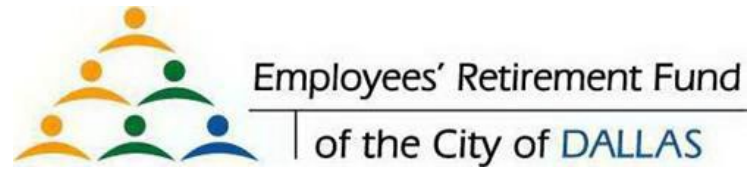




COOK STREET

CONSULTING

EST. 1999



## Investment Practices and Performance Review

June 2024

- Purpose:

**Independent Review** of the Investment Practices and Performance of the Employees' Retirement Fund of the City of Dallas (the "ERF" or the "Fund").

- Scope:

Identify and review existing investment policies, procedures, and practices.

- Investment Policy Statement (IPS)
- any informal procedures and practices
- not necessary to review past policies, procedures, and practices that are no longer applicable

Compare the existing policies and procedures to industry best practices.

Generally, assess whether the ERF Board of Trustees (the "Board"), internal Staff, and external consultants are adhering to the established policies.

Identify the strengths and weaknesses of the current policies, procedures, and practices and make recommendations for improvement.

Include a detailed description of the criteria considered and methodology used to perform the evaluation, including an explanation of any metrics used and associated calculations.

- The Texas Pension Review Board has provided guidance on the different areas required by statute to be reviewed by independent consulting firms. Evaluations will vary based on specific characteristics of each system's size, governance and investments.
- Cook Street's evaluation identified and reviewed the existing policies and procedures of the ERF as it relates to the oversight and management of the Fund's investments. Our examination included a review of the ERF's Investment Policy Statement and other documents related to the investment of plan assets as well as formal and informal procedures adopted by the ERF management and Staff. We compared the ERF's policies and procedures to industry best practices and assessed the likelihood the Board, internal Staff and external consultants are adhering to the established policies.
- Our evaluation considered strengths and potential weaknesses of the current policies and procedures, and where appropriate, we provided recommendations for improvements of any deficiencies we identified.

Founded in 1999, Cook Street is one of the largest retirement consulting firms in the U.S.†

