

MEMORANDUM

FROM: Carmen Heredia, CFA, ISAC CIO
TO: ISAC Investment Committee
DATE: November 15, 2021
SUBJECT: Garcia Hamilton Review

During the Investment Committee meeting of May 28, 2020, we reviewed the market performance of the College Illinois! investment managers. We presented a lengthy review of Garcia Hamilton & Associates (Garcia Hamilton or GH) and recommended that the investment manager not be placed on the Watch List at that time. We have provided updates and discussion of their performance at each Investment Committee/Commission Meeting since then.

Today, we update our review of Garcia Hamilton and recommend that the manager be placed on Watch List status.

This memo details our evaluation of Garcia Hamilton due to the ongoing underperformance. We reviewed the guidelines that are included in our Statement of Investment Policy and analyzed and evaluated the manager's performance along with relevant investment statistics.

I. STATEMENT OF INVESTMENT POLICY, Manager evaluation and review section
“Investment Staff and the Investment Consultant will evaluate each investment manager from a qualitative and quantitative standpoint on a quarterly basis.

Qualitative factors include, but are not limited to, the following.

- Ownership changes or departure of key personnel.
- Assets under management at the firm and product level.
- Conflicts of interest.
- Changes in investment strategy or process.
- Material litigation or regulatory challenges involving the investment manager.
- Material client-servicing problems.
- Minority brokerage utilization.

Quantitative Review

Long-term performance standards should measure an investment manager's performance from inception and on *a rolling five-year returns basis in relation to a broad market index or indices that the investment manager previously agreed to be measured against*. If an investment manager fails to generate a return premium in excess of the agreed-upon index or indices, then the CIO and Investment Consultant shall conduct due diligence and make a recommendation to the Investment Committee as to the appropriate action to take.

Shorter-term performance will be measured in relation to an appropriate style index and “Peer Group.” Each investment manager is to be measured against the median return of a peer group of investment managers with similar investment styles.

Managers are expected to maintain their stated investment style and philosophy. Quantitative measures of investment style and philosophy include style mapping, style attribution analysis, and

tracking error relative to the benchmark. The Investment Consultant will report these factors on a quarterly basis.

Watch List Procedure and Criteria

A number of factors may contribute to a manager's over- or under-performance at any given time – market dynamics, investment skill, and/or pure chance. ***Given this uncertainty, it is unwise to mandate termination purely for lagging performance at any specific point.*** A Watch List will be utilized to identify managers of concern, due to performance or other issues.

The Watch List shall be considered at each meeting of the Investment Committee. Investment Staff may recommend managers to be included on or removed from the Watch List. A manager may be recommended for the Watch List based on the qualitative or quantitative criteria described above or in the applicable guidelines or statement of work (SOW). Watch List managers will be closely monitored and scrutinized. Watch List managers may not receive new contributions (including rebalancing) without the approval of the Investment Committee.”

II. GARCIA HAMILTON REVIEW & EVALUATION

A. PERFORMANCE AND PEER GROUP ANALYSIS

Garcia Hamilton is one of our fixed income managers that focuses on the preservation of principal while maintaining high current income. We hired them on September 30, 2016 to manage our **Fixed Income Intermediate Govt./Credit strategy**; the benchmark is the Bloomberg Intermediate Government/Credit Index. **Garcia Hamilton's goal is to outperform the benchmark net of fees with higher credit quality, lower risk, and less volatility.** The strategy uses a top-down approach with both qualitative and quantitative components. The manager only invests in select high quality issues of Treasuries, agency debentures, agency MBS and corporate securities rated A- or better. The primary factors for adding relative value to the portfolio are interest rate management, sector rotation and yield curve management.

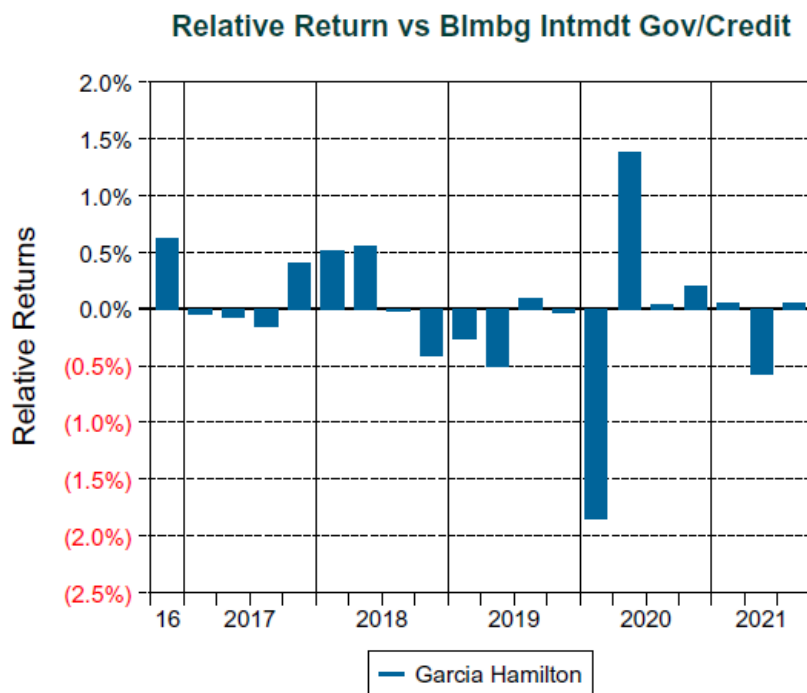
We have included an exhibit that shows a detailed profile of the manager for information purposes, which was prepared by our consultant Callan LLC.

Garcia Hamilton's relative performance over time has been strong and has typically ranked top decile among peers. Since our initial investment, ISAC investment staff had been pleased with the manager portfolio positioning and duration management through September 2018, which had resulted in strong outperformance. During the 4th quarter of 2018, GH faced headwinds due to the Federal Reserve and market expectations that were indicating a gradual shift to lower rates. GH's portfolio positioning and investment thesis were that interest rates would continue moving higher due to strong economic indicators. Thus, the portfolio's short duration position ended up hurting performance (-0.65% excess return) in December 2018 as interest rates started to decrease (10-year Treasury rate dropped from 3.01% as of 11/30/18 to 2.69% as of 12/31/18). However, GH still outperformed for the 2018 calendar year.

