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September 27, 2023

The Honorable Glenn A. Youngkin  
Governor of Virginia  
1111 East Broad Street  
Richmond, Virginia 23219

The Honorable George L. Barker  
Co-Chair, Senate Finance and Appropriations Committee  
Senate of Virginia  
Post Office Box 10527  
Alexandria, Virginia 22310

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

The Honorable Barry D. Knight  
Chair, House Appropriations Committee  
House of Delegates  
General Assembly Building  
201 North 9<sup>th</sup> Street, Room 1223  
Richmond, Virginia 23219

Re: Report on Virginia Retirement System Internal Asset Management

Dear Governor Youngkin, Co-Chair Barker, Co-Chair Howell, and Chair Knight:

Pursuant to Item 499 of Chapter 1, 2023 Special Session I Acts of Assembly (the 2023 Appropriation Act), I am pleased to provide a report on the fiscal year 2023 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, 2023, the internal investment management team managed a total of approximately \$29 billion in assets, representing approximately 28% of the fund. This amount consisted of approximately \$16.3 billion managed in equity related strategies, and approximately \$12.7 billion

managed in fixed income strategies. In addition, both programs engage in other money management activity to support other areas of the total fund.

Due to the nature of VRS' liabilities, VRS has a long-term investment time horizon. Accordingly, the VRS Board of Trustees has established certain external benchmarks for evaluating portfolio managers and believes that longer term time frames are the 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, 2023, 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 their policy benchmark over the 3-and 10-year periods. For the 5-year period where there were strong equity market returns, the internally managed equity mandates captured most of the returns; however, due to the risk-managed nature of the strategy, underperformed the overall equity market. We estimate the average annual value added to the total fund from these excess returns over the last 10 years is approximately \$97 million, resulting in about \$968 million in additional dollars to the fund for the 10-year period.

<b>IAM Track Record as of June 30, 2023</b>				
<i>(Expressed in Percentages, Net of Fees)</i>				
		3 Years	5 Years	10 Years
Fixed Income Mandates	<b>Internal Core Portfolio</b>	<b>-2.9</b>	<b>1.8</b>	<b>2.3</b>
	<i>Benchmark</i>	<i>-4.0</i>	<i>0.8</i>	<i>1.5</i>
	Excess	1.1	1.0	0.8
	<b>Internal Emerging Market Debt</b>	<b>-2.5</b>	<b>na</b>	<b>na</b>
	<i>Benchmark</i>	<i>-3.4</i>	<i>na</i>	<i>na</i>
	Excess	0.9	na	na
	<b>Internal High Yield</b>	<b>3.7</b>	<b>na</b>	<b>na</b>
	<i>Benchmark</i>	<i>2.6</i>	<i>na</i>	<i>na</i>
	Excess	1.1	na	na
Equity Mandates	<b>Portfolio</b>	<b>12.1</b>	<b>8.1</b>	<b>9.8</b>
	<i>Benchmark</i>	<i>11.2</i>	<i>8.4</i>	<i>9.6</i>
	Excess	0.9	-0.3	0.2

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 \$60.7 million in fees 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 \$97 million annually in excess returns over the last 10 years, but also achieved significant

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The Honorable Barry D. Knight

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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 "A. Scott Andrews". The signature is fluid and cursive, with a large initial "A" and "S".

A. Scott Andrews  
Chairman