



Minutes of the PRIM Administration and Audit Committee  
Thursday, November 15, 2018

Committee members present:

- Robert L. Brousseau, Chair
- Treasurer Deborah B. Goldberg
- Patrick E. Brock
- Michele A. Whitham, Esq.
- Dennis J. Naughton
- Joseph A. Connolly

Committee members not present:

- Eileen Glovsky
- Karen E. Gershman, CPA
- James B.G. Hearty
- Theresa T. McGoldrick, Esq.

The PRIM Administration and Audit Committee meeting was called to order at 10:08 a.m.

**I. Executive Director / Chief Investment Officer Comments**

Michael G. Trotsky, CFA, Executive Director and Chief Investment Officer, made comments to the Committee, including:

Mr. Trotsky began by congratulating Treasurer Goldberg on her resounding re-election. The Treasurer thanked everyone for their support and emphasized continuing “onward and upward”.

**Organizational Updates**

PRIM has hired five new full-time employees and two interns since the last meeting.

**Iris Sosa** joined PRIM in August as an executive assistant supporting the Executive Director/Chief Investment Officer. Ms. Sosa joined PRIM after nearly 15 years of supporting the CEO of Santander Bank, and prior to that was an executive assistant at the Boston Housing Authority.

**Maureen Aquino** also joined PRIM in August as PRIM’s new receptionist. Ms. Aquino has almost 20 years of experience as an Office Manager and Receptionist working for AIG in New York and holds a bachelor’s degree from William Patterson University.

**Grace Gao** joined PRIM in October as an Investment Research Analyst in the Strategy group, reporting to Eric Nierenberg. Ms. Gao recently received her master’s degree in finance from MIT Sloan. She previously interned at Baidu, Bain & Company, and PwC, and earned her bachelor’s degree in finance from Peking University in China.

**Liu Liu** joined PRIM in October on a permanent basis as an Investment Analyst after spending 18 months as an intern working in PRIM’s Strategy team, reporting to Eric Nierenberg. Ms. Liu received her master’s degree in finance from the Brandeis International Business School and earned her bachelor’s degree in finance from Shanghai Jiao Tong University in China.

**Sara Coelho** joined PRIM in November as a Corporate Accountant on the Finance team. Ms. Coelho spent several years at Bulger Partners as an accounting analyst and accounts payable clerk, and has a bachelor’s degree in finance and accounting management from Northeastern University. She reports to Dan Eckman.

The Strategy group also welcomed two new interns this fall. **Anita Huang** is currently a graduate student at the Brandeis International School of Business, majoring in economics and finance, and **Shijia Chen** recently received her master's degree in International economics and finance from Johns Hopkins University.

Also, we congratulate **Christina Marcarelli**, an Investment Officer on the Real Estate team, on receiving the Chartered Alternative Investment Analyst (CAIA) credential. The CAIA curriculum is designed to provide a broad knowledge in alternative investments including Real Assets, Hedge Funds, Private Equity and structured products. The credential requires the passing of 2 exams, at 2 levels, and typically requires 12-18 months and more than 200 hours of study.

We are now 45 people strong, with the following degrees/certifications: 2 Ph.D., 10 Masters Degrees, one J.D., 10 CFAs, 6 CPAs, 2 CAIAs, and 19 CFA Investment Foundations Program Certificates.

And last, **Andrew Gromer**, an Investment Analyst on the Public Markets team, was appointed Chair of the CFA Boston Society Young Leaders Committee. As Chair, Andrew will organize events for the Society's new generation of investment professionals focused on engagement, career development, and networking. It is a very vibrant and active committee.

The September quarter-end was strong, but market volatility returned in October and November as global equities sold off sharply. The VIX spiked to 21.2 in October after reaching a low of 12.1 during the September quarter. The five-year average for the VIX is 14.8. October 2018 was the third worst month for the S&P 500 since the world financial crisis, with the S&P down 6.8%, the worst month since September 2011 when the S&P was down more than 7%. September 2011 was one month before the US debt downgrade and market sell-off that occurred amid continuing concerns about the European debt crisis. The only other worse month was in May 2010 when the S&P was down 8% in the aftermath of the "Flash Crash", which was caused in part by the early stages of the European debt crisis. One of the big challenges that surfaced recently is the stand-off between Brussels (the EU) and Rome concerning Italy's dire fiscal situation.