Since then we have seen a continued deterioration of relative performance driven by the same factor (lower interest rates hurt portfolio performance due to the short duration positioning) as interest rates continued to decrease during the period (10-year Treasury rate dropped from 2.69% as of 12/31/18

to 0.70% as of 3/31/20). The Federal Reserve is still taking an accommodative stance and the 10-year Treasury stood at 1.49% as of 9/30/21.

The chart below shows ISAC’s quarterly performance since inception experience with GH’s Fixed Income Intermediate Govt./Credit strategy versus the benchmark, the Bloomberg Intermediate Government/Credit Index.



The table below presents the strategy’s calendar year performance along with the current calendar year-to-date performance. **From this data, we note that Garcia Hamilton has underperformed net-of-fees on a calendar year basis for all but one year, 2018.** To the right of the performance numbers, in italics, are the peer ranking number for their peer universe as compiled by Callan, our investment consultant. A rank of 1 is best while 100 is worst in the peer group. **We note that their ranking has dropped to near bottom for calendar years 2019, 2020 and year-to-date 2021.**

Account	CYTD				
	09.30.21	2020	2019	2018	2017
ISAC's GH account (gross of fees)	-1.34	6.18	6.08	1.53	2.27
ISAC's GH account (net of fees)	-1.48	5.97	5.88	1.35	2.12
Index: Blmbg Intmdt Gov/Credit	-0.87	6.43	6.80	0.88	2.14
Excess Return using gross of fees	(0.47)	(0.25)	(0.72)	0.65	0.13
Excess Return using net of fees	(0.61)	(0.46)	(0.92)	0.47	(0.02)

Source: Callan

Since ISAC hired Garcia Hamilton on Sept. 30, 2016, we do not have much long-term performance numbers [*a rolling five-year returns basis in relation to a broad market index or indices that the investment manager previously agreed to be measured against.*] that we can measure them against as referenced in our Statement of Investment Policy. The next best analysis we can use is:

- 1) The strategy's composite rolling 5-yr returns versus the benchmark and versus its peers (Callan universe), a composite represents all accounts managed by the firm in a similar strategy in which ISAC invests,
- 2) ISAC's portfolio rolling 3-yr returns versus the benchmark and versus its peers (Callan universe),
- 3) Compare the growth of a dollar for ISAC's tenure and the Intermediate Govt/Credit composite.

1) Composite rolling 5-yr return analysis

Determination: Observing various end dates with rolling 5-yr returns vs the strategy's benchmark we show that the sizeable 1Q20 underperformance (-185bps) has deeply affected GH's longer-term performance. The 1Q20 quarter turned the rolling 5 yr. outperformance to an underperformance (-16bps). Most recently as of 2Q21 and 3Q21, the rolling 5 yr. performance has turned negative once again.

Rolling 5 yr period ended:	30-Sep-21	30-Jun-21	31-Mar-21	31-Dec-20	30-Sep-20	30-Jun-20	31-Mar-20
ISAC's GH account (gross of fees)	2.61% 79						
GH FI Interm Govt/Credit Composite	2.49% 87	2.55% 87	2.75% 83	3.73% 74	3.47% 77	3.68% 49	2.60%
Index: Blmbg Intmtdt Gov/Credit	2.60 80	2.63 80	2.75 83	3.64 79	3.39 81	3.46 80	2.76
Actual Excess Return (gross of fees)	0.01						
Excess Return using composite	(0.11)	(0.08)	0.00	0.09	0.08	0.22	(0.16)

Source: Callan

2) ISAC's portfolio rolling 3-yr return analysis

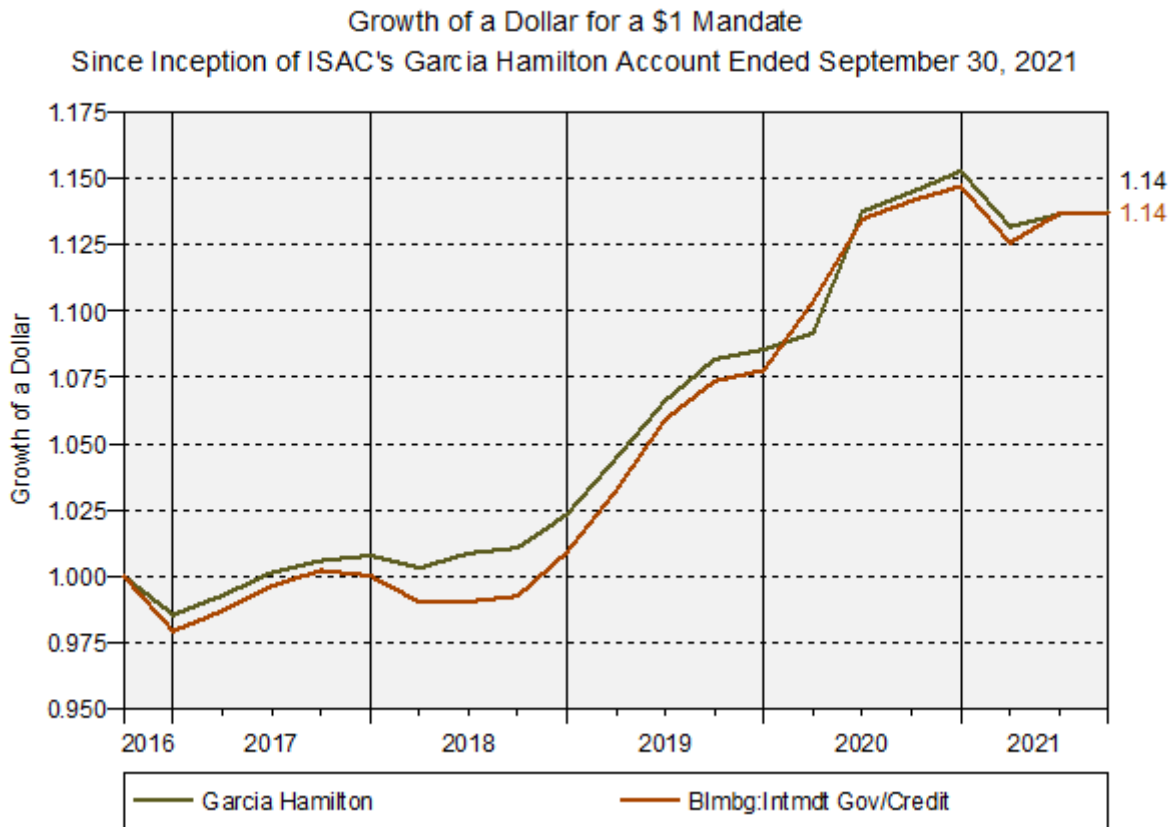
Determination: Garcia Hamilton is a newer manager with ISAC versus our other two fixed income managers whose inception year is 2013. However, we have started to get 5 yr. rolling performance numbers. The rolling 3 yr. rolling performance numbers are a medium-term gauge of their longer-term stature. The conclusion here is that their performance started lagging at the end 2018 and into 2019. Then came the significant 1Q20 underperformance (-185 bps) that worsened the rolling 3-yr underperformance. Since then, GH has not been able to turn around the underperformance. Further, it considerably affected GH's peer ranking.