## Firm Highlights

**24+**  
Years providing investment advisory and fiduciary services

**20+**  
Years average financial industry experience of consultants

**80%+**  
Of consultants have earned the CFA® charterholder designation

**99%**  
Client retention from 2006 through 2023

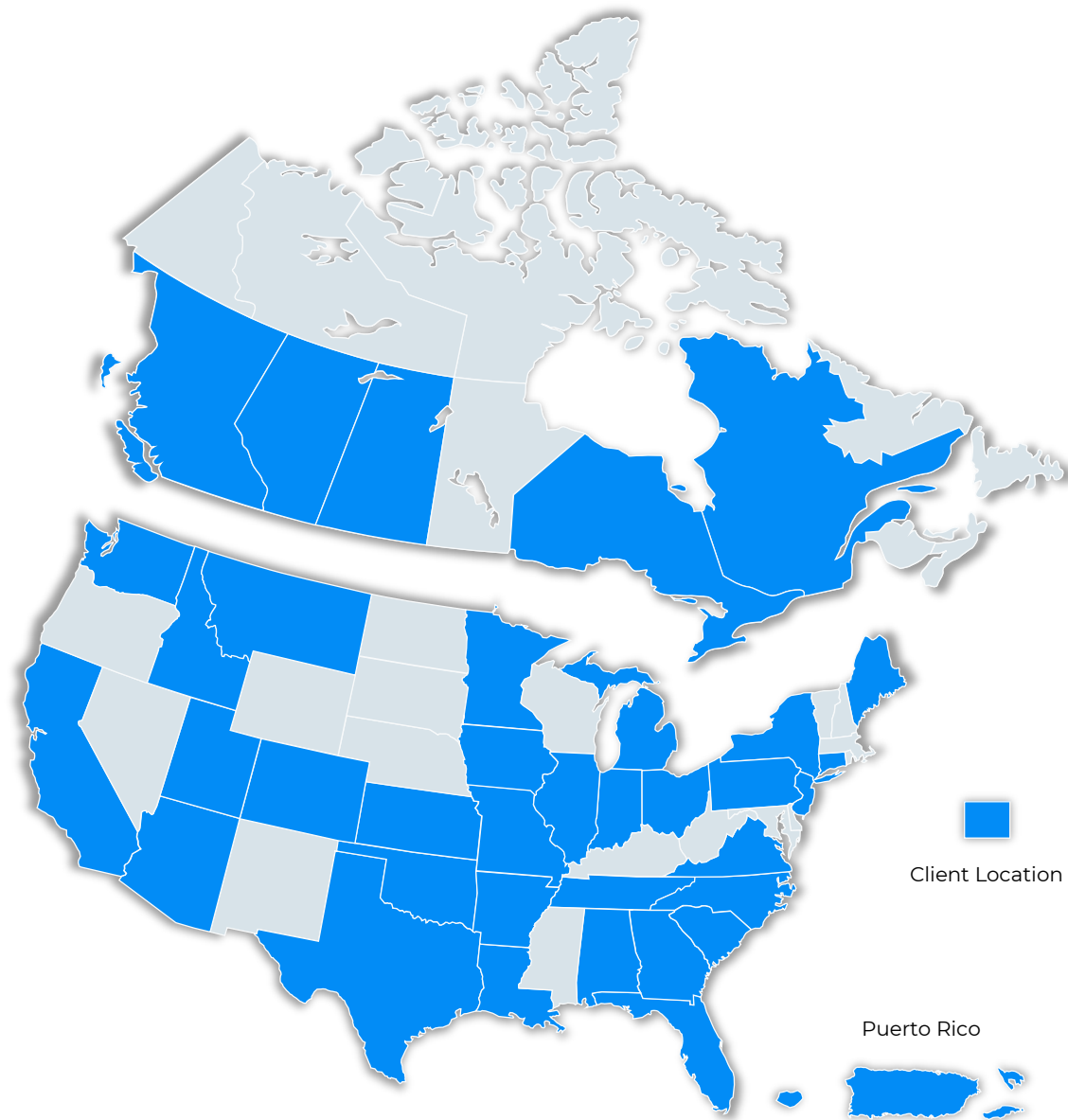
**Zero**  
Soft dollar arrangements with other plan providers

**\$6.5T**  
Total client assets of Cook Street's parent company, Morgan Stanley (12/31/2023)

**106** Billion  
Client Assets

**242** Institutional  
Clients

**1.2** Million  
Participants &  
Beneficiaries



†Source: Source: Pensions and Investments Magazine (November 20, 2023) 2022 Largest Worldwide Investment Consultants. The Pensions and Investments Magazine is based on assets under advisement and assets under management. Cook Street's assets are included in the "Morgan Stanley / Inst'l Consulting" category which is ranked number 14. Cook Street's standalone assets would rank the firm in the top 30. Neither Cook Street nor its consultants paid a fee to Pensions and Investments in exchange for the ratings. Cook Street is a business of Morgan Stanley. Client assets include those advised to in a discretionary and non-discretionary manner. Client assets, client count, and participants and beneficiaries are approximate and based on data as of 12/31/2023 or the most recently available (e.g. from a Form 5500) and may include clients who retained Cook Street after that date. Client location is as of March 2024.

## Accountability

- The Board and Staff operate under the authority of Dallas City Code Chapter 40A (“Chapter 40A”) which addresses the creation of the Board, powers and duties of the Board, administration of the Fund, and contributions.
- The Fund has engaged an Investment Consultant, who is also a fiduciary, to review asset allocations, investment policies, and make recommendations to Staff and the Board. The Fund has also engaged outside legal counsel to review investment contracts. The Board makes all decisions with detailed and comprehensive input from Staff, Investment Consultant, and Legal Counsel.
- The ERF’s Investment Consultant is independent of the investment managers and trading platforms.
- The ERF conducts a Strategic Plan each year to set goals for key issues like investments, communications, customer service, and operational management. Staff then reports to the Board each year on their progress toward these goals.
- The ERF’s current governance structure strikes a good balance between risk and efficiency and is consistent with best practices.

## Investment Policy Statement (IPS)

An **Investment Policy Statement** is a manifestation of a disciplined process for selecting and monitoring the components in an investment program. It forms a foundation for a fund's investment strategy, formally establishes the governance structure and asset class representation, and defines the processes for investment manager selection and monitoring.

