MEMORANDUM

PROPOSAL TO TRANSITION THE CURRENT ACTIVE INTERNATIONAL EQUITY PORTFOLIO TO PASSIVE MANAGEMENT

Submitted for: Action

Summary: At the end of 2016, ISAC investment staff began executing a transition of our International Equity (IE) asset class towards two commingled funds managed by Ativo Capital Management LLC (Ativo) and Dimensional Fund Advisors LP (DFA). The active strategies were benchmarked vs. MSCI ACWI ex US.

Below we have included brief summaries of both the current managers (Ativo and DFA) profiles for information purposes.

Ativo Capital Management LLC Profile

Ativo Capital Management LLC (Ativo) was founded in 2001 and is a registered investment advisor with a goal of delivering top quartile performance and exceptional service to institutional clients. They follow a rules-based process that combines quantitative methodologies with a fundamental overlay to build long-only, high active share portfolios. They invest globally, with an emphasis on international markets. Central to their approach is a proprietary model that scores stocks based on our assessment of their intrinsic value, price momentum and other important factors.

Dimensional Fund Advisors LP Profile

Since 1981, Dimensional Fund Advisors LP has sought to provide better investment outcomes for clients through a transparent, rules-based approach that combines the knowledge gained from rigorous theoretical and empirical research with thoughtful and effective implementation. Dimensional has developed an array of investment solutions across a broad range of asset classes and geographic regions, all based on a single philosophy and implemented through an integrated, process-driven approach. DFA's portfolio is tilted towards value and small cap premias as their historical research shows that both premias tend to outperform over the long-term.

In the following table we can see the trailing performance summary since inception for each manager as well as the composite for the IE asset class.

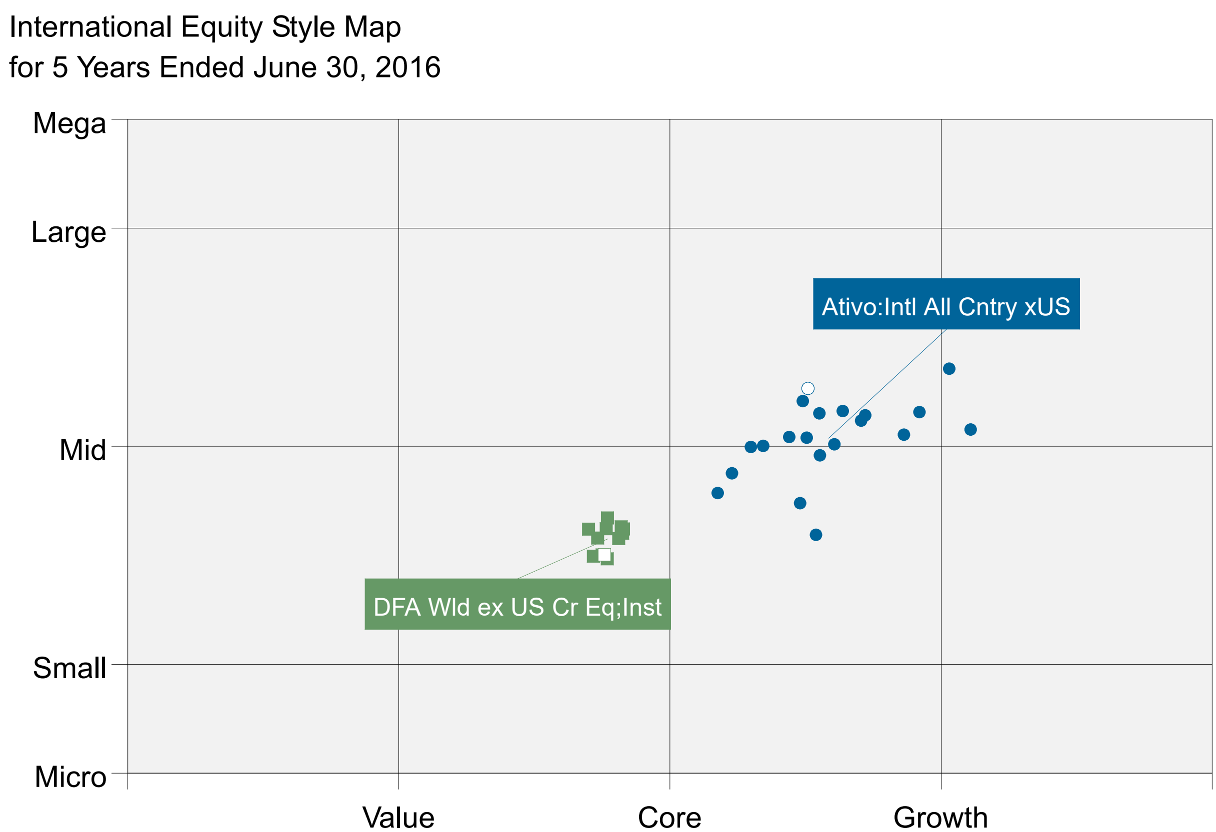
<u>Performance Summary net of fees through 03/31/23</u>

