

**Executive Team:**

**Dominic D. Brown, CPA, CFE**  
Chief Executive Officer

**Daryn Miller, CFA**  
Chief Investment Officer

**Jennifer Zahry, JD**  
Chief Legal Officer

**Matthew Henry, CFE**  
Chief Operations Officer



**Board of Retirement:**

Phil Franey, Chair  
David Couch, Vice-Chair  
Deon Duffey  
Juan Gonzalez  
Joseph D. Hughes  
Jordan Kaufman  
Rick Kratt  
John Sanders  
Tyler Whitezell  
Dustin Contreras, Alternate  
Chase Nunneley, Alternate  
Robb Seibly, Alternate

August 29, 2024

Members, Board of Retirement  
Employee Bargaining Units  
Requesting News Media  
Other Interested Parties

Subject: Meeting of the Kern County Employees' Retirement Association Investment Committee

Ladies and Gentlemen:

A meeting of the Kern County Employees' Retirement Association Investment Committee will be held on Thursday, September 5, 2024 at 8:30 a.m. in the KCERA Boardroom, 11125 River Run Boulevard, Bakersfield, California, 93311.

**How to Participate: Listen to or View the Board Meeting**

To listen to the live audio of the Board meeting, please dial one of the following numbers (for best audio a landline is recommended) and enter ID# 839 1885 4889

- (669) 900-9128; U.S. Toll-free: (888) 788-0099 or (877) 853-5247

To access live audio and video of the Board meeting, please use the following:

- <https://us02web.zoom.us/j/83918854889?pwd=dbz4YVNBYtrFiEdRAg3ymHE8t6ow9d.1>
- Passcode: 708814

Items of business will be limited to the matters shown on the attached agenda. If you have any questions or require additional service, please contact KCERA at (661) 381-7700 or send an email to [administration@kcera.org](mailto:administration@kcera.org).

Sincerely,

Dominic D. Brown  
Chief Executive Officer

Attachments

**AGENDA:**

All agenda item supporting documentation is available for public review on KCERA's website at [www.kcera.org](http://www.kcera.org) following the posting of the agenda. Any supporting documentation that relates to an agenda item for an open session of any regular meeting that is distributed after the agenda is posted and prior to the meeting will also be available for review at the same location.

**AMERICANS WITH DISABILITIES ACT  
(Government Code §54953.2)**

Disabled individuals who need special assistance to listen to and/or participate in the meeting of the Board of Retirement may request assistance by calling (661) 381-7700 or sending an email to [administration@kcera.org](mailto:administration@kcera.org). Every effort will be made to reasonably accommodate individuals with disabilities by making meeting materials and access available in alternative formats. Requests for assistance should be made at least two (2) days in advance of a meeting whenever possible.

**CALL TO ORDER**

**ROLL CALL (IN PERSON)**

**AB 2449 REMOTE APPEARANCE(S)**

*Items 1 and/or 2 withdrawn from agenda if no trustee(s) request to appear remotely:*

1. JUST CAUSE CIRCUMSTANCE(S):
  - a) The following Trustee(s) have notified the Committee of a "Just Cause" to attend this meeting via teleconference. (See Government Code § 54953).
    - NONE
  - b) Call for Trustee(s) who wish to notify the Committee of a "Just Cause" to attend this meeting via teleconference. (See Government Code § 54953) – RECEIVE/HEAR REQUEST(S); NO COMMITTEE ACTION REQUIRED
2. EMERGENCY CIRCUMSTANCE(S):
  - a) The following Trustee(s) have requested the Committee approve their attendance of this meeting via teleconference due to an "Emergency Circumstance." (See Government Code § 54953).
    - NONE
  - b) Call for Trustee(s) requesting the Committee approve their attendance of this meeting via teleconference due to an "Emergency Circumstance". (See Government Code § 54953) – TAKE ACTION ON REQUEST(S) FOR REMOTE APPEARANCE DUE TO EMERGENCY CIRCUMSTANCE

3. [Discussion and appropriate action on private credit fund recommendation](#) presented by Keirsten Lawton, Partner, Cambridge Associates<sup>1</sup>, and Senior Investment Officer Geoff Nolan – RECOMMEND THE BOARD OF RETIREMENT APPROVE UP TO \$25MM COMMITMENT TO MAGNETAR STRUCTURED SOLUTIONS FUND; AUTHORIZE CHIEF EXECUTIVE OFFICER TO SIGN, SUBJECT TO LEGAL ADVICE AND REVIEW
4. [Presentation on Midstream Energy deep dive presented by Brian Kwan, CFA, CAIA, Verus, Chief Investment Officer Daryn Miller, CFA, and Investment Analyst Melekte Yohannes](#) – HEAR PRESENTATION; RECEIVE EDUCATIONAL TRAINING (15 MINUTES TRUSTEE EDUCATION CREDIT)
5. [Discussion and appropriate action on termination recommendations presented by Chief Investment Officer Daryn Miller, CFA, Senior Investment Officer Geoff Nolan, and Brian Kwan, CFA, CAIA, Verus](#) – RECOMMEND THE BOARD OF RETIREMENT: A) TERMINATE WESTERN ASSET CORE PLUS; AND B) TERMINATE WESTERN ASSET HIGH YIELD

### **PUBLIC COMMENTS**

6. The public is provided the opportunity to comment on agenda items at the time those agenda items are discussed by the Committee. This portion of the meeting is reserved for persons to address the Committee on any matter not on this agenda but under the jurisdiction of the Committee. Committee members may respond briefly to statements made or questions posed. They may ask a question for clarification and, through the Chair, make a referral to staff for factual information or request staff to report back to the Committee at a later meeting. Speakers are limited to two minutes. Please state your name for the record prior to making a presentation.

### **REFERRALS TO STAFF, ANNOUNCEMENTS OR REPORTS**

7. On their own initiative, Committee members may make a brief announcement, refer matters to staff, subject to KCERA's rules and procedures, or make a brief report on their own activities.
8. Adjournment

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<sup>1</sup> Written materials and investment recommendations from the consultants, fund managers and KCERA investment staff relating to alternative investments are exempt from public disclosure pursuant to California Government Code § 7928.710, § 7922.000, and §54957.5.

**ALTERNATIVE INVESTMENTS RECORDS**

**EXEMPT FROM PUBLIC DISCLOSURE**

**(California Government Code § 7928.710)**

**(California Government Code § 7922.000)**

**(California Government Code § 54957.5)**

**DO NOT REPRODUCE**

**DO NOT DISTRIBUTE**



## Midstream Deep Dive

Presented by:

**Daryn Miller, CFA**

Chief Investment Officer

**Jack Bowman**

Senior Investment Analyst

**Melekte Yohannes**

Investment Analyst

# Introduction and Objective

*What is Staff seeking to achieve with this analysis?*

- Recap the history of the Midstream allocation and investment thesis
- Evaluate the Midstream allocation to determine if it is achieving its goals
  - Understand the performance, attribution, and risks
- Revisit the investment thesis—does the opportunity persist?
- Review strategic considerations for potential changes

# Midstream Investment Objectives

*Per the Investment Policy Statement (IPS), the Midstream allocation has the following Primary and Secondary Goals.*



## Primary Goals

The primary goals of the midstream allocation are return generation, income generation, and diversification.



## Secondary Goal

The secondary goal for the midstream allocation is to potentially act as a hedge for inflation, through positive correlation with inflation.

