MassPRIM

Appendix G

Multi-Asset Credit RFP Recommendation Presentation

Mass PRIM Investment Committee
Tuesday, May 7, 2024

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MULTI-ASSET CREDIT

RFP RECOMMENDATION

Chuck LaPosta, CFA, Director of Fixed Income
Richer Leung, CFA, Investment Officer

May 7, 2024

Executive Summary

Recommendation

- Hire **Anchorage, HPS, KKR, and Shenkman** to provide active investment management services for a Multi-Asset Credit mandate.
  - Allocate **$2.0 billion** into separately managed accounts (SMA) as follows:
    - $300 million to Anchorage Capital Advisors, LLC.
    - $600 million to HPS Investment Partners.
    - $500 million to KKR Credit (KMAC strategy).
    - $200 million to KKR Credit (GCOF strategy).
    - $400 million to Shenkman Capital.
  - Funding will be sourced from existing Public Value-Added Fixed Income (VAFI) managers as well as re-balancing funds from the recent asset allocation target adjustment to Global Equities.
  - Target funding date is **July 1, 2024.**

Rationale

Multi-Asset Credit Strategy Attributes:
- *Interest rate management flexibility* – managers can invest in both fixed and floating rate instruments.
- *Relative value opportunities across capital structure* – managers can assess varying credit obligations of the same issuer.
- *Increased flexibility and asset types* – managers can leverage additional asset classes such as CLOs, Convertibles, CMBS, and other structured credit to achieve greater risk-adjusted returns.

Recommended Allocation Attributes:
- Recommended set of managers has ***diverse set of alpha levers*** to generate excess returns.
  - KKR (KMAC) and Shenkman employ a top-down asset allocation approach coupled with bottom's up credit research to build a well diversified portfolio focused on capital preservation and income generation.
  - Anchorage leverages a highly active trading strategy and special situations team to overweight issues with lower credit ratings.
  - HPS and KKR (GCOF) use concentrated positions and a highly selective credit process .
- Each recommended manager has shown ***positive risk-adjusted excess returns*** against the 50/50 High Yield/Bank Loan benchmark.
  - Several existing Public Value-Added Fixed Income managers have underperformed their respective benchmark index.

Search Objectives

Multi-Asset Credit

- **Capital Allocation**: Approximately $2.0 billion across 3-4 managers. Target allocation ranges from $300 to up to $600 million per strategy.

- **Benchmark:** 50% ICE BAML US HY Constrained / 50% Morningstar LSTA US Leveraged Loan. Which is consistent with the existing components of the Value-Added Fixed Income portfolio

- **Manager-specific**: Identify and fund best-in-class managers. Preference will be given to managers who have a strong, consistent track record of risk-adjusted returns in multi-asset credit strategies. Evidence of a stable and sustainable organization (firm + team), robust investment process, operational efficiency, and prudent risk management will also be important considerations.

- **Attribution**: Preference will be given to managers with demonstrated ability in credit selection, relative value analysis across the capital structure, and capability to rotate between asset classes with positive results over a credit cycle. The manager's ability to preserve capital over the long term will also be evaluated.

- **Fit**: Consistent with PRIM's allocation objective in Value-Added Fixed Income, managers should have exposure to both fixed rate high yield bonds and floating rate bank loans. Additional high yielding liquid fixed income asset types such as Collateralized Loan Obligations (CLO) debt and convertible bonds may be used as a core investment in the strategy. Other non-traditional, non-public, or illiquid investments such as investment grade credit, non-US securities, and private credit should be limited in use and supplemental to the strategy.

- **Account Structure**: Separately Managed Accounts only.

- **Cost**: Target an effective fee of less than the median of managers who submitted RFP responses (0.39%).

Manager Selection Process

Search Committee: Chuck LaPosta, Mike McElroy, Jay Leu, Shannon Ericson, Dave Gurtz, Matt Liposky, Andre Abouhala, and Richer Leung
Advisors: Meketa and Albourne

Sourcing

- RFP Issued - 10/31/2023
- RFP Q&A - 11/17/2023
- RFP Submissions - 12/1/2023
  - Total Responses = 51

Quantitative & Qualitative Analysis

- Scope of Services
- Minimum Qualifications
- Returns-based Data Analysis
- Consultant Feedback

Due Diligence & Implementation

- Semi-Finalist Presentations
- Onsite Finalist Meetings
- Portfolio Allocation Analysis
- Reference Checks
  - Recommendation – 5 strategies

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Recommendation

Public Value-Added Fixed Income Portfolio as of March 31, 2024

- **Return -** MAC managers showed higher excess returns against their respective benchmark compared to siloed existing managers.
- **Risk -** While Tracking Error increases marginally with the MAC managers, the risk-adjusted metrics improve.
- **Cost** - The allocation to the MAC mandate has an estimated fee of 33.5bps, lower than both the median threshold manager and the effective fee of the current managers.

