JUDICIAL FORM RETIREMENT SYSTEM

QUARTERLY INVESTMENT UPDATE

PUBLIC PENSION OVERSIGHT BOARD – OCTOBER 25, 2022

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EXECUTIVE DIRECTOR

INVESTMENT PERFORMANCE

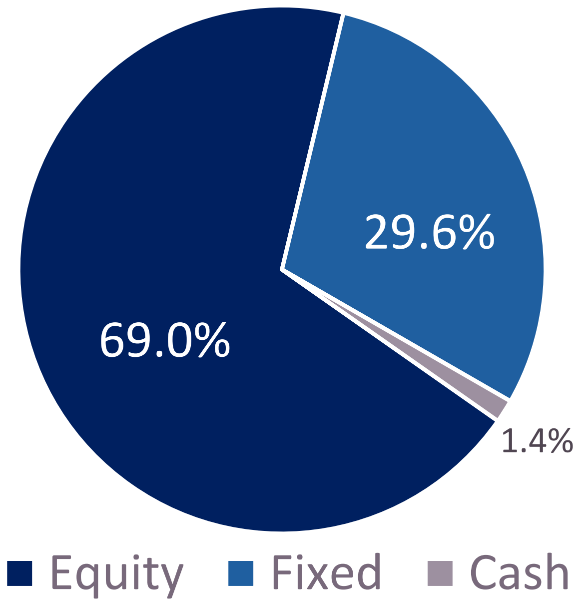
		MV	FYTD23	1 Year	3 Years	5 Years	10 Years	20 Years	ITD[1]
Investment Performance *As of September 30, 2022*									
JRP	Defined Benefit	$482.3M	(3.3%)	(13.3%)	7.5%	8.8%	10.4%	8.3%	8.5%
	Cash Balance	$3.2M	(3.3%)	(13.7%)	5.7%	7.1%	-	-	7.2%
	Benchmark[2]		(4.2%)	(13.6%)	5.5%	6.8%	8.6%	8.0%	-
LRP	Defined Benefit	$136.1M	(3.3%)	(13.3%)	7.4%	8.7%	10.4%	8.2%	8.4%
	Cash Balance	$0.8M	(3.3%)	(13.7%)	5.6%	7.0%	-	-	7.2%
	Benchmark[2]		(4.2%)	(13.6%)	5.5%	6.8%	8.6%	8.0%	-

Returns are Net of Fees with exception of 20-year and Since Inception

[1] Inception to Date performance: January 1, 1993 (Legacy DB) and June 1, 2015 (Cash Balance)
[2] Benchmark is 70% S&P 500 Index + 30% Barclays Intermediate Government/Credit Index (compounded monthly)

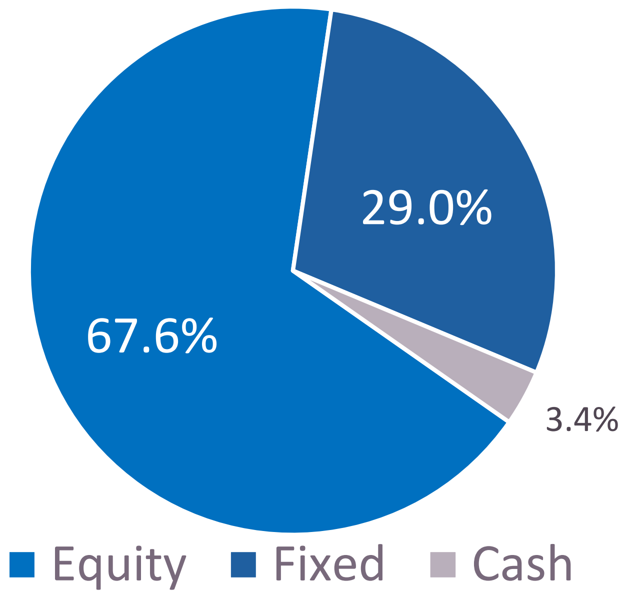
ASSET ALLOCATION

JUDICIAL RETIREMENT PLAN



JRP			
	Actual	Target	Range
Equity	69.0%	70.0%	60%-80%
Fixed Income	29.6%	30.0%	20%-40%
Cash	1.4%	0.0%	