- The ERF has a written IPS for the overall plan as well as sub-asset classes, clearly customized for the ERF
- It is reviewed at least annually, and the files demonstrate the evolution of targets and expectations.
- The ERF has a formal funding policy, developed with input from Legal Counsel.

## Investment Policy Statement (IPS) – cont.

- The IPS is written clearly so existing as well as newly appointed or elected Trustees will find it helpful as an ongoing tool for evaluating the Fund's investment program, consistent with best practices.
- The Investment Manager Guidelines contain specific, measurable objectives for the managers, net of fees, over “a full market cycle”, which is expected to be 3-5 years.
- “Discussion Sheets” in the Board materials provide an example of the Fund following its IPS.
- We found the ERF's IPS is consistent with best practices.

## Asset Allocation

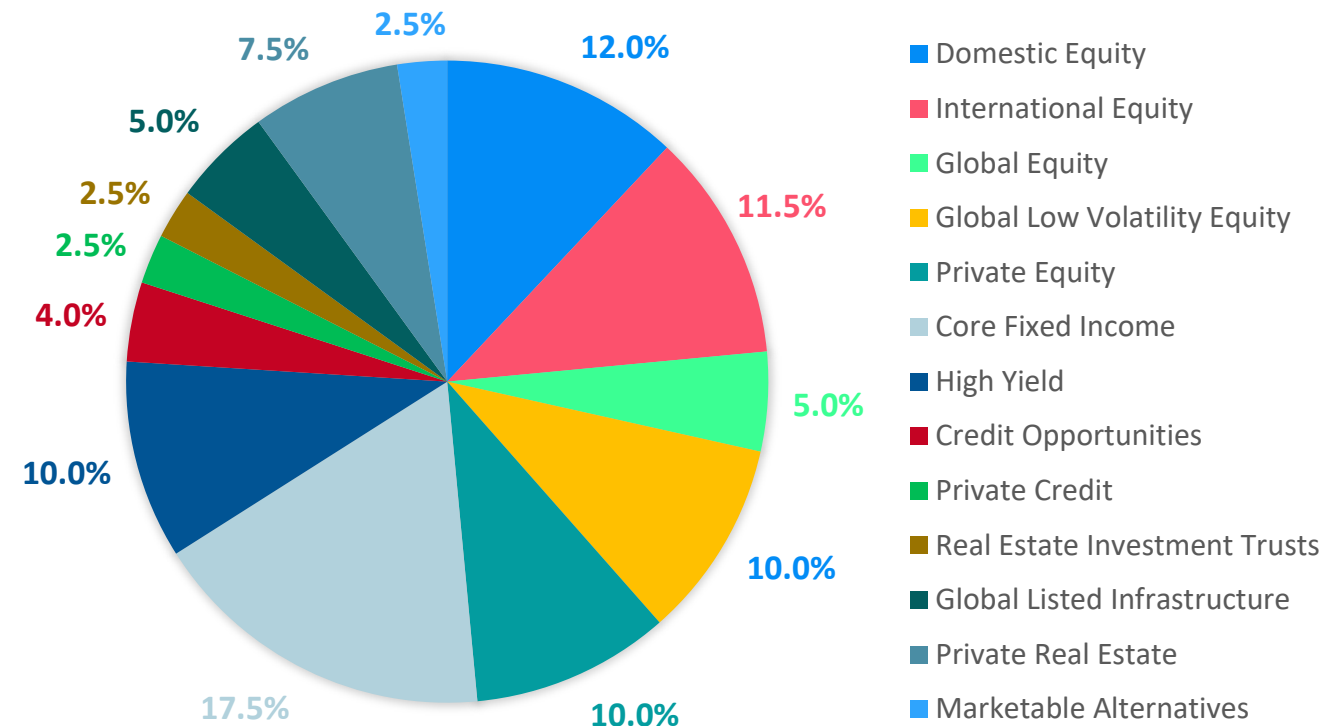
- The ERF has a formal asset allocation policy defined within the IPS. It is specific in terms of asset classes used, ranges around target allocations, and evaluation criteria.
- The Staff, working with the Investment Consultant, makes recommendations to the Board for approval. They examine the asset allocation monthly and will rebalance to targets based on defined ranges.
- An asset allocation study is conducted annually, incorporating current capital market assumptions and the Investment Consultant's current views on the market. We found these assumptions to be in-line with peers.
- In the asset allocation study, the ERF will consider new asset classes and their contribution to increasing or stabilizing return and its impact on the ERF's overall risk and standard deviation.
- The ERF's Investment Consultant and Actuary communicate regularly on the expected returns for the ERF. The Actuary examines the Investment Consultant's expectations and compares them to a survey of other capital market expectations from other sources.