This all only adds to the brew of caution that we identified last quarter. At the last meeting of the Board, we discussed the risks in the market and we compared current conditions to those of mid-2014 through early 2016, when there was an unprovoked global economic slowdown that led to a correction in world financial markets. Not much has changed on the economic front in the last few months to change our view. US GDP growth is growing at a 3.5% clip, the employment picture is bright, wages are finally rising, and so too is inflation. With this backdrop, the US Fed seems intent on raising rates one more time this year and three times next year. Meanwhile, economies in the rest of the world, including Europe, China and Japan, are slowing. At our last meeting, we pointed out that we were observing some of the same market characteristics that we observed in the mid 2014 to 2016 downturn – and today we still observe many of the same conditions, namely: 1) narrowing stock markets as the first quarter equity rebound left many global markets, and many US sectors; 2) liquidity issues – it became difficult to secure US dollars from outside the US in 2015, and note that global funding conditions are still very tight for dollar funding; 3) the economic situation – there were vulnerabilities in the global economy before there were tariffs, and tariffs are an additional negative for global growth, and most believe that a change in control of the U.S. House of Representative as a result of the mid-term elections is not likely to impact or restrain the Trump Administration's protectionist trade policies.

We also note that equity markets generally peak at the peak acceleration of earnings, and not on the earnings peak itself, and S&P earnings were up approximately 20% on an 8% growth in sales for the second quarter and are expected to show similar if not better growth in Q3. Consensus is that it will be hard to maintain that strong level of growth going forward.

And last, in regard to the mid-term elections and the firing of Attorney Jeff Sessions immediately afterward, it seems increasingly likely that we could have two years of political gridlock before the next general election. President Trump warns of a “war-like” atmosphere in Washington, and pundits generally have reduced the prospects of enacting bipartisan fiscal stimulus (infrastructure spending, for example) and have increased the prospects of having a prolonged government shutdown.

We believe the PRIT Fund is appropriately positioned for weakness in world equity markets. Our main focus during the past several years has been to reduce our global equity exposure while identifying diversifying assets in our Portfolio Completion Strategies allocation. However, it is important to note that the PRIT Fund is not completely immune to a global equities downturn, since in order to achieve our long-term 7.35% target return rate, our Fund is by necessity growth and equity focused.