	As of	Last 3 months	1-year	3-years	5-years	Inception to date	Inception date
Ativo ACWI ex US	03/31/23	5.25%	-11.46%	8.73%	1.25%	4.06%	01/31/17
MSCI ACWI ex US GD	03/31/23	7.00%	-4.56%	12.32%	2.97%	5.77%	
DFA	03/31/23	6.63%	-4.23%	16.18%	2.40%	5.60%	01/31/17
MSCI ACWI ex US GD	03/31/23	7.00%	-4.56%	12.32%	2.97%	5.77%	
Ativo/DFA composite	03/31/23	5.95%	-7.85%	12.35%	1.79%	4.82%	01/31/17
MSCI ACWI ex US IMI GD	03/31/23	6.70%	-5.07%	12.82%	2.89%	5.80%	

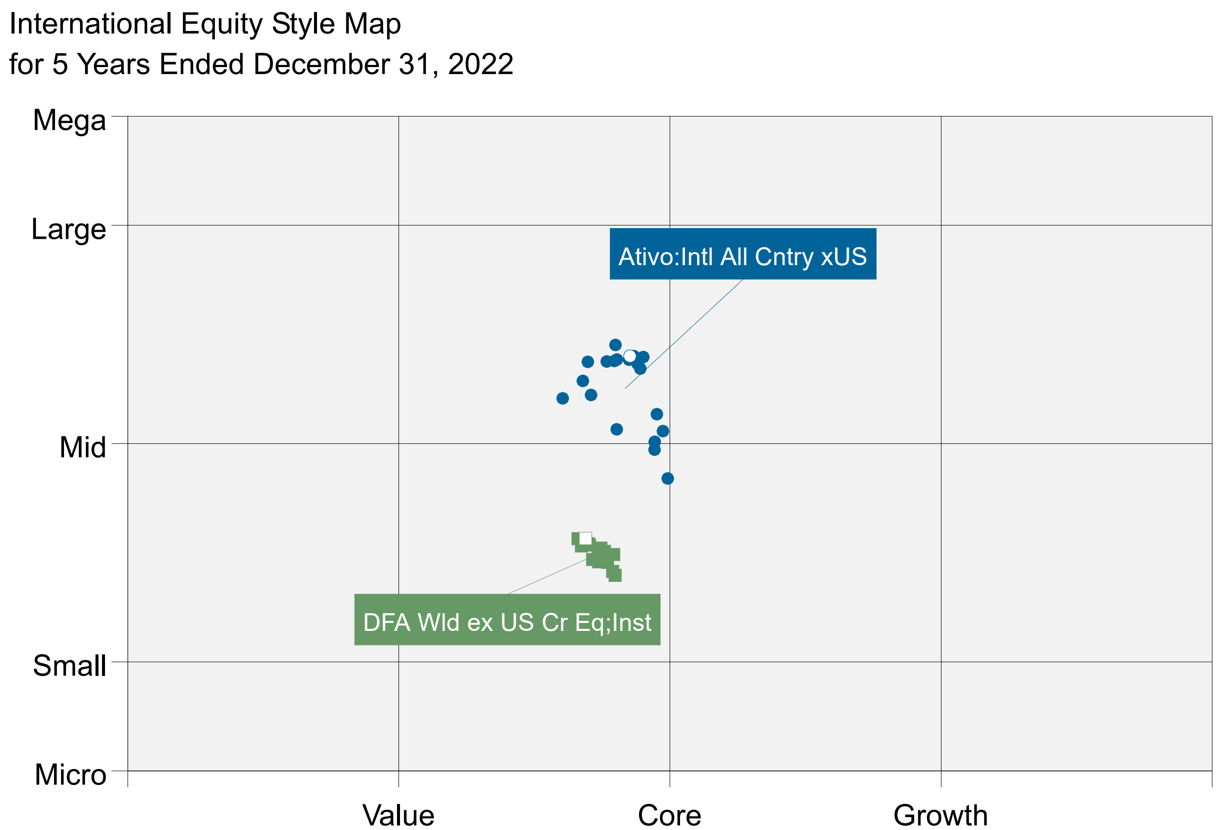
As you can see in the table above DFA (+5.60%) has performed in line with the benchmark (+5.77%) as well as the risk premias in which their strategy is based since inception through 03/31/23. Ativo (4.06%) has lagged the index (+5.77%) since inception as their quantitative model has struggled over the past few years, which has become a concerning factor for investment staff. Because of Ativo's performance lag the IE composite portfolio (+4.82%) has underperformed the MSCI ACWI ex US IMI (+5.80%) by approximately 1% since inception. Because of this underperformance, we would normally recommend to place Ativo on watch or to move forward to replace them with a new manager in the existing strategy, but in this case, we are choosing to take a broader perspective to optimize the portfolio.

