

Podcast Name: TRS Afterschool Special

Episode 2: Strong Today, Ready for Tomorrow: The TRS Investment Approach

Length: 19 minutes 32 seconds

Host: Rob Maxwell

Guest: Jase Auby, TRS Chief Investment Officer

Description: How does TRS help build the pension fund that pays retirement benefits for more than 520,000 annuitants? In this episode, TRS Chief Investment Officer Jase Auby offers an inside look at one of the largest pension funds in the country. Learn how TRS invests for the long term, balances risk, and uses a diversified investment strategy to help generate the returns needed to pay retirement benefits for Texas public education employees. He also shares what drives his team and why every investment decision is ultimately about serving the members and families who count on TRS.

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Welcome to the Afterschool Special, a podcast from the Teacher Retirement System of Texas.

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These are real conversations with the people we work with - and work for - about

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how we support more than 2 million active and retired members across the Lone Star State.

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We're talking retirement benefits, investments and the topics teachers are thinking about right now.

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So, put your pencils down, skip the pop quiz and take a listen. Hi everybody. I'm Rob Maxwell. I

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work here at the Teacher Retirement System of Texas in the Communications Division. I'm your

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host of our podcast. With me today is our Chief Investment Officer, Jase Auby. Hi, Jase. Hi,

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Rob. So glad you're here. Thank you for having me. It's always my pleasure to come and explain

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exactly what we do to our members. This is great.
This is a unique opportunity for us to really

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reach out into our members' ears and eyes. So,
we're just thrilled to be able to offer this.

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Tell me, you've been at TRS since 2009. You've
moved up through the ranks a little bit. A few

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years ago, I had the privilege of watching
you be appointed Chief Investment Officer.

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Is that kind of like the CEO for the Investment
Division? Exactly. I lead a team of 270 people,

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and we invest the \$229 billion that's in the fund,
everyday, and we are solely focused on that. And,

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you should think of me, yeah, as the CEO of that
group, with that sole task. Let's jump back a

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little bit, I want to get a personal reflection
from you. Give me a few sentences as to why TRS

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matters to you personally, Jase. Yeah, you know,
for one, I'm the product of Texas public schools.

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I have four kids. They're all the product
of Austin Independent School District, Texas

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public schools. My mom is a teacher. My sister
is a counselor, currently. And I work for them.

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I work for the future of our students in Texas.
That's outstanding. I'm going to give a little

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bit of context, a little setup here into our next section. So, let's start with the sheer size of

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the TRS pension fund. The market value varies from day to day, but you mentioned \$229 billion

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valuation. That's a number so large, it's hard to fathom. I can't picture, you know, \$229 in \$100

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bills. But, for many members, it may not even feel connected to their day-to-day lives. Each year,

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TRS pays out about \$14 billion in annuities and other benefit payments. Breaks down to about a

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billion a month going out the door. Now, in terms of putting dollars back into the fund,

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once our pension receives annual contributions from members, TRS employers, and the state, Jase,

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that's where you and your investment team come in. You're responsible for generating about 2/3

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of the pension fund value to be able to pay for those benefits long term. I mean,

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that's a huge task. It is. It absolutely is. It's a foundational task. And you know,

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we're really assisted in that task because it's just our sole focus. Every day we come in

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and we have one goal, and that is to maximize the value of this fund for the teachers of Texas.

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As you mentioned, Rob, when you put a dollar into the fund, so that later when you retire,

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you receive that dollar back, what you're actually receiving back is \$3.

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You put the dollar in, and then you're going to get another \$2 of investment earnings. And so,

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what our job is in the Investment Management Division is, we're here to make those extra \$2.

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What that translates into is an assumption of 7% per year. So, as long as that dollar is in

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the fund, it will be earning an average of 7% per year, and we need to deliver that 7%. And that's

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onerous in my view. I know last year I looked at our financial report, we brought in a net value of

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9.77% which is above that 7%. So, it's a floating annualized average, not floating perhaps.

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You can correct me on the financial terms. You're absolutely right. Sometimes we'll be more than 7%.

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Sometimes we'll be less than 7%. And because it is a long-term investment, the average life

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of the investment is 26 years, because we do have the luxury of that long-time horizon, we can have

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some years lower than seven and some years higher than seven. When you have that luxury,

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then you can take a little bit more risk, a little bit more risk prudently. We certainly would never

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take, you know, uncompensated risks or risks that wouldn't be good for the fund. However,

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we can take a little bit more risk and therefore make a little bit more return. And just deliver

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an enhanced benefit to teachers. I think we're going to break down risk in a little bit,

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in a couple of minutes. But I wanted to keep things a little broad. How do you

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set priorities for a \$229 billion fund? I mean, looking at all the parameters,

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we're competing against other North American pension funds and European, Australian funds,

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and sovereign wealth funds around the world. How do you and your very talented staff

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figure it all out? Yeah, I mean, the first step for sure is to just look at the

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menu of asset types that we can invest in. The first place you start there is obviously cash.