# Executive Summary

*The Midstream Portfolio has outperformed expectations*

- Midstream performance has been strong and while producing an income component—both consistent with the mandate’s goals
- The Midstream allocation correlation with the Total Plan was 0.6, partially meeting the diversification goal
- Midstream performed well in a high-inflation environment, consistent with the mandate’s secondary goal
- The implementation decision to include a hybrid mandate into the structure, weighed on performance
- The investment opportunity has persisted longer than expected



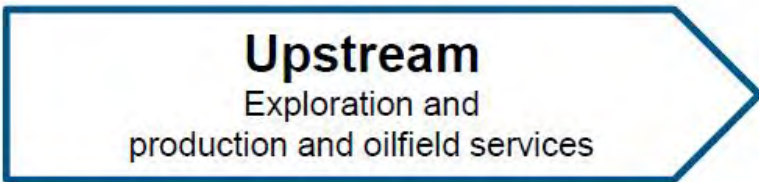


# Contents

- What is Midstream?
- History and Midstream Investment Thesis
- KCERA's Midstream Investments
- Performance, Attribution, & Risk
- Midstream Thesis Update
- Considerations

# What is Midstream?

- Midstream is the channel that connects upstream (wells) and downstream (refiners) by providing the infrastructure to efficiently gather, process, store, and distribute natural gas and other energy products.



Crude oil | Natural gas | Natural gas liquids

Crude oil | Natural gas | Natural gas liquids

Gasoline | Diesel | Heating oil | Ethylene

# KCERA Midstream History



## IDENTIFICATION & ANALYSIS

- In early 2020, Staff identified an investment opportunity in Midstream assets
- After completing a thorough review, Staff concluded that the Midstream opportunity was attractive and should be added to the portfolio



## IMPLEMENTATION APPROACHES

- Add to the Public Equity Portfolio
  - Consideration: Would create material tracking error, and would fund from another risk seeking/return generating asset class
- Add to the Opportunistic Portfolio
  - Consideration: The investment opportunity was broader in nature, and didn't fit the Opportunistic mandate
- Create a new allocation as part of the annual Asset Allocation Review process
  - Seemed to be the most appropriate solution and was the path KCERA pursued

# History, cont.



**5%**  
TARGET  
MIDSTREAM  
ALLOCATION



## EDUCATION & APPROVAL

- At the April 2020 Board meeting, Trustees received education on Midstream
- Following Board education, a recommendation was made to change the Strategic Asset Allocation to include a 5% allocation to Midstream funded through a 5% reduction to Core Fixed Income



## STRATEGY SELECTION & EXECUTION

- Staff released an RFP in April 2020 for Public Market Midstream Energy Investment Strategies
- Staff received 10 responses; diligence was completed; recommendations made for the **Harvest Midstream** and **PIMCO Midstream** strategies at the August 2020 BOR meeting
- Harvest and PIMCO contracts were executed, and the strategies were funded in September 2020 and October 2020, respectively



# INITIAL MIDSTREAM INVESTMENT THESIS

## STRUCTURAL IMPROVEMENT

- Management team incentives shifted away from production & distribution to sustainable earnings & cash flow generation and capex discipline
- Removing Incentive Distribution Rights (“IDRs”)
- Shift from Master Limited Partnership (“MLP”) to C-Corp structures

## STRONG FUNDAMENTALS & COMPELLING VALUATION

- Balance sheet improvement/reduced leverage, higher coverage ratios
- High FCF yields, low EV/EBITDA, and reasonable growth
- Solid and better covered distributions



## OUT OF FAVOR/ NON-CONSENSUS

- Investors exiting; some for non-economic reasons
- ESG; transition from traditional energy
  - Traditional energy is not going away for the foreseeable future, absent radical step-function technological improvement
- Energy as a percentage of the S&P dipped to ~3%



# Midstream Investments



## BLACKSTONE HARVEST (HARVEST) MIDSTREAM

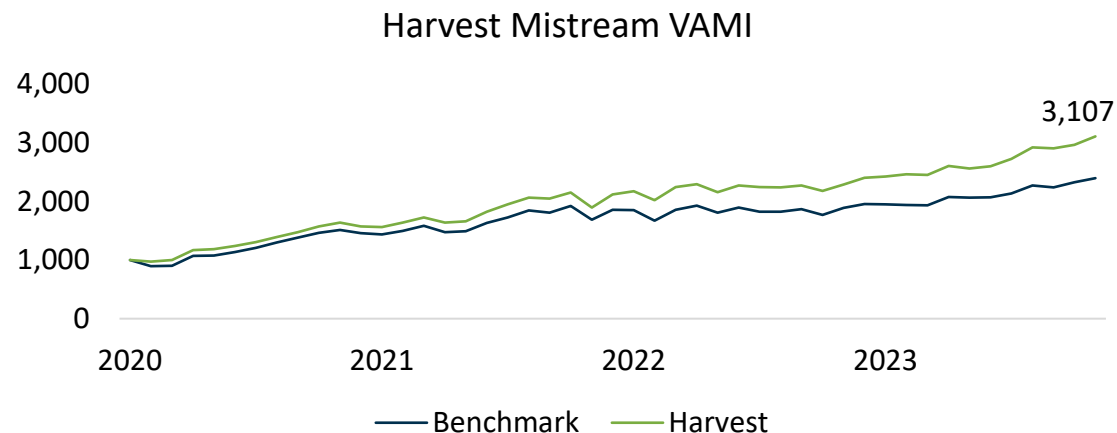
- Harvest Midstream, \$165.3M market value as of 7/31/2024
- Equity only mandate
- Benchmark: Alerian Midstream Total Return Index

## PIMCO MIDSTREAM

- PIMCO Midstream, \$143.3M market value as of 7/31/2024
- Hybrid Equity and Debt mandate
- Benchmark:
  - 50% Alerian Midstream Total Return Index
  - 25% ICE BofA US Pipeline
  - 25% ICE BofA US HY Midstream

# Harvest Midstream Strategy

- Founded in 2005, Harvest pursues a strategy focused on public market midstream energy equities. The core thesis for the strategy is the belief that there is fundamental mispricing caused by a lack of clear understanding of the space, and potentially other factors. Harvest leverages the investment team's expertise in the space to identify opportunities and drive value creation. The Harvest portfolio is concentrated and leans toward higher quality Midstream names. In 2017, Harvest was acquired by Blackstone, the Fund has seen some operational efficiencies associated with synergy, however, the business unit retained its autonomy.
- Harvest was added to the KCERA Midstream portfolio in September of 2020. The strategy has generated an annualized return of 34.4%, which equates to +8.8% excess return, with lower volatility than the benchmark, and an Information Ratio of 1.5.



	Harvest	Bench. (a)	Difference
ITD Return	210.7%	139.5%	+71.2%
Annualized Return	34.4%	25.6%	+8.8%
Vol	18.1%	20.5%	-2.4%
Tracking Error	5.8%		
Excess Return	8.8%		
Information Ratio	1.5		

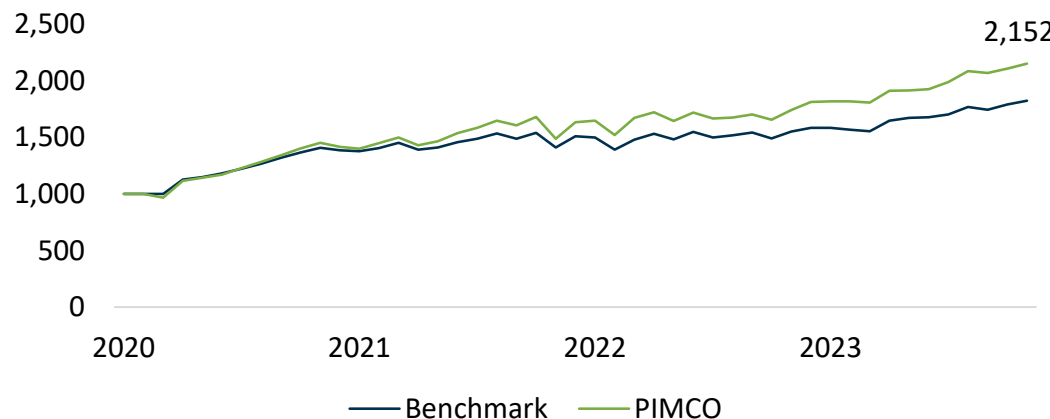
Source: KCERA, Harvest, PIMCO. Inception September 2020.