## Asset Allocation – Target Allocation

- The changes in the assumed rate of return are reflected in the Actuary's modeling each year when the actuarial valuation is updated.
- The ERF maintains a strategic asset allocation that is monitored and rebalanced as needed.
- The ERF does not implement any tactical asset allocation component but does recognize and attribute its managers' returns by their invested sectors and geographical positioning.
- The ERF's asset allocation is appropriate for a plan of its size and is consistent with best practices.

## CURRENT TARGET POLICY

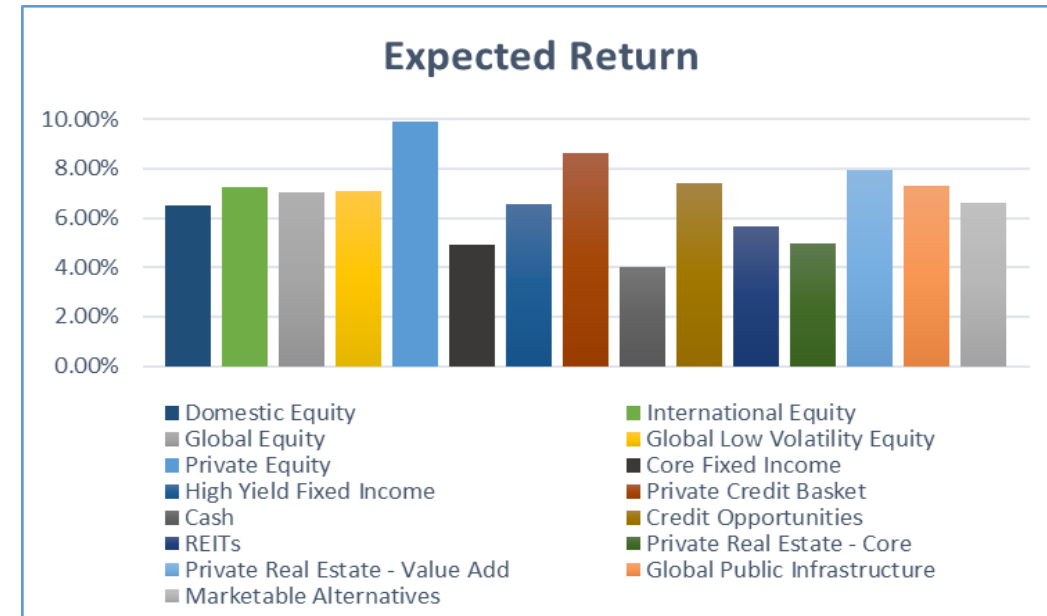


## Asset Allocation – Expected Risk and Return

- The ERF has a target strategic allocation of 48.5% Equity, 34.0% Fixed Income, 15.0% Real Assets, and 2.5% Diversifying Strategies.
- Each sub-asset class has its own expected risk and return.
- The ERF's expectations for risk examines standard deviation and opportunities for diversification.
- The ERF is implementing its strategy using both active and passive management.
- The ERF's return and risk expectations used in the asset allocation process are stress tested under different scenarios as well as 5<sup>th</sup> and 95<sup>th</sup> percentile measurements.

## Asset Allocation – Expected Risk and Return (cont.)

- The Investment Consultant develops return expectations using an Income Growth Valuation Model, Dividend Discount Model, and Cyclically Adjusted P/E Model.
- The inputs for the asset allocation modeling are reasonable, and the approach used by the system to develop the expected returns and asset mix is disciplined and reviewed regularly. It is consistent with best practices, and results in a well-diversified portfolio that is appropriate for the plan's size.
- The ERF's frequent evaluation of expected returns is an example of a Fund procedure that is consistent with best practices.