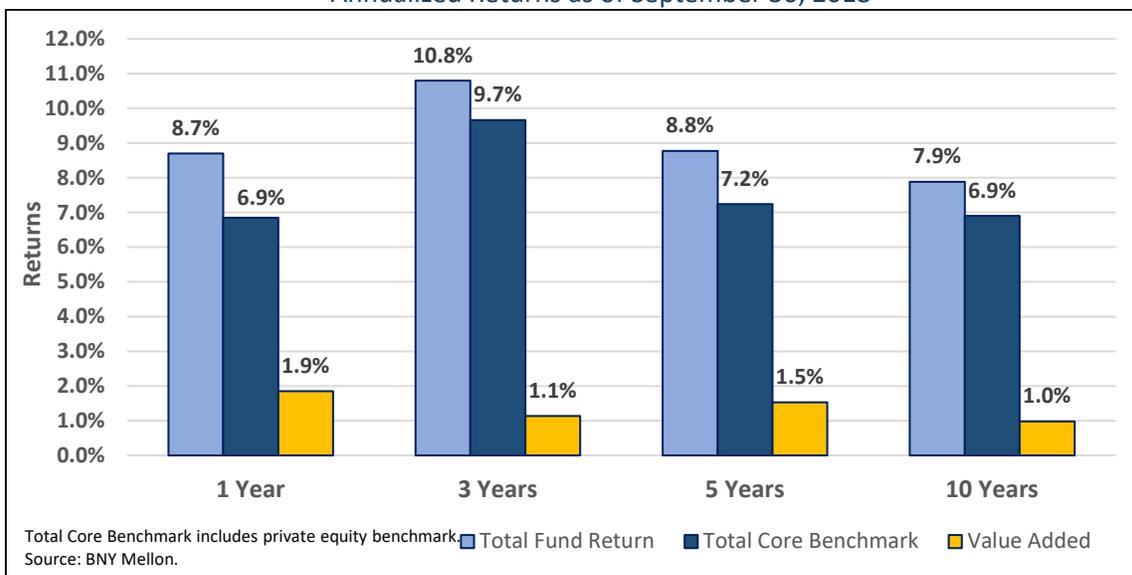
**PRIT Fund Performance Summary**

As of September 30, 2018, the PRIT Fund net asset value stood at \$73.8 billion. For the one-year ended September 30, 2018, the PRIT Fund rose 8.7% gross (8.2% net), outperforming the total core benchmark of 6.9% by 182 basis points (136 bps net).

- This performance equates to an investment gain of \$5.7 billion, net of fees.
- This outperformance equates to \$944 million of value above the benchmark return, net of fees.
- All seven major asset classes outperformed their respective benchmarks.
- Net total outflows to pay benefits for the one-year ended September 30, 2018, were approximately \$1.3 billion.

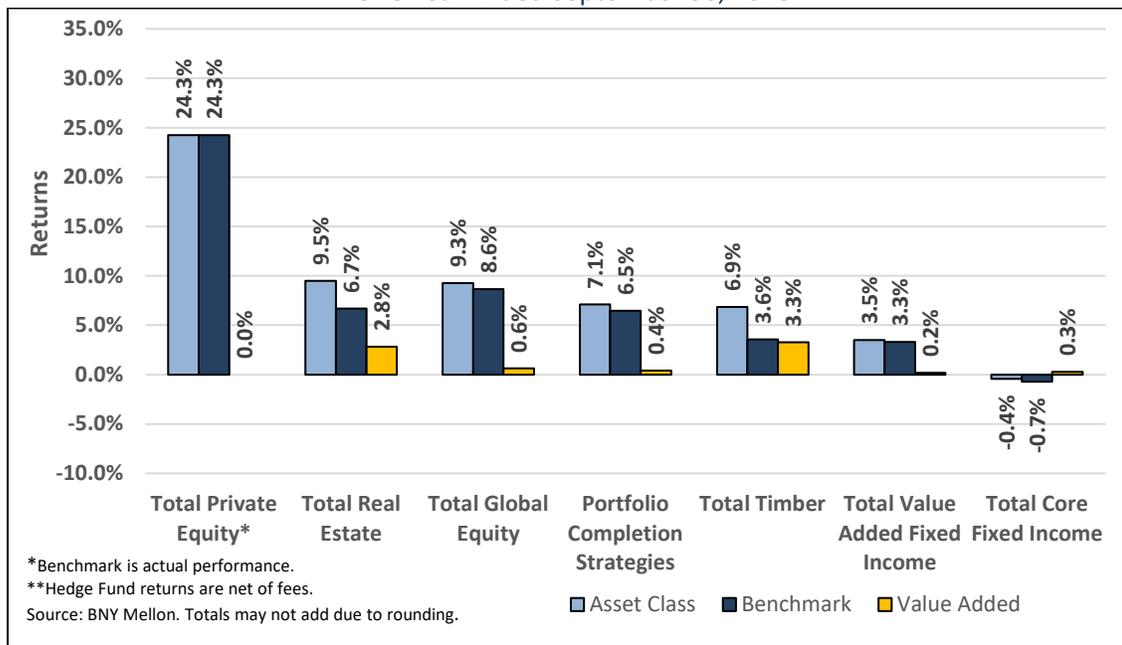
Mr. Trotsky made reference in his remarks to the following charts:

