ALA Endowment Trustees  
Midwinter Meeting  
Bank of America Building  
One Bryant Park, 51st floor - Mumbai Room  
New York, NY  
Wednesday, February 22, 2017

Draft Minutes

Present: Rod Hersberger – Senior Trustee, Pat Wand, Siobhan Reardon, Robert Newlen, Teri Switzer, Brian Schottlaender and Susan Hildreth - Treasurer

Staff: Mark Leon and Keith Brown


Agenda Review

R. Hersberger opened the meeting by reviewing the agenda. No changes were noted. It was suggested that that Trustee’s spring meeting should be Tuesday, May 30th in Chicago. Additionally, that the Trustees’ should hear from Sheila O’Donnell of the Development Office during that meeting.

Approval of Minutes

R. Hersberger asked the Trustees if they had an opportunity to read and review the minutes from the Fall meeting in Washington, DC and if there were any changes that needed to be made. None were noted. The following action was taken:

Motion: B. Schottlaender and seconded by P. Wand

To approve the minutes of the Trustees’ fall meeting (9/21/16)
Endowment Portfolio Review

R. Bhatia began the discussion by reminding the Trustees’ of the genesis of the February meetings, which were started at the suggestion of R. Hersberger about three years ago. It was pointed out that this meeting was designed to be educational in nature due to the rich history and accumulation of investment talent in NYC. As a result, it was deemed this meeting would provide the Trustees’ with a wealth of knowledge that would benefit the portfolio in the long run.

The discussion then proceeded to cover the following Points:

Global Equities Summary:
- Global equity performance was lower during the 4th quarter
- US equity markets were up 3.8% driven by small caps
- 4th quarter growth estimated at 2.5% for US GDP
- Risk taking came back during 4th quarter
- Emerging markets lagged international developed markets

Fixed Income Summary:
- Market increased expectation for rising inflation
- US bonds fell 3.1%
- Sovereign debt performed well during the year (9.5%) despite the fourth quarter fall (-2.6%)

Macroeconomic Outlook:
- Expect a shift from secular stagnation to fiscal reflation
- Improved capital spending accelerating mid-cycle slowdown
- China economic growth stabilizing, while other emerging markets poised for a cyclical upswing
- 2017 performance will be driven by a recovery of resource sectors and expected corporate earnings
- Improving sales favor large US cap equities
Asset Allocation and Performance:

- Noted that $4.8 million taken out of endowment since 2008 – Current value at $40.0 million and book value of $12.7 million, resulting in net earnings of $27.3 million
- Equities overweight by 6% - 1% gain in January. This is where we should be
- Fixed income has done very well despite the 4th quarter decline
- Smaller allocation in mid/small caps hurt performance

Recommended Portfolio Changes:

- Expect 1 – 3 interest rate hikes by the Federal Reserve during the year
- No recommended changes in the overall equity (65.7%) fixed income (28.3%) allocation
- Recommend reducing the overweight in US REIT by 3% and allocate to new manager US Small Cap equity, which replaces Invesco US REIT fund
- Recommend shortening the overall duration in the fixed income portion of the portfolio. Resulting in the removal of Loomis Sayles and Western and add new managers Pimco Income Fund and Lord Abbett Short Duration Fund.
- Rebalance allocation among the five fixed income managers to 5.7% each

After some additional discussion the following action was taken:

Motion: T. Switzer seconded by S. Reardon
Replace Invesco US REIT fund with Schwab US small cap Equity EFT

Motion: B. Schottlaender seconded by R. Newlen
Replace Loomis Sayles and Western with Pimco Income Fund and Lord Abbett Short Duration Fund

International and Emerging Market Equity Investing

Eduardo Abreu – Senior Vice President, provided the Trustee with an outlook of investing internationally and via emerging markets. The
discussion began with the acknowledgement that political uncertainty has ruled the day. The expected negative fallout from Brexit ruled the first half of the year and the underreaction of post Brexit ruled the second half. Lazard viewed the geopolitics of the situation as a nonevent. However, the firm does believe that the European Union is at a crossroads. Britain has always been just on the outside of Europe. Additionally, the European Union only accounts for about 5% of its revenue from Britain. Generally, political concerns for the US, Britain and the European Union faded as the year closed out. Emerging market stocks benefited from the return to relative value and stimulus from China.

Market performance during the year was positive. Generally, the market ignored risk and piled into equities. While lower quality stocks did well performance was primarily driven by financials and materials. Lower ROE cyclical stocks rallied on global central bank actions in the second half of the year. The rally in materials was driven by China. Eurobanks rallied in tandem with US banks due to lower expected future taxes and regulations.

In closing, a few points were highlighted:

- The MSCI benchmark is an appropriate benchmark
- ESG is a top concern and is part of the process of choosing stocks
- Do allow clients to restrict selections but not in mutual fund
- Will provide a paper on diversity out of South Africa

**Economic and Financial Market Outlook - 2017**

Karin Kimbrough – Director of Investment Strategy, provided the Trustees with an overview of Merrill Lynch’s perspective on the economic and financial markets for the US and globally. During her discussion, the following points were highlighted:

