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New Mexico State Investment Council looks to illiquid assets for extra return

The New Mexico State Investment Council, which manages $41bn of assets for seven permanent endowment funds, is looking to increase its exposure to illiquid assets in a bid to boost returns. Charles Wollmann, the SIC's director of communications, legislative and client relations, tells MandateWire that allocations to fixed income have been reduced to allow for more investment in private markets and because the funds' need for "ballast" has lessened due to large inflows into the portfolios.

The SIC's investment strategy is focused on optimizing the earnings of the funds – which contribute to the state's overall operating budget – while preserving and growing the real value of the funds in the long term. To that end, the investment portfolios of the seven funds are comprised largely of a diversified range of return-seeking assets.

Private markets

A key objective over the coming years is to increase exposure to illiquid assets, namely private equity, real estate and real return investments, specifically infrastructure and transitional energy, in a bid to increase returns.

Last September, the SIC released three pacing plans laying out commitment amounts to reach new target allocations to illiquid assets over a five-year or 10-year timeframe.

In private equity, the council will make $755mn worth of commitments in 2023, $900mn in 2024 and $1bn annually from 2025 through to 2027 in order to reach its target allocation of 11.4 per cent, according to the fiscal year 2023 annual investment plan, released in September.

For real estate, the annual plan states that the fund will need to commit approximately $525mn annually to its real estate portfolio starting in 2023 if it wishes to meet its long-term target allocation of 12 per cent.

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The fund will also need to invest $300mn in real returns assets this year in order to push its invested net asset value closer to its long-term target allocation of 10 per cent to real return assets.

The average return of the seven investment portfolios was 1.5 per cent over the 12 months to February 23 2023, 7.4 per cent over the three years to February 23, and 6 per cent over the five years to February 23.

Private equity investments returned 2.8 per cent over the past year, 20 per cent over the three years and 16 per cent over the five years to February 23.

The SIC has seen a significant increase in asset inflows into its portfolios due to excess returns from its oil and gas investments during 2023, as detailed in its report from the fund's April 25 council meeting.

These large inflows have afforded the SIC more flexibility with regard to the asset allocation decisions it makes for all seven funds it oversees.

Four of the funds – the Land Grant Permanent Fund, the Severance Permanent Tax Fund, the Tax Stabilization Return Fund, and the Water Trust Permanent Fund – have approved adjustments to their respective asset allocations.

Wollmann says allocations to fixed income within each portfolio has "typically acted as ballast for the portfolio and for cash management", but that "with cash flows being as significant as they are, we don't need to have as high of an allocation to low-risk assets".

Illiquidity premium

He adds that the council is reducing allocations to non-core fixed income and increasing its exposure to private equity in order to "take advantage of [the] illiquidity [premium] and double down on compound returns".

Within private equity, the fund "has worked in the past few years to expand exposure to venture capital to which historically we had been underweight", Wollmann says. Buyouts remain the largest private equity investment.

MandateWire reported in April that the SIC had committed a total of $615mn between January and February to six private equity funds, the largest of which was a $300mn allocation to TA Associates' TA XV-A and TA Select Opportunities III-A funds.

Within the real returns portfolio, the exposure to conventional energy, particularly in the upstream portion of the value chain, will decline, according to the fiscal year 2023 annual investment plan.

The investment focus in the coming years will be on making commitments to traditional and energy transition-focused infrastructure.

"While renewable power generation is richly valued, there may be opportunities in supporting/enabling technology such as battery storage and power distribution infrastructure," investment staff said in the annual investment plan.

The SIC committed $220mn in February to the EQT Infrastructure VI fund.

Fixed income reductions

For approved changes to the Land Grant Permanent Fund portfolio, the target allocation to US aggregate fixed income decreased by 4 percentage points, while the target allocation to real return assets increased to 2 percentage points, and the target allocation to private equity also rose by 2 percentage points.

The total asset allocation now stands at 20 per cent broad US equity, 20 per cent international equity, 6 per cent US aggregate fixed income, 15 per cent non-core fixed income, 12 per cent real estate, and 15 per cent private equity.

In the Severance Permanent Tax Fund, the target allocation to US aggregate fixed income decreased to 5 per cent, real return assets increased to 12 per cent, and private equity rose to 10 per cent

The new strategic asset allocation for this fund is 20 per cent US equity, 20 per cent international equity, 5 per cent US aggregate fixed income, 12 per cent non-core fixed income, 12 per cent real return assets, 12 per cent real estate, 10 per cent private equity, and 9 per cent private equity.

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For the Water Trust Permanent Fund, both the US equities allocation and the international equities allocation targets were increased by 5 percentage points, US aggregate fixed income was decreased by 1 percentage point, real return assets was reduced by 5 percentage points, real estate was decreased by 7 percentage points, and private equity was increased by 3 percentage points.

The new strategic asset allocation is 15 per cent US equity, 15 per cent international equity, 7 per cent US aggregate fixed income, 8 per cent non-core fixed income, 15 per cent real return assets, 15 per cent real estate, and 25 per cent private equity.

Finally, the Tax Stabilization Return Fund reduced its target allocation to low-duration fixed income to 5 percentage points, US aggregate fixed income decreased to 2 percentage points, non-core fixed income was raised 2 percentage points, and real estate was reduced by 5 percentage points.

The asset allocation is now 35 per cent low-duration fixed income, 20 per cent US aggregate fixed income, 30 per cent non-core fixed income, and 15 per cent to real estate.