# Healthcare CIO Corner

## J.P. Morgan Asset Management Endowments, Foundations & Healthcare

Summer 2018

ON JUNE 19–20, J.P. MORGAN ASSET MANAGEMENT HOSTED OUR FIRST ANNUAL NATIONAL HEALTHCARE INVESTMENT FORUM ON THE THEME OF "ENTERPRISE RISK MANAGEMENT: BUILDING STRONGER PORTFOLIOS IN A COMPLEX WORLD."

One session exploring healthcare investment was a CIO panel featuring **Jacque Millard** of Intermountain Healthcare, **Leslie Lenzo** of Advocate Aurora Health and **John Barker** of Partners HealthCare, who shared their perspectives and investment approaches. In the excerpt below, they discuss the complex programs they oversee, managing risk and liquidity and what works in governance.

**INTERESTED IN ATTENDING OUR 2019 NATIONAL HEALTHCARE INVESTMENT FORUM IN CHICAGO?**

**Contact your J.P. Morgan Asset Management representative for details.**

### Q: We'll focus on risk first. How do you define risk and how does your organization approach, measure and report risk?

**MILLARD:** Before 2008, we did all the scenario modeling that everybody did, but we didn't factor in some of the individual debt issues and our pension. So now we do a full enterprise risk management evaluation. We don't run it every year. We also established a risk budget that targets 9% volatility, which we haven't been hitting recently. We report risk metrics quarterly to our investment committee and while it doesn't really inform our day to day work, the enterprise risk management and the other risk metrics potentially influence long-term decisions.

**LENZO:** We run an enterprise risk management study every couple of years to calibrate the level of risk in the investment portfolio compared to the organization's key financial metrics. We stress test our portfolio in terms of days cash on hand, cash-to-debt, debt-to-capitalization and if we had another 2008 scenario. We also look at liquidity. We run a pretty draconian stress test where we say, "If you had another financial crisis and at that same time had 100% of your uncalled commitments called all at once, how illiquid or liquid would your portfolio be?" We also look at optimizing the return/risk ratio within each individual portfolio, keeping in mind how those portfolios interact with the broader organization.

**BARKER:** We do a lot of the same things. It takes a long time to scrub the information that comes from our managers to understand exactly where we're exposed. We run our internal analyses through all different scenarios, for example the 1972–1973 financial crisis, etc. J.P. Morgan's annual Long Term Capital Market Assumptions model is one input. The rating agencies are also an important consideration.

### Q: How do you think about tail risk and do you use tail risk hedging strategies?

**MILLARD:** You always wonder if it's the right time to consider any kind of tail risk hedging. We conduct analysis every quarter on our hedge funds' liquidity position, looking at all the underlying gates of every single one of our hedge fund managers. So we know what the

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worst case is going to be. At this point our portfolio remains risk-on and fortunately the investment committee agrees with the positioning.

**LENZO:** I think it's helpful to know the types of environments in which we'd want to take different actions—to know what would cause us to take that action. For example, when we would consider de-risking or re-risking the portfolio. These are just good mental exercises to walk through with the committee.

**BARKER:** Based on my past experience, I think that you're probably going to get the timing wrong. Today we'd probably be in the red in those positions. Instead, we have tried to size up those managers that during the financial crisis protected a ton of capital, and then rebounded.

### Q: The next topic is governance. What lessons have you learned about governance and what would you change to make things run better?

**MILLARD:** I've been pretty fortunate to have a fairly consistent investment committee. We have committee members with institutional memory back to 2008 and now take new members through an orientation when they join. We have also recruited external CIOs. In 2010, staff started to select managers allowing the investment committee to focus more at the portfolio level. We also changed to rolling five-year evaluations, we thought anything shorter may lead to bad behavior.

**LENZO:** With the Advocate-Aurora merger, we have combined our investment committee into one that oversees all of the assets, balance sheet and pension assets. I think that's going to be very helpful in terms of efficiencies. And like Jacque, the investment committee is no longer going to be making the investment manager hire and fire decisions.

**BARKER:** Our investment committee is made up of institutional investors as well as CIOs, which is just great. As a result, the level of discussion is raised to a much higher level at board meetings to areas we should be most focused on such as setting risk and the direction we are heading and that's been terrific.

### Q: How do each of you manage liquidity? How much liquidity do you have in your portfolios today vs. 10, 15 years ago?