(a) Harvest Benchmark: Alerian Midstream Total Return Index

# PIMCO Midstream Strategy

- Founded in 2014, the PIMCO Midstream strategy is an actively managed portfolio consisting of both equity and debt (investment grade and high yield). The hybrid approach is pursued as the Midstream space can be volatile and the addition of debt with equities, allows for other sources of return, dampens volatility, and increases diversification with Harvest. PIMCO deploys its expertise in the energy space, looking across the capital structure, and focuses on researching individual assets with benefit of time-tested top-down process.
- PIMCO was added to the KCERA Midstream portfolio in October of 2020. The strategy has generated an annualized return of 22.7%, which equates to +5.3% excess return, with higher volatility than the benchmark, and an Information Ratio of 1.2.

PIMCO Midstream VAMI

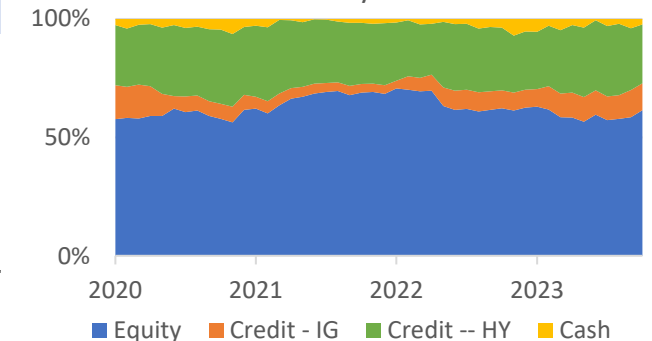


	PIMCO	Bench. (a)	Difference
ITD Return	115.2%	82.5%	+32.7%
Annualized Return	22.7%	17.4%	+5.3%
Vol	15.7%	12.7%	+3.1%
Tracking Error	4.5%		
Excess Return	5.3%		
Information Ratio	1.2		

Source: KCERA, PIMCO. Inception October 2020.

(a) PIMCO Benchmark: 50%/25%/25% Alerian Midstream Total Return Index / ICE BofA US Pipeline/ ICE BofA US HY Midstream

Allocation by Asset Class

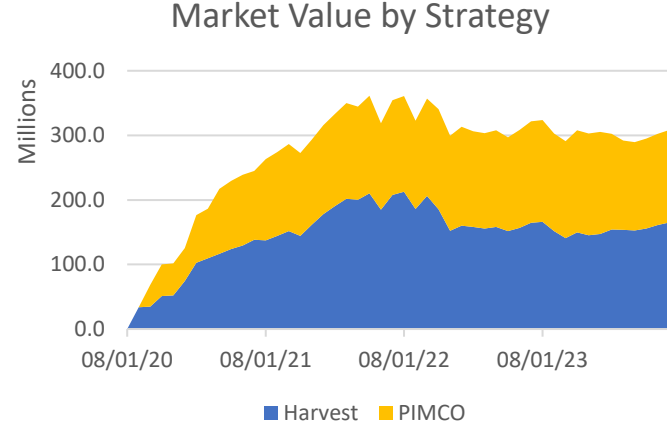
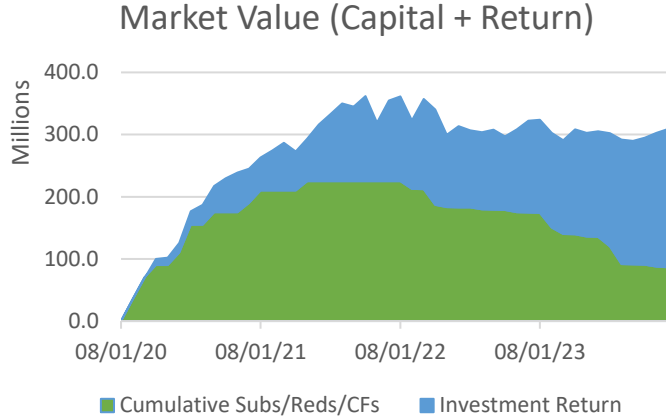
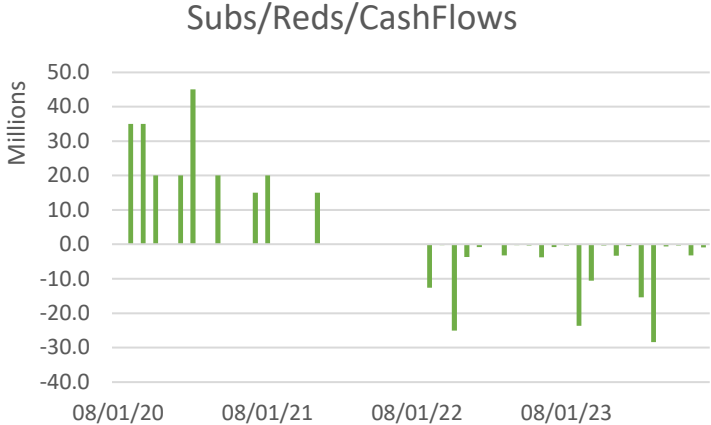




