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September 30, 2019

The Honorable Ralph S. Northam
Governor of Virginia
1111 East Broad Street
Richmond, Virginia 23219

The Honorable Thomas K. Norment, Jr.
Co-Chairman, Senate Finance Committee
Senate of Virginia
P.O. Box 6205
Williamsburg, Virginia 23188

The Honorable Emmett W. Hanger, Jr.
Co-Chairman, Senate Finance Committee
Senate of Virginia
P.O. Box 2
Mount Solon, Virginia 22843-0002

The Honorable S. Chris Jones
Chairman, House Appropriations Committee
House of Delegates
P.O. Box 5059
Suffolk, Virginia 23435

Re: Report on Virginia Retirement System Internal Asset Management

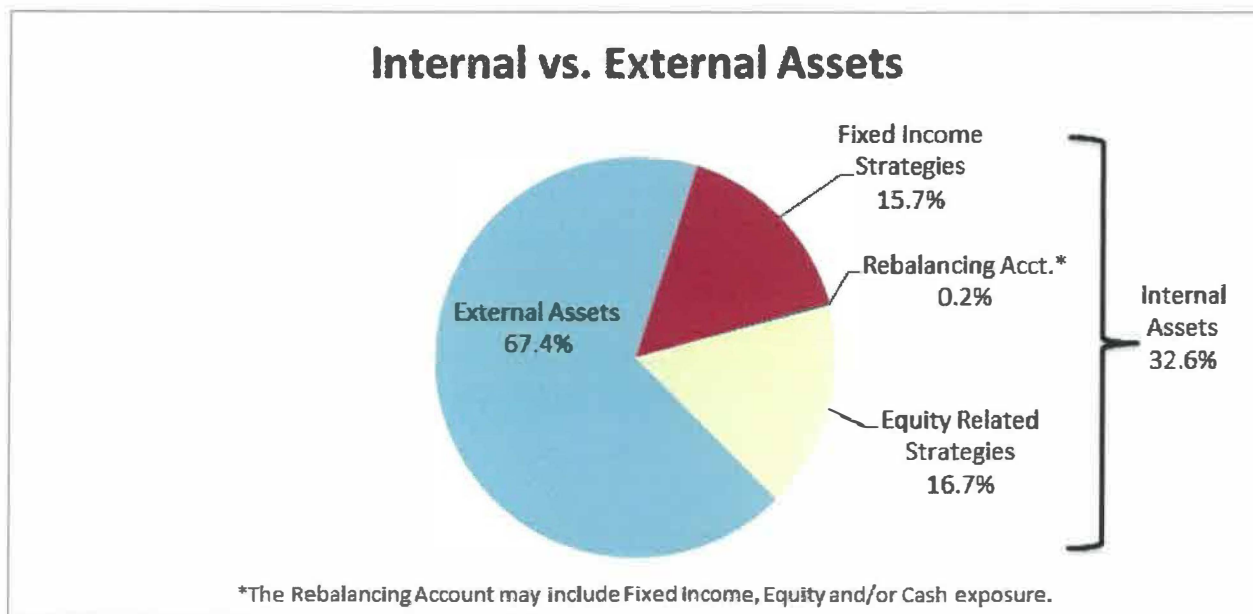
Dear Governor Northam, Co-Chairman Norment, Co-Chairman Hanger and Chairman Jones:

Pursuant to Item 487 of Chapter 854, 2019 Virginia Acts of Assembly (the "Appropriation Act"), I am pleased to provide a report on the fiscal 2019 results obtained by the internal investment management program at the Virginia Retirement System ("VRS").

The VRS internal investment management program continues to make an important contribution to the total fund. As of June 30, 2019, the internal investment management team managed a total of approximately \$26.8 billion in assets (excludes the Currency Hedge Overlay Account), representing approximately 32.6% of the fund. This amount consisted of approximately \$13.9 billion managed in

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equity related strategies, and approximately \$12.9 billion managed in fixed income strategies. The following pie chart provides the breakdown between internally and externally managed assets as of June 30, 2019. In addition, I am attaching, as a supplementary exhibit, a schedule that shows the various investment mandates being managed internally by VRS staff at fiscal year-end.



The VRS Board of Trustees has established certain external benchmarks for evaluating portfolio managers and believes that intermediate time frames of 3 to 5 years are most useful for evaluating performance. I am pleased to report that the internally managed funds, particularly considering the volatility of domestic and global markets during the past year, delivered solid performance relative to policy benchmarks across both the 3 and 5 year periods ending on June 30, 2019, as demonstrated in the following table. We estimate that the value added to the total fund from these excess returns over the last 10 years is approximately \$820 million.

IAM Track Record as of June 30, 2019			
		3 Years	5 Years
Equity Mandates	Portfolio	11.6%	8.1%
	Benchmark	12.0%	8.2%
	Excess	-0.4%	-0.1%
Fixed Income Mandates	Portfolio	2.8%	3.4%
	Benchmark	2.3%	2.9%
	Excess	0.5%	0.5%

The Honorable Ralph S. Northam, The Honorable Thomas K. Norment, Jr., The Honorable Emmett W. Hanger, Jr. and The Honorable S. Chris Jones

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In addition to delivering performance largely consistent with policy benchmarks during a volatile market, the internal asset management team continues to operate at a low level of cost when compared to fees that would be charged by outside managers who offer similar strategies. By managing these strategies internally, VRS is saving approximately \$52 million annually based on an outside consultant's analysis. (The consultant provides benchmarking information for large pools of capital including pension funds, endowments/foundations and sovereign wealth funds and serves over 350 blue-chip corporate and government clients worldwide.)

In summary, during a volatile market the internal asset management team at VRS delivered performance aligned with established benchmarks. Further, these efforts not only generated approximately \$820 million in excess returns over the last 10 years, but also achieved significant savings compared to external managers. The Board of Trustees is proud of the efforts and results of the internal asset management team at VRS, and we are confident that the fund will continue to benefit in the years ahead from their work.

Sincerely,

A handwritten signature in black ink, appearing to read 'M L Nason', with a long horizontal flourish extending to the right.

Mitchell L. Nason
Chairman

Attachment

EXHIBIT A

VRS Internal Mandates as of June 30, 2019		
Asset Class	Objective	Assets (MM)
Equity	Passive, Emerging Market Small Cap	\$80.6
	Low Tracking Error, U.S. Large Cap	\$4,965.1
	Low Tracking Error, Non-U.S. Large Cap	\$2,752.7
	Low Tracking Error, U.S. Small Cap	\$636.3
	Low Tracking Error, U.S. REIT	\$628.2
	Low Tracking Error, Emerging Market Large Cap	\$628.3
	Low Volatility, U.S. Large Cap	\$2,156.0
	Low Volatility, Non-U.S. Large Cap	\$1,929.2
	Rebalancing Account	\$140.9
	Currency Hedge (Overlay)	\$5,070.2
	Subtotal	\$18,987.5
Fixed Income	Securitized	\$4,664.9
	Credit	\$4,052.2
	Government Related	\$3,824.7
	Emerging Market Debt	\$114.9
	Opportunistic	\$130.2
	Rate Overlay	\$25.8
	Opportunistic Overlay	\$4.2
	Transition	\$106.6
	Subtotal	\$12,923.5
	Total*	\$31,911.0

* Includes the Currency Hedge Overlay Account