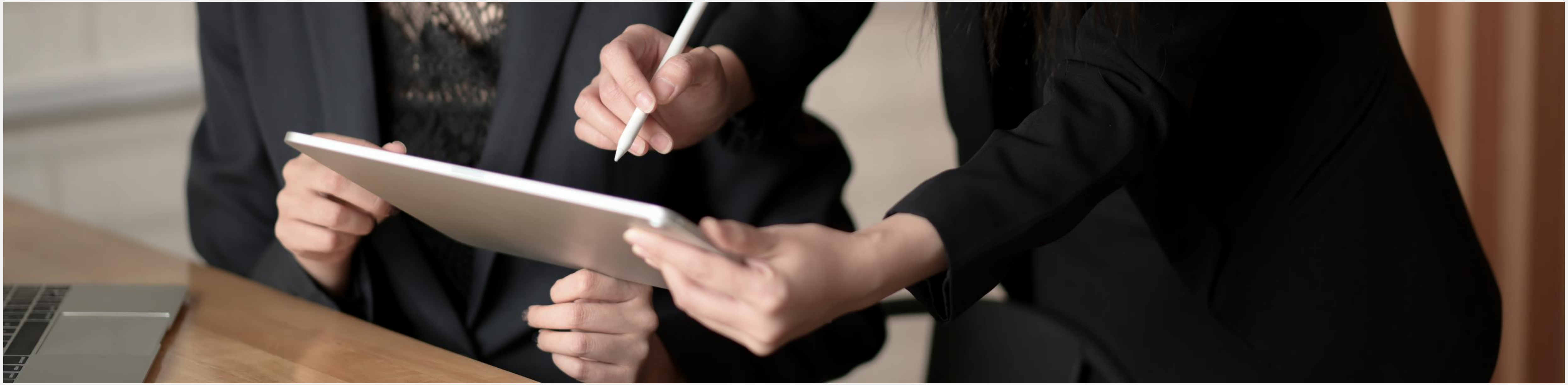
LEGISLATORS RETIREMENT PLAN



LRP			
	Actual	Target	Range
Equity	67.6%	70.0%	60%-80%
Fixed Income	29.0%	30.0%	20%-40%
Cash	3.4%	0.0%	

APPENDIX

Baird Trust Co – October 2022 Market Commentary



Market Commentary

October 2022

Andrew W. Means, CFA®
Director
Director of Equity Investments

John C. Watkins III, CFA®
Senior Vice President
Equity Portfolio Manager

"There are two kinds of forecasters: those who don't know, and those who don't know they don't know."

– John Kenneth Galbraith

Focusing on What's Knowable

The third quarter was characterized by rapidly rising interest rates and continued stock price declines. The stock market hit a new low for the year on the last day of September, with the S&P 500 down over 25% from its January high. Bond indices also posted record losses with the U.S. Aggregate Bond Index dropping 15% year-to-date. These falling prices fueled mounting fears over a future that feels highly uncertain. Today's list of investors' concerns is a long one:

- Stubbornly high inflation in the U.S. and globally
- The Federal Reserve aggressively raising interest rates, increasing the risk of a recession in the U.S.
- A war and energy crisis in Europe and a deteriorating relationship with China
- Volatile global currencies led by a rapidly strengthening U.S. dollar
- Political divisions at home and a contentious upcoming midterm election

Our Desire For Certainty

It is natural to worry about these issues and an uncertain future. Nearly every human does to some degree, especially when it has an impact on their hard-earned life savings. We all crave certainty, wanting to believe that the unknowable and unpredictable future is, in fact, knowable and predictable.

Unfortunately, evidence shows that it is nearly impossible to predict the future accurately and consistently. The events of the last few years – a global pandemic, the stock market gyrations, the booming job market, surging inflation – serve as a great reminder that, when it comes to the future, we know very little. At the beginning of this year, even the Federal Reserve, with its army of highly intelligent PhDs, was unable to foresee the aggressive monetary policy tightening they would need to pursue in 2022.

Admitting What's Unknowable

In our view, to be a successful long-term investor, you must have a clear understanding of what is knowable and what is unknowable. In our investment process, we admit right up front that the future is not knowable. It never has been, and it never will be. Therefore, we believe it is counterproductive to spend time trying to predict the unknowable future.

We don't know what inflation will do over the coming months and years. We don't know what all the impacts from higher interest rates will be. We don't know when the next recession will occur (but we are certain there will be more recessions in the future). We can't predict geopolitical events around the world or how fluctuating currencies will impact the global economy. And we have already written about our view on politics and investing in our October 2020 market commentary titled "Politics and Investing Don't Mix Well".

We believe famed investor Phil Fisher had it right when he wrote in his 1957 book Common Stocks and Uncommon Profits, "The amount of mental effort the financial community puts into this constant attempt to guess the economic future from a random and probably incomplete series of facts makes one wonder what might have been accomplished if only a fraction of such mental effort had been applied to something with a better chance of proving useful."