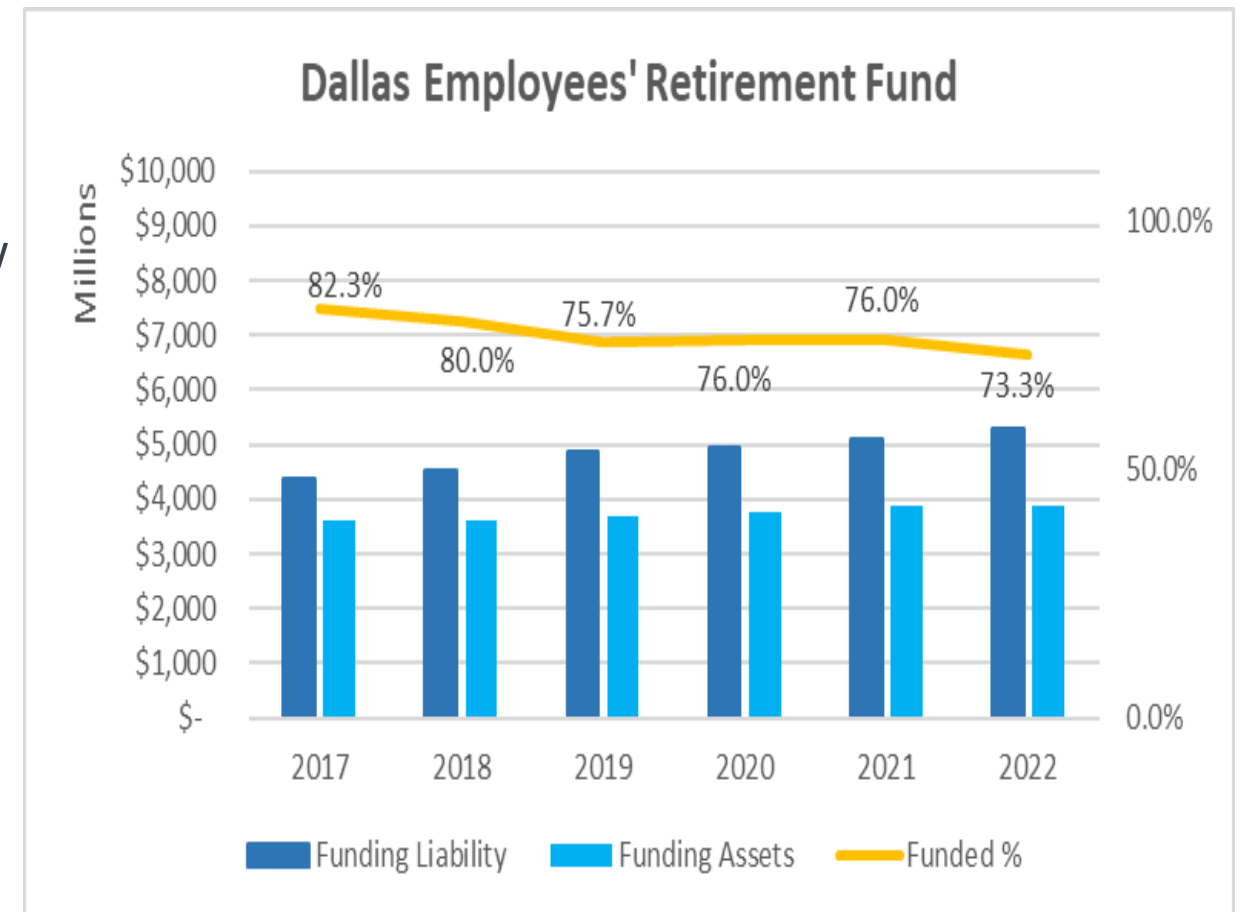


## Asset Allocation – Appropriateness of Alternatives and Illiquid Assets

- The IPS outlines the specific types of **alternative assets** allowed including ranges and maximum allocations. The ERF's long-term time horizon provides the context for properly setting and measuring performance of these assets as well as defining their target allocations.
- The IPS, along with Staff procedures and manager selection, help mitigate the implied risk of these asset classes. For example, Private Equity investments are managed in a fund-of-fund structure with multiple managers utilizing two layers of audit and valuation (pricing).
- The targets defined in the IPS are consistent with industry norms. The ERF's target allocations for alternatives are (as of 5-16-2023):
  - Private Real Estate (7.5% target)    -Private Equity (10.0% target)    -Private Credit (2.5% target)
  - Global Listed Infrastructure (5.0% target)    -Marketable Alternatives/Hedge Funds (2.5% target)
- The ERF's Staff has extensive experience with alternative asset investing, both with ERF and prior to joining the ERF. The Staff is actively engaged in monitoring the alternatives and makes a concentrated effort to stay current with industry trends, products, and strategies.
- The ERF's alternative investments are appropriate given its size and level of investment expertise.