Rolling 3 yr period ended:	30-Sep-21	30-Jun-21	31-Mar-21	31-Dec-20	30-Sep-20
ISAC's GH account (gross of fees)	4.01% 95	4.05% 95	4.10% 88	4.57% 81	4.41% 79
ISAC's GH account (net of fees)	3.81% 96	3.85% 96	3.91% 96	4.38% 92	4.21% 89
Index: Blmbg Intmtdt Gov/Credit	4.63 73	4.70 75	4.36 76	4.67 80	4.43 78
Excess Return using gross of fees	(0.62)	(0.65)	(0.26)	(0.10)	(0.02)
Excess Return using net of fees	(0.82)	(0.85)	(0.45)	(0.29)	(0.22)
Rolling 3 yr period ended:	30-Jun-20	31-Mar-20	31-Dec-19	30-Sep-19	
ISAC's GH account (gross of fees)	4.33% 85	3.21% 89	3.27% 81	2.66% 46	
ISAC's GH account (net of fees)	4.14% 95	3.04% 97	3.10% 89	2.49% 70	
Index: Blmbg Intmtdt Gov/Credit	4.43 83	3.79 51	3.24 84	2.40 86	
Excess Return using gross of fees	(0.10)	(0.58)	0.03	0.26	
Excess Return using net of fees	(0.29)	(0.75)	(0.14)	0.09	

Source: Callan

3) Growth of a dollar comparison:

The chart below is ISAC's experience since inception with Garcia Hamilton. We note that the performance is benchmark like.



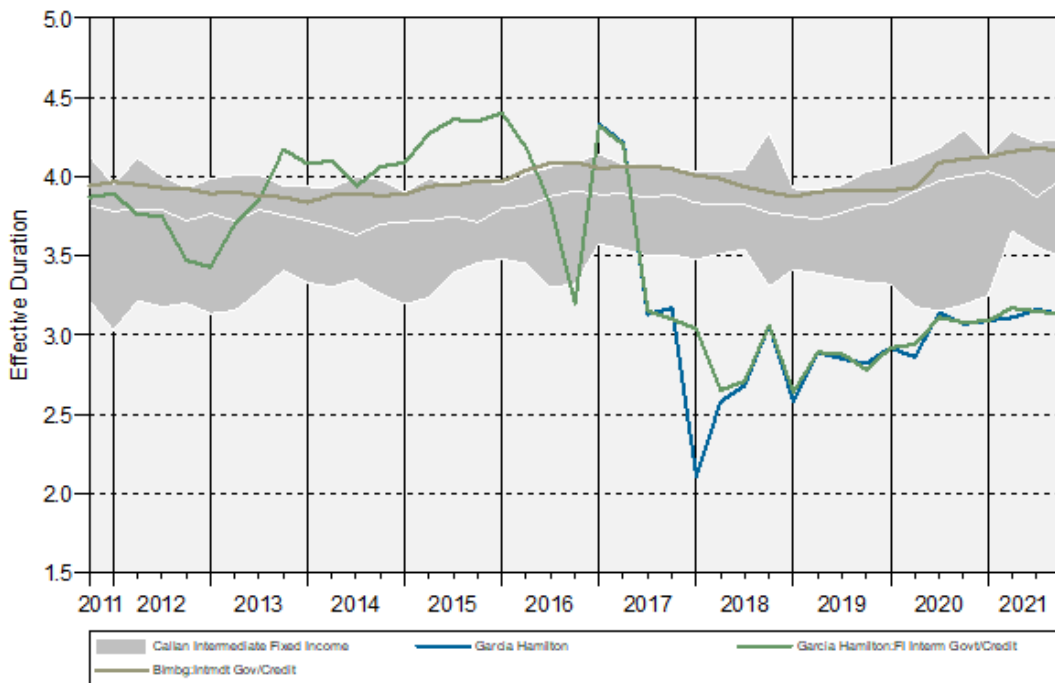
B. INVESTMENT PHILOSOPHY AND INVESTMENT STATISTICS

As noted, Garcia Hamilton's strategies (including the ISAC mandate strategy of Intermediate Government/Credit) employ a top-down approach with both qualitative and quantitative components. In constructing its portfolios, the firm sets target portfolio ranges for duration, yield curve, sector allocation, and sector duration contribution. As a result of its top-down approach, sector and security weightings are more a by-product of the target portfolio composition rather than a driving force in portfolio construction. To manage risk, the Intermediate Government/Credit strategy has maximum and minimum ranges for the main sectors [0-75% for Treasuries, 0-50% for Agencies, 0-50% for mortgage backed securities, and 0-65% for corporate bonds]. In addition, GH manages risk by investing in high-quality securities.