**Total PRIT Fund Returns (Gross of Fees)**  
Annualized Returns as of September 30, 2018



**PRIT Asset Class Performance (Gross of Fees)**

One Year Ended September 30, 2018



**PRIT Core Fund Performance Summary**

**Gross of Fees Performance**

Trailing 1-Year Performance as of September 30, 2018

Trailing 1-Year Performance: September 30, 2018	Return	Benchmark Return	Over/(Under) Benchmark (bps)	\$Value (millions)	% of PRIT Fund
<b>Total PRIT Fund</b>	<b>8.7%</b>	<b>6.9%</b>	<b>182</b>	<b>73,847</b>	<b>100%</b>
<b>Total Global Equity</b>	<b>9.3%</b>	<b>8.6%</b>	<b>63</b>	<b>31,083</b>	<b>42.1%</b>
<i>Domestic Equity</i>	<i>18.3%</i>	<i>17.8%</i>	<i>48</i>	<i>14,675</i>	<i>19.9%</i>
<i>International Developed</i>	<i>3.6%</i>	<i>3.1%</i>	<i>52</i>	<i>11,916</i>	<i>16.1%</i>
<i>Emerging Markets</i>	<i>-1.3%</i>	<i>-1.7%</i>	<i>33</i>	<i>4,493</i>	<i>6.1%</i>
<b>Private Equity</b>	<b>24.3%</b>	<b>24.3%</b>	<b>0</b>	<b>8,010</b>	<b>10.9%</b>
<b>Real Estate</b>	<b>9.5%</b>	<b>6.7%</b>	<b>281</b>	<b>6,421</b>	<b>8.7%</b>
<b>Total Timberland</b>	<b>6.9%</b>	<b>3.6%</b>	<b>328</b>	<b>2,635</b>	<b>3.6%</b>
<b>PCS</b>	<b>7.1%</b>	<b>6.5%</b>	<b>69</b>	<b>10,036</b>	<b>13.6%</b>
<b>Value Added Fixed Income</b>	<b>3.5%</b>	<b>3.3%</b>	<b>19</b>	<b>5,864</b>	<b>7.9%</b>
<b>Core Fixed Income</b>	<b>-0.4%</b>	<b>-0.7%</b>	<b>29</b>	<b>9,063</b>	<b>12.3%</b>

**PRIT Asset Class Performance (Gross of Fees)**  
Annualized Returns as of September 30, 2018

1 Year	3 Year	5 Year	10 Year
PRIVATE EQUITY 24.3%	PRIVATE EQUITY 19.3%	PRIVATE EQUITY 20.1%	PRIVATE EQUITY 14.9%
REAL ESTATE 9.5%	GLOBAL EQUITY 14.1%	REAL ESTATE 10.5%	GLOBAL EQUITY 8.9%
GLOBAL EQUITY 9.3%	REAL ESTATE 9.1%	GLOBAL EQUITY 9.1%	VALUE-ADDED FIXED INCOME 7.5%
TOTAL PCS 7.1%	VALUE-ADDED FIXED INCOME 6.9%	TIMBER 7.2%	REAL ESTATE 7.2%
TIMBER 6.9%	TIMBER 5.6%	TOTAL PCS 4.9%	CORE FIXED INCOME 4.8%
VALUE-ADDED FIXED INCOME 3.5%	TOTAL PCS 5.5%	VALUE-ADDED FIXED INCOME 4.4%	TIMBER 4.6%
CORE FIXED INCOME (0.4%)	CORE FIXED INCOME 2.2%	CORE FIXED INCOME 3.9%	TOTAL PCS 4.6%

**II. Approval of the Minutes (Voting Item)**

The PRIM Administration and Audit Committee unanimously approved the minutes of its August 2, 2018 meeting.

**III. Fiscal Year 2018 Audit Results (Voting Item)**

Deborah Coulter, CPA, Chief Financial Officer, introduced KPMG Audit Partner, David Gagnon and KPMG Senior Manager, Jennifer Daly who attended the meeting to review their summary of the Fiscal Year 2018 PRIM and PRIT audits and the two Agreed-Upon Procedures (AUPs) that they perform each year. Ms. Coulter noted that the AUPs and audits had once again resulted in clean opinions and thanked the Finance and Operations teams for their hard work, especially Qingmei Li, PRIM's Financial Reporting Manager, who coordinates the audits and prepares the financial statements. Ms. Coulter then described how the addition of new innovative investments to the portfolio had greatly increased the complexity of the financial reporting. Ms. Coulter also stated that PRIM staff and KPMG staff worked very well together, and she pointed out the value of having continuity in the KPMG Partner and Senior Manager on the PRIM and PRIT engagements.

Mr. Gagnon began KPMG's presentation by discussing the growing complexities associated with the PRIT Fund and PRIM Board audits based on new investment strategies and the growing number of investment advisors. He also informed the Committee of the high level of involvement from both PRIM staff and KPMG, with audits being performed almost all year-round by KPMG, as approximately 30 PRIM-related audits and reports are issued by KPMG annually.