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You could just invest the entire fund in cash. That would certainly be very safe. You wouldn't

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take much any risk. However, we know that cash does not earn 7%. But that is the foundational

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asset, cash. And then the next asset you really think about is bonds. Bonds earn a little bit more

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than cash. Still probably not enough to get to that 7% but bonds do provide an important

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diversification benefit. And finally, the one that people are probably most familiar with is stocks,

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equity securities. We invest in quite a lot of those and that provides that extra return

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and also a little bit of extra risk that can make it a little bit more volatile year-to-year

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but that extra return that over the long term can get us up to 7%. Those are the three

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foundational assets in any asset allocation, but then we can branch out from there.

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Look at things like real estate, private markets, infrastructure, hedge funds. Things like that, all

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with an idea to just eke out a little bit more, a little bit more with each incremental decision

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to exceed that 7%. And you mention these alternative investments so when the stock

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market swings, help me understand this. You know, I look at the NASDAQ up and down at the

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end of the day or the Dow or any of these figures that we hear on you know our radio and TV shows.

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What happens to the TRS pension fund when the market does these daily gyrations? The TRS

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fund does go up and down however it goes up and down less than the broad equity market does and

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that is due to that diversification. When you're diversified that means some assets will be going

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up but others will be going down and vice versa over time and it evens out to a smoother path and

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that helps us manage the risk in a prudent way. So you mention this long-term piece and you know the

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steady discipline patience that it takes. Cause a lot of people, you know, and myself as media

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relations manager here at TRS, I get calls from journalists around the world saying, you know,

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"The market did this today, do you have any comment?" Well typically no and the reason is why?

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Yeah, we rarely have comment on any one single day because we're putting all of our time and energy

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into long-term decision making that will deliver over the long-term. Any given day, a stock can

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go up or down and it really is hard to explain exactly why. But over longer periods of time,

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it is easier to explain. Yeah, I think that's a good answer, a good way to frame it because you

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know geopolitics all kinds of factors get headlines. But you know, you like to point

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out...I love this mantra of yours, that we're in the wise-decisions business. For sure. And that

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talks about managing that risk and basically, as the kids say today, just staying chill. Right, and

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staying under control. Yeah, the wise-decisions business and remembering our long-term horizon,

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remembering what our strengths are as we invest the assets. We have staying power. We will never

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be forced to sell out of a position or something like that if, for example, the market goes down.

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We have the ability to simply hold and wait for that market to normalize. And so we can weather

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any crisis that the fund might encounter. I can hear a member out there saying,

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"Well. wait a minute, is there going to be enough cash always in the trust fund to pay my annuities

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in now and five years from now?" There will be if we achieve the 7% actuarial rate. The 7% was

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chosen by our board of trustees as being something that is eminently achievable and something that we

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can do over the long-term. Another question I get, and I've been at our health care road shows for

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a number of years now and talk to members even coming into our headquarters here in Austin. You

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mention different asset classes and let's dig into a bit about there because the question I get is,

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"Well, why not just invest in stocks and bonds, that 60/40 split that we've heard

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about especially in the last, you know, prior to the last 10 or 15 years. Why not just stick with

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stocks and bonds? That's safe, isn't it?" Yeah, stocks and bonds is definitely safe. It's a good,

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it's an excellent excellent starting point. However, what we have shown over the years,

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and not just us, many of our peers, and it really is considered best practice amongst

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how to manage large funds like TRS, you can do better than just simply doing stocks and bonds.

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For one, within stocks and bonds, you can beat the market. You can have an additional

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increment of performance over what the market does. So, the S&P 500 might do 8%, but if you

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choose stocks wisely and choose managers wisely who manage those funds, you might do 9% instead.

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And then in your choice of asset classes, for example, you can invest in something like private

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equity where, because we are long-term holders of stocks, we don't need to be able to buy and

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sell them everyday the way that the stock market allows you to do. So, we don't need to effectively

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hold all of our risk in that form. We can take something called, illiquidity risk. So, we can put

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those investments into private equity instead of public equity and earn just an incremental return

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on that and over time do better than what a 60/40 might indicate. Good answer. And building on that,

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you know, the scale of investments involves working with outside financial managers with

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some of those private investments. How do those relationships work in general? They work really

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well. They're absolutely a two-way street. We, of course, would always prefer to invest every

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dollar we have internally, and we do that to the extent that we have the capability to do so.

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But we do only have 270 people for \$229 billion. So just a little bit more people per billion

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dollars that we have in assets. And so we can't do everything in-house.

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We don't have the expertise for everything. So if we can't do something in-house,

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but it's a prudent strategy for the fund, we will not hesitate to hire an external manager

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that can deliver that extra value for the fund. And so in simpler terms, there's an outgoing

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fee paid for that, but the return potentially and oftentimes is higher than we would be able

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to do on our own. Correct. We always measure our returns after fees. So, net of fees. So whenever

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you hear a return from us, unless we say the fees are not subtracted, and we would rarely do that,

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any return you hear from us is net of fees. And we're only going to invest with a manager if they

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can beat the market after paying those fees. Good stuff. And what about cryptocurrencies?