Determination: The investment philosophy of Garcia Hamilton has not deviated, however the investment thesis in place has not played out to their advantage. They have admitted that their thesis has delivered inconsistent returns at best in the shorter-term periods. The performance was negatively impacted by reducing their credit exposure too soon (3Q20 to 1Q21). The portfolio management team has strong conviction that the US economy remains fundamentally strong. Therefore, they have kept a short duration stance with the belief of rising interest rates

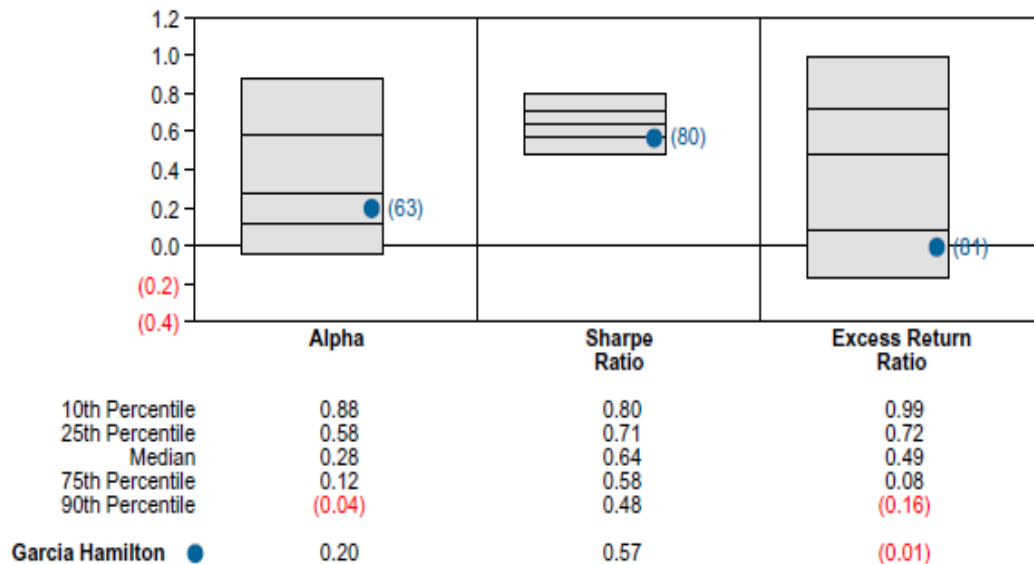
sooner than market expectations (see chart below). They have not deviated from their investment philosophy or thesis.

Effective Duration
for 10 Years Ended September 30, 2021



INVESTMENT STATISTICS: Typically, the minimum time frame for the calculations and use of investment performance statistics is 5 yrs. ISAC’s account just achieved the 5 yr. mark and below are the 5 yr. statistics:

**Risk Adjusted Return Measures vs Blmbg Intmtd Gov/Credit
Rankings Against Callan Intermediate Fixed Income (Gross)
Five Years Ended September 30, 2021**



1. **Sharpe Ratio*** – For the latest 5-yr period, Garcia Hamilton’s Sharpe ratio is positive, but it is below the median of its peer group.

**Note: The Sharpe ratio is a commonly used measure of risk-adjusted return. It is calculated by subtracting the risk-free return (usually the 3-month Treasury bill) from a portfolio’s return and then dividing this excess return by the portfolio’s total standard deviation (a measure of portfolio volatility, or risk). The ratio thus represents the return gained per unit of risk taken.*

2. **Excess Return Ratio** – The Excess Return Ratio is a measure of risk-adjusted relative return. This ratio captures the amount of active management performance (value added relative to an index) per unit of active management risk (tracking error against the index). It is calculated by dividing the manager’s annualized cumulative excess return relative to the index by the standard deviation of the individual quarterly excess returns. **The Excess Return Ratio can be interpreted as the manager’s active risk/reward tradeoff for diverging from the index.**

Result: The excess return ratio turned negative as of March 31, 2020 for the GH Intermediate government/credit composite. As of 9/30/21, ISAC’s actual 5 yr. excess return ratio is negative and at the 81st percentile. A negative excess return is not desirable.

Determination: Based on the statistics, Garcia Hamilton is at the bottom half of its peer group universe and is delivering a negative excess return versus its benchmark Bloomberg Intermediate Government/Credit Index.

III. RECOMMENDATION

Reviewing the quantitative factors (relative performance, peer group rankings and other quantitative measures) we get a consistent picture of underperformance for medium term (3 yr.) and longer-term period (5 yr.). Additional factors to consider are the qualitative factors such as, but not limited to, personnel turnover, ownership changes, deviation from investment philosophy, business risk, etc. Staff and Callan do not have qualitative factor concerns on Garcia Hamilton. The magnitude and length of the underperformance, relative to their benchmark and peer ranking, warrant the recommendation for Garcia Hamilton to be placed on the Watch List.

Recommendation

Investment staff recommend Garcia Hamilton for addition to the Watch List.