# Subscriptions & Redemptions

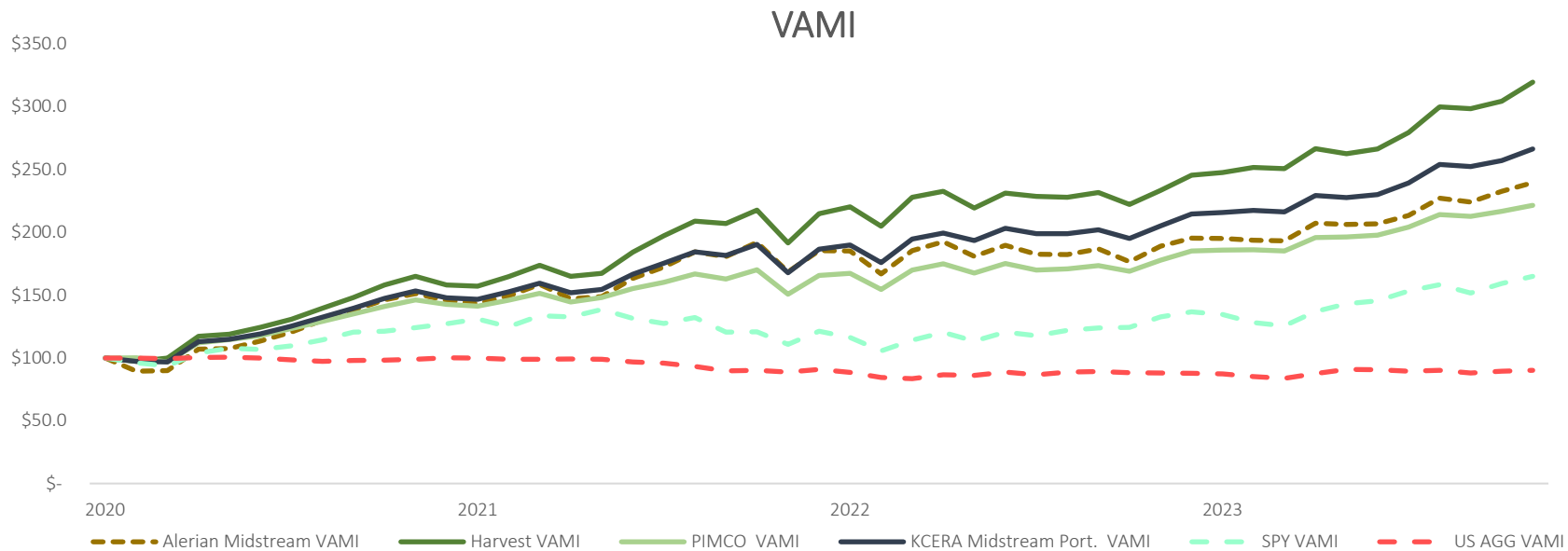


- Capital was invested in the Midstream allocation beginning September 2020
- Total capital invested was \$225M, phased in from September 2020 through December 2021
- In second half of 2022, Staff changed the Harvest and PIMCO distributions/coupons from being reinvested to paid out
- The Total Midstream market value stands at \$308M (5.2% of Plan assets) as of 7/31/24
  - This is comprised of \$86.8M cumulative net subscriptions, redemptions and cash flows, and \$221.8M investment gains



# Performance

- The KCERA Midstream Portfolio has provided strong and consistent returns over the past 4 years, which includes a partial market cycle.
- The 5% Midstream allocation was funded through a reduction to Core Fixed Income (Bloomberg US Aggregate Bond Index), which has had a material positive impact on returns.
  - KCERA Midstream Portfolio outperformed the Core Fixed Income (Bloomberg US Aggregate) by 31.74%, annualized
  - KCERA Midstream Portfolio outperformed the S&P 500 by 15.17%, annualized



Note: Analysis period begins September 2020 and ends in June 2024

# Performance, Cont.

- Performance has been strong; both managers exceeded their benchmarks, while the overall allocation exceeded the policy benchmark
- Both Harvest and PIMCO have strong Information Ratios (“IR”) 1.5 and 1.2 respectively
  - IR is a measure of excess return for risk taken (IR = Excess Return / Tracking Error)
- However, when combined the Total Midstream allocation IR drops to an acceptable level of 0.5
  - The lower Total Midstream IR is a function of PIMCO’s hybrid strategy (equity & debt), which increases tracking error but weighs on total and excess returns (when measuring against the Policy benchmark)



	Harvest	Bench. (a)	Difference	PIMCO	Bench. (b)	Difference	Total	Bench. (c)	Difference
ITD Return	210.7%	139.5%	+71.2%	115.2%	82.5%	+32.7%	160.3%	139.5%	+20.8%
Annualized Return	34.4%	25.6%	+8.8%	22.7%	17.4%	+5.3%	28.3%	25.6%	+2.8%
Vol	18.1%	20.5%	-2.4%	15.7%	12.7%	+3.1%	16.8%	20.5%	-3.7%
Tracking Error	5.8%			4.5%			5.9%		
Excess Return	8.8%			5.3%			2.8%		
Information Ratio	1.5			1.2			0.5		

Source: KCERA, Harvest, PIMCO. Inception September 2020.

(a) Harvest Benchmark: Alerian Midstream Total Return Index

(b) PIMCO Benchmark: 50%/25%/25% Alerian Midstream Total Return Index / ICE BofA US Pipeline/ ICE BofA US HY Midstream

(c) Midstream Policy Benchmark: Alerian Midstream Total Return Index (same as Harvest benchmark)

# Attribution Details – Harvest



- Harvest produced strong and consistent excess returns each year; with 2022 an outsized contribution
- Excess returns are driven by Selection & Interaction Effects (primarily stock picking)
- Allocation Effects detracted value (-5.6%); however, this was largely driven by a cash drag as the average cash position of 1.75% detracted (-4.5%) from performance -- due to strong overall Midstream market returns

**Attribution Analysis 2020 - 2024 (a)**

	Allocation	Selection & Interaction	Total	By Year	Total
Natural Gas Pipelines	1.2%	14.6%	15.9%	2020	2.3%
Oil & Products Pipelines	-0.9%	9.5%	8.7%	2021	1.4%
Processors	-0.7%	7.5%	6.8%	2022	10.2%
Refining	-0.4%	0.0%	-0.4%	2023	5.2%
Specialty	1.1%	-1.0%	0.1%	2024	5.8%
Utility	-1.5%	0.0%	-1.5%		
Cash (b)	-4.5%	0.0%	-4.5%		
<b>TOTAL</b>	<b>-5.6%</b>	<b>30.6%</b>	<b>24.9%</b>		<b>24.9%</b>

Source: Harvest.

(a) September 2020 through June 2024  
 (b) Average cash exposure was 1.75%

# Attribution Details – PIMCO

- PIMCO produced strong and consistent excess returns each year
- Excess return has been a function of both Allocation and Selection effects, due to a persistent overweight in equity and strong market returns, plus solid stock and bond picking
- Equity has been the largest contributor; Credit Selection was additive, while Credit Allocation detracted.

## Attribution Analysis 2020 - 2024 (a), (b)

	Selection &			By Year	Total
	Allocation	Other	Total		
<b>Equity</b>	<b>9.8%</b>	<b>12.6%</b>	<b>22.4%</b>	2020	4.5%
Gathering & Processing	4.6%	2.8%	7.5%	2021	6.7%
Pipeline Transportation   Petroleum	-0.5%	3.3%	2.8%	2022	8.5%
Pipeline Transportation   Natural Gas	0.5%	1.9%	2.4%	2023	3.6%
Marketing & Distribution	0.1%	0.0%	0.1%	2024	3.4%
Storage	0.2%	0.0%	0.2%		
Liquefaction	-0.2%	0.3%	0.2%		
Other (c)	-0.6%		-0.6%		
<b>Credit</b>	<b>-3.1%</b>	<b>3.5%</b>	<b>0.5%</b>		
Investment grade	1.0%	1.6%	2.7%		
High yield	0.3%	0.6%	0.9%		
<b>Other</b>		<b>3.8%</b>	<b>3.8%</b>		
<b>TOTAL</b>	<b>6.8%</b>	<b>19.8%</b>	<b>26.6%</b>		<b>26.6%</b>

Source: PIMCO.

