Dallas Police and Fire Pension System

Asset Allocation Implementation Plan

M E K E T A I N V E S T M E N T G R O U P
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Recap

- Long-term asset allocation considerations were discussed at the September and October DPFP board meetings.
- In October, the Board of Trustees approved a long-term asset allocation policy with significant changes from current exposure.
- The Board, Staff, and Meketa Investment Group discussed the possible different approaches/paths (along with the pros and cons of each) that could be followed to transition the current exposure to the long-term policy mix.
- This presentation summarizes our recommended approach.

Considerations Evaluated

- Net cash outflows of approximately $130 million per year (approximately 6% of assets).
- Less than 50% funded.
- Significant illiquidity in current portfolio.
- Approximately 25% of the Fund comprised of legacy[1] assets. Uncertainty on distribution amounts/timing.
- Lower than projected contributions entering DPFP.
- Pension reform passed in 2017.

[1] Assets defined as "legacy" were identified by DPFP staff as those assets with limited/no liquidity and expectations for low returns and high volatility.

Implementation – Impact on Manager Roster

	Increase/Decrease (%)	Mix 15% Private (%)	Expected Timeframe
Legacy Assets[1]	**-26**	Full liquidation	Uncertain
Equities	**+32**		
Global Equity	+19	Manager Search(es)	Dependent on legacy unwind
Emerging Market Equity	+8	Manager Search(es)	Dependent on legacy unwind
Private Equity	+5	$100+ mm in commitments	~5 years
Safety Reserve and Fixed Income	**+6**		
Cash Equivalents	0	-	
ST Investment Grade Bonds	0	-	
Investment Grade Bonds	+4	Manager Search(es)	Less than 1 year
High Yield Bonds	0	-	
Bank Loans	-1	Rebalancing	Less than 1 year
Private Debt Composite	-1	Full liquidation	~5+ years
Global Bonds	+1	Rebalancing	Less than 1 year
Emerging Market Bonds (50/50)	+3	Rebalancing	Less than 1 year
Real Assets	**-12**		
Private Real Estate	-6	Manager Search (Core)	~3-5 years
Private Natural Resources	-4	Partial Liquidation	~1-2 years
Private Infrastructure	-2	Full liquidation	~3-5 years

[1] Assets defined as "legacy" were identified by DPFP staff as those assets with limited/no liquidity and expectations for low returns and high volatility.

Recommended Approach

Overview

- Based on current funded status and expected net cash outflows (approximately 6% per year for benefit payments and expenses, net of contributions), DPFP is in a precarious situation.
- As discussed in September and October, preserving capital in the near term is crucial for DPFP.
- We recommend a reallocation plan that combines elements of the "Conservative to Aggressive" and "Dollar Cost Averaging" approaches that were discussed at the October meeting.
- Those two approaches are summarized on the following page with the known pros and cons of each approach.

Recommended Approach

Overview (continued)

- Conservative to Aggressive:
  - Concept: Allocate distributions first to the least volatile asset class that is underweight. Once the long-term target is reached for that asset class, proceed to the underweight asset class with the second lowest volatility, and so forth.
  - Pros: Reduces drawdown; reduces likelihood of early heavy hit to funded status in event of large decline in markets; easy to implement and monitor.
  - Cons: May lead to lower total Fund returns; may lead to lower funded status; may lead to tracking error vs. peers if markets rise.
- Dollar Cost Averaging:
  - Concept: Since market returns are unknown in advance, allocate a set dollar amount of distributions to risk assets so as to diversify contributions over time. For example, allocate the first $10 mm in distributions per quarter to equities, and any excess to fixed income.
  - Pros: Methodical approach to build a larger public equity exposure; lowers risk of market decline after large contribution; easy to implement and monitor.
  - Cons: Allocating to volatile equities first may backfire in the event of a market correction; in a severe correction may lead to strong decline in funded status. If coupled with losses in legacy assets and/or lower payroll than budgeted, it could put the Fund's solvency into question.

Recommended Approach

Procedures

- We suggest cash is re-allocated as followed when distributions are received from private markets investments.

Order of Reallocation

Allocate up to Target, then proceed to next asset class	
1.	Safety Reserve – Cash
2.	Safety Reserve – Short-Term Investment Grade Bonds
3.	Global Equity, only if current exposure is less than 22% of DPFP[1]
4.	Emerging Market Equity, only if current exposure is less than 2.5% of DPFP[2]
5.	Investment Grade Bonds
6.	Global Bonds
7.	Bank Loans
8.	High Yield Bonds
9.	Emerging Markets Debt
10.	Global Equity
11.	Emerging Markets Equity
12.	Private Real Estate (aggregate illiquid exposure must be under 20%)
13.	Private Equity (aggregate illiquid exposure must be under 15%)

[1] Target weight is 40%. If current exposure is more than 22% proceed to next asset class in the matrix. The reallocation framework is designed to maintain at least the mid-2018 exposure to public equity, prior to increasing fixed-income exposure.
[2] Target weight is 10%. If current exposure is more than 2.5% proceed to next asset class in the matrix. The reallocation framework is designed to maintain at least the mid-2018 exposure to public equity, prior to increasing fixed-income exposure.

Near-Term Next Steps

- The previous table should serve as a guide to redeploy capital, starting with the Safety Reserve®.
- There is one new asset class that will require a manager search in the near-term: investment grade bonds. One option to move quickly with respect to investment grade bonds is indexing (temporarily or permanently). An account could be established very quickly if the Board authorizes such move. We expect DPFP could access a Bloomberg Barclays Aggregate Index Fund for between 0.03% - 0.04% annual management fee.
- Public equity is viewed as a two-step approach. There is a relatively high priority to maintain current/recent equity exposure with a lower priority to building the public equity allocation using a dollar cost average approach.
  - Distributions up to one-third of the starting shortfall can be deployed in a given year. For example, if fixed income asset classes were fully funded by the end of 2019, then the global equity allocation would increase 6% per year, from 22% to 40%, during 2020 through 2022.
  - Should there be annual distributions that exceed this limit, the additional capital will be parked in the Safety Reserve® account until the following year.
  - We recommend a structure study for public equity during 2019 to evaluate considerations such as home-country bias, small-cap exposure, other factor weightings, active vs. passive deployment.
- Currently the only overweight asset class with liquidity is bank loans, which can eventually be reduced by one percent to bring it to target weight.