

Chief Investment Officer's Report



Missouri State Employees' Retirement System
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October 19, 2018

Dear Members,

The MOSERS portfolio generated a time-weighted rate of return, based on market value, of 7.4% for fiscal year 2018. This was 2.6% better than the policy expectation of 4.8%. For the past two years, we have focused on achieving excess returns and reducing fees. Fiscal year 2018 continued the pattern of achievement around those goals.

We exceeded our expectations for the asset allocation by 2.6%. The overwhelming majority of the extra return came from our external alternative beta managers. However, staff's market positioning was additive to the result.

We also lowered management fees by \$9 million in fiscal year 2018. This represents an approximate 15% year-over-year reduction in management fees. In addition, there was a \$37 million year-over-year reduction in total fees paid because of a drop in incentive fees earned by external managers. Fiscal year 2018 fees reflected the work from prior years on reducing the number of illiquid alternative managers in the portfolio.

So, fiscal year 2018 was a good year. We earned more money than the asset allocation suggested possible at lower fees than the year before. In total, those efforts created about \$260 million more than would have been expected by the asset allocation alone.

The negative for the year was simple – equity markets continued to perform well, which means diversification did not work in our favor this year. This year, more equities meant more return. However, the key to successful long-term portfolios is to diversify. Diversification simply is putting eggs into several baskets. While this year's results would have been better if we had put all of our eggs in the equity basket, that won't be the outcome in every year. We continue to remain confident that diversification will win in the long term.

As we plan for the future, our focus is on:

- Building a portfolio that better serves the needs of all of our stakeholders
- Continuing to reduce investment management fees
- Continuing to lead the industry in fee transparency

The investments staff continues working to set a higher standard for due diligence. We are implementing a due diligence process that equally incorporates the four distinct risk areas of manager/investment risk, quantitative risk, operational risk, and legal risk. The work product being created in the MOSERS investments department is second to none. This protects our fiduciary interests, because we can demonstrate that our processes are thorough and prudent.

I would like to thank the MOSERS Board of Trustees and Executive Director, Ronda Stegmann, for their continued support in all the above endeavors. As always, we are here for the benefit of our members and, in all ways, our efforts will continue to focus on strengthening MOSERS' already strong financial foundation.

Sincerely,

A handwritten signature in black ink, appearing to be "Seth Kelly".

Seth Kelly
Chief Investment Officer