Overtime we have been simplifying the portfolio given the College Illinois! (CI) winddown scenario and believe this is a good moment to continue the path to simplification as the trust fund assets are expected to decrease by approximately 40% over the next two fiscal years. Because of the fund's limited remaining life, we believe going passive for the IE asset class is the most sensible approach to avoid taking unnecessary tracking error risk going forward, as we might not have enough time to recover given our situation. Furthermore, this should provide further assurance that we are not going to increase the fund's current deficit due to potential active management underperformance. Another advantage of transitioning the IE portfolio to passive management is the extremely low-cost relative to the higher expense we incur with the current active management.

At the time of hiring Ativo and DFA in 2016 they had shown to have different styles overtime, which we thought was a good complement from a diversification standpoint within the asset class. You can see the details in the style map below.



Over the years we have noticed that Ativo's profile has shifted from growth into value and DFA's portfolio is already tilted towards value and small cap premias. Because of that we believe that the diversification benefits from a style standpoint are no longer as valid as previously envisioned. You can see the details in the style map below.



Therefore, based on the rationale provided above, we are recommending transitioning the International Equity asset class to passive management. The passive management approach would result in the replacement of both Ativo and DFA with a passive international equity fund managed by Rhumbline Advisers LP. Rhumbline Advisers is a current manager of the trust fund and they have managed our Domestic Equity asset class passive strategies since July 2009. The firm has performed an excellent job overtime, so we expect to see an excellent management of this additional strategy too. Investment staff will work with the current managers (Ativo, DFA and Rhumbline) to ensure we have a smooth transition to the new investment commingled fund while minimizing costs and managing risks. Rhumbline is in the process of setting up this new commingled fund which should be ready in about 3 months. We are also including Rhumbline Advisers brief summary below for information purposes. Furthermore, agenda item 6B provides a comprehensive profile of Rhumbline's ACWI ex US strategy for representation purposes.

<u>Rhumbline Advisers LP Profile</u>

RhumbLine Advisers is a Boston-based institutional investment firm specializing in the development, management and customization of index-based products. A Massachusetts Limited Partnership, RhumbLine is 100% owned by current and former employees of the firm.

RhumbLine Advisers registered with the SEC on April 20, 1990. Incorporating in October 1990, the firm began managing U.S. tax-exempt assets in December 1990. RhumbLine's mission is to offer clients index tracking and competitive fees while providing responsive, flexible and comprehensive client service. A key driver of the firm's success is its focus on remaining a dedicated asset-manager specializing in passive index-based products without the distraction of offering other services such as securities lending, participant recordkeeping or actively managed products. RhumbLine maintains a simple, non-hierarchical organizational structure to increase its accessibility for clients, and enhance its ability to provide attentive service.

Our investment consultant Callan LLC was engaged thoroughly in the International Equity asset class review process and is supportive of the portfolio simplification recommendation of ISAC investment staff.

We presented in detail this memorandum at the May 25, 2023, Investment Committee meeting. The Investment Committee reviewed and approved unanimously the transition to passive management recommended by investment staff and investment consultant.

Action Requested: That the Commission approves the Investment Committee recommendation to transition the International Equity portfolio to a passive commingled fund managed by Rhumbline Advisers benchmark against the MSCI ACWI ex US.