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It's a big term. Yeah, for sure. So the question becomes, you know, and I've heard this from

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others, are we investing crypto? And I often say yes and no. How would you answer that? Yeah,

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we do not tend to own crypto outright just invest in it. You know, just to simplify the discussion

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a little bit. Owning, for example, Bitcoin, we don't just buy and hold Bitcoin. Bitcoin is still

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a young asset. It's still a difficult asset to really place within our asset allocation,

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to really place on that menu of investment options. I like to compare Bitcoin to gold.

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You know, gold has been around for you know, thousands of years, much longer than

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Bitcoin has. And we actually still have difficulty placing gold in the structure.

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You don't always know how gold is going to act in a crisis. Is it going to be sold and the price

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goes down because people are looking to liquidate that asset or is it going to go up? And so

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Bitcoin's just still a little bit too young for us to hold it in size. We do participate

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though in the crypto industry by investing in the business of crypto. Some of the firms that

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are in that industry, you know, that trade the securities, that sort of thing. So there are

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other ways to participate than simply holding the digital asset. We do have a little bit of gold,

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I understand, too indirectly. We do. We do have some gold. Yeah. Yeah, we do. Good to know.

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Hey, beyond diversifying the fund assets, more broadly how do we measure risk? And this

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is where you came up through the pension system. You were our risk, you know, boss for a while.

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Right. Yeah. And the head of risk. So how do we measure risk today here at the pension fund? Sure.

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There are many many ways to define risk, explain risk. You know, there's lots and lots of different

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statistics that you can calculate. But there really are two main ways to think about risk.

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One is just simply how much an asset's value will go up and down in any given day. So cash,

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you know, that value doesn't tend to go down much in any given day. If you have a dollar today,

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you're going to have a dollar tomorrow. So that's a very for example, low risk asset. But

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we of course know that something like the stock market can go up and down each day. And so, you

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can just simply calculate a measure of how much assets go up and down each day and then you can

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take the average of that across all of the assets you own and that is a surprisingly durable and

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easy-to-use, just rough measure of risk. Good answer. Where do you think we'll be

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broadly in the next say 5 to 8 years here at TRS, financially speaking?

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You know, it's been constructed wisely under the supervision of the board, our outside consultants,

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and of course our investment staff.
It is structured to deliver that 7%

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and I believe that it will do so. I also think
that you know, as an investment theme the

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potential for increased productivity in the market
that is possible through artificial intelligence,

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will in fact be a durable investment theme.
It will increase economic growth and it will

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increase the productivity of companies. When
productivity goes up, earnings go up. And when

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earnings go up, stock prices for example, go up.
So I am pretty optimistic about the next say 5

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to 7 years. I think we need to do a whole other
episode on AI and investments. I think there's a

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lot to talk about there in the next say 4 to 6 or
8 months. There really is. I mean AI is affecting

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all aspects of just our personal lives. It's
affecting our processes at TRS that we use to

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invest and it's affecting how the investments
perform that we invest in. And I should point

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out to our listeners and viewers that we are
being thoughtful, that we have an AI use policy

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here at TRS, that no member data is put out into
the wide world and our investment strategies are

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thoughtful and highly governed. Absolutely. Yeah, that's you know, data security is foundational.

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You don't move forward with AI unless you have a sound data security process and policy. I'm

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proud of what we're doing here at TRS on that level. Let's take it back personal.

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As we wrap up. Can you share a story about a favorite educator or maybe a time when you

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connected with a TRS member that made the purpose behind this work just that much more tangible?

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Yeah, I mean my favorite educator, ever, was my junior year English teacher. That was you know,

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American literature primarily. I think it still is in the Texas public schools to this day.

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And I was more of a STEM guy, you know, a math and science and she really opened my eyes,

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opened my eyes to the possibility of a broader world. And made me a book reader for the rest of

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my life and I absolutely am indebted and grateful to her. That's a fantastic, touching story. We're

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grateful that you're here. I know under your leadership TRS is stronger than it has been and

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it's just such a testament to the talent of your broader crew as well that we're in such a good

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situation today. Yeah, the team is incredible.
So thankful for just the strength of what we've

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been able to build here on the investment side and
the support of the board of trustees as we do so

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and the support of our members as they watch
what we do and allow us to move forward

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managing their funds. Yeah, we're all TRS members
after all. For sure. Let me end with a closing

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thought then. At the end of the day, trust and
goodwill come from members knowing TRS is here

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for them not just when they retire but throughout
their entire career and beyond. Jase, I want to

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thank you so much for stopping by. Absolutely.
Thank you, Rob. This is great. Yeah, we'll

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do it again soon. Very good. I hope to. Yeah,
we'll talk AI, right? A bit more. You bet. And

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thank you for stopping by. Until next time. TRS
touches nearly every corner of Texas. If today's

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conversation sparked a question or comment,
send us a note at communications@trs.texas.gov.

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Your topic might shape a future episode.
Until next time, do your homework.