Investment Beliefs

The Marin County Employees' Retirement Association (MCERA) Board of Retirement adopted a set of Investment Beliefs intended to provide a basis for strategic management of the investment portfolio, inform organizational priorities, and ensure alignment between the Board and MCERA staff.

June 2016

Investment Belief 1

Liabilities must influence the asset structure

Sub-beliefs:

- Ensuring the ability to pay promised benefits by maintaining an adequate funding status is the primary measure of success for MCERA.
- MCERA has a growing cash requirement and inflation-sensitive liabilities; assets that generate cash and hedge inflation should be an important part of the MCERA investment strategy.
- MCERA cares about both the income and appreciation components of total return.
- Concentrations of illiquid assets must be managed to ensure sufficient availability of cash to meet obligations to beneficiaries.

Investment Belief 2

A long time investment horizon is a responsibility and an advantage

Long time horizon requires that MCERA:

- Consider the impact of its actions on future generations of members and taxpayers.
- Encourage external managers to consider the long-term impact of their actions.
- Favor investment strategies that create long-term, sustainable value and recognize the critical importance of a strong and durable economy in the attainment of funding objectives.
- Advocate for public policies that promote fair, orderly and effectively regulated capital markets.

Long time horizon enables MCERA to:

- Invest in illiquid assets, provided an appropriate premium is earned for illiquidity risk.
- Take advantage of factors that materialize slowly such as demographic trends.
- Tolerate some volatility in asset values and returns, as long as sufficient liquidity is available.

Investment Belief 3

MCERA's investment decisions may reflect wider stakeholder views, provided they are consistent with its fiduciary duty to members and beneficiaries

Sub-beliefs:

- As a public agency, MCERA has many stakeholders who express opinions on investment strategy or ask MCERA to engage on an issue. MCERA's preferred means of responding to issues raised by stakeholders is engagement.
- MCERA's primary stakeholders are members/beneficiaries, employers, and local taxpayers as these stakeholders bear the economic consequences of MCERA's investment decisions.
- In considering whether to engage on issues raised by stakeholders, MCERA will use the following prioritization framework:
  - Capacity – does MCERA have the expertise, resources and standing to influence an outcome?
  - Materiality – does the issue have the potential for an impact on portfolio risk or return?
  - Definition and Likelihood of Success – is success likely, in that MCERA's action will influence an outcome which can be measured? Can we partner with others to achieve success or would someone else be more suited to carry the issue?

Investment Belief 4

Governance is the primary tool to align interests between MCERA and managers of its capital, including investee companies and external managers

Sub-beliefs:

- Strong governance increases the likelihood that companies will perform well over the long term and manage risk effectively.
- MCERA may engage external managers on their governance and sustainability issues where such engagement maintains diversification of the system's investments so as to minimize the risk of loss and maximize the rate of return, unless under the circumstances it is clearly not prudent to do so, including:
  - Governance practices as outlined in MCERA's Corporate Governance Policy, including but not limited to alignment of interests;
  - Risk management practices;
  - Human capital practices, including but not limited to fair labor practices, health and safety, responsible contracting and diversity;
  - Environmental practices, including but not limited to climate change and natural resource availability.

Investment Belief 5

Strategic asset allocation is the dominant determinant of portfolio risk and return

Sub-beliefs:

- MCERA will utilize a strategic asset allocation process as a method for achieving its assumed rate of return.
- MCERA will aim to diversify its overall portfolio across distinct risk factors / return drivers.
- MCERA will consider investment strategies if they have the potential to have a material impact on portfolio risk and return.

Investment Belief 6

MCERA will take risk only where we have a strong belief we will be rewarded for it

Sub-beliefs:

- An expectation of a return premium is required to take risk; MCERA aims to maximize return for the risk taken.
- Markets are not perfectly efficient, but inefficiencies are difficult to exploit after costs.
- MCERA will use index tracking strategies where we lack conviction or demonstrable evidence that we can add value through active management.
- MCERA should measure its investment performance relative to a reference portfolio of public, passively managed assets to ensure that active risk is being compensated at the Total Fund level over the long term.

Investment Belief 7

Costs matter and need to be effectively managed

Sub-beliefs:

- MCERA will balance risk, return and cost when choosing and evaluating investment managers and investment strategies.
- Transparency of the total costs to manage the MCERA portfolio is required of MCERA's business partners and itself.
- Performance fee arrangements and incentive compensation plans should align the interests of the fund, staff and external managers.
- When deciding how to implement an investment strategy, MCERA will implement in the most cost effective manner.

Investment Belief 8

Risk to MCERA is multi-faceted and not fully captured through measures such as volatility or tracking error

Sub-beliefs:

- MCERA uses and maintains a broad set of investment and actuarial risk measures and clear processes for managing risk.
- The path of returns matters, because highly volatile returns can have unexpected impacts on contribution rates and funding status.
- As a long-term investor, MCERA will consider risk factors, for example climate change and natural resource availability, that emerge slowly over long time periods, but could have a material impact on company or portfolio returns.

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