AGENDA ITEM 3.
CALLAN PROFILE FOR GARCIA

Garcia Hamilton

Period Ended September 30, 2021

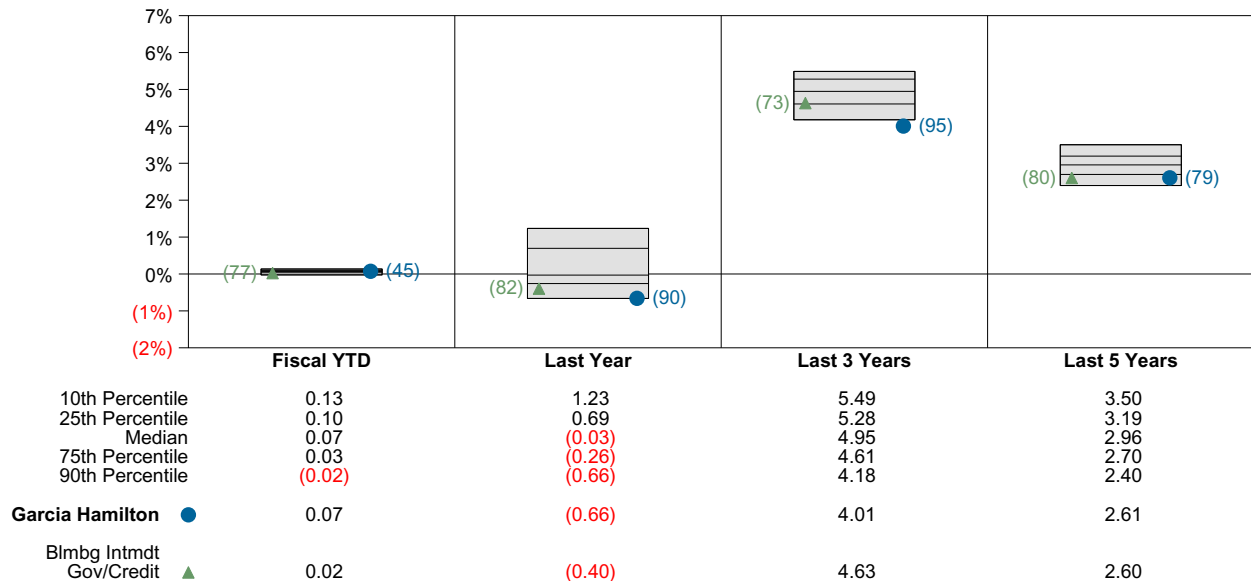
Investment Philosophy

Garcia Hamilton's fixed income philosophy focuses on the preservation of principal while maintaining high current income. Their goal is to outperform benchmark indices with higher credit quality, lower risk and less volatility. Garcia Hamilton believes that intermediate maturities capture the bulk of the yield of long maturities but with significantly less price volatility. Thus, their strategy primarily utilizes intermediate securities with a maturity or average life between 2 and 10 years to limit volatility. Garcia Hamilton only invests in high quality issues. The corporate bonds they purchase are from issuers rated a minimum of Single "A" by the major rating services. They do not purchase non-dollar denominated bonds, Yankees, high yield securities, zero-coupon bonds or derivatives. Thus, Garcia Hamilton adds value to their portfolios through interest rate anticipation and sector rotation. With sector rotation, they will aggressively underweight or overweight sectors to increase the yield of their portfolios. Funded in 4Q 2016. Returns prior are of the composite.

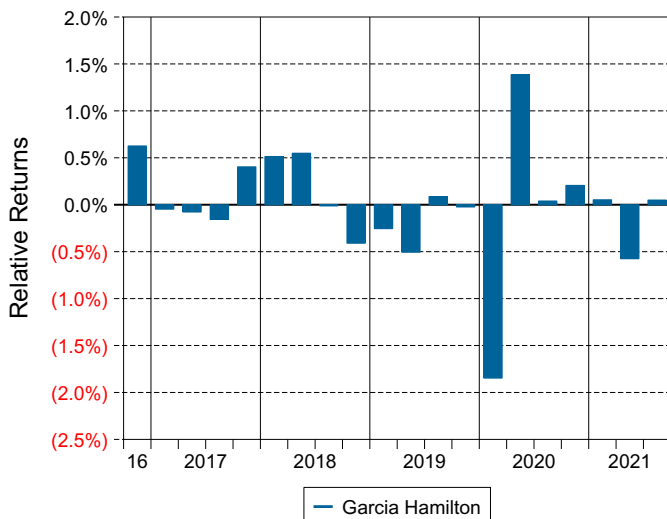
Quarterly Summary and Highlights

- Garcia Hamilton's portfolio posted a 0.07% return for the quarter placing it in the 45 percentile of the Callan Intermediate Fixed Income group for the quarter and in the 90 percentile for the last year.
- Garcia Hamilton's portfolio outperformed the Blmbg Intmtd Gov/Credit by 0.05% for the quarter and underperformed the Blmbg Intmtd Gov/Credit for the year by 0.26%.

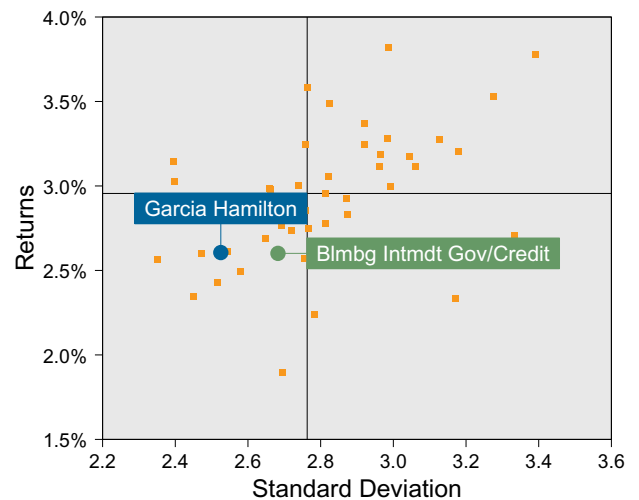
Performance vs Callan Intermediate Fixed Income (Gross)