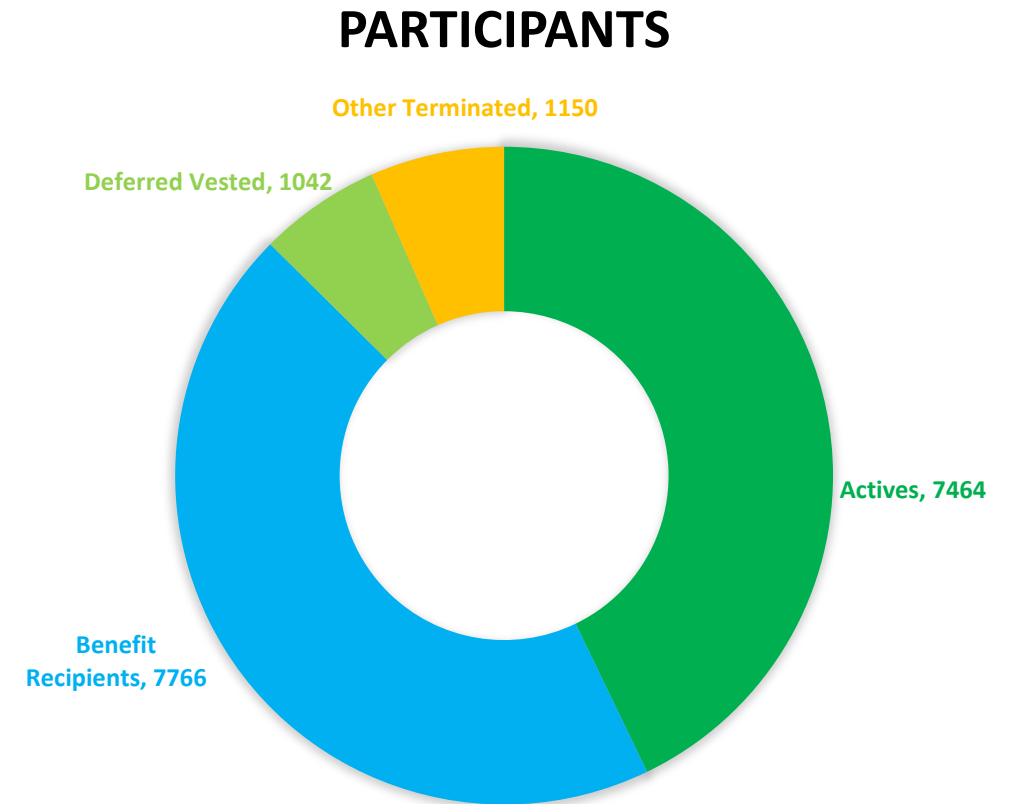
## Asset Allocation – Future Cash Flows and Liquidity Needs

- An **Asset Liability Study** is conducted annually, reflecting the current population and expected cash flow needs.
- Though the Fund is currently experiencing negative net cash flow due to larger benefit payments vs. current contributions, it does not offer lump-sums, and the population is very stable and predictable. This, in turn, provides predictable, stable cash requirements.
- The Asset Liability Study includes stress testing the portfolio in different market environments. The ERF does not expect any stresses applied to the portfolio in these tests to negatively impact the ERF's cash flow or liquidity requirements.
- The Funded Ratio is in line with long-term expectations.



## Asset Allocation – Future Cash Flows and Liquidity Needs (cont.)

- The ERF has a formal cash management policy to manage the benefit payments and expenses which includes a process for systematically raising cash from investment managers and rebalancing as needed.
- The ERF examines expected cash flows each year and models the plan's cash timing needs in light of contributions, expected income, and dividends. The ERF's policy for future cash flow and liquidity needs is adequate for the plan's size and consistent with best practices.
- The plan has about the same number of retirees and non-retirees.
- The ERF's annual Asset Liability Study is an example of a Fund procedure that is consistent with best practices.