(a) October 2020 through June 2024

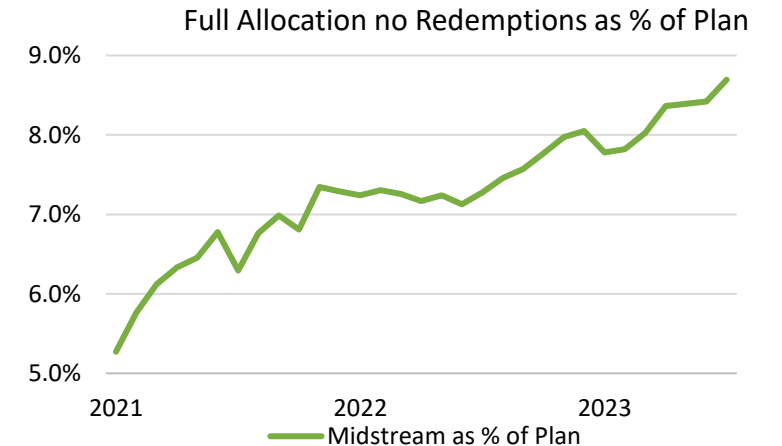
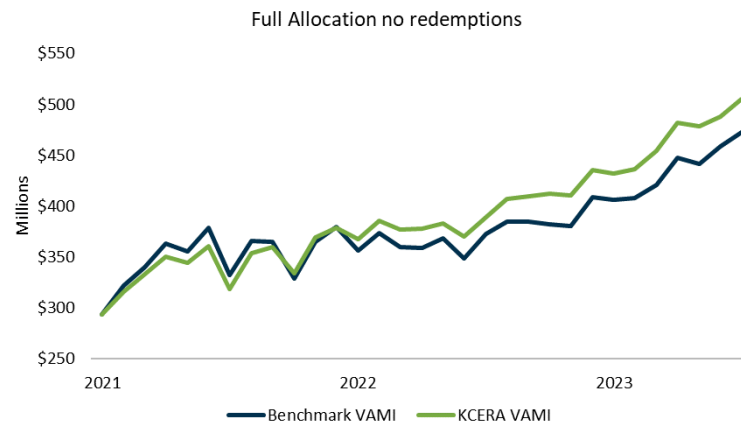
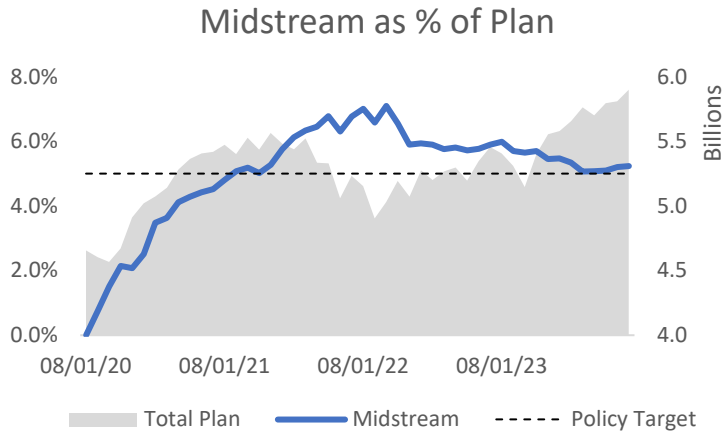
(b) Attribution analysis vs strategy benchmark: 50% Alerian Midstream Energy Index, 25% ICE BofA U.S.

Pipeline Index, 25% ICE BofA U.S. High Yield Midstream Index

(c) For "Other", Allocation and Selection & Other effects have been combined

# Changes in Capital Allocation

- Staff has managed the size of the Midstream allocation over time
  - The allocation has been re-sized or allowed to deviate relative to the 5% Policy target to a) reflect conviction in the opportunity, b) to manage risk, and c) keep the allocation within the Policy Range
- The target is 5%, the actual allocation has been as high as 7.1% (October 2022), and as low at 5.0% (ignores the initial portfolio build-out phase, Sept 2020 to Dec 2021)
  - The Policy Range for Midstream was initially 0-7% and was increased to 0-8% in the 2022 Asset Allocation Review
- Managing the position size over time has detracted value; if the initial subscriptions were left in the Midstream portfolio, the allocation would be over \$500M today and approaching 9% of Plan



# Risk Measures

- The PIMCO strategy has a lower beta and higher tracking error to the Alerian Midstream Index, and lower volatility than Harvest; this is not surprising given the strategy's debt component
- Correlation of excess returns between Harvest and PIMCO, 0.48, offers only modest diversification benefit
- Both strategies experienced similar max drawdowns, and at the same time—June 2022

	Harvest	PIMCO
Beta (a)	0.85	0.71
Volatility	18.1%	15.7%
Tracking Error (a)	5.8%	8.1%
Tracking Error (b)	5.8%	4.5%
Max drawdown (c)	-12.0%	-11.5%
Correlation (d)	0.51	0.72
Correlation (e)	0.96	
Correlation (f)	0.48	

*Source: KCERA, Harvest, PIMCO.*

(a) To the Alerian Midstream Index.

(b) To the manager's respective benchmark

(c) Both drawdowns occurred in June 2022 and lasted 1 month

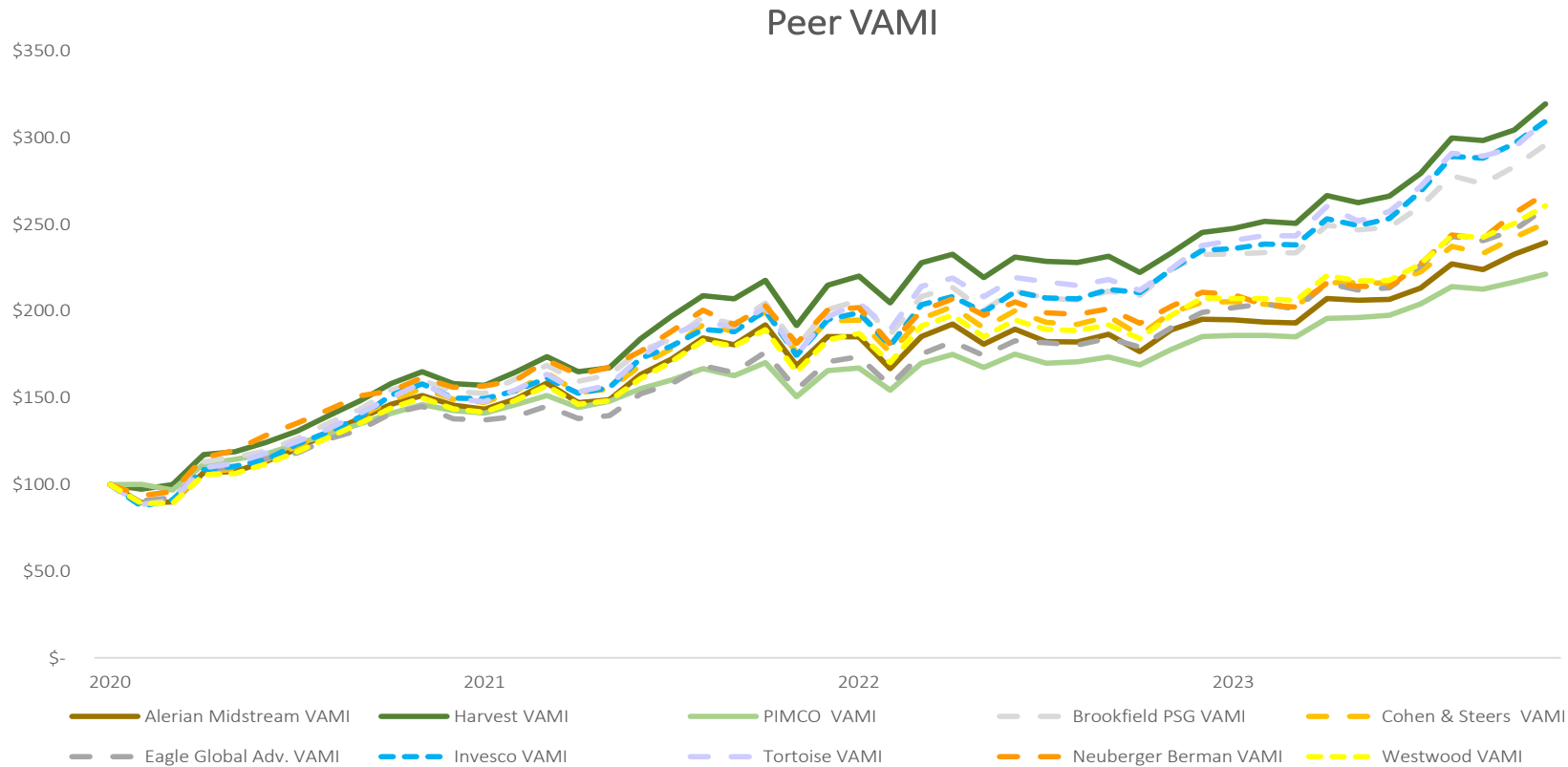
(d) To Total Plan returns

(e) Correlation between Harvest and PIMCO total returns

(f) Correlation between Harvest and PIMCO of excess returns (benchmark: Alerian Midstream)