Mr. Gagnon then moved on to the prepared remarks from KPMG by discussing the responsibilities of those involved in the audit as it relates to management, the Administration and Audit Committee, and KPMG. He then discussed the areas of emphasis for both the PRIM Board and PRIT Fund audits.

Ms. Daly then reviewed the audit approach for the investments of the PRIT Fund, including the various procedures related to testing the marketable securities and the alternative investments.

Also presented were drafts of the procurement AUP report and the benchmarking AUP report, of which there were no material findings noted based on KPMG's performed procedures.

A discussion with the Committee was then held regarding the PRIM Board's adoption of GASB 75 which required PRIM to recognize an expense and corresponding revenue for its proportionate share of the Commonwealth's other postemployment benefits (OPEB) other than pension costs – principally retiree healthcare.

The Administration and Audit Committee voted (unanimously) to recommend to the PRIM Board that the Board accept 1) the Fiscal Year 2018 PRIM and PRIT audited financial statements, as well as 2) the Agreed-Upon Procedures reports on PRIM's Procurement Process for Investment Management and Other Professional Services, and 3) the Agreed-Upon Procedures reports on the PRIT Fund's Benchmark Calculation, all as contained in Appendix D to the Expanded Agenda, and further to authorize the Executive Director to take all actions necessary to effectuate this vote.

In accordance with best practice, PRIM staff left the room at 11:00 a.m. so that Committee members could have an opportunity to speak with the auditors without staff present.

PRIM staff returned at 11:15 a.m.

#### **IV. Draft Fiscal Year 2018 Comprehensive Annual Financial Report (CAFR) (Voting Item)**

Anthony Falzone, Chief Operating Officer, explained that the Comprehensive Annual Financial Report (CAFR) is PRIM's 14<sup>th</sup> annual submission to the Government Finance Officers Association (GFOA) and is designed to provide a complete and transparent picture of a governmental entity.

Mr. Falzone described the CAFR's four sections: Introductory, Investment, Financial and Statistical, and reminded the Committee that PRIM's report has received the Certificate of Achievement for Excellence in Financial Reporting for the past 13 straight years and is optimistic that this year's submission will earn the award as well. He thanked all areas of the business and reminded the Committee that this task is a total team effort, singling out Qingmei Li, PRIM's Financial Reporting Manager, as the leader of the effort.

The Administration and Audit Committee voted (unanimously) to recommend to the PRIM Board that it approve the draft Fiscal Year 2018 PRIT Fund Comprehensive Annual Financial Report ("CAFR") attached as Appendix E to the Expanded Agenda, and further to authorize the Executive Director to take all actions necessary to effectuate this vote.

#### **V. 2019 Proposed PRIM Board and Committee Meeting Schedule (Voting Item)**

Mr. Falzone reviewed the updated calendar with the Administration and Audit Committee and at that time several conflicts were identified. The Committee asked that Mr. Falzone work through any conflicts and present a finalized schedule to the Board at its November 29<sup>th</sup> meeting.

#### **VI. Legal/Legislative Update**

PRIM's General Counsel indicated there were no significant updates to provide on legal and legislative matters. Michael Bergquist, Policy Analyst on Treasurer Goldberg's staff, mentioned a recent legislative proposal filed that would require PRIM to divest from companies that manufacture guns and ammunition.

## VII. Other Matters:

The Committee members briefly discussed the following topics:

- a. September 2018 PRIM budget
- b. Travel
- c. Client Service

The PRIM Administration and Audit Committee meeting adjourned at 11:32 a.m.

### List of documents and exhibits used during the meeting:

- *Minutes of the PRIM Administration and Audit Committee Meeting of August 2, 2018*
- *PRIT Fund Performance Report*
- *BNY Mellon Gross of Fees Performance Report*
- *KPMG 2018 Audit Results Report*
- *Draft Fiscal Year 2018 Comprehensive Annual Financial Report*
- *Proposed 2019 PRIM Board and Committee Meeting Schedule*
- *September 2018 PRIM Operating Budget*
- *Travel*