Value-Added Fixed Income
Asset Allocation Range: 6 – 12%
Current Allocation: 7.3%

Public Value-Added Fixed Income
Current Allocation: 4.6%

Private Debt
Current Allocation: 1.0%

Other Credit Opportunities
Current Allocation: 1.7%

Current

High Yield Bonds
Allocation: 1.5%

Bank Loans
Allocation: 2.2%

Emerging Markets Debt
Allocation: 0.9%

Proposed

High Yield Bonds
Allocation: 1.0%

Multi-Asset Credit
Allocation: 2.0%

Bank Loans
Allocation: 1.0%

Emerging Markets Debt
Allocation: 0.9%

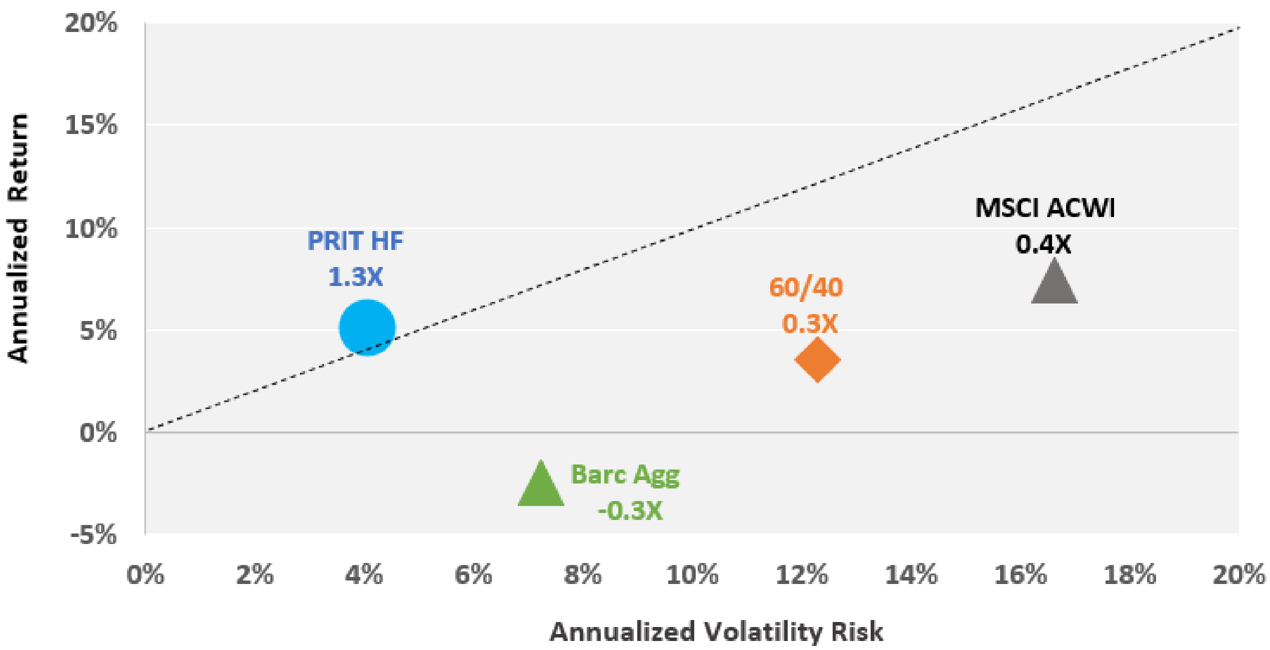
Source: BNY Mellon and PRIM Staff.
Portfolio assets and weights are as of March 31, 2024.

Manager Snapshot

Finalist Summary

Firm/ Strategy	Style	Alpha Lever	Return/Risk/Cost
Anchorage	• Concentrated Holdings • Medium Risk	• Allocation to CLOs • O/W CCCs • Trading • Special situations	• Large standalone CLO business helping to support CLO strategy in MAC • Highly active trading and portfolio rebalancing • Dedicated special situations team to work out distressed situations • Risk of overlap with OCO strategy that PRIM invests • Medium/High cost compared to median RFP manager
HPS	• Concentrated Holdings • Medium Risk	• Strong fundamental credit selection • O/W CCCs • U/W Duration	• Leverages private credit platform for deal sourcing and allocations and to inform credit selection • Highly selective fundamental credit process with concentrated position sizing leading to outsized returns • Risk in CCC allocation leading to outsized drawdowns/default rates • Medium cost compared to median RFP manager
KKR (KMAC)	• Diversified Holdings • Asset Allocation approach	• Allocation to CLOs • Alpha from individual Asset Sleeves • Asset class rotation	• Focus on capital preservation and income generation • Leverages broader KKR platform to help inform credit selection • Low tracking error and highly diversified • Risk in overlap with GCOF • Lowest cost compared to median RFP manager
KKR (GCOF)	• Concentrated Holdings • Highest Risk	• Strong fundamental credit selection • O/W CCCs • Best ideas on KKR credit platform	• Leverages broader KKR platform to help inform credit selection • Highly concentrated and idiosyncratic • Tilted heavily towards CCCs, relying on credit selection to identify mis-pricing and avoid defaults • Risk in CCC allocation leading to outsized drawdowns/default rates • High cost compared to median RFP manager
Shenkman	• Diversified Holdings • Combination of Asset Allocation and Credit Selection	• Well-defined credit analysis process • ~15% allocation to converts • Top-down allocation process	• Focus on capital preservation and interest income • Differentiated use of convertibles to capture upside leading to lower correlation with other strategies • Risk in special situations/defaults where the team may have limited experience • Low/Medium cost compared to median RFP manager

Risk-Adjusted Return: 3 Years



Diversifying Benefit - PRIT HF's Beta