## Appropriateness of Investment Fees and Commissions

- The ERF has a disciplined and detailed evaluation procedure to **measure, reconcile, and benchmark fees.**
- Applicable investment fees and commissions have been assessed against appropriate benchmarks. Such fees and commissions within the Plan have been deemed reasonable.\*
- The ERF's custodian provides reporting on securities trading, brokerage fees, and other risk measures, such as sector weights, country weights, cash levels, etc.
- All fees are transparent and reconciled with service agreements. The ERF does not use commission recapture or directed trades.
- Manager fees as well as trading and commissions are reported monthly and evaluated formally each quarter.
- Staff monitors the utilization of brokers by the managers, noting both new brokers and long-tenured providers.
- Fees deemed to be outside of acceptable variances are flagged, questioned, and reconciled.
- The ERF's discipline around fees is very thorough, and we consider these Fund procedures to be consistent with best practices.

\*For a specific assessment of investment fees and commissions relative to appropriate benchmarks, please reference the Appendix.

## Governance Related to Investment Activities and Transparency

- The ERF and the Board are organized under Chapter 40A.
- The ERF has Investment Policies related to all asset classes (e.g. International Equity, REITs, Private Equity, Real Assets, etc.) as well as a Manager Selection and Monitoring Policy.
- The ERF's Code of Ethics (this "Code") covers the Board and Staff and addresses topics such as travel, gifts, prohibited transactions, and conflicts of interests.
- This Code also covers the ERF's consultants, advisors, vendors, employees, and other fiduciaries of the ERF.
- This Code is read and enforced together with the code of ethics found in Chapter 12A of the Dallas City Code and the travel policy adopted by the Board for itself and its Staff.
- Meeting agendas, minutes, and report materials are easily available to the Board and the public online.
- The ERF's governance policy and transparency of practices is adequate for a plan of its size and is consistent with best practices.



## Investment Knowledge/Expertise

- The Board members are required to complete the **PRB Trustee education** with the ERF filing annual disclosure statements.
- Many members come to the Board with prior professional investment experience.
- The Board members and Staff attend educational training and conferences and are required to report back on what they learn.
- The Board and Staff also frequently attend their Investment Consultant's Client Conference covering investment and fiduciary topics.
- The ERF issues RFPs for their Investment Consultant typically every 5 years.

## Manager Selection and Monitoring Process

- Managers are selected by issuing an RFP for each asset class. Working with the Investment Consultant, Staff will recommend candidates for due diligence visits for Board approval. After conducting due diligence, Staff then recommends finalist candidates to present to the Board.
- Once hired, managers are required to meet with the Board as needed, typically once every two years.
- The ERF reviews performance monthly, examining both gross-of-fee and net-of-fee returns compared to index benchmarks.
- Quarterly, the ERF examines managers compared to peer groups, net of fees, attributing returns to sector, timing, and manager skill.
- Managers can be placed on “watch” for different periods of time depending on the market environment for that manager’s asset class. The Board is provided special information related to watch manager evaluation criteria and the expectations on timing and conditions for improvement.
- The manager selection and monitoring process is consistent with best practices.

## Investment Practices and Performance Review

- The ERF's current governance structure strikes a good balance between risk and efficiency.
- It is consistent with best practices and is ample for a plan of its size.
- We found that the ERF Investment Policy Statement is consistent with other plans and best practices, and their asset allocation is appropriate for a plan of its size and is consistent with best practices.
- The Capital Market Assumptions are reasonable and consistent with best practices, and results in a well-diversified portfolio appropriate for the plan's size.
- The ERF's alternative investments are appropriate given its size and level of investment expertise.

## Investment Practices and Performance Review (cont.)

- The manager selection and monitoring process is consistent with the Investment Policy Statement and in-line with industry standards.
- The ERF's discipline around fees is very thorough and consistent with best practices.
- The ERF confirms the services and fees provided by its independent Investment Consultant by periodically soliciting open bids through an RFP process.
- In our review of the ERF's processes, procedures and documentation, we found no clear deviances from industry standards or prescribed norms for similar funds. The ERF's management and Staff maintain a well-defined set of policies and procedures designed to oversee, manage, and report the performance and current status of the ERF.