Relative Return vs Blmbg Intmtd Gov/Credit



Callan Intermediate Fixed Income (Gross) Annualized Five Year Risk vs Return

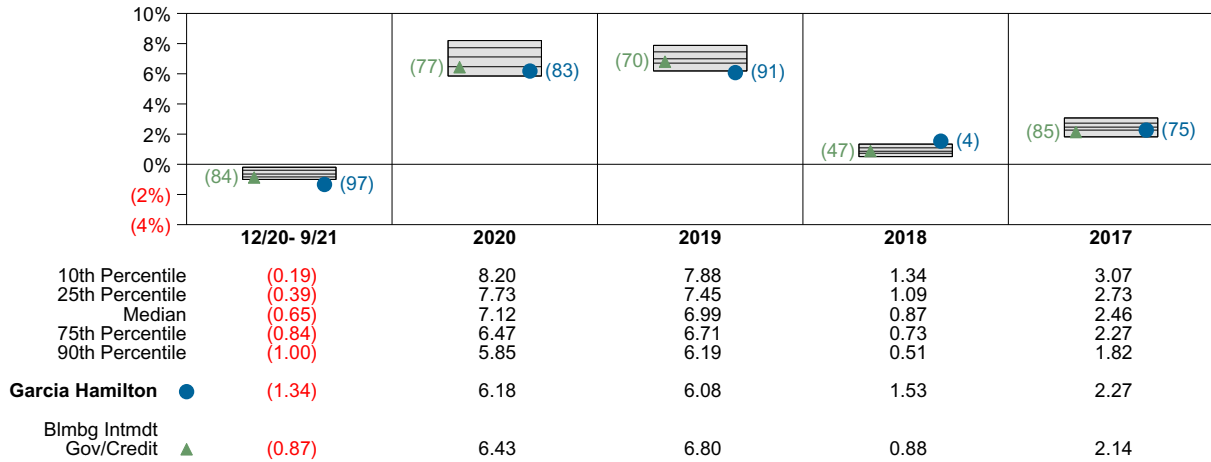


Garcia Hamilton Return Analysis Summary

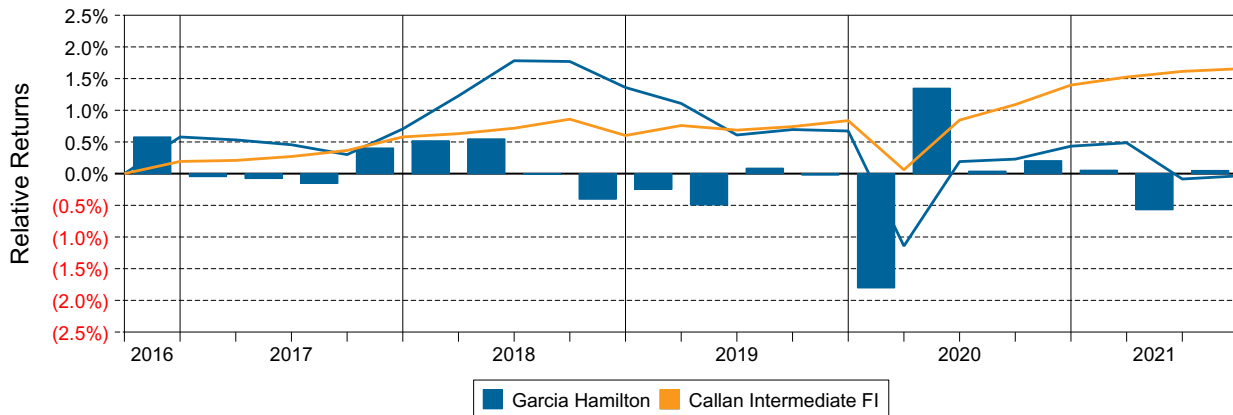
Return Analysis

The graphs below analyze the manager's return on both a risk-adjusted and unadjusted basis. The first chart illustrates the manager's ranking over different periods versus the appropriate style group. The second chart shows the historical quarterly and cumulative manager returns versus the appropriate market benchmark. The last chart illustrates the manager's ranking relative to their style using various risk-adjusted return measures.

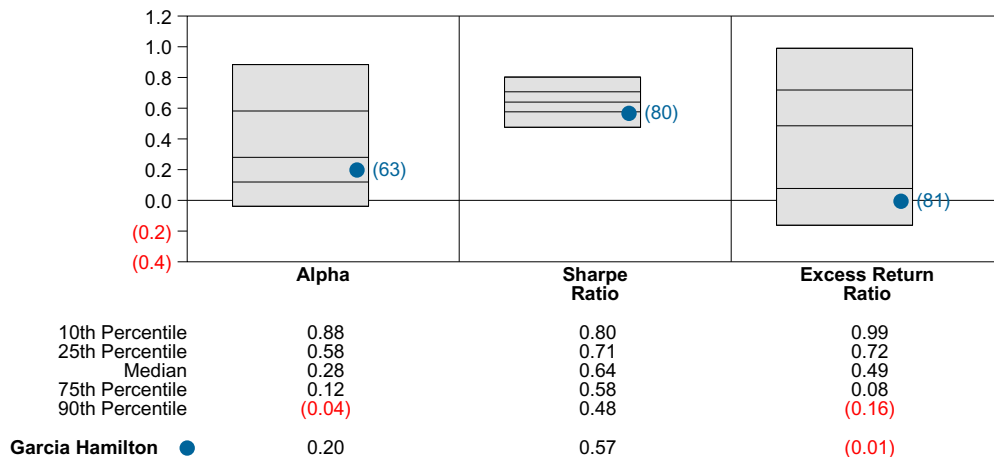
Performance vs Callan Intermediate Fixed Income (Gross)



Cumulative and Quarterly Relative Return vs Bmbg Intmtd Gov/Credit



Risk Adjusted Return Measures vs Bmbg Intmtd Gov/Credit Rankings Against Callan Intermediate Fixed Income (Gross) Five Years Ended September 30, 2021