- Growth has been improving in the US for some time now
- Emerging markets came back strong
- Europe surprises with an upswing in growth with fiscal policy acting as a shot in the arm
- Views the H1 visa program as a redistribution play to bring in high skilled workers and less on lower skilled workers
- Worker training programs in US highlighting a big gap in training and education. Unions previously filled this gap
Earnings expectations are high for US firms and emerging markets
Execution by the new administration could derail
A 5% - 10% pull back in the market during the year is not unusual and to a large degree expected
Banks are in a better place due to Dodd-Frank
Banks wouldn’t mind some regulation going away i.e. documentation requirements
Bright underlying themes for the year include a strong consumer, strong earnings, business investment and higher income growth, rising middle classes in China, India and South Africa
Risks in 2017 include inflation, a stronger dollar, rising interest rates, geopolitical risks and high yield space pullback

**Smart Beta Investing**
Emmanuel Hatzakis – Director of Merrill Lynch presented to the Trustees information on indexing using smart beta strategies. “smart beta” generates returns that are differentiated from those generated from market cap weighted indices i.e. a collection of strategies of defined indexing schemes. It is based on rules, algorithms and other structured approaches. The idea has been around for decades and challenges efficient markets. It also goes by the term “factoring.” Smart beta strategies are a bridge between the gap in traditional passive investing and active management that departs from market capitalization weights.

There are two types of smart beta strategies:

- Based on constructed value, growth, momentum, size, quality, low volatility and other common risk Factors
- Fundamentally weighted indices using metrics such as dividends, sales and cash flows

It was noted that smart beta EFT’s (90 bps) are more expensive than regular EFT’s (10 bps)
TIAA ESG Investing

Jason Pastoiza – Director of Client Portfolio Management and Khaled Hussain, provided the Trustees with the TIAA perspective on Environmental, Social and Governance (ESG). Note: that because of meeting being held in a Bank of America building of the host Merrill Lynch, TIAA was restricted on the type of presentation that could be provided to the Trustees i.e. no pure sales/product pitch.

J. Pastoiza began the discussion by pointing out that TIAA has been an active participant in Socially Responsibility Investing (SRI) for over five decades beginning with the creation of the Investor Responsibility Research Center in 1972. As of 12-31-16 TIAA has over $882 billion in assets of all types under management. Approximately $17.0 billion of these assets fall under the ESG banner. TIAA takes the approach of viewing responsible investing as a continuum of approaches that use ESG criteria in investment making decisions. The firm’s approach to responsible investing is carried out through four key areas:

- ESG Integration
- Active Ownership & Engagement
- Market Development
- Transparency & Disclosure

The general TIAA ESG evaluation criteria for investing consists of the following:

Environmental
- Climate Change
- Natural Resource Usage
- Waste Management

Social
- Human Capital
- Product Safety
- Housing, Health, Community Development

Governance
- Corporate Governance
- Business Ethics
- Public Policy

Stakeholders
K. Hussain highlighted for the Trustees the various asset classes that TIAA applies ESG criteria. Although the firm practices ESG investing in a number of asset classes, the Trustees focused on the activities within the fixed income space. This represented their first exposure to ESG investing in an area outside of equities. The ESG criteria for fixed income securities is the same as for other security holdings. The review process is a little more complex due to the range of bond issuers. As a result, the internal expertise is paramount given the external resources.

TIAA uses proprietary classification – Proactive Social Investment (PSI), which is a framework developed in partnership between TIAA Responsible Investment team and Global Public Markets Team in 2007. The classification focuses primarily six fixed income sectors – Agency, ABS, CMBS, Corporate, MBS and Municipal. These sectors are funneled down into four PSI themes - Affordable Housing, Community & Economic Development, Renewable Energy/Climate Change and Natural Resources. This process leads to investment examples i.e. government agency funding for low/moderate income housing, direct investment in large scale solar energy production facilities, vaccine bonds funding global immunization programs etc.

In closing the discussion, the Trustees expressed an interest in having a more detailed discussion with TIAA regarding their fixed income options at another meeting. R. Bhatia stated that meeting in Chicago would not present a issue and was welcomed, particularly as TIAA was in the process of being included on the Merrill Lynch investment platform.

**Portfolio Benchmarking**

M. Leon and K. Brown briefed the Trustees on benchmarking for the portfolio. It was pointed out the while the investment policy does a good job in giving some general guardrails for evaluating the performance of the portfolio, there are likely other benchmarks that more closely resemble the characteristics of the portfolio. The Trustees were referred to several exhibits that compared the performance of the portfolio against similar sized NACUBO portfolios, investment policy based benchmarks and the ML
domestic bond index. The results were shown from two different perspectives – column and bar styles. There was some debate with respect to which style best illustrated the results.

One of the objectives of this exercise will be to find other endowments around the country that are better fits from a comparative perspective. S. Hildreth noted that the Seattle library endowment was like ALA’s and that she would forward that information for future comparisons. The finance staff will continue its search for endowments that a similar in characteristics to the ALA endowment. Two Trustees (S. Hildreth and S. Reardon) offered to send possible benchmark candidates for similar sized endowments from their own institutions.

**Accounting for Alternatives**

Mark Leon and Keith Brown updated the Trustees on recent actions by staff to strengthen its procedures related to monitoring and accounting for due diligence related to alternatives. It was noted that the finance staff has had several meetings to solidify the policies and procedures related to valuing alternatives, as well as, gaining an understanding of the valuation process used by KKR and Blackstone managers. As one step in this process, K. Brown is scheduled to meet (2-23-17) with both KKR and Blackstone to discuss their valuation processes.

**Spring Meeting**

The Trustees were asked to review their calendars for possible dates for their spring meeting in Chicago. After much discussion Tuesday, May 30\textsuperscript{th}, 2017 was chosen.

With no further action the meeting was adjourned.