AC Transit
Employees' Retirement System

(510) 891-7257
fax (510) 891-7169
retirement@actransit.org

AC Transit Retirement System

To: AC Transit Board of Directors March 27, 2023

From: Jeffrey Lewis - Chair, AC Transit Retirement Board

Jeffrey Lewis

Re: 2023 Semi-Annual Retirement Board Report (#1)

The first Semi-Annual Report of the year will focus on the following:

1) The Plan's investment results in 2022 and the first three months of 2023
2) ESG (Environmental, Social & Governance)
3) The Plan's long-term investment results and asset allocation
4) The upcoming Actuarial Valuation and Experience Study
5) PEPRA Implementation
6) Retirement of Hugo Wildmann and hiring of Damien Charlety

2022 and Early 2023 Investment Results

As we are all aware, 2022 was a bad year for almost all investors. Both equity and fixed-income markets suffered double digit negative returns. Historically, when equity markets have experienced significant declines, government bonds have proved to be a safe haven, but this was not the case in 2022. The Plan's diversified portfolio of investments returned a negative 13.8% for the year. (All public and private employer plans with significant equity exposure experienced comparable losses.) This is more than 20% below the Plan's assumed rate of return of 6.75%. The District is well aware that the investment returns of 2022 will have an impact on its contribution going forward.

In 2022, the broad U.S. stock market (Russell 3000) returned a negative 19.2%, small cap stocks (Russell 2000) returned a negative 14.8%, non-U.S. developed market equities returned a negative 14.92%, and emerging market equities returned a negative 21.95%. The domestic U.S. bond market (Barclays Aggregate) returned a negative 12.5%. Through March 27th, worldwide equity markets are essentially unchanged for the year.

I am including a paragraph that was in this report last year:

> In the past 10 years, U.S. equity markets have only had one year with a negative return. While we hope the next 10 years bring similar investment returns to the past 10 years, we cannot count on this to occur. As you are aware, the Plan's assets are invested in a diversified portfolio, including U.S. stocks, bonds, other fixed income investments, international stocks, emerging markets, real estate, and other types of investments. As has been mentioned numerous times in these

reports, the investment results of the Plan are highly dependent on the performance of the equity markets.

We should all expect that when markets go down, the Plan will most likely incur negative returns. As long-term investors, we know that these periods will come and go, and we continue to think, as does our investment consultant, that in the years ahead our investment portfolio will generate investment returns in line with our assumed rate of return. The reduction in equity values and the increase in interest rates that occurred in 2022 should lead to an increase in returns for the Plan in the years ahead.

Diversity and ESG

In the past year the Board spent several Board meetings on Environmental, Social and Governance (ESG) and heard presentations from our consultant and from one of our money managers, BlackRock, on this topic. ESG is a complex topic, and the Board continues to work to ascertain how ESG should be incorporated into our portfolio. At the moment, the Board is reviewing how it handles proxy voting and considering possible changes to our current policy. We are looking at possibly instructing a manger to vote proxies in accordance with certain guidelines and/or investing at least some portion of Plan assets in investment funds that follow specified ESG factors in exercising proxy voting rights.

The Board plans to continues to discuss the issue of ESG in the upcoming months.

Longer-Term Investment Results as of 12/31/22 and Asset Allocation

Since its inception in 1992, the Plan has achieved an average annual return of 7.3%. Over the last 10 years, the Plan has returned an average of 5.8% annually. Over the last 5 years, the Plan's return averaged 3.4% annually, while for the last 3 years, the Plan's average return was 2.0%. These figures are of course skewed by 2022 investment results. As a reminder to the AC Transit Board, the current actuarially assumed rate of return for the Plan was reduced in 2021 from 7.0% to 6.75%.

The Board invests for the long term and expects equity markets over the long term to produce returns in excess of our actuarially assumed rate. On the other hand, we expect the fixed-income portion of the portfolio to produce returns below our assumed rate (6.75%), but to provide diversification (given the historical lack of correlation between equity and fixed income investments). The Board's relatively smaller allocations to other categories of investments provides further diversification and, in some cases, the potential for higher returns. The Board consistently reviews our asset allocation with NEPC, which is our investment consultant, and, when appropriate, adjusts our allocation to various asset classes.

In 2022 the Board made its first allocation to Private Equity. It allocated $20 million to HarbourVest, a private equity manager with over $100 billion in assets. The Board will consider increasing its allocation to Private Equity in the upcoming months.

Upcoming Actuarial Valuation and Experience Study

On an annual basis, our actuary (Cheiron) produces an Actuarial Valuation, and every four years, it produces an Experience Study. We will soon provide our actuary with the data they need to begin the 2022 Valuation and Experience Study. As in past years, we will inform the District of the preliminary figures we receive from our actuary. As it does every year, the Retirement Board will take a close look at all the major assumptions embedded in the Actuarial Valuation. Of course, the District will have many opportunities to provide input to the Retirement Board and our actuary. At our February meeting, our actuary provided very preliminary information on the possible impact on the District's contribution and the Funded Ratio of the 2022 investment results. The General Manager attended this meeting (via Zoom) and was involved in the preliminary discussion.

PEPRA Implementation

Retirement Department staff continues to work on implementing PEPRA and returning contributions to employees who leave employment prior to vesting.

Staffing Within the Retirement Department

As was mentioned in these reports last year and at the Joint Meeting, the Retirement Board began planning for the retirement of Hugo Wildmann over a year ago. In January, Damien Charlety began working for the Retirement Board as the new Retirement System Manager. The Board adopted a transition plan that gave Damien decision making authority as of March 28th. Hugo will continue working for the Plan through the month of April and will assist Damien during this time. He will retire on May 1st.

As I have mentioned in the past, and as Hugo mentioned at the Joint Meeting, we will likely need additional staff in the near future as a result, among other things, of the work required to implement the employee contribution piece of PEPRA. The Retirement Board will work with Damien to determine the staffing needs of the Department and then will work with the District on securing the required resources.

Please feel free to call me, Jeffrey Lewis (510-463-3900), or Damien Charlety, the new Retirement System Manager, (510-891-5494) if you would like to discuss this report or request additional information.