly, as our board meetings are televised. So, they can do

those three things and if they are kind enough, every once in a while they can ask us to come out and talk to them--which we very much enjoy.

Rhonda Price: Well, unfortunately that is our time for now but we really appreciate your being on the show with us.

Britt Harris My pleasure. Thank you for having me.

Rhonda Price: And thank you for joining us. Please be sure to watch the second part of our series in which Britt will provide an in-depth look at TRS investments.

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