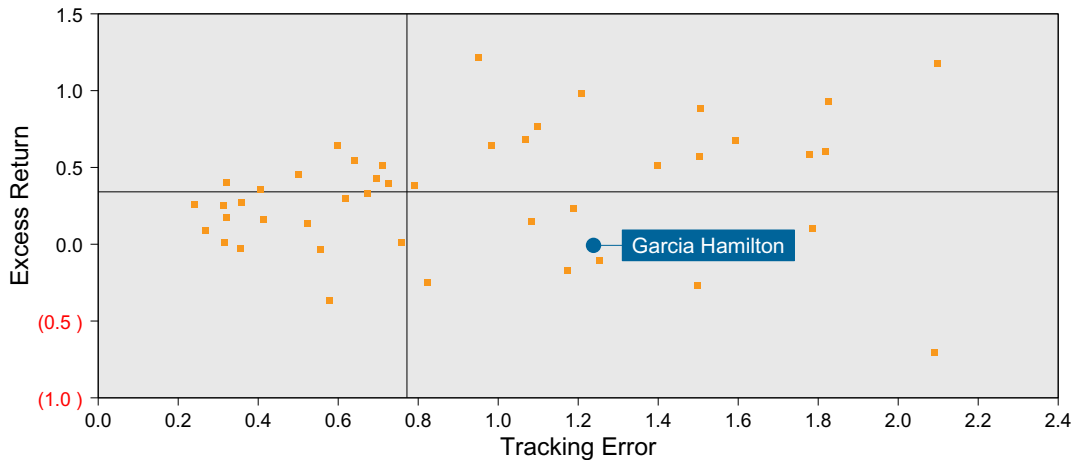


Garcia Hamilton Risk Analysis Summary

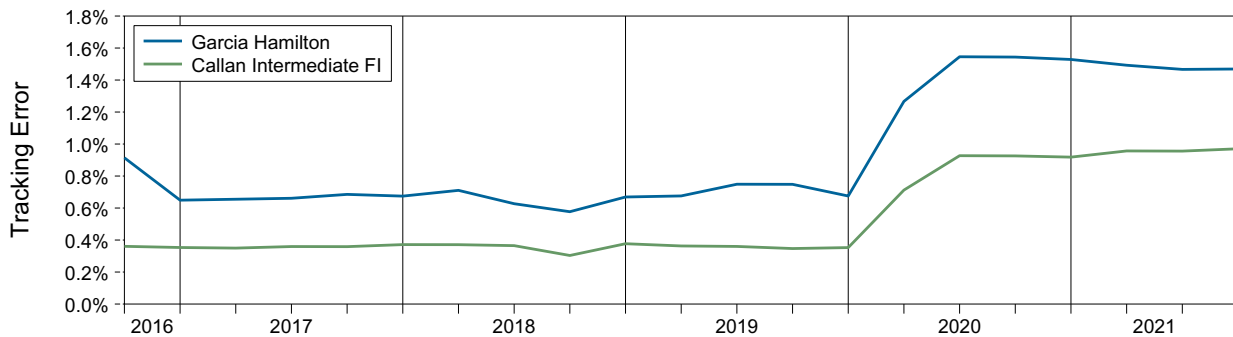
Risk Analysis

The graphs below analyze the risk or variation of a manager's return pattern. The first scatter chart illustrates the relationship, called Excess Return Ratio, between excess return and tracking error relative to the benchmark. The second chart shows tracking error patterns versus the benchmark over time. The last two charts show the ranking of the manager's risk statistics versus the peer group.

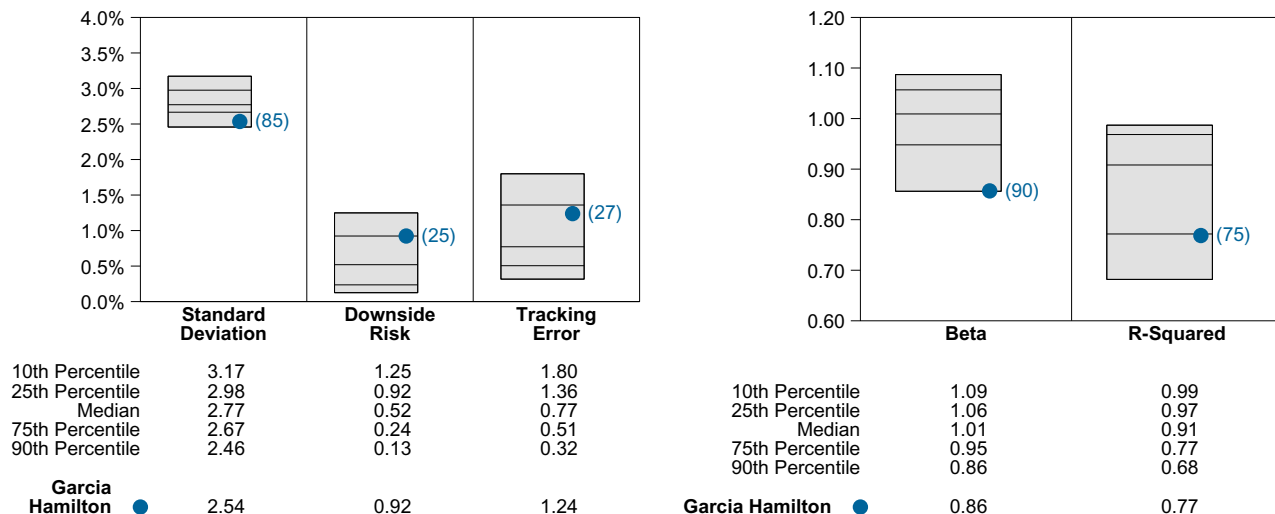
Risk Analysis vs Callan Intermediate Fixed Income (Gross) Five Years Ended September 30, 2021



Rolling 12 Quarter Tracking Error vs Bloomberg Intmtd Gov/Credit



Risk Statistics Rankings vs Bloomberg Intmtd Gov/Credit Rankings Against Callan Intermediate Fixed Income (Gross) Five Years Ended September 30, 2021

