CLIFFWATER LLC

Recommendations for the Absolute Return Portfolio

To: Rhode Island State Investment Commission
Prepared: April 12, 2019
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This memo provides two recommendations for the Absolute Return Portfolio ("ARP"). First, a recommendation for rebalancing the ARP to reduce the total fund allocation back to its 6.5% target. Second, a recommendation to reinvest a mandatory redemption from Capula Global Relative Value fund ("Capula") into a new share class.

Strategic Asset Allocation and the Role of the Absolute Return Portfolio

ERSRI has a 6.5% target allocation for the ARP. The strategic expected return (per PCA) for the ARP is 4.95% with an expected risk of 9.75. From a portfolio construction perspective, the ARP was designed to achieve three objectives: low equity beta/correlation, protection from a downturn in equity markets, and significant alpha. The ARP is achieving its objectives. Over the three-year period ending February 28, 2019, the ARP has generated a net annualized total return of 6.30%, net annualized alpha of 4.11% and a beta to equities (MSCI ACWI) of 0.09.

Recommendation 1: Rebalancing

The ARP is currently over the strategic target allocation by approximately 0.3%. We recommend a reduction of $25 million to bring the ARP closer to its target allocation. The table below shows the current weightings of the managers in the ARP and Cliffwater's recommended target weights and recommended reductions.

	28-Feb-19					
Manager	**Value**	**Weight**	**Target Weight**	**Recommended Rebalancing**	**Notice Date**	**Redemption Date**
Capula	75,115,487	13.5%	15%			
Davidson Kempner	89,080,608	16.0%	15%	(8,000,000)	26-Apr	30-Jun
DE Shaw	121,077,807	21.7%	20%			
Elliott	108,935,641	19.5%	20%			
Viking	64,473,643	11.6%	10%	(8,000,000)	15-Oct	30-Nov
Graham	61,334,841	11.0%	10%	(9,000,000)	31-May	30-Jun
Winton	37,802,016	6.8%	10%			
ARP Total	**557,820,042**	**100.0%**	**100%**	**(25,000,000)**		

Recommendation 2: Capula Reinvestment

Capula recently required a 15% mandatory redemption from its quarterly share class. They are allowing investors to reinvest this redemption into one of two less liquid share classes (Class H or K). Class H provides quarterly redemptions with a 25% investor gate at the same fee level as the current share class. Class H also provides a 3% redemption fee if an investor desires to fully redeem sooner than 24 months. Class K provides for a rolling-three year lock with a 50 basis point (0.50%) reduction in the management fee and adds a return hurdle to the performance fee. Cliffwater recommends that the proceeds of Capula's mandatory redemption be reinvested in Class H, providing liquidity nearest the current share class. Our recommendation is based on the risk benefits of Capula (low absolute risk, low beta, and low correlation to other managers) and Capula's strong absolute return and alpha generation. Furthermore, the impact of the longer liquidity terms of Capula's new share classes will not meaningfully affect the overall portfolio liquidity.