# Peer Analysis

- During the midstream RFP process, Staff conducted due diligence on a total of 9 investment managers. The chart below displays the performance of the 2 managers hired (PIMCO and Harvest), plus the 7 managers not hired. Additionally, the Alerian Midstream Index is included for further context.



Note: Analysis period begins September 2020 and ends in June 2024



# Peer Analysis, Cont.

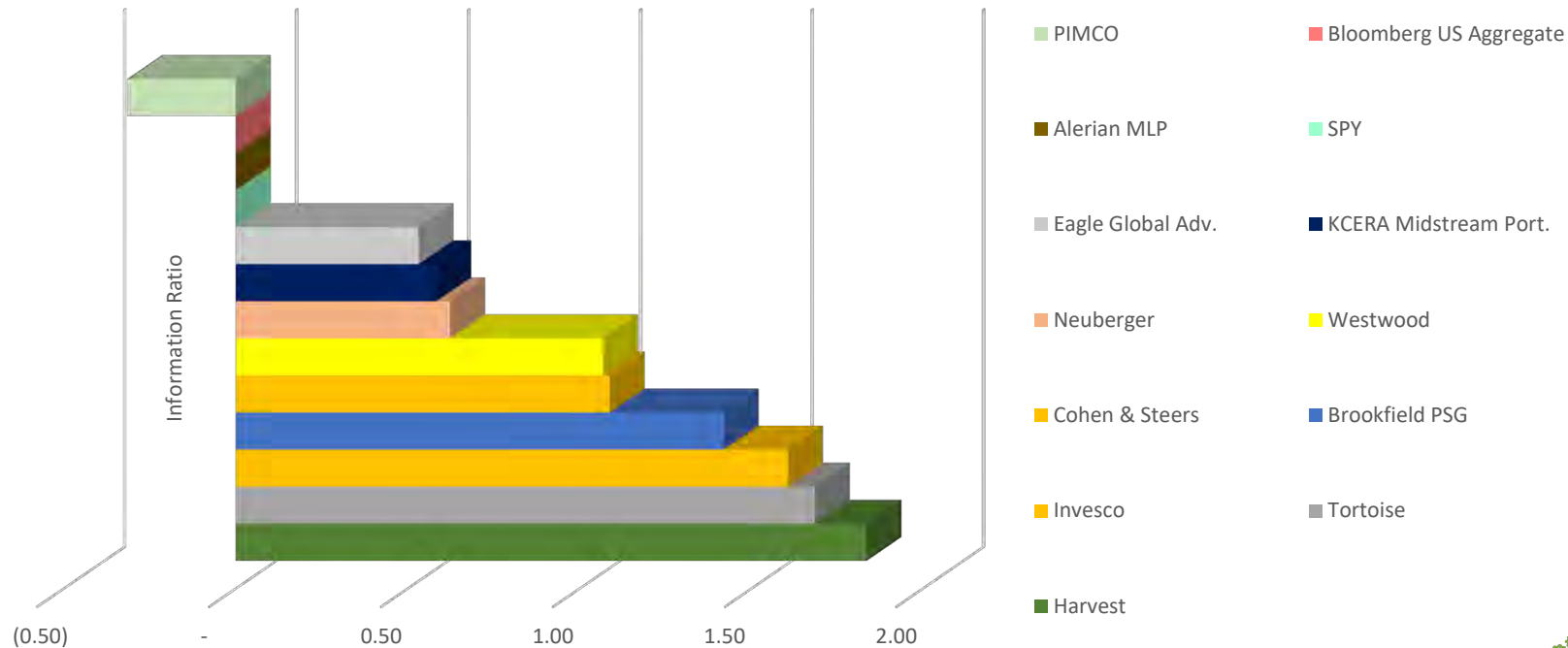
- The correlation matrix below analyzes the correlation of excess returns gross of fees.
  - Mixed correlations across the various midstream strategies, with some strategies quite diversifying, but others showing a strong positive correlation
    - Strong correlation: Invesco to Tortoise (+0.72) and Westwood to Tortoise (+0.75)
    - Little to no correlation: Eagle Global to Cohen & Steers (+0.06) and Invesco to Neuberger (+0.04)
  - PIMCO and Harvest have a moderate correlation (+0.48)

	Brookfield PSG	Cohen & Steers	Eagle Global Adv.	Invesco	Tortoise	Neuberger Berman	Westwood	PIMCO	Harvest	KCERA Midstream Port.	SPY	Bloomberg US Aggregate
Brookfield PSG	1.00											
Cohen & Steers	0.24	1.00										
Eagle Global Adv.	0.43	0.06	1.00									
Invesco	0.66	0.13	0.63	1.00								
Tortoise	0.55	0.16	0.55	0.72	1.00							
Neuberger Berman	0.16	0.23	0.30	0.04	0.23	1.00						
Westwood	0.45	0.26	0.42	0.54	0.75	0.14	1.00					
PIMCO	0.28	0.20	0.45	0.35	0.32	0.34	0.42	1.00				
Harvest	0.20	0.21	0.55	0.33	0.54	0.36	0.46	0.48	1.00			
KCERA Midstream	0.17	0.20	0.52	0.24	0.39	0.44	0.41	0.88	0.91	1.00		
SPY	0.06	0.16	0.31	0.01	-0.13	0.54	0.01	0.68	0.20	0.49	1.00	
Bloomberg US Aggregate	-0.10	0.10	0.36	0.03	-0.07	0.39	-0.06	0.76	0.44	0.67	0.73	1.00

Note: Analysis period begins September 2020 and ends in June 2024

# Peer Analysis, Cont.

- Information Ratio was also factored into the analysis. The KCERA Midstream Portfolio was dragged down by the PIMCO allocation, which underperformed the Alerian Midstream Index.
- The shift from the Bloomberg US Aggregate Bond Index was additive as the KCERA Midstream portfolio outperformed it by nearly 30%.
- The addition of Harvest to the KCERA Midstream portfolio has been additive.