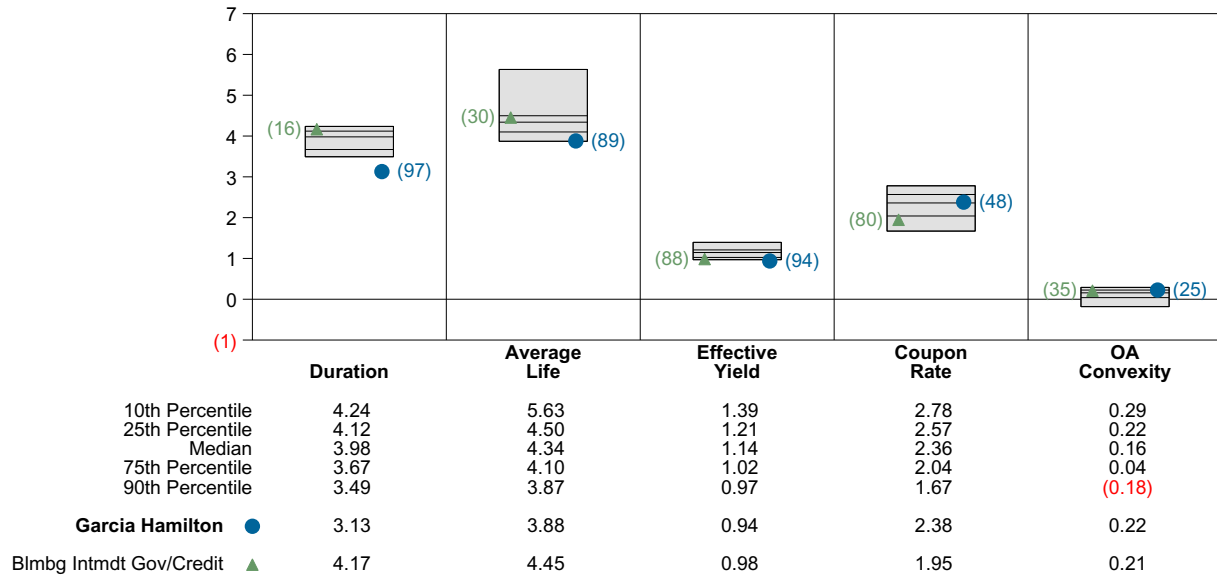


Garcia Hamilton Bond Characteristics Analysis Summary

Portfolio Characteristics

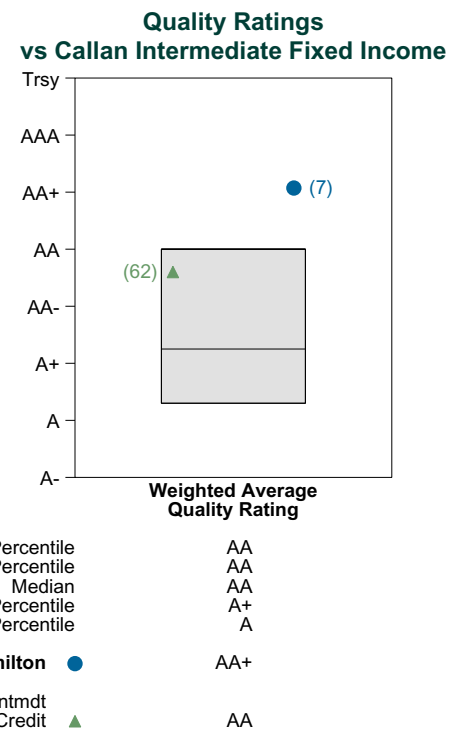
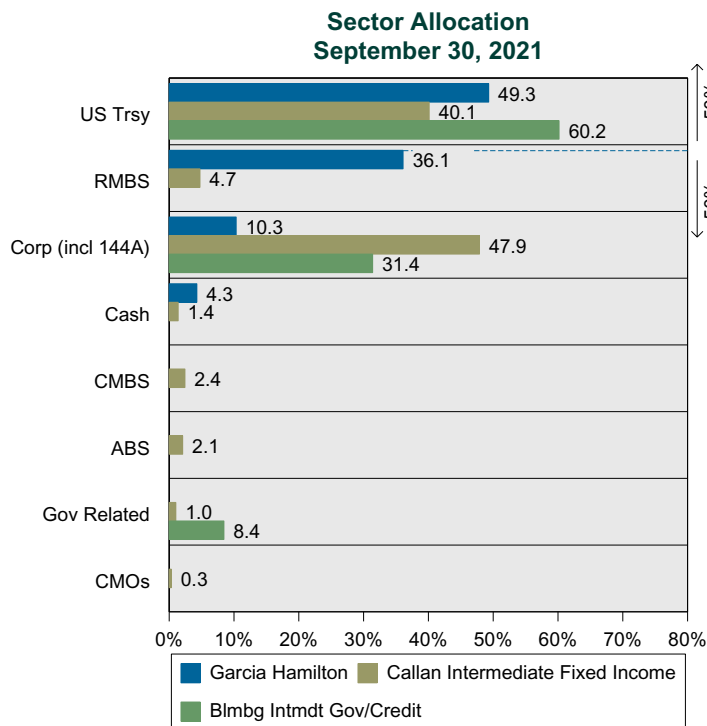
This graph compares the manager's portfolio characteristics with the range of characteristics for the portfolios which make up the manager's style group. This analysis illustrates whether the manager's current holdings are consistent with other managers employing the same style.

Fixed Income Portfolio Characteristics Rankings Against Callan Intermediate Fixed Income as of September 30, 2021



Sector Allocation and Quality Ratings

The first graph compares the manager's sector allocation with the average allocation across all the members of the manager's style. The second graph compares the manager's weighted average quality rating with the range of quality ratings for the style.

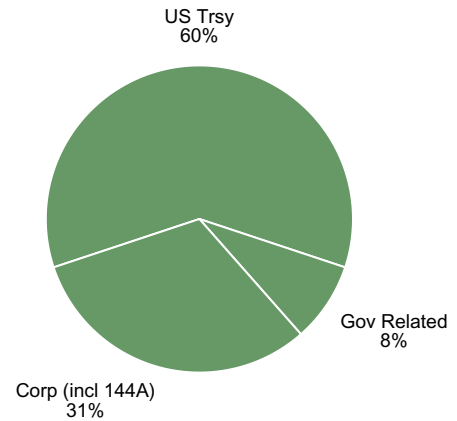
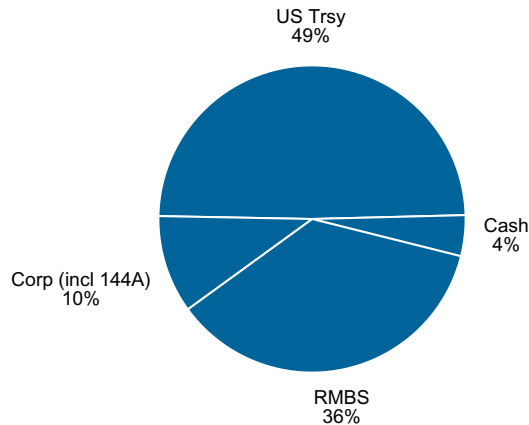


Garcia Hamilton Portfolio Characteristics Summary As of September 30, 2021

Portfolio Structure Comparison

The charts below compare the structure of the portfolio to that of the index from the three perspectives that have the greatest influence on return. The first chart compares the two portfolios across sectors. The second chart compares the duration distribution. The last chart compares the distribution across quality ratings.

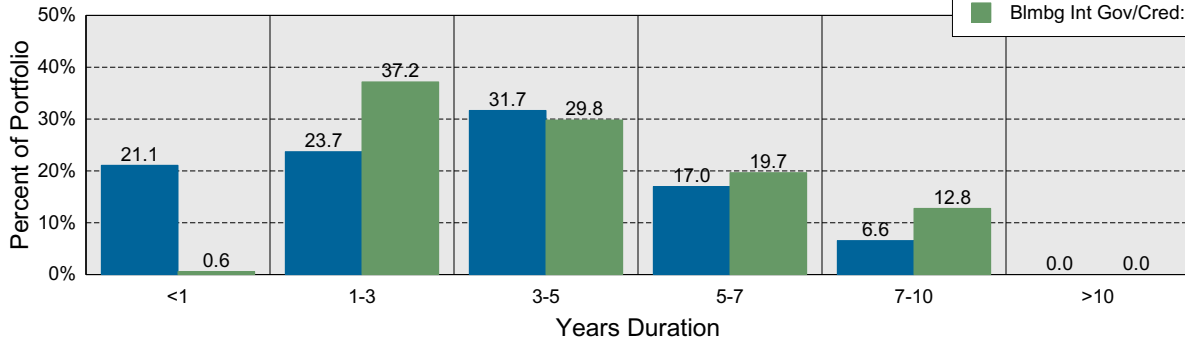
Sector Allocation



Garcia Hamilton

Blmbg Int Gov/Cred

Duration Distribution



Quality Distribution

