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September 30, 2021

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

The Honorable Janet D. Howell
Chair, Senate Finance and Appropriations Committee
Senate of Virginia
P.O. Box 2608
Reston, Virginia 20195-0608

The Honorable Luke E. Torian
Chair, House Appropriations Committee
House of Delegates
4222 Fortuna Plaza, Suite 659
Dumfries, Virginia 22025

Re: Report on Virginia Retirement System Internal Asset Management

Dear Governor Northam, Chair Howell, and Chair Torian:

Pursuant to Item 493 of Chapter 552, 2021 Special Session I Acts of Assembly (the "Appropriation Act"), I am pleased to provide a report on the fiscal year 2021 results attained 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, 2021, the internal investment management team managed a total of approximately \$28 billion in assets, representing approximately 28% of the fund. This amount consisted of approximately \$15 billion managed in equity-related strategies, and approximately \$13 billion managed in fixed income strategies. In addition, both programs engage in other money management activity to support other areas of the total fund.

The VRS Board of Trustees has established certain external benchmarks for evaluating portfolio managers and believes that longer term time frames are most useful for evaluating performance. I am pleased to report that the internally managed funds delivered strong performance relative to policy benchmarks over the 10-year period ending on June 30, 2021, as demonstrated in the following table.

The internally managed fixed income mandates continued to have stellar performance over intermediate and longer-term time periods. The internally managed equity mandates outperformed the policy benchmark over the 10-year period. In looking at the intermediate time periods during strong equity market returns, the internally managed equity mandates captured most of the returns; however, due to the policy mandates to maintain a lower risk profile for the fund, there was underperformance when compared to the market. We estimate the average annual value added to the total fund from these excess returns over the last 10 years is approximately \$68 million, resulting in about \$680 million in additional dollars to the fund.

IAM Track Record as of June 30, 2021				
		3 Years	5 Years	10 Years
Fixed Income Mandates*	Internal Core Portfolio	6.8%	4.1%	4.1%
	Benchmark	5.3%	3.0%	3.4%
	Excess	1.5%	1.1%	0.7%
Equity Mandates	Portfolio	12.6%	13.4%	11.9%
	Benchmark	14.4%	14.3%	11.6%
	Excess	-1.8%	-0.9%	0.3%

* - Fixed Income Mandates also include Emerging Market Debt and High Yield. As these mandates were added in 2019, they do not yet have a 3-, 5-, or 10-year performance history. As these mandates mature, their applicable historical performance will be included in the above table.

In addition to delivering performance largely consistent with policy benchmarks during a volatile market, the internal asset management team continues to operate at a lower cost when compared to fees that would be charged by outside managers offering similar strategies. By managing these strategies internally, VRS saves approximately \$45 million in fees annually based on an analysis by an outside consultant that 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 \$68 million annually 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 VRS internal asset management team, and we are confident that the fund will continue to benefit in the years ahead from their work.

Sincerely,



O'Kelly E. McWilliams, III
 Chairman, VRS Board of Trustees