**MILLARD:** We use enterprise risk modeling, liquidity-based cash on hand, and monitor all the metrics to determine our liquidity position; the daily, the weekly, one- month, three-month. We probably have 50% weekly liquidity in our portfolios. We also have credit lines in place and other tools that further reduce our dependency on portfolio liquidity while providing additional flexibility compared to the past.

**LENZO:** We're very similar. I would add that with hedge funds, which I categorize as quasi-liquid, you have to make sure they are in a structure that allows you to be nimble. Sometimes you need to source liquidity very quickly to be able to take advantage of an opportunity.

**BARKER:** We're a lot less liquid today than we were 10 years ago, however, we're still far too liquid. We probably spend 80% of our time on illiquid investments, including hedge funds. To Leslie's point, you always have to have that contingency plan, the exit route. So it's just ranking all of our managers against each other, in terms of conviction: a domestic equity manager vs. an EM manager, vs. a fixed income manager, vs. a Chinese growth manager. It's really hard to do because they're apples, oranges and hand grenades. But you really need that. To source liquidity quickly, you need to know exactly who to go to.

### Q: I know diversifying strategies are top of mind. What are you most looking at when you think about diversification at this point in the cycle?

**BARKER:** We feel as though, in a portfolio that can handle a lot of vol, diversification-for-diversification's-sake strategies don't really hold up long-term. They just don't generate the return you want. Or they're so super-complicated in diversifying that they get wrapped around the axle a few times, and you find it just didn't work.

**MILLARD:** We have a diversified portfolio. I only want real alpha generators. I want to concentrate a little bit more, and get rid of any excess managers and excess fees.

**BARKER:** Concentrating is so important today, because as you diversify and increase the number of managers, but you diversify all your returns away.

**LENZO:** I actually worry that our portfolio is *too* diversified, which goes to your point about, are you going to meet your hurdle rate? I don't stay up at night worrying about a market downturn because I think we're pretty well insulated from that. I do worry that our volatility is too low. I do worry that we're not going to meet our expected return. So we're actually looking a lot at China right now, both from a beta and an alpha perspective, because I think a lot of interesting opportunities there fall into both camps and can add a different return profile compared to a lot of our diversifiers—absolute return investments that are low risk but also low return.

| |  **Jacque Millard, Vice President and CIO, Intermountain Healthcare** |  **Leslie Lenzo, CIO, Advocate Aurora Health** |  **John Barker, CIO, Partners HealthCare** |
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| **Years in current position / industry** | 14 / 28 | 5 / 16 | 6 / 24 |
| **Organization overview** | Utah-based with facilities in Idaho. Our 37,500 employees include 1,600 clinicians/ physicians in 185 clinics and 22 hospitals. Rating: Aa1 | The largest healthcare systems in Illinois and Wisconsin employing 70,000, with 3,300 physicians at 500 outpatient locations and 27 hospitals, serving 2.7 million unique patients. Rating: Aa3 | New England's largest health system employing 73,000 in 16 hospitals, two academic medical centers and 20 community health centers serving 1.5 million patients annually. Rating: Aa3 |
| **Investment assets (USD $)** | $13 billion, directly managing $6.5 billion of strategic capital, $2.9 billion pension assets and support advisement of $3 billion of DC. We oversee five pools: Corporate assets (open, DB and DC pension plans); insurance assets, endowment and foundation assets. | $18 billion, including $9 billion operating assets, $2.5 billion pension assets and support advisement of $6.5 billion of defined contribution assets | About $16 billion ($9 billion non-ERISA*; $6 billion pension assets, $8 billion DC assets) with a money market pool, a bond pool, a long-term pool. |
| **Asset allocation** | Equities 44%; fixed income 28%; alternatives 19% (including fairly heavy allocation to private debt and private equity and some hedge funds), "other" 7% and cash 2%. | Hedge funds 25%; fixed income 20%, International equities 18%; real assets 15%, U.S. equities 12%, private equity 10%. | Equities (with a lot of international and EM exposure) 45%; hedge funds (with a lot of equity-like exposure) 29%; fixed income, 15%; private equity 11%. |
| **Investment team members** | 8 | 8 (2 are open analyst positions) | 20 |

*The Employee Retirement Income Security Act (ERISA) of 1974 is a federal United States tax and labor law that establishes minimum standards for pension plans in private industry.



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