What is Knowable and Useful?

We aim to spend all our time on things that will prove useful to our goal of generating attractive long-term investment returns for our clients. We do this by ignoring what we consider to be unknowable and focusing instead on what we believe to be knowable.

We know that in order to generate strong long-term investment returns, the investments we make must survive the long term. Therefore, risk mitigation is, and always has been, a fundamental pillar of our investment strategy. With a future that is so unpredictable, controlling risk must be a top priority.

In fixed income, we do this by investing only in the highest quality bonds of companies and municipalities with sound balance sheets. In recent years, we have also remained focused on shorter maturity bonds to reduce interest rate risk. With interest rates near zero for the bulk of the last decade, stretching for yield by investing in lower quality fixed income (high yield bonds) or longer maturity issues became commonplace in our industry. But as we are seeing this year, rising interest rates punish those higher-risk strategies. One of the main goals of our fixed income portfolio is capital protection in tough times.

In equities, we try to mitigate risk by primarily investing in high quality businesses with sustainable competitive advantages and talented leaders. We know that companies with these qualities are typically better able to adapt and thrive in whatever kind of external environment is thrown at them. In fact, they are often able to increase their market share through down cycles and emerge stronger on the other side. If purchased at a sensible price and held for many years, we believe a portfolio of equity investments with these qualities is likely to generate an attractive investment return regardless of near-term macroeconomic hiccups or uncertainties along the way.

Additionally, we know that, in the short term, a company's stock price is often much more volatile than the fundamentals of its underlying business. Stock prices can gyrate wildly based on investor emotion while a business' cash flows are driven by things like market share gains, revenue growth, and margin expansion. Sometimes, like 2021, stock prices increase much faster than business fundamentals, and sometimes, like today, they decline more rapidly than fundamentals. We remain more focused on what is happening with the business rather than the stock price.

An example we have written about in the past and will highlight again is Home Depot (HD). We have owned shares in this company for over 20 years. During those two decades, there have been numerous macroeconomic twists and turns, including volatile interest rates, varying levels of inflation, a pandemic, and the massive 2004-2006 housing bubble and subsequent collapse in 2008-2009.

Over this 20-year period, HD grew its earnings-per-share from $1.56/share to $15.53/share. However, HD's stock price was much more volatile than its underlying business fundamentals, with the stock experiencing 8 declines of 20% or more during this time. In fact, HD's stock price is down nearly 34% year-to-date. Each of these declines, including today, were driven by fears and uncertainties regarding the future direction of the economy, the housing market, or interest rates.

But we believe the long-term success or failure of our investment in Home Depot doesn't hinge on any of those unpredictable macroeconomic outcomes. Instead, it depends on HD's business fundamentals – its ability to grow earnings per share at an attractive rate over time. We have owned five stocks (including HD) for 20 or more years. In our experience, a company's stock price generally correlates to earnings performance over a full market cycle, but if you zoom into shorter periods (one year or less), the stock price can perform much differently than earnings due to swings in investor sentiment based on the news of the day.

Declining Prices = Higher Future Returns

Finally, we know that as stock or bond prices decline, all else being equal, their potential future returns increase proportionally. Buying a one-dollar bill for sixty cents is obviously more attractive and will generate a higher return than buying that same one-dollar bill for eighty cents. But this rational fact doesn't make price declines any easier to stomach.

We understand and appreciate that the price declines in bonds and stocks that we have seen this year are unnerving. Watching account values decline is extraordinarily difficult. But it is the price of admission, especially in the stock market. Market volatility and bear markets are regular occurrences that must be endured to achieve the attractive returns equities provide over decades.

While sell-offs and bear markets are always difficult to endure, they are also filled with attractive investment opportunities. Today is no different. As prices decline, we are now seeing more attractively priced investment opportunities in both stocks and bonds than at any time in the last decade, except for a few days during the COVID-19 pandemic lows. Unfortunately, this does not tell us anything about where stock or bond prices might go over the coming weeks, months, or quarters.

Our focus, as always, is to try to find and take advantage of the best long-term investment opportunities available to grow your wealth at an attractive rate over very long periods of time. We do this by thinking in decades rather than in months, quarters, or even years. In an unpredictable world, we believe this gives us the best chance to achieve our goal for you, our clients, even though there will be bumps, twists, and turns along the way.

As always, we are immensely grateful for the confidence you place in us at Baird Trust as stewards of your financial assets. Thank you!

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