## Investment Practices and Performance Review (cont.)

### Recommendations:

- Maintain current rigorous reviews of the ERF's performance, providers, and consultants.
- Maintain a focus on transparency.
- Continue to monitor training and education requirements and make adjustments as needed to stay abreast of evolving investment strategies in a very dynamic and global environment.



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Thank You!



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# Appendix

# Appendix – Fee Benchmarking

Asset Class, Fund	Dallas ERF Fee (bps)	Morningstar Category Instl Share Class Only (bps)
<b>US Large Blend</b>	-	<b>65</b>
T. Rowe Price	28	65
<b>US Small Value</b>	-	<b>95</b>
Channing Capital	100	95
<b>US Small Blend</b>	-	<b>91</b>
Systematic Financial	84	91
<b>Foreign Large Blend</b>	-	<b>82</b>
Acadian	55	82
AQR	53	82
Ativo	60	82
Earnest Partners	60	82
<b>Foreign Large Growth</b>	-	<b>85</b>
Baillie Gifford	53	85
<b>Global Large Stock Value</b>	-	<b>90</b>
Ariel	64	90
<b>Global Large Stock Blend</b>	-	<b>83</b>
Acadian Low Volatility	35	83
BlackRock Low Volatility	4	83
<b>Global Large Stock Growth</b>	-	<b>90</b>
Wellington	63	90
<b>US Intermediate Core Bond</b>	-	<b>44</b>
Garcia Hamilton	25	44
Wellington	17	44
Western Asset	25	44

Asset Class, Fund	Dallas ERF Fee (bps)	Morningstar Category Instl Share Class Only (bps)
<b>US High Yield Bond</b>	-	<b>69</b>
BlackRock	45	69
Oaktree Capital	49	69
<b>US Multisector Bond</b>	-	<b>69</b>
Neuberger Berman	27	69
<b>US Infrastructure</b>	-	<b>97</b>
Atlantic Trust	64	97
Cohen & Steers	59	97
Harvest Fund Advisors	74	97
<b>US Real Estate</b>	-	<b>86</b>
Adelante	59	86
CenterSquare	50	86

Asset Class, Fund	Dallas ERF Fee (bps)	Wilshire Median (bps)
<b>Private Real Estate (Core)</b>	-	<b>100 + 10% Carry</b>
Heitman	86	100 + 10% Carry
Invesco	83	100 + 10% Carry
<b>Private Real Estate (Value-Add)</b>	-	<b>100 + 10% Carry</b>
AEW	79	100 + 10% Carry
Brasa	140	100 + 10% Carry
Long Wharf	150 + 2% Carry	100 + 10% Carry
Virtus	135	100 + 10% Carry
<b>Private Equity</b>	-	<b>200 + 20% Carry</b>
Fairview	60	200 + 20% Carry
Grosvenor	80	200 + 20% Carry
Hamilton Lane	95	200 + 20% Carry
<b>Private Credit</b>	-	<b>TBD</b>
MGG	100 + 10% Carry	TBD
Silver Point	150 + 20 Carry	TBD
Vista	150 + 15% Carry	TBD
<b>Marketable Alternatives</b>	-	<b>150 + 17.5% Incentive</b>
Davidson Kempner	150	150 + 17.5% Incentive
Hudson Bay	200	150 + 17.5% Incentive



# Evaluation Footnotes and Disclosure



1. The Pension Review Board has provided guidance on the different areas required by statute to be reviewed by independent consulting firms. The PRB recognizes that evaluations should and will vary significantly based on the specific characteristics of each system's size, governance structure, and investment program.
2. This evaluation of the Employees' Retirement Fund of the City of Dallas was conducted independently by Cook Street Consulting based on guidelines provided by the Pension Review Board and legislation enacted in the State of Texas under Senate Bill 322 (86R).
3. SB 322 requires systems with assets of at least \$100 million must complete an evaluation once every 3 years.
4. Information for this review was found in public filings of Board agendas, meeting minutes and other supporting documentation including meetings with Staff, and transcripts of Board meetings.

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