Note: Analysis period begins September 2020 and ends in June 2024



# Midstream Thesis Update

- **Midstream fundamentals has been largely consistent with the initial thesis, although performance has been stronger than expected**
- The space has benefited from structural improvements
- The energy sector has shifted from broadly out of favor to a more nuanced view
- Low valuations partially reverted
- In addition, Midstream benefited from some unexpected tailwinds over the past few years, including:
  - The largest inflation surge in 40 years
  - Energy security concerns following Russia/Ukraine war
- Two recent developments could provide further support for Midstream
  - Chevron decision and potential reduced regulatory headwinds
  - AI/data center energy demand

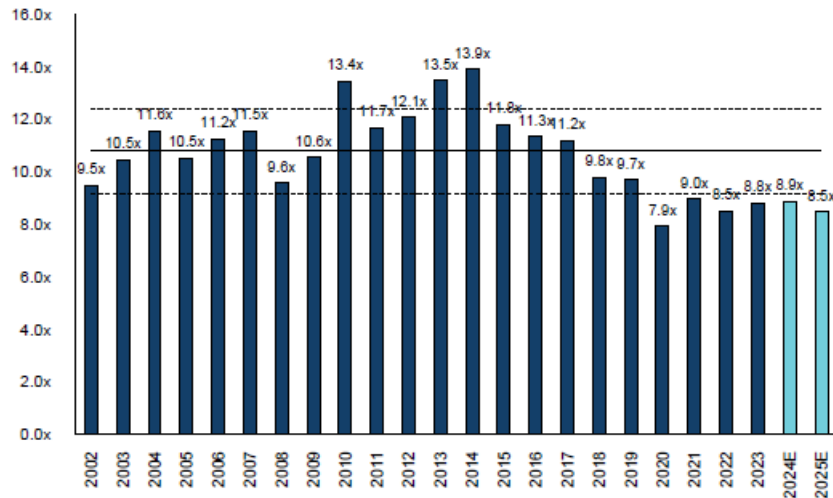
# Midstream Thesis Update, cont.

- Valuations for Midstream (MLPs + C-Corps) are slightly higher than 2020, but are still below historical levels
- Distribution coverage and leverage remain solid
- FCF strong, but below 2021-2022 levels
- Portfolio yield has declined from ~8% to ~6%

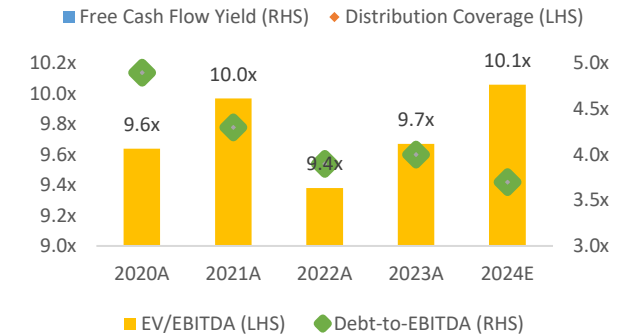
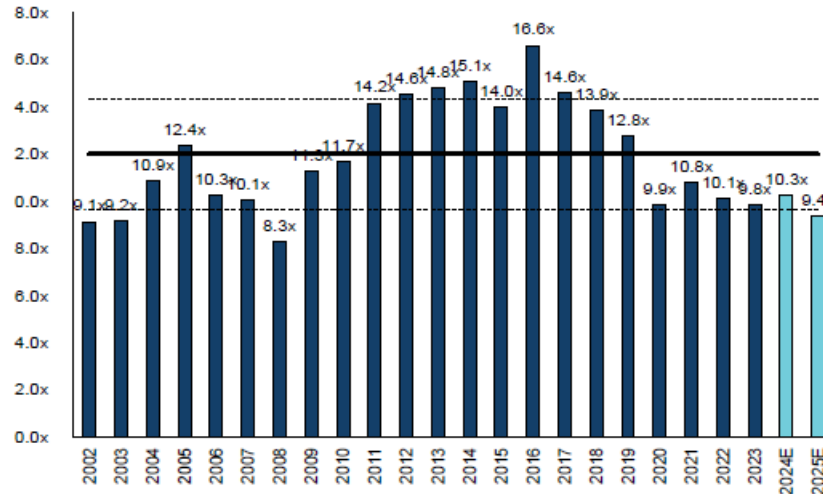
Year	Free Cash Flow Yield (RHS)	Distribution Coverage (LHS)	Debt-to-EBITDA (RHS)	EV/EBITDA (LHS)
2020A	6.0%	1.8x	4.9x	9.6x
2021A	8.4%	1.9x	4.3x	10.0x
2022A	8.8%	2.0x	3.9x	9.4x
2023A	6.4%	1.9x	4.0x	9.7x
2024E	6.0%	1.8x	3.7x	10.1x

Source: Wells Fargo.

MLP: EV / EBITDA



C-Corp: EV / EBITDA



# Midstream Thesis Update, cont.

- Midstream Total Return can be decomposed into component parts:
  - Total Return = Stock Price Change + Dividends
- Additionally, Stock Price Change can be further decomposed:
  - Stock Price Change = EPS Growth + P/E Multiple Change
- A full decomposition looks like:
  - Total Return = EPS Growth + P/E Multiple Change + Dividends
- Applying this framework to the Midstream Index Total Return provides:

## Decomposition of Midstream Index Returns

Analysis Period: June 30, 2020 - June 30, 2024 (4 years)

Midstream Index (a)	Total	CAGR
EPS Growth	77%	15.3%
P/E Multiple Expansion	33%	7.4%
Distributions	27%	6.1%
Total Return	137%	28.8%
P/E <sub>0</sub>	12.6X	
P/E <sub>1</sub>	16.8X	

(a) An approximation for the Midstream Index was utilized for this analysis—current Alerian Midstream constituents, truncated for holdings less than 1%; securities with negative earnings in 2020 are excluded

- This analysis shows that EPS growth was the primary driver of returns, followed by P/E expansion, and then dividends/distributions
  - P/E expansion as a driver of returns, is not considered sustainable as P/Es are limited and are generally a one-time driver of returns
  - That said, excluding P/E expansion, attractive returns potentially remain if EPS growth and Distributions persist
- It is interesting to note that while P/E expanded notably, EV/EBITDA expansion is muted
  - P/E is an equity only metric, while EV/EBITDA is a whole firm metric



# Considerations

- Initially the Midstream thesis was thought to be a 2-3 year opportunity—now 4 years in, does the opportunity persist? Should the allocation remain? If retained, how should it be sized?
- PIMCO, a hybrid (equity and debt) strategy was included as one of the two strategies in the Midstream allocation to control risk and volatility. However, the allocation, while adding value, has dragged on overall performance, while risk control benefits have been muted.
  - Should a replacement be considered?
  - Consider another equity only Midstream strategy—some candidate strategies had better performance and more attractive correlation benefit
- The traditional energy space has some strong fundamental tailwinds--should the Midstream allocation be converted to a broader energy mandate?

# Appendix

# Investment Strategies

Brookfield Concentrated Energy Infrastructure: A high conviction and high-octane portfolio that leans on the Brookfield Energy Infrastructure Securities' team's experience to identify and construct a concentrated portfolio of high-quality holdings that will performance well through market cycles. The Brookfield\_Concentrated Energy Infrastructure strategy is composed of high-quality assets, contact mix, strategic positioning, and management teams.

Cohen & Steers Midstream Energy & MLP Strategy: A strategy based on the thesis there is an inherent mispricing in the midstream energy space. Manager leverages its experience in the midstream space to identify mispricing in company fundamentals. The strategy typically holds 30-45 securities, creating a concentrated but high conviction portfolio which add values through active management.

Eagle Global Advisors MLP Quality Core: The MLP Quality Core strategy hones-in on businesses that have strong, stable, and sustainable business models, adding value through its security selection process. The strategy utilizes debt and equity to generate value, emphasizing a portfolio of limited but high-quality holdings.

Harvest Midstream & MLP Alpha: The Harvest thesis is grounded on the belief that there is a disconnect between current valuations in the midstream space and expectations of future growth. The fund identifies mispriced future energy infrastructure growth projects and valuation anomalies by leveraging its experiences as an operator as well as its close relationship with management teams to create a sustainable and additive portfolio.

Invesco SteelPath Focused MLP: The SteelPath Focused MLP strategy seeks to identify firms with the potential for long-term capital appreciation and attractive level of current income, investing in companies with healthy balance sheets, sustainable distributions, and strategically positioned for expansion. The strategy focuses on large-cap MLP names, specifically in the natural gas pipeline and petroleum transportation space.

Neuberger Berman Group LLC: A strategy that seeks to add value by identifying high yielding securities with attractive risk/return profiles, lower correlation to interest rate fluctuations, and an increasing distributions. Additionally, the strategy assesses management quality, capital structure, and asset quality in the portfolio construction process.

PIMCO MLP & Energy Infrastructure: MLP & Energy Infrastructure utilizes both equity and debt of mid-stream energy companies to maximize total return through four tenants, attractive secular growth, strong underlying assets and high barriers to entry, portfolio capital structure, and rigorous risk management.

Westwood Salient MLP & Energy Infrastructure: MLP & Energy Infrastructure is a strategy that is total return- oriented, seeking to provide high level of current income and capital appreciation through a focus on a broad range of energy infrastructure opportunities.

Tortoise Midstream MLP: The Midstream MLP strategy focuses on quality, growth, and yield. Investments are centralized around in long-haul, fee-based pipeline companies that generate stable, fee-based revenues with attractive growth potential and controlled risk.





**Date:** September 5, 2024  
**To:** Trustees, Investment Committee  
**From:** Daryn Miller, CFA, Chief Investment Officer  
Geoff Nolan, Senior Investment Officer  
Jack Bowman, Senior Investment Analyst  
Rafael A. Jimenez, Senior Investment Analyst  
**Subject:** **Fixed Income Manager Termination**

### RECOMMENDATION

Staff recommends the termination of Western Asset Management Company (“Western Asset” or “Manager”) from the Plan’s Fixed Income allocation. Western Asset is responsible for the management of two mandates, which include *Western Asset Core Plus* in the Core Fixed Income portfolio and *Western Asset High Yield* in the High Yield & Specialty Credit portfolio. Staff’s recommendation is consistent with the structural changes to the Fixed Income portfolio that were approved by the Board of Retirement in August 2023. Staff has arrived at this termination decision through an assessment of the investment characteristics of the Western Asset mandates relative to the target exposures following the approved restructuring. Western Asset has been subject to organizational changes in senior leadership and Staff believes it is prudent to terminate the manager in anticipation of the recomposition expected to take place over the following quarters.

### FIXED INCOME ANALYSIS & TRANSITION

In 2023, Staff undertook an analysis of the Fixed Income allocation with the purpose of measuring the efficacy of the portfolio to serve its role within the context of the broader Plan portfolio. Staff identified the objectives of the asset class, pursuant to the Investment Policy Statement (“IPS”), to be risk mitigation, liquidity, and portfolio diversification. Staff’s analysis demonstrated that the ability to meet the portfolio’s objectives could be enhanced through de-risking the portfolio.

In August 2023, the Board of Retirement approved an updated Strategic Asset Allocation which reflected structural shifts in the Fixed Income portfolio and revised the Fixed Income Policy Benchmark. The proposed changes relevant to the current investments with Western Asset include a transition from “Core Plus” mandates to “Core” and the replacement of “High Yield” credit mandates with dedicated Bank Loan and Securitized Product exposures. Changes to the Plan’s Strategic Asset Allocation (“SAA”) included an increase in the total target allocation to Fixed Income from 24% to 25% and the bifurcation of Fixed Income into “Core” and “Credit” allocations. The blended Fixed Income benchmark is detailed below:

Fixed Income	25.0%	Blend †
Core	15.0%	3% ICE BofAML 7-10 Year US Treasury Index 4% ICE BofAML US Treasury 10+ 4% Bloomberg Barclays US Aggregate Total Return Value Unhedged USD Index 4% Bloomberg US Corporate Credit 1-3 Year Index
Credit	10.0%	5% Securitized (50% Bloomberg Non-Agency CMBS Index; 33.33% Bloomberg ABS Index; 16.67% JP Morgan CLOIE AAA Index) 2.5% Morningstar LSTA Leverage Loan Index 2.5% JP Morgan Emerging Market Bond Index Global Diversified

Staff is currently conducting the necessary manager searches to fulfil the proposed Fixed Income changes and anticipates bringing manager recommendations to subsequent Investment Committee and Board of Retirement meetings.

**BACKGROUND**

**Western Asset Core Plus:** The Plan has maintained an investment in the strategy (“Core Plus”) since June 2004 and as of the end of Q2 2024, the market value of Core Plus was valued at \$85M and represented 1.5% of total Plan Assets. Western Asset’s investment process combines top-down and bottom-up analyses and begins with the Firm’s macro and credit investment outlook. The process is led by the US Broad Strategy Committee chaired by the Firm’s CIO, Michael Buchanan, and comprised of the Firm’s senior leaders. The committee, which formulates the Firm’s investment themes and strategies, has been subject to recent turnover including the departure of John Bellows and the leave of absence of former co-CIO, Kenneth Leech.

Core Plus is benchmarked to the Bloomberg US Aggregate Index, a market capitalization-weighted benchmark that measures the investment grade, US dollar-denominated taxable bond market. The index includes exposure to Treasury bonds, Agency bonds, and Corporate bonds that meet the minimum BBB rating threshold. The manager seeks to earn a premium above the benchmark while maintaining a level of risk that approximates the benchmark through interest rate duration, yield curve, sector allocation, country and currency strategies. In order to achieve its stated objective, the strategy allows for investments in high-yield, emerging markets and non-US-dollar denominated securities.

Staff believes that non-investment grade, emerging markets, and currency risk are not suitable for the “Core” mandate and is not aligned with the objective of risk reduction in the Fixed Income portfolio. Staff will seek to replace the strategy with a mandate that more closely resembles the composition and risk exposures of the Bloomberg US Aggregate Index.

**Western Asset High Yield:** The Plan has maintained an investment in the strategy (“High Yield”) since June 2005 and as of the end of Q2 2024, the market value of High Yield was valued at \$170M and represented 2.9% of total Plan Assets.

High Yield is benchmarked to the ICE Bank of America US High Yield Index, a market capitalization-weighted benchmark that tracks the performance of US dollar-denominated corporate debt rated below investment grade (BB and lower). The manager seeks to earn a premium above the benchmark over the course of a market cycle through issuer selection, quality positioning, and sector rotation.

Per the Strategic Asset Allocation and Fixed Income review, Staff will replace the broader allocation to High Yield fixed income with dedicated exposure to Bank Loans and an increased allocation to Securitized Products.

### **RECENT ORGANIZATION CHANGES**

Western Asset has had multiple senior leadership changes over the past year. In the fall of 2023, Western established a co-CIO structure, and in May 2023 the co-portfolio manager of the Core Plus strategy abruptly left the firm. Most recently, co-CIO Kenneth Leech went on a leave of absence after receiving an SEC Wells Notice. While the team has a deep bench of resources, the senior leadership changes over the past year are notable.

### **REINVESTMENT**

The Core Plus dollars will be transitioned to the passive Mellon Aggregate Bond Index Fund. The High Yield dollars will be transitioned to the Bank Loan investments